

# Bringing technology to life



# Highlights

**EPS up 5% and continued strong headline operating cash conversion at 95%, despite revenue decline of 2%**

**Smiths Medical delivers highest revenue growth in almost a decade**

**John Crane aftermarket strength underpins resilient performance**

**Smiths Detection reports margin improvement and strong order book**

**Difficult trading conditions at Smiths Interconnect**

**Continued solid performance from Flex-Tek**

**Increased investment in growth initiatives through *Engineered for Growth* programme**

**Net accounting pension deficit reduced to £108m – its lowest reported level since 2008**

## Continuing activities

	2015 £m	2014 £m
Revenue	<b>2,897</b>	2,952
Headline operating profit	<b>511</b>	504
Statutory operating profit	<b>394</b>	378
Headline basic EPS	<b>86.1p</b>	81.8p
Statutory basic EPS	<b>62.4p</b>	59.0p
Free cash-flow	<b>158</b>	143
Dividend	<b>41.00p</b>	40.25p
Return on capital employed	<b>16.0%</b>	15.7%

Headline profit is before exceptional items, amortisation and impairment of acquired intangible assets, pension charges and financing gains/losses from currency hedging. Free cash-flow and return on capital employed are described in the Financial review.

Underlying performance is organic growth adjusting for foreign exchange translation.



Read more at  
[www.smiths.com](http://www.smiths.com)

## Revenue

£m

**£2,897m down 2%**

2015	2,897
2014	2,952
2013	3,109
2012	3,038
2011	2,842

Read more on page 23  
and note 1

## Headline operating profit

£m

**£511m up 1%**

2015	511
2014	504
2013	560
2012	554
2011	517

Read more on pages 23, 174  
and note 1

## Free cash-flow

£m

**£158m up 10%**

2015	158
2014	143
2013	237
2012	217
2011	236

Read more on pages 54, 174  
and note 27

## Headline earnings per share

Pence

**86.1p up 5%**

2015	86.1
2014	81.8
2013	92.7
2012	92.6
2011	86.5

Read more on pages 54, 174  
and note 6

The purpose of this document is to provide information to the members of the Company. This document contains certain statements that are forward-looking statements. They appear in a number of places throughout this document and include statements regarding our intentions, beliefs or current expectations and those of our officers, directors and employees concerning, amongst other things, our results of operations, financial condition, liquidity, prospects, growth, strategies and the business we operate. By their nature, these statements involve uncertainty since future events and circumstances can cause results and developments to differ materially from those anticipated. The forward-looking statements reflect knowledge and information available at the date of preparation of this document and unless otherwise required by applicable law the Company undertakes no obligation to update or revise these forward-looking statements. Nothing in this document should be construed as a profit forecast. The Company and its directors accept no liability to third parties in respect of this document save as would arise under English law.

This report contains brands that are trademarks and are registered and/or otherwise protected in accordance with applicable law.

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# Strategic report



Smiths Detection's Lightweight Chemical Detector (LCD) is one of the most widely used devices to protect soldiers and emergency responders from chemical warfare agents or toxic substances. Easily held or clipped to a belt, the LCDs continually sample the air and the latest version features both audible and visual alarms.

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A woman with dark hair tied back, wearing a high-visibility yellow-green safety vest over a dark top, is crouching on a dark surface at night. She is smiling and looking towards the camera while holding a smartphone in her hands. The background is dark with out-of-focus city lights creating a bokeh effect. The overall mood is professional yet approachable, highlighting the use of technology in a safety or field environment.

**We bring technology  
to life to help to make the  
world safer, healthier  
and more productive.**

**We transform laboratory science into advanced, hands-on technologies that solve our customers' toughest challenges and make the world a safer, healthier and more productive place. Our products and services – often hidden from view – touch the lives of millions of people around the world every day.**

# Making the world safer

Millions of air travellers around the world are protected every day by Smiths Detection equipment. Over 75,000 of our advanced X-ray scanners have been deployed around the world. In aviation security they detect and identify threat items in passenger bags, hold luggage and freight.

# Making the world healthier

**Smiths Medical's Gripper safety needles access implanted ports to draw blood or deliver medication, particularly in cancer and transplant patients. The safety needle of choice among clinicians, a Gripper is used on average every 3.6 seconds in hospitals and clinics in more than 80 countries.**

# Making the world more productive

From extraction and transport to storage and refining, the world's oil and gas industries rely on John Crane for vital equipment and support. Its mechanical seals, filtration systems and bearings, backed by a global service network, help ensure safe and efficient delivery of the energy that powers the modern world.

# Who we are

Smiths Group is a global technology company listed on the London Stock Exchange. Our vision is to establish Smiths Group as a world-leading engineering business.



## What we do

We apply leading-edge technology to design, manufacture and deliver innovative solutions that meet our customers' needs. Our products and services – often hidden from view – touch the lives of millions of people every day. We have helped provide the energy you use to boil the kettle, ensure the safe delivery of pain medication, protect ports and borders from terrorist threat, help make cars and aeroplanes more fuel efficient and improve mobile phone signals.

## Our markets

We serve a wide range of end markets – from healthcare, energy and petrochemicals through to threat and contraband detection, telecommunications and equipment manufacture. Our customers range from governments and their agencies, to hospitals, petrochemical companies and equipment manufacturers and service providers in various sectors around the world.

## How we create competitive advantage

Our products and services are often critical to our customers' operations, while our proprietary technology and high service levels help create competitive advantage.

## Our structure

We employ over 23,000 people in more than 50 countries through our five divisions: John Crane, Smiths Medical, Smiths Detection, Smiths Interconnect and Flex-Tek.

## Our approach

We do this responsibly, through the combined expertise of our people and effective, focused leadership, to deliver value to our customers, shareholders and wider stakeholders.

## Revenue in 2015

**£2,897m**

## Headline operating profit in 2015

**£511m**

## Investment in new product development in 2015

**£110m**

## Waste reduction since 2011

**26%**

## Safety improvement since 2011 (Recordable incident rate)

**17%**

## Smiths opened its doors for business

**1851**

# Our geographic reach

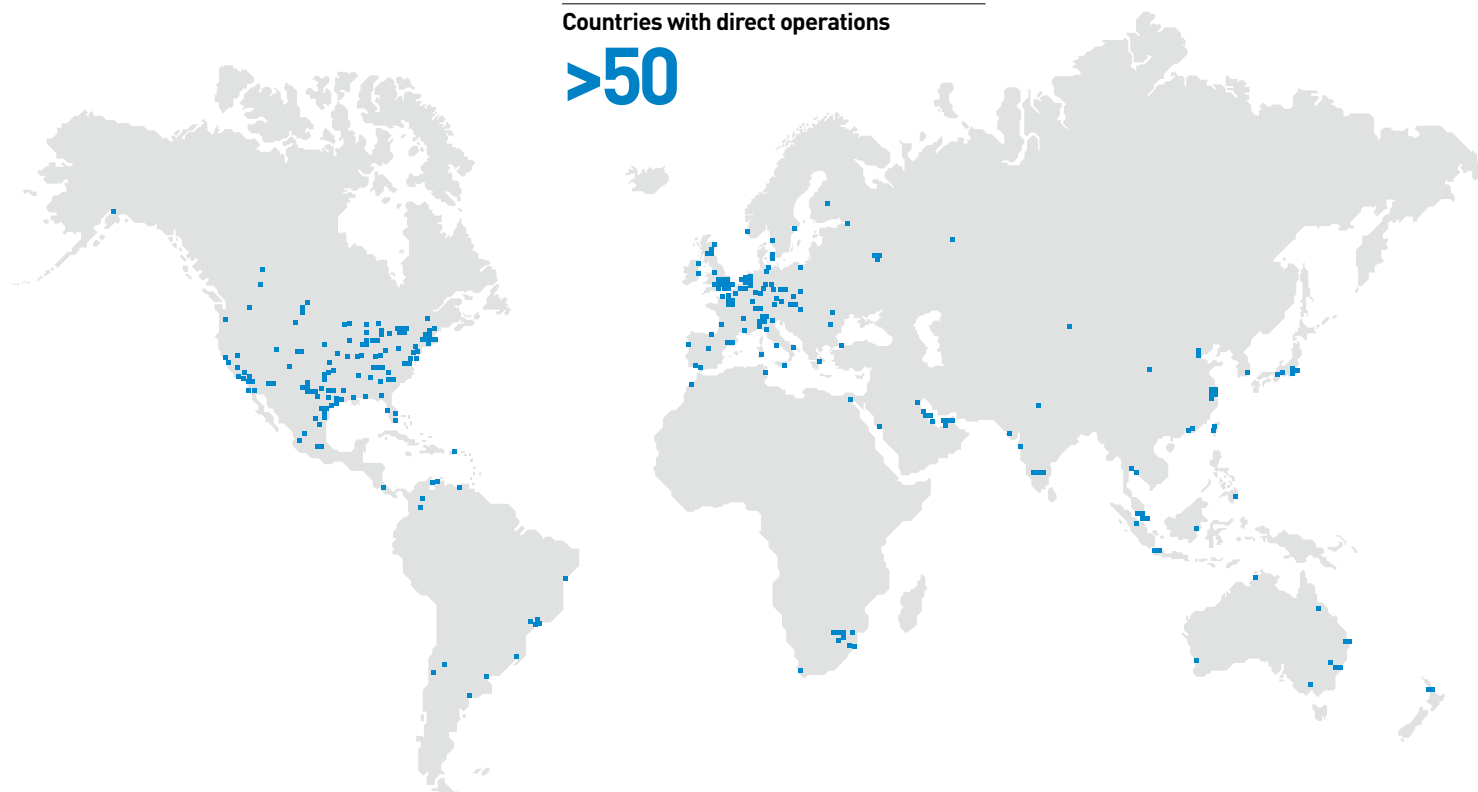
We have operations in more than 50 countries, with a network of dealers and distributors in many more. North America accounts for more than half our revenue and around a third of our employees, and we are investing to grow our presence in high-growth, emerging markets.

We have grown our exposure to emerging markets to 16% of revenue through targeted investment in our Sales and Marketing capabilities over the past five years and we continue to invest to expand our footprint.

## Group manufacturing and service locations

Countries with direct operations

>50



## Employees worldwide

23,250

## Countries our products and services reach

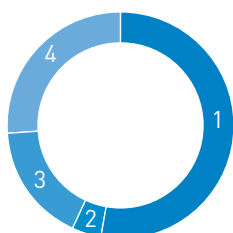
>200

## Percentage of revenue from emerging markets

16%

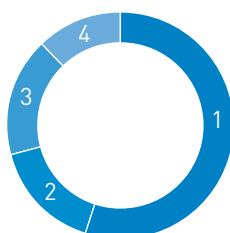
## Group revenue by destination

- 1 North America 53%
- 2 United Kingdom 4%
- 3 Europe other 17%
- 4 Rest of World 26%



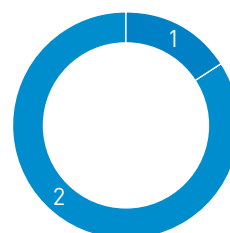
## Location of assets

- 1 North America 55%
- 2 United Kingdom 16%
- 3 Europe other 17%
- 4 Rest of World 12%



## Revenue from emerging and developed markets

- 1 Emerging markets 16%
- 2 Developed markets 84%



➔ Read more in note 1 on page 138

Excludes cash and cash equivalents

# Our divisions

Smiths Group has five divisions: John Crane, Smiths Medical, Smiths Detection, Smiths Interconnect and Flex-Tek.

We are focused on the energy, medical devices, threat and contraband detection, communications and engineered components markets worldwide.

Our businesses are highly competitive, with strong technology positions, operating in sectors with excellent opportunities for growth. They are united by high-quality brands, a deep understanding of their customers and markets, the ability to engineer products to meet customers' specific needs, expertise in small-batch manufacturing and aftermarket service and an unwavering commitment to operating responsibly.

## John Crane

A leading provider of products and services to global energy services customers. Our solutions help ensure the reliability of mission-critical equipment in challenging operating environments.



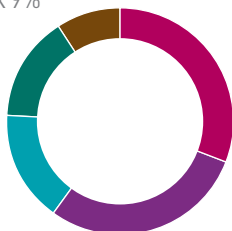
## Smiths Medical

A leading supplier of medical devices and consumables that are vital to patient care around the world. Our products include infusion systems, vascular access, vital care and specialty products.



### Divisional revenue

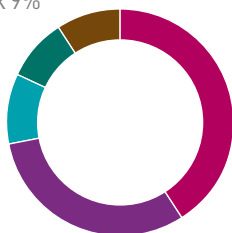
- John Crane 31%
- Smiths Medical 29%
- Smiths Detection 16%
- Smiths Interconnect 15%
- Flex-Tek 9%



➔ Read more on page 138

### Divisional headline operating profit\*

- John Crane 41%
- Smiths Medical 31%
- Smiths Detection 10%
- Smiths Interconnect 9%
- Flex-Tek 9%



➔ Read more on page 138

\*Before corporate costs

### Revenue 2015

**£905m**

### Headline operating profit margin 2015

**24.8%**

### Employees

**6,950**

### Strengths

- Strong proprietary technology with expertise in applied engineering
- Market leader in mechanical seals
- Over half of sales in aftermarket
- Global network of c. 230 sales and service centres

➔ Read more on pages 24-29 or [www.johncrane.com](http://www.johncrane.com)

### Revenue 2015

**£836m**

### Headline operating profit margin 2015

**19.8%**

### Employees

**7,950**

### Strengths

- Strong market positions in select clinical areas
- Highly recognised and respected brands
- Reputation for quality and safety
- Differentiated lower risk, short-duration, interventional devices
- Building an innovative pipeline of new product launches
- Extensive global sales network

➔ Read more on pages 30-35 or [www.smiths-medical.com](http://www.smiths-medical.com)

## Smiths Detection

A world-leading designer and manufacturer of sensors that detect and identify explosives, narcotics, weapons, chemical agents, biohazards, nuclear and radioactive material and contraband.



Revenue  
2015

**£467m**

Headline operating profit margin  
2015

**11.9%**

Employees

**2,150**

### Strengths

- Market leader with strong global brand
- Operates in regulated markets that require product certification
- Technology leveraged across broad range of markets and applications
- More than a third of sales from aftermarket service and growing

➔ Read more on pages 36-41  
or [www.smithsdetection.com](http://www.smithsdetection.com)

## Smiths Interconnect

A leader in electronic components and sub-systems that connect, protect and control critical systems for wireless telecommunications, aerospace, defence, space, test, medical, rail, data centres and industrial markets.



Revenue  
2015

**£420m**

Headline operating profit margin  
2015

**11.6%**

Employees

**3,850**

### Strengths

- Innovative and technically differentiated technologies
- Ultra-high reliability solutions used in demanding applications
- High degree of customer intimacy and product customisation
- Addressing highly regulated markets with strong barriers to entry

➔ Read more on pages 42-47  
or [www.smithsinterconnect.com](http://www.smithsinterconnect.com)

## Flex-Tek

A global provider of engineered components that heat and move fluids and gases for the aerospace, medical, industrial, construction and domestic appliance markets.



Revenue  
2015

**£269m**

Headline operating profit margin  
2015

**18.5%**

Employees

**2,050**

### Strengths

- Manufacturer of qualified components for the aerospace industry
- Largest supplier of open coil heating elements worldwide
- Leading manufacturer of flexible gas piping and HVAC ducting for US construction market

➔ Read more on pages 48-53  
or [www.flextekgroup.com](http://www.flextekgroup.com)

# Chairman's statement

**Smiths Group has delivered a robust performance in an uncertain and challenging trading environment. Its diversity of markets and geographies provides both scope for business growth and security against adverse trading conditions.**

**Sir George Buckley**  
Chairman



## Strength through diversity

The broad diversity of Smiths Group has again proved invaluable in offering both scope for business growth and security against the tough trading conditions that still persist in many markets. Delivering such a resilient performance amid significant management change is all the more remarkable and our employees deserve great credit for their professionalism and commitment.

While John Crane, a consistently strong performer in recent years, has shown signs of slowing sales as energy prices fall, its concentration in the aftermarket ought to ultimately ease pressure on sales as the practice of deferring plant maintenance eventually runs out. Other businesses like Smiths Medical have strengthened to help the Group maintain a steady overall performance. The scale of the challenge we still face, however, is highlighted by the recent results of our engineering peers, which show many struggling to deliver consistent revenue growth. In addition, the turmoil in global markets that began in August underlines the fragility of any recovery.

The portrait of many British engineering companies is one of high margins and stagnant growth. Clearly these varied businesses are run very efficiently to achieve the high margins, but the magic of innovation and the higher organic growth that ultimately comes from it, has still not been fully tapped by Smiths. Investing in invention and innovation certainly introduces a level of uncertainty in R&D outcomes, but it always beats the alternative of focusing

only on margin. We will continue to invest in innovation with the goal of achieving long-term sustainable competitiveness and we believe that higher growth will ultimately come if we do.

There is no shortage of positives to encourage the Group, its employees and investors. Smiths Medical has reported its best sales performance in almost a decade as revenues benefited from consistent investment in innovative infusion therapies. And we will do more. Smiths Detection is also back on track after a difficult trading period and as I said earlier, John Crane has demonstrated the strength of its business model, as its compelling aftermarket offering helped to underpin its performance, despite the weakening petrochemical market. While Smiths Interconnect has struggled this year with delays to some programmes and with certain customers, Flex-Tek has again delivered a robust performance with further growth.

We are also fortunate in managing businesses that serve a wide range of markets, all with inherent positive attributes and long-term growth potential. While oil prices are under pressure for now, the economic logic for producers to regulate production and to allow oil prices to float back up again is compelling. Demand for energy is still increasing. Ageing populations need additional medical care, particularly in developing countries that are growing more affluent. Terror threats show no sign of abating across the world. The expansion of wireless devices and applications is a hi-tech wonder to behold. Add the needs of new fuel-efficient aircraft and the

turnaround in the US housing market and the picture is complete: much of what makes the modern world go round is built, supplied and serviced by Smiths Group.

The theme of your Annual Report this year is the comprehensive scope of end markets that feature our products. Largely unseen they may be, but these products touch the lives of millions of people every minute of every day. As a consequence, the world is a healthier, safer and more dynamic place and we should all be proud of our contribution.

## Anatomy of a successful business

In my experience, the defining features of truly great companies are readily identified though never easy to achieve. Such businesses must boast products, qualities or brands that mark them out from the herd and allow them to deliver steadily expanding market share at equal or better margins. In the case of an engineering company like Smiths, innovation is crucial to drive growth and I am pleased to see we have again prioritised investment in inventing and developing new products for existing and new markets.

Another hallmark of a great company is the ability to deliver steady improvements in employee and customer satisfaction year in, year out. Under Philip Bowman's leadership, Smiths has made significant progress in enhancing employee engagement through its regular MyVoice surveys which have typically exceeded an 80% participation rate. Each division has also carried out in-depth market perception studies to improve the customer intimacy that is crucial to providing world-class products and service.

## The growth imperative

Great businesses are also distinguished by relentless above-peer growth, and one major legacy of Philip's leadership is that Smiths has now repositioned itself for accelerated top-line growth. Momentum has been maintained by a cross-divisional programme focusing on four specific areas: sales and marketing excellence; quality improvement; customer-led innovation; and expansion in China. *Engineered for Growth* builds on the sterling work already done in boosting new product development, expanding our footprint in higher growth markets and extending technology and product offerings through acquisitions.

Such expansion requires an unrelenting focus on working capital efficiency. The good cash conversion and low capital intensity of our businesses help underpin our ability to invest in organic growth and acquisitions. However, there is no room for complacency and we must continue to improve the cash use and conversion characteristics of the Group.

Operational excellence is also a central priority in helping to fund these growth initiatives. We have begun to rationalise our manufacturing footprint, streamline management and further upgrade our IT systems to maximise informed decision-making. A tight rein on costs is essential and John Crane, for instance, has already started to cut discretionary spending to manage the business through the cyclical oil downturn.

As ever, our people hold the key to the future through their talent, hard work and commitment. These qualities, harnessed to commercially minded research and technological excellence, nurture the motivation needed to drive Smiths towards its goal of becoming a world-class business and employer of choice. We want people to want to work for Smiths.

Behaving ethically, working safely and gradually reducing our environmental impact help create long-term shareholder value. Promoting these goals through employee engagement remains a central priority. Lost time incidents were maintained at their record low levels. Our Code of Business Ethics was reinforced through expanded online access and the fourth global ethics forum was held in Berlin, focusing on individual responsibility of all employees. The growing importance

of ensuring global supplier compliance was underlined by the launch of a code of practice specifically for contractors to ensure their ethics standards match our own. We made further progress in meeting medium-term environmental targets for reductions in energy, greenhouse gas emissions, waste and water consumption.

## Managing a diversified set of businesses

I have already touched on the advantages of a diversified business whose products cover a range of industry sectors and geographies and so help smooth the impact of economic cycles and fluctuations in regional growth. However for its size, Smiths is a highly complex group and your Board is duty-bound to regularly review whether it is the best owner of all our businesses. Consolidating the strongest divisions through targeted acquisitions and possibly exiting others over time would greatly simplify its structure. In parallel we would seek to minimise any value leakage from the legacy liabilities of our defined benefit pension schemes and product liability litigation. This approach is driven by three objectives: enhanced organic growth; expansion and strengthening of our best-performing businesses; and streamlining the rest through 'prune and graft' – divestments and bolt-on acquisitions.

## Leadership changes

The innate strength of an organisation can often be gauged by its ability to manage change and, as I mentioned in my opening remarks, Smiths has emerged from a year of some uncertainty in good shape. I would like to thank Philip and former Finance Director, Peter Turner, for their valued contribution to Smiths Group. The Board is very sorry to see them leave and I am sure you will join me in wishing them well for the future.

Philip has delivered improved margins, cash and returns through one of the worst economic recessions in memory. There is no doubt he leaves the business in substantially better shape than when he joined. But change also brings opportunity and I am delighted to welcome someone of the calibre of Andrew Reynolds Smith as our new Chief Executive. The Board was keen to appoint an engineer or scientist with a proven track record of growing a business through organic investment and M&A. It is doubly fitting that he joins us from another

great British engineering company, one of the few to rival Smiths in historic legacy, global reach and technological excellence. Having entered industry as an apprentice, he will bring us a wealth of invaluable experience. He will have the support of a newly appointed Finance Director, Chris O'Shea, whose broad understanding of international finance roles, particularly in the energy sector, will complement the in-depth engineering skills of the new CEO. We warmly welcome them both to Smiths.

I am also sorry that David Challen has decided to step down after the AGM. David has been an excellent non-executive director, serving the Board for 11 years, first as Chair of the Audit Committee and more recently as Senior Independent Director. The Board has benefited from his insight and expertise and he will be sorely missed.

Under the new management team, Smiths embarks on the latest leg of a remarkable journey that began in a small London workshop 164 years ago. We have reinvented ourselves many times, but always around a core of dynamic businesses and creativity that pursued sustained, achievable growth. Today is no different and the results detailed in this Annual Report testify the determination of our employees to uphold this long and distinguished heritage. On behalf of the Board, I thank all employees for their support and ask them to show the same outstanding level of commitment to the new leadership team.

**Sir George Buckley**  
**Chairman**

# Chief Executive's statement

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

**Philip Bowman**  
Chief Executive



## Results summary

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

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

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

## Headline earnings per share

Up 5%

**86.1p**

➔ Read more on page 54  
and in note 6 on page 144

## Dividend per share

Up 2%

**41.0p**

➔ Read more on pages 14-16, page 23  
and in note 25 on page 172

## Statutory earnings per share

Up 6%

**62.4p**

➔ Read more on page 54  
and in note 6 on page 144

## Free cash-flow

Up 10%

**£158m**

➔ Read more on page 54  
and in note 27 on page 173

## Employees around the world

In over 50 countries

**23,250**

➔ Read more on pages 69-71  
and in note 8 on page 147

## Strategy

Our strategy is to grow shareholder value by:

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

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

### Investing to accelerate revenue growth – *Engineered for Growth*

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

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

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

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

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

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

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

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

### Programme to fund growth investment

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

### Promoting responsibility

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

### Cash generation and balance sheet

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

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

### Managing our pension liabilities

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

However, much has been done over recent years, in conjunction with the pension scheme trustees, to mitigate liabilities and de-risk the assets so that they correspond more closely to the liabilities. The benefits of these actions, as well as the significant cash contributions, have caused the accounting pension deficit to fall to £108m – its lowest reported level since 2008. Although the preliminary results of the triennial reviews for the two UK schemes have yet to be agreed with the UK Trustees, the actions taken in recent years have resulted in significant reductions in the actuarial deficits. For example, the actuarial deficit for the Smiths Industries Pension Scheme

has improved from £535m in March 2012 to around £330m in March 2015. Netting of the escrow assets would allow a further substantial improvement and lessen the cash needs of the schemes and significantly free the Board's hand to simplify and focus the Group's structure.

### Dividend

The Board has a progressive dividend policy for future payouts while maintaining a dividend cover of around 2.5 times. This policy will enable us to retain sufficient cash-flow to meet our legacy liabilities and finance our investment in the drivers of growth. While the medium-term objective is to maintain this dividend cover, we will operate some flexibility in applying the 2.5 times cover to take account of short-term impacts such as foreign exchange.

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

### Outlook

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

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

**Philip Bowman**  
Chief Executive

# Our markets

Smiths Group serves a wide range of end markets that have the potential for long-term profitable growth. Our businesses are either market leaders in their sectors or are well placed in attractive niches. Around half our revenue is derived from servicing our customers' aftermarket needs or from supplying single-use consumables used as part of our customers' everyday procedures. This provides a resilience to our revenues and strong, stable cash-flows.

## Healthcare

Our largest single end market is healthcare, with the majority of revenue from medical devices supplied by Smiths Medical, although both Smiths Interconnect and Flex-Tek also supply components to medical device manufacturers. The medical device market is driven over the long term by ageing populations, patient and health worker safety legislation and increasing healthcare spending in developing countries. Smiths Medical typically derives around 85% of revenue from single-use devices used in everyday hospital procedures. Procedural growth rates have remained relatively low with continued constraints on healthcare budgets. The remaining 15% of revenue is from capital equipment (eg infusion pumps) which can be affected by hospital capital budgets. Many markets are experiencing price headwinds caused by healthcare affordability, hospital consolidation and group purchasing organisations.

## Oil, gas & petrochemical

This market is primarily served by John Crane, representing c. 60% of its revenues. The long-term drivers include the global demand for energy, a desire for national energy independence and increasing environmental and safety requirements. John Crane's mechanical seals and seal support systems are primarily used in the process equipment found in midstream (eg pipelines, gas storage, LNG transportation) and downstream applications (eg refineries, ethylene crackers, etc). They also have a small exposure to upstream applications – largely through the supply and service of artificial lift equipment (7% of revenue). Demand for original equipment (c. 44% of revenue) is affected by customer capital expenditure cycles, while aftermarket service (c. 56% of revenue) depends on utilisation rates and equipment age. The drop in oil prices in late 2014 has reduced customer capital expenditure, causing a recent fall in original equipment revenue. However, aftermarket service revenue has held up as utilisation rates of the installed base have remained high.

## Homeland security

Smiths Detection provides threat detection equipment for airports, ports and borders, critical infrastructure and emergency responder markets. Demand is driven in the medium term by ongoing geopolitical unrest and the associated terrorist and criminal

threats, but there is considerable variation by geography and end market. The growing installed base creates opportunities for aftermarket and upgrade revenues.

## Industrial

Smiths Group serves a range of general industrial sectors including power generation, alternative energy, mining, automotive, test equipment and rail, among others. There are different drivers for each of these markets but overall they tend to track GDP. They are served by John Crane, Smiths Interconnect and Flex-Tek.

## Semiconductors, data centres and telecoms

Smiths Interconnect supplies a range of high-performance microwave equipment to support the build-out and upgrade of wireless telecommunications infrastructure. It also provides high-reliability connectors for semiconductor test and power supply equipment for data centres. Growth is driven by the proliferation of mobile communication devices, internet usage, the demand for higher data rates, and the capital expenditure of network operators and data centre providers.

## Defence

This segment is served by both Smiths Interconnect and Smiths Detection and is primarily driven by defence spending in developed markets like the US. While global defence spending is stabilising following recent declines, it is expected to remain constrained as western governments limit budgets. Demand for both businesses tends to be programme specific.

## US residential construction and household appliances

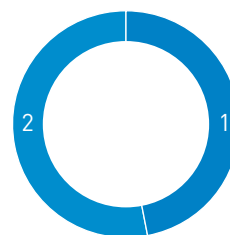
Flex-Tek manufactures a range of products such as flexible gas piping and ducting for HVAC applications that are used in the construction of homes, primarily in the US. Demand for single family home starts is driven by population growth.

## Aerospace and space

Flex-Tek provides hydraulic hoses and fuel lines for airframes and aeroengines while Smiths Interconnect sells connectors and microwave components for aircraft and satellite communications. Aerospace demand is driven by investment in new fuel-efficient aircraft and by increasing passenger and freight traffic. Good recent growth at Flex-Tek is expected to continue with a strong order book.

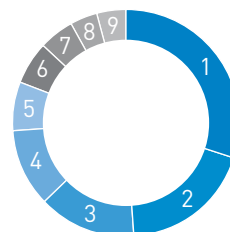
## Revenue from equipment sales and aftermarket/consumables

- 1 Equipment sales 47%
- 2 Aftermarket/consumables 53%



## Revenue by end market

- 1 Healthcare 30%
- 2 Oil, gas and petrochemical 19%
- 3 Homeland security 14%
- 4 Industrial 11%\*
- 5 Semiconductors, data centres and telecoms 7%
- 6 Defence 6%
- 7 US residential construction and household appliances 5%
- 8 Aerospace, space 4%
- 9 Chemical and pharma 4%



\*Industrial includes power generation, alternative energy, mining, test, rail and other general industrial applications

➔ More detailed market commentary can be found in the divisional operational reviews

# Our business model

Smiths Group’s business model operates at two levels. The Group manages our portfolio to create value for shareholders, while the five divisions manage their businesses to meet customers’ needs and create value for the Group.

## The Group’s role

We have a lean corporate centre, which sets our strategic priorities and allocates capital to manage the portfolio and drive returns. It also co-ordinates strategic initiatives across the divisions and fosters a common culture of responsibility and accountability wherever we work around the world.

The corporate centre focuses on a number of core activities:

### Strategy

Sets Group strategy and ensures divisional strategies are aligned with Group strategy.

### Budgeting, planning and reporting

Agrees and reviews annual Group and divisional budgets.

### Governance

Provides an effective governance framework and ensures good governance is embedded across the business.

### Risk management

Sets risk appetite, ensures a strong risk management framework is in place and provides effective oversight.

### Performance monitoring

Regularly reviews performance against agreed targets with the divisions.

### Information systems

Makes sure the right business systems and processes are in place so that decisions are made efficiently based on high-quality data.

### Ethics and compliance

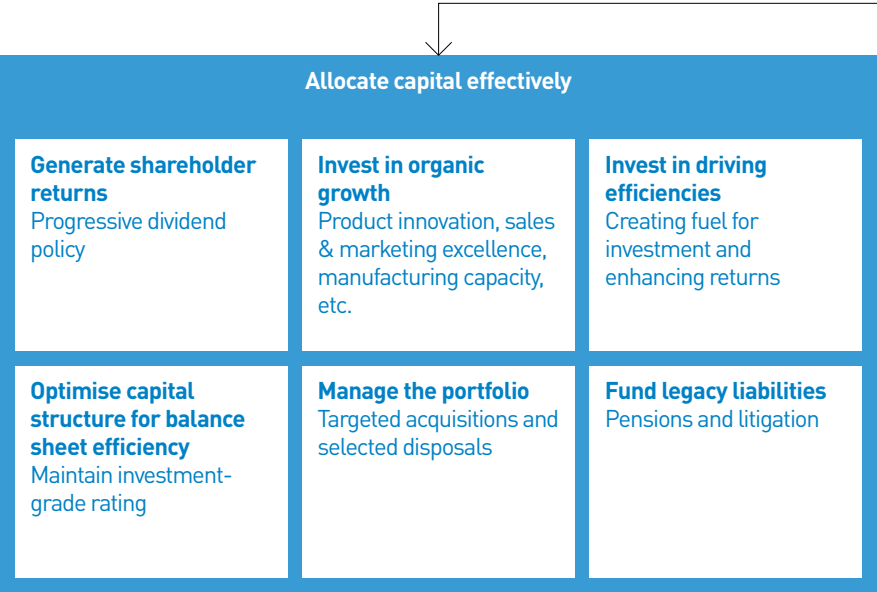
Approves policies and provides oversight to ensure a strong culture of ethical behaviour and compliance.

### EHS, talent and retention

Sets the Group’s environment, health and safety, and people development policies and monitors compliance and performance.

### Best practice and shared services

Provides shared services in areas such as IT, HR and indirect procurement to drive efficiency and leverage benefits of scale. Shares best practice in areas such as sales and marketing excellence, quality and innovation.



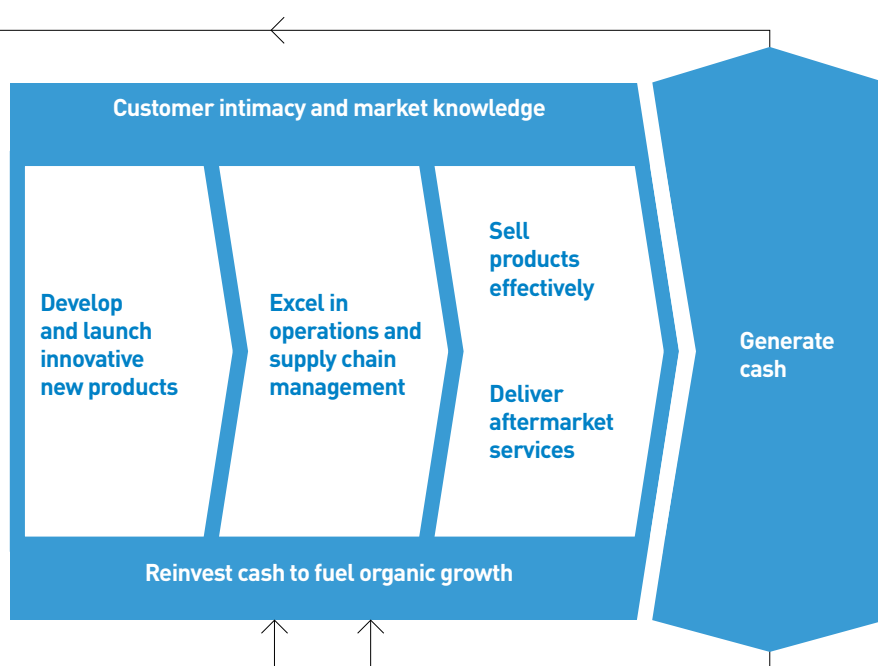
### Capital allocation

The corporate centre is responsible for the effective allocation of capital across the business. This is important in a multi-industry organisation where our businesses are strongly cash generative and have limited need for fixed capital. We do this through:

- **Securing financing and optimising the Group’s capital structure for balance sheet efficiency.** We seek to maintain a strong investment-grade credit rating and net debt/EBITDA gearing at 1.5-2x.
- **Generating shareholder returns through dividend payments and capital returns.** Our focus on cash generation enables us to reinvest in the business to drive growth and to generate attractive shareholder returns. We have a progressive dividend policy, while maintaining a target of 2.5 times cover.

- **Managing and funding legacy liabilities,** such as our defined benefit pension schemes and legacy product liability issues, in order to minimise their impact on value creation. These are managed at either Group or divisional level, as appropriate.
- **Targeted acquisitions and selected disposals.** We buy businesses that add complementary technologies and products, expand our geographical footprint, particularly in emerging markets, or allow us to leverage our existing scale and infrastructure in order to increase shareholder returns. We are also active in disposing of businesses that offer less attractive returns.
- **Investing in organic growth** through new product development, sales and marketing initiatives and manufacturing capacity.
- **Investing in driving efficiencies** to create the fuel for growth investment and to enhance returns.

## The divisional business model



Our diversified portfolio offers a wide range of long-term growth markets with different customers, demand drivers and competitors. It makes our business relatively resilient throughout the economic cycle.

Our businesses also share a common business model:

- creating sustainable technological differentiation by developing products to meet customers' specific needs;
- achieving operational excellence through low-cost, flexible manufacturing; and
- developing strong, lasting customer relationships by providing outstanding aftermarket services.

Our decentralised structure ensures our businesses are close to their target markets and customers and encourages a culture of entrepreneurship. Our divisions are responsible for actively managing their risks, ensuring that a strong culture of ethics and compliance is embedded across their businesses, and developing and retaining their people, with regular reporting back to the Group centre.

### Create a differentiated market understanding and customer intimacy

Our businesses consistently refine their knowledge of their markets. This includes segmenting those markets, understanding their dynamics, analysing competitors and their activities, identifying opportunities to improve our services and assessing potential sources of competitive advantage. This helps us anticipate and respond to developments.

This deep market knowledge enables us to achieve a high degree of customer intimacy, allowing us to anticipate their specific needs. This in turn helps us to keep our customers for the long term.

### Develop and launch innovative products

R&D is a key driver of sales growth and margins. It enables us to keep at the forefront of technology and develop products that meet our customers' evolving needs.

We fund the majority of our R&D but also seek funding from our customers. Our spend is focused more on product development than pure research. In 2015, we invested £110m in R&D, of which £6m was customer-funded.

### Excel in operations and supply chain management

The majority of our manufacturing processes are small-batch, low-cost assembly, much of which is made to meet specific customer orders. This makes us capital-light and flexible.

Where appropriate, we have established production facilities in lower-cost countries, such as Mexico, China, Malaysia, India, the Czech Republic, Costa Rica and Tunisia.

### Sell products effectively

We take our products to market through our own sales and marketing teams and a network of dealers and distributors around the world. Our focus on building long-term customer relationships is fundamental to the success of our sales force.

### Develop lasting relationships through outstanding aftermarket services

Many of our businesses provide a high level of aftersales service. We also sell significant quantities of single-use consumables. These activities help us to retain customer loyalty, improve our understanding of how our products perform over their lifetime and increase our resilience throughout the economic cycle.

### Generate cash

By emphasising working capital management, particularly debtors and inventory, we are able to convert a high proportion of headline operating profit into cash.

### Re-invest cash to fuel organic growth

Our strong cash-flow enables us to reinvest in the business to drive top-line growth by investing in new product development, optimising our systems and operations and expanding our sales and marketing presence in key growth markets.

This investment enables us to maintain our technology leadership and accelerates sales and margin growth across the business, providing a platform for sustained growth.

# Our strategy and progress

We have a six-part strategy for creating long-term value for our shareholders and we measure our performance against this strategy through several key performance indicators

## 1: Driving growth

We drive growth in four ways. We invest in new product development – our lifeblood as a technology business. We expand our presence in higher growth markets such as China, India and Brazil, through investment in sales resources. We improve sales and marketing effectiveness through sharing tools and best practice. And fourth, we make bolt-on acquisitions to add complementary technologies and increase our exposure to high-growth markets.

### Performance in 2015

Revenue £m

**£2,897m down 2%**

	Revenue	Reported	Underlying
2015	2,897	(2)%	(2)%
2014	2,952	(5)%	–
2013	3,109	2%	2%
2012	3,038	7%	5%
2011	2,842	3%	1%

Revenue declined 2% on a reported and constant currency basis as growth in Smiths Medical and Flex-Tek was more than offset by declines in Smiths Interconnect, Smiths Detection and John Crane.

The absolute level of revenue achieved in the year. This includes the effect of portfolio changes and currency movements.

Earnings per share Pence

**86.1p up 5%**

2015	86.1
2014	81.8
2013	92.7
2012	92.6
2011	86.5

Headline earnings per share grew 5% with higher headline operating margin and lower finance and taxation costs.

### Priorities

We aim to accelerate growth through continued improvement of our market and customer understanding and investment in new product development, sales and marketing in high-growth markets and in targeted acquisitions.

➔ Read more on pages 12-16, page 23 and in note 1 on page 138

## 2: Enhancing margins through operational excellence

We continue to enhance our attractive margins through further operational improvement, leveraging our scale and IT systems, and focusing on low-cost manufacturing. These operational efficiencies also provide the fuel to invest in growth.

### Performance in 2015

Headline operating margin %

**17.6% up 50bps**

2015	17.6
2014	17.1
2013	18.0
2012	18.2
2011	18.2

Headline operating profit margin rose 50 basis points, reflecting a recovery in profitability at Smiths Detection.

Based on our headline operating profit, which excludes a number of items that do not reflect the portfolio's underlying performance.

### Priorities

Continue to drive cost savings and operational improvements through the ongoing initiatives in our divisions.

➔ Read more on pages 12-16, page 23 and in note 1 on page 138

## 3: Attracting the best talent and developing smarter ways of working

Attracting, retaining and developing the right people with the right skills is key to transforming Smiths into a world-class organisation. We are raising the bar in terms of fostering talent through a rigorous focus on succession planning, assessment programmes and personal development. We also look for opportunities to foster smarter ways of working and encourage collaboration.

### Performance in 2015

#### Leadership

We have appointed a new CEO and Finance Director and confirmed the appointment of Roland Carter as President of Smiths Interconnect during the year.

#### Talent pipeline

Our focus on succession planning has delivered significant progress in building our talent pipeline, through a more rigorous and consistent approach to talent assessment and the preparation and monitoring of personal development plans. Around 150 managers from across the business are currently on, or have been through, our refreshed junior and senior leadership development programmes.

#### People management

Since 2010 we have transformed our HR function to ensure that we have the appropriate infrastructure in place to support growth.

### Priorities

Further develop our leadership capabilities and technological expertise, and continue to roll-out e-enabled HR. Continue to address the MyVoice engagement survey results and conduct our fourth survey to monitor progress.

➔ Read more on pages 12-16, 69-71 and [www.smiths.com/responsibility](http://www.smiths.com/responsibility)

#### 4: Promoting a culture of responsibility

We promote a culture of responsibility throughout Smiths Group. This requires us all to work according to our Code of Business Ethics. We are committed to working in a way that protects the health and safety of employees and minimises the environmental effects of our activities and detrimental effects of our products and services. This delivers real business benefits, while ensuring that we meet our obligations to all our stakeholders.

##### Performance in 2015 A range of indicators for safety and environmental impact

Recordable incident rate per 100 employees (RIR) 0.55

	FY2013-FY2018 Reduction target	FY2015 v FY2013
Energy	15%	2% increase
Greenhouse gas emissions	15%	4% reduction
Total non-recycled waste	15%	17% reduction
Water consumption	10%	6% reduction

While our goal is zero harm, our RIR increased slightly from 0.50 to 0.55. Focused programmes to address this at the few sites that experienced increased incidents have already delivered significant improvements and we continue to drive world-class safety standards across the organisation. Our environmental performance continued its long-term improvement trend, with good reductions in GHG emissions, non-recycled waste and water usage, but a minor increase in energy, compared to our 2013 baseline year.

##### Priorities

We will continue to embed a culture of ethical behaviour and responsibility across the business.

→ Read more on pages 65-71 and [www.smiths.com/responsibility](http://www.smiths.com/responsibility)

#### 5: Generating cash and managing the balance sheet effectively

By emphasising working capital management, particularly our debtors and inventories, we are able to convert a high proportion of headline operating profit into cash.

We also look to optimise our capital structure and secure long-term financing. Our borrowings are mainly through long-term bonds rather than bank debt. We also closely match the currency of our debt with our assets and earnings.

##### Performance in 2015

Cash conversion %

**95% down 2%**

2015	95
2014	97
2013	98
2012	99
2011	95

Operating cash generation remained strong, with headline operating cash of £484m (2014: £490m), resulting in cash conversion of 95%.

This is the proportion of headline operating profit that we are able to convert to headline operating cash.

##### Priorities

Continue to focus on cash generation and balance sheet management, so that we have the financial strength to grow the business and generate returns for shareholders.

→ Read more on pages 12-16, page 23 and in note 27 on page 173 and page 174

#### 6: Allocating capital to maximise returns

Smiths Group delivers high returns on capital. We achieve this through disciplined capital allocation to the divisions, by enhancing our profitability and through active portfolio management, with a targeted programme of acquisitions and disposals.

At the same time, we actively manage our portfolio of liabilities, such as our defined benefit pension schemes and legacy product liability issues, so that we minimise their impact on our value creation.

##### Performance in 2015

Return on capital employed %

**16.0% up 30bps**

2015	16.0
2014	15.7
2013	16.6
2012	16.5
2011	16.4

Return on capital employed increased 30 basis points to 16.0% as a result of improved profitability at Smiths Detection.

This is headline operating profit divided by monthly average capital employed, expressed as a percentage. Capital employed is total equity, adjusted for goodwill recognised directly in reserves, net post-retirement benefit-related assets and liabilities, litigation provisions relating to exceptional items and net debt. Return on capital for 2011 has been restated.

##### Priorities

Continue to manage our portfolio to create maximum value for shareholders.

→ Read more on pages 12-16, page 23 and in note 1 on page 138 and page 174

# The investment case

**Smiths Group offers a clear proposition to investors.**  
**We have a portfolio of fundamentally strong businesses,**  
**which gives us six key benefits:**

## Strong market positions in sectors with long-term profitable growth

Our businesses are generally either market leaders or are well placed in attractive niches. This allows us to benefit from the long-term growth drivers in their industries. Across our portfolio, these growth drivers include:

- global demand for energy
- healthcare needs of ageing populations
- threat of terrorism
- expansion of wireless communications
- aerospace demand
- US residential construction

 Read more on pages 17 and 24-53

## Leading-edge technologies and service levels that command high margins

We stay at the forefront of technology by understanding the needs of our customers and investing in research and development to meet those needs. Our technological strengths give us a competitive advantage and create customer loyalty, enabling us to earn attractive margins.


Our businesses often provide significant levels of aftermarket service and essential consumables. This helps us retain customers and provide recurring income as well as insight into customer needs.

 Read more on pages 12-21

## Further scope for operational improvement and margin enhancement

Operational efficiencies will drive our margins higher. Our restructuring programme has already delivered significant value, with more to come in the next two years.


We have invested to improve our systems, with enterprise resource planning systems installed in Smiths Detection, Smiths Medical and John Crane. Better information enables us to leverage the Group's scale and deliver further savings. Portfolio profitability reviews are also improving operational efficiency.

 Read more on pages 12-16

## Opportunity to realise value through portfolio management

We also assess portfolio management opportunities where we see the potential to create a more focused portfolio through a targeted programme of acquisitions and disposals.


We invest in business acquisitions to increase our exposure to attractive and adjacent growing sectors as well as to expand our current businesses.

 Read more on pages 12-16 and 18-21

## High returns on capital employed

Our divisions generate attractive margins and tend to specialise in small-batch, low-cost manufacturing. As a result, they have low capital intensity and deliver returns above our weighted average cost of capital.

We have opportunities to invest for growth in our businesses to generate attractive incremental returns for our shareholders. We maintain a strong discipline to ensure we make informed investment choices.

 Read more on pages 14-16 and 54

## Strong cash generation to reinvest in top-line growth and increase dividends

Closely managing our working capital enables us to convert most of our operating profit into cash-flow.

Our focus on cash ensures we have the resources needed to reinvest in our businesses through targeted acquisitions, and in organic growth drivers such as product development, and sales and marketing in growth markets. At the same time, it allows us to increase dividend payments to shareholders, while maintaining an efficient balance sheet and meeting the obligations of our legacy liabilities, such as pensions and product liability litigation.

 Read more on pages 14-16, 23 and 54, and in note 27 on page 173 and on page 174

# Operational review: Group

**Smiths Group is a world leader in the practical application of advanced technologies. We deliver products and services for the threat and contraband detection, energy, medical devices, communications and engineered components markets worldwide.**

## Revenue

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

## Profit

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

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

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

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

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

## Cash generation

Operating cash generation remained strong with headline operating cash of £484m (2014: £490m), representing 95% (2014: 97%) of headline operating profit (see note 27 to the accounts for a reconciliation of headline operating cash and free cash-flow to statutory cash-flow measures). Free cash-flow increased £15m to £158m (2014: £143m). Free cash-flow is stated after interest, tax and pensions financing, but before acquisitions, financing activities and dividends.

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

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

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

## Company-funded R&D

Down 4% underlying to

**£104m**

➔ Read more on page 54

## Net debt

Up £14m to

**£818m**

➔ Read more on pages 54-57 and 131 and in note 18 on page 161

## Annual dividend

Up 2%

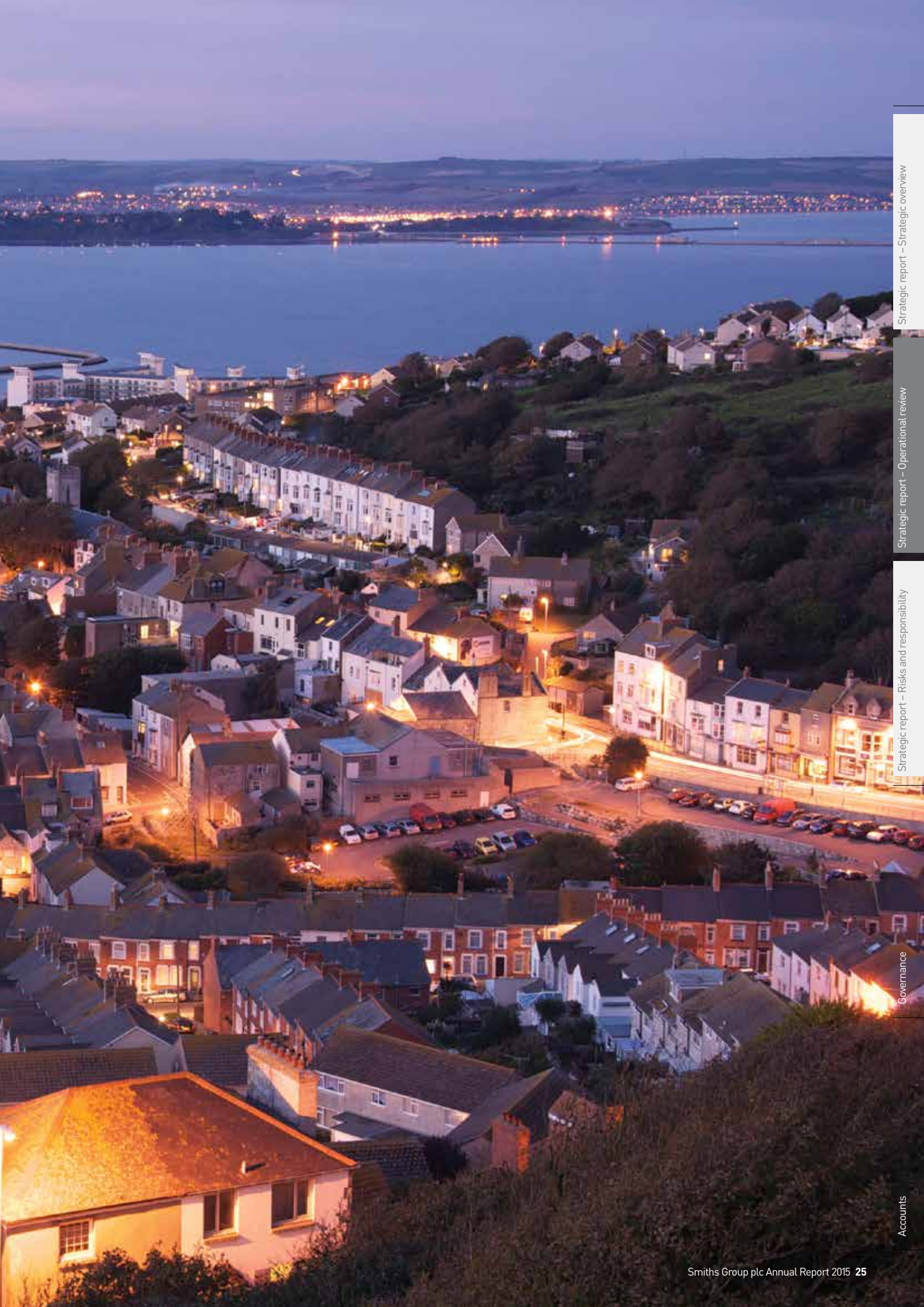
**41.0p**

➔ Read more on pages 14-16 and in note 25 on page 172

# John Crane

## Green credentials

Having invented non-contacting gas seal technology almost 50 years ago, John Crane is as determined as ever to retain its industry-leading role in helping protect the environment. Its 1968 innovation helped slash methane emissions from seals by a factor of 10, paving the way for pumps to securely transfer carbon dioxide – another greenhouse gas – and enable customers to meet ever-tightening environmental controls. Its latest advance is AURA 220, the next generation of gas seal technology which uses a common global design and patented polymeric sealing device with Active Deflection Control to help customers cut operating and transaction costs.



## John Crane

A leading provider of engineered products and services to global energy services customers.

Our products and services help ensure the reliability of mission-critical equipment in challenging operating environments. In addition to lowering total cost of ownership of equipment, our products reduce emissions and help our customers meet environmental responsibilities. For nearly 100 years, our customers have depended on our global service network and technical excellence.

Duncan Gillis  
President, John Crane



### Revenue performance

£m

£905m down 4%

2015	905
2014	941
2013	986
2012	973
2011	894

### Principal operating regions

John Crane is a global business with a presence in more than 50 countries. We have the largest global service network in the industry with 17 super service centres around the globe supported by more than 230 sales and service centre locations. We have 19 manufacturing sites in 14 countries and global R&D centres in the US, UK and China.

### Customers

John Crane serves companies in the energy services sector including production, transmission & storage, refining, power generation, petrochemical, as well as pump and compressor manufacturers. Its main customers include Chevron, BP, Dresser Rand, Valero, ExxonMobil, SABIC, Pemex, Saudi Aramco, Shell, Petrom, Sulzer, Flowserve, GE Energy, Siemens, Solar Turbines and Weir Group. No customer is larger than 3% of revenue.

### Competitors

For rotating equipment technologies, John Crane's main competitors are Flowserve and Eagle Burgmann Industries (mechanical seals); Kingsbury and Waukesha (engineered bearings); Danaher and Hydac (filtration systems); Rexnord and Regal Beloit (couplings). For equipment in upstream oil services, John Crane's principal global competitors include Weatherford and Dover.

### Suppliers

John Crane operates a global supply chain, using regional and local partnerships to meet the required service levels. Major suppliers include Morgan Advanced Materials, CoorsTek, Penn United Carbide, Schunk, Earle M. Jorgensen and DuPont.

### Contribution to 2015 Group revenue

31%

### Contribution to 2015 Group headline operating profit

41%

Percentage relates to headline operating profit before corporate costs

### Revenue by sector

First-fit: 44%

1 First-fit 44%

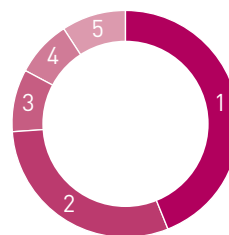
Aftermarket: 56%

2 Oil, gas and petrochemical 30%

3 Chemical and pharmaceutical 9%

4 Distributors 8%

5 General industry 9%



### Revenue by product

A broad portfolio from seals and bearings to couplings and artificial lift equipment

Mechanical seals and systems

78%



Couplings

5%



Bearings

5%



Filtration systems

5%



Artificial lift

7%





## Markets and trends

Recognised globally across the energy services sector, John Crane provides engineered solutions that drive reliability improvements and sustain the effective operation of customers' rotating equipment and other machinery. The comprehensive product portfolio includes mechanical seals, seal support systems, engineered bearings, power transmission couplings and specialised filtration systems. John Crane also helps maintain and enhance oilfield productivity through the servicing and provision of onshore down-hole 'artificial lift' pumping hardware and systems. Our technology is supported by the industry's largest global sales and service network that provides performance-enhancing services, utilising expertise developed from decades of technology leadership coupled with proven field experience. Service teams in more than 50 countries maintain and support customers' mission-critical operations throughout the economic lifetime of our products.

More than half of John Crane's sales stem from the aftermarket servicing and support of existing installed equipment, with the remainder from the design and supply of products to first-fit customers. The business serves a range of industries including oil and gas, chemical and power generation.

Demand for John Crane products and services is influenced by a number of factors including the global demand for energy and an increasing desire for national energy independence, and more stringent environmental and safety requirements. John Crane is a market leader in its traditional product areas – mechanical seals and seal support systems. There is opportunity to continue growing market share across all product areas.

John Crane's global network is a key asset which allows for quick-response and effective aftermarket service close to customers' operations. These facilities provide a range of value-added services including repair and refurbishment, root-cause analysis, alignment and condition monitoring – all designed to improve the performance of customers' rotating equipment and to reduce operational downtime. The geographic footprint continues to expand through opening additional service centres in support of our growth strategy in selected high-growth markets.

## Strategy

The division's business strategy is focused on sustaining a cycle of growth and productivity. It is built around four core priorities: to profit from core products and services, build-out selected growth markets, drive continuous productivity and expand across the energy value chain. Our company values remain a key element in delivering our strategy: a relentless focus on customer service, improving quality, developing our people, business ethics and safety.

## Supporting performance

Phillips66 Texas, Solvay Brazil and Japan's Sanyo Chemical are among the latest major companies to benefit from John Crane's Performance Plus (PP) reliability programme. Exploiting its large global service footprint, John Crane engineers and technicians provide oil, gas and processing companies on-site support to improve operations and cut costs. Around 150 PP employees are stationed at customer sites where they analyse root cause failures, identify areas for improvement and apply performance-based solutions. Plant reliability can be improved by more than 50% because of the dramatic reduction in equipment outages and downtime. The long-term reward for John Crane is a steadily growing and dependable aftermarket business that accounts for more than half its revenue.

## Competitive strengths

- Strong proprietary technology with expertise in applied engineering
- Market leader in mechanical seals
- Over half of sales in aftermarket
- Global network of c. 230 sales and service centres

## Growth drivers

- Growing demand for energy
- Investment in oil and gas infrastructure
- Expansion in emerging markets
- Developing new products and applications

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

## Performance

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

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

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

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

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

## Key operational highlights

- **Demonstrated resilience of its business model and aftermarket strength**
- **Expanded installed base in focus markets**
- **Increased global service network productivity**
- **Increased machining capacity in existing lower cost facilities**



### Research and development

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

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

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

### Outlook

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

➔ Go to [www.johncrane.com](http://www.johncrane.com) for more information

### Higher output, lower costs

A long-standing strategic partnership with Romania's Petrom, the EU's largest onshore oil producer, is helping drive operational innovations in John Crane's upstream business. John Crane has supplied and serviced Petrom's c. 8,000 wells for the past six years. Its design, repair and optimisation support of crucial artificial lift equipment helps to improve the efficiency and output of existing wells. Under pressure from low crude prices, oil producers are looking to boost production while curbing costs. Reflecting this, a new agreement with a progressing cavity pump manufacturer has expanded John Crane's upstream product portfolio to include cost-efficient technology, ideal for use in a lower oil-price environment.

### Priorities for 2016

- Expand installed base
- Build-out selected growth markets
- Maximise aftermarket performance
- Drive continuous productivity

### Medium-term operating ranges

- Underlying revenue growth: mid-single digits (4-6%)
- Headline operating margin: margin range (22-25%)

# Smiths Medical

## IVF almost 40 years on

Smiths Medical's unrivalled expertise in IVF (in vitro fertilisation) is bringing hope to a new generation of childless couples. Having designed the pioneering embryo transfer catheter used in the conception of Louise Brown, the world's first 'test-tube' baby, in 1978, Smiths Medical's Wallace brand now supplies a micro-pipette that elevates IVF treatment to a new level.

Wallace ICSI (intra-cytoplasmic sperm injection) micro-pipettes are used by embryologists to select a single sperm for injection directly into an egg, unlike in conventional IVF which involves many sperm being placed in a dish with an egg. ICSI enables fertilisation when sperm are few or slow-moving. Introduced in 2012, Wallace ICSI pipettes have been used more than 70,000 times in the past year in clinics worldwide.



## Smiths Medical

A leading supplier of specialty medical devices and consumables that are vital to patient care around the world. Smiths Medical is dedicated to providing innovative solutions and superior support to help healthcare professionals and providers ensure safety, enhance patient outcomes and improve the total cost of care.

Our broad portfolio offers products that aid in the delivery of medication, protect healthcare workers and patients from cross-infection and injury, manage patient airway and temperature, as well as deliver specialised care in areas of invitro fertilisation, diagnostics and emergency patient transport.

Jeff McCaulley  
President, Smiths Medical



### Headline revenue performance

£m

**£836m up 4%**

2015	836
2014	804
2013	850
2012	864
2011	838

### Principal operating regions

We have operations in over 30 countries with manufacturing located in the US, UK, Mexico, Italy, Germany, Czech Republic, and China. We sell to approximately 120 markets and, while the US continues to be our largest single market with over 50% of sales, we continue to build our presence in developing markets.

### Customers

Approximately three-quarters of our end user customers are hospitals with the remainder comprising the alternate care market, such as homecare, clinics, and other surgery centres, as well as OEM relationships. We have a direct sales presence in over 20 countries and distribution arrangements in approximately 100 others.

### Competitors

The competitive landscape for Smiths Medical is complex, as we compete with different companies across our business units. Major competitors include Medtronic (Covidien), Teleflex, B Braun, Becton Dickinson (CareFusion), Terumo, C R Bard, 3M, Edwards Lifesciences, and Pfizer (Hospira). We often compete with a portion of a major competitor's medical device business, as well as single product line companies as they enter a particular market segment. In developing markets, we compete with both large multinational companies and smaller domestic players.

### Suppliers

We engage with suppliers to drive product innovation, value engineering and a commitment to quality. We work continuously with our supplier base to reduce product and supply chain costs, improve delivery performance and ensure supply continuity plans. The majority of our direct spending is on resins, plastic injection mouldings and electronics.

### Contribution to 2015 Group revenue

**29%**

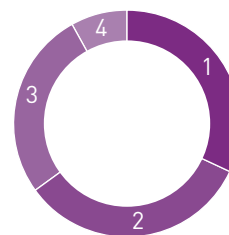
### Contribution to 2015 Group headline operating profit

**31%**

Percentage relates to headline operating profit before corporate costs

### Revenue by sector

- 1 Infusion systems 32%
- 2 Vascular access 33%
- 3 Vital care 27%
- 4 Specialty products 8%



Infusion systems  
**32%**



Vascular access  
**33%**



Vital care  
**27%**



Specialty products  
**8%**





## Markets and trends

Despite market challenges, the medical device industry remains attractive, driven by population trends, safety legislation, device integration and connectivity, and increasing global prosperity – particularly in developing markets. Procedural growth rates are improving slightly, though we anticipate they will continue to be constrained by health system reforms, reduced healthcare budgets, and increasing requirements for economic and clinical evidence.

The global market served by Smiths Medical products is estimated to be approximately £6bn, with further opportunities in adjacent target markets. Smiths Medical has strong design, production and distribution capabilities to capitalise on these global opportunities.

We are well positioned in lower risk, short-duration, interventional devices, that have application in a wide variety of procedures. Our broad portfolio includes strong brands in hardware and consumable products, as well as software and services for both hospital and alternate care settings.

## Infusion systems

Smiths Medical designs and manufactures medication delivery systems that relieve acute and chronic pain (Portex and CADD), treat the most at-risk patients in intensive care units (Medfusion and Graseby), and address the needs of patients with chronic conditions, such as cancer, pulmonary hypertension and Parkinson's disease in hospice and home settings (CADD). The global market for infusion systems products in which we compete is estimated to be £1.6bn. We expect continued market growth through the increasing treatment of chronic conditions, the integration of medication delivery devices with hospital information technology systems and the move of patients to alternate care settings. Our CADD brand is a leader in ambulatory infusion, we have a strong position in the syringe pump market

with our Medfusion and Graseby products, and our Portex brand is a leader in the pain management market.

## Vascular access

Our Vascular access portfolio protects healthcare workers and patients from the risk of infection and injury through the use of safety-enabled devices. Smiths pioneered safety devices, including the first safety peripheral intravenous catheter (PROTECTIV) and the first port for delivery of chemotherapeutic agents (PORT-A-CATH). Smiths portfolio covers a range of functions including drawing blood samples, administering injections and vaccinations (Jelco and Portex), and delivering chemotherapeutic agents for cancer patients (Deltec). Our Medex product provides blood pressure monitoring for critically ill patients in the intensive care unit. The global market we serve is estimated to be almost £2.6bn and is expected to grow as the focus on safety and reducing the risk of infection intensifies. Our latest innovation in IV catheters – ViaValve – offers blood control and needlestick injury protection and remains a significant growth opportunity. Smiths is well positioned to capitalise on the advancement of sharps safety initiatives, including directives in the EU and Brazil, as well as the recent WHO guideline on the use of safety-engineered syringes to be designed to protect healthcare workers from needlestick injuries.

## Vital care

Smiths Medical Vital care products manage patient airways before, during and after surgery (Portex), alleviate breathing difficulties (Portex), and help maintain body temperature (Level 1). The vital care market, estimated at over £1.6bn, has been affected by slowdowns in procedure rates over recent years, but is expected to grow more strongly driven by increasing chronic disease incidence rates (COPD), ageing populations and rising healthcare spend in developing markets.

## Emerging market success

India has proved an auspicious testing ground for Smiths Medical's drive to accelerate sales growth, particularly in emerging markets. By reshaping its marketing and distribution strategies, Smiths Medical set out to capitalise on the steadily rising demand for medical devices in the subcontinent. Its incumbent distribution agent was replaced with a more dynamic network of 350 distributors and sub-distributors to improve penetration of the local market. Working closely with hospitals to identify priorities, the new local management established a highly trained sales team to consolidate the start-up organisation and upgrade its technology offerings. It also built a more flexible storage, IT, sales and marketing structure. Sales growth of 23% in 2014/15 indicates the strategy is working.

## Specialty products

Smiths Medical's products for specialised care areas improve patient outcomes through in vitro diagnostics and fertilisation (Wallace), animal health clinics and surgical sites (SurgiVet), during the emergency transport of patients with life support ventilation (Pneupac) and through the monitoring of critical vital signs (BCI).

## Strategy

Our primary focus is on improving patient outcomes and reducing the total cost of care by helping healthcare providers solve their clinical needs efficiently and economically. This drives investment in new product development, manufacturing optimisation, and improvements in our supply chain, marketing and distribution models. We are investing for growth in both developed and developing markets, and are well positioned to take advantage of the ongoing shift in healthcare delivery from hospitals to alternate sites (eg clinics) and home care.

## Competitive strengths

- Strong market positions in select clinical areas
- Highly recognised and respected brands
- Reputation for quality and safety
- Differentiated lower risk, short-duration, interventional devices
- Building an innovative pipeline of new product launches
- Extensive global sales network

## Growth drivers

- Ageing populations and increasing life spans add to growing healthcare demand
- Rising expectations for increasing quality of care
- Patient and health worker safety and legislation requirements
- Growing incidence of chronic diseases
- Growth of alternate site care
- Rising healthcare spend in developing markets, offsetting budget constraints in developed markets

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

## Performance

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

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

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

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

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

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

## Key operational highlights

- **Strong Infusion systems performance continued, driven by focused investment in ambulatory infusion amid competitor disruptions**
- **Return to growth of Vital care business unit and stabilisation of Vascular access in the face of stiff competition**
- **Developing market growth driven by China, up 14%; continued traction from onshore model switch in India**
- **Improvement in supply chain reliability continued through the year**
- **R&D investment grew by £7m to £45m (17% increase) and is now 5.4% of sales (up 60 bps)**



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

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

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

### Research and development

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

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

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

### Outlook

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

 Go to [www.smiths-medical.com](http://www.smiths-medical.com) for more information

### Building our Future boosts sales

A business transformation plan initiated by Smiths Medical's new president has started paying early dividends with annual revenue growth of 4% reported – the biggest underlying increase in almost a decade. Shortly after his appointment in March 2014, Jeff McCaulley launched Building Our Future, a holistic approach focused on driving strong and sustainable performance through aligning culture and strategy with the division's operating model. Within a framework of Purpose, Principles, Priorities and Performance, Smiths Medical has committed to becoming a world-class business through enhanced transparency in performance scorecards with closely linked rewards and greater individual accountability. Employee engagement has increased and better professional development programmes are boosting employee retention.

### Priorities for 2016

- Build a highly competitive portfolio of products and services through establishment of multi-generational product plans that create sustainable competitive advantage
- Improve marketing and sales force impact in both developed and developing markets
- Drive operational excellence through reduction in cost of quality, overheads and cost of goods, and supply chain reliability and efficiency

### Medium-term operating ranges

- Underlying revenue growth: low single digits (0-3%)
- Headline operating margin: margin range (20-24%)

# Smiths Detection

## Strategic reliability

Regularly operating at more than 98% capacity, Heathrow Airport views safety and reliability as paramount when awarding major supply contracts. So Smiths Detection took particular pride in winning an order for 17 of its newest XCT scanners, which check hold baggage for explosives. The high-speed systems, combining X-ray technology with 3D computer tomography, will be deployed over the next four years as one of the world's biggest and busiest airports upgrades its baggage security operations with minimum disruption or delay. The scanner's efficiency is enhanced by its large tunnel opening, allowing the inspection of awkward, outsize items.

Ian Ballentine, Procurement Director of Heathrow Airport, said: "Smiths Detection is one of our strategic suppliers and its HI-SCAN 10080 XCT, which had already gained key US and EU certification, was selected for screening our outsize baggage, having been successfully evaluated against our requirements."



## Smiths Detection

A world-leading designer and manufacturer of sensors that detect and identify explosives, weapons, chemical agents, biohazards, nuclear & radioactive material, narcotics and contraband.

Our comprehensive range of detection technologies, including X-ray, trace detection and infra-red spectroscopy helps customers in the global transportation, ports and borders, critical infrastructure, military and emergency responder markets.

**Richard Ingram**  
President, Smiths Detection



### Revenue performance

£m

**£467m down 9%**

2015	467
2014	512
2013	559
2012	519
2011	510

### Principal operating regions

Our manufacturing centres are concentrated in Germany, France, Malaysia, USA and the UK. We sell to over 200 countries around the world either direct or through third-party distributors.

### Customers

The majority of revenues are influenced by more than 100 governments and their agencies, including homeland security authorities, customs authorities, emergency responders and the military. These include the US Department of Defense, US Transportation Security Administration (TSA), and the UK Ministry of Defence. All US sales and support activities are controlled under a Special Security Agreement with the US Department of Defense and managed by the operating subsidiary Smiths Detection Inc., to provide independent oversight of the business, its classified contracts and work.

### Competitors

Smiths Detection's exposure to the homeland security and defence sectors brings it into competition with a wide range of companies in each end-use market. Principal competitors include: Morpho (transportation), Rapiscan (transportation, ports and borders, critical infrastructure), L-3 Security & Detection Systems (transportation), Nuctech (ports and borders, critical infrastructure), Astrophysics (critical infrastructure), AS&E (ports and borders), Leidos (transportation, ports and borders), Chemring (military), Bruker (military, emergency responders), and Thermo Fisher (military and emergency responders).

### Suppliers

We are achieving increased synergies across manufacturing sites and aligning purchasing activity to ensure that we fully leverage the size of our business. These developments are ongoing and take into account the requirement for local content from some of our major customers, as well as our stringent quality and delivery standards.

### Contribution to 2015 Group revenue

**16%**

### Contribution to 2015 Group headline operating profit

**10%**

Percentage relates to headline operating profit before corporate costs

### Revenue by sector

- 1 Transportation 52%
- 2 Ports and borders 11%
- 3 Military and emergency responders 14%
- 4 Critical infrastructure 23%



### Transportation

**52%**



### Ports and borders

**11%**



### Military and emergency responders

**14%**



### Critical infrastructure

**23%**





## Markets and trends

Smiths Detection produces equipment for customers in the air transportation, ports and borders, critical infrastructure, military and emergency responders end-use markets, to help them assure the safety and security of people and critical assets.

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 end-use market. The growing installed equipment base creates significant opportunities for aftermarket (service and support) and upgrade revenues.

Regionally, the Americas remain the principal source of demand but will experience a lower annual growth rate than the Asia Pacific region, where demand levels are expected to match those in the EMEA region within five years, fuelled largely by the requirements of the critical infrastructure and ports and borders sectors.

The heavily regulated air transportation sector is the largest market for the division. Rising passenger volumes are resulting in new airport investment, especially in the Middle East and Southeast Asia. This, together with continuing security threats, a strong replacement cycle and globalisation of trade, boosting air freight volumes, is expected to continue to support market growth. There is additional focus on the efficiency and effectiveness of the screening processes based on the analysis of operational data, creating the requirement to integrate airport information systems with screening equipment.

In the ports and borders market, continuing globalisation of trade combined with increasing regulatory standards will drive the growth in demand for security screening equipment. 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.

The critical infrastructure market is large but fragmented and unregulated. Growth in demand continues at more than 5% as public and private sector organisations seek to provide better protection for their assets and staff. As the market develops, customers are increasingly demanding products tailored to their specific needs: smaller, lighter and considerably cheaper equipment, which can fit into existing buildings and be operated by staff with basic training.

Global demand for chemical warfare agent detection equipment and other threat-specific sensors required by the military is forecast to grow steadily. It is driven by governments' need to protect troops, equipment and infrastructure from threats, irrespective of where they are deployed: in theatre; domestically; or held in readiness for rapid deployment. In addition, new equipment must be capable of detecting a wider range of threats whilst becoming smaller, lighter and more sensitive.

Demand in the emergency responder end-use market, a subset of the military market, is driven by customers needing to deploy equipment to detect and identify chemical releases as a consequence of both terrorist and non-terrorist events.

## Focus on cargo flow

As manager of one of Asia's busiest airports, Malaysia Airports Holdings Berhad (MAHB) is constantly seeking the most cost-effective ways to speed the flow of cargo containers through customs and security. So its enthusiasm for Smiths Detection's latest advance in HCVP cargo inspection technology is no surprise. The Virtualisation Project focused on reducing the hardware needed to support the sophisticated detection capability of a high-energy X-ray portal. MAHB project manager Noor Sabrina Mat Barhan said: "By installing the new HCVP with Virtualisation we can now perform many critical functions in parallel, reducing the number of servers from five to one. This allows us to cut our system IT costs by up to two-thirds with no loss of detection effectiveness."

## Strategy

Smiths Detection's strategy is one of balanced growth supported by continuous improvement. Operational savings achieved through ongoing cost control initiatives and elimination of waste will be reinvested in focused development of products and software systems, as well as improvements in aftermarket coverage and service levels. The division's primary goal is to deliver the best solutions for customers. Future product development will be driven increasingly by greater customer insight. Product development priorities remain competitive differentiation and ease of installation, service and upgrade. Operational improvements will be based on value engineering, quality improvements and continuous improvement initiatives to drive out waste and reduce lead times. Better aftermarket penetration to generate revenues, which help to smooth out the volatility of prime contracting, is being successfully achieved, along with an increase in the number of long-term contracts, which underpin the traditional aftermarket business.

## Competitive strengths

- **Market leader with strong global brand**
- **Operates in several regulated markets that require product certification**
- **Technologies leveraged across a broad range of markets and applications**
- **More than a third of sales from aftermarket service and growing**

## Growth drivers

- **Persistent and evolving terror threats**
- **Changing security regulations for air cargo and passengers**
- **Equipment replacement cycle – typically 7-10 years**
- **Growing opportunities in software-driven solutions to provide greater functionality, networking and systems integration**
- **Growth of security infrastructure in emerging markets**

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

## Performance

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

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

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

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

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

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

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

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

## Key operational highlights

- Underlying revenue declined 7% in a tough trading environment
- Margin recovery without last year's one-off charges
- Aftermarket revenues now 36% of sales
- Extensive business improvement programme instigated
- Strong order book for delivery in the coming year



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

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

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

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

### Research and development

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

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

### Outlook

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

➔ Go to [www.smithsdetection.com](http://www.smithsdetection.com) for more information

### Deterring contraband

It took only weeks for Smiths Detection's mobile cargo scanner to prove its worth to Luxembourg Customs. The HCVM T, which features advanced 'material discrimination' software, uncovered a carefully concealed cache of 12 million cigarettes in a truck stopped for random inspection. Guy Loesch, Head of Luxembourg Customs Security, said: "Demand from consumers for cheap cigarettes and the high prices in countries such as the UK make the illegal cross-border trade very attractive."

The high-energy X-ray system is in great demand around the world: its use deters the movement of threat items and contraband and the hefty fines levied on smugglers generate considerable revenue for hard-pressed governments.

### Priorities for 2016

- Strengthen sales channels in all regions
- Maintain product development at current levels based on targeted R&D investment
- Launch value engineered products in specific end markets
- Deliver further growth in aftermarket revenues
- Implement continuous improvement initiatives

### Medium-term operating ranges

- Revenue growth: variable, averaging mid-single digits (4-6%)
- Headline operating margin: margin range (14-20%)

# Smiths Interconnect

## Power of data

From providing the 'cloud' used by many applications to processing a wide array of vital information, data centres play an unseen but vital role in our lives. So they must receive continuous, ultra-reliable electrical power.

To meet this challenge, Smiths Interconnect has developed a new, high-density Power Distribution Unit (PDU) which enables space savings of up to 50%. Like conventional PDUs, the PowerHub2 converts electricity into appropriate currents and voltages and distributes it to the racks of computer servers. Its modular design also reduces maintenance costs and easily accommodates customer variations.

Nathan Hazelwood, Director of Strategic Procurement at QTS Data Centers in the US, said: "The innovative designs of Smiths Interconnect's PDUs deliver installation and serviceability benefits that help enable our flexible solutions to support the rapidly evolving infrastructure demands of web and IT applications."



## Smiths Interconnect

A recognised leader in technically differentiated electronic components and sub-systems providing signal, power and microwave solutions.

We design and manufacture products that connect, protect and control critical systems for the global data centre, wireless telecommunications, aerospace, defence, space, medical, rail, test and industrial markets.

Our products are application-specific and incorporate innovative technologies to provide our customers with a competitive advantage.

**Roland Carter**  
President, Smiths Interconnect



### Revenue performance

£m

**£420m down 6%**

2015	420
2014	445
2013	461
2012	449
2011	379

### Principal operating regions

Smiths Interconnect operates globally and has locations in the US, Mexico, Costa Rica, UK, France, Germany, Italy, Tunisia, Singapore, China and Australia.

### Customers

Smiths Interconnect supplies to multiple levels of the supply chain and its blue chip customers include prime contractors and service providers, OEMs, system suppliers and sub-system manufacturers. Amongst our largest customers are Raytheon, Finmeccanica, BAE Systems, AAI/Texttron, Lockheed Martin, Thales, Global Eagle Entertainment, Rockwell Collins, Telstra, Motorola, Verizon, Vodafone, Huawei, Foxconn, Schneider, CyrusOne, Microsoft, Qualcomm, NVIDIA, Broadcom, GE Healthcare, Biosense Webster and Varian.

### Competitors

Smiths Interconnect operates in relatively fragmented markets with many small, medium and larger competitors in various product and technology areas. Connector competitors include Amphenol, TE Connectivity, MultiTest (part of Xcerra), Yokowo, Glenair, ODU and Harting. Microwave competes with, amongst others, Anaren, KMW, Dover, CommScope, Cobham, Honeywell and Teledyne. Emerson Network Power, Cyberex (part of ABB), Eaton, Starline (part of Universal Electric), Huber & Suhner, Dehn + Söhne and Phoenix Contact offer competitive power management products.

### Suppliers

Smiths Interconnect strategically manages its supply base through a single global sourcing organisation that develops supplier partnerships whilst ensuring no material dependencies on any individual supplier. Machined parts and electronic components together represents approximately half of the total spend.

Contribution to 2015  
Group revenue

**15%**

Contribution to 2015  
Group headline operating profit

**9%**

Percentage relates to headline operating profit before corporate costs

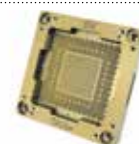
### Revenue by sector

- 1 Connectors 35%
- 2 Microwave 40%
- 3 Power 25%



Connectors

**35%**



Microwave

**40%**



Power

**25%**





## Markets and trends

Smiths Interconnect comprises three technology-focused business units:

**Connectors** provides application-specific, high-reliability electrical interconnect solutions, from highly integrated assemblies to microminiature connectors and spring probe contacts.

**Microwave** provides components, sub-assemblies and systems for defence, aerospace, wireless telecommunications and electronic test applications.

**Power** provides distribution, conditioning, protection and monitoring solutions for data centres, wireless communications and other critical or high-value electrical systems.

Smiths Interconnect addresses a variety of end markets, particularly defence, wireless telecommunications, data centres, test and measurement, and semiconductor test.

Global defence spending has stabilised but remains constrained as western governments maintain tight control of their budgets. New investment is focused on system upgrades rather than new platforms. Critical areas such as intelligence, surveillance and reconnaissance (ISR), improved battle space awareness and force protection are likely to remain priorities. Military applications for Smiths Interconnect technology include unmanned aerial systems (UAS), next-generation ground vehicles, communications systems, radars and electronic warfare (EW) systems, surveillance systems and self-protection systems. Our microwave technology, ruggedised connectors and electromagnetic pulse (EMP) protection solutions are deployed in the most extreme environments, such as enabling sensor and communications systems and next-generation radar and EW systems.

Evidenced by a strong new build aircraft order book, the commercial aerospace market remains strong, driven by increasing passenger and freight demand particularly

in developing regions, and the need to upgrade fleets to more efficient aircraft. Smiths Interconnect provides connector and satellite communications antenna solutions for various aircraft and space applications.

The wireless telecommunications infrastructure market continues to be driven by network improvements and in-building capacity increases to enable higher data rates and bandwidth utilisation. These support the proliferation of mobile communication devices and their data-intensive applications. Smiths Interconnect supplies niche, high-performance microwave components used in cell sites and in-building networks, as well as products and test equipment that help optimise network performance, and protect high-value infrastructure from lightning strikes and power surges.

Data centre demand is largely driven by internet traffic growth due to the expansion of web-enabled devices (the Internet of Things) and applications, virtualisation or cloud computing. Industry-specific data regulations, for example in financial services and healthcare, also create new capacity requirements. Co-location data centre providers have continued to grow faster than enterprise demand as companies choose to outsource rather than fund large capital projects. Smiths Interconnect's conditioning, distribution, protection and monitoring solutions ensure power quality is delivered to sensitive IT equipment and enable accurate monitoring and metering, an increasingly important issue as electricity costs increase.

Smiths Interconnect provides connector and cable assembly solutions to semiconductor test and test and measurement applications. The continued proliferation of electronic devices, high rate of technology refresh, increased functionality and greater connectivity requirements are key drivers for these markets.

## Emission control

Stricter international controls on diesel emissions have opened another market for Smiths Interconnect to leverage its expertise in thick film processing to produce a key component of new sensors for the auto industry. Its newly launched Automotive Soot Sensor is a specialised electrode that attracts and measures carbon particles found in diesel exhaust. In addition, when the carbon deposits accumulate, the sensor triggers a current to clean the electrode and maximise its effectiveness. In this way, engine performance is continuously monitored and the driver is alerted when maintenance is needed. The unique design integrates elements into a single layer, simplifying manufacture and reducing costs.

## Strategy

Smiths Interconnect continues to build a global business model that enables the organisation to position itself in growth markets and to be viewed as a local, responsive and agile supplier of innovative and technically superior value propositions. We leverage our strong technology and deep customer relationships facilitated by teams of highly specialised technologists. Diversified end markets provide resilience, and we allocate resources to markets, customers and regions with the most attractive prospects, particularly wireless telecommunications, data centres, test, commercial aerospace, Asia and other emerging geographies. Restructuring and efficiency initiatives, including lean and value engineering, deliver the funds for investment. By providing a technically challenging, exciting and rewarding environment, we attract and retain the necessary talent to drive our future performance.

## Competitive strengths

- Innovative and technically differentiated technologies
- Ultra-high reliability solutions used in demanding applications
- Customer intimacy, responsiveness and product customisation
- Addressing highly regulated markets with strong barriers to entry

## Growth drivers

- Proliferation of electronic devices
- Demand for greater connectivity
- Growth in high data rate applications
- Increasing sophistication of customer needs in emerging markets

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

## Performance

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

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

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

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

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

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

## Key operational highlights

- Results affected by tough trading conditions in certain markets
- Volumes also reduced due to programme slowdowns and delays
- Efficiencies delivered from further site rationalisation
- Continued investment in business development in new sectors and geographies
- Product launches in several areas



### Fine art of testing

Just as technology becomes smaller and smarter, so must the equipment that tests it. The tiny semiconductor chips that drive mobile phones and wearable technology are growing in complexity and capability while also shrinking in size. A 'connected' watch typically contains more than 16 chips providing Bluetooth capability, graphics processing, power management and many other functions. To keep pace, Smiths Interconnect has developed Monet, a socket that enables electrical testing of these minute chips using an extremely fine grid of highly accurate and reliable spring-probe compression contacts. Using a radically thin, embedded barrel design, the Monet probes also offer benefits such as low electrical resistance, high current ratings and excellent z-axis travel with low contact force.

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

### Research and development

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

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

### Outlook

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



Go to [www.smithsinterconnect.com](http://www.smithsinterconnect.com) for more information

### Priorities for 2016

- Continued focus on commercial market opportunities
- International expansion, particularly Asia
- Further investment in new product launches targeted at higher growth and nascent segments
- Improve cost base through further site rationalisation, quality improvements and value engineering

### Medium-term operating ranges

- Underlying growth: low to mid-single digits (3-5%)
- Headline operating margin: margin range: (16-18%)

# Flex-Tek



## **Tender connections**

The increasing use of Liquefied Natural Gas (LNG) to fuel US locomotives has opened a potentially lucrative market for Flex-Tek's specialty hose division.

Titeflex has designed a specific LNG railroad hose with a unique braiding pattern that provides far greater strength in delivering liquids between wagons. Unlike most other hoses, it is robust and resilient enough to hold the connection even when the tender itself becomes otherwise separated. This gives a crucial cost advantage to Titeflex's railroad customers, who have seen major savings in downtime and hose repair or replacement. The hoses, currently sold mainly in the US, have already been successfully tested in China.



## Flex-Tek

A global provider of engineered components that heat and move fluids and gases for the aerospace, medical, industrial, construction and domestic appliance markets.

Our flexible hosing and rigid tubing provide fluid management for fuel and hydraulic applications on commercial and military aircraft, deliver fuel gas and conditioned air in residential and commercial buildings, and provide respiratory care for medical applications. Flex-Tek heating elements and thermal systems improve the performance of a range of devices, from medical and diagnostic equipment to domestic appliances such as clothes tumble dryers and HVAC equipment.

Tedd Smith  
President, Flex-Tek



### Revenue performance

£m

**£269m up 8%**

2015	269
2014	250
2013	253
2012	233
2011	221

### Principal operating regions

Flex-Tek operations are mainly located in the US and Mexico with Asian operations located in India, China and Malaysia, and European facilities in France and Germany.

### Customers

We serve mainly aerospace engine and airframe manufacturers, domestic appliance manufacturers and the US construction industry. Large customers include Boeing, Airbus, Pratt & Whitney, GE Aerospace, Whirlpool, Electrolux, Trane, and Carrier. Our notable distributors in the US construction market include Ferguson and Watsco.

### Competitors

Competitors for our Fluid Management business include specialty segments of Parker-Hannifin, Eaton, and Kongsberg; as well as vertically integrated capacity from key customers. Heat Solutions competitors in the US include: Zoppas, Nibe, Watlow and Chromalox; and in China, Kawai and Dongfang manufacture a wide variety of electric heaters. Flex-Tek's Construction Products compete with US manufacturers: Wardflex, Atco, Omega-Flex, Hart & Cooley and Goodman. Flexible Solutions competes globally with a number of smaller privately owned businesses which manufacture specialty hoses.

### Suppliers

Flex-Tek sources key raw materials from world-class companies including electrical resistance wire from Sandvik, fibreglass insulation from Owens Corning, specialty plastic resins from Chemours and Teknor Apex, and stainless steel from Allegheny Ludlum. Each of these supply chain partners is chosen based on its ability to provide exceptional quality, service and value.

### Contribution to 2015 Group revenue

**9%**

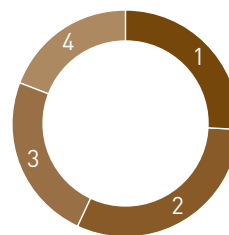
### Contribution to 2015 Group headline operating profit

**9%**

Percentage relates to headline operating profit before corporate costs

### Revenue by sector

- 1 Fluid Management 26%
- 2 Construction Products 31%
- 3 Heat Solutions 24%
- 4 Flexible Solutions 19%



Fluid Management  
**26%**



Construction Products  
**31%**



Heat Solutions  
**24%**



Flexible Solutions  
**19%**





## Markets and trends

Flex-Tek designs and manufactures engineered components which heat and move fluids and gases for aerospace, consumer products, construction, medical, and industrial applications. The diverse nature of these markets reduces Flex-Tek's reliance on any specific technology, although the division is highly leveraged to the US economy.

Flex-Tek is organised under four market-specific segments focusing on superior technology and service:

### Fluid Management

We are a market-leading manufacturer of specialty high-performance, flexible and rigid tubing assemblies for aerospace applications worldwide. Our specialised tubing provides reliable and efficient delivery of hydraulic fluids and jet fuel for both commercial and military aircraft.

The strong demand for more fuel-efficient, quieter commercial aircraft has driven the OEM order book to an all-time high of over 12,000 units for the aerospace industry. This is equivalent to over nine years of production for the sector and represents a key growth driver for the business.

### Heat Solutions

As the world's largest manufacturer of open coil heating elements, our products serve customers that manufacture tumble dryers, HVAC equipment, medical devices, and bespoke applications. Our specialised elements and thermal systems provide consistent temperature controls which improve system efficiency and performance. Revenue growth is driven by the US appliance and housing market, along with an increasing number of specialty heating applications in North America and Asia.

## Construction Products

Flex-Tek manufactures market-leading flexible gas piping and HVAC flexible ducting for the US construction market. Our customers are large national wholesale distributors in North America, supplying both plumbing and HVAC tradesmen. The recovering US housing market is driving positive revenue and market share gains.

### Flexible Solutions

Flexible Solutions hoses and hose assemblies are focused into four distinct markets: medical respiratory care, floorcare appliances, industrial ventilation and automotive. Automotive applications include petrol and brake fluid delivery in traditional automobiles as well as next-generation fuels for natural gas and hydrogen-powered vehicles.

The business performance generally follows macroeconomic indicators such as healthcare spending, US GDP and capital goods expenditure.

### Strategy

In Fluid Management we are focused on securing positions on the next-generation airframes and engines in order to support the delivery of the commercial aircraft order book. Our Construction Products segment is positioned to continue to grow revenue and market share in a recovering US housing market. In Heat Solutions we are expanding our product portfolio and application range through new product development. We are also continuing to seek out strategic bolt-on acquisitions to support business development, through expansion of our product portfolio and market share gains. Quality, safety, environmental impact reductions and people development provide the basis for sustainable growth.

## Demanding standards

With strong growth expected in the aerospace sector, United Technologies Corp (UTC), a provider of high-tech systems and services to the building and aerospace industries, has finalised a 10-year supply agreement with Titeflex Aerospace. UTC has enjoyed a long partnership with the Flex-Tek subsidiary, which specialises in providing fluid management for aircraft applications and is a world leader in steel-braided and ultra-strong polymer hose. Sam Abdelmalek, a UTC Vice President, said: "Suppliers such as Titeflex Aerospace who commit to our new contractual governance standards, meet our demanding performance requirements through the UTC Supplier Gold programme and satisfy our cost-saving initiatives, will have the opportunity to share in the growth of our aerospace business for years to come."

## Competitive strengths

- **Manufacturer of qualified components for the aerospace industry**
- **Largest supplier of open coil heating elements worldwide**
- **Leading manufacturer of flexible gas piping and HVAC ducting for US construction market**

## Growth drivers

- **Leveraged to the improving US residential construction market**
- **Strong backlog for commercial aerospace customers**

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

## Performance

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

Return on capital employed was virtually unchanged at 34%.

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

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

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

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

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

## Key operational highlights

- Continued growth, with margin pressure on gas tubing products.
- Gaining content on next-generation airframes and engines
- High ROCE supports continued investment in the business

## Research and development

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

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

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

## Outlook

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

 Go to [www.flextekgroup.com](http://www.flextekgroup.com) for more information



#### Priorities for 2016

- Increased R&D investment in new products and technologies
- Well positioned to meet opportunities in the US residential construction market
- Expansion of our manufacturing resources to meet global aerospace demand

#### Medium-term operating ranges

- Underlying growth: mid-single digits (3-6%)
- Headline operating margin: margin range (15-20%)

#### China business growth

By expanding geographic and market reach, Flex-Tek's China business has shrugged off the effects of a slowing national economy to double both sales and profit in the last three years. Tutco is the world's biggest manufacturer of open coil heaters and its Changshu-based operation started by providing components for local companies that sold clothes dryer and heating and air conditioning equipment to the US.

Supported by new products developed in close partnership with customers, Tutco has greatly expanded its range of heating applications both by geography and end-user market. Sales this year alone are 12% higher with Food Service, Transportation and Medical markets now targeted across Asia and into the Middle East.

# Financial review

**The Group converts a high proportion of its operating profit into cash. These strong and stable cash-flows coupled with a healthy balance sheet support our medium-term investment in organic growth initiatives and targeted acquisitions.**

## Earnings per share

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

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

## Exceptional and other items relating to continuing activities excluded from headline profit before tax

These items amounted to a charge of £134m compared to a charge of £143m in 2014. They comprised:

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

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

## Cash generation and net debt

Operating cash generation remained strong with headline operating cash-flow of £484m (2014: £490m), representing 95% (2014: 97%) of headline operating profit (see note 27 to the accounts for a reconciliation of headline operating cash and free cash-flow to statutory cash-flow measures). Free cash-flow increased by £15m to £158m (2014: £143m). Free cash-flow is stated after all legacy costs, interest and taxes but before acquisitions and dividends.

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

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

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

## Interest and other financing costs

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

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

## Research and development

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

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

## Revenue

Down 2% to

**£2,897m**

➔ Read more on page 23 and in note 1 on page 138

## Headline operating profit

Up 1% to

**£511m**

➔ Read more on page 23 and in note 1 on page 138 and in note 3 on page 142

## Statutory operating profit

Up 4% to

**£394m**

➔ Read more on page 23 and in note 1 on page 138 and in note 4 on page 143

## Taxation

The principles of the Group's approach to taxation remain unchanged. The Group seeks to mitigate the burden of taxation in a responsible manner to enhance its competitive position on a global basis while managing its relationships with tax authorities on the basis of full disclosure, co-operation and legal compliance. A semi-annual tax report is reviewed by the Audit Committee to monitor compliance with these principles to ensure the Group delivers its tax objectives.

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

The Group continues to take advantage of global manufacturing, research and development and other tax incentives, the tax-efficient use of capital and tax compliance management. A rate of between 25.5% and 26.5% is expected in the year ending 31 July 2016.

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

## Return on capital employed

The return on capital employed (ROCE) is calculated over a rolling 12-month period and is the percentage that headline operating profit comprises of monthly average capital employed. Capital employed comprises total equity adjusted for goodwill recognised directly in reserves, post-retirement benefit-related assets and liabilities net of tax, litigation provisions relating to exceptional items net of tax, and net debt. ROCE increased 30 basis points to 16.0% (2014: 15.7%) as a result of increased profitability in Smiths Medical and Smiths Detection more than offsetting reduced profitability in John Crane, Smiths Interconnect and Flex-Tek.

## Retirement benefits

As required by IFRS the balance sheet reflects the net surplus or deficit in retirement benefit plans, taking assets at their market values at 31 July 2015 and evaluating liabilities at period-end AA corporate bond interest rates.

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

The retirement benefit position was:

	31 July 2015	31 January 2015	31 July 2014
Funded plans			
UK plans – funding status	104%	99%	99%
US plans – funding status	78%	73%	84%
Other plans – funding status	86%	80%	79%
	31 July 2015	31 January 2015	31 July 2014
Surplus/(deficit)	7	(224)	(135)
Funded plans	(115)	(114)	(107)
Unfunded plans			
Total deficit	(108)	(338)	(242)
	31 July 2015	31 January 2015	31 July 2014
Retirement benefit assets	170	158	123
Retirement benefit liabilities	(278)	(496)	(365)
	(108)	(338)	(242)

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

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

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

## Exchange rates

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

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

Intangible assets arising from business combinations ('acquired intangibles') are assessed at the time of acquisition in accordance with IFRS 3 (Revised) and are amortised over their expected useful life. This amortisation is excluded from the measure of headline profits. When indicators of impairments are identified, the intangible assets are tested and any impairment identified is charged in full. The impairment charge is excluded from the measure of headline profits. Other intangible assets comprise development costs or software which are capitalised as intangible assets as required by IFRS. Amortisation charged on these assets is deducted from headline profits.

#### **Accounting policies**

The accounts in this report are prepared under International Financial Reporting Standards (IFRS), as adopted by the European Union (EU). The accounting policies used in preparing these accounts are set out on pages 133-137.

#### **Significant judgements, key assumptions and estimates**

Applying accounting policies requires the use of certain judgements, assumptions and estimates. The most important of these are set out on pages 132-133.

#### **Treasury**

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 for the Executive Committee, for every Board meeting and on a semi-annual basis for the Audit Committee.

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

#### **1 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 2015 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 headline operating cash conversion of greater than 90% and net debt/headline EBITDA at less than two times. At 31 July 2015, these measures were 95% (2014: 97%) and 1.4 times (2014: 1.4 times) respectively.

#### **2 Debt and interest rate management**

Debt financing is managed centrally. At 31 July 2015 net debt was £818m (2014: £804m). The Group's strategy remains to finance the significant majority of its debt capital from long-term bond markets and at 31 July 2015 £1,298m of bonds were outstanding (2014: £875m). As part of the Group's pro-active management of its debt maturity and cost profile, in April 2015 the Group issued €600m of new Senior Notes with a coupon of 1.25% and maturity in 2023. The core backstop financing for the Group is provided by a US\$800m committed revolving credit facility provided by a group of 10 global banking partners. This facility has a maturity in February 2020 with a one-year uncommitted extension option exercisable in December 2015. The Group remains in full compliance with all covenants within its debt agreements. 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 2015, these measures were 0% (2014: 13%); 5.0 years (2014: 4.5 years) and 58% (2014: 63%).

#### **3 Liquidity management**

At 31 July 2015, the US\$800m committed bank facility was undrawn. 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 2015, these measures were £512m (2014: £367m) and 55 months (2014: 55 months). At 31 July 2015, cash resources were £495m (2013: £190m). These included funds received from the 2015 €600m 1.25% Senior Notes issuance partly targeted at repayment of the 7.25% £150m sterling bond on its normal maturity date in June 2016.

The Group aims to ensure that these resources are placed on deposit with highly rated relationship bank counterparties at short-notice availability. Credit exposure to every approved bank is defined by the

Treasury Risk Management Policy with counterparty limits established by reference to their Standard & Poor's long-term debt rating and CDS trading levels. Compliance is measured and reported to the Executive Committee and the Board. At 31 July 2015, 99% (2014: 97%) of cash resources were on deposit with the 10 global banking partners. Of these resources £33m (2014: £36m) was invested with counterparties rated less than A+.

#### **4 Currency management**

The Group has adopted hedge accounting for the significant majority of transaction hedging positions, thereby mitigating the impact of market value changes in the income statement. Material sales or purchases in foreign currencies are hedged at their inception by appropriate financial instruments, principally forward foreign exchange contracts and swaps. The Group's objective is to reduce medium-term volatility to cash-flow, margins and earnings.

The Group is an international business with the majority of its net assets denominated in foreign currency. It protects its balance sheet and reserves from adverse foreign exchange movements by financing its currency assets in the same currency such that, where the value of net asset exposure is over £30m equivalent, over 50% of those assets are matched with the same currency liability. At 31 July 2015, 53% (2014: 45%) of total foreign currency assets were matched by related currency liabilities.

#### **Financial controls**

While the Group's decentralised organisation delegates day-to-day control to local management, Smiths Group has comprehensive control systems in place with regular reporting to the Board. The Group has continuous formalised business risk management processes operating at each business unit.

The Internal Audit Department reviews all reporting units over a rolling three-year cycle, and its findings are reported to the Audit Committee. All acquisitions are reviewed within 12 months of acquisition, to verify compliance with Group procedures. Further information regarding the Group's procedures to maintain strict controls over all aspects of risk, including financial risk, is set out in Risk management on pages 58-64 and the Corporate governance statement on pages 77-93.

#### **Essential contracts**

The divisional reviews describe our main customer and supplier relationships and the 'Risks and uncertainties' section outlines the risk management aspects of our contractual arrangements. Smiths Group has a wide range of suppliers and customers, and while the loss of, or disruption to, certain of these arrangements could temporarily affect the operations of an individual division, none is considered essential.

## Litigation

Smiths Group faces different types of litigation in different jurisdictions. The high level of activity in the US, for example, exposes the Company 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.

### John Crane, Inc. litigation

John Crane, Inc. (JCI), a subsidiary of the Group, is currently one of many co-defendants in litigation in the USA relating to products previously manufactured which contained asbestos. This litigation began more than 30 years ago and, typically, involves claims for a number of diseases including asbestosis, lung cancer and mesothelioma. The JCI products generally referred to in these cases consist of industrial sealing products, primarily packing and gaskets. The asbestos was encapsulated within these products in such a manner that, according to tests conducted on behalf of JCI, the products were safe. John Crane ceased manufacturing products containing asbestos in 1985.

 Read more in note 23 on page 169

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.

JCI continues to actively monitor the conduct and effect of its current and expected asbestos litigation, including the efficacious presentation of its 'safe product' defence, and intends to resist these asbestos cases based on this defence. Approximately 242,000 claims against JCI have been dismissed before trial over the last 36 years. JCI is currently a defendant in cases involving approximately 76,000 claims. Despite these large numbers of claims, since the inception of litigation JCI has had final judgments against it in 133 cases, and has had to pay awards amounting to approximately US \$153m.

At 31 July 2015, the aggregate provision for JCI asbestos litigation, including for adverse judgments and defence costs, amounted to £216m 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. Moreover, in establishing this provision no account has been taken of any recoveries from insurers as their nature and timing are subject to pending litigation. Because of the significant uncertainty associated with the future level of asbestos 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.

### 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 2015, provision of £71m has been made for the costs which the Group expects to incur in respect of these claims. 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.

# Managing risk in delivering our strategy

**Smiths Group is exposed to a wide range of risks in running its businesses. We regularly review these risks and ensure we have the appropriate processes and policies for managing them.**

## Our approach to risk governance

Smiths Group is exposed to a wide range of risks in running its businesses. The Company and its divisions consider these risks on a regular basis and put in place appropriate risk management processes, policies and other measures, including insurance where appropriate.

The Board has overall responsibility for our risk management policies and ensuring we have an effective system of internal control. The Group's process for identifying, evaluating and managing significant business risks is reviewed by the Audit Committee and monitored by the Group Internal Audit Department. An outline of this year's review process by the Board and Audit Committee is set out on pages 85 to 91. A description of the Company's internal control and risk management processes is given in the Corporate governance statement on page 85.

## Our approach to risk management

In delivering our strategy, it is important to understand and manage the risks that face us. We achieve this through our embedded risk management approach, combining a top-down strategic view of risks with a bottom-up divisional process.

Our top-down approach involves a review of the external and internal environment, and an assessment by the Executive Committee of the key risks that face Smiths Group. This review is formalised twice a year. A 'risk owner' is assigned to each risk and has the responsibility to monitor the risk and ensure it is managed.

These 'Group-wide' risks are categorised as either:

- Major business challenges
- Risks caused by uncontrollable external factors
- Other risks

A summary of these 'Group-wide' risks is presented for discussion at the July Board meeting. In reviewing the major risks, the Board determines the level of risk that we are prepared to accept in the pursuit of our business goals – this is our risk tolerance. Where the risk impact is greater than that which we are prepared to accept, further mitigation actions are agreed to reduce the potential impact. Where further mitigation actions are not possible or are considered to be cost prohibitive, the risk is closely monitored.

Our bottom-up divisional approach involves the identification, management and monitoring of the material risks in each of our divisions. Each division is required to maintain risk registers and monitor significant risks on an ongoing basis. Each division attends one Audit Committee a year to explain and discuss the inherent risks and challenges faced by the division. Additionally, the strategic risks are further discussed at divisional strategy presentations, which are made annually to the Group Board. The divisions are also required to provide an update regarding their risk mitigation actions at the Quarterly Business Reviews held with the Chief Executive and Finance Director.

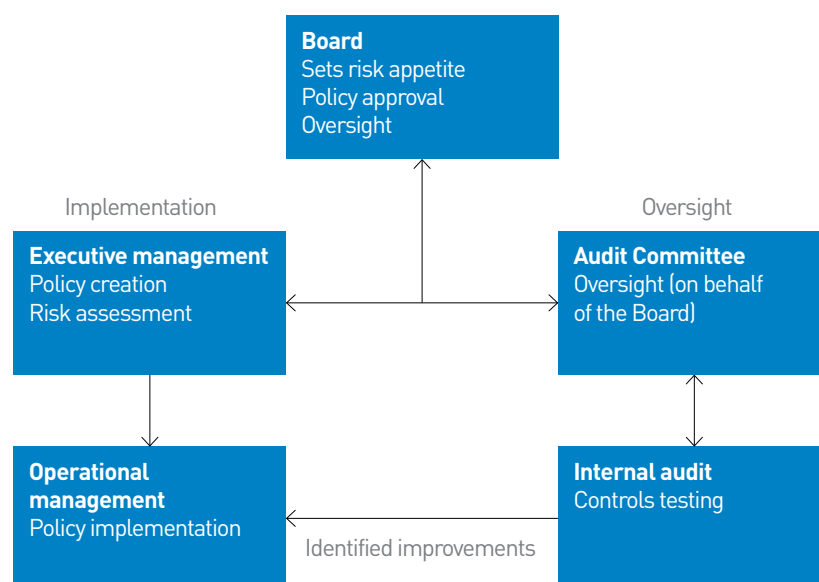
This dual process provides a framework such that the Group's strategic, financial and operational risks are adequately considered and discussed by the Executive Committee and the Board.

There can be no assurance that our approach to risk management will be effective in any particular case. If any of the risks we identify, or other unforeseen risks, materialise, they could have a significant adverse effect not only on our business and financial condition but also on our reputation and the trading prices and liquidity of our securities. This could lead to a loss for investors of part or, in a worst case scenario, all of their investment.

## Managing risk

### The diagram summarises how we manage risk

The Board has ultimate responsibility for our risk management policies and for ensuring we have an effective system of internal control. Our executive and operational management assess the risks facing our businesses and respectively create and implement our risk management policies. The Audit Committee ensures appropriate oversight of risk management and is supported by our internal audit function, which tests the effectiveness of our controls and identifies areas for improvement.



## The risks to our strategy

The table below shows the main categories of risks we face and which of our strategic objectives they could affect.

Risk	Strategy					
	Driving top-line growth	Enhancing margins	Transforming Smiths into a world-class organisation	Promoting a culture of responsibility	Generating cash and managing the balance sheet	Allocating capital to maximise returns
Economic outlook and geopolitical environment	■	■			■	■
Financial risks	■	■			■	■
Global supply chain and business/process transformation	■	■				
Government customers	■	■			■	
Information technology/cyber security	■	■			■	
Acquisitions and disposals	■	■			■	■
Legislation and regulations	■	■		■	■	
Pension funding					■	■
Product liability and litigation	■	■			■	
Contractual liabilities	■	■			■	
Technology and innovation	■	■	■			
Talent and succession planning	■	■	■	■	■	

Although the Group faces more risks than those listed above, these are the risks that are currently of most concern to the business and have been considered at recent Board or Audit Committee meetings.

## Our Group-wide risks as assessed by the Board

### Risks caused by uncontrollable external factors

#### Economic outlook and geopolitical environment

##### Potential impact

High



##### Trend

Higher



##### Risk and potential impact

Global economic and financial market conditions have partly stabilised after the turmoil following the 2008 financial crisis, in large part due to the various impacts of quantitative easing and austerity measures. However, there remains continued uncertainty arising from a range of geopolitical and economic issues across the world. Smiths operates in more than 50 countries and is affected by global economic and political conditions. The business is affected by government spending priorities, in particular in the US and UK, and the willingness of governments to commit substantial resources to homeland security and defence.

Global security concerns continue to drive uncertainty. These include the continuing situation in Syria and the Middle East, as well as the recent events in Ukraine that have led to economic and political sanctions against Russia and the devaluation of the Russian Rouble. Whilst growth is gradually returning in the Eurozone, the economic situation in Greece continues to provide uncertainty in global financial markets. There is the potential for the UK to leave the EU, which may have economic and operational considerations for the Group.

The global oil price continues to trade at levels well below the average of the past few years. This potentially represents the biggest risk to our businesses, particularly John Crane.

##### Mitigation

The Group has a diversified portfolio of businesses that mitigates exposure to any one country or sector.

The divisions regularly monitor their order flows and other leading indicators, where available, so that they may respond quickly to deteriorating trading conditions.

In the event of a significant economic downturn, there may be opportunities to identify and implement further cost-reduction measures to offset the impact on margins from deteriorating sales.

#### Compliance with legislation and regulations

##### Potential impact

Low to medium



##### Trend

No change



##### Risk and potential impact

There is a risk that the Group may not always be in complete compliance with laws, regulations or permits, for example concerning environmental or safety requirements. The Group could be held responsible for liabilities and consequences arising from past or future environmental damage, including potentially significant remedial costs. There can also be no assurance that any provisions for expected environmental liabilities and remediation costs will adequately cover these liabilities or costs.

The Group operates in highly regulated sectors. Smiths Detection, Smiths Interconnect and Smiths Medical are particularly subject to regulation, with certain customers, regulators or other enforcement bodies routinely inspecting the Group's practices, processes and premises.

Smiths Detection and Smiths Interconnect manufacture security products and components, which are subject to numerous export controls, technology licensing and other government regulations.

In addition, new legislation, regulations or certification requirements may require additional expense, restrict commercial flexibility and business strategies or introduce additional liabilities for the Company or directors. There also appears to be a growing trend for legislation that could be described as 'protectionist', which may affect our businesses.

Should a regulator's approval process take a particularly long time, our products may be delayed in getting to market, which could lead to a loss of revenue or benefit a competitor with a similar product.

Corruption on the part of a single employee can entail severe consequences for the Group.

Failure to comply with certain regulations may result in significant financial penalties, debarment from government contracts and/or reputational damage.

##### Mitigation

Environmental, health and safety data are reported to the Quarterly Business Reviews, Executive Committee and the Board, along with actions to improve performance.

Smiths Medical has dedicated staff who maintain close contact with the US Food and Drug Administration and other key regulators.

All divisions have trade compliance advice and training. This includes training on the Group's Code of Business Ethics and assessments to support compliance.

Divisional and Group General Counsel monitor legislative changes (assisted by Government Relations staff) and report and monitor actions as necessary. This may require modifications to our supply chains and customer arrangements.

## Risks caused by uncontrollable external factors

### Pension funding

Potential impact  
Medium to high



Trend  
Reduced slightly



#### Risk and potential impact

At 31 July 2015, the Group has legacy defined benefit pension plans, with aggregate liabilities of approximately £4.1bn on an accounting basis.

Changes in discount rates, inflation, asset returns or mortality assumptions could lead to a materially higher deficit. For example, the cost of a buyout on a discontinued basis, and therefore using more conservative assumptions, is likely to be significantly higher than the accounting deficit. In addition, there is a risk that the plan's assets, such as investments in equity and debt securities, will not be sufficient to cover the value of those benefits.

The implications of a higher pension deficit include a direct impact on the Group's valuation and credit rating, and potential additional funding requirements at subsequent triennial reviews. We have started the 2015 triennial review, which will establish future cash payments to the principal UK pension schemes when concluded.

In the event of a major disposal that generates significant cash proceeds that are returned to shareholders, the Group may be required to make additional cash payments to the schemes or provide additional security.


#### Mitigation

All major schemes (US/UK) have been closed to new members and future accrual.

Agreed funding plans are in place with the major UK schemes following the last triennial reviews. The Group seeks a good working relationship with the trustees through regular update meetings.

There are plans in place to reduce the mismatch between assets and liabilities, as relative outperformance of the assets versus liabilities is achieved, although there is no downside protection in place should this not occur.

Pension matters are regularly reported to the Board.

 Read more in note 9 on page 148

### Financial risks (foreign exchange, funding, tax and insurance)

Potential impact  
Low to medium



Trend  
No change



#### Risk and potential impact

Foreign exchange: Exchange rate fluctuations have had, and could continue to have, a material impact on the reported results. The Group is exposed to two types of currency risk: transaction and translation. The Group's reported results will fluctuate as average exchange rates change. The Group's reported net assets will fluctuate as the year-end exchange rate changes.

Funding: The Group's ability to refinance its borrowings in the bank or capital markets is dependent on market conditions and the proper functioning of financial markets. The Group may be unable to refinance its debt when due.

Tax: The Group's future profitability, particularly in the US where there are higher rates of corporation tax, may cause the headline tax rate to increase over time. Changes in tax and fiscal regulations and transfer pricing rules in the countries in which we operate could affect the Group, particularly at times when public sector debt is high. Taxation costs could rise and earnings per share could deteriorate, which could affect the Group's market valuation.

Insurance: The Group cannot be certain that it will be able to obtain insurance on acceptable terms or at all. Furthermore, the Group cannot be certain that its insurance will cover losses arising from events or that insurers will not dispute coverage. In addition, even if our coverage is sufficient, the insurance industry is subject to credit risk, particularly in the event of a catastrophe or where an insurer has substantial exposure to a specific risk. If insurance cover is inadequate or does not pay out as expected, the Group could be exposed to an unexpected material cash outflow, which may impact the Group's liquidity and/or share price.

#### Mitigation

Foreign exchange: The Group's hedging strategy, whereby larger transactions are hedge accounted, mitigates the risk to profitability to some extent. Net investment hedging of overseas assets of approximately 50%, through borrowing in non-sterling currencies, mitigates the impact of exchange rate fluctuations on net assets.

Funding: The Group's debt maturity is staggered so that the refinancing risk is minimised. As at 31 July 2015, the US\$800m committed revolving credit facility was undrawn.

Tax: The Group's taxation staff co-ordinate tax management to mitigate possible increases in the effective tax rate. Regular reporting to the Board of tax risks and exposures provides good visibility of issues.

Insurance: Insurance risk is spread across a number of carriers to minimise individual insured risk and counterparty risk.

 Read more on page 56

## Business challenges / thematic risks

### Product liability and litigation

#### Potential impact

Medium



#### Trend

No change



#### Risk and potential impact

In the ordinary course of its business, the Group is subject to litigation such as product liability claims and lawsuits, including potential class actions, alleging that the Group's products have resulted or could result in an unsafe condition or injury.

In addition, manufacturing flaws, component failures or design defects could require us to recall products. Many of our products are used in critical applications where the consequences of a failure could be extremely serious and, in some cases, potentially catastrophic.

Products sold to the aviation, security, healthcare, energy and consumer/domestic industries are particularly critical in nature.

Furthermore, over half the Group's sales are in the US, where there is potentially increased litigation risk.

Any liability claim against the Group, with or without merit, could be costly to defend and could increase our insurance premiums. Some claims might not be covered by our insurance policies, either adequately or at all.

An adverse event involving one of our products could damage our reputation and reduce market acceptance and demand for all of our products.

#### Mitigation

Quality assurance processes are embedded in our manufacturing locations for critical equipment, supporting compliance with industry regulations.

A global best practice programme is continuing to enhance product quality processes across the Group. This is sponsored by the Executive Committee and leverages the ongoing work in Smiths Medical and John Crane.

The divisions have procedures for dealing with product liability issues and potential product recalls. These procedures are informed by crisis management planning workshops and rehearsals.

The Group has insurance cover for certain product liability risks. The US 'Safety Act' provides legislative protection for certain Smiths Detection products in the US; and we support efforts to implement similar legislation in other markets.

Any litigation is managed under the supervision of the Group's legal function. We have detailed action plans to manage actual or threatened litigation.



Read more on page 57 and  
in note 23 on page 169

### Global supply chain and business/process transformation

#### Potential impact

Medium



#### Trend

Reduced slightly



#### Risk and potential impact

The Group's business depends on the availability and timely delivery of raw materials and purchased components, and could be affected by a disruption to its supply chain. In particular, we rely on sole suppliers to provide raw materials or components for some of our products.

The Group's manufacturing facilities are exposed to a number of natural catastrophe risks that, like other external events such as terrorist attacks or a disease pandemic, could have significant adverse consequences. The Group is also affected by the social, economic, regulatory and political conditions in the countries in which it operates. These are often unpredictable and outside the Group's control, particularly in developing countries.

The concentration of manufacturing in lower cost countries, in particular in Mexico and China, increases the length of the supply chain and means that an adverse event could have more significant consequences for our ability to supply customers on time. A longer supply chain also affects transport costs, which could be exacerbated by energy cost inflation.

As part of the *Fuel for Growth* initiative, there are significant restructuring and reorganisation initiatives underway across the Group. These include site rationalisation and consolidation of manufacturing. There is a risk that these initiatives could cause disruption to the business, including manufacturing processes, supply chain, fulfilment of customer demand, and business systems and processes, or lead to industrial action. However, we are already halfway through this programme and the initiatives to date have been delivered with minimal business disruption. The risk has therefore reduced.

#### Mitigation

Business continuity and disaster recovery plans are in place and tested for critical locations, to reduce the impact of an event.

Single-source supplier risks are identified and, where possible, key materials or components are dual sourced to mitigate the impact of an event.

The Group regularly evaluates its key sites for a range of risk factors using externally benchmarked assessments, and takes action to improve these ratings where appropriate.

The Group has business interruption and property damage insurance.

Transformation programme and project management is in place in John Crane, Smiths Medical, Smiths Detection and Smiths Interconnect.

All transformation projects are approved by the Group Chief Executive and Finance Director. We are experienced in driving change programmes and all projects are subject to ongoing monitoring at Group and divisional levels.

## Business challenges / thematic risks

### Government customers

#### Potential impact

Medium



#### Trend

No change



#### Risk and potential impact

We derive a significant proportion of our revenues in mature Western economies and approximately 35% of the Group's revenues are directly related to government expenditure. Additionally, a high proportion of our products and services are in some way influenced by government regulation and certification.

Smiths Detection, Smiths Medical and Smiths Interconnect frequently tender for government contracts. The timing of contract awards and payments under these contracts may be uncertain and uneven over a given financial year.

Any significant disruption or deterioration in relationship with these governments could result in fewer contracts and lower revenues.

At a time when government finances are under pressure, these headwinds may lead to slower growth across the business. A decrease in spending by key government customers could materially affect the Group's results and financial condition. Delays in awarding government contracts can affect the Group's sales, margins and cash conversion in a particular reporting period.

#### Mitigation

The Group has a diversified portfolio of businesses that mitigates exposure to any one country or sector.

Some of our government-related business has a services or consumables component, which can be more resilient during an economic downturn.

The Group has a government relations function so that it can inform policy and maintain close relationships with customers.

### Technology and innovation

#### Potential impact

Medium



#### Trend

No change



#### Risk and potential impact

Developing new products and improving existing products is critical to our business. There is a risk that competitors may innovate more effectively. The emergence of a disruptive technology could have an impact on a major cash-flow contributor to the Group over time.

The speed of innovation in certain markets may lead to shorter product lifecycles, increasing the need for innovation. Additionally, the entry of new competitors, the consolidation of existing competitors and changed or irrational competitor behaviour could significantly affect the Group's business.

The failure of the Group to develop its products and services, or more effective innovation by a competitor, could have a materially adverse effect on sales growth.

#### Mitigation

The Group has a diversified technology portfolio in a range of sectors and geographies.

Our continued investment in R&D supports new product and service development. There is an increased focus on new product development processes across the Group as part of the *Engineered for Growth* programme.

The Group looks to expand the addressable markets of its key businesses by building capabilities in adjacent markets, through organic investment and through targeted acquisitions.

### Talent and succession planning

#### Potential impact

Medium to high



#### Trend

Slightly higher



#### Risk and potential impact

The loss of key personnel, or the failure to plan adequately for succession or develop new talent may impact the reputation of the Group, or lead to a disruption in the leadership of the business.

Competition for personnel is intense and the Group may not be successful in attracting or retaining qualified personnel, particularly engineering professionals. In addition, certain personnel may be required to receive security clearance and substantial training to work on certain programmes. The loss of key employees, the Group's inability to attract new or adequately trained employees, or a delay in hiring key personnel, could seriously harm the Group's business.

The change in executive management may lead to a transition period as they go through their induction programme, with the risk of losing key personnel.

Over time, our competitive advantage is defined by the quality of our people – should we fail to attract, develop and retain key talent, in time our competitive advantage will erode, leading to weaker growth potential or returns.


#### Mitigation

Each division or function holds talent and succession plan reviews at least annually. These plans are reviewed by the Nomination Committee.

Remuneration packages, including variable and long-term elements of the compensation arrangements, are evaluated regularly against market practice.

The Chief Executive assesses, on an annual basis, the Top 25 people in the organisation for performance, skills and competencies and presents development and succession plans to the Board.

Two leadership development programmes and formal career counselling support the talent pipeline.

 Read more on pages 12-13 and 69-71

## Business challenges / thematic risks

### Programme delivery

#### Potential impact

Medium



#### Trend

No change



#### Risk and potential impact

Failure to deliver, in a timely fashion or at all, the products and services Smiths is obliged to deliver, or any fault in contract execution due to delays or breaches by its suppliers or other counterparties, may lead to higher costs, liquidated damages or other penalties.

Differences between the estimated costs in the Group's medium- and long-term contracts and actual costs may arise from a number of factors including production delays, cost overruns and other items.

Certain of the Group's contracts, particularly those with governments, may include terms that provide for unlimited liabilities on the part of the Group or allow the government body or counterparty to terminate unilaterally, reduce or modify the relevant contracts or seek alternative sources of supply at the Group's expense.

#### Mitigation

Contracts are managed and delivered by programme management teams that regularly review contract risks and take appropriate action.

A Group-level procedure for reviewing and approving high-risk contracts is in place and further enhancements to our governance processes have been implemented during 2015.

Divisional boards review significant contracts.

The diversified nature of the Group mitigates the exposure to any single contract.

### Acquisitions and disposals

#### Potential impact

Low



#### Trend

Reduced



#### Risk and potential impact

Targeted acquisitions and selected disposals form part of the Group's growth strategy. The success of our acquisition strategy depends on identifying targets, obtaining authorisations and having available financing. Even if an acquisition is completed, the acquired products and technologies may not be successful or may require significantly greater resources and investment than anticipated.

The Group may not be able to integrate the businesses that it acquires. If integration is unsuccessful, anticipated benefits are not realised or trading by acquired businesses falls below expectations, it may be necessary to impair the carrying value of these assets.

The Group's return on capital employed may fall if acquisition hurdle rates are not met. The Group's financial performance may suffer from goodwill or other acquisition-related impairment charges. Insufficient allowance for indemnities and warranties given at disposal may affect our financial position.

The risk is reduced as a result of more limited activity and lower value transactions in recent years.

#### Mitigation

The Executive Committee and Board review the acquisition pipeline. There are monthly reviews with strategy leads for each division.

We perform comprehensive strategic and financial reviews of all opportunities. Detailed due diligence, including an assessment of the target's talent and competencies, and integration planning is undertaken and reviewed in accordance with Group policy.

The Board only authorises acquisitions after completion of due diligence, and approval is subject to meeting the capital allocation and other financial hurdles set by the Board. The Board reviews post-acquisition performance and integration.

On disposals, the Group seeks to minimise its exposure to indemnities and warranties and any that are provided are reviewed on a regular basis.

### Information technology and cyber-security

#### Potential impact

Medium to high



#### Trend

Higher



#### Risk and potential impact

The Group's information systems, personnel and facilities are subject to security risk. The Group is dependent on information technology systems for both internal and external communications and for the day-to-day management of its operations. The incidence and sophistication of cyber-security crime is on the rise and some Group companies operate in sectors where cyber-criminals are active.

Any disruption to the information systems could have significant adverse consequences on the Group's operations or its ability to trade. It could result in the loss of confidential information and intellectual property, which could affect the Group's competitive position and cause reputational damage.

#### Mitigation

Extensive controls and reviews are undertaken to maintain the integrity and efficiency of IT infrastructure and data. We have continued to improve our capability to detect and respond to hostile activity early in an attack.

There are also processes to deal with significant IT security incidents.

A Group-wide information security awareness programme has been launched.

# Corporate responsibility

**Promoting a culture of responsibility, developing smarter ways of working and attracting the best talent, and delivering operational efficiencies to enhance margins form key elements of our six-point business strategy. Behaving ethically, working safely, reducing our environmental impact, attracting and developing our people and contributing to our communities creates long-term value for our shareholders and our wider stakeholders.**

## Why Corporate responsibility (CR) is important to Smiths

Many of our products and services benefit the environment and contribute to the safety, health, security and productivity of people around the world. For example, Smiths Detection's security scanners play a vital role in helping to prevent terror attacks, while John Crane's seals help its customers to reduce their environmental impact. Similarly, how we do business is critical to our long-term success. Conducting our business responsibly enables us to meet our obligations to our stakeholders and delivers real business benefits, creating long-term value for shareholders by:

- Protecting our reputation and ability to grow
- Helping us to win business from customers who value strong CR performance
- Enhancing our efficiency
- Enabling our people to work productively, in a safe and ethical environment
- Helping us to attract and retain talent, and encouraging employees to take pride in working for us
- Reducing the risk of incidents and their associated costs

Our approach also helps us to address key trends in our markets, including an increased regulatory focus on avoiding bribery and corruption, increased competition for talent, pressure on energy and water use, climate change, materials safety and the ability to recycle waste and products which have reached the end of their useful life.

Here we provide an overview of our approach and performance. Further detail on our approach, CR governance, performance and case studies can be found in our 2015 CR Report, which is available to download from [www.smiths.com](http://www.smiths.com)

## Our Code of Business Ethics

Our Code of Business Ethics sets out 12 broad principles for how we do business, based on the common values of integrity, honesty, fairness and transparency. The Code provides the framework for the way we do business and, more specifically, how we manage many of our CR issues. It is intended to enable our employees to make ethical decisions every time.

## Our strategic focus areas

We focus on five priority issues: ethics, the environment, health and safety, our people and the communities in which we operate.

## Key relationships

As a global technology company operating in highly regulated sectors, building strong relationships with our employees, customers, governments and their agencies, regulators and suppliers across the globe is critical to our long-term success.

Our employees are key to delivering our strategy and are committed to attracting, retaining and developing the best talent.

Strong, long-term customer relationships underpin our success. Many of our products are developed to meet customers' specific needs and our aftermarket services, especially in Smiths Detection and John Crane, help to build customer loyalty and improve our insight.

We engage with governments, their agencies and regulators directly through our divisions and a centralised government relations team, as well as working in partnership with industry bodies to leverage the benefits of scale. For example, we are working with Medical Device Manufacturers Association to campaign for the repeal of the Medical Device Tax in the US.

We work with a broad range of suppliers and partners, such as distributors, across the Group and we require them to maintain high ethical standards comparable to our own (see pages 66-67).

## Our Code of Business Ethics

- 1 We comply with the law
- 2 We compete fairly
- 3 We act with integrity in all our business dealings
- 4 We treat suppliers, partners and customers properly
- 5 We treat our co-workers respectfully
- 6 We contribute to healthy, safe and secure workplaces
- 7 We respect the environment
- 8 We contribute to our communities
- 9 We participate in relevant public debates
- 10 We respect human rights
- 11 We have high standards of financial record-keeping and reporting
- 12 The Code applies to all of us

## Ethics

We believe ethical behaviour is the responsibility of every Smiths employee at every level of the organisation. Our objective is not only to protect the reputation of our company and to safeguard the investment of our shareholders, but also to protect the interests of every employee by ensuring he or she has the knowledge and tools necessary for individual legal or regulatory compliance and ethical decision-making.

### 2015 Highlights

- **Held our fourth global ethics forum in Berlin, Germany. The theme was the individual ethical responsibility of every employee**
- **Developed additional online training courses in areas such as anti-bribery and corruption for both employees and third parties, international trade compliance, compliance with applicable embargoes and sanctions, and global competition and anti-trust compliance**
- **Enhanced the availability of Code of Business Ethics materials with internal and external online resources**
- **Included ethics questions in employees' annual performance reviews and the MyVoice global employee engagement survey to gauge the knowledge and understanding of ethical principles at all levels of the organisation**
- **Met with key suppliers to introduce the Supplier Code of Business Ethics, which has been implemented through contractual terms that set the Code as a minimum standard for ethical operations and behaviours**

### Strategy, objectives and approach

Our ethics programme is focused on continuing to embed the Code and ethics and compliance-related policies through communication, training and awareness programmes. We aim to ensure our employees understand the expectations of them and are able to make the right, ethical decision every time and to know when to ask for help, as well as to ensure compliance with our ethics-related policies and controls and the laws and regulations of the jurisdictions in which we operate.

We continually review and update our policies and business controls to mitigate changing areas of risk. We also review, evaluate and update our ethics programme, systems and procedures for fostering, monitoring and auditing ethical business conduct.

Other focus areas include expanding our online training, encouraging open discussion of ethical risks with employees at every level of the organisation and developing additional policies to enhance governance of key risk areas, and continued collaboration with Internal Audit, as part of our risk management and assurance processes.

### 2015 activities

Every year we expand and update training on key compliance topics to address evolving global risks, changes in laws or regulations and enforcement trends in jurisdictions around the world. We also continue to increase the number of languages in which training is offered. The courses include global competition law and international trade compliance. We offer online training on Ethics for Third Parties for our agents, distributors and external sales representatives. We recently introduced a new Supplier Code of Business Ethics, which is available externally on smiths.com and provided to all major suppliers. The Supplier Code and our contractual provisions require suppliers to maintain high ethical standards in line with our Supplier Code or their own comparable ethics programme.

We use a variety of communication channels and face-to-face training to spread the ethics and compliance messages to every employee. Following the success of our global ethics forums in Shanghai, China; São Paulo, Brazil; and Dubai, UAE over the past four years, we held a similar forum in Berlin, Germany in June 2015.

### Reporting concerns and managing specific issues

We encourage employees who have concerns or queries about the Code to raise them with line management, Human Resources or their local in-house legal counsel. They also may report those concerns through our confidential Ethics Alertline, which is managed by a third party. It is available 24/7 via email, the internet, and toll-free phone numbers in every language used by Smiths employees. All issues are addressed promptly and referred, as required, to relevant internal or external specialists for investigation. Our strict non-retaliation policy means that any employee who in good faith reports an act of apparent misconduct or unethical behaviour will not be victimised or treated adversely.

### Controls on defence sales

We seek to comply with the national laws in every country in which we operate. More particularly, we seek to ensure that all sales and exports of defence equipment are undertaken in accordance with international trade regulations and national government export and approval procedures and regulations, such as the International Traffic in Arms Regulation and the Export Administration Regulations in the US. These laws prohibit export of certain items to specific countries. The Group's policy is to adhere to all relevant government guidelines designed to ensure that products are not incorporated into weapons or other equipment used for the purposes of terrorism or abuse of human rights, with internal controls to ensure compliance with these guidelines.

### Global ethics forum

**We held our fourth global ethics forum in June 2015 in Berlin, Germany. The forum brought together 75 senior executives and managers from across the Group to consider the business and ethical challenges of doing business in Eastern, Central and Western Europe, with a focus on the individual ethical responsibility of all employees. The programme included input from subject matter experts and local business leaders, together with case study scenarios. The participants had to develop action plans to respond to a variety of ethical challenges, which they then discussed with members of the Smiths Group Executive Committee. This event is one of a series of interactive programmes addressing similar issues in many of the markets in which we operate.**



## Human rights

Smiths seeks to uphold all internationally recognised human rights wherever its operations are located. Within this framework, we do not tolerate the use of child or forced labour at Smiths facilities or those of our suppliers. The Supplier Code of Business Ethics and contractual clauses incorporate and implement these prohibitions. Furthermore, we take all steps reasonably possible to ensure our products are not used to abuse human rights

### Priorities for 2016

- Hold regional ethics conferences in countries considered a compliance risk
- Continue to update our training and compliance programmes in line with changing business needs and regulations, such as expanding international sanctions and embargoes
- Continue to refresh employees' online Code of Ethics training every two years
- Continue to train suppliers on our ethical standards and requirements to support the new Supplier Code of Business Ethics, including the prohibition of any abuse of human rights
- Continue to ensure ethics messages are received and understood by all employees worldwide

## Environment, health and safety

We are committed to achieving excellence in environment, health and safety management and performance and providing effective leadership in the pursuit of injury-free and environmentally responsible workplaces.

### 2015 Highlights

- Environmental performance continued its long-term improvement trend
- Continued implementation of a new EHS management software system
- Developed global technical minimum safety standards for serious EHS risks and conducting job risk assessment
- Implemented new EHS issue tracking software to ensure proper and timely closure
- Initiated sustainability materiality assessments in two divisions

### EHS governance and management

Our environmental, health and safety (EHS) approach starts with our EHS policy and is supported by our EHS strategy, KPIs and goals. Our divisions adapt the Group EHS strategy to reflect their specific impacts and any opportunities to improve their EHS management and performance.

We believe in the power of continuous improvement and use management systems to realise its benefits. In addition, management systems provide a framework for the identification of risks and issues that helps sites to prioritise and focus on the most concerning risks.

### EHS strategy

We aim to protect our employees, communities, environment, and shareholder value by effectively managing safety and environmental risks. Our principal focus areas include safety culture, training, risk identification and mitigation and energy management. Our EHS KPIs are aligned to the strategy, allow us to assess progress and form part of our senior management performance assessment.

## Environmental targets

In 2013, we set new five-year targets for our environmental metrics. Our targets are to achieve 15% reductions in energy usage, greenhouse gas emissions and waste generation, and a 10% reduction in water usage by FY2018, all normalised to revenue against a baseline of FY2013.

Our greenhouse gas (GHG) emissions calculation methodology closely follows the Greenhouse Gas Protocol and includes emissions from sources under our control. In addition, the inventory consists of Scope 1 (direct GHG emissions from sources owned or controlled by the company) and Scope 2 (GHG emissions from the generation of purchased electricity consumed by the company) emissions. In 2014, an external adviser performed a review of our GHG emissions calculation methodology and prepared a GHG Inventory Management Plan that has been used to further align our emissions calculation methodology with the GHG Protocol. It was concluded that emissions from vehicles, production processes and fugitive sources are small and not material compared to our total GHG emissions. Due to the difficult nature of collecting emission data from these sources and their immateriality, they have been excluded from the inventory totals. The materiality of these sources will be reviewed again in the future.

Over the past five years we have significantly reduced our environmental impact, with 14% energy, 25% GHG, 23% water and 26% non-recycled waste reductions, normalised to revenue. Overall, our environmental performance continued its long-term improvement trend in FY2015. We continued to reduce our GHG emissions, non-recycled waste and water usage while energy usage was flat, by comparison to 2014. Compared to our baseline year of FY2013, we have achieved good progress in reducing GHG emissions, non-recycled waste and water, though energy usage increased slightly. This increase in energy use was due to colder than normal winter temperatures, increases in production to build inventory and a few facilities operating concurrently for a short period while in the process of consolidating.

### Total energy

'000MWh

**278,000 MWh**

2015	278
2014	283
2013	278
2012	279
2011	303

### Total CO<sub>2</sub> emissions

'000 tonnes

**96,000 tonnes**

2015	96
2014	101
2013	103
2012	110
2011	121

### Water use

'000m<sup>3</sup>

**403,000m<sup>3</sup>**

2015	403
2014	440
2013	437
2012	465
2011	485

### Total non-recycled waste

'000 tonnes

**4,900 tonnes**

2015	4.9
2014	5.4
2013	5.9
2012	5.5
2011	6.1

### Total energy efficiency

MWh/£m revenue

**96 MWh/£m revenue**

2015	96
2014	96
2013	94
2012	97
2011	112

### Total CO<sub>2</sub> emissions

Tonnes/£m revenue

**33 tonnes/£m revenue**

2015	33
2014	34
2013	35
2012	37
2011	44

### Water consumption

m<sup>3</sup>/£m revenue

**139m<sup>3</sup>/£m revenue**

2015	139
2014	149
2013	148
2012	158
2011	180

### Total non-recycled waste

Tonnes/£m revenue

**1.7 tonnes/£m revenue**

2015	1.7
2014	1.8
2013	2.0
2012	2.0
2011	2.3

### Health and safety management

The Group is committed to working in a way that protects, as far as reasonably practicable, the health and safety of its employees. Our employees recognise this commitment. In our Group-wide engagement surveys, workplace safety continues to be the highest scoring dimension, exceeding the worldwide benchmark for manufacturing industry.

Our Group-wide activities to reduce incidents have focused on leadership and employee safety awareness and involvement and risk reduction. We continue to implement and build on these activities and are monitoring them through our Safety Leading Indicator Activities Programme. We use a safety leading indicator activity score as a KPI for safety, complementing the recordable incident rate (RIR).

### Health and safety targets

Our FY2015 safety performance metrics were the Safety Leading Indicator Activity Score, RIR and Lost Time Incident Rate (LTIR). Smiths Group as a whole and all the divisions completed the required number of safety leading indicator activities, which will support our efforts to improve our safety culture and risk management.

As part of our strategic plan updating and benchmarking in FY2013, we also updated our safety performance targets. These safety targets increase focus on leading indicator activities designed to reduce the risk of incidents. We place less emphasis on the lagging indicator Recordable Incident Rate (RIR). However, we continue to monitor RIR and Lost Time Incident Rate and investigate incidents for contributing factors and trends to help focus risk assessments. Our ultimate ambition is 'zero harm' to employees. Adopting this further emphasises to employees and other stakeholders how seriously we take our EHS performance.

A small number of historical metrics have been revised marginally to reflect refinements in monitoring

### Performance against environmental targets

	Target FY2013-18	FY2015 progress against FY2013
Energy	15% reduction	<b>2% increase</b>
Greenhouse gas emissions	15% reduction	<b>4% reduction</b>
Total non-recycled waste	15% reduction	<b>17% reduction</b>
Water consumption	10% reduction	<b>6% reduction</b>

Reduction targets are compared to the FY2013 baseline year and normalised to revenue consolidated at FY2015 closing exchange rates.

## Recordable incident rate

Where an employee requires medical attention beyond first aid (per 100 employees per year)

2015	0.55
2014	0.50
2013	0.54
2012	0.60
2011	0.66

## Lost time incident rate

Where an employee is unable to work the day after an incident (per 100 employees per year)

2015	0.22
2014	0.22
2013	0.22
2012	0.21
2011	0.29

## Health and safety performance

From FY2004 to FY2014, we achieved a steady reduction in our RIR, improving from 4.6 to 0.50. Whilst our goal is zero harm, our RIR increased slightly from 0.50 to 0.55. Focused programmes to address this at the few sites that experienced increased incidents have already delivered significant improvements and we continue to drive world-class standards across the organisation.

After years of reductions, our LTIR has been steady at 0.22 for the past three years. This is still well below our FY2008 LTIR of 0.54. Over the past twelve years, we have experienced three occupational fatalities, with an employee at a former facility in Sweden in 2003, a contractor in Costa Rica in 2007 and an employee in a vehicle accident in 2014.

## Priorities for 2016

- **Develop additional global technical minimum standards to address our remaining most serious EHS risks**
- **Finish the implementation of our new EHS management software system**
- **Complete formal sustainability materiality assessments in two divisions and begin in other divisions**

## People

Attracting, retaining and developing the right people with the right skills is central to our ambition of transforming Smiths into a world-class organisation and supporting our growth ambitions.

We believe that people growth is a strong enabler of business growth and we develop our employees' capabilities so they can fulfil their potential and help us to fulfil ours.

## 2015 Highlights

- **Continued to strengthen our talent pipeline through targeted external recruitment and a focus on talent assessment, personal development and succession planning**
- **Put new cohorts through our early career and senior leadership development programmes**
- **Conducted an interim MyVoice ('Pulse') global employee engagement survey**
- **Further embedded our e-enabled HR operating model to support business growth**

## Governance

The Board places a high priority on attracting and retaining the right people and the Chief Executive is the Board member nominated to bring these ambitions to life. He is supported by the Group Human Resources Director, a team of Human Resources (HR) professionals and line managers across the organisation.

Over the past five years, we have transformed our HR function to bring world-class people management to Smiths and to leverage our strength and scale. Our model combines consistent, best practice approaches and programmes in key areas with divisional initiatives that address specific business needs, supported by GlobalView, Smiths first HR information system. The utilisation of an e-enabled model empowers managers and employees to take more responsibility for many aspects of their working lives.

## Strategy and objectives

We have consistently focused on strengthening our leadership capabilities and talent pipeline at both senior and junior levels, improving our recruitment and assessment techniques, succession planning, enhancing employee engagement and transforming our HR function to provide a strong platform for growth. We benchmark the effectiveness of our processes against world-class standards and put in place year-on-year improvement plans to help us become best-in-class.

As we work to transform Smiths into a world-class organisation, a talented and determined workforce, united by commercial acumen, an appetite for innovation, strong leadership and a commitment to collaboration and responsibility will be essential to achieving our ambitions. To support this, we will continue to develop our leadership capabilities throughout the organisation to ensure we have the depth and breadth necessary to support growth; deepen our focus on our technological and engineering expertise in order to drive innovation and maintain our technological leadership; and continue to build employee engagement across the business in response to the global MyVoice survey and ongoing feedback.

## Performance

### Building the talent pipeline and succession planning

Our focus on succession planning has delivered significant progress in building our talent pipeline, through a more rigorous and consistent approach to assessing talent and a greater focus on preparing and monitoring personal development plans. We have also invested significantly in our two leadership development programmes. 'Horizons' fosters emerging talent at junior levels, while 'Aspire2' develops senior leaders. These programmes challenge and engage our employees, build their understanding of the wider Group, increase their exposure to our senior leaders and enhance their core leadership competencies. The programmes will also improve the diversity of candidates, especially in the areas of gender, educational routes and emerging market backgrounds. Around 150 managers from across the business have been on or are currently participating in these programmes.

We provide a wide variety of learning and training opportunities, ranging from workshops and mentoring to online resources and internal and external training courses. Personal development planning and identification of training and development needs form a key part of our annual performance review process and we are rolling out a new, enhanced toolkit to support this as part of the development of GlobalView.

We constantly challenge ourselves as to whether we have the right skills and competencies to support our growth ambitions and believe this is best achieved through a healthy balance of recruiting the very best external candidates to bring fresh approaches and perspectives, while also strengthening our internal talent pipeline. As part of the *Engineered for Growth* programme, we have increased our focus on developing our technological capabilities in both the short term and over the next 10 years.

## Performance and reward

Managing performance is critical to ensuring our employees fulfil their potential and deliver business results. In a competitive marketplace, we recognise the importance of rewarding employees appropriately and aim to offer compensation and benefits packages that enable us to attract, develop and retain key talent. Our new HR operating model is driving consistent best-in-class approaches to reward across the Group. We encourage our people to share in our success and periodically offer employees opportunities to participate in share plans, aligning their interests more closely with those of shareholders.

## Diversity and inclusion

With operations in more than 50 countries and a strategic focus on innovation and expanding into new geographic markets, having a diverse, engaged workforce that reflects our footprint and brings local knowledge, fresh perspectives and constructive challenge is critical. We aim to provide an inclusive, collaborative culture that values every individual, fosters collaboration, and provides the tools, opportunities and challenges to enable them to fulfil their potential and add value to the business. Of particular note is the establishment this year of a dedicated management team for China, recruited locally and made up entirely of Chinese nationals.

At the end of FY2015, 38% of our global workforce and 10% of our senior managers were women. We are committed to increasing the diversity (in its broadest sense) of our workforce, and our two leadership development programmes aim to increase the diversity of candidates for senior positions. Two of our Board directors are women, representing 25% of the Board as at 31 July 2015. However, as at that date the Board had reduced to eight directors following the departure of Peter Turner. Following the appointment of Chris O'Shea as Finance Director in September 2015 this will reduce to 22%, which is slightly below the level recommended by the Davies Report.

	Male	Female	Total
Board directors	6	2	8
Senior managers*	231	25	256
Total employees†	14,050	8,600	22,650

\*Senior managers are as defined by the Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013, which includes employees who have responsibility for planning, directing or controlling the activities of the Group or a strategically significant part of the Group (other than Board members) and/or who are directors of subsidiary undertakings

†Full-time equivalents at 31 July 2015

It is our policy to provide equal employment opportunities. The Group recruits, selects and promotes employees 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 appropriate alternative jobs for those who are unable to continue in their existing job because of disability.

All our employees are treated with respect and dignity. Accordingly, any harassment or bullying is unacceptable. The Group respects the right of each employee to join or not to join a trade union or other bona fide employee representative organisation.

## Employee engagement

We recognise that an engaged and motivated workforce is critical to achieving our objectives. Our MyVoice survey is a valuable tool for measuring engagement and providing insight into our employees' motivations and priorities.

We conducted our third full survey in 2014 in partnership with Kenexa, a part of IBM and a leading survey provider, to ensure that responses were anonymous and to enable us to conduct the survey in local languages. We achieved a participation rate of 85% and benchmarked results against global norms for the manufacturing industry. We communicated divisional, local and functional results and action plans in place across the business to address the most significant issues highlighted. During FY2015, we continued to address the results from this, as well as conducting an interim engagement survey in April on a significant, representative sample of around 5,000 employees in order to monitor progress. The next full survey is planned for Spring 2016.

## Communication

Communication is fundamental to engaging employees. This having been identified as a key theme in the last MyVoice survey, we have implemented a number of initiatives to improve information sharing, facilitate greater collaboration and improve news flow at both Group and divisional levels. These include developing a new intranet platform, more regular updates on performance and key business issues, and providing greater opportunities for feedback and dialogue. This has built on the wide variety of well-established tools and channels used across the Group, including site meetings, team briefings, presentations and newsletters. Continuing to improve two-way communications is one of our major focus areas.

In European Union (EU) countries we have workplace information and consultation arrangements at our sites. These link to the Smiths Group European Forum, through which employee representatives from across the EU meet annually to discuss transnational matters with Group executives. Our 2015 Forum was held in Germany and saw 16 representatives from across the Group meet with senior executives to discuss matters such as *Engineered for Growth*, the interim MyVoice survey results, market conditions and business strategy and performance. Feedback from the event was extremely positive.

## Acquisition integration

When new businesses are acquired, we implement plans to integrate them into the Group, ensuring that our business ethics, employee development and EHS policies and programmes are well established. We regularly review our processes in these areas, to identify opportunities to improve.

## Priorities for 2016

- Continue to develop leadership capabilities throughout the organisation
- Deepen our focus on technological and engineering expertise
- Continue the roll-out of GlobalView tools to support performance management, individual development and succession planning
- Conduct the fourth MyVoice Group-wide engagement survey



### Leadership development programmes

Almost 150 managers have been through our junior and senior leadership development programmes since 2012, Horizons and Aspire2. Aspire2 aims to develop candidates for senior divisional and corporate leadership roles through world-leading facilitation, business simulations and strategic business projects.

“Aspire2 represents an impressive investment in talent development by Smiths – unlike anything I’ve experienced previously in my career. The business simulations provided immediate feedback from senior executives and leading external business advisors on my leadership behaviours and competencies. And the business projects allowed me to work with other rising leaders from across Smiths on strategic challenges such as improving our culture of innovation,” said participant Michael Blum, Associate General Counsel at Smiths Medical.

Our early career development programme, Horizons, uses theory, business simulations, presentations and psychometric testing and business projects in order to build participants’ understanding of the Group, increase their exposure to senior leadership and enhance their core leadership competencies.

“The Horizons programme has definitely helped me develop my leadership capabilities and expand my professional network across both John Crane and the wider Smiths organisation,” commented Mustafa Al-Hammadi, a regional Sales manager for John Crane, Saudi Arabia. “I’ve developed a broader understanding of the business through the group business projects, as well as improving my commercial and decision-making skills.”

### Communities

Contributing to the communities in which we operate benefits both local people and our business. It helps to drive prosperity in local communities, enhance our profile and reputation, promote employee engagement and attract new employees.

Given the diversity of our business and our decentralised structure, our community relationships and charitable programmes are primarily managed at a local level to allow our businesses to focus on the particular needs of their markets and communities. We also offer some Group-level support to community and charitable organisations, considering charities and organisations that demonstrate how a donation will enhance the well-being of people through improved education, health and welfare or environment.

In FY2015, we made charitable donations of £154,000 as a Group. Our employees also raised money for a wide range of charitable causes through a variety of fund-raising initiatives across the business.

### Strategic report

The Strategic report was approved by the Board on 22 September 2015.

By order of the Board

**Philip Bowman**  
Chief Executive



# Governance

Smiths Medical's Jelco safety devices for hypodermic injection, blood collection and sampling have protected healthcare workers across the globe from needle stick injuries and blood exposure for over 25 years. Its ProtectIV and ProtectIVPLUS models also pioneered the innovative safety design of PIVCs (peripheral intravenous catheters) for use in all care settings.



We introduce our Board, explain our approach to corporate governance and give details of the Company's remuneration principles and policies to support shareholder value creation

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# Board of directors

**Sir George Buckley**  
Chairman



Aged 68, Sir George Buckley joined the Board on 1 August 2013 as a non-executive director and Deputy Chairman and was appointed as its Chairman on 19 November 2013. A citizen of both the UK and US, Sir George has a PhD. in Electrical Engineering.

## Strengths and experience

Sir George retired in 2012 as Chairman and CEO of 3M, the US-based global technology company and Dow Jones 30 component, after a long and successful business career spent mainly in the United States. He was previously Chairman and CEO of Brunswick Corporation and Chief Technology Officer at Emerson Electric Company. He currently holds a number of non-executive positions at major international companies, as well as chairmanships of two fund management and private equity groups. Sir George's expertise in engineering and innovation, combined with his extensive experience of multi-industry businesses that operate in global markets, are of huge benefit to Smiths.

## Committee membership

- Chairman of the Nomination Committee
- Remuneration Committee

## External appointments

- Chairman of Ownership Capital
- Chairman of Arle Capital
- Non-executive director of Hitachi, Ltd.
- Non-executive director and a member of the Audit Committee of PepsiCo, Inc.
- Non-executive director and member of the Audit and Compensation Committees of Stanley Black & Decker, Inc.

**Philip Bowman**  
Chief Executive



Aged 62, Philip Bowman is Australian with an MA in Natural Sciences. He has extensive experience of leadership at major international public companies and was appointed Chief Executive of Smiths Group in 2007. Philip is expected to retire from the Board on 24 September 2015.

## Strengths and experience

Philip was previously Chief Executive of Scottish Power plc and Allied Domecq plc. He also held non-executive directorships at British Sky Broadcasting Group plc, Scottish and Newcastle Group plc and Coles Myer Limited as well as having been Chairman of Liberty plc and Coral Eurobet plc. His earlier career included five years as a director of Bass plc, where he held the roles of Chief Financial Officer and subsequently Chief Executive of Bass Taverns.

## External appointments

- Senior Independent Director and Chairman of the Audit Committee of Burberry Group plc
- Non-executive director of Better Capital PCC Limited
- Chairman of The Miller Group (UK) Limited and Chairman of its Remuneration Committee and a member of its Audit Committee

**Chris O'Shea**  
Finance Director



Aged 41, Chris O'Shea is British with an MBA from Duke University. He is a qualified Chartered Accountant with a finance degree from the University of Glasgow. He joined Smiths Group as Finance Director on 18 September 2015.

## Strengths and experience

Chris joined Smiths Group from the metals technology company, Vesuvius plc, where he was the CFO from 2012, following its demerger from Cookson Group plc. He was also a non-executive director of Foseco India Ltd, an Indian-listed supplier to the foundry industry and a part of Vesuvius plc. Chris has also held a number of senior finance roles at BG Group, latterly serving as CFO for the group's businesses in Africa, the Middle East and Asia. From 1998 to 2005 Chris worked in the UK, the US and Nigeria for Royal Dutch Shell in a variety of roles, including CFO for Shell's offshore exploration and production business in Nigeria. Chris has wide knowledge and experience of multi-national operations, including the manufacturing and oil and gas sectors. He also has experience of international tax and financing through roles at Ernst & Young and Royal Dutch Shell.

**Bruno Angelici**  
Non-executive director



Aged 68, Bruno Angelici is French with an MBA (Kellogg School of Management) and Business and Law degrees from Reims. He was appointed to the Board of Smiths Group in 2010.

#### **Strengths and experience**

Bruno's career includes senior management roles in pharmaceutical and medical device companies. Bruno retired from AstraZeneca in 2010 as Executive Vice President, International after a 20-year career. He was responsible for Europe, Japan, Asia Pacific, Latin America, Middle East and Africa and originally joined as President of ICI Pharma France. Prior to this, he was at Baxter, a US-based global supplier of medical devices. He has extensive international experience, including in the US, and brings a deep understanding to the Group of the medical device and pharmaceutical industries.

#### **Committee membership**

- Audit Committee
- Nomination Committee
- Remuneration Committee

#### **External appointments**

- Member of the Global Advisory Board of Takeda Pharmaceutical Company Ltd, Japan
- Non-executive director and a member of the Nomination Committee of Novo Nordisk A/S, a Danish healthcare company
- Member of the Supervisory Board and the Audit Committee of Wolters Kluwer nv, a Dutch-based information services and publishing company
- Chairman of the Board and a member of the Nomination and Remuneration Committees of Vectura Group plc, a UK-listed specialty pharmaceutical company

**David Challen, CBE**  
Senior Independent Director



Aged 72, David Challen CBE was appointed to the Board in 2004. He is British with a BA in Mathematics, a BSc in Natural Science – Physics and an MBA from Harvard.

#### **Strengths and experience**

David had a long and distinguished career in investment banking. He is a former Chairman of J Henry Schroder & Co., where he spent most of his professional career. He was the first chairman of the Financial Services Practitioner Panel set up under the act which created the Financial Services Authority (the predecessor to the Financial Conduct Authority). He has an in-depth understanding of capital markets and provides valuable support to the Group on key financial matters.

#### **Committee membership**

- Audit Committee
- Nomination Committee
- Remuneration Committee

#### **External appointment**

- Deputy Chairman of the Takeover Panel

**Tanya Fratto**  
Non-executive director



Aged 54, Tanya Fratto was appointed to the Board in 2012. An American, she is a qualified electrical engineer with a BSc in Electrical Engineering.

#### **Strengths and experience**

Tanya was CEO of Diamond Innovations Inc., a world-leading manufacturer of super-abrasive products for the material removal industry, until 2010. Before that she enjoyed a successful 20-year career with GE. She held a number of senior positions in product management, operations, Six Sigma and supply chain management. Tanya provides Smiths with wide experience in product innovation and sales and marketing in a range of sectors.

#### **Committee membership**

- Audit Committee
- Nomination Committee
- Remuneration Committee

#### **External appointment**

- Non-executive director and a member of the Audit Committee of Advanced Drainage Systems, Inc., a US-listed water management and drainage company

**Anne Quinn, CBE**  
**Non-executive director**



Aged 64, Anne Quinn was appointed to the Board in 2009. She is from New Zealand and has a BCom from Auckland University and MSc in Management Science from the Massachusetts Institute of Technology.

**Strengths and experience**

Anne spent her early career with NZ Forest Products Limited and the US management consulting company, Resource Planning Associates. She has extensive overseas experience in the oil and gas sector, having enjoyed a successful 25-year career with Standard Oil of Ohio and BP. She held a number of executive positions including Group Vice President in the US, Belgium, Colombia and the UK. Following her career with BP, Anne was the managing director of Riverstone LLP, an energy private equity group. Anne's experience is a great benefit to the Group in its development of new geographic markets and its exposure to the oil and gas sector.

**Committee membership**

- Chair of the Remuneration Committee
- Audit Committee
- Nomination Committee

**External appointments**

- Senior Independent Director and Chair of the Remuneration Committee of Mondi plc and Mondi Limited, a packaging and paper company, dual-listed in the UK and South Africa

**Bill Seeger**  
**Non-executive director**



Aged 63, Bill Seeger was appointed to the Board in May 2014. He is a US citizen with a BA in Economics and an MBA, both from UCLA (University of California, Los Angeles).

**Strengths and experience**

Bill joined GKN plc, the global engineering company, in 2003 as Senior Vice-President and Chief Financial Officer of Aerospace. In 2007 he became a member of the Executive Committee as President and Chief Executive Propulsion Systems and Special Products before being appointed to the Board as Group Finance Director the same year. Bill retired as the Finance Director of GKN in 2014. He previously held a number of senior finance posts during a 28-year career with TRW, the US-based automotive and aerospace group. His long career in finance in the engineering sector and in-depth knowledge of global markets, contracting and strategy execution greatly benefits Smiths.

**Committee membership**

- Chairman of the Audit Committee
- Nomination Committee
- Remuneration Committee

**External appointments**

- Non-executive director and Chairman of the Audit and Risk Committee of Spectris plc, a UK-listed instrumentation and controls company.
- Visiting Professor – UCLA Anderson School of Management

**Sir Kevin Tebbit, KCB, CMG**  
**Non-executive director**



Aged 68, Sir Kevin Tebbit was appointed to the Board in June 2006. Sir Kevin is British and has a BA in History.

**Strengths and experience**

Sir Kevin held policy management and finance posts in the MoD, Foreign and Commonwealth Office and NATO. These included three years' service in Washington as Defence and European Counsellor at the British Embassy before becoming Director of GCHQ and finally Permanent Under Secretary at the Ministry of Defence from 1998 to 2005. Sir Kevin's career as a former senior British civil servant provides Smiths with considerable experience in the defence sector and in government relations issues.

**Committee membership**

- Audit Committee
- Nomination Committee
- Remuneration Committee

**External appointments**

- Senior Adviser to AECOM
- Senior Associate Fellow at Royal United Services Institute
- Visiting Professor at Kings College, London
- Member of the Advisory Board of the Imperial College Institute for Security, Science and Technology

# Corporate governance statement

## Chairman's introduction

**Sir George Buckley**  
Chairman



Strong governance and uncompromising ethical standards and behaviours are the hallmarks of excellent companies and this is particularly the case during times of challenging market conditions and internal change. In my second year as Chairman of Smiths I have been proud to lead a Board that promotes good conduct and behaviours wherever we operate. It is our responsibility to support management in its strategic aims to enable the Company to continue to perform successfully and sustainably for our shareholders and wider stakeholders and this is underpinned by our aim to operate to the highest standards of corporate governance.

I have referred in my Chairman's statement to the important changes that we have made to the Smiths Board during 2015. The Directors are extremely grateful for the good work done by Peter Turner, who left us in April, and to Rob White, who stepped in as Interim Chief Financial Officer, pending Chris O'Shea joining as our new Finance Director on 18 September. We are also grateful to Philip for agreeing to remain as Chief Executive until we identified a replacement of the right calibre, which I am delighted the Board has found in Andrew Reynolds Smith, who joins us shortly. It is at these times that Board members play an enhanced role. The Nomination Committee carried out rigorous processes in the selection and appointment of Chris and Andrew to their new roles. The Board will continue to oversee their induction process and endeavour to provide the extra support and constructive challenge that the new executive team may require.

During the year the Board and its Committees have spent time with Philip and his management team during Board meetings and also in less formal discussions. We have engaged with leaders from the five divisions during strategic reviews and the additional operating reviews introduced during 2014. In addition, Board meetings have been held at operational sites where Board members have had the opportunity to get under the skin of the businesses and to meet with employees at all levels to hear first-hand their enthusiasm for Smiths and some of the opportunities and challenges they face.

As for the Board itself, we have a set of annual objectives against which we consider our performance and we intend to set new objectives for this coming year. The Board also carries out annual reviews of its own performance, the performance of its Committees and the individual performances of its members. Further details of this year's review, which was externally facilitated, are contained in this Governance statement.

I can also report that during the year Bill Seeger took on the Chairmanship of the Audit Committee and has benefited from a very comprehensive director induction programme which he completed in October 2014. The induction of our new directors and the continued improvement in the quality of information provided to all Board members will be key activities for 2015/16.

I am sorry to report that David Challen will retire from our Board after the AGM. David has been a non-executive director of Smiths Group for nearly eleven years and I will personally miss his wisdom and experience. I will announce his successor as the Board's Senior Independent Director in due course.

In September 2014 a revised UK Corporate Governance Code was issued which applies to accounting periods commencing on or after 1 October 2014. The Board and its Remuneration and Audit Committees have discussed the changes and in the light of them have been reviewing current practices for 2015/16. In the meantime, we must expect the coming year to be a further period during which Smiths and its peers are impacted by the challenging external environment – the Board will remain focused on supporting the transition of our new executive directors and supporting Smiths management in the execution of strategies in the long-term interests of the Company.

**Sir George Buckley**  
Chairman



#### Site visit

The Board visited Smiths Detection's facility in Edgewood, US as part of its programme of visits to the Group's operations

#### Compliance with the UK Corporate Governance Code

Throughout the period 1 August 2014 to 31 July 2015 the Company has been in full compliance with the September 2012 edition of the UK Corporate Governance Code (the 'Code'), published by the Financial Reporting Council and available on its website (<https://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Corporate-Governance-Code.aspx>) except that:

- 1) The Company has not put the external audit contract out to tender for more than ten years. During the year the Company has kept the related issues of competitive audit tendering and audit firm rotation under review. Details of this review and the conclusions the Company has drawn from it are more fully examined in the Audit Committee report on page 90.
- 2) The value of any fees received by executive directors in respect of external non-executive directorships is not disclosed in the Directors' remuneration report, as this has not been considered relevant to the Company.

#### Disclosure & Transparency Rule 7

This Corporate governance statement is a section of the Group directors' report and is incorporated into the report by reference. This statement complies with sub-sections 2.1; 2.2(1); 2.3(1); 2.5; 2.7; and 2.10 of Rule 7 of the UK Listing Authority Disclosure & Transparency Rules. The information required to be disclosed by sub-section 2.6 of Rule 7 is shown in the Group directors' report on pages 113 and 114 and is incorporated into this Corporate governance statement by reference.

#### 2014/15 in summary

- Succession planning for the Board and senior management has been a priority and will remain so in 2015/16, together with oversight of a focused, comprehensive induction programme for the new Executive Directors.
- An external Board evaluation process was conducted during the year.
- As part of its ongoing commitment to setting high ethical standards, the Board supported a number of Ethics programmes during the year, including a global Ethics Forum, the new Supplier Code of Business Ethics and a targeted Supplier Ethics awareness programme.
- The Board increased its focus on cyber-security risks, including overseeing the implementation of several key initiatives and improvements as part of the Company's ongoing programme to manage this major risk area.
- The Remuneration Committee reviewed the effectiveness of its long-term incentives and, following consultation with shareholders, is proposing a simplified approach for 2015/16.
- The Board has also reviewed the new provisions set out in the UK Corporate Governance Code 2014, which the Board will report on next year.

#### Governance structure

The governance of the Group is assured by a structured hierarchy of committees and boards that approve and monitor the strategies and policies under which the Company operates. The hierarchy comprises a mixture of Board committees and various management committees and subsidiary boards, as illustrated in the diagram on page 79. The Board is responsible to the shareholders and other stakeholders for overseeing these activities and supervising management in its implementation of the policies and strategies within a framework of prudent and effective controls which enables risk to be assessed and managed. The Board is also responsible for setting the Company's culture of ethical behaviour and compliance, and for promoting policies and providing oversight. The main activities of the Board are illustrated in the diagram on page 80.

#### The Board

##### Board role and responsibilities

The Board holds formal meetings at least six times a year to make and review major business decisions and monitor current trading against the plans which it has approved, and holds additional meetings to consider the strategy of each of the divisions and the overall strategy of the Company. Further meetings are arranged as necessary to deal with urgent items. The Board exercises control by determining matters specifically reserved to it in a formal schedule which only the Board may change: these matters include the acquisition or divestment of significant companies or businesses, the issue of shares, significant contractual commitments, the review of the effectiveness of risk management processes and major capital expenditure.

The Board sets the Company's values and standards, including the Company's Code of Business Ethics which is referred to on pages 65 to 67. The role of the Board in the governance of the Group is illustrated in the diagram on page 79 and its main activities are outlined in the diagram on page 80.

The executive directors and senior management team are responsible for the Company's financial performance, the day-to-day management of the Company's businesses and implementation of the strategy and direction set by the Board.

## Governance structure

### Board

Responsible for reviewing and agreeing the Group's strategy, provides the leadership of the Company, supervises the management of the Company, monitors the operational and financial performance of the Company, and reports to shareholders on its stewardship of the shareholders' assets

### Board Committees

#### Nomination Committee

Reviews the structure, size and composition of the Board and Board committees and considers succession planning for directors and senior management

#### Remuneration Committee

Makes recommendations to the Board on the Company's remuneration framework and sets the remuneration of the Chairman, the Chief Executive, the Finance Director and senior management

#### Audit Committee

Monitors the integrity of the Company's financial statements, its systems of internal controls and risk management and its internal and external audit controls

### Executive Management Committees

#### Executive Committee

Monitors performance of the businesses and the functions supporting the businesses, and makes recommendations on the implementation of strategy, operations, people and organisational development and Group policies

#### Disclosure Committee

Makes recommendations concerning the identification of inside information and the timing and method of disclosure, and advises the Chief Executive and the Board in accordance with the Company's disclosure policy

#### Acquisitions & Divestments Committee

Considers, approves and sets conditions in relation to Group acquisitions and divestments within parameters established by the Board

### Divisional Boards

John Crane

Smiths Medical

Smiths Detection

Smiths Interconnect

Flex-Tek

Monitor the delivery of short-term and medium-term performance targets in accordance with the financial and operational performance targets and the strategic plans set by the Board. A corporate member of the Executive Committee sits on each divisional board as an investor director

### Functional Boards

#### Environment Health & Safety Steering Committee

Develops and monitors implementation of EHS policies and strategy

#### Security Committee

Contributes to the development of Group Security policies and associated minimum standards and monitors their execution

#### Ethics Code Compliance Council

Oversees the implementation of the Smiths Group Code of Business Ethics and makes recommendations to management and to the Audit Committee

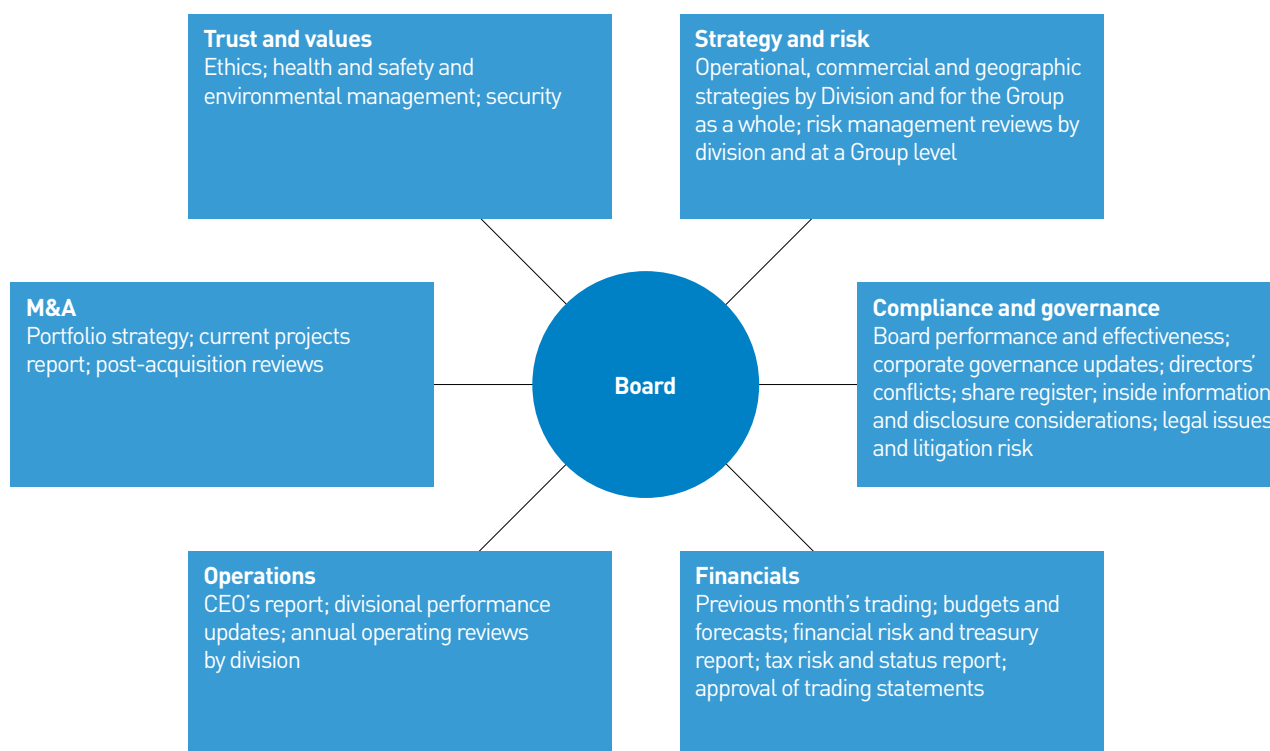
#### Investment Committee

Assesses high-value and high-risk proposals requiring the approval of the Board or the Chief Executive, including capital expenditure, asset disposal and special revenue expenditure projects (including litigation costs); commercial bids; contracts for supplying goods and services; reorganisation expenditure; contractual commitments to purchase goods and services; research and development programmes; and property

#### IT Global Governance Board

Responsible for all aspects of IT service support for the Group's business divisions and the corporate centre. This includes the delivery of all day-to-day IT services and the development of new IT solutions and services

## Board activities



### Trust and values

The Board sets the tone for the Company's culture of compliance with high ethical standards and with all the laws and regulations that apply to its businesses. The Board supported the holding of an Ethics Conference in Berlin in June 2015 which addressed the ethical risks arising from doing business in Eastern, Central and Western Europe and covered a number of topics, including issues arising from the use of agents and distributors. The Board also supported the launch of the Supplier Code of Business Ethics which sets minimum standards for supplier behaviours.

### Strategy and risk

The Board holds a number of dedicated strategy sessions each year, focusing on long-term targets and initiatives to improve the growth, efficiency and capability of each division and of the Company. The information and proposals which are provided to the Board are underpinned by a number of work streams amongst the executive teams in each division and on a Group-wide basis. In May 2015 the Board held a new format two day strategy meeting at which it considered strategic options across the Group as a whole. Also during 2015 the Company held a senior management conference which was focused on its *Engineered for Growth* strategy where topics included developing markets and M&A.

In addition to the regular divisional risk reviews presented to the Audit Committee, at least once a year, the Board reviews risks at a Group level. In July this year the Group-wide risk report that was presented to the Board included analyses of risks faced by the Company in the areas of cyber and information security, talent management and succession planning and commercial and legal risks relevant to sales bids and contracts and the measures in place to mitigate against these risks. A report on cyber-risk is submitted to each scheduled Board meeting.

### Compliance and governance

The Board receives regular corporate governance updates on relevant issues, including amendments to the Listing Rules and the UK Corporate Governance Code and developments in regulatory and legal regimes and sanctions.

### Financials

The Board considers the Group's trading performance and financial risk at each meeting. On 17 March 2015 the Board approved a cash interim dividend of 13p per ordinary share. In April 2015, the Board approved a €600 million senior bond offering for general corporate funding purposes and to repay certain existing debt. The offering closed on 29 April 2015 and the Notes have an eight-year maturity and were priced at a fixed coupon of 1.25%.

### Operations

The Board regularly monitors the optimal operating structure of the Group, including consideration of the interaction between the role of the Corporate Centre (operating under the Board's direction and subject to the Board's reserved powers) and the divisions. Since 2014 there has been a particular focus on the resources and optimum structure required, both at a divisional and Group level, to achieve growth. The new post of Group Commercial Director was created in May 2014 to leverage growth potential across all five divisions and lead initiatives on sales and marketing effectiveness and expansion into key developing markets. The Company has built on this platform during this year with the creation of a new role of China President in June 2015.

### M&A

The Board considers a report on potential changes to the Group's portfolio of assets at each meeting and additional meetings of the Board are convened, as necessary, to discuss significant acquisitions and divestments.

## Board composition

As at 21 September 2015, the Board comprises Sir George Buckley (Chairman), Mr Philip Bowman (Chief Executive), Mr Chris O'Shea (Finance Director, appointed on 18 September 2015) and six independent non-executive directors: Mr David Challen (Senior Independent Director), Mr Bruno Angelici, Ms Tanya Fratto, Ms Anne Quinn, Mr Bill Seeger and Sir Kevin Tebbit. During the year Mr Peter Turner resigned as Finance Director and has recently been succeeded by Mr O'Shea. The Company has announced that Mr Bowman will retire from the Company on 31 December 2015 and his successor as Chief Executive will be Mr Andrew Reynolds Smith. Mr Reynolds Smith is expected to start his appointment as an executive director and as the Chief Executive on 25 September 2015. Mr Bowman is expected to resign from the Board and step down as Chief Executive on 24 September 2015 but will remain as an employee of the Company until the end of December 2015, in accordance with his contract. Mr Challen intends to retire as a non-executive director at the conclusion of the AGM in November 2015. Biographies of the current directors, giving details of their experience and other main commitments, are set out on pages 74 to 76.

The Board and its committees have the appropriate balance of skills, experience, independence and knowledge of the Company to enable them to discharge their respective duties and responsibilities effectively. The wide-ranging experience and backgrounds of the non-executive directors ensure that they can debate and constructively challenge management in relation to both the development of strategy and the evaluation of performance against the goals set by the Board.

The Chairman meets the non-executive directors without the executive directors present at least twice a year. The Senior Independent Director meets the other non-executive directors without the Chairman present at least annually and is available to provide support to the Chairman and to serve as an intermediary for the other directors, if required.

The Directors and officers of the Company and its subsidiaries have the benefit of a directors' and officers' liability insurance policy.

## Board balance and independence

There is a balance of executive and non-executive directors such that no individual or small group can dominate the Board's decision making. Throughout the financial year at least half the Board, excluding the Chairman, has comprised independent non-executive directors. The ratio of non-executive directors to executive directors changed from 7:2 to 7:1 after the departure of Mr Turner in April 2015. The ratio returned to 7:2 with the appointment of Mr O'Shea as Finance Director on 18 September 2015. Although the Board does not endorse the setting of rigid quotas to achieve diversity, it does believe in the merits of a mixture of age; professional qualifications and experience; interests; and personalities in order to create a breadth of skill and character on the Board. The diagrams below illustrate the good balance of longer standing Board members and more recent appointments, and the diversity in gender and nationality. The individual qualifications, strengths and experiences of the Directors are included in their biographies on pages 74 to 76.

## Board balance, diversity and tenure

The Smiths Group Board reduced from nine to eight members in 2014/15 following the departure of Peter Turner as Finance Director. It will revert to nine members in September 2015 with the appointment of Chris O'Shea. The charts below illustrate the diversity of the Board in relation to tenure, gender and nationality as at 31 July 2015.

## Nationality

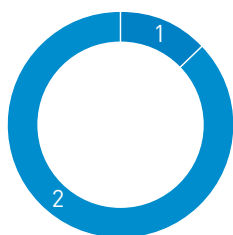
Five nationalities are represented on the Board (United Kingdom, France, Australia, United States and New Zealand), although the international experience of Board members is much wider than this.



## Executive balance

- 1 Executive 13%
- 2 Non-executive 87%

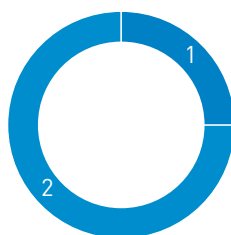
The majority of the Board are independent non-executives, who bring a wealth of skills and experience to Smiths.



## Gender balance

- 1 Female 25%
- 2 Male 75%

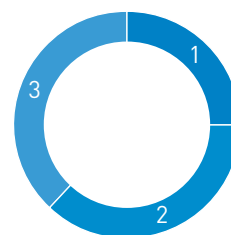
There are two women on the Board, Anne Quinn and Tanya Fratto.



## Board tenure

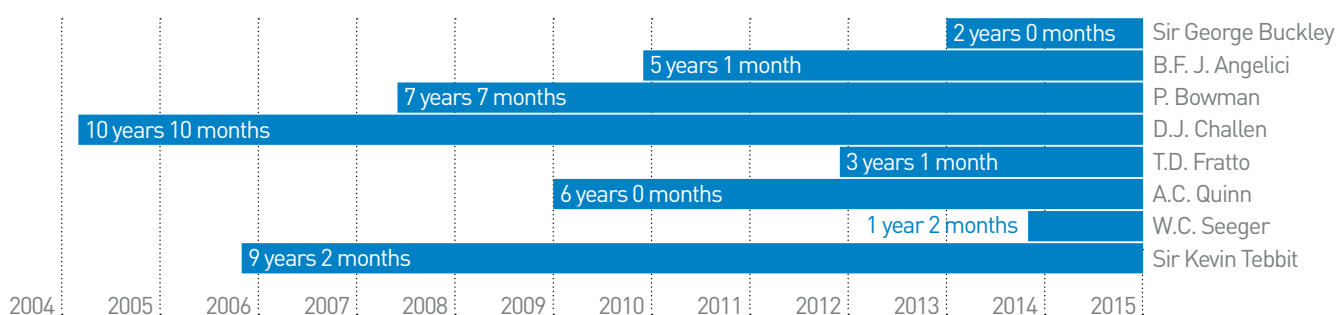
- 1 From 0 to 2 years 25%
- 2 From 3 to 6 years 37%
- 3 From 7 to 10 years 38%

Further details on the tenure of each director are shown on pages 74 to 76.



## Tenure of the Board

The Board and Nomination Committee regularly review the mix of skills and experience on the Board. The chart illustrates the good balance of longer standing Board members and more recent appointments, providing both continuity and fresh perspectives.



In deciding the chairmanship and membership of the Board committees, the need to refresh membership of the committees is taken into account. The table on page 81 indicates the service, to 31 July 2015, of each of the directors. Each of the non-executive directors is considered to be independent and Sir George Buckley was considered to be independent at the time of his appointment as Chairman. In the light of the lengths of service of Mr Challen and Sir Kevin Tebbit on the Board (over 10 years and 9 years, respectively), the Board and each of its committees undertook a rigorous review of their performance in order to evaluate their respective contributions to the Board and to the committees on which they sit. The Board is completely satisfied that both Mr Challen and Sir Kevin continue to be independent directors and valuable members of the Board and its committees. During the review, the Board also determined that Mr Challen should remain in the role of Senior Independent Director until his retirement from the Board. Since that date, Mr Challen has informed the Board of his intention not to stand for re-election at the Annual General Meeting in November 2015. His replacement as the Senior Independent Director will be announced in due course.

#### **Chairman and Chief Executive**

The Board has established clearly defined roles for the Chairman and the Chief Executive. The Chairman is responsible for leadership of the Board, ensuring its effectiveness and setting its agenda. Once agreed by the Board as a whole, it is the Chief Executive's responsibility to ensure delivery of the strategic and financial objectives approved by the board.

#### **Key roles and responsibilities**

##### **Chairman**

The Chairman's responsibilities include:

- Leadership of the Board
- Setting the agenda and tone for the Board
- Promoting high standards of integrity and corporate governance
- Ensuring the effectiveness of the Board

##### **Chief Executive**

The Chief Executive's responsibilities include:

- Ensuring implementation of the strategic and financial objectives approved by the Board
- Providing leadership on all executive management matters affecting the Company
- Chairing the Executive Committee
- Ensuring the Company's diverse stakeholder relationships (including with shareholders, employees and customers) are properly managed

##### **Senior Independent Director**

The Senior Independent Director's responsibilities include:

- Acting as a sounding board for the Chairman
- Acting as an intermediary for the directors where necessary
- Being available to shareholders if they have concerns which cannot be resolved through the Chairman or executive management
- Conducting an annual review of the Chairman's performance

##### **Company Secretary**

The Company Secretary's responsibilities include:

- Maintaining the Group's governance and listing rule compliance framework
- Ensuring that all Board and Board committee meetings are properly held and advising the Board on matters of governance and on legislative and regulatory developments
- Assisting the Chairman and the Chief Executive in ensuring that the directors are provided with all relevant information in a timely manner
- Organising new director induction and ongoing director training requirements

#### **Appointments to the Board**

The Nomination Committee has a formal, rigorous and transparent procedure for the appointment of new directors, which are made on merit and against objective criteria, having due regard for the benefits of diversity, including gender. This procedure was followed in the selection and appointment of Mr Chris O'Shea, as an executive director and Finance Director on 18 September 2015, and the selection of Mr Andrew Reynolds Smith, who is expected to be appointed as an executive director and Chief Executive on 25 September 2015. Further information in relation to the recruitment of Mr O'Shea and Mr Reynolds Smith is contained in the Nomination Committee report on pages 92 and 93.

The Board is satisfied that the directors are able to allocate sufficient time to their responsibilities relating to the Company. During the year, the Board considered the other engagements and proposed engagements of the directors as part of the director conflicts of interest procedure, as further described below.

#### **Re-election**

All directors stand for election by the shareholders at the first AGM following their appointment. 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. Non-executive directors are appointed for a specified term of three years, subject now to annual re-election at each AGM, and reappointment for a second three-year term is not automatic. Any term for a non-executive director beyond six years is subject to a particularly rigorous review. The Chairman has confirmed that, following the performance reviews undertaken in 2014, the performance of each of the directors standing for re-election at this year's AGM continues to be effective and that they each continue to demonstrate commitment to their respective roles and dedicate the time necessary to perform their duties.

#### **Conflicts of interest**

Under the Companies Act 2006 (the '2006 Act') a director must avoid a situation where he or she has, or could have, a direct or indirect interest that conflicts or possibly may conflict with the Company's interests. The requirement is very broad, and could apply, for example, if a director becomes a director of another company or a trustee of another organisation. The 2006 Act allows directors of public companies to authorise conflicts and potential conflicts where appropriate and where the articles of association contain a provision to this effect. Article 65 of the Company's Articles of Association provides that the directors can authorise potential conflicts of interest.

The Board has put procedures in place for directors to report any potential or actual conflicts to the other members of the Board for their authorisation where appropriate. Each director is aware of the requirement to seek approval of the Board for any new conflict situations, as they may arise. The process of formally reviewing conflicts disclosed, and authorisations given (including such conditions as the Board may determine in each case), is repeated twice a year. Any conflicts or potential conflicts considered by the Board and any authorisations given are recorded in the Board minutes and in a register of director conflicts which is maintained by the Company Secretary.

## Board meetings

The table below shows the number of Board meetings held during the financial year ended 31 July 2015 and, opposite each director's name, the number of meetings they were eligible to attend and the number actually attended.

	Board meetings	
	Eligible to attend*	Attended*
Sir George Buckley (Chairman)	12	12
P. Bowman**	12	10
P.A. Turner***	9	9
B.F.J. Angelici†	12	11
D.J. Challen	12	12
T.D. Fratto†	12	11
A.C. Quinn	12	12
W.C. Seeger	12	12
Sir Kevin Tebbit	12	12

\*Includes two occasions where matters were conducted by written resolutions approved by all members of the Board

\*\*Mr Bowman did not attend two meetings: he did not attend a meeting at which his retirement from the Board and as Chief Executive was the only agenda item nor did he attend a subsequent meeting at which the appointment of his successor was the only agenda item

\*\*\*Mr Turner resigned on 24 April 2015

† Mr Angelici and Ms Fratto were each unable to attend non-scheduled meetings, called at short notice, due to prior commitments

Following Peter Turner's resignation on 24 April 2015, Rob White was appointed as Interim Chief Financial Officer and attended two Board meetings in that capacity during the remainder of the financial year. During the year, the Divisional General Managers, Heads of Corporate Departments and other external advisers were invited to attend certain Board meetings, as and when required.

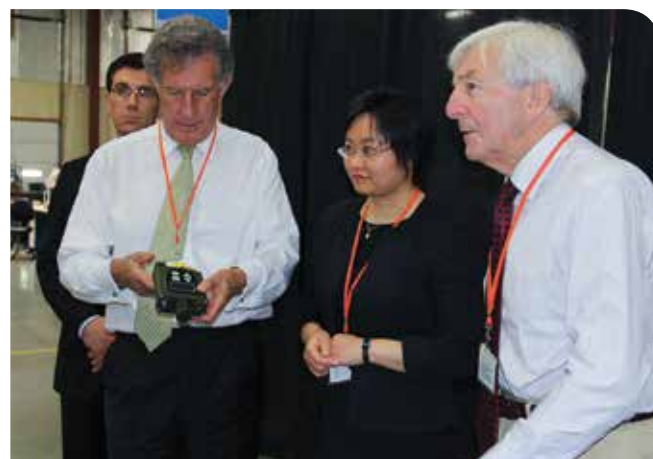
## Board visits

The Board regards attendance at meetings as only one measure of directors' contributions to the Company. In addition to formal Board meetings, the directors attend other meetings and make site visits during the year. For example, Bill Seeger completed more than 15 site visits in the USA and Europe as part of his induction programme and met employees and management from all five divisions and BIS, the Group's IT function. In November 2014 the Board met at the John Crane headquarters in Chicago, USA and in July 2015, the Board visited the Smiths Detection manufacturing facilities and offices in Edgewood, Maryland, USA.

## Induction, information and professional development

The Board is provided with detailed information up to a week in advance on matters to be considered at its meetings and non-executive directors have ready access to the executive directors and other senior corporate staff. Non-executive directors are also provided with information and updates between meetings. Regular site visits are arranged and non-executive directors are encouraged to visit sites independently. During site visits, briefings are arranged and the directors are free to discuss aspects of the business with employees at all levels.

Newly appointed directors undergo an induction programme to ensure that they have the necessary knowledge and understanding of the Company and its activities. They undertake briefing sessions on corporate governance, strategy, stakeholder issues, finance and risk management and HR, as well as meetings and site visits to business locations. Each director's individual experience and background is taken into account in developing a programme tailored to his or her own requirements. For example, Bill Seeger was well versed in the obligations of UK-listed companies by virtue of his recent experience as the Finance Director of GKN plc, so the focus of his induction was on getting to know the Smiths products, businesses and people. The Chairman consults with the directors on their respective training and development requirements. The suitability of external courses is kept under review by the Company Secretary who is charged with facilitating the induction of new directors and with assisting in the ongoing training and development of all directors.



**Board visit to Smiths Detection, Edgewood, USA**  
**As part of its 2014/15 programme of visits to the Group's businesses, the Board visited the head office and manufacturing facilities of Smiths Detection in Edgewood in July 2015.**  
**The visit included updates on strategy and performance from senior management, a tour of the facility and the opportunity to meet employees.**

## Corporate governance statement

### Continued

All directors have access to the advice and services of the Company Secretary and a procedure is in place for them to take independent professional advice at the Company's expense should this be required. Tailored induction programmes have been designed for Chris O'Shea and Andrew Reynolds Smith in order to ease their transitions into their new roles and to expedite their integration into the Group.

#### Performance evaluation

The Board undertakes an annual evaluation of its own performance and that of its committees and each director. In 2014 the Board evaluation was conducted by Ms Sheena Crane, an external consultant with whom the Company has no other connection. The results of the evaluation were presented to the Board in November 2014. Ms Crane's evaluation included interviews with Board members and covered such topics as strategy and the process of developing strategy; monitoring of financial and non-financial matters; risk management; Board balance and composition; succession planning; executive remuneration; and overall working efficiency of the Board. The presentation highlighted the need for closer alignment between the Chairman, the executive directors and other Board members on vision and strategy and a need for the Board to focus on succession; technology and innovation; and cyber-security. This has been borne in mind in preparing a framework of periodic agenda items which guides the drafting of the agendas for Board meetings. As our new Chief Executive will have joined the Board by the time of the next review and the last review was conducted at a time of change on the Board, this year's Board evaluation will again be externally facilitated.

The Board continued with its practice of setting itself a series of written objectives for the financial year. Those for the year ended 31 July 2015 included objectives relating to succession planning and to creating a vision for the Smiths of the future that builds on the drive and imagination shown by the Smiths of the past.

The current directorships in listed companies and other significant commitments of the Chairman and the non-executive directors are shown on pages 74 to 76. During the year, Bruno Angelici was appointed as Chairman of Vectura Group plc; Tanya Fratto retired from the board of Boart Longyear Ltd; and Bill Seeger was appointed as a non-executive director and Chairman of the Audit & Risk Committee of Spectris plc. It is confirmed that the Chairman and the non-executive directors have sufficient time to fulfil their commitments to the Company and that no executive director holds more than one non-executive directorship of another FTSE 100 company.

#### Relations with shareholders and other capital providers

##### Dialogue with shareholders

The Chief Executive, the Finance Director and the Director, Investor Relations communicate with institutional investors through analysts' briefings and extensive investor roadshows in the UK, US and continental Europe, as well as timely Stock Exchange announcements, meetings with management and site visits, as shown in the table below. Members of the Board, and in particular non-executive directors, are kept informed of investors' views, in the main through distribution of analysts' and brokers' briefings. At least twice a year a report is made to the Board on the number and types of meetings between the Company and institutional shareholders. The Board is confident that this process enables the non-executive directors to maintain a balanced understanding of the views and concerns of major shareholders. The Chairman held a number of calls and meetings with shareholders regarding the recruitment process for the new executive directors. It is expected the new Chief Executive and Finance Director will continue the dialogue with shareholders in the UK, US and continental Europe as part of the 2015/16 investor relations programme. The Chairman, the Senior Independent Director and the other non-executive directors are available to meet shareholders on request.

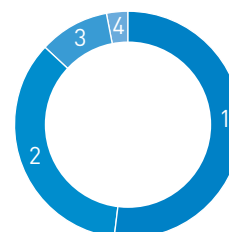
#### Investor relations activities timeline 2014/15

	Roadshows	Presentations
June 2015	US, Canada equity	
April 2015	UK equity & debt, France debt, Germany debt, Netherlands debt	
March 2015	UK, US equity	Interim results
December 2014	Private client brokers	
November 2014	Private client brokers	AGM
October 2014	UK, US, Canada, Germany equity	
September 2014	UK equity	Annual results

**During financial year 2014/15, senior management and the investor relations team had contact with over 300 analysts and investors.**

#### Contact with investors/analysts

- 1 United Kingdom 52%
- 2 US and Canada 35%
- 3 Rest of Europe 10%
- 4 Rest of World 3%



## Dialogue with other capital providers

The Company values the contribution of its committed lending banks and bond holders to the achievement of its strategic aims. The Finance Director and the Director, Tax and Treasury meet with and communicate pro-actively with this investor base and the rating agencies, Standard & Poor's and Moody's, on a regular basis and also on a formal, annual basis with the rating agencies. They communicate to the debt markets generally via investor roadshows at the time of financing activity. Committed banks are invited to the biannual presentations of its trading results and the Capital Markets Days to enable them to keep informed of business strategy and meet both senior corporate and divisional management. Members of the Board are kept informed of the current credit views of debt investors, generally, and the rating agencies, specifically, by regular commentary and financial metric reporting to meetings.

## Constructive use of the Company's Annual General Meeting ('AGM')

All directors normally attend the AGM and shareholders are invited to ask questions during the meeting and to meet directors after the formal proceedings have ended. The Board values the AGM as an opportunity to meet with those shareholders who are able to attend and to take their questions.

At the 2014 AGM all directors, including the Chairs of the Audit, Nomination and Remuneration Committees, were available to answer shareholders' questions. The notice of the AGM and related papers were sent to shareholders at least 20 working days before the meeting.

The 2015 AGM will be held on 17 November 2015 and is an opportunity for shareholders to vote on certain aspects of Group business in person. It is intended that there shall be a poll vote on each resolution at the 2015 AGM. The audited, final results of the poll votes will be released to the London Stock Exchange and published on the Company's website, [www.smiths.com](http://www.smiths.com), as soon as is practicable after the conclusion of the AGM.

## Accountability and audit

### Financial reporting

The Board is required to present a fair, balanced and understandable assessment of the Company's position and prospects in the Annual Report and in interim and other public reports. The directors are required to explain in the Annual Report the basis on which the Company both generates and preserves value over the longer term and its strategy for delivering the Company's objectives. The Board is satisfied that it has met these obligations in this Annual Report. A summary of the directors' responsibilities for the financial statements is set out on page 120.

The 'going concern' statement required by the Code is set out in the Group directors' report on page 113.

### Internal control

The Board is responsible for determining the nature and extent of the significant risks it is willing to take in achieving its particular objectives and ensuring that there are sound risk management and internal control systems in place to safeguard shareholders' investments and the Company's assets. The effectiveness of the internal control system is monitored periodically and formally reviewed at least annually by the Audit Committee, covering all material controls, including financial, operational and compliance controls and risk management systems. The Audit Committee carried out such a review during the year ended 31 July 2015.

The Company has in place internal control and risk management systems in relation to the Company's financial reporting process and the Group's process for preparation of consolidated accounts. These systems include policies and procedures that: pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect transactions and dispositions of assets; provide reasonable assurance that transactions are recorded as necessary to permit the preparation of financial statements in accordance with International Financial Reporting Standards ('IFRS'); require representatives of the businesses to certify that their reported information gives a true and fair view of the state of affairs of the business and its results for the period; and review and reconcile reported data. The Audit Committee is responsible for monitoring these internal control and risk management systems.

The Company's internal control is based on assessment of risk and a framework of control procedures to manage risks and to monitor compliance with procedures. The procedures for accountability and control are outlined below.

The Company's internal control systems are designed to meet the Company's particular needs and the risks to which it is exposed and, by their nature, can provide only reasonable, not absolute, assurance against material loss to the Company or material misstatement in the financial accounts.

The Group has an embedded process for the identification, evaluation and management of significant business risks. The process is reviewed through the Audit Committee and monitored by the Group Internal Audit department. The Company has during the year identified and evaluated the key risks and has ensured that effective controls and procedures are in place to manage these risks.

In the highly regulated environment of the industries in which the Company operates, procedures are codified in detailed operating procedures manuals and are reinforced by training programmes. These are designed to ensure compliance not only with the regulatory requirements but also with general principles of business integrity.

A key element in any system is communication: the executive directors and senior corporate staff meet regularly with representatives from the businesses to address financial, human resource, legal, risk management and other control issues.

Throughout the financial year the Board, through the Audit Committee, reviews the effectiveness of internal control and the management of risks. In addition to financial and business reports, the Board has reviewed medium- and longer-term strategic plans; management development programmes; reports on key operational issues; tax; treasury; risk management; insurance; legal matters; and Audit Committee reports, including internal and external auditors' reports.

## Audit Committee and auditors

The Audit Committee makes formal and transparent arrangements for considering how financial reporting and internal control principles are applied and for maintaining an appropriate relationship with the independent external auditors, PricewaterhouseCoopers LLP.

## Remuneration

Information regarding the Remuneration Committee is set out on page 93 and the Directors' remuneration report is on pages 94 to 111.

## Board Committees

The Company has established the Audit, Nomination and Remuneration Committees of the Board. Each such committee meets regularly in accordance with its respective terms of reference. Each committee's responsibilities, activities and membership are described below in this Corporate governance statement. The full terms of reference of the following Board committees are available upon request and on the Company's website, [www.smiths.com](http://www.smiths.com).

## Audit Committee

**Bill Seeger**  
Chairman of the Audit Committee



### Introduction from the Chairman of the Audit Committee

I am delighted to have assumed the role of Chairman of the Audit Committee this past year. I would particularly like to thank David Challen for his past ten years of leadership of the Committee, during which time he has skilfully guided us through significant changes in the Group's composition as well as numerous developments in financial and governance regulations.

During the year, the Committee has conducted a thorough review of its procedures and processes. As a result, a number of adjustments have been made in order to align them more closely with the requirements of the 2012 and 2014 editions of the UK Corporate Governance Code. A key change for 2015/16 will be the introduction of a fourth annual meeting of the Audit Committee which will bring together the risk reviews for all the Group's businesses into a single, focused session. This will be of particular benefit as the Board will be complying with the Corporate Governance Code requirement to explain its 'long-term viability' assessment of the Group in the 2016 Annual Report.

Throughout the year we have benefited from very productive relationships with our external auditor, the Internal Audit function and the Group's management. This year has seen a strengthening of the capabilities of the Internal Audit department, with enhanced internal resources and a reduced reliance on outsourcing. Internal Audit has also extended its remit to include the assessment of longer term programme management. The contributions of PwC, Internal Audit and Group senior management have all enhanced the effective operation of the Committee and its oversight of the Company's controls and risk management. In a business with the scale, diversity and geographical spread of Smiths Group, issues relating to internal financial and other risk controls, codes of conduct and ethical standards arise from time to time for review by the Committee. We are satisfied that the Group has systems in place to identify such issues promptly and that management has the appropriate processes and resources available to address them effectively.

The Committee has continued to review the changing rules and regulations regarding the external auditor and its own role in the governance of the Group audit. The Board has accepted the Committee's recommendation that the most practical and business-driven approach to our external auditor appointment would be to conduct a competitive tendering in 2019. This timeframe would coincide with the normal audit partner rotation and comply with the auditor rotation transition rules. Review of the independence and effectiveness of our external auditor will continue on an annual basis.

We look forward to working with our new executive directors, the management team and the auditors as we strive to achieve continuous improvement in our financial and risk controls and our high standards of corporate governance.

### Committee membership

The members of the Committee during the 2014/15 financial year were:

	Appointed/last re-appointment
W.C. Seeger (Chairman)	12 May 2014
B.F.J. Angelici	1 July 2013
D.J. Challen	21 September 2014
T.D. Fratto	1 July 2015
A.C. Quinn	1 August 2015
Sir Kevin Tebbit	12 July 2015

All members served on the Committee throughout the year. Mr Seeger took over Chairmanship of the Committee from Mr Challen after the AGM in November 2014.

All members of the Committee are independent non-executive directors and, in the view of the Board, have recent and relevant financial and accounting experience, gained from their respective business activities in international businesses. In particular, Bill Seeger was the Group Finance Director of GKN plc, which post he had held for over six years before his retirement in 2014. Further details of the qualifications and experience of the members of the Committee are contained in the biographies of the directors on pages 74 to 76.

There have been no changes to the membership of the Committee since the financial year-end.

### Meetings and attendance

The Committee met three times during the 2014/15 financial year, with the meetings timed to align with the financial reporting and audit cycles of the Company, namely: the approval of the Annual Report in September; the approval of the half-year report in March; and the presentation of the pre-year-end 'early warnings' report from the external auditor, PricewaterhouseCoopers LLP ('PwC'), in July. In view of the changes in corporate governance and financial reporting requirements, the Committee will add a fourth meeting to its schedule each year. The additional meeting will be held in May, with the existing schedule of meetings in September, March and July being retained to align with the Company's financial and reporting cycles.

The attendance record of the members of the Committee was:

	Attendance
W.C. Seeger (Chairman)	3/3
B.F.J. Angelici	3/3
D.J. Challen	3/3
T.D. Fratto	3/3
A.C. Quinn	3/3
Sir Kevin Tebbit	3/3



More information can be found at  
[www.smiths.com](http://www.smiths.com)

In order to maintain effective communications between all relevant parties, the following were frequent attendees at the meetings:

- the Chairman of the Board;
- the Group Finance Director;
- the Group Financial Controller;
- the Company Secretary;
- the Director of Internal Audit;
- the Group Director of Tax and Treasury; and
- the Group audit partners of the external auditor, PwC.

In addition, annual presentations on risk management were given to the Committee by the divisional general manager of each of the Group's five divisions and the head of Business Information Services ('BIS', the Group's IT function). The Senior Vice-President & General Counsel – Ethics & Compliance reported to the Committee on the implementation of the Business Ethics Programme; the work of the Company's Code Compliance Council; and the investigations into allegations of non-compliance with the Ethics Code, including issues raised through the Group's whistleblowing procedures.

At the conclusion of the meetings, the representatives of the external auditor and the Director of Internal Audit were each given the opportunity to discuss matters without executive management being present. The Director of Internal Audit, the Senior Vice-President & General Counsel – Ethics & Compliance and the external auditor have direct access to the Chairman and the members of the Committee should they wish to raise any concerns outside formal Committee meetings.

The members of the Committee also had the opportunity to meet separately at the end of each meeting to discuss any relevant matters in the absence of all the invitees.

The members of the Committee receive briefing notes from the Company and from PwC on all relevant developments in company law; governance standards; and international and domestic financial accounting practices and regulations.

All the members of the Committee attended the Annual General Meeting of the Company in November 2014.

Outside of the formal meetings schedule, the Chairman of the Audit Committee has met separately with the senior management of the Company, the representatives of PwC and the Director of Internal Audit to discuss the Company's financial reporting and governance.

### Role and responsibilities

The primary role of the Audit Committee is to ensure the integrity of the financial reporting and audit processes and the maintenance of sound internal control and risk management systems. This includes responsibility for monitoring and reviewing:

- integrity of the Group's financial statements; the significant reporting issues and judgements contained therein; and the reports of the external and internal auditors;
- the bases for the Board's statement on the adoption of the 'going concern' basis of accounting and its description of the information contained in the Annual Report as enabling a 'fair, balanced and understandable' assessment of the Group;
- financial announcements released by the Company and any reports or returns made by the Group to financial regulators;
- the appropriateness of the Group's relationship with the external auditor, including auditor independence and objectivity; auditor compliance with relevant ethical and professional standards and guidance; audit fees; and provision of non-audit services;
- the terms of engagement of the external auditor;
- the scope of the annual external audit plan and the quality and experience of the external audit team assigned to its execution;
- the reports of the external auditor, including any major issues or reservations and significant accounting and audit judgements highlighted therein;
- the effectiveness of the external audit process, making recommendations to the Board on the appointment or re-appointment or the removal of the external auditor;
- the remit and effectiveness of the internal audit function and the appropriateness of the resources available thereto;
- the effectiveness of the Group's policies on internal control and risk management systems in the evaluation and management of significant business risk;
- statements on the assessment and management of risks and on internal controls;
- the Group's implementation of the Company's Code of Business Ethics and Business Ethics Programme, including the Group's arrangements for its employees to raise any issues of concern and the process for the investigation and resolution of any such issues; and
- the Group's procedures for detecting fraud and systems and controls for preventing bribery.

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

Written terms of reference that define the Committee's authority and responsibility are available on our website at [www.smiths.com](http://www.smiths.com).

### Financial and narrative reporting

During the financial year, the Committee has:

- considered information presented by management on key matters of accounting judgements and policies, adopted in respect of the Company's 2014 Annual Report and 2015 half-year report, and relevant changes to accounting standards and agreed their appropriateness;
- discussed with PwC the firm's audit reports and noted the key accounting matters and significant judgements highlighted by PwC in respect of each set of financial statements;
- reviewed documentation prepared to support the statement on internal control in the 2014 Annual Report and was satisfied that the Company was operating an effective system of internal controls to manage risk;
- reviewed documentation prepared to support the going concern judgement in the 2014 Annual Report and concluded that the accounts had been properly prepared on a going concern basis;
- reviewed the processes and activities undertaken by the Group in order to ensure that the 2014 Annual Report, taken as a whole, would be '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 performance, business model and strategy;
- examined key points of disclosure and presentation to ensure the adequacy, clarity and completeness of the 2014 Annual Report and 2015 half-year report and the preliminary announcement of the annual results;
- reported to the Board its views on significant financial reporting issues and judgements applied to the 2014 Annual Report, the 2015 half-year report and the associated information releases (including matters communicated to the Committee by the external auditor);
- reviewed the bases for and the content of the Strategic Report, the operational review and the corporate governance statements contained in the 2014 Annual Report;
- satisfied itself that the 2014 Annual report was consistent within itself and that the 'front half' and the 'back half' of the publication were thoughtfully cohesive; and
- in addition to the press releases for the preliminary annual results for 2013/14 and the 2015 half-year results, reviewed the Company's press releases and announcements containing price-sensitive material and reports made to financial regulators during the year.

Subsequent to the end of the financial year, the Committee has also reviewed and reported to the Board on the reports and information supplied by management and by PwC on the judgements and policies adopted for the 2015 Annual Report and the content of that document. The Committee considered that the quality and range of the material included within the 2015 Annual Report was sufficient to provide shareholders with the necessary information for them to assess properly the Group's position, performance, business model and strategy and that the report was presented in such a way as could be considered 'fair, balanced and understandable'. This was considered to meet the requirements of the 2014 edition of the UK Corporate Governance Code (the 'new Code'), although the new Code does not apply to the 2015 Annual Report. The Committee approved the statement on internal controls and the going concern statement; and the content of the announcement of the financial results for 2014/15.

### **Corporate governance**

During the year, the Audit Committee has reviewed the Company's compliance with its governance obligations and its plans to comply with forthcoming changes thereto. In particular, the Committee has:

- monitored the changes introduced by the Company to ensure full compliance in the 2014 Annual Report with the requirements of the Companies Act 2006 [Strategic Report and Directors' Report] Regulations 2013; the 2012 edition of the UK Corporate Governance Code (the 'Code'); and The Large & Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013 – all of which also govern the 2015 Annual report;
- considered the amendments to and developments in the International Financial Reporting Standards that affected the 2014/15 financial year; and the proposals to replace the UK GAAP accounting framework;
- reviewed the procedural changes required to ensure full compliance in the 2016 Annual Report with the requirements of the new Code and the 'early adoption' of some of the changes in the 2015 Annual Report; and
- reviewed the implications of the Competition & Markets Authority's Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014 (the 'CMA Order').

In relation to the new Code, the Committee noted and approved the Company's plan to introduce the 'long-term viability' assessment and the detailed description of the strategies for managing and mitigating principal risks and threats in the 2015/16 financial year. Certain other changes introduced by the new Code have already been adopted by the Company and have been reflected in the 2015 Annual report.

The CMA Order will apply to the Company's 2015/16 financial year. Under the transitional provisions of the order, the competitive audit tendering regulations will require the Company to put the external auditor role out to tender by 2023. The Committee has decided not to recommend a competitive tender in the short term in order to enable the Company's next Chief Executive and recently appointed Finance Director the opportunity to fully acquaint themselves with the Group. The Committee took into account that the current audit engagement partner has had a full year in the role, in addition to his experience in shadowing the 2014 audit. The Committee's proposal for a competitive audit tender and auditor rotation is described in the External Auditor effectiveness and reappointment section below.

### **External audit**

In relation to the activities of the external auditor, during the financial year, the Committee:

- considered PwC's audit report on the 2014 Annual report; its review of the 2015 half-year results; and its 'Early Warning' report on the 2014/15 audit;
- monitored PwC's execution of the audit plans for 2013/14 and 2014/15;
- discussed all major 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;
- considered the draft letter of representation from the Company to PwC in connection with the audit of the 2013/14 financial statements;
- reviewed the non-audit fees paid to PwC and found them to have been incurred in accordance with the policy on the provision of non-audit services;
- conducted the annual review of the independence and objectivity of PwC and was satisfied that PwC's behaviour had been professional in both respects;
- determined that PwC remained effective in its role as external auditor; and
- recommended to the Board that PwC be proposed for re-appointment as external auditor at the 2014 AGM for a further year.

Subsequent to the financial year-end, the Committee has considered the same items in respect of the 2015 Annual Report and recommended that PwC be proposed for re-appointment as external auditor at the 2015 AGM.

The Committee considered that each of the Company's directors had taken all necessary steps to ensure that he or she was aware of all pertinent audit information and that such information had been properly communicated to PwC in a timely manner.

Martin Hodgson's five-year tenure as Group audit engagement leader and statutory auditor expired with the completion of the 2014 audit. The Committee met with Andy Kemp and approved his appointment as Martin Hodgson's successor. It also approved the transition plan proposed by PwC to manage the change in audit partner. Andy Kemp shadowed the 2014 Group audit and has taken over as Group audit engagement leader following the signing of the 2014 audit report.

### **External audit plan**

PwC presented its Group Audit Plan for the financial year ending 31 July 2015. The Committee discussed with PwC:

- its risk matrix and the factors affecting the various audit risk assessments; the proposed audit scope, taking into consideration statutory audit requirements, financially significant components and significant risk components and central programme testing;
- materiality levels;
- the testing of IT controls within the ERP environments in Detection, John Crane EMEA and Medical; and
- the impact of changes in governance regulations and professional standards.

The Committee noted the focus on the audit risks associated with revenue recognition; certain litigation risks; impairment of goodwill; and management override of controls. PwC's proposal to maintain the overall materiality level at £18m (approximately 3.5% of headline operating profit) and a de-minimis reporting threshold of £500,000 was accepted as prudent and appropriate. The Committee considered the resources proposed by PwC, including the qualities, seniorities and experience of the audit team members, to be consistent with the scope of the audit. It was noted that the Audit Plan had been discussed and co-ordinated with Internal Audit. Through a combination of full-scope audits, specified audit procedures and local GAAP statutory audits, business units producing 88% of the Group's forecast headline operating profit for 2014/15 would be audited by PwC under the 2015 Audit Plan.

The fee structure and terms of the audit engagement letter, which had been agreed with Smiths management, and PwC's assessment of its independence were considered appropriate for the work proposed and were approved.

### Non-audit services

In order to safeguard auditor independence, the Committee has monitored compliance with the Group policy on the engagement of external audit firms for non-audit work. Non-audit services are divided into three categories in relation to the incumbent external auditor:

- Pre-approved (but subject to the Group Finance Director's approval for projects likely to exceed £10,000) – where the threat to auditor objectivity and independence is considered low, such as regulatory compliance work and tax advisory work;
- Permitted (but subject to the approval of the Audit Committee for projects over £10,000 and competitive tendering for projects over £100,000) – such as larger acquisitions; corporate reorganisation; tax structuring; and IT risk and security;
- Not permitted – such as book keeping; financial system design; actuarial services; management functions; and internal audit.

The Committee recognises that non-audit services falling in the Pre-approved category can be purchased more cost-effectively from and completed more efficiently by the incumbent auditor due to the audit firm's existing knowledge of the Group and its systems. 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.

### External auditor independence

The Committee is responsible for the development, implementation and monitoring of the Company's policies on external audit which are designed to maintain the objectivity and independence of the external auditor. These policies also regulate the appointment by the Group of former employees of PwC and set out the approach to be taken when using the external auditor for non-audit work.

The external auditor is not permitted to provide services which could result in:

- the external auditor auditing its own firm's work;
- the external auditor making management decisions for the Group;
- a mutuality of interests being created; or
- the external auditor being put in the role of advocate for the Group.

The Committee's review of the independence of the external auditor 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 has so rotated following the conclusion of the 2014 audit);
- monitoring the ratio between the fees for audit work and non-audit services (17% in 2013/14); and
- checking that management confirmed compliance with the Group's policies on the employment of former employees of PwC and the use of PwC for non-audit work.

As a result of this review, the Committee concluded that PwC remained appropriately independent in the role of external auditor.

Details of the fees paid to PwC in 2014/15 can be found in note 2 to the 2015 Annual report. Non-audit fees incurred during 2014/15 amounted to £0.6m which related principally to M&A work and tax services. Non-audit fees as a percentage of audit fees totalled 12%. All such activities remained within the policy approved by the Board.

### External auditor effectiveness and reappointment

The Committee's review of the performance of PwC and the effectiveness of the external audit process included consideration of the views and opinions of the executive directors and senior management on PwC's effectiveness in a number of areas including independence and objectivity, audit strategy and planning, conduct and communication, audit findings and feedback, and expertise and resourcing. The Committee also considered the results of the survey, conducted by PwC's independent client perspective team (which is separate from the audit team), of 23 key contacts within the Company on the outcome of the 2013/14 Group audit and the results of the review meetings between PwC's independent senior partner and the Company's Chief Executive, Finance Director and Chairman of the Audit Committee. The results were positive and confirmed that both PwC and its audit process were appropriate and effective and that the relationships between the audit teams and the Company's businesses were strengthening. The Committee recognised the challenges in ensuring consistency in the audit process across the whole Group and the need to continue to improve communication at local and divisional levels.

The Committee received and considered the Independence Letters, sent by PwC in September 2014 in respect of its 2013/14 audit and September 2015 in respect of the 2014/15 audit, and concurred with PwC's opinion that it had complied with all relevant regulatory and professional requirements and that the firm's objectivity had not been compromised.

The Committee reviewed the findings in the Financial Reporting Council's May 2015 Audit Quality Inspection report on PwC. It evaluated a summary of PwC's internal quality control procedures and noted that the lead engagement partner, Andy Kemp, is accountable directly to the Committee for the execution of the audit. The Committee satisfied itself that the quality of the work exhibited by the firm and its commitment to improvements were of a sufficiently high standard.

The Committee considered the risk that PwC would withdraw from the audit market and found it acceptable in the short and medium terms.

PwC has been the Company's external auditor since its formation in 1998, although a predecessor organisation of PwC held office as sole auditor in 1997. In determining whether to recommend PwC for reappointment as auditor in 2015, the Committee took into consideration the following factors:

- the length of PwC's appointment and the guidance on the new audit firm rotation regulations and proposals;
- the results of the effectiveness review detailed above;
- the qualities and experience of the new audit partner (following the rotation of the previous audit partner whose five-year term expired at the completion of the 2013/14 audit), and
- the changes in the executive management team during 2014/15 and 2015/16, in particular the appointment of a new Finance Director who took up his post on 18 September 2015 and the recruitment of a new Chief Executive (who is expected to assume that position on 25 September 2015) and the appointments of a new Director of Internal Audit and a new Company Secretary.

Taking these elements into account and acknowledging that it would take around 18 months to stage a competitive audit tender from initial planning to final selection, the Committee concluded (a) that it would not be practical to put the auditor appointment for 2015 out to competitive tender at this stage and (b) 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 2015 AGM.

Recognising the various requirements in the Code, the CMA Order and the Department for Business, Innovation and Skills proposals to implement the EU's June 2014 Audit Directive and Regulation, the Committee concluded that it would be in the best interests of the Company to plan for a competitive audit tender for the rotation of the external auditor in 2019. This would coincide with the end of the current PwC audit partner's five-year term and enable the Company to plan its implementation of the final audit firm rotation regulations. Notwithstanding the recommendation for 2019, the Committee will keep the performance of the incumbent audit firm under annual review.

The Board has considered and adopted the Committee's recommendations to propose the reappointment of PwC as auditor in 2015 and to plan for a competitive audit tender and auditor rotation in 2019.

There are no contractual obligations restricting the Group's choice of external auditor.

### **Internal control and risk management**

In fulfilling its responsibilities, the Committee:

- reported to the Board on its evaluation of the Group's risk assurance framework and embedded risk management processes, based on consideration of the reports by PwC on the Group's control environment and ERP systems and on fraud risk; the audits undertaken by Internal Audit; and the risk management reports presented by and discussed with each of the divisions and BIS; and
- reviewed management's plans to mitigate and remedy the failings and weaknesses in the Company's internal financial and risk controls that were identified by PwC and Internal Audit and has monitored their effectiveness. The Committee did not view any of the issues that had been identified and addressed as significant.

The Board has reserved to itself responsibility for reviewing the effectiveness of the identification and management of risk at the Group level. Each division also presents an analysis of its own business strategic risks to the Board on an annual basis.

Further information on the Group's systems of internal control and risk management is given on page 85.

### **Internal audit**

During the financial year the Committee:

- received progress reports on the execution of the 2014/15 Internal Audit Plan (which comprised 55 site audits, one programme management review, two process reviews and one IT review);
- considered and approved management's candidate for the post of Director of Internal Audit (following the transfer of the previous incumbent to a senior role within the Group finance team);
- discussed the recommendations made by the internal auditors;
- noted the progress being made by management in reducing the numbers of aged outstanding recommendations;
- reviewed the effectiveness of Internal Audit as a part of the Company's risk management process, including its use of KPMG as an external contractor to provide additional resources and capabilities in certain overseas audit visits;
- considered the remit of Internal Audit, its budget and resources and the nature and extent of the outsourcing to KPMG; and
- approved the 2015/16 Internal Audit Plan (54 site visits, five programme management reviews, two process reviews and five IT reviews), including the proposed audit scope, approach, coverage and allocation of resources and the proposal to expand the number and quality of staff employed within Internal Audit.

### **Treasury and tax**

During the financial year, the Committee reviewed the report of the Treasury department of the Group on financial risk and treasury management, noting the Group's borrowing position and debt capacity. The extension of the Group's revolving credit facility to 2020, at no cost, was duly noted.

The Committee also received status reports on tax risk from the Group's Tax department, noting the assessments of compliance, tax audit risk, tax provisions and international tax rates. The Company's assessment of its appetite for tax risk was also reviewed.

### **Ethics**

During the financial year, the Committee reviewed the annual report on the Group-wide Ethics programme. The report included details of the investigations into allegations of non-compliance with the Ethics Code and whistleblowing events, including bribery and corruption investigations. It noted that a new communications programme had been introduced during 2014 and that further programmes were being developed in order to refresh and extend the scope of the training regime. The volume of complaints and reports received in 2014 was in line with the numbers recorded in 2011 and 2012 but represented a significant increase in comparison with the unusually low level of complaints filed in 2013. The year-on-year increase, in part at least, was considered to be indicative of the success of the communications programme in maintaining and developing the culture of ethical behaviour and compliance across the Group. The Committee commended the objective of the Ethics programme to promote high ethical standards across the Group world-wide rather than simply aiming to meet minimum legislation and regulatory requirements. The Committee considered that the Company's processes and arrangements for staff to report concerns about any improprieties were both appropriate and effective. The Committee also considered that the Company's investigation of such reports and consequential actions (where required) were timely and effective.

## Constitution and membership

During the year the Committee considered and approved changes to its terms of reference to reflect the changes contained in the new Code and CMA Order, which will apply to the Company's 2015/16 financial year.

During the year, the committee memberships of David Challen, Tanya Fratto, Anne Quinn and Sir Kevin Tebbit came up for review. After a rigorous review of their individual performances as members of and their history on the Committee (with each individual not participating in the discussion concerning their own performance), the Committee determined to recommend to the Nomination Committee to propose to the Board that Tanya Fratto and Anne Quinn should each be reappointed as a member of the Committee for a further three-year term. In the cases of David Challen and Sir Kevin Tebbit, both of whom had over nine years' service as non-executive directors of the Company but were still considered to be independent, the Committee recommended that each should be reappointed as a member of the Committee for a further year. It was noted that membership of the Committee would automatically lapse if a member ceased to be a director of the Company.

## Performance evaluation

An annual evaluation of the performance of the Committee is conducted as part of the annual evaluation of the performance of the Board. Details of the latest evaluation are given in the Corporate governance statement on page 84.

## Significant judgements and issues

An important responsibility of the Audit Committee is to review and agree the most significant management judgements and issues. To satisfy this responsibility, the Committee requests a written formal update from the Finance Director and Director of Tax and Treasury twice a year and requires regular reports from the external auditors at each Committee meeting. The Committee carefully considers the content of these reports and the most significant issues and areas of judgement raised. The key areas of judgement in the year were as follows:

### Revenue recognition

The Committee reviewed the key judgements on revenue recognition. Attention was given to large, multi-faceted and nonstandard contracts in Smiths Detection and to contracts where 'percentage of completion' accounting was used in Smiths Detection and Smiths Interconnect. The Committee reviewed the accounting treatment of four large programmes in Smiths Detection where management has assessed the portion of revenue to be attributed and the anticipated profit margin and concluded that the revenue judgments made were appropriate.

### Impairment

The Committee considered the Group's intangible assets and the assumptions used to justify the carrying values. Particular attention was given to Smiths Interconnect Power, Smiths Detection and Smiths Interconnect Microwave. The Committee also reviewed the 'fair value less costs to sell' for the Smiths Interconnect Microwave CGUs and Smiths Detection. The Committee also reviewed the carrying value of capitalised development assets for Smiths Medical and Smiths Detection. The Committee agreed that the projected future cash flows from these businesses and assets supported the carrying value and that the disclosures contained in the financial statements appropriately reflect the sensitivity of the judgements made. Details of impairment testing and sensitivities are included in note 12 of the financial statements.

The Committee considered the change in CGUs in Smiths Interconnect and the rationale for the division of Microwave from one CGU into three (Components, Telecoms and Sub-systems). The Committee agreed that the change in organisational and reporting structure that had led to the change in CGUs was correctly reflected.

## Working capital

The Committee considered the key judgements within working capital and in particular the level of provisions and overdue receivables in emerging markets. The Committee determined that the judgements made were appropriate to justify the working capital provision levels at 31 July 2015.

## Provisions for liabilities and charges

The Committee continued to monitor carefully the expert assessments of the financial exposure of the Group to the John Crane, Inc. asbestos litigation and to the Titeflex, Inc. CSST claims. The treatment of potential liabilities and the assumptions made in calculating the provisions were reviewed and determined fairly to reflect the position at 31 July 2015. Further details of the assumptions used are included in note 23 of the financial statements.

## Deferred taxation

The Committee assessed the appropriateness of the Group's assumptions and judgements in relation to the estimates of the assets and liabilities to be recognised in income and deferred tax as well as the treatment of losses in the UK. Particular focus was given to deferred tax assets relating to the John Crane, Inc. asbestos provision, the Titeflex CSST provision and Smiths Detection US. In reviewing projected profit streams the Committee was satisfied that the relevant entities will generate sufficient future profits to utilise those assets recognised. Further details on movements in tax balances are set out in note 7 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 2015 and the changes to US mortality assumptions on the pension liabilities. The Committee agreed the treatment and the corresponding disclosures on these matters. More detail on post-retirement benefits is contained in note 9 of the financial statements.

## Discharge of responsibilities

During the year, the Committee has monitored its discharge of responsibilities. In addition to the actions reported in the sections above, the Committee has:

- following the resignation of the Company's Finance Director in April 2015, considered the appointment of an Interim Chief Financial Officer and the appointment of a new Finance Director (with effect from 18 September 2015);
- monitored the process for the recruitment of a new Chief Executive who is expected to join the Company on 25 September 2015; and
- considered practical ways to improve the quality and clarity of the Company's reporting.

The Committee has enjoyed a constructive relationship with the Board throughout the year and has no contentious or unresolved issues to report.

## Advice

The Committee has independent access to the services of Internal Audit and to the external auditor and may obtain outside professional advice, at the expense of the Company, as it sees fit, in the performance of its duties.

## Nomination Committee

### Sir George Buckley Chairman of the Nomination Committee



#### Introduction from the Chairman of the Nomination Committee

The role of the Nomination Committee is to review the structure, size and composition of the Board and the Board committees and consider succession planning for directors and senior management, to ensure that the Company has the correct balance of skills, experience and knowledge to meet the changing needs of the Company. The Nomination Committee supports the Board with the review of the 'talent pipeline' for senior management roles. This is particularly important in a multi-industry global company with a five-division structure, where talented individuals in one division may not be personally known to the leadership team in another division.

During 2015 the Committee has overseen the implementation of some key initiatives which followed from the detailed review carried out in July 2014. These have focused on succession planning, especially in the context of the number of changes in the Executive Committee, the action needed to improve the bench strength and the initiatives to support our growth strategy, including increased focus on engineering talent, through the introduction of an Engineering Council, and Innovation Awards; recruitment for the new role of China President and other key positions in China; and the integrated approach to management training and the launch of the new global performance review system.

The primary focus of the Nomination Committee during the year has been succession of the Company's two executive directors and process for identifying potential candidates for the roles of Chief Executive and Finance Director. I am very pleased with the outcome of this which has resulted in the appointment of Andrew Reynolds Smith as our new Chief Executive and Chris O'Shea as our new Finance Director, both of whom join us during September 2015. As I stated in my introduction to this Governance statement, David Challen has informed the Board that he will be retiring at the conclusion of this year's AGM. An announcement of his replacement as the Senior Independent Director will be made in due course.

#### Meeting attendance

	Nomination Committee	
	Eligible to attend*	Attended*
Sir George Buckley (Chairman)**	3	2
B.F.J. Angelici	3	3
D.J. Challen	3	3
T.D. Fratto**	3	2
A.C. Quinn	3	3
W.C. Seeger	3	3
Sir Kevin Tebbit	3	3

\*includes occasions where matters were conducted by written resolutions approved by all Committee members

\*\*Sir George Buckley was unable to attend one Committee meeting due to the cancellation of a flight delaying his travel plans and Tanya Fratto was unable to attend a meeting called at short notice, due to prior commitments

➔ More information can be found at  
[www.smiths.com](http://www.smiths.com)

#### Committee membership

The Committee meets periodically, as and when required. During the financial year the members of the Committee were: Sir George Buckley (Chairman), Mr Angelici, Mr Challen, Ms Fratto, Ms Quinn, Mr Seeger and Sir Kevin Tebbit.

The Chief Executive is normally invited to attend the Nomination Committee. The HR Director, the Director of Talent and the Director of Reward have also attended these meetings in order to advise the Committee. External advisers may also be invited by the Committee to aid its deliberations.

#### Role and responsibilities

The Committee leads the process for identifying and makes recommendations to the Board regarding candidates for appointment as directors of the Company and as Company Secretary (and their removal or retirement), giving full consideration to succession planning and the leadership needs of the Group. It also makes recommendations to the Board on the composition of the Nomination Committee and the composition and chairmanship of the Audit and Remuneration Committees. It reviews the structure, size and composition of the Board, including the balance of skills, knowledge and experience and the independence of the non-executive directors, and makes recommendations to the Board with regard to any changes. The Board has continued with its practice of setting itself a series of written objectives for the financial year and those for the year ended 31 July 2015 included objectives relating to succession planning.

Following a recommendation by the Nomination Committee, Bill Seeger was appointed to the Board in May 2014 and subsequently replaced David Challen as the Chairman of the Audit Committee, in November 2014, as noted in more detail in the Audit Committee report.

The Chairman and the rest of the Board continue to support Lord Davies' aspiration for female board representation, but this presents a particular challenge for a small board. The resignation of Peter Turner in April 2015 meant that the proportion of women on the Board increased to 25% at the end of the financial year. However this ratio has returned to 22%, following the appointment on 18 September 2015 of Chris O'Shea as the new Finance Director. The Nomination Committee and the Board remain committed to ensuring diversity is included within the remit for appointments at all levels in the Company, but does not think it is appropriate to set specific Group-wide targets or objectives at this stage. Further information on diversity is provided in the Strategic report.

An annual evaluation of the performance of the Committee is conducted as part of the annual evaluation of the performance of the Board. The Board evaluation for the year ended 31 July 2014 was facilitated by Ms Sheena Crane, an external consultant. The Company has no other connections with Ms Crane. The results of the evaluation were presented to the Board in November 2014 and further details have been set out above. It was noted in the evaluation report that there was diversity of gender and of industrial and geographical background in the Company's Board.

During 2015 the Nomination Committee worked to find a replacement for Peter Turner as Finance Director of the Company and appointed Inzito, a leading search firm, to handle the search. The Company has no other connections with Inzito. The Nomination Committee worked with Inzito to produce a detailed specification for the role including the capabilities and attributes which were either required or desirable. These included the benefits to the Board of diversity in its widest sense (gender, nationality, age, experience, and background) and the particular skills which would benefit the Company as a multi-industry company operating in a global market. In April 2015, after an extensive search and interview process, which involved nearly every member of the Board, the Nomination Committee resolved to recommend to the Board the appointment of Chris O'Shea as Finance Director and as a member of the Board from 18 September 2015.

Also during 2015 the Nomination Committee worked to find a replacement for Philip Bowman as Chief Executive of the Company and appointed Egon Zehnder ('EZ') to handle the search. The Company has no other connections with EZ. Again, the Nomination Committee worked with EZ to produce a detailed specification for the role including the capabilities and attributes which were either required or desirable. These included the benefits to the Board of diversity and the particular skills referred to above of specific relevance to Smiths. In addition, the Committee felt that a professional background as an engineer would add significant value. After an extensive search and interview process the Nomination Committee, in July 2015, resolved to recommend to the Board the appointment of Andrew Reynolds Smith to succeed Mr Bowman as Chief Executive and as a member of the Board from 25 September 2015.

In July 2015 the Committee considered the appointment and re-appointment of certain members of the Audit, Remuneration and Nomination Committees and the appointment of the Chairs of those committees and recommended the appointment and reappointment of members and Chairs as set out in more detail in the relevant sections of this Statement. The Committee also carefully assessed the independence of each of the non-executive directors and concluded that all of them were independent notwithstanding in the cases of Mr Challen, the Senior Independent Director, and Sir Kevin Tebbit, that they had both served on the Board for more than nine years. The Committee and the Board each considered the matter carefully and decided that both these non-executive directors continue to demonstrate the qualities of independence and judgement in carrying out their roles, supporting the executive directors and senior management in an objective manner. In addition, based on the recommendation of the Nomination Committee, the Board resolved that Mr Challen should continue as Senior Independent Director until his retirement. Mr Challen has since notified the Board of his decision not to stand for re-election at the AGM but to retire from the Board after nearly eleven years' service. His replacement as Senior Independent Director will be announced in due course.

The Committee has access to such information and advice both from within the Group and externally, at the cost of the Company, as it deems necessary. This may include the appointment of external search consultants, where appropriate. The Committee reviews annually its terms of reference and effectiveness and recommends to the Board any changes required as a result of such review. The annual review of the Committee's terms of reference was conducted in July 2015 and certain changes were approved with effect from 1 August 2015.

In the coming year, when the new Chief Executive is in place, the Committee will conduct a review of senior management and succession plans with a view to ensuring a strong and robust plan exists in all parts of the Group.

## Remuneration Committee

**Anne Quinn, CBE**

**Chair of the Remuneration Committee**



### Introduction from the Chair of the Remuneration Committee

The responsibilities of the Remuneration Committee are to make recommendations to the Board on the Company's remuneration framework, giving full consideration to the matters set out in the Code. The Committee also agrees with the Board the policy for the remuneration of the Chairman, the Chief Executive, the Finance Director and senior management. The Committee sets the remuneration for these individuals within the agreed policy having regard to a number of factors, including their performance, remuneration across the Company and market positioning. The Committee takes note of the policies and trends in remuneration across the whole Group in relation to all levels of employees. Further information about the activities and focus of the Remuneration Committee during the year is set out in the Directors' remuneration report.

### Meeting attendance

	Remuneration Committee	
	Eligible to attend*	Attended*
A.C. Quinn (Chair)	7	7
B.F.J. Angelici	7	7
Sir George Buckley**	7	6
D.J. Challen	7	7
T.D. Fratto**	7	6
W.C. Seeger	7	7
Sir Kevin Tebbit	7	7

\*includes one occasion where matters were conducted by written resolutions approved by all Committee members

\*\*Sir George Buckley was unable to attend one Committee meeting due to the cancellation of a flight delaying his travel plans and Tanya Fratto was unable to attend a meeting called at short notice, due to prior commitments

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### Committee membership

The members of the Committee during the financial year were: Ms Quinn (Chair of the Committee), Mr Angelici, Sir George Buckley, Mr Challen, Ms Fratto, Mr Seeger and Sir Kevin Tebbit.

The Chief Executive is normally invited to attend Remuneration Committee meetings (except when his own remuneration is under discussion). The HR Director, the Director of Reward and Kepler Associates, the external remuneration adviser, have also attended meetings in order to advise the Committee, as and when required.

The Committee's activities are further described in the following Directors' remuneration report. The Committee reviews its terms of reference annually and recommends to the Board any changes required as a result of such review. The latest annual review of the Committee's terms of reference was conducted in July 2015.

# Directors' remuneration report

## Remuneration Committee

**Anne Quinn, CBE**

**Chair of the Remuneration Committee**



### Annual Statement

On behalf of the Board, I am pleased to present the report of the Remuneration Committee for the year to 31 July 2015. As last year, this report is split into three parts:

- this Annual Statement;
- a policy report, which presents the Group's forward-looking Directors' remuneration policy; and
- an Annual Report on Remuneration, which details how our remuneration policy was implemented during the year to 31 July 2015 and how we intend to apply our policy in the year to 31 July 2016.

The policy report includes a number of changes that are being proposed to simplify the Group's executive director remuneration arrangements and bring them into line with current best practice. The revised Policy is being put to a new binding shareholder vote at the AGM on 17 November 2015; the Annual Report on Remuneration will be put to an advisory vote at the same Meeting. The Remuneration Committee hopes that it can count on your support for both these resolutions.

### Summary of 2014/15

- **5% increase in headline EPS**
- **Strong cash conversion performance**
- **Remuneration decisions on cessation of employment for executive directors in line with remuneration policy**
- **Determination of recruitment packages for the new Chief Executive and Finance Director**
- **Proposed simplification of long-term incentives for 2015/16**

As highlighted by the Chairman and Chief Executive in their annual statements on pages 12 to 16 of this Annual Report, the markets remained challenging in the year to 31 July 2015. In this difficult economic climate, the Group saw a decline in revenue of 2% but a 5% increase in headline EPS. Cash conversion remained strong at 95% and ROCE, which improved to 16%, remains well ahead of the Group's weighted average cost of capital. Against this backdrop, annual bonus payouts are between target and maximum but the TSR and EPS elements of 2012 LTIP awards lapsed in full following the end of the performance period on 31 July 2015. The Group's cash conversion, however, warranted the full payout of that element of the annual bonus and a partial vesting of the LTIP. The matching award under the CIP vested based on our sustained ROCE performance. The Committee recognises the importance of close alignment of remuneration with Group performance, and we consider the incentive outcomes for this year (further details of which are disclosed in this year's Annual Report on Remuneration) to demonstrate this link appropriately.

As indicated last year, in 2015 the Committee reviewed the effectiveness of its long-term incentives in attracting, motivating and retaining our key talent. Following the initial conclusion of this review, we consulted shareholders about our intentions. Further consultation was then conducted on substantive changes to the long-term incentive arrangements for executive directors and relevant approvals will be sought at the AGM for these changes, which are supported by the significant majority of those shareholders we consulted.

During the year, the Committee also considered and agreed the implications on remuneration of Mr Bowman's retirement and Mr Turner's resignation. The Committee operated within the provisions of its Policy. Mr Turner resigned in October 2014 and, on leaving the Company in April 2015 following his contractual six months' notice period, all of his outstanding incentive awards lapsed. Mr Bowman signalled early in FY2015 his intention to retire from the Company in FY2016, to ensure an effective transition to his successor. He will retain his full interest in outstanding CIP and LTIP awards, which will vest on the normal vesting date to the extent warranted by performance at the end of the normal performance period. In addition, the Committee determined the packages for Mr Reynolds Smith and Mr O'Shea on their joining the Group. These are in line with both the Policy in force at the time of their joining, as well as the Policy proposed to take effect from the 2015 AGM, subject to shareholder approval being obtained at that meeting.

On behalf of the Board, I would like to thank shareholders for their continued support.

**Anne Quinn, CBE**

**Chair of the Remuneration Committee**

The Directors' remuneration report is presented to shareholders by the Board. The report complies with Regulation 11 and Schedule 8 of the Large and Medium-Sized Companies and Groups (Accounts and Reports) Regulations 2008 (the 'Regulations'). As required by the Regulations, the remuneration policy report will be put to a binding shareholder vote at the Annual General Meeting on 17 November 2015. The Annual Report on Remuneration (pages 102-111) will be put to a separate, advisory vote at the same Meeting. The Committee also continues to comply with the provisions of the UK Corporate Governance Code relating to directors' remuneration, except as disclosed in the Corporate governance statement on page 78.

## Remuneration policy report

### Summary of 2014/15

- **The proposed simplification of our executive director remuneration policy**
- **Malus and clawback provisions to be extended to cover all parts of executive director incentives**
- **Packages for new executive directors consistent with the Policy in force on their dates of joining Smiths, as well as that proposed for approval at the 2015 AGM**

This section of the report sets out a revised remuneration Policy for executive directors and non-executive directors. This Policy is subject to a binding vote at the 2015 AGM and, if approved at the AGM, will come into effect on that date. The policy will be put to shareholders again no later than the 2018 AGM. A summary of the key changes from the Policy approved at the 2014 AGM (and which has been in operation since that date) is set out in the notes to the future remuneration policy table.

### Future remuneration policy for the executive directors

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

Base salary			
<b>Element and link to strategy</b> To attract, motivate and retain executive directors with the required skills and expertise to deliver the Group's objectives.	<b>Operation</b> Salaries are reviewed (but not necessarily increased) 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 are typically effective 1 August.	<b>Opportunity</b> 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.	<b>Performance measures</b> Not applicable.
Pension			
<b>Element and link to strategy</b> Enables executive directors to save for their retirement in a cost-efficient manner.	<b>Operation</b> 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.	<b>Opportunity</b> 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.	<b>Performance measures</b> Not applicable.

## Annual bonus

### Element and link to strategy

Incentivises short-term cash management and profit growth, as well as annually defined non-financial goals.

### Operation

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.

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. 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 for performance in 2015/16 onwards 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.

### Opportunity

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 % payout then increases according to the level of achievement against targets.

### Performance measures

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 and cash measures.

## Long-Term Incentive Plan (LTIP)

### Element and link to strategy

Incentivises long-term value creation for shareholders, sustainable profit growth and effective management of the balance sheet.

### Operation

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 2015/16 onwards, vested shares may also be subject to a post vesting holding period. Details of any 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.

### Opportunity

The maximum LTIP award opportunity for executive directors is up to 400% of salary.

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.

### Performance measures

Based on measures of performance that are aligned with the Group's strategy.

For awards to be made in 2015/16, measures comprise revenue, earnings per share, return on capital employed and cash conversion.

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).

## Benefits

### Element and link to strategy

To provide market-competitive benefits to executive directors.

### Operation

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.

### Opportunity

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 (eg to facilitate recruitment, relocation, expatriation, etc.) or in circumstances where factors outside the Group's control have changed materially (eg market increases in insurance costs).

### Performance measures

Not applicable.

## Sharesave

### Element and link to strategy

Encourages ownership of shares in the Company and alignment with shareholder interests.

### Operation

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.

### Performance measures

Not applicable.

## Shareholding guidelines

### Element and link to strategy

Encourages ownership of shares in the company and alignment with shareholder interests.

### Operation

Executive directors must build a minimum shareholding of two times 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.

### Performance measures

Not applicable.

### Changes from the 2014 shareholder approved remuneration policy for executive directors

The changes from the previous Policy are as summarised in the table below:

Element	Proposed 2015 Policy	2014 Policy
<b>Annual bonus</b>	Mandatory deferral of at least 33% of earned bonus into shares for three years.  Malus/clawback provisions introduced on cash and deferred share bonuses for a period of 3 years from the end of the relevant performance year in case of misconduct or material misstatement in the published results of the Group.	Mandatory deferral of 50% of earned bonus into shares for three years (and with a matching opportunity under the CIP).  No malus/clawback provisions.
<b>Long-term incentives</b>		
Long-Term Incentive Plan	Maximum award opportunity: 400% of salary.  Performance period of at least three years.  Performance measures: revenue, EPS, return on capital employed and cash.  Flexibility to introduce a holding period in future years.	Maximum award opportunity: 300% of salary.  Performance period of three years.  Performance measures: TSR, EPS and cash.  No holding period.
Co-Investment Plan	Executive directors no longer eligible to participate in the Co-Investment Plan.	Deferred shares eligible for up to a 2-for-1 matching opportunity subject to three-year average return on capital employed exceeding WACC by at least 3%.
<b>Shareholding requirement</b>	All executive directors: 2x gross annual salary.	CEO: 2x gross annual salary.  Finance Director: 1.5x gross annual salary.

### 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 prevailing strategy. For 2015/16 awards, the LTIP measures will continue to reinforce the four key drivers of value creation highlighted elsewhere in this Annual Report: revenue growth, operating margin (which the Committee continues to advocate is best represented by EPS), cash conversion and ROCE.

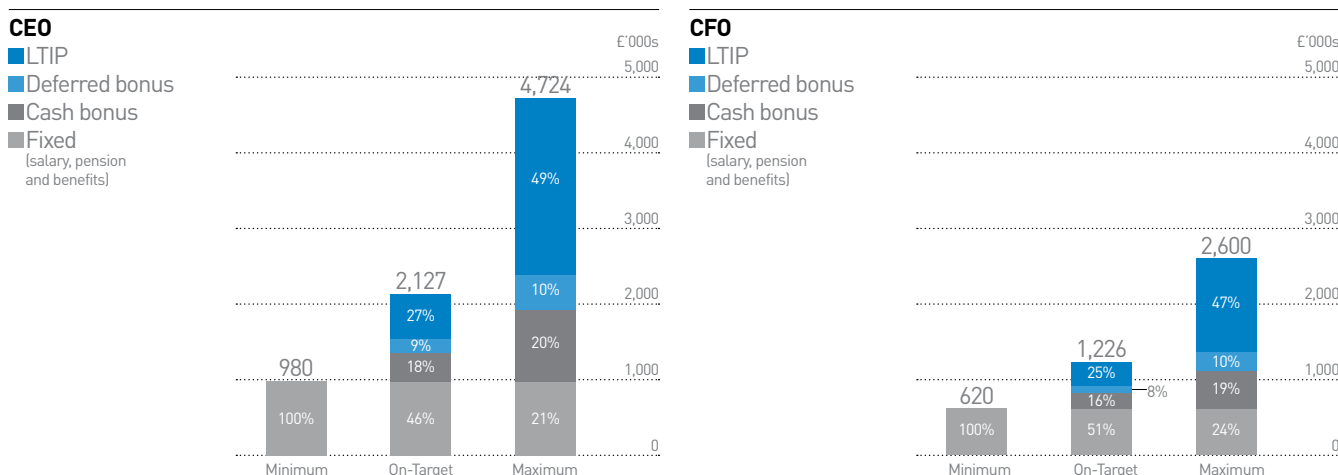
Annual bonus and LTIP targets are reviewed annually, and take into account the Company's strategic plan, analyst forecasts for Smiths and its sector comparators and external expectations for Smiths key markets. The Remuneration Committee sets targets that it considers to be challenging but attainable 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 strategy with incentives, targets are designed to ensure that participants are aligned with the interests of shareholders.

### Difference in policy between executive director 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 Remuneration 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 executive directors, and the potential mix between the different elements of remuneration under three different performance scenarios; 'Minimum', 'On-Target' and 'Maximum'.



Potential opportunities illustrated above are based on the Policy which will apply in the 2015/16 financial year, applied to the annualised base salary in force from the date of joining for Mr Reynolds Smith and Mr O'Shea. For the annual bonus, the amounts illustrated are those potentially receivable in respect of performance for 2015/16. 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 illustrations also exclude one-off arrangements made in relation to the recruitment of Mr Reynolds Smith and Mr O'Shea replicating outstanding awards they forfeited on joining Smiths. The following assumptions have been made in compiling the above charts:

CEO				CFO			
Base salary		Annual base salary		Base salary		Annual base salary	
Pension		Company pension allowance		Pension		Company pension allowance	
Other benefits		Taxable value of annual benefits provided		Other benefits		Taxable value of annual benefits provided	
Cash bonus	'Minimum'	'On-Target'	'Maximum'	Cash bonus	'Minimum'	'On-Target'	'Maximum'
	0% of salary (Minimum)	48% of salary (Target)	120% of salary (Maximum)		0% of salary (Minimum)	40% of salary (Target)	100% of salary (Maximum)
Deferred bonus	'Minimum'	'On-Target'	'Maximum'	Deferred bonus	'Minimum'	'On-Target'	'Maximum'
	0% of salary	24% of salary (Target)	60% of salary (Maximum)		0% of salary	20% of salary (Target)	50% of salary (Maximum)
LTIP	'Minimum'	'On-Target'	'Maximum'	LTIP	'Minimum'	'On-Target'	'Maximum'
	0% of salary (Minimum)	75% of salary (Threshold)	300% of salary (Maximum)		0% of salary (Minimum)	62.5% of salary (Threshold)	250% of salary (Maximum)

### 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. It is proposed that the annual fee may be paid in cash or a combination of cash and shares (2014: fees paid in cash):

Annual fee			
Element and link to strategy	Operation	Opportunity	Performance measures
To attract, motivate and retain non-executive directors with the required skills and expertise.	<p>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.</p> <p>Additional fees are paid to the chairs of the Remuneration, Nomination and Audit Committees and to the Senior Independent Director to reflect the additional time commitment of these roles.</p> <p>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 Chairman and executive directors.</p>	<p>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 £750,000, as approved by shareholders in 2006 in the Company's Articles of Association.</p> <p>Fee levels for the year under review and for the current year are disclosed in the Annual Report on Remuneration.</p>	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 are paid an attendance allowance for each overseas meeting attended in addition to the annual fee and are reimbursed for actual expenses incurred (transportation, hotels etc.).			

### Approach to recruitment remuneration

#### External appointments

The Remuneration 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:

External appointments	
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 proportion of year served. Maximum annual award opportunity: 180% of salary*.
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 Remuneration 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 Remuneration 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.

\*Annual bonus maximum shown is prior to mandatory deferral of at least 33% of earned bonus

## 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.

## 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 and 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 are available for viewing at the Company's Registered Office.

## Mr Bowman

Mr Bowman is employed under a service contract with the Company dated 15 November 2007 and effective from 10 December 2007. It may be terminated by 12 months' notice given by the Company or six months' notice given by Mr Bowman. Mr. Bowman gave more than his contractual six months' notice when he signalled his intention to retire in December 2014. He will be employed by the Company until 31 December 2015.

## Mr Reynolds Smith

Mr Reynolds Smith is employed under a service contract with the Company dated 6 July 2015 and effective from 25 September 2015. It may be terminated by 12 months' notice given by the Company or six months' notice given by Mr Reynolds Smith. The Company may elect to terminate the contract by making a payment in lieu of notice equal to Mr Reynolds Smith'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 Mr Reynolds Smith finds alternative employment during the notice period.

## Mr O'Shea

Mr O'Shea is employed under a service contract with the Company dated 30 April 2015 and effective from 18 September 2015. It may be terminated by 12 months' notice given by the Company or six months' notice given by Mr O'Shea. The Company may elect to terminate the contract by making a payment in lieu of notice equal to Mr O'Shea'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 Mr O'Shea finds alternative employment during the notice period.

## 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	Expiry of current term	Date of election/last re-election
B.F.J. Angelici	1 July 2010	2015	18 November 2014
Sir George Buckley	1 August 2013	2015	18 November 2014
D.J. Challen	21 September 2004	2015	18 November 2014
T.D. Fratto	1 July 2012	2015	18 November 2014
W. Seeger	12 May 2014	2015	18 November 2014
A.C. Quinn	1 August 2009	2015	18 November 2014
Sir Kevin Tebbit	14 June 2006	2015	18 November 2014

### **Leaving and change-of-control provisions**

For those individuals regarded as 'bad leavers' (eg voluntary resignation or dismissals for cause), annual bonus awards are forfeited, and outstanding matching awards under the CIP and outstanding awards under the LTIP automatically lapse.

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 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 judgment 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 external appointments where it considers that such appointments 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. Each year the Committee is provided with information on pay trends and ratios of the wider employee population across the Group.

### **Consideration of shareholder views**

The Committee has actively consulted with major shareholders whenever there have been changes to the remuneration policy in a manner that is 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 2015.

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### **Summary of 2014/15**

- **Remuneration arrangements for Mr Bowman on his retirement, consistent with 'good leaver' treatment in Policy**
- **Remuneration arrangements for Mr Turner on his leaving the Group, consistent with default treatment in Policy**
- **Remuneration packages for Mr Reynolds Smith and Mr O'Shea on their joining Smiths, consistent with Policy**
- **Buyout awards for Mr Reynolds Smith and Mr O'Shea calibrated to reflect fair value and structure of those forfeited**

### **Committee members and meeting attendance in 2014/15**

The members of the Committee are Anne Quinn, Sir George Buckley, David Challen, Sir Kevin Tebbitt, Bruno Angelici, Tanya Fratto and Bill Seeger. Their attendance at meetings held during the year are set out in the Corporate governance statement on page 93.

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 HR Director (who is also Secretary to the Committee), the Group Director of Reward, Kepler (the Committee's appointed independent remuneration adviser) and Freshfields Bruckhaus Deringer LLP.

The Company paid a total annual fee of £84,718 to Kepler in relation to remuneration advice to the Remuneration Committee during the year. Fees were determined on the basis of time and expenses. During FY2015, Kepler provided the Remuneration 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 Remuneration Committee via competitive tender in 2013. Kepler is a founding member of the Remuneration Consultants Group and a signatory to its Code of Conduct. Kepler does not provide any other material services to the Group, and the Committee is therefore satisfied that the advice provided by Kepler is objective and independent. Freshfields Bruckhaus Deringer LLP was appointed by the Company to advise the Group on various legal matters during the year.

### **Main activities during the year**

During the year under review, the Committee's main activities included:

- consideration of market trends and pay levels for executive directors and the Chairman;
- review of all senior executive salary and bonus payments;
- target setting for both the Annual Incentive Plan and Long-Term Incentive Plan;
- performance review of the executive directors against the targets for the financial year;
- determining remuneration arrangements for Mr Bowman and Mr Turner in relation to cessation of their employment;
- agreeing the packages and recruitment arrangements for Mr Reynolds Smith and Mr O'Shea; and
- other activities including consideration of the effectiveness of the incentive arrangements.

## Summary of shareholder binding vote on Directors' Remuneration Policy (2014)

The resulting voting outcome for last year's Directors' Remuneration Policy was as follows:

Votes for	% of votes cast for	Votes against	% of votes cast against	Total votes cast	Votes withheld (abstentions)
280,811,132	95.0%	14,877,828	5.0%	295,688,960	8,401,829

## Summary of shareholder advisory vote on Directors' Remuneration Report (2014)

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)
282,664,143	93.6%	19,249,494	6.4%	301,913,637	2,177,153

## Directors' single figure of annual remuneration (auditable)

### Executive directors

	Salary / fees		Benefits <sup>4</sup>		Annual bonus <sup>7</sup>		Long-term incentives <sup>8</sup>		Payments in lieu of pension contribution		Other <sup>9</sup>		Total	
	2015 £000	2014 £000	2015 £000	2014 £000	2015 £000	2014 £000	2015 £000	2014 £000	2015 £000	2014 £000	2015 £000	2014 £000	2015 £000	2014 £000
P. Bowman	860	840	32	31	1,239	643	1,920	2,039	361	353	-	6	4,412	3,912
P. A. Turner	302	400	1	1	-	223	-	702	75	100	-	-	378	1,426

### Chairman and non-executive directors

	Salary / fees		Benefits <sup>4</sup>		Annual bonus <sup>7</sup>		Long-term incentives <sup>8</sup>		Payments in lieu of pension contribution		Other		Total	
	2015 £000	2014 £000	2015 £000	2014 £000	2015 £000	2014 £000	2015 £000	2014 £000	2015 £000	2014 £000	2015 £000	2014 £000	2015 £000	2014 £000
Sir George Buckley <sup>1</sup>	410	340	134	40									544	380
D.H. Brydon <sup>2</sup>		95		16										111
D.J. Challen <sup>3</sup>	91	79											91	79
Sir Kevin Tebbit	74	63											74	63
A.C. Quinn <sup>4</sup>	91	79											91	79
B.F.J. Angelici	74	63	4	8									78	71
T.D. Fratto	77	63	54	22									131	85
W.C. Seeger <sup>5</sup>	89	14	64										153	14

<sup>1</sup> Sir George Buckley's fees for 2014 comprised his non-executive director's fee; an additional fee for being Deputy Chairman from his appointment to 19 November 2013; an additional fee for being Chairman from 19 November to 31 July 2014; and his additional fee for the Chairmanship of the Nomination Committee from 19 November 2013. His fees for 2015 comprised his non-executive director's fee; an additional fee for being Chairman and his additional fee for the Chairmanship of the Nomination Committee.

<sup>2</sup> Mr. Brydon's fees comprised his non-executive director's fee; his additional fee for being Chairman; and his additional fee for the Chairmanship of the Nomination Committee – all up to his retirement on 19 November 2013.

<sup>3</sup> Mr Challen waived his right to the fee payable to the Senior Independent Director but he did receive the fee paid for his Chairmanship of the Audit Committee, in addition to his non-executive director's fee.

<sup>4</sup> Ms Quinn's fees comprised her non-executive director's fee and her additional fee for Chairing the Remuneration Committee.

<sup>5</sup> Mr Seeger's fees for 2014 are for a part year, covering the period from his appointment on 12 May 2014 until the end of the financial year on 31 July 2014.

<sup>6</sup> Benefits for executive directors include car allowance, life assurance and private healthcare insurance. For the Chairman and non-executive directors, this value relates to reimbursed travel-related expenses.

<sup>7</sup> Mr Bowman and Mr Turner each deferred 50% of their net bonus earned into Smiths shares. The total bonus paid during the year, including deferral, is captured under 'annual bonus' above.

<sup>8</sup> Figure for 2015 has been valued using the three-month average share price to 31 July 2015 (£11.54) and includes the projected payouts from the 2012 CIP and 2012 LTIP awards. Figure for 2014 has been trued up (compared to last year's figure) to reflect the vest-date share price on 25 September 2014 of £12.55.

<sup>9</sup> Other includes amounts received from the Company's Sharesave Scheme for the Chief Executive.

## Directors' remuneration report

### Continued

#### Incentive outcomes for 2014/15

##### 2014/15 annual bonus outcome for Mr Bowman

The table below summarises the structure of the 2014/15 annual bonus, our performance and the resulting annual bonus payout for Mr Bowman.

Mr Turner was not eligible for an annual bonus for 2014/15.

Measure	Weighting	Performance level	Earned bonus		
			(% of max. bonus)	(% salary)	£000
Group EPS	50%	Just Below Target	66.1%	59.5%	512
Cash conversion	20%	At Maximum	100.0%	36.0%	310
Personal objectives	30%	Between Target and Maximum	90.0%	48.6%	417
Challenging personal objectives are derived from the Company's annual and strategic plans. For 2014/15, these targets included talent development and succession planning with an emphasis on building capability in the Sales, Commercial and Finance functions, implementing a new country organisation to bring higher rates of growth in China, bringing back stability and earnings growth to Detection, the <i>Engineered for Growth</i> programme, the strengthening of our CSR position including a focus on Ethics and Compliance.					
<b>Total</b>			<b>80.1%</b>	<b>144.1%</b>	<b>1,239</b>

2014/15 targets are not disclosed in this report as they are considered commercially sensitive by the Board, given the close link between performance targets and Smiths longer-term strategy. In addition, the Committee believes disclosing targets would put Smiths at a competitive disadvantage to its international and privately held competitors, which are not subject to similar disclosure requirements. The Committee will disclose targets at such a time as they will no longer be deemed to affect the commerciality of Smiths Group.

#### 2012 CIP outcome

Included in the 2015 'Long-term incentives' column of the executive director annual remuneration table above is the outcome of CIP awards granted in 2012. Matching awards granted under the CIP in 2012 were subject to the following performance condition:

Measure	Weighting	Performance period	Vesting schedule		Actual performance	
			ROCE performance	% match	ROCE	% match
Group ROCE	100%	1 August 2012 to 31 July 2015	< WACC+1% p.a.	0%	>WACC+3% p.a.	200%
			WACC+1% p.a.	100%		
			WACC+1% to 3% p.a.	100%		
			≥ WACC+3% p.a.	200%		

2012 CIP	Interests held	Vesting %	Interests vesting	Date of vesting	Market price <sup>1</sup>	Value £000
Mr Bowman	107,704	100%	107,704	Oct 2015	£11.54	1,243
Mr Turner	35,950	0%	0	n/a	£11.54	0

<sup>1</sup> Based on the average share price over the three months to 31 July 2015 of £11.54.

The CIP values carried in the 2015 long-term incentive element of the single figure table also include dividend equivalents of £178,315 for Mr Bowman in respect of the vested 2012 CIP shares.

Mr Turner's 2012 CIP matching award lapsed on his resignation from the Group.

## 2012 LTIP outcome

Also included in the 2015 'Long-term incentives' column of the executive director annual remuneration table above, is the outcome of the LTIP awards granted in 2012, details of which are summarised in the table below:

Measure	Weighting	Performance period	Vesting schedule		Actual performance	
			Performance	% vesting	Outturn	% vesting
Group EPS growth	50%	1 August 2012 to 31 July 2015	<6% p.a.	0%	< 6% p.a.	0%
			6% p.a.	12.5%		
			≥ 14% p.a.	50.0%		
			Straight-line vesting between these points			
Total Shareholder Return rank vs. FTSE 100 companies (excluding financial services)	30%	1 August 2012 to 31 July 2015	Below median	0%	Below median	0%
			Median	7.5%		
			Upper quartile or above	30.0%		
			Straight-line vesting between these points			
Average cash conversion	20%	1 August 2012 to 31 July 2015	< 85%	0%	96.7%	16.7%
			85%	5.0%		
			≥ 100%	20.0%		
			Straight-line vesting between these points			
<b>Total</b>						<b>16.7%</b>

2012 LTIP	Interests held	Vesting %	Interests vesting	Date of vesting	Market price <sup>1</sup>	Value £000
Mr Bowman	226,937	16.7%	37,823	Oct 2015	£11.54	436
Mr Turner	73,800	0%	0	n/a	£11.54	0

<sup>1</sup> Based on the average share price over the three months to 31 July 2015 of £11.54.

The 2012 LTIP values carried in the single figure table also include dividend equivalents of £62,620 for Mr Bowman in respect of the vested LTIP shares.

Mr Turner's award lapsed on the date of his leaving following his resignation from the Company.

## Directors' remuneration report

### Continued

#### Scheme interests awarded in 2014/15 (auditable)

##### 2014 LTIP

During the year ended 31 July 2015, the executive directors were awarded conditional share awards under the LTIP, details of which are summarised in the table below:

Executive	Form of award	Date of grant	Number of shares awarded	Award price <sup>1</sup>	Face value		
					£'000	% of salary	Date of vesting
Mr Bowman	Conditional shares	26 Sept 2014	200,796	£12.55	2,520	300%	26 Sept 2017
Mr Turner	Conditional shares	26 Sept 2014	63,745	£12.55	800	200%	26 Sept 2017

<sup>1</sup> The closing price on 25 September 2014.

The performance conditions attached to these 2014 LTIP awards are as follows:

Measure	Weighting	Performance period	Vesting schedule	
			Performance	% vesting
Group EPS growth	50%	1 August 2014 to 31 July 2017	< 4% p.a.	0%
			4% p.a.	12.5%
			≥ 12% p.a.	50.0%
			Straight-line vesting between these points	
Total Shareholder Return rank vs. FTSE 100 companies (excluding financial services)	30%	1 August 2014 to 31 July 2017	Below median	0%
			Median	7.5%
			Upper quartile or above	30.0%
			Straight-line vesting between these points	
Average cash conversion	20%	1 August 2014 to 31 July 2017	< 85%	0%
			85%	5.0%
			≥ 100%	20.0%
			Straight-line vesting between these points	

##### 2014 CIP

During the year ended 31 July 2015, the executive directors were also awarded conditional matching share awards under the CIP, set with reference to the annual bonus outcome for the year ended 31 July 2014. Details of these awards are summarised below:

Executive	Form of award	Date of grant	Number of shares awarded	Award price <sup>1</sup>	Face value		
					£'000	% of salary	Date of vesting
Mr Bowman	Conditional shares	26 Sept 2014	51,203	£12.55	643	76.5%	26 Sept 2017
Mr Turner	Conditional shares	26 Sept 2014	17,737	£12.55	223	55.7%	26 Sept 2017

<sup>1</sup> The closing price on 25 September 2014.

2014 CIP matching shares vest after three years, subject to the achievement of the following ROCE performance targets:

Measure	Weighting	Performance period	Vesting schedule	
			Performance	% vesting
Group ROCE	100%	1 August 2014 to 31 July 2017	< WACC+1% p.a.	0%
			WACC+1% p.a.	100%
			WACC+1% to 3% p.a.	100%
			≥ WACC+3% p.a.	200%

#### Percentage change in remuneration from 2013/14 to 2014/15

	Salary	Benefits	Bonus
CEO remuneration	2.4%	3.2%	92.7%
Average of all employees	2.6%	0%	32.9%

All employees is defined as the global senior management population of approximately 60 individuals who are eligible to participate in the same incentive arrangements (AIP, CIP and LTIP) as the Chief Executive.

### Relative importance of spend on pay

The table below shows shareholder distributions (ie dividends and share buybacks) and total employee pay expenditure for the financial years ended 31 July 2014 and 31 July 2015, and the percentage change.

	2015 £m	2014 <sup>1</sup> £m	Change
Shareholder distributions	160	275	(41.8)%
Employee costs	857	846	1.3%

<sup>1</sup> The decrease in shareholder distributions in 2015 reflects the payment of a special dividend that was made in 2014.

### Payments to past directors (auditable)

No payments have been made to past directors in the year.

### Payments for loss of office (auditable)

Peter Turner stepped down from the Board on 24 April 2015. Mr Turner's remuneration for the year under review is captured in the single figure table. He was not eligible for an annual bonus for the 2014/15 year, and all outstanding CIP and LTIP awards lapsed on cessation of employment. No other payments have, or will be, made in connection with Mr Turner's cessation of employment.

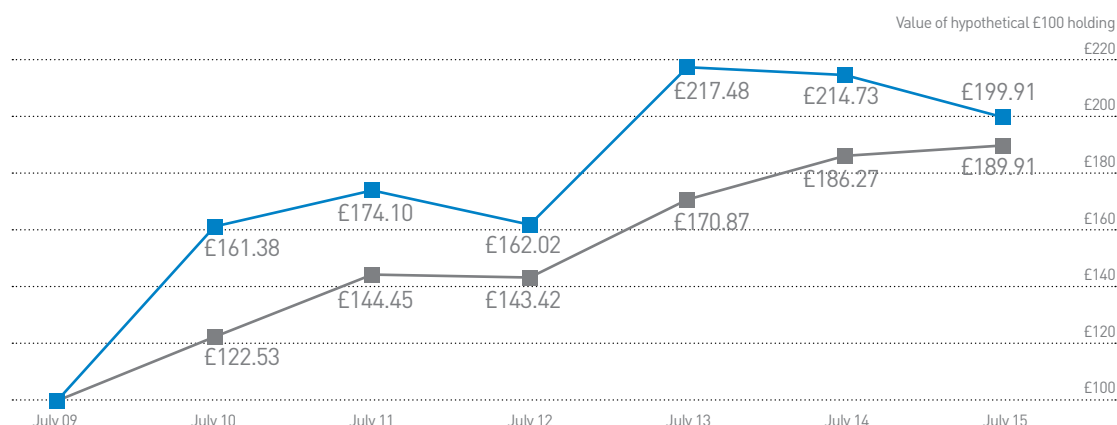
Philip Bowman will retire from the Board later in 2015. Mr Bowman's remuneration for the year under review is captured in the single figure table. Details of Mr Bowman's 2015/16 remuneration will be captured in next year's Annual Report on Remuneration. He will continue to receive salary and benefits (including pension allowance) until his retirement. He will be eligible for a pro-rata annual bonus for 2015/16 but he will not receive any further LTIP awards. The Committee will exercise its discretion not to time pro-rate his outstanding CIP and LTIP awards. These will vest on their normal vesting dates subject to the achievement of the original performance conditions over the relevant performance periods.

### TSR performance

The following graph shows the Company's total shareholder return (TSR) performance over the past six 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 were £189.91 and £199.91 respectively.

### Total shareholder return

— Smiths Group plc  
— FTSE 100



### CEO remuneration for the last six years

Year	2010	2011	2012	2013	2014	2015
CEO total remuneration £000	3,399	4,776	5,026	3,864	3,912	<b>4,412</b>
Annual bonus outcome (% max)	95%	64%	79%	39%	43%	<b>80%</b>
CIP outcome (% max)	n/a	100%	100%	100%	100%	<b>100%</b>
2007 PSP outcome (% max) <sup>1</sup>	46%	33%	n/a	n/a	n/a	<b>n/a</b>
2011 LTIP outcome (% max)					18%	<b>17%</b>

<sup>1</sup> The 2007 PSP outcome shown for 2010 represents the outcome under the EPS element of that award only (2/3 of the award). The 2007 PSP outcome shown for 2011 represents the outcome under the TSR element of that award (1/3 of the award) as TSR performance was measured over a three-year period commencing on the date of the grant.

Note: VSP outcome as a percentage of maximum is not shown in table above as award opportunity was uncapped. Awards received are included in the CEO total remuneration table above and the values are: £1,453,000 for 2011 (150,694 shares at a price of £9.64); £1,899,000 for 2012 (175,193 shares at a price of £10.84); and £364,000 for 2013 at (25,885 shares at a price of £14.06).

## Statement of implementation of remuneration policy in 2015/16

### Base salary and benefits

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 2015/16:

Executive director	2014/15	2015/16
P. Bowman	£860,000	£860,000
A. Reynolds Smith (from date of joining)	N/A	£780,000
C. O'Shea (from date of joining)	N/A	£495,000

### Pension and benefits

There is no change in the pension contribution rate for Mr Bowman for 2015/16. From their dates of joining, Mr Reynolds Smith and Mr O'Shea will each receive a cash allowance in lieu of pension of 25% of their base salaries.

### Annual bonus

For 2015/16, Mr Reynolds Smith will have a maximum bonus opportunity of 180% of salary and Mr O'Shea will have a maximum bonus opportunity of 150% of salary. Mr Bowman is eligible for a pro-rata annual bonus for 2015/16. Annual bonus measures (and their weightings) will remain unchanged from 2014/15. 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.

### Co-Investment Plan (CIP)

From 2015 CIP will no longer continue to operate for executive directors.

### 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 (from 2015/16 onwards) of up to 400% of salary. Under the LTIP, the normal annual grants are 300% of salary for the Chief Executive and 250% of salary for the Finance Director.

Mr Bowman will not receive an LTIP award in 2015/16. LTIP awards to be granted to Mr Reynolds Smith and Mr O'Shea in 2015/16 (at the normal annual grant levels of 300% and 250% of salary respectively) will vest on the achievement of the following performance conditions:

Performance measure	Weighting	Threshold performance target	Maximum performance target (full vesting of element)
3-year Revenue growth	30%	2% p.a.	5% p.a.
3-year EPS growth	30%	3% p.a.	12% p.a.
3-year average annual cash conversion	20%	85%	100%
3-year average return on capital employed	20%	15%	18%

For performance between 'threshold' and 'maximum', awards vest on a straight-line sliding scale.

### Buyout arrangements on recruitment for Mr Reynolds Smith and Mr O'Shea

In line with the approved Remuneration Policy, the Committee agreed that it was appropriate to broadly replicate the structure and fair value of annual bonus and unvested long-term incentive awards forfeited by Mr Reynolds Smith and Mr O'Shea as a consequence of their joining Smiths Group. Details of these awards are set out below:

#### Mr Reynolds Smith

On joining Smiths Group, Mr Reynolds Smith will receive:

- a one-off restricted share award over 86,693 Smiths Group shares, vesting 35% on 30 June 2016 and 65% on 30 June 2017
- a one-off performance share award over 133,010 Smiths Group shares, vesting 60% following the announcement of the Company's results for the 2017/18 financial year, 20% following the announcement of the Company's results for the 2018/19 financial year, and 20% following the announcement of the Company's results for the 2019/2020 financial year. Vesting of each tranche will be subject to satisfaction of the same performance conditions that apply to awards made under the Company's LTIP vesting at the same time.

Mr Reynolds Smith will also be entitled to a cash payment in early 2016, reflecting the actual reported outcome of the pro-rated 2015 annual bonus foregone in respect of his former employment.

#### Mr O'Shea

Mr O'Shea will receive a one-off restricted share award over 71,938 Smiths Group shares on his joining Smiths, vesting in equal instalments on the first and second anniversaries of his start date.

Mr O'Shea will also be entitled to a cash payment in early 2016, reflecting the actual reported outcome of the pro-rated 2015 annual bonus opportunity foregone in respect of his former employment.

## Non-executive director fees

NED fees paid for 2014/15 and to be paid in 2015/16 are shown below :

	2014/15	2015/16
NED base fee	£64,575	No change
Additional fee payable to the Chairman of the Board	£328,425	No change
Additional fee payable to the Senior Independent Director	£17,000	£20,000
Additional fees for Audit, Nomination and Remuneration Committee Chairs	£17,000	£20,000
Attendance allowance for meetings outside the NED's home continent	£3,000 per meeting	No change

## Share ownership guidelines

It is proposed that executive directors should, over time, acquire a shareholding with a value equal to at least two years' base salary. 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. There is no shareholding policy for non-executive directors.

## Directors' shareholdings (auditable)

The table below shows the shareholding of each director and for executive directors the shareholding against their respective shareholding requirement as at 31 July 2015.

	Shareholding requirement [% 2014/15 salary]	Shares owned outright	Shares subject to performance	Performance tested but unvested shares	Shares subject to CIP deferral	Save As You Earn (SAYE)	Current shareholding [% 2014/15 salary]	Guideline met
P. Bowman	200%	610,599	807,023	0	50,152	1,818	802%	Yes
P. A. Turner <sup>1</sup>	150%	87,605					243%	Yes
B. F. J. Angelici		2,000						
Sir George Buckley		0						
D. J. Challen		1,333						
T. D. Fratto		1,500						
A. C. Quinn		1,024						
W. C. Seeger		5,000						
Sir Kevin Tebbit		1,000						

<sup>1</sup> The shares owned outright is at the date that Mr Turner left the Company on 24 April 2015 and the value of his shareholding is based upon the share price on that date of £11.35.

There are no changes in the interests of the directors and their connected persons between 31 July 2015 and the date of this report.

## Share scheme dilution limits

The Company complies with the guidelines laid down by the Association of British Insurers. These restrict the issue of new shares under all the Company's share schemes in any 10-year period to 10% of the issued ordinary share capital and under the Company's discretionary schemes to 5% in any 10-year period. As at 31 July 2015, the headroom available under these limits was 7.06% and 2.60%, respectively.

## Auditable part

The directors' single figure of annual remuneration and accompanying notes on page 103; the scheme interests awarded in 2014/15 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 pages 110-111 have been audited.

The Directors' remuneration report has been approved by the Board and signed on its behalf by:

**A.C. Quinn**

22 September 2015

**Directors' remuneration report**  
**Continued**

**Directors' share options and long-term share plans (Auditable)**

Director and Plans	Options and awards held on 31 July 2015	Options and awards held on 31 July 2014	Option and award data					Awards vested 2014/15				
	Number	Number	Performance test	Exercise price	Grant date	Vesting date*	Expiry date**	Exercise/ vesting date	Number	Exercise price	Market price at date of grant#	Market price at date of exercise##
<b>P. Bowman</b>												
LTIP	0	137,661	A	n/a	16/12/11		25/09/14 †					
	0	82,596	B	n/a	16/12/11		25/09/14 †					
	0	55,064	C	n/a	16/12/11			25/09/14	49,588	n/a	893.50p	1276.68p
	113,469	113,469	A	n/a	19/10/12	Oct 2015	Oct 2015					
	68,081	68,081	B	n/a	19/10/12	Oct 2015	Oct 2015					
	45,387	45,387	C	n/a	19/10/12	Oct 2015	Oct 2015					
	89,235	89,235	A	n/a	19/09/13	Oct 2016	Oct 2016					
	53,541	53,541	B	n/a	19/09/13	Oct 2016	Oct 2016					
	35,694	35,694	C	n/a	19/09/13	Oct 2016	Oct 2016					
	100,398	0	A	n/a	26/09/14	Oct 2017	Oct 2017					
	60,239	0	B	n/a	26/09/14	Oct 2017	Oct 2017					
	40,159	0	C	n/a	26/09/14	Oct 2017	Oct 2017					
CIP	0	95,377	D	n/a	24/10/11			25/09/14	95,377	n/a	937.50p	1276.68p
	107,704	107,704	D	n/a	19/10/12	Oct 2015	Oct 2015					
	41,913	41,913	D	n/a	26/09/13	Oct 2016	Oct 2016					
	51,203	0	D	n/a	26/09/14	Oct 2017	Oct 2017					
SAYE	0	2,750		569.00p	21/05/09	01/08/14	01/02/15	01/08/14	2,750	569.00p	766.00p	1285.00p
	1,818	1,818		990.00p	14/05/14	01/08/17	01/02/18					
<b>P.A. Turner</b>												
LTIP	0	44,768	A	n/a	16/12/11		25/09/14 †					
	0	26,860	B	n/a	16/12/11		25/09/14 †					
	0	17,907	C	n/a	16/12/11			25/09/14	16,116	n/a	893.50p	1276.68p
	0	36,900	A	n/a	19/10/12		24/04/15 ◇					
	0	22,140	B	n/a	19/10/12		24/04/15 ◇					
	0	14,760	C	n/a	19/10/12		24/04/15 ◇					
	0	28,329	A	n/a	19/09/13		24/04/15 ◇					
	0	16,997	B	n/a	19/09/13		24/04/15 ◇					
	0	11,331	C	n/a	19/09/13		24/04/15 ◇					
The award over 63,745 shares granted to Mr Turner under LTIP on 26 September 2014 lapsed on his resignation.												
CIP	0	33,781	D	n/a	24/10/11			25/09/14	33,781	n/a	937.50p	1276.68p
	0	35,950	D	n/a	19/10/12		24/04/15 ◇					
	0	17,296	D	n/a	26/09/13		24/04/15 ◇					
The award over 17,737 shares granted to Mr Turner under CIP on 26 September 2014 lapsed on his resignation.												

## Key

LTIP	The Smiths Group Long-Term Incentive Plan
CIP	The Smiths Group Co-Investment Plan
SAYE	The Smiths Group Sharesave Scheme
*	The vesting dates shown above in respect of awards made under LTIP and CIP are subject to the relevant performance test(s) being passed.
**	The expiry dates shown above apply in normal circumstances. No expiry date is shown if the option or award was exercised or vested or lapsed prior to 22 September 2015.
#	Mid-market closing price of a Smiths share on the business day preceding the date of grant. The exercise price of an option under the SAYE is set at 20% less than the mid-market closing price of a Smiths share on the business day immediately preceding the day on which employees are invited to participate in the grant.
##	Actual sale price on date of option exercise or vesting of award.
†	Awards which lapsed during the period 1 August 2014 to 31 July 2015.
◇	Awards which lapsed following Mr Turner's resignation. He left the Company on 24 April 2015.

## Performance tests

A	LTIP Earnings Per Share (EPS) growth test
B	LTIP Total Shareholder Return (TSR) rank test
C	LTIP Cash Conversion test
D	CIP Return on Capital Employed (ROCE) test
–	There are no performance criteria for SAYE

## Notes

The high and low market prices of the ordinary shares during the period 1 August 2014 to 31 July 2015 were 1363p and 1006p respectively.

The mid-market closing price on 31 July 2014 was 1275p and on 31 July 2015 was 1129p.

The mid-market closing price of a Smiths share on the dates of awards made to directors in the 2014/15 financial year was 1247p (26 September 2014 for the LTIP and CIP Awards).

The option over 1,818 shares granted to and held by a director under SAYE at 31 July 2015 was granted at an exercise price below the market price of a Smiths Group share on 14 April 2015 (1124p). None of the options or awards listed above was subject to any payment on grant.

No other director held any options over the Company's shares during the period 1 August 2014 to 31 July 2015.

Other than the SAYE option which was exercised on 1 August 2014, no options or awards have been granted to or exercised by directors or have lapsed during the period 1 August to 22 September 2015.

At 31 July 2015 the trustee of the Employee Share Trust held 852 shares (none of the directors had an interest in these shares at 31 July 2015). The market value of the shares held by the trustee on 31 July 2015 was £9,619 and dividends of approximately £345 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, death, etc.

Smiths ROCE over the performance period for the 2011 CIP awards (1 August 2011 to 31 July 2014) exceeded the Company's weighted average costs of capital (WACC) over the period by more than 3% p.a. and accordingly, the 2011 CIP Awards vested in full. The notional gross dividends accrued in respect of the performance period amounted to 161.40p per share. This amount, after deduction of income tax and national insurance contributions, was paid in cash in respect of each share that vested.

Over the three-year period from 1 August 2011 to 31 July 2014, Smiths TSR performance and EPS performance did not result in the vesting of any shares under those elements of the 2011 LTIP awards. The Cash Conversion element of the awards partially vested (90%) which resulted in 49,558 shares vesting to the Chief Executive and 16,116 shares vesting to the Finance Director (the only directors to have participated in LTIP). All share awards under the TSR and EPS elements and the balance of the share awards under the Cash Conversion element lapsed.

# Group directors' report

## Results and dividends

The results for the financial year ended 31 July 2015 are set out in the Consolidated income statement. Revenues for the year amounted to £2,897m (2014: £2,952m). The profit for the year after taxation amounted to £248m (2014: £235m).

An interim dividend of 13p per ordinary share of 37.5p was paid on 24 April 2015. The directors recommend for payment on 20 November 2015 a final cash dividend of 28p on each ordinary share of 37.5p, making a total dividend of 41p for the financial year.

## Directors

Sir George Buckley; Messrs B.F.J. Angelici, P. Bowman, D.J. Challen, CBE, and W.C Seeger; Ms T.D. Fratto; Ms A.C. Quinn, CBE; and Sir Kevin Tebbit, KCB, CMG all served as directors of the Company throughout the year. Mr P.A. Turner resigned as a director of the Company on 24 April 2015. After the year-end, Mr C. O'Shea was appointed as an executive director on 18 September 2015 and it is expected that Mr A. Reynolds Smith will be appointed as an executive director on 25 September 2015. Mr Bowman is expected to resign as a director on 24 September 2015. Mr Challen has informed the Board of his intention to retire at the forthcoming AGM.

## Reappointment of directors

In accordance with the UK Corporate Governance Code, Sir George Buckley, Mr Angelici, Ms Fratto, Ms Quinn, Mr Seeger and Sir Kevin Tebbit will retire voluntarily from office at the AGM and will seek re-election. Mr O'Shea and Mr Reynolds Smith will retire at the AGM under Article 49 of the Company's Articles of Association, following their respective appointments during the year, and will seek election. Separate resolutions to re-elect or elect each of them as a director of the Company will be proposed at the AGM. Mr Bowman is expected to resign from the Board as mentioned above and Mr Challen intends to retire and not stand for re-election at the AGM. Biographical details of all the directors at the date of this report are set out on pages 74 to 76.

## Directors' remuneration report and policy

The Directors' remuneration report and the proposed Directors' remuneration policy are on pages 94 to 111.

Ordinary resolutions to approve the report and to adopt the policy will be put to shareholders at the AGM.

## Directors' interests in contracts

Details of the executive directors' service contracts are disclosed in the service contracts section of the Directors' remuneration report on page 101. Details of the interests of the executive directors in the Company's share option schemes and plans are shown in the Directors' remuneration report on pages 110 and 111.

Qualifying third-party indemnity provisions (as defined by section 234 of the Companies Act 2006 (the '2006 Act')) have remained in force for the directors of the Company and certain other employees in respect of their directorships of some subsidiary companies during the financial year ended 31 July 2015 and, at the date of this report, are in force for the benefit of the current directors and certain other employees who are directors 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 company, as applicable.

Apart from the exceptions referred to above, no director had an interest in any significant contract to which the Company or its subsidiaries was a party during the year.

## Changes in the Company and its interests during the financial year

On 22 April 2015, the Company sold the issued share capitals of Specac Limited and Specac, Inc. for an aggregate consideration of £2.3m in cash.

## Post balance sheet events

As mentioned, Mr C. O'Shea was appointed as the Finance Director on 18 September 2015; Mr A. Reynolds Smith is expected to be appointed as the Chief Executive on 25 September 2015; and Mr Bowman is expected to resign from the Board on 24 September 2015. The contractual arrangements relating to the appointments of Mr O'Shea and Mr Reynolds Smith and the retirement of Mr Bowman are described on page 101. There have been no other post-balance sheet events.

## Political donations

The Group made contributions to non-EU political parties totalling US\$68,000 (£44,000) during the year. 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 the interests of the Company. The Group has a number of key manufacturing sites and approximately 8,300 employees in the US.

## Interests in voting rights

As at 31 July 2015 the Company had been notified, pursuant to the FCA's Disclosure & Transparency Rules, of notifiable voting rights in its issued share capital or had received disclosures pursuant to the 2006 Act of shareholding interests in excess of 3% of its share capital, as follows:

	Number of shares	Percentage of issued ordinary share capital*	Date of notification or disclosure
Ameriprise Financial / Threadneedle Asset Management	19.4m	4.9%	22/07/2015
BlackRock Investment Management (UK) Ltd	20.0m	5.1%	14/08/2014
Dodge & Cox	20.3m	5.2%	26/11/2014
Harris Associates LP	29.3m	7.4%	15/08/2014
M&G Investment	15.7m	4.0%	15/08/2014
Massachusetts Financial Services Company	17.1m	4.3%	11/08/2014

During the period 1 August to 21 September 2015 the Company has received the following notifications or disclosures:

	Number of shares	Percentage of issued ordinary share capital**	Date of notification or disclosure
Ameriprise Financial / Threadneedle Asset Management	19.3m	4.9%	09/09/2015
BlackRock Investment Management (UK) Ltd	21.4m	5.4%	09/09/2015
Dodge & Cox	34.0m	8.6%	11/09/2015
Harris Associates LP	36.6m	9.3%	09/09/2015
M&G Investment	13.3m	3.4%	17/09/2015
Massachusetts Financial Services Company	17.5m	4.4%	09/09/2015
Morgan Stanley Investment Management Ltd	13.4m	3.4%	09/09/2015

\*Percentage of ordinary share capital in issue on 31 July 2015.

\*\*Percentage of ordinary share capital in issue on 21 September 2015.

Note: The Disclosure & Transparency Rules oblige shareholders to notify to a company when interests in the voting rights of that company's shares exceed or fall below 3% of the company's issued share capital and every whole percentage point above 3%. Where the voting rights in shares are managed by an investment manager under certain defined schemes, the manager is obliged to notify a company when its interests in the voting rights in the shares it manages under such schemes exceed or fall below 5% or 10% of the company's issued share capital.

The interests of the directors, their families and any connected persons in the issued share capital of the Company are shown in the Directors' remuneration report on page 109.

## Corporate responsibility

The Company has Group policies on environmental, employee and health & safety matters and operates a Code of Business Ethics. The Company seeks to minimise, as far as is reasonably practicable, any detrimental effects on the environment of its operations and products. The Group HR director has responsibility for environmental, health and safety matters, which are subject to preventative, investigatory and consultative systems, overseen by the Group Environment, Health and Safety Committee, and reports regularly to the Board on these matters. Issues relevant to the Company pension schemes are likewise covered by means of structured committees, including representation from recognised trade unions.

Further information on environmental, employee and health and safety matters, including key performance indicators, is contained in the Corporate responsibility summary on pages 67 to 71. The full Corporate responsibility report is available online at [www.smiths.com/responsibility](http://www.smiths.com/responsibility).

## Corporate governance statement

The Corporate governance statement is on pages 77 to 93 and is incorporated in this Directors' report by reference. PricewaterhouseCoopers LLP has reviewed the Company's statements as to compliance with the UK Corporate Governance Code, to the extent required by the UK Listing Authority Listing Rules. The results of its review are set out in the Independent auditors' report on pages 121 to 126.

## Strategic report

The statements and reviews on pages 2 to 71 comprise the Group Strategic report which contains certain information, outlined below, that is incorporated into this Directors' report by reference:

- an indication of the Group's likely future business developments;
- an indication of the Group's research and development activities;
- information on the Company's policies for the employment of disabled persons and employee involvement; and
- the Group's disclosures regarding greenhouse gas emissions.

## Branches

The Company does not operate through any branches. Some Group subsidiary companies have established branch operations outside the UK.

## Financial instruments

The financial risk management objectives and policies of the Group; the policy for hedging each major type of forecasted transaction for which hedge accounting is used; and the exposure of the Group to foreign exchange risk, interest rate risk, price risk, financial credit risk, liquidity risk and cash-flow risk is outlined in note 19 of the Group accounts.

## 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 on pages 2 to 71. The financial position of the Company, its cash-flows, liquidity position and borrowing facilities are described in the Financial review on pages 54 to 56. 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.

In April 2015 the Group issued €600m of new long term public debt securities with a maturity in 2023. The new issue has increased the average maturity of gross debt to 5 years (from 4.5 years at 31 July 2014).

At 31 July 2015 the net debt of the Group was £818m, unchanged on an underlying basis from 31 July 2014. At 31 July 2015 the Group had available cash and short-term deposits of £495m which include funds from the new debt issue initially earmarked for repayment of a £150m bond at its normal maturity date in June 2016. These liquid resources are immediately available with 99% invested with the Group's global banking partners.

The Group maintains a core US\$800m revolving credit facility with these banks which was undrawn at 31 July 2015. This committed facility matures in February 2020 and the Group has an option to extend to February 2021 exercisable in December 2015. This facility has certain financial covenants however they are not expected to prevent full utilisation at the Group's discretion if required. This financial position and debt maturity profile provides confidence that the Group has sufficient financial resources for the foreseeable future. As a consequence, the directors believe that the Company is well placed to manage its business and its liabilities as they fall due. In coming to this conclusion, the directors have taken account of the Group's risk management process, described on pages 60 to 66, and have paid particular attention to the financial and pension funding risks and their mitigation (see page 63).

The directors, having made appropriate enquiries, have a reasonable expectation that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future and for a period of at least twelve months from the date of this report. Thus they continue to adopt the going concern basis of accounting in preparing the annual accounts of the Company and the Group.

## Share capital and control

As at 31 July 2015, the Company's issued share capital was £148,082,502 and comprised 394,860,004 ordinary shares of 37.5p each nominal value (ordinary shares). The ordinary shares are listed on the London Stock Exchange. The Company has an American Depositary Receipt ('ADR') programme for which J.P. Morgan acts as Depositary and transfer agent. One ADR equates to one Smiths Group ordinary share which trade as a level 1 ADR over-the-counter programme under the ticker symbol SMGZY. At the year-end, 5,090,036 ordinary shares were held by the nominee of the programme depositary in respect of the same number of ADRs in issue at that time.

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.

There are no restrictions on transfer or limitations on the holding of any class of shares and no requirements for prior approval of any transfers. None of the shares carries any special rights with regard to control of the Company. There are no restrictions on the voting rights attaching to the ordinary shares (other than a 48 hour cut-off for the casting of proxy votes prior to a general meeting). There are no arrangements of which the directors are aware under which financial rights are held by a person other than the holder of the shares and no known agreements relating to or restrictions on share transfers or voting rights.

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 2015 the trust held 852 ordinary shares in the Company. The trust waived all but 0.1p per share of its dividend entitlement on its holding during the year: the trust abstains from voting the shares at general meetings.

The tables on page 112 set out the notifications received by the Company pursuant to the FCA's Disclosure & Transparency Rules and the 2006 Act, as at 31 July 2015 and any changes thereto up to 21 September 2015, from persons with significant direct or indirect holdings in the Company's share capital.

The rules about the appointment and replacement of directors are contained in the Company's Articles of Association and legislation in force from time to time. Changes to the Articles of Association must be approved by the shareholders in accordance with the legislation in force from time to time.

The powers of the directors are determined by English law and the Articles of Association of the Company in force from time to time. The directors have been authorised to issue and allot ordinary shares, pursuant to Article 5. The directors have authority to make market purchases of ordinary shares. The powers to issue and allot shares and, subject to specified limits, to allot shares on a non pre-emptive basis and on a pre-emptive basis, are referred to the shareholders at the AGM each year for renewal. At the AGM the shareholders are also requested to renew the power to make market purchases of ordinary shares. Any ordinary shares so purchased may be cancelled or held in treasury.

The Company has in place credit facility agreements under which a change in control would trigger prepayment clauses and 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. The Company's share plans (including the buy out awards being made to the new executive directors) 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. The Company is not party to any other significant agreements that would take effect, alter or terminate upon a change of control following a takeover.

If there is a change in control of the Company, the terms of Mr Bowman's service contract require that all available discretions will be exercised under the Company's share schemes and in default the Company must indemnify Mr Bowman for the value of any awards that do not vest on the change in control. Mr Bowman has tendered his resignation and will leave the Company's employ on 31 December 2015.

No other director or employee is contractually entitled to compensation for loss of office or employment as a result of a change in control except that provisions of the Company's share schemes may cause options and awards granted to employees under such schemes to vest on a change in control, in some cases subject to the satisfaction of performance conditions at that time.

#### **Purchase of own shares**

No shares in the Company were either purchased or acquired or charged or disposed of by the Company or any nominee of the Company during the financial year ended 31 July 2015.

#### **Electronic communications at [www.smiths.com](http://www.smiths.com)**

The 2006 Act recognises the growing importance of electronic communication ('e-communication') and enables companies to provide documentation and communications to shareholders via their websites, except to those shareholders who elect to receive hard (printed paper) copies by post. E-communication allows shareholders faster access to important information about the Company; saves the Company considerable overheads, by reducing its print production costs and postage; and helps the environment by saving the energy and raw materials that would otherwise be used in producing and dispatching printed documents. At the Extraordinary General Meeting held on 11 June 2007 shareholders approved the adoption of electronic communications.

Electronic copies of the Annual Report 2015 and the Notice of AGM will be posted on the Company's website, [www.smiths.com](http://www.smiths.com). The Company's announcements to the Stock Exchange and press releases are available online through the website. Shareholding details and practical help on share transfers and changes of address can be found at [www.shareview.co.uk](http://www.shareview.co.uk).

Shareholders wishing to change their election and receive documents in hard copy form can do so at any time by contacting the Company's Registrar or by logging on to [www.shareview.co.uk](http://www.shareview.co.uk).

#### **Annual General Meeting ('AGM')**

The 2015 AGM will be held on Tuesday 17 November 2015 at 10.30 am. The Notice of the AGM will be published on the Company's website, [www.smiths.com](http://www.smiths.com), on or around 15 October 2015.

#### **Remuneration policy**

At the AGM shareholders will be asked to approve the Directors' remuneration policy (2015), as shown on pages 95 to 102, which gives details of the remuneration policy being proposed by the Remuneration Committee for the executive directors, the Chairman and the non-executive directors. Under the regulations which now form part of the 2006 Act, the remuneration policy must be put to a binding shareholder vote at least once every three years. Shareholders will be invited to approve the Directors' remuneration policy (2015) at the AGM. If so approved, the policy will take effect at the conclusion of the meeting. Once effective, all future payments to former and current directors must comply with the terms of the policy, unless specifically approved by shareholders in general meeting.

#### **Authority to issue shares**

At the AGM shareholders will be asked to renew and extend the authority, given to the directors at the last AGM, to allot shares in the Company, or grant rights to subscribe for, or to convert any security into, shares in the Company for the purposes of Section 551 of the 2006 Act (the 'Allotment Resolution').

The authority in the first part of the Allotment Resolution will allow the directors to allot new shares in the Company or to grant rights to subscribe for or convert any security into shares in the Company up to a nominal value which is equivalent to approximately one-third of the total issued ordinary share capital of the Company as at the latest practical date prior to the publication of the Notice of AGM.

The authority in the second part of the Allotment Resolution will allow the directors to allot new shares or to grant rights to subscribe for or convert any security into shares in the Company only in connection with a rights issue up to a nominal value which is equivalent to approximately one-third of the total issued ordinary share capital of the Company as at the latest practical date prior to the publication of the Notice of AGM. This is in line with corporate governance guidelines. The Board has undertaken to seek the re-election of each director annually by the shareholders, whether or not this authority were to be used.

At 21 September 2015, the Company did not hold any shares in treasury.

There are no present plans to undertake a rights issue or to allot new shares other than in connection with the Company's share option schemes and plans. The directors intend to take note of relevant corporate governance guidelines on the use of such powers in the event that the authority is exercised.

If the Allotment Resolution is passed the authority will expire on the earlier of 31 January 2017 and the end of the next AGM, due to be held in 2016.

Also at the AGM shareholders will be asked to pass a special resolution to renew the power granted to directors to disapply shareholders' pre-emption rights under certain circumstances (the 'Pre-emption Resolution').

If the directors wish to allot new shares and other equity securities, or sell treasury shares, for cash (other than in connection with an employee share scheme) company law requires that these shares are offered first to shareholders in proportion to their existing holdings. There may be occasions, however, when the directors need the flexibility to finance business opportunities by the issue of shares without a pre-emptive offer to existing shareholders. This cannot be done under the 2006 Act unless the shareholders have first waived their pre-emption rights.

The purpose of the first part of the Pre-emption Resolution is to authorise the directors to allot new shares, pursuant to the authority given by the first part of the Allotment Resolution, or to sell treasury shares for cash:

- a) in connection with a pre-emptive offer; and/or
- b) otherwise up to a nominal value equivalent to 10% of the total issued ordinary share capital of the Company as at the latest practical date prior to the publication of the Notice of AGM,

in each case without the shares first being offered to existing shareholders in proportion to their existing holdings.

The Board intends to adhere to the provisions in the Pre-emption Group's Statement of Principles, as updated in March 2015, and not to allot shares for cash on a non-pre-emptive basis pursuant to the authority in Pre-emption Resolution:

- in excess of an amount equal to 5% of the total issued ordinary share capital of the Company (excluding treasury shares); or
- in excess of an amount equal to 7.5% of the total issued ordinary share capital of the Company (excluding treasury shares) within a rolling three-year period, without prior consultation with shareholders,

in each case other than in connection with an acquisition or specified capital investment which is announced contemporaneously with the allotment or which has taken place in the preceding six-month period and is disclosed in the announcement of the allotment.

The purpose of the second part of the Pre-emption Resolution is to authorise the directors to allot new shares, pursuant to the authority given by the second part of the Allotment Resolution, or to sell treasury shares for cash in connection with a rights issue, without the shares first being offered to existing shareholders in proportion to their existing holdings. This is to allow the Directors to make exclusions or such other arrangements as may be appropriate to resolve legal or practical problems which, for example, might arise with overseas shareholders. This is in line with corporate governance guidelines.

If the Pre-emption resolution is passed the authority will expire on the earlier of 31 January 2017 and the end of the next AGM, due to be held in 2016.

During the financial year ended 31 July 2015, the following ordinary shares in the Company were issued:

- 403,869 ordinary shares of 37.5p pursuant to the terms of the Company's shareholder-approved share option schemes and share plans.

### Authority to purchase own shares

At the AGM the Company will seek to renew the authority, granted at the last AGM to the directors, to purchase the Company's ordinary shares in the market.

The effect of the resolution is to renew the authority granted to the Company to purchase its own ordinary shares until the next AGM (due to be held in 2016) or 31 January 2017 whichever is the earlier. This authority is limited to 10% of the ordinary shares in issue as at the latest practical date prior to the publication of the Notice of AGM and the Company's exercise of this authority is subject to the stated upper and lower limits on the price payable, which reflect the requirements of the Listing Rules.

Pursuant to the 2006 Act, the Company can hold the shares which have been purchased as treasury shares and either resell them for cash, cancel them, either immediately or at a point in the future, or use them for the purposes of its employee share schemes. The directors believe that it is desirable for the Company to have this choice as holding the purchased shares as treasury shares would give the Company the ability to resell or transfer them in the future, and so provide the Company with additional flexibility in the management of its capital base. No dividends will be paid on, and no voting rights will be exercised in respect of, treasury shares. However, it is not the Company's present intention to hold shares in treasury in the event that any shares were to be purchased under this authority.

Shares will only be purchased if the directors consider such purchases to be in the best interests of shareholders generally and that they can be expected to result in an increase in earnings per share. The authority will only be used after careful consideration, taking into account market conditions prevailing at the time, other investment opportunities, appropriate gearing levels and the overall financial position of the Company. Shares held as treasury shares will not automatically be cancelled and will not be taken into account in future calculations of earnings per share (unless they are subsequently resold or transferred out of treasury).

If any shares purchased by the Company are held in treasury and used for the purposes of its employee share schemes, the Company will count those shares towards the limits on the number of new shares which may be issued under such schemes.

### Political donations

A resolution will be proposed at the AGM to renew the authority, granted by the shareholders at the last AGM to the Company and its UK subsidiaries, to make donations to political organisations and to incur political expenditure.

Part 14 of the 2006 Act requires companies to obtain shareholders' authority for donations to registered political parties and other political organisations in the EU totalling more than £5,000 in any twelve-month period, and for any political expenditure in the EU, subject to limited exceptions. The definition of donation in this context is very wide and extends to bodies such as those concerned with policy review, law reform and the representation of the business community. It could include special interest groups, such as those involved with the environment, which the Company and its UK subsidiaries might wish to support, even though these activities are not designed to support or influence support for a particular political party.

It is the policy of the Company not to make political donations or incur political expenditure in the EU, as those expressions are normally understood. To avoid inadvertent infringement of the 2006 Act, the directors are seeking shareholders' authority for the Company and its UK subsidiaries to make political donations (as defined in the 2006 Act) and to incur political expenditure (as defined in the 2006 Act) for the period from the date of the AGM to the conclusion of next year's AGM up to a maximum aggregate amount of £50,000.

### Auditors

Resolutions will be proposed at the AGM to reappoint PricewaterhouseCoopers LLP as independent auditors, to hold office until the next meeting at which the accounts are laid, and to authorise the directors to determine the auditors' remuneration. Further information on the process for recommending the appointment of auditors is contained in the Audit Committee report on pages 89 and 90.

**Disclosure table pursuant to Listing Rule LR9.8.4C**

Listing Rule	Information to be included	Disclosure
9.8.4(1)	Interest capitalised by the Group	£1.9m interest was capitalised as part of the costs of development projects. £0.6 m of tax relief has been recognised as current tax relief in the period.
9.8.4(2)	Unaudited financial information (LR9.2.18)	The supplementary US dollar financial statements on pages 175 to 179 The Group financial record 2011-2015 on page 174
9.8.4(4)	Long-term incentive scheme only involving a director (LR9.4.3)	None (Note: the terms of the contracts with Chris O'Shea, who was appointed as Finance Director on 18 September 2015, and Andrew Reynolds Smith who is expected to be appointed as Chief Executive on 25 September 2015, are described on page 101)
9.8.4(5)	Directors' waivers of emoluments	Mr David Challen waived the portion of the fee payable to him as the Senior Independent Director during the part of the year he was Chairman of the Audit Committee but received a pro-rated part of the fee for the balance of the year (during which he continued to be the Senior Independent Director). (Mr Challen's fee for chairing the Audit Committee was pro-rated to the time he held that office.)
9.8.4(6)	Directors' waivers of future emoluments	None
9.8.4(7)	Non pro-rata allotments for cash (issuer)	Shares have been issued and allotted pursuant to the exercise of options awarded under shareholder-approved schemes
9.8.4(8)	Non pro-rata allotments for cash (major subsidiaries)	None
9.8.4(9)	Listed company is a subsidiary of another company	Not applicable
9.8.4(10)	Contracts of significance involving a director	None
9.8.4(11)	Contracts of significance involving a controlling shareholder	Not applicable
9.8.4(12)	Waivers of dividends	(1) Wealth Nominees Limited WAIVED a/c (per pro the Smiths Industries Employee Share Trust) waived all the dividends payable in the year except for 85p (being 0.1p per share) on its holding of 852 shares; and (2) Reuter File Limited waived its dividends in full (on 2 shares).
9.8.4(13)	Waivers of future dividends	(1) Wealth Nominees Limited WAIVED a/c (full waiver) (2) Reuter File Limited (full waiver)
9.8.4(14)	Agreement with a controlling shareholder LR9.2.2AR(2)(a)	Not applicable

**Additional information pursuant to LR9.8.6**

Listing Rule	Information to be included	Disclosure
9.8.6(1)	Directors' (and their connected persons') interests in Smiths shares at year-end and at not more than one month prior to date of the Notice of AGM	See page 109 above
9.8.6(2)	Interests in Smiths shares disclosed under DTR5 at year-end and not more than one month prior to date of the Notice of AGM	See page 112 above
9.8.6(3)	The going concern statement	See page 113 above
9.8.6(4)(a)	Amount of the authority to purchase own shares available at year-end	Authority available in full at year-end
9.8.6(4)(b)	Off-market purchases of own shares during the year	None
9.8.6(4)(c)	Off-market purchases of own shares post year-end	None
9.8.6(4)(d)	Non pro-rata sales of treasury shares during the year	None
9.8.6(5)	Compliance with the Main Principles of the UK Corporate Governance Code	See the Corporate governance statement on page 78
9.8.6(6)(b)	Details of non-compliance with UK Corporate Governance Code	See the Corporate governance statement on page 78
9.8.6(7)	Re directors proposed for re-election: the unexpired term of any director's service contract and a statement about directors with no service contracts	Details of the executive directors' service contracts are given in the Directors' remuneration report on page 101 The Chairman and the non-executive directors serve under letters of appointment – see page 101.

### Notice period for extraordinary general meetings

A special resolution will be proposed at the AGM to renew the authority, granted by the shareholders at the last AGM to the Company, to call a general meeting of the Company (other than an AGM) with a minimum notice period of 14 clear days. Changes made to the 2006 Act by the Shareholders' Rights Regulations increased the notice period required for general meetings of the Company to 21 days unless shareholders approve a shorter notice period, which cannot, however, be less than 14 clear days. AGMs will continue to be held on at least 21 clear days' notice.

Before the coming into force of the Shareholders' Rights Regulations on 3 August 2009, the Company was able to call general meetings other than an AGM on 14 clear days' notice without obtaining such shareholder approval. In order to preserve this ability, such approval is sought at the AGM. Any exercise of this power by the Company will be conducted in accordance with any relevant corporate governance guidelines applicable at the time. In particular, the shorter notice period will only be used where flexibility is merited by the business of the meeting and is thought to be to the advantage of shareholders as a whole. The approval will be effective until the Company's next AGM, when it is intended that a similar resolution will be proposed.

The Company will comply with the requirement to provide appropriate facilities for all shareholders to vote by electronic means at general meetings held on less than 21 clear days' notice.

### Employee Sharesave Scheme for UK employees

An ordinary resolution will be proposed at the AGM to renew the Smiths Group Sharesave Scheme for a further ten years. Full details of the proposed scheme renewal are included with the Notice of AGM.

### Proposed long-term incentive arrangement

Following a review by the Remuneration Committee in which the views of shareholders and institutional investor groups on share-based incentive arrangements were considered, the Company will be seeking approval for a new long-term incentive plan ('LTIP') under which the executive directors and senior executives of the Company would be entitled to receive awards. It is proposed that awards under the LTIP will be made as follows:

- annual grants which may vest after three years, subject to demanding performance conditions;
- awards will be granted over fixed numbers of the Company's ordinary shares with a value at the date of grant equivalent to a percentage of a participant's salary; and
- vesting conditions for 2015 awards to executives with Group-wide responsibilities will be based on: revenue growth; earnings per share; return on capital employed; and cash conversion.

Shareholders' approval for this LTIP will be sought at the AGM on 17 November 2015. Further details on the LTIP can be found in the notes accompanying the Notice of AGM. If the LTIP is approved at the AGM, the first awards will be made in November 2015 and no awards will be made under the Company's existing 2011 LTIP. The Company's executive directors will no longer receive awards under the Company's Co-Investment Plan.

### Electronic proxy voting

The Company continues to provide electronic proxy voting for this year's AGM. Shareholders who are not Crest members can appoint a proxy and vote online for or against (or consciously not vote on) the resolutions to be proposed at the AGM by visiting the website [www.sharevote.co.uk](http://www.sharevote.co.uk). The onscreen instructions will give details on how to complete the appointment and voting process. 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. The Company may treat as invalid a Crest proxy voting instruction in the circumstances set out in Regulation 35(5)(a) of the Uncertificated Securities Regulations 2001.

Paper proxy cards will be distributed with the Notice of AGM to all shareholders other than those who have elected for notification by email.

Shareholders who will not be able to attend the AGM on 17 November 2015 in person are encouraged to vote their shares by appointing a proxy and issuing voting instructions (either electronically or by completing and returning their proxy cards). Electronic and paper proxy appointments and voting instructions must be received by the Company's Registrar not later than 48 hours before the AGM in order to be valid.

### Adoption of financial reporting standard FRS 101

Following the publication of FRS 100 'Application of financial reporting requirements' by the Financial Reporting Council, the Company is required to change its accounting framework for its financial statements, which is currently UK GAAP, for the financial year commencing 1 August 2015.

The Board considers that it is in the best interests of the Company to adopt FRS 101 'Reduced Disclosure Framework'. No disclosures in the current UK GAAP financial statements would be omitted on adoption of FRS 101.

Shareholders holding in aggregate 5% or more of the total allotted or issued shares in the Company may object to the use of this Reduced Disclosure Framework by writing to the Company at its registered office, 2nd Floor Cardinal Place, 80 Victoria Street, London SW1E 5JL, for the attention of the Company Secretary, by no later than 10.30am on 15 November 2015.

### Registrar

The address and contact details of Equiniti Limited, the Company's Registrar, are listed on the inside back cover of this report. Individual shareholders' access to their personal shareholder information is available online, through the [www.shareview.co.uk](http://www.shareview.co.uk) website. The UK shareholder helpline telephone number has changed to 0371 384 2943. Helpline services are available from 08:30 to 17:30, Monday to Friday (including UK Bank Holidays.) The international shareholder helpline telephone number is +44 (0) 121 415 7047.

### Important information

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. If you received this document in printed form from the Company and have recently sold or transferred all your shares in Smiths Group plc, please pass this document to the purchaser or transferee or to the agent through whom the sale or transfer was effected for transmission to the purchaser or transferee.

### Disclosure of information to the auditors

As at the date of this report, as far as each director is aware, there is no relevant audit information of which the Company's auditors are 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.

### Recommendation

Your directors believe that all the proposals to be considered at the AGM are in the best interests of the Company and its shareholders as a whole and recommend shareholders to vote in favour of the resolutions. The directors intend to vote in favour of the resolutions in respect of their own beneficial holdings.

By Order of the Board


**Melanie Jane Rowlands**

**Secretary**

Smiths Group plc  
2nd Floor, Cardinal Place  
80 Victoria Street, London SW1E 5JL

22 September 2015

# Accounts



With the continued proliferation of mobile connectivity, Smiths Interconnect's microwave and protection devices deliver reliability from the tower to the network core, increasing capacity, enabling higher data rates and improving call quality.



This section contains the financial statements, the auditors' report, the accounting policies and the notes to the accounts

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# 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;
- 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 performance, business model and strategy.

Each of the directors (who are listed on pages 74 to 76) 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 2015 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 of the Group, together with a description of the principal risks and uncertainties that the Group faces.

Signed on behalf of the Board of directors:

**Philip Bowman**  
**Chief Executive**  
22 September 2015

**Chris O'Shea**  
**Finance Director**

# Independent auditors' report to the members of Smiths Group plc

## Report on the Group financial statements

### Our opinion

In our opinion, Smiths Group plc's Group accounts (the "financial statements"):

- give a true and fair view of the state of the Group's affairs as at 31 July 2015 and of its profit and cash flows for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards ("IFRSs") as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006 and Article 4 of the IAS Regulation.

### What we have audited

The financial statements comprise:

- the consolidated balance sheet as at 31 July 2015;
- 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 for the year then ended;
- the accounting policies; and
- the notes to the financial statements, which include other explanatory information.

Certain required disclosures have been presented elsewhere in the Annual Report 2015 (the "Annual Report"), rather than in the notes to the financial statements. These are cross-referenced from the financial statements and are identified as audited.

The financial reporting framework that has been applied in the preparation of the financial statements is applicable law and IFRSs as adopted by the European Union.

## Our audit approach

### Overview

Materiality	• Overall Group materiality: £18 million which represents 3.5% of headline operating profit.
Audit scope	<ul style="list-style-type: none"><li>• We conducted audit work in 15 countries covering 41 reporting units.</li><li>• The reporting units where we performed audit work accounted for 75% of the Group's revenues and 78% of the Group's headline operating profit.</li></ul>
Areas of focus	<ul style="list-style-type: none"><li>• Revenue recognition (occurrence and cut off), together with accounting for complex programmes and contract accounting in the Smiths Detection and Smiths Interconnect Divisions.</li><li>• Working capital and associated provisions.</li><li>• Goodwill and intangible asset impairment assessments, particularly in the Smiths Detection, Smiths Interconnect and John Crane Divisions.</li><li>• Product litigation provisions for asbestos in John Crane, Inc. and flexible gas piping product in Titeflex Corporation, a subsidiary of the Flex-Tek Division.</li><li>• Taxation provisions and the recognition of deferred tax assets.</li><li>• Defined benefit pension plan net assets and liabilities.</li></ul>

### The scope of our audit and our areas of focus

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) ("ISAs (UK & Ireland)").

We designed our audit by determining materiality and assessing 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. As in all of our audits we also addressed the risk of management override of internal controls, including evaluating whether there was evidence of bias by the directors that represented a risk of material misstatement due to fraud.

The risks of material misstatement that had the greatest effect on our audit, including the allocation of our resources and effort, are identified as "areas of focus" in the table below. We have also set out how we tailored our audit to address these specific areas in order to provide an opinion on the financial statements as a whole, and any comments we make on the results of our procedures should be read in this context. Each of the areas of focus below is referred to in the Significant Judgements and Issues section of the Audit Committee Report on page 91 and in the Significant judgement, key assumptions and estimates section of the Accounting Policies on pages 132 to 133. This is not a complete list of all risks identified by our audit.

## Revenue recognition (occurrence and cut off), together with accounting for complex programmes and contract accounting in the Smiths Detection and Smiths Interconnect Divisions

### Area of focus

We focused on revenue recognition for all divisions in the final month of the financial year to check that revenue was recorded in the correct period.

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 on 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.

### How our audit addressed the area of focus

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 transactions which occurred near 31 July 2015.

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 and its financial ledgers.

In the case of the Smiths Detection and Smiths Interconnect divisions, for a sample of contracts, we read extracts of 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 directors' 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.

## Working capital and associated provisions

### Area of focus

Refer also to notes 14, 15 and 16

We focused on this area because inventory provisions include subjective estimates and are influenced by assumptions concerning future revenue, and the Group also has material amounts of trade receivables that are overdue and not impaired (as disclosed in note 15 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.

Management's related provisions are subjective and are influenced by assumptions concerning future selling prices and the level of sales activity.

### How the scope of our audit addressed the area of focus

We evaluated the directors' 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 directors' 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 for each customer.

In addition, we performed the procedures documented above for revenue recognition in relation to the key long term revenue contracts.

As a result, we satisfied ourselves that both inventory and receivables provisions have been prepared in line with policy and we found the estimates to be in line with our expectation.

## Goodwill and intangible asset impairment assessments, particularly in the Smiths Detection, Smiths Interconnect and John Crane Divisions

### Area of focus

#### Refer also to note 12

The Group holds significant amounts of goodwill and intangible assets on the balance sheet, as detailed in note 11 to the financial statements. The risk is that these balances are overstated.

We focused, in particular, on the estimated value in use of the John Crane Production Solutions cash generating unit ("CGU"), which has a closing net book value of goodwill of £5m and has been impaired by £27m in the year. This impairment is due to a decrease in forecast revenue as a result of the impact of lower oil prices on their customers.

We focused on the estimated values in use of the Smiths Interconnect CGUs, which have a combined net book value of goodwill of £340m, and the Smiths Detection CGU, which has a net book value of goodwill of £343m. As these CGUs have a lower headroom between their carrying value and value in use, judgements in the valuation models are even more important.

### How the scope of our audit addressed the area of focus

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 found the assumptions to be consistent and in line with our expectations.

We evaluated the reasonableness of the directors' forecast performance by performing a sensitivity analysis around the key drivers of the cash flow forecasts, in particular:

- the current order book;
- the proportion of recent tenders which have been successful; and
- independent projections of the expected growth of key markets.

We also evaluated the directors' assessment of the fair value less costs of disposal by comparing it to external analyst valuations.

For the Smiths Interconnect CGUs and Smiths Detection division, having ascertained the extent of change in the assumptions that either individually or collectively would be required for the goodwill to be impaired, we considered the likelihood of such a movement in those key assumptions and the disclosures on sensitivity analyses set out in note 12, and found such a movement to be unlikely.

In respect of the John Crane Production Solutions CGU, we sensitised each key driver of the cash flow forecasts, including the underlying assumptions listed above, by determining what we considered to be a reasonable possible change in assumption, based on current market data and historical and current business performance. Through this we determined an appropriate range of value in use. We found the assumptions used in determining the £27m impairment to be within an appropriate range.

## Product litigation provisions for asbestos in John Crane, Inc. and flexible gas piping product in Titeflex Corporation, a subsidiary of the Flex-Tek Division

### Area of focus

#### Refer also to note 23

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 £216m 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 £71m 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.

### How the scope of our audit addressed the area of focus

In John Crane Inc. we used our own internal specialists to challenge management's assumptions underlying the adverse judgement 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 and considering alternative outcomes. In addition we tested the mathematical accuracy of the underlying calculations and the input data.

At Titeflex Corporation we challenged management's underlying assumptions supporting their 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, that the provisions have been recognised in line with IAS 37 and that appropriate disclosures have been provided within the financial statements.

## Taxation provisions and the recognition of deferred tax assets

### Area of focus

Refer also to note 7

The Group has recognised £218m 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.

### How the scope of our audit addressed the area of focus

We evaluated the directors' assessment as to whether there will be sufficient taxable profits in future periods to support the recognition of deferred tax assets by evaluating 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 found the assumptions to be consistent and in line with our expectations.

We used our tax specialists to challenge 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 assessed the adequacy of the directors' taxation provisions by considering factors such as whether the matter represents a permanent or temporary difference, and whether the provision addresses possible penalties and interest.

We did not identify any material exceptions from our audit work.

## Defined benefit pension plan net assets and liabilities

### Area of focus

Refer also to note 9

The Group has defined benefit pension plans with net post-retirement assets of £170m and net post-retirement liabilities of £278m, which are significant in the context of the overall balance sheet of the Group.

The valuation of the pension liabilities requires significant levels of 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, the fair value measurement of which includes some 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.

### How the scope of our audit addressed the area of focus

We evaluated the directors' assessment of the assumptions they 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 valuations 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 new census data was available in the year we tested the controls at the scheme administrators and tested it on a sample basis to assess whether this data is accurate.

Where there was no new census data in the year we assessed the assumptions used by the actuaries.

### 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 geographic structure of the Group, the accounting processes and controls, and the industry in which the Group operates.

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 21 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 20 reporting units, to give appropriate coverage of material balances at both divisional and Group levels. We conducted work in 15 countries and the Group engagement team visited multiple reporting sites in the North America and Europe, and participated in each of the Divisional audit clearance meetings. Together, the reporting units subject to audit procedures accounted for 75% of the Group's revenues and 78% of the Group's headline operating profit.

Further specific audit procedures over IT general controls, central functions such as treasury and areas of significant judgement, including 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 and to evaluate the effect of misstatements, both individually and on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

Overall Group materiality	£18 million (2014: £18 million).
How we determined it	3.5% of "headline operating profit". Headline operating profit is operating profit adjusted for exceptional items, amortisation and impairment of acquired intangible assets, net pensions finance credit and financing gains/losses from currency hedging.
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.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £0.5 million (2014: £0.5 million) as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

### Going concern

Under the Listing Rules we are required to review the directors' statement, set out on page 113, in relation to going concern. We have nothing to report having performed our review.

As noted in the directors' statement, the directors have concluded that it is appropriate to prepare the financial statements using the going concern basis of accounting. The going concern basis presumes that the Group has adequate resources to remain in operation, and that the directors intend it to do so, for at least one year from the date the financial statements were signed. As part of our audit we have concluded that the directors' use of the going concern basis is appropriate.

However, because not all future events or conditions can be predicted, these statements are not a guarantee as to the Group's ability to continue as a going concern.

### Other required reporting

#### Consistency of other information

##### Companies Act 2006 opinion

In our opinion, the information given in the Strategic Report and the Group Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

#### ISAs (UK & Ireland) reporting

Under ISAs (UK & Ireland) we are required to report to you if, in our opinion:

Information in the Annual Report is:	We have no exceptions to report arising from this responsibility.
<ul style="list-style-type: none"> <li>• materially inconsistent with the information in the audited financial statements; or</li> <li>• apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Group acquired in the course of performing our audit; or</li> <li>• otherwise misleading.</li> </ul>	
The statement given by the directors on page 120, in accordance with provision C.1.1 of the UK Corporate Governance Code ("the Code"), that they consider the Annual Report taken as a whole to be fair, balanced and understandable and provides the information necessary for members to assess the Group's performance, business model and strategy is materially inconsistent with our knowledge of the Group acquired in the course of performing our audit.	We have no exceptions to report arising from this responsibility.
The section of the Annual Report on page 91, as required by provision C.3.8 of the Code, describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.	We have no exceptions to report arising from this responsibility.

## **Independent auditors' report to the members of Smiths Group plc**

### **Continued**

#### **Adequacy of information and explanations received**

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. We have no exceptions to report arising from this responsibility.

#### **Directors' remuneration**

Under the Companies Act 2006 we are required to report to you if, in our opinion, certain disclosures of directors' remuneration specified by law are not made. We have no exceptions to report arising from this responsibility.

#### **Corporate governance statement**

Under the Listing Rules we are required to review the part of the Corporate Governance Statement relating to the company's compliance with ten provisions of the UK Corporate Governance Code. We have nothing to report having performed our review.

#### **Responsibilities for the financial statements and the audit**

##### **Our responsibilities and those of the Directors**

As explained more fully in the Statement of directors' responsibilities set out on page 120, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and ISAs (UK & Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

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.

##### **What an audit of financial statements involves**

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- whether the accounting policies are appropriate to the Group's circumstances and have been consistently applied and adequately disclosed;
- the reasonableness of significant accounting estimates made by the directors; and
- the overall presentation of the financial statements.

We primarily focus our work in these areas by assessing the directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

We test and examine information, using sampling and other auditing techniques, to the extent we consider necessary to provide a reasonable basis for us to draw conclusions. We obtain audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

#### **Other matter**

We have reported separately on the company financial statements of Smiths Group plc for the year ended 31 July 2015 and on the information in the Directors' Remuneration Report that is described as having been audited.

#### **Andrew Kemp**

##### **(Senior Statutory Auditor)**

for and on behalf of PricewaterhouseCoopers LLP  
Chartered Accountants and Statutory Auditors  
London

22 September 2015

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

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

# Consolidated income statement

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

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 132 to 173, which form an integral part of the consolidated accounts.

# Consolidated statement of comprehensive income

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

# Consolidated balance sheet

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

The accounts on pages 127 to 173 were approved by the Board of Directors on 22 September 2015 and were signed on its behalf by:

**Philip Bowman**  
Chief Executive

**Chris O'Shea**  
Finance Director

# Consolidated statement of changes in equity

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

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

# Consolidated cash-flow statement

	Notes	Year ended 31 July 2015 £m	Year ended 31 July 2014 £m
<b>Net cash inflow from operating activities</b>	27	<b>266</b>	256
<b>Cash-flows from investing activities</b>			
Expenditure on capitalised development		(18)	(23)
Expenditure on other intangible assets		(18)	(17)
Purchases of property, plant and equipment	13	(59)	(54)
Disposals of property, plant and equipment		11	5
Investment in financial assets		(27)	(28)
Acquisition of businesses			(1)
Disposals of businesses		2	3
<b>Net cash-flow used in investing activities</b>		<b>(109)</b>	(115)
<b>Cash-flows from financing activities</b>			
Proceeds from exercise of share options	24	3	6
Purchase of own shares		(11)	(13)
Dividends paid to equity shareholders	25	(160)	(275)
Cash inflow/(outflow) from matured derivative financial instruments		4	11
Increase in new borrowings		568	138
Reduction and repayment of borrowings		(257)	(180)
<b>Net cash-flow used in financing activities</b>		<b>147</b>	(313)
<b>Net increase/(decrease) in cash and cash equivalents</b>		<b>304</b>	(172)
Cash and cash equivalents at beginning of year		189	387
Exchange differences		2	(26)
<b>Cash and cash equivalents at end of year</b>	18	<b>495</b>	189
Cash and cash equivalents at end of year comprise			
– cash at bank and in hand		104	115
– short-term deposits		391	75
– bank overdrafts			(1)
		<b>495</b>	189
Included in cash and cash equivalents per the balance sheet		495	190
Included in overdrafts per the balance sheet			(1)
		<b>495</b>	189
<b>Reconciliation of net cash-flow to movement in net debt</b>			
	Notes	Year ended 31 July 2015 £m	Year ended 31 July 2014 £m
<b>Net increase/(decrease) in cash and cash equivalents</b>		<b>304</b>	(172)
Net (increase)/decrease in borrowings resulting from cash-flows		(311)	42
<b>Movement in net debt resulting from cash-flows</b>		<b>(7)</b>	(130)
Capitalisation, interest accruals and unwind of capitalisation fees		(1)	3
Movement from fair value hedging		7	(3)
Exchange differences		(13)	70
<b>Movement in net debt in the year</b>	18	<b>(14)</b>	(60)
Net debt at start of year		(804)	(744)
<b>Net debt at end of year</b>	18	<b>(818)</b>	(804)

# Accounting policies

## Basis of preparation

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

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

## Significant judgements, key assumptions and estimates

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

## Revenue recognition

The timing of revenue recognition on contracts depends on the assessed stage of completion of contract activity at the balance sheet date. This assessment requires the expected total contract revenues and costs to be estimated based on the current progress of the contract. Revenue of £39m (2014: £29m) has been recognised in the period in respect of contracts in progress at the period end with a total expected value of £137m (2014: £113m) and cumulative revenue recognised to date of £100m (2014: £70m). A 5% reduction in the proportion of the contract activity recognised in the current period would have reduced operating profit by less than £1m for both Smiths Detection and Smiths Interconnect (2014: less than £1m).

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

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

## Taxation

The Group has recognised deferred tax assets of £28m (2014: £21m) relating to losses and £99m (2014: £91m) relating to the John Crane, Inc. and Titeflex Corporation litigation provisions. The recognition of assets pertaining to these items involves judgement by management as to the likelihood of realisation of these deferred tax assets and this is based on a number of factors, which seek to assess the expectation that the benefit of these assets will be realised, including appropriate taxable temporary timing differences, and it has been concluded that there are sufficient taxable profits in future periods to support recognition. Further detail on the Group's deferred taxation position is included in note 7.

## Retirement benefits

The consolidated financial statements include costs in relation to, and provision for, retirement benefit obligations. The costs and the present value of any related pension assets and liabilities depend on such factors as life expectancy of the members, the returns that plan assets generate and the discount rate used to calculate the present value of the liabilities. The Group uses previous experience and independent actuarial advice to select the values of critical estimates. The estimates, and the effect of variances in key estimates, are disclosed in note 9.

At 31 July 2015 there is a retirement benefit asset of £170m (2014: £123m) which arises from the rights of the employers to recover the surplus at the end of the life of the scheme. If the pension schemes were wound up while they still had members, the schemes would need to buy out the benefits of all members. The buyouts would cost significantly more than the present value of the scheme liabilities calculated in accordance with IAS 19: Employee benefits.

## Working capital provisions

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

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

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

## Impairment

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

See note 12 for details of the critical assumptions made, including the sales and margin volatility in Smiths Detection and Smiths Interconnect and disclosures on the sensitivity of the impairment testing to these key assumptions, including details of the changes in assumptions which would be required to trigger an impairment in Smiths Detection or Smiths Interconnect Power.

## Provisions for liabilities and charges

As previously reported, John Crane, Inc., a subsidiary of the Group, is currently one of many co-defendants in litigation relating to products previously manufactured which contained asbestos. Provision of £216m (2014: £204m) has been made for the future defence costs which the Group is expected to incur and the expected costs of future adverse judgments against John Crane, Inc. Whilst published incidence curves can be used to estimate the likely future pattern of asbestos related disease, John Crane, Inc.'s claims experience is significantly impacted by other factors which influence the US litigation environment. These can include: changing approaches on the part of the plaintiffs' bar; changing attitudes amongst the judiciary at both trial and appellate levels; and legislative and procedural changes in both the state and federal court systems. Therefore, because of the significant uncertainty associated with the future level of asbestos claims and of the costs arising out of the related litigation, there can be no guarantee that the assumptions used to estimate the provision will result in an accurate prediction of the actual costs that may be incurred. John Crane, Inc. takes account of the advice of an expert in asbestos liability estimation in quantifying the expected costs.

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

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

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

## Accounting policies

### Basis of consolidation

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

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

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

### Foreign currencies

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

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

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

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

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

## Accounting policies

### Continued

#### Revenue

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

#### Sale of goods

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

#### Services

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

#### Construction contracts

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

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

#### Employee benefits

##### Share-based compensation

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

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

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

##### Pension obligations and post-retirement benefits

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

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

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

#### Leases

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

#### Exceptional items

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

- profits/(losses) on disposal of businesses and costs of acquisitions and disposals;
- spend on the integration of significant acquisitions and other major restructuring programmes;
- significant goodwill or other asset impairments;
- income and expenditure relating to material litigation in respect of products no longer in production; and
- other particularly significant or unusual items.

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

## Taxation

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

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

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

Deferred tax liabilities and assets are not discounted.

## Discontinued operations

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

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

## Intangible assets

### Goodwill

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

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

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

## Research and development

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

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

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

## Intangible assets acquired in business combinations

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

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

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

## Software, patents and intellectual property

The estimated useful lives are as follows:

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

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

## Property, plant and equipment

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

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

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

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

## Accounting policies

### Continued

#### Inventories

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

#### Trade and other receivables

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

#### Provisions

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

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

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

#### Assets and businesses held for sale

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

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

#### Cash and cash equivalents

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

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

#### Financial assets

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

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

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

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

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

#### Financial liabilities

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

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

## Derivative financial instruments and hedging activities

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

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

### Fair value hedge

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

### Net investment hedge

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

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

### Cash-flow hedge

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

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

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

## Fair value of financial assets and liabilities

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

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

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

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

## Dividends

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

## Recent accounting developments

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

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

A review of the impact of these standards and interpretations is being undertaken, and the impact of adopting them will be determined once this review has been completed. In particular the review of the impact of 'IFRS 15: Revenue from contracts with customers' will require an assessment at contract level for the military and long-term service businesses, and the impact of adopting this standard cannot be reliably estimated until this work is substantially complete.

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

## Parent Company

The accounts of the Parent Company, Smiths Group plc, have been prepared in accordance with UK GAAP. The Company accounts are presented in separate financial statements on pages 182 to 193.

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

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

# Notes to the accounts

## 1 Segment information

### Analysis by operating segment

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

- John Crane – mechanical seals, seal support systems, engineered bearings, power transmission couplings and specialist filtration systems;
- Smiths Medical – infusion systems, vascular access (including safety needles), patient airway and temperature management equipment and specialty devices in areas of in vitro fertilisation, diagnostics and emergency patient transport;
- Smiths Detection – sensors that detect and identify explosives, narcotics, weapons, chemical agents, biohazards and contraband;
- Smiths Interconnect – specialised electronic and radio frequency components and sub-systems that connect, protect and control critical systems;
- Flex-Tek – engineered components that heat and move fluids and gases, flexible hosing and rigid tubing.

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

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

	Year ended 31 July 2015						
	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Corporate costs £m	Total £m
Revenue	905	836	467	420	269		2,897
Divisional headline operating profit	225	166	55	49	50		545
Corporate headline operating costs						(34)	(34)
<b>Headline operating profit/(loss)</b>	<b>225</b>	<b>166</b>	<b>55</b>	<b>49</b>	<b>50</b>	<b>(34)</b>	<b>511</b>
Exceptional operating items (note 4)	(25)	(16)	(10)	(3)	(9)	14	(49)
Legacy retirement benefits	(1)					(7)	(8)
Amortisation and impairment of acquired intangible assets	(34)	(8)		(18)			(60)
<b>Operating profit/(loss)</b>	<b>165</b>	<b>142</b>	<b>45</b>	<b>28</b>	<b>41</b>	<b>(27)</b>	<b>394</b>
Exceptional finance costs – adjustment to discounted provision (note 4)	(4)				(1)		(5)
Net finance costs – other							(64)
<b>Profit before taxation</b>							<b>325</b>

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

## 1 Segment information continued

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

	31 July 2015					
	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Total £m
Property, plant, equipment, development projects and other intangibles	96	175	84	38	22	415
Working capital assets	351	247	260	160	83	1,101
<b>Operating assets</b>	<b>447</b>	<b>422</b>	<b>344</b>	<b>198</b>	<b>105</b>	<b>1,516</b>
Derivatives, tax and retirement benefit assets						442
Goodwill and acquired intangibles						1,351
Corporate assets						176
Cash						495
<b>Total assets</b>						<b>3,980</b>
Working capital liabilities	(141)	(108)	(156)	(64)	(37)	(506)
Corporate and non-headline liabilities						(316)
Derivatives, tax and retirement benefit liabilities						(417)
Borrowings						(1,313)
<b>Total liabilities</b>						<b>(2,552)</b>
Average divisional capital employed	872	1,126	577	535	148	3,258
Average corporate capital employed						(61)
<b>Average total capital employed</b>						<b>3,197</b>

Capital employed is a non-statutory measure of invested resources. It comprises statutory net assets adjusted to add goodwill recognised directly in reserves in respect of subsidiaries acquired before 1 August 1998 of £815m (2014: £815m) and eliminate post-retirement benefit related assets and liabilities and litigation provisions relating to exceptional items, both net of related tax, and net debt.

	31 July 2014					
	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Total £m
Property, plant, equipment, development projects and other intangibles	91	159	97	39	19	405
Working capital assets	350	228	275	161	73	1,087
<b>Operating assets</b>	<b>441</b>	<b>387</b>	<b>372</b>	<b>200</b>	<b>92</b>	<b>1,492</b>
Derivatives, tax and retirement benefit assets						359
Goodwill and acquired intangibles						1,382
Corporate assets						142
Cash						190
<b>Total assets</b>						<b>3,565</b>
Working capital liabilities	(143)	(97)	(166)	(70)	(26)	(502)
Corporate and non-headline liabilities						(317)
Derivatives, tax and retirement benefit liabilities						(507)
Borrowings						(994)
<b>Total liabilities</b>						<b>(2,320)</b>
Average divisional capital employed	876	1,100	632	518	139	3,265
Average corporate capital employed						(47)
<b>Average total capital employed</b>						<b>3,218</b>

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

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

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

## 1 Segment information continued

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

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

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

The capital expenditure for each division is:

	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Reconciling items £m	Total £m
<b>Capital expenditure year ended 31 July 2015</b>	<b>19</b>	<b>44</b>	<b>11</b>	<b>12</b>	<b>5</b>	<b>6</b>	<b>97</b>
Capital expenditure year ended 31 July 2014	18	44	14	11	3	5	95

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

### Analysis of revenue

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

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

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

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

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

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

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

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

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

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

## 1 Segment information continued

### Analysis of revenue continued

The Group's statutory revenue is analysed as follows:

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

### Analysis by geographical areas

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

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

## 2 Operating profit is stated after charging

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

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

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

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

### 3 Headline profit measures

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

The following items have been excluded from the headline measure:

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

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

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

#### Headline earnings before interest, tax, depreciation and amortisation

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

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

## 4 Exceptional items

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

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

### Year ended 31 July 2015

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

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

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

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

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

### Year ended 31 July 2014

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

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

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

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

## 5 Net finance costs

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

## 6 Earnings per share

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

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

Diluted earnings per share are calculated by dividing the profit attributable to ordinary shareholders by 398,552,818 (2014: 398,399,449) ordinary shares, being the average number of ordinary shares in issue during the year adjusted by the dilutive effect of employee share schemes. For the year ended 31 July 2015 no options (2014: no options) were excluded from this calculation because their effect was anti-dilutive for continuing operations.

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

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

## 7 Taxation

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

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

### Reconciliation of the tax charge

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

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

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

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

The net retirement benefit credit to equity includes £nil (2014: £1m) relating to UK schemes. The UK schemes are closed and this amount represents tax relief that was set off against amounts previously charged to equity.

## 7 Taxation continued

### Deferred taxation

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

Included in other deferred tax balances above are:

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

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

The expiry date of operating losses carried forward is dependent upon the law of the various territories in which the losses arise. A summary of expiry dates for losses in respect of which deferred tax has not been recognised is set out below.

### Restricted losses

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

## 8 Employees

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

The average number of persons employed was:

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

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

### Key management

The key management of the Group comprises Smiths Group plc Board directors and Executive Committee members. Their aggregate compensation is shown below. Details of directors' remuneration are contained in the report of the Remuneration Committee on pages 94 to 111.

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

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

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

### Related party transactions

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

## 9 Post-retirement benefits

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

### Defined contribution plans

The Group operates a number of defined contribution plans across many countries. In the UK a defined contribution plan has been offered since the closure of the UK defined benefit pension plans. In the US a 401k defined contribution plan operates. The total expense recognised in the consolidated income statement in respect of all these plans was £28m (2014: £30m).

### Defined benefit and post-retirement healthcare plans

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

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

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

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

### UK pension schemes

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

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

#### Smiths Industries Pension Scheme (“SIPS”)

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

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

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

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

#### TI Group Pension Scheme (“TIGPS”)

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

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

## 9 Post-retirement benefits continued

### Defined benefit and post-retirement healthcare plans continued

#### UK pension schemes continued

##### Ti Group Pension Scheme ("TIGPS") continued

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

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

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

#### US pension plans

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

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

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

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

#### Risk management

The pensions schemes are exposed to risks that:

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

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

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

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

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

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

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

#### Discount rate assumptions

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

## 9 Post-retirement benefits continued

### Defined benefit and post-retirement healthcare plans continued

#### Risk management continued

##### Mortality assumptions

The mortality assumptions used in the principal UK schemes are based on the recent actual mortality experience of members within each scheme. The assumptions are based on the new SAPS All Birth year tables with relevant scaling factors based on the experience of the schemes. The assumption also allows for future improvements in life expectancy in line with the 2014 CMI projections, blended to a long-term rate of 1.25%. The mortality assumptions used in the principal US schemes are based on the RP-2014 table projected generationally with scale MP-14 as of 31 July 2015. The table selected allows for future mortality improvements and applies an adjustment for job classification (blue collar versus white collar). The assumptions give the following:

Expected further years of life	UK schemes				US schemes			
	Male 31 July 2015	Female 31 July 2015	Male 31 July 2014	Female 31 July 2014	Male 31 July 2015	Female 31 July 2015	Male 31 July 2014	Female 31 July 2014
Member who retires next year at age 65	23	24	23	25	22	24	20	21
Member, currently 45, when they retire in 20 years' time	25	27	25	27	23	26	20	21

##### Sensitivity

Sensitivities in respect of the key assumptions used to measure the principal pension schemes as at 31 July 2015 are set out below. These sensitivities show the hypothetical impact of a change in each of the listed assumptions in isolation, with the exception of the sensitivity to inflation which incorporates the impact of certain correlating assumptions. While each of these sensitivities holds all other assumptions constant, in practice such assumptions rarely change in isolation and the impacts may offset to some extent.

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

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

#### Retirement benefit plan assets

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

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

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

## 9 Post-retirement benefits continued

### Defined benefit and post-retirement healthcare plans continued

#### Retirement benefit plan assets continued

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

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

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

#### Net retirement benefit obligations

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

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

#### Amounts recognised in the consolidated income statement

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

## 9 Post-retirement benefits continued

### Defined benefit and post-retirement healthcare plans continued

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

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

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

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

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

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

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

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

#### Cash contributions

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

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

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

## 10 Employee share schemes

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

### Long-Term Incentive Plan (LTIP)

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

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

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

Divisional LTIP awards made before 2014 have three performance conditions, and the relative significance of the conditions reflects the strategic priorities for each division. The performance conditions are: 20% to 40% of the awards are conditional on three-year revenue growth; 30% to 40% of the awards are conditional on three-year average annual headline operating margins; and 30% to 40% of the awards are conditional on three-year average annual headline operating cash conversion.

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

### Smiths Group Co-Investment Plan (CIP)

Under the CIP participants are required to invest 50% of their post-tax bonus purchasing the Company's shares at the prevailing market price. At the end of a three-year period, if the executive is still in office and provided the performance test is passed, matching shares will be awarded in respect of any invested shares retained for that period. The number of matching shares to be awarded is determined by the Remuneration Committee at the end of the year in which the bonus is earned by reference to annual bonus, and other corporate financial criteria. The maximum award will not exceed the value, before tax, of the bonus or salary invested in shares by the executive.

Vesting of matching shares will occur, and the matching shares will be released, at the end of the three-year period if the Group's Return on Capital Employed ('ROCE') over the performance period exceeds the Group's weighted average cost of capital ('WACC') over the performance period by an average margin of at least 1% per annum. If ROCE exceeds WACC by an average margin of 3% per annum, the enhanced performance condition is met, and a second matching share will be issued for every purchased share.

## 10 Employee share schemes continued

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

Options were exercised on an irregular basis during the period. The average closing share price over the financial year was 1,176.19p (2014: 1,353.95p). There has been no change to the effective option price of any of the outstanding options during the period.

Range of exercise prices	Total shares under option at 31 Jul 2015 ('000)	Weighted average remaining contractual life at 31 July 2015 (months)	Total shares under option at 31 Jul 2014 ('000)	Weighted average remaining contractual life at 31 July 2014 (months)	Options exercisable at 31 July 2015 ('000)	Exercisable weighted average exercise price for options exercisable at 31 July 2015	Options exercisable at 31 July 2014 ('000)	Exercisable weighted average exercise price for options exercisable at 31 July 2014
£0.00 – £2.00	<b>4,018</b>	<b>15</b>	4,263	9				
£2.01 – £6.00	<b>18</b>	<b>17</b>	164	9			23	£5.69
£6.01 – £10.00	<b>1,091</b>	<b>27</b>	1,093	30	<b>263</b>	<b>£8.97</b>	463	£8.85
£10.01 – £14.00	<b>385</b>	<b>25</b>	487	34	<b>257</b>	<b>£10.96</b>	289	£10.96

For the purposes of valuing options to arrive at the share-based payment charge, the Binomial option pricing model has been used for most schemes and the Monte Carlo method is used for schemes with total shareholder return performance targets. The key assumptions used in the models for 2015 and 2014 are volatility of 20% to 25% (2014: 25%) and dividend yield of 3.75% (2014: 3.75%). Assumptions on expected volatility and expected option term have been made on the basis of historical data, for the period corresponding with the vesting period of the option. These generated a weighted average fair value for CIP of £12.47 (2014: £14.04), Group long-term incentive plans of £10.78 (2014: £12.26) and divisional long-term incentive plans of £12.55 (2014: £14.12). The fair value disclosed for the CIP award treats the two matching shares as separate options.

Included within staff costs is an expense arising from share-based payment transactions of £9m (2014: £10m), of which £8m (2014: £9m) relates to equity-settled share-based payment.

## 11 Intangible assets

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

In addition to goodwill, the acquired intangible assets comprise:

	Patents, licences and trademarks £m	Technology £m	Customer relationships £m	Total acquired intangibles £m
<b>Cost</b>				
At 1 August 2013	75	144	211	430
Exchange adjustments	(7)	(14)	(21)	(42)
Business combinations				
Disposals		(2)		(2)
At 1 August 2014	68	128	190	386
Exchange adjustments	4	10	5	19
Disposals		(2)		(2)
<b>At 31 July 2015</b>	<b>72</b>	<b>136</b>	<b>195</b>	<b>403</b>
<b>Amortisation</b>				
At 1 August 2013	40	98	170	308
Exchange adjustments	(4)	(10)	(18)	(32)
Charge for the year	5	15	19	39
Disposals		(2)		(2)
At 31 July 2014	41	101	171	313
Exchange adjustments	2	8	4	14
Charge for the year	6	13	14	33
Disposals		(2)		(2)
<b>At 31 July 2015</b>	<b>49</b>	<b>120</b>	<b>189</b>	<b>358</b>
<b>Net book value at 31 July 2015</b>	<b>23</b>	<b>16</b>	<b>6</b>	<b>45</b>
Net book value at 31 July 2014	27	27	19	73
Net book value at 1 August 2013	35	46	41	122

## 12 Impairment testing

### Goodwill

Goodwill is not amortised but is tested for impairment at least annually. Value in use calculations are used to determine the recoverable amount of goodwill held allocated to each group of cash generating units (CGU). Value in use is calculated as the net present value of the projected risk-adjusted cash-flows of the CGU. These forecast cash-flows are based on the 2016 budget, the four-year strategic plan approved by the Board and detailed divisional strategic projections, where these have been prepared and approved by the Board.

Goodwill is allocated by division as follows:

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

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

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

### Goodwill impairment

#### John Crane Production Solutions ("JCPS")

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

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

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

Sales assumptions for JCPS are based on:

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

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

### Impairment testing assumptions

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

- Sales: projected sales are built up with reference to markets and product categories. They incorporate past performance, historical growth rates and projections of developments in key markets.
- Margins: projected margins reflect historical performance and the impact of all completed projects to improve operational efficiency and leverage scale. The projections do not include the impact of future restructuring projects to which the Group is not yet committed.
- Discount rate: the discount rates have been calculated based on the Group's weighted average cost of capital and risks specific to the CGU being tested. The discount rates disclosed incorporate risk adjustments where the projected sales and margins are affected by significant delivery risks. Pre-tax rates of 10.7% to 16.2% (2014: 10.7% to 13.6%) have been used for the impairment testing.
- Long-term growth rates: as required by IAS 36, growth rates for the period after the detailed forecasts are based on the long-term GDP projections of the primary market for the CGU. The average growth rate used in the testing was 2.16% (2014: 2.03%). These rates do not reflect the long-term assumptions used by the Group for investment planning.

## 12 Impairment testing continued

### Goodwill continued

#### Impairment testing assumptions continued

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

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

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

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

### Sensitivity analysis

#### Smiths Detection

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

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

Sales assumptions for Smiths Detection are based on:

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

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

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

## 12 Impairment testing continued

### Goodwill continued

#### Sensitivity analysis continued

##### Smiths Interconnect Power

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

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

Sales assumptions for Smiths Interconnect Power are based on:

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

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

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

##### Smiths Interconnect Microwave Components

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

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

Sales assumptions for Smiths Interconnect Microwave Components are based on:

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

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

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

##### Other CGUs

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

### Other intangible assets

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

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

## 13 Property, plant and equipment

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

## 14 Inventories

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

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

## 15 Trade and other receivables

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

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

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

Credit risk is managed separately for each customer and, where appropriate, a credit limit is set for the customer based on previous experience of the customer and third party credit ratings. The Group has no significant concentration of credit risk, with exposure spread over a large number of customers. The largest single customer is the US Federal Government, representing less than 5% (2014: less than 4%) of Group revenue.

### Ageing of trade receivables

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

## 16 Trade and other payables

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

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

## 17 Financial assets

Available for sale financial assets include £147m (2014: £111m) UK government bonds. This investment forms part of the deficit-funding plan agreed with the trustee of one of the principal UK pension schemes. See note 9 for additional details.

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

## 18 Borrowings and net debt

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

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

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

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

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

### Net cash and cash equivalents

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

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

### Netting

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

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

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

## 18 Borrowings and net debt continued

### Movements in net debt

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

### Secured loans

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

## 19 Financial risk management

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

Treasury and risk management policies are set by the Board. The policy sets out specific guidelines to manage foreign exchange risk, interest rate risk, credit risk and the use of financial instruments to manage risk. The instruments and techniques used to manage exposures include foreign currency derivatives, debt and other interest rate derivatives. The central treasury function monitors financial risks and compliance with risk management policies. The management of operational credit risk is discussed in note 15.

### (a) Foreign exchange risk

#### Transactional currency exposure

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

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

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

	At 31 July 2015				
	Sterling £m	US\$ £m	Euro £m	Other £m	Total £m
<b>Financial assets and liabilities</b>					
Financial instruments included in trade and other receivables	34	316	111	150	611
Financial instruments included in trade and other payables	(41)	(185)	(55)	(55)	(336)
Cash and cash equivalents	311	115	20	49	495
Borrowings not designated as net investment hedges	(151)	(11)	(3)		(165)
	153	235	73	144	605
Exclude balances held in operations with the same functional currency	(155)	(149)	(72)	(138)	(514)
Exposure arising from intra-group loans		(101)	(28)	(49)	(178)
Forward foreign exchange contracts	(163)	48	79	36	
	(165)	33	52	(7)	(87)

## 19 Financial risk management continued

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

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

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

	Impact on profit for the year 31 July 2015 £m	Gain/(loss) recognised in reserves 31 July 2015 £m	Impact on profit for the year 31 July 2014 £m	Gain/(loss) recognised in reserves 31 July 2014 £m
US dollar	4	(2)	4	(1)
Euro		4	(1)	
Sterling	1		4	1

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

### Cash-flow hedging

The Group uses foreign currency contracts to hedge future foreign currency sales and purchases. At 31 July 2015 contracts with a nominal value of £317m (2014: £201m) were designated as hedging instruments. In addition, the Group had outstanding foreign currency contracts with a nominal value of £314m (2014: £237m) which were being used to manage transactional foreign exchange exposures, but were not accounted for as cash-flow hedges. The fair value of the contracts is disclosed in note 20.

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

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

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

## 19 Financial risk management continued

### Translational currency exposure

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

### Net investment hedges

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

	At 31 July 2015				
	Sterling £m	US\$ £m	Euro £m	Other £m	Total £m
Loans designated as net investment hedges		(524)	(624)		(1,148)
Cross currency swap contracts		(306)	302		(4)
Currency swap contracts	90			(90)	
	90	(830)	(322)	(90)	(1,152)

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

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

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

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

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

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

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

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

### (b) Interest rate risk

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

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

## 19 Financial risk management continued

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

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

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

### Interest rate hedging

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

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

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

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

### Sensitivity of interest charges to interest rate movements

The Group has exposure to sterling, US dollar and euro interest rates. However the Group does not have a significant exposure to interest rate movements for any individual currency. Based on the composition of net debt and foreign exchange rates at 31 July 2015, and taking into consideration all fixed rate borrowings and interest rate swaps in place, a one percentage point (100 basis points) change in average floating interest rates for all three currencies would have a £0.2m (2014: £0.7m) impact on the Group's profit before tax.

Based on the investments held at 31 July 2015 a one percentage point (100 basis points) increase in sterling interest rates would reduce the carrying value of investments by £19m (2014: £15m), generating a corresponding charge to reserves.

### (c) Financial credit risk

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

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

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

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

## 19 Financial risk management continued

### (d) Liquidity risk

#### Borrowing facilities

The Board policy specifies the maintenance of unused committed credit facilities of at least £200m at all times to ensure it has sufficient available funds for operations and planned development, which is provided by a multi-currency revolving credit facility.

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

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

#### Cash deposits

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

#### Gross contractual cash-flows for borrowings

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

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

#### Gross contractual cash-flows for derivative financial instruments

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

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

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

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

## 20 Derivative financial instruments

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

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

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

### Currency swaps not hedge accounted

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

### Accounting for other derivative contracts

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

### Netting

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

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

## 21 Fair value of financial instruments

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

Investments with level 1 valuations comprise quoted government bonds.

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

Borrowings are valued at the net present value of the future cash-flows using credit spreads and yield curves derived from market data. Borrowings are carried on the balance sheet at amortised cost adjusted for fair value interest rate hedging. The fair value of fixed rate borrowings is only used for supplementary disclosures.

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

## 22 Commitments

### Operating lease commitments – minimum lease payments

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

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

### Other commitments

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

## 23 Provisions and contingent liabilities

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

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

### Trading

#### Warranty provision and product liability

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

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

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

### Contingent liabilities

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

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

### Exceptional and legacy

#### John Crane, Inc.

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

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

## 23 Provisions and contingent liabilities continued

### Exceptional and legacy continued

#### John Crane, Inc. continued

##### John Crane, Inc. litigation provision

JCI continues to actively monitor the conduct and effect of its current and expected asbestos litigation, including the most efficacious presentation of its 'safe product' defence, and intends to continue to resist these asbestos claims based upon this defence. Approximately 242,000 claims (2014: 235,000 claims) against JCI have been dismissed before trial over the last 36 years. JCI is currently a defendant in cases involving approximately 76,000 claims (2014: 80,000 claims). Despite the large number of claims brought against JCI, since the inception of the litigation it has had final judgments against it, after appeals, in 133 cases (2014: 131 cases) over the period, and has had to pay awards amounting to approximately US\$153m (2014: US\$149m). JCI has also incurred significant additional defence costs. The litigation involves claims for a number of allegedly asbestos related diseases, with awards, when made, for mesothelioma tending to be larger than those for the other diseases JCI's ability to defend mesothelioma cases successfully is, therefore, likely to have a significant impact on its annual aggregate adverse judgment and defence costs. The provision is based on past history and published tables of asbestos incidence projections and is determined using asbestos valuation experts, Bates White LLC. Whilst published incidence curves can be used to estimate the likely future pattern of asbestos related disease, John Crane, Inc.'s claims experience is significantly impacted by other factors which influence the US litigation environment. These can include: changing approaches on the part of the plaintiffs' bar; changing attitudes amongst the judiciary at both trial and appellate levels; and legislative and procedural changes in both the state and federal court systems. The projections use a 10 year time horizon on the basis that Bates White LLC consider that there is substantial uncertainty in the asbestos litigation environment so probable expenditures are not reasonably estimable beyond this time horizon.

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

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

The provision in respect of JCI is a discounted pre-tax provision using discount rates, being the risk-free rate on US debt instruments for the appropriate period. The deferred tax asset related to this provision is shown within the deferred tax balance (note 7). Set out below is the gross, discounted and post-tax information relating to this provision:

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

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

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

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

##### John Crane, Inc. contingent liabilities

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

##### Titeflex Corporation

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

## 23 Provisions and contingent liabilities continued

### Exceptional and legacy continued

#### Titeflex Corporation continued

##### Titeflex Corporation litigation provision

The continuing progress of claims and the pattern of settlement, together with the recent market place activity, provide sufficient evidence to recognise a liability in the accounts. Therefore provision has been made for the costs which the Group is expected to incur in respect of future claims to the extent that such costs can be reliably estimated. Titeflex Corporation sells flexible gas piping with extensive installation and safety guidance (revised in 2008) designed to assure the safety of the product and minimise the risk of damage associated with lightning strikes.

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

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

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

The provision of £71m (2014: £61m) is a discounted pre-tax provision using discount rates, being the risk-free rate on US debt instruments for the appropriate period. The deferred tax asset related to this provision is shown within the deferred tax balance (note 7).

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

##### Titeflex Corporation litigation provision sensitivities

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

##### Titeflex Corporation contingent liabilities

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

### Other exceptional and legacy

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

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

#### Reorganisation and property

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

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

#### Disposal

Other provisions include disposal provisions of £3m (2014: £3m) relating to warranties and other obligations in respect of the disposal of the Marine Systems and Aerospace businesses. Most of the balance is expected to be utilised within the next four years.

## 24 Share capital

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

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

## 25 Dividends

The following dividends were declared and paid in the period:

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

The final dividend for the year ended 31 July 2015 of 28.00p per share was recommended by the Board on 22 September 2015 and will be paid to shareholders on 20 November 2015, subject to approval by the shareholders. This dividend has not been included as a liability in these accounts and is payable to all shareholders on the register of Members at close of business on 23 October 2015.

## 26 Reserves

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

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

### Capital management

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

The capital structure is based on the directors' judgement of the balance required to maintain flexibility while achieving an efficient cost of capital. The Group has a target gearing, calculated on a market value basis, of approximately 20%. At the balance sheet date the Group had gearing of 16% (2014: 15%).

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

As part of its capital management the Group strategy is to maintain a solid investment grade credit rating to ensure access to the widest possible sources of financing and to minimise the resulting cost of capital. At 31 July 2015 the Group had a credit rating of BBB+/Baa2 (2014: BBB+/Baa2) with Standard & Poor's and Moody's respectively. The credit rating is managed through the following cash-flow targets: headline operating cash conversion of greater than 90% and a ratio of net debt to headline EBITDA of less than two. For the year ended 31 July 2015 these measures were 95% (2014: 97%) and 1.4 (2014: 1.4).

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

### Hedge reserve

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

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

## Cash-flow

### Cash-flow from operating activities

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

### Smiths Group cash-flow measures

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

### Headline operating cash-flow

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

### Free cash-flow

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

# Unaudited Group financial record 2011-2015

	Year ended 31 July 2015 £m	Year ended 31 July 2014 £m	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m
Revenue	2,897	2,952	3,109	3,030	2,842
<b>Headline operating profit</b>	<b>511</b>	504	560	554	517
Amortisation and impairment of acquired intangible assets and goodwill	(60)	(39)	(46)	(62)	(50)
Exceptional items	(49)	(81)	(20)	(85)	(29)
Legacy retirement benefits	(8)	(6)	(7)		
<b>Operating profit</b>	<b>394</b>	378	487	407	438
Net finance costs	(69)	(76)	(91)	(47)	(44)
Share of post-tax profits of associated companies				6	4
<b>Profit before taxation</b>	<b>325</b>	302	396	366	398
Taxation	(77)	(67)	(79)	(108)	(92)
<b>Profit after taxation – continuing operations</b>	<b>248</b>	235	317	258	306
<b>Profit/(loss) after taxation – discontinued operations</b>					79
<b>Shareholders' equity</b>	<b>1,419</b>	1,237	1,486	973	1,373
Represented by					
– intangible assets	1,518	1,544	1,746	1,717	1,610
– property, plant & equipment and investments	415	375	366	331	333
– net current assets/provisions/retirement benefit liabilities	304	122	118	(284)	159
Net borrowings	(818)	(804)	(744)	(791)	(729)
<b>Funds employed</b>	<b>1,419</b>	1,237	1,486	973	1,373
<b>Ratios</b>					
Headline operating profit: turnover (%)	17.6	17.1	18.0	18.2	18.2
Headline effective tax rate (%)	25.5	27.0	26.5	26.5	26.5
Return on capital employed (%)	16.0	15.7	16.6	16.5	16.4
Return on shareholders' funds (%)	15.8	14.9	17.8	18.3	17.7
<b>Cash-flow</b>					
Headline operating cash	484	490	548	549	489
Headline operating cash conversion (%)	95	97	98	99	95
Free cash-flow (before acquisitions and dividends, after capital expenditure)	158	143	237	217	236
Free cash-flow per share (p)	40.1	36.2	60.3	55.3	60.4
<b>Earnings per share</b>					
Headline earnings per share (p)	86.1	81.8	92.7	92.6	86.5
<b>Dividends</b>					
Pence per share	41.00	40.25	39.50	38.00	36.25
Special dividend			30.00		
Headline dividend cover	2.1	2.0	2.3	2.4	2.4
<b>Number of employees (000s)</b>					
United Kingdom	1.7	1.8	1.9	1.9	2.0
Overseas	21.6	21.4	21.4	21.3	20.9
	23.3	23.2	23.3	23.2	22.9

\*The years ending 2012 and 2011 have not been restated for the adoption of IAS 19 (revised 2011). As a result, the statutory operating profit is higher, since it does not include administration costs for retirement benefit schemes, and statutory finance costs are lower, since they benefit from higher interest credits on pension assets. There is no impact on figures reporting on a headline basis.

# Unaudited supplementary consolidated income statement – US dollar translation

	Year ended 31 July 2015 \$m	Year ended 31 July 2014 \$m
<b>Continuing operations</b>		
Revenue	4,525	4,849
Cost of sales	(2,443)	(2,671)
Gross profit	2,082	2,178
Sales and distribution costs	(634)	(654)
Administrative expenses	(832)	(904)
<b>Operating profit</b>	<b>616</b>	<b>620</b>
Comprising		
– headline operating profit	798	828
– exceptional items, amortisation of acquired intangibles	(182)	(208)
	616	620
Interest receivable	5	4
Interest payable	(86)	(102)
Other financing losses	(14)	(12)
Net finance charges – retirement benefits	(12)	(14)
Finance costs	(107)	(124)
<b>Profit before taxation</b>	<b>509</b>	<b>496</b>
Comprising		
– headline profit before taxation	717	730
– exceptional items, amortisation of acquired intangibles and other financing gains and losses	(208)	(234)
	509	496
Taxation	(121)	(111)
<b>Profit after taxation</b>	<b>388</b>	<b>385</b>
Attributable to		
Smiths Group shareholders	385	382
Non-controlling interests	3	3
	388	385
<b>Earnings per share</b>		
Basic	97.5c	96.9c
Diluted	96.5c	95.9c

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

	Year ended 31 July 2015 \$m	Year ended 31 July 2014 \$m
Profit for the period	388	385
<b>Other comprehensive income</b>		
Actuarial gains/(losses) on retirement benefits	95	(126)
Taxation recognised on actuarial movements	31	10
<b>Other comprehensive income and expenditure which will not be reclassified to the consolidated income statement</b>	126	(116)
Other comprehensive income which will be, or has been, reclassified		
Exchange gains/(losses)	(143)	(179)
Fair value gains/(losses)		
– on available for sale financial assets	17	5
– deferred in the period on cash-flow and net investment hedges	(9)	195
– reclassified to income statement	1	(4)
<b>Total other comprehensive income</b>	(8)	(99)
<b>Total comprehensive income</b>	380	286
Attributable to		
Smiths Group shareholders	380	284
Non-controlling interests		2
	380	286

# Unaudited supplementary consolidated balance sheet

## – US dollar translation

	31 July 2015 \$m	31 July 2014 \$m
<b>Non-current assets</b>		
Intangible assets	2,371	2,606
Property, plant and equipment	404	436
Financial assets – other investments	244	197
Retirement benefit assets	266	207
Deferred tax assets	341	312
Trade and other receivables	63	59
Financial derivatives	7	16
	<b>3,696</b>	<b>3,833</b>
<b>Current assets</b>		
Inventories	710	722
Current tax receivable	47	57
Trade and other receivables	962	1,072
Cash and cash equivalents	774	321
Financial derivatives	31	13
	<b>2,524</b>	<b>2,185</b>
<b>Total assets</b>	<b>6,220</b>	<b>6,018</b>
<b>Non-current liabilities</b>		
Financial liabilities		
– borrowings	(1,797)	(1,658)
– financial derivatives	(10)	(7)
Provisions for liabilities and charges	(395)	(414)
Retirement benefit obligations	(433)	(615)
Deferred tax liabilities	(112)	(98)
Trade and other payables	(38)	(46)
	<b>(2,785)</b>	<b>(2,838)</b>
<b>Current liabilities</b>		
Financial liabilities		
– borrowings	(255)	(21)
– financial derivatives	(19)	(8)
Provisions for liabilities and charges	(123)	(138)
Trade and other payables	(728)	(783)
Current tax payable	(78)	(126)
	<b>(1,203)</b>	<b>(1,076)</b>
<b>Total liabilities</b>	<b>(3,988)</b>	<b>(3,914)</b>
<b>Net assets</b>	<b>2,232</b>	<b>2,104</b>
<b>Shareholders' equity</b>		
Share capital	231	250
Share premium account	546	585
Capital redemption reserve	9	10
Revaluation reserve	3	3
Merger reserve	367	396
Retained earnings	1,161	943
Hedge reserve	(98)	(97)
Total shareholders' equity	<b>2,219</b>	<b>2,090</b>
Non-controlling interest equity	13	14
<b>Total equity</b>	<b>2,232</b>	<b>2,104</b>

# Unaudited supplementary consolidated statement of changes in equity – US dollar translation

	Share capital and share premium \$m	Other reserves \$m	Retained earnings \$m	Hedge reserve \$m	Equity shareholders' funds \$m	Non-controlling interest \$m	Total equity \$m
At 31 July 2014	835	409	943	(97)	2,090	14	2,104
Profit for the year			385		385	3	388
Other comprehensive income							
Actuarial gains on retirement benefits and related tax			126		126		126
Exchange gains/(losses)	(63)	(30)	(54)	7	(140)	(3)	(143)
Fair value gains/(losses) and related tax			17	(8)	9		9
<b>Total comprehensive income for the year</b>	(63)	(30)	474	(1)	380		380
Transactions relating to ownership interests							
Exercises of share options	5				5		5
Taxation recognised on share options			(2)		(2)		(2)
Purchase of own shares			(17)		(17)		(17)
Dividends							
– equity shareholders			(250)		(250)		(250)
– non-controlling interest						(1)	(1)
Share-based payment			13		13		13
<b>At 31 July 2015</b>	<b>777</b>	<b>379</b>	<b>1,161</b>	<b>(98)</b>	<b>2,219</b>	<b>13</b>	<b>2,232</b>

	Share capital and share premium \$m	Other reserves \$m	Retained earnings \$m	Hedge reserve \$m	Equity shareholders' funds \$m	Non-controlling interest \$m	Total equity \$m
At 31 July 2013	741	368	1,410	(264)	2,255	12	2,267
Profit for the year			382		382	3	385
Other comprehensive income							
Actuarial losses on retirement benefits and related tax			(116)		(116)		(116)
Exchange gains/(losses)	84	41	(279)	(24)	(178)	(1)	(179)
Fair value gains/(losses) and related tax			5	191	196		196
<b>Total comprehensive income for the year</b>	84	41	(8)	167	284	2	286
Transactions relating to ownership interests							
Exercises of share options	10				10		10
Taxation recognised on share options			(1)		(1)		(1)
Purchase of own shares			(21)		(21)		(21)
Dividends							
– equity shareholders			(452)		(452)		(452)
– non-controlling interest							
Share-based payment			15		15		15
<b>At 31 July 2014</b>	<b>835</b>	<b>409</b>	<b>943</b>	<b>(97)</b>	<b>2,090</b>	<b>14</b>	<b>2,104</b>

# Unaudited supplementary consolidated cash-flow statement

## – US dollar translation

	Year ended 31 July 2015 \$m	Year ended 31 July 2014 \$m
<b>Net cash inflow from operating activities</b>	<b>416</b>	421
<b>Cash-flows from investing activities</b>		
Expenditure on capitalised development	(28)	(37)
Expenditure on other intangible assets	(28)	(29)
Purchases of property, plant and equipment	(92)	(89)
Disposals of property, plant and equipment	17	8
Investment in financial assets	(42)	(45)
Acquisition of businesses		(2)
Disposals of businesses	3	5
<b>Net cash-flow used in investing activities</b>	<b>(170)</b>	(189)
<b>Cash-flows from financing activities</b>		
Proceeds from exercise of share options	5	10
Purchase of own shares	(17)	(21)
Dividends paid to equity shareholders	(250)	(452)
Dividends paid to non-controlling interests	(1)	
Cash inflow/(outflow) from matured derivative financial instruments	7	18
Increase in new borrowings	887	227
Reduction and repayment of borrowings	(402)	(295)
<b>Net cash-flow used in financing activities</b>	<b>229</b>	(513)
<b>Net increase/(decrease) in cash and cash equivalents</b>	<b>475</b>	(281)
Cash and cash equivalents at beginning of year	319	587
Exchange differences	(20)	13
<b>Cash and cash equivalents at end of year</b>	<b>774</b>	319
Cash and cash equivalents at end of year comprise		
– cash at bank and in hand	163	194
– short-term deposits	611	127
– bank overdrafts		(2)
	<b>774</b>	319
Included in cash and cash equivalents per the balance sheet	<b>774</b>	321
Included in overdrafts per the balance sheet		(2)
	<b>774</b>	319
<b>Reconciliation of net cash-flow to movement in net debt</b>		
	Year ended 31 July 2015 \$m	Year ended 31 July 2014 \$m
<b>Net increase/(decrease) in cash and cash equivalents</b>	<b>475</b>	(281)
Net (increase)/decrease in borrowings resulting from cash-flows	(485)	68
<b>Movement in net debt resulting from cash-flows</b>	<b>(10)</b>	(213)
Capitalisation, interest accruals and unwind of capitalisation fees	(2)	4
Movement from fair value hedging	12	(5)
Exchange differences	80	(15)
<b>Movement in net debt in the year</b>	<b>80</b>	(229)
Net debt at start of year	(1,358)	(1,129)
<b>Net debt at end of year</b>	<b>(1,278)</b>	(1,358)

# Independent auditors' report to the members of Smiths Group plc

## Report on the Company financial statements

### Our opinion

In our opinion, Smiths Group plc's Company financial statements (the "financial statements"):

- give a true and fair view of the state of the Company's affairs as at 31 July;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

### What we have audited

The financial statements comprise:

- the Company balance sheet as at 31 July 2015;
- the accounting policies; and
- the notes to the financial statements, which include other explanatory information.

The financial reporting framework that has been applied in the preparation of the financial statements is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

### Other required reporting

#### Consistency of other information

##### Companies Act 2006 opinion

In our opinion, the information given in the Strategic Report and the Group directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements.

#### ISAs (UK & Ireland) reporting

Under International Standards on Auditing (UK and Ireland) ("ISAs (UK & Ireland)") we are required to report to you if, in our opinion, information in the Annual Report is:

- materially inconsistent with the information in the audited financial statements; or
- apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Company acquired in the course of performing our audit; or
- otherwise misleading.

We have no exceptions to report arising from this responsibility.

#### Adequacy of accounting records and information and explanations received

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
- the 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.

### Directors' remuneration

#### Directors' remuneration report – Companies Act 2006 opinion

In our opinion, the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006.

#### Other Companies Act 2006 reporting

Under the Companies Act 2006 we are required to report to you if, in our opinion, certain disclosures of directors' remuneration specified by law are not made. We have no exceptions to report arising from this responsibility.

## Responsibilities for the financial statements and the audit

### Our responsibilities and those of the directors

As explained more fully in the Statement of directors responsibilities set out on page 120, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and ISAs (UK & Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

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.

### What an audit of financial statements involves

We conducted our audit in accordance with ISAs (UK & Ireland). An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- whether the accounting policies are appropriate to the Company's circumstances and have been consistently applied and adequately disclosed;
- the reasonableness of significant accounting estimates made by the directors; and
- the overall presentation of the financial statements.

We primarily focus our work in these areas by assessing the directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

We test and examine information, using sampling and other auditing techniques, to the extent we consider necessary to provide a reasonable basis for us to draw conclusions. We obtain audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

In addition, we read all the financial and non-financial information in the Annual Report 2015 (the "Annual Report") to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

### Other matter

We have reported separately on the Group financial statements of Smiths Group plc for the year ended 31 July 2015.

### Andrew Kemp

#### (Senior Statutory Auditor)

for and on behalf of PricewaterhouseCoopers LLP  
Chartered Accountants and Statutory Auditors  
London

22 September 2015

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

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

# Company balance sheet

	Notes	31 July 2015 £m	31 July 2014 £m
<b>Fixed assets</b>			
Tangible assets	2		1
Investments and advances	3	<b>3,486</b>	3,495
Available for sale financial assets	4	<b>147</b>	111
		<b>3,633</b>	3,607
<b>Current assets</b>			
Debtors			
– amounts falling due within one year	5	<b>60</b>	58
Cash at bank and on deposit		<b>330</b>	17
Financial derivatives			
– amounts falling due within one year		<b>12</b>	5
– amounts falling due after more than one year		<b>4</b>	9
		<b>406</b>	89
Creditors: amounts falling due within one year	6	<b>(236)</b>	(58)
<b>Net current assets/(liabilities)</b>		<b>170</b>	31
<b>Total assets less current liabilities</b>		<b>3,803</b>	3,638
Creditors: amounts falling due after more than one year	6	<b>(1,148)</b>	(981)
Provisions for liabilities and charges	7	<b>(2)</b>	(3)
Financial derivatives		<b>(6)</b>	(4)
<b>Net assets excluding pension liabilities</b>		<b>2,647</b>	2,650
Retirement benefit liabilities	8	<b>(89)</b>	(202)
<b>Net assets including pension liabilities</b>		<b>2,558</b>	2,448
<b>Capital and reserves</b>			
Called up share capital	9	<b>148</b>	148
Share premium account	10	<b>349</b>	346
Capital redemption reserve	10	<b>6</b>	6
Other reserves	10	<b>181</b>	181
Profit and loss account	10	<b>1,874</b>	1,767
<b>Shareholders' equity</b>		<b>2,558</b>	2,448

The accounts on pages 182 to 193 were approved by the Board of Directors on 22 September 2015 and were signed on its behalf by:

**Philip Bowman**  
Chief Executive

**Chris O'Shea**  
Finance Director

# Company accounting policies

## Basis of preparation

The accounts have been prepared in accordance with the Companies Act 2006 and all applicable accounting standards in the United Kingdom (UK GAAP).

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 entity profit and loss account and statement of total recognised gains and losses have not been presented. As permitted by Section 408(2), information about the Company's employee numbers and costs is not presented.

The Company has taken advantage of the exemption in 'FRS 8: Related Party Disclosures' not to disclose transactions with other wholly owned members of the Smiths Group.

## Adoption of Financial Reporting Standard (FRS) 101 'Reduced Disclosure Framework'

Following changes to the UK accounting standards and regulations, from 1 August 2015 Smiths Group plc will need to adopt a new accounting framework for the Company financial statements. It is considered that adopting FRS 101 would provide the most relevant and cost-effective disclosures for Smiths Group plc. On adoption of FRS 101, no disclosures in the current financial statements would be omitted. Shareholder approval for the adoption of FRS 101 will be sought at the Group's next Annual General Meeting in November 2015.

## 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.

## Tangible fixed assets

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 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%.

## Fixed asset investments

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 132 to 137 for recognition, measurement and presentation of financial instruments are applied in the Company accounts.

Where there are no differences between the disclosures required for the Group and the Company in respect of a class of financial instruments, an appropriate cross-reference is made to the Group accounts.

## Taxation

Deferred tax is recognised in respect of timing differences that have originated but not reversed as at the balance sheet date.

Timing differences are differences between the Company's taxable profits and its results as disclosed in the accounts, arising from the inclusion of gains and losses in tax assessments in periods different from those in which they are recognised in the accounts.

Deferred tax is not recognised on any fixed assets that have been revalued unless there is a binding agreement to sell the asset.

## 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 in the period in which they occur, outside of the profit and loss account, and are presented in the statement of total recognised gains and losses. Past service costs are recognised immediately in the profit and loss account, unless the changes to the pension plan are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past service costs are amortised on a straight-line basis over the vesting period.

For defined contribution plans, the 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 certain post-retirement healthcare schemes which 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 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.

### **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 (2014: £0.1m).

## 2 Property, plant and equipment

	Plant and equipment £m
<b>Cost or valuation</b>	
<b>At 31 July 2014 and 31 July 2015</b>	<b>7</b>
<b>Depreciation</b>	
At 31 July 2014	6
Charge for the period	1
<b>At 31 July 2015</b>	<b>7</b>
<b>Net book value at 31 July 2015</b>	
Net book value at 31 July 2014	1

Property, plant and equipment comprises plant, machinery, fixtures, fittings, tools and equipment.

## 3 Investments and advances

	Shares at cost £m	Due from subsidiaries £m	Due to subsidiaries £m	Total £m
<b>Cost or valuation</b>				
At 31 July 2014	2,396	1,919	(797)	3,518
Exchange adjustments		14	2	16
Contribution through share options	5			5
Additions	4			4
Liquidations	(14)			(14)
Increases in advances due from/(due to) subsidiaries		169	(201)	(32)
<b>At 31 July 2015</b>	<b>2,391</b>	<b>2,102</b>	<b>(996)</b>	<b>3,497</b>
<b>Provision for impairment</b>				
At 31 July 2014	22	1		23
Additional provisions	1			1
Liquidations	(13)			(13)
<b>At 31 July 2015</b>	<b>10</b>	<b>1</b>		<b>11</b>
<b>Net book value at 31 July 2015</b>	<b>2,381</b>	<b>2,101</b>	<b>(996)</b>	<b>3,486</b>
Net book value at 31 July 2014	2,374	1,918	(797)	3,495

Loans due to subsidiaries are only 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. 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

### 3 Investments and advances continued

The principal subsidiaries and their countries of incorporation are:

#### England

Smiths Detection – Watford Ltd  
Smiths Medical International Limited  
John Crane UK Limited

#### Europe

Smiths Heimann SAS (France)  
Smiths Heimann GmbH (Germany)  
Smiths Medical France SA (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)

#### United States

Smiths Detection, Inc.  
Smiths Medical ASD, Inc.  
John Crane, Inc.  
Titeflex Corporation  
Flexible Technologies, Inc.  
Tutco, Inc.  
Hypertronics Corporation  
Transtector Systems, Inc.  
Interconnect Devices, Inc.  
Power Distribution, Inc.  
JC Production Solutions, Inc.

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 subsidiaries operate in their country of incorporation.

See pages 191 to 193 for a complete list of subsidiary undertakings.

### 4 Available for sale financial assets

Available for sale financial assets comprise UK government bonds. This investment forms part of the deficit funding plan agreed with the trustee of one of the principal UK pension schemes. See note 8 for additional details.

### 5 Debtors

	31 July 2015 £m	31 July 2014 £m
<b>Amounts falling due within one year</b>		
Amounts owed by subsidiaries	<b>56</b>	53
Other debtors	<b>4</b>	5
	<b>60</b>	58

### 6 Creditors

	31 July 2015 £m	31 July 2014 £m
<b>Amounts falling due within one year</b>		
Term loans	<b>150</b>	
Amounts owed to subsidiaries	<b>55</b>	34
Other creditors	<b>23</b>	16
Accruals and deferred income	<b>8</b>	8
	<b>236</b>	58

## 6 Creditors continued

	31 July 2015 £m	31 July 2014 £m
<b>Amounts falling due after more than one year</b>		
Term loans	<b>1,148</b>	981
	<b>1,148</b>	981

### Term loans

The currency and coupons for the term loans are disclosed in note 18 of the Group accounts.

	31 July 2015 £m	31 July 2014 £m
Less than one year	<b>150</b>	
Between one and two years	<b>214</b>	150
Between two and three years	<b>112</b>	243
Between three and four years	<b>159</b>	104
Between four and five years		253
Greater than five years	<b>663</b>	231
Smiths Group plc term loans	<b>1,298</b>	981

See the liquidity risk disclosures in note 19 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 2020.

## 7 Provisions for liabilities and charges

	At 31 July 2014 £m	Charged against profit £m	Utilisation £m	At 31 July 2015 £m
Disposals	3		(1)	<b>2</b>
	3		(1)	<b>2</b>

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.

## 8 Post-retirement benefits

The Company operates three defined benefit plans in the UK. The largest of them is a funded scheme with assets held in a separate trustee-administered fund. The Company is the sole employer in that scheme and, accordingly, accounts for it as a defined benefit pension plan, in accordance with FRS 17. The UK defined benefit pension schemes were closed with effect from 31 October 2009.

Pension costs are assessed in accordance with the advice of independent, professionally qualified actuaries. The most recent actuarial valuation of the funded scheme was performed using the Projected Unit Method as at 31 March 2012. This valuation has been updated by independent qualified actuaries in order to assess the liabilities of the scheme as at 31 July 2015, incorporating demographic experience identified during work on the 31 March 2015 valuation, which is ongoing. Scheme assets are stated at their market values. Contributions to the schemes are made on the advice of the actuaries.

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

	31 July 2015	31 July 2014
Rate of increase in salaries	<b>n/a</b>	n/a
Rate of increase for active deferred members	<b>4.1%</b>	4.2%
Rate of increase in pensions in payment	<b>3.2%</b>	3.3%
Rate of increase in deferred pensions	<b>3.2%</b>	3.3%
Discount rate	<b>3.5%</b>	4.0%
Inflation rate	<b>3.2%</b>	3.3%
Healthcare cost increases	<b>4.7%</b>	4.3%

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.

## 8 Post-retirement benefits continued

The mortality assumptions used are based on the recent actual mortality experience of members. The assumptions are based on the new SAPS All Birth year tables with relevant scaling factors based on the experience of the schemes. The assumption also allows for future improvements in life expectancy in line with the 2014 CMI projections blended to a long-term rate of 1.25%. The assumptions give the following:

Expected further years of life	31 July 2015		31 July 2014	
	Male	Female	Male	Female
Member who retires next year at age 65	23	24	23	25
Member, currently 45, when they retire in 20 years' time	24	26	25	27

The assets in the scheme and the expected rates of return as at 31 July 2015 were:

	31 July 2015		31 July 2014	
	Long-term rate of return	Value £m	Long-term rate of return	Value £m
Equities			7.3%	23
Government bonds	2.5%	770	3.2%	508
Corporate bonds	3.5%	284	4.0%	267
Insured liabilities	3.5%	22	4.0%	31
Property	6.2%	174	6.9%	181
Managed growth funds	5.4%	337		
Cash and money market funds	10.9%	226	3.2%	629
Total market value		1,813		1,639
Present value of funded pension scheme liabilities		(1,843)		(1,784)
Deficit		(30)		(145)
Unfunded pension plans		(52)		(50)
Post-retirement healthcare		(7)		(7)
<b>Net retirement benefit liability</b>		<b>(89)</b>		<b>(202)</b>

The growth rate on cash and money market funds represents the expected growth on the synthetic equity investment strategy which SIPS introduced in August 2014, because the cash is held to meet margin calls on the exchange-traded futures used to implement this strategy. At 31 July 2015 the fair value of the equity future contract derivatives held by the scheme was £(0.03)m.

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

### History of experience gains and losses

	31 July 2015 £m	31 July 2014 £m	31 July 2013 £m	31 July 2012 £m	31 July 2011 £m
Fair value of scheme assets	1,813	1,639	1,581	1,413	1,439
Present value of pension and post-retirement healthcare obligations	(1,902)	(1,841)	(1,771)	(1,743)	(1,588)
Net retirement benefit liability	(89)	(202)	(190)	(330)	(149)
Actual return less expected return on pension scheme assets	120		127	(88)	46
As a percentage of scheme assets	7%	(0%)	8%	(6%)	3%
Experience gains and losses arising on the scheme liabilities	28	11	(5)	79	(16)
As a percentage of present value scheme liabilities	2%	1%	0%	5%	(1%)

### Changes in present value of scheme assets and defined benefit obligations

	Assets 31 July 2015 £m	Assets 31 July 2014 £m	Obligations 31 July 2015 £m	Obligations 31 July 2014 £m
At beginning of the period	1,639	1,581	(1,841)	(1,771)
Service cost				
Expected return on assets	91	94		
Interest on obligations			(73)	(76)
Actuarial gain/(loss)	120		(64)	(69)
Contributions by employer	39	39		
Benefits paid	(76)	(75)	76	75
<b>At end of the period</b>	<b>1,813</b>	<b>1,639</b>	<b>(1,902)</b>	<b>(1,841)</b>

## 8 Post-retirement benefits continued

### Cash contributions

Negotiations with the trustees on the 2015 triennial valuations for the principal UK schemes are ongoing. Until these negotiations are completed, the current contributions will continue as follows:

- Cash contributions to SIPS of £36m a year until October 2019.
- In connection with SIPS, an ongoing investment of £24m a year in index-linked gilts held in an escrow account. The escrow account remains an asset of the Group until 2020. At that time the assets in escrow will be allocated subject to the funding position of SIPS. In addition, the escrow account may revert to the Group, should there be a surplus at an intervening triennial review.

Contributions to the scheme are made on the advice of the scheme actuaries.

The impact of changes in healthcare cost trend rates is not material, because a substantial proportion of the post-retirement healthcare liability has been capped at a fixed annual contribution.

## 9 Share capital

	Number of shares	Issued capital £m	Consideration £m
<b>Ordinary shares of 37.5p each</b>			
At 31 July 2014	394,456,135	148	
Exercise of share options	403,869		3
<b>Total share capital at 31 July 2015</b>	<b>394,860,004</b>	<b>148</b>	

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

	31 July 2015	31 July 2014
Number of ordinary shares issuable under outstanding options	<b>1,442,268</b>	1,678,684

	Year issued	Number of shares	Subscription prices	Dates normally exercisable
Smiths Sharesave Scheme	2008	2,601	724.00p	2011/2015
	2009	18,361	569.00p	2012/2016
	2010	25,838	894.00p	2013/2017
	2011	17,061	1035.00p	2014/2018
	2012	183,149	811.00p	2015/2019
	2013	112,681	1008.00p	2016/2018
	2014	328,763	990.00p	2017/2019
	2015	294,433	900.00p	2018/2020
Smiths Industries Executive Share Option Schemes	2005	71,852	901.00p	2008/2015
	2006	160,500	896.50p	2009/2016
	2007	227,029	1,097.00p	2010/2017

## 10 Share premium account and reserves

	Share premium £m	Capital redemption reserve £m	Other reserves £m	Profit and loss account £m
At 31 July 2014	346	6	181	1,767
Exercise of share options	3			
Purchase of own shares				(11)
Profit for the period				202
Dividends paid to equity shareholders				(160)
Actuarial gain on retirement benefits				56
Fair value gains on available for sale financial assets				11
Share-based payment				9
<b>At 31 July 2015</b>	<b>349</b>	<b>6</b>	<b>181</b>	<b>1,874</b>

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 £11m (2014: £13m) and £nil (2014: £nil) was received as a result of the issue of shares. At 31 July 2015 the Trust held 852 (2014: 855) ordinary shares.

The Company's profit and loss reserve of £1,874m includes £908m (2014: £896m) not available for distribution as dividend.

During the year, the Company received £3m (2014: £6m) on the issue of shares in respect of the exercise of options awarded under various share option schemes.

Other reserves arose from the cancellation of the share premium arising from an equity-funded acquisition in the year ended 30 July 1988.

## 11 Deferred tax

The Company is part of a UK tax group including all its UK-based subsidiaries. At 31 July 2011 the Company recognised UK tax assets relating to revenue losses brought forward of £28m, and other timing differences of £4m. The value of these assets is reviewed regularly and is dependent on the ability to recover them against forecast UK taxable profits of the tax group. Having considered the impact of the increased pension deficit on the outlook for the UK tax base, the Company decided to derecognise the tax assets at 31 July 2012 because it is no longer probable that they will be recovered.

At 31 July 2015 the Company has unrecognised deferred tax assets of £63m (2014: £91m) relating to:

- retirement benefit obligations £16m (2014: £39m);
- losses carried forward £44m (2014: £48m);
- share-based payments £1m (2014: £2m); and
- other timing differences £2m (2014: £2m).

These tax allowances remain available to the Company and can be utilised should the UK tax base improve.

## 12 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 (2014: £51m).

The Company has guaranteed the US\$800m revolving credit facility available to a subsidiary.

## 13 Post balance sheet event

The directors propose a final dividend of 28.00p per share (totalling approximately £111m) for the year ended 31 July 2015. The dividend will be submitted for formal approval at the Annual General Meeting to be held on 17 November 2015.

In accordance with FRS 21, 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 2016. During the year ended 31 July 2015, a final dividend of 27.00p per share (totalling £108m) was paid in respect of the dividends declared for the year ended 31 July 2014.

# Smiths Group plc subsidiaries

Subsidiary	Country	Security	Direct (%)	Total (%)
Air Log Limited	United Kingdom	ORD 1p		100
Antares Advanced Test Technologies (Suzhou) Co. Ltd	China	Ord \$1		100
Antares China Holdings, Inc	United States	Common shares		100
Ashfield Medical Systems Limited	United Kingdom	Ord £1		100
CDI Oilfield Services Srl	Romania	Ord RON 10		100
Changshu Flex-Tek Thermal Fluid Systems Manufacturer Co. Ltd	China	US\$520,800 (reg capital)		100
Compania EMC Tecnologia S.A.	Costa Rica	Ord \$1		100
CVE Trustee Limited	United Kingdom	Ord £1	100	100
EIS Group Plc	United Kingdom	ORD 25p	100	100
Flagtown Limited	United Kingdom	Ord £1	100	100
Flexible Ducting Malaysia Sdn Bhd	Malaysia	Ord \$1		100
Flexible Ducting, Limited	United Kingdom	Ord £1		100
Flexible Technologies (Canada) Ltd	Canada	Ordinary shares \$1		100
Flexible Technologies, Inc	United States	Ordinary shares \$0.01		100
Flexibox (Northern Ireland) Limited	United Kingdom	Ord £1		100
Flexibox (Pty) Limited	South Africa	Ord		100
Flexibox International Limited	United Kingdom	Ord £1		100
Flexibox Japan KK	Japan	Ord JPY 1000		100
Flexibox Limited	United Kingdom	Ord £1		100
Flexibox Pty Limited	Australia	Ord AUS\$ each		100
Flexschlauch Produktions GmbH	Germany	Ord		100
Flightspares Limited	United Kingdom	Ord £1; Ord 10p	100	100
Francis Shaw And Company (Manchester) Limited	United Kingdom	Ord £1		100
Francis Shaw P L C	United Kingdom	37% 2nd Pref Ord 10p; 5.25% Cum Pref £1; Def 20p; Ord 10p		100
George Maclellan Holdings Limited	United Kingdom	Def Ord 25p; Ord 5p	100	100
Global TI Limited	United Kingdom	Ord £1		100
Graseby Limited	United Kingdom	ORD 25p	100	100
Graseby Medical Ireland Limited	Ireland	Ord €1.269738 each		100
Graseby Medical Limited	United Kingdom	Ord £1		100
Hypertac GmbH	Germany	Ord €1		100
Hypertac Limited	United Kingdom	Ord £1		100
Hypertac S.A.	France	Ord €76		100
Hypertac SpA	Italy	Ord €5		100
Hypertronics Corporation	United States	Common stock		100
Indufil BV	Netherlands	Ord		100
Industrias John Crane Mexico S.A. de C.V.	Mexico	Series A MXN 1; Series B MXN 1		100
Interconnect Devices, Inc.	United States	Common stock		100
John Crane (Angola) Prestacao De Services Ltd	Angola	Ord AOA 1		100
John Crane (Ireland) Limited	Ireland	ORD US\$1		100
John Crane (Switzerland) AG	Switzerland	Ord 1 CHF		100
John Crane (Thailand) Limited	Thailand	Ord THB1		100
John Crane Argentina SA	Argentina	Common \$1 ARS		100
John Crane Australia Pty Limited	Australia	Ord AUS\$1		100
John Crane Baku LLC	Azerbaijan	Ord US 10		100
John Crane Bearing Technology GmbH	Germany	Ord		100
John Crane Belgium NV	Belgium	No par value		100
John Crane Canada Inc	Canada	Common \$1		100
John Crane Caribe Ltd	Puerto Rico	Common shares		100
John Crane Chile SA	Chile	Ord		100
John Crane China Co. Limited	China	ORD CNY1		100
John Crane Colombia SA	Colombia	Ord COP\$1		100
John Crane Dominicana SA	Dominican Republic	Ord DP\$1		100
John Crane Egypt LLC	Egypt	Ord EGP 1		100
John Crane Egypt Sealing Systems LLC	Egypt	Ord EGP 1		100
John Crane Endustriyel Sızdırmazlık Sistemleri Ltd	Turkey	Ord TRY 25		100
John Crane Flexibox India Private Limited	India	Ord INR 10		100
John Crane France SAS	France	Ord €286		100
John Crane GmbH	Germany	Ord €1		100
John Crane Group Corporation	United States	Ord		100
John Crane Group Limited	United Kingdom	Ord £1		100
John Crane Hellas – Engineered Sealing Systems Monoprosopi EPE	Greece	Ord €1		100
John Crane Holland BV	Netherlands	Ord €1		100
John Crane Hungary Kft	Hungary	Ord €1		100
John Crane Iberica SA	Spain	Ord €6.010121		100
John Crane Inc	United States	Common \$0.01; preferred \$0.10		100
John Crane International Inc.	United States	Common shares		100
John Crane International Limited	United Kingdom	Ord £1		100
John Crane Investments Limited	United Kingdom	Ord £1		100
John Crane Ireland Limited (In Liquidation)	Cayman Islands	Ord \$1		100
John Crane Italia SpA	Italy	Ord €5.16		100
John Crane Japan Inc	Japan	Ord JPY1,000		70
John Crane Korea Co Ltd	Korea, Republic of	Ord KWON5,000		100
John Crane Malaysia Sdn. Bhd.	Malaysia	Ord MYR \$1		100
John Crane Middle East FZE	United Arab Emirates	Ord AED 1		100
John Crane Peru SAC	Peru	Common shares		100
John Crane Poland Sp Z O.O.	Poland	Ord 50 PLN		100
John Crane Production Solutions Inc	United States	Ord \$0.01		100
John Crane Pty Ltd	South Africa	Ord ZAR 1		100
John Crane Safematic Oy	Finland	Ord		100
John Crane Saudi Arabia Ltd	Saudi Arabia	Ord SAR 1		100
John Crane Sealing Systems India Private Limited	India	Ord INR10		100
John Crane Sigma AS	Czech Republic	Ord CZK 1m		100
John Crane Singapore Pte Limited	Singapore	Ord S\$1		100
John Crane Slovakia sro	Slovakia	Ord €1		100
John Crane Sociedad De Responsabilidad Limitada De Capital Variable	Mexico	Ord MXN \$1		100

Strategic report – Strategic overview

Strategic report – Operational review

Strategic report – Risks and responsibility

Governance

Accounts

**Smiths Group plc subsidiaries**  
**Continued**

Subsidiary	Country	Security	Direct (%)	Total (%)
John Crane Sverige AB	Sweden	Ord		100
John Crane Taiwan Inc	Taiwan Province of China	Ord T\$1		100
John Crane Technology (Tianjin) Co Limited	China	Ord US\$1		100
John Crane UK Limited	United Kingdom	Ord £1		100
John Crane Venezuela CA	Venezuela	CLASS "A" VEF1; CLASS "B" VEF1; COMMON VEF1		100
Kaelus Communications Equipment (Shanghai) Co. Ltd	China	Ord \$1		100
Kaelus Interconnect (Shanghai) Co. Ltd.	China	Ord \$1		100
Kaelus Pty Ltd	Australia	E shares AUS \$1; ord AUS \$1		100
Kaelus, Inc.	United States	Class A common stock \$0.01; Class B common stock \$0.01		100
Kiinteisto Oy Ainolantie 21	Finland	Ord		100
Kontak Manufacturing Company Limited	United Kingdom	Ord £1		100
Lighthome Limited (in liquidation)	United Kingdom	Ord £1	100	100
LLC John Crane Rus	Russian Federation	Ord RUB 1 each		100
M.J.A. Dynamics Limited	United Kingdom	Ord £1	100	100
Machinefabriek Bromefab BV	Netherlands	Ord		100
Medex Cardio-Pulmonary, Inc	United States	Common Stock of \$0.01		100
Medex Medical Limited	United Kingdom	Ord £1		100
Micro Circuit Engineering Limited	United Kingdom	Ord £1	100	100
Millitech, Inc.	United States	Common stock		100
Oil Plus Limited	United Kingdom	Ord £1		100
Orion Corporation	United States	Ord 1 cent		100
Plenty India Limited	India	Ord		100
Pneupac Limited	United Kingdom	Ord £0.50		100
Power Distribution, Inc.	United States	Common		100
Powercam-Houdaille, Inc.	United States	Common shares		100
Project Sugar Limited	United Kingdom	Ord £1		100
Pt John Crane Indonesia	Indonesia	Ord IDR1,000		99
Pyzotec Limited	United Kingdom	Ord £1	75	75
Radio Waves, Inc.	United States	Common stock		100
Roof Units (Group) Limited	United Kingdom	ORD 10p	100	100
S.I. Pension Trustees Limited	United Kingdom	Ord £1	100	100
Sabritec	United States	Ordinary shares		100
Sedding (No.1) Limited	United Kingdom	DEF £1; ORD 1p		100
Sedding (No.3) Limited	United Kingdom	Ord £1		100
Shenzhen Dowin Lightning Protection Engineering Co. Ltd	China	Ord 1RMB		100
Shenzhen Dowin Lightning Technologies Co. Ltd.	China	Ord 1RMB		100
SI Overseas Holdings Limited	United Kingdom	Ord £1		100
SI Properties Limited	United Kingdom	Ord 25p	100	100
SITI 1 Limited	United Kingdom	US\$1 shares	100	100
Smiths Aerospace Components Tyseley Limited	United Kingdom	Ord £1		100
Smiths Aerospace Components-Burnley Limited	United Kingdom	Ord £1		100
Smiths Aerospace Gloucester Limited	United Kingdom	Ord 25p; Ord A 25p		100
Smiths Brasil LTDA	Brazil	Ord R\$1		100
Smiths Business Information Services Limited	United Kingdom	Ord £10		100
Smiths Business Information Services, Inc.	United States	Ord \$0.01		100
Smiths Connectors Asia Pte. Ltd.	Singapore	Ord SGD\$1		100
Smiths Connectors Tunisia Sarl	Tunisia	Ord 1 DT		100
Smiths Detection – Toronto Ltd.	Canada	Common shares; Preference shares		100
Smiths Detection (Asia Pacific) Pte. Ltd	Singapore	Ord S\$1		100
Smiths Detection (Australia) Pty Ltd	Australia	Ord AUD 1		100
Smiths Detection (Thailand) Limited	Thailand	Ord THB100; Pre THB100		100
Smiths Detection Brasil Comerico De Equipamentos LTDA	Brazil	Common		100
Smiths Detection GmbH	Germany	1 share of € 25,000; 1 share of €183,100; 1 shares of € 791,900		100
Smiths Detection Group Limited	United Kingdom	Ord £1		100
Smiths Detection Inc	United States	Common stock of \$0.0001		100
Smiths Detection Investments Limited	United Kingdom	Ord £1		100
Smiths Detection Ireland Limited	Ireland	Ord €1.25; Ord B of €1.269738; Ord D €1.25; Series C shares €1.25		100
Smiths Detection Italia Srl	Italy	Quota value of shares		100
Smiths Detection Limited	United Kingdom	Ord £1	100	100
Smiths Detection Malaysia Sdn Bhd	Malaysia	Share of 1 MYR		100
Smiths Detection Middle East FZE	United Arab Emirates	Share of AED 1,000,000		100
Smiths Detection Montreal Inc.	Canada	Class A shares; Class B shares		100
Smiths Detection New Zealand Limited	New Zealand	Ord NZ\$1		100
Smiths Detection Saudi Arabia Co. Ltd	Saudi Arabia	Share of 1000 Saudi Riyals		100
Smiths Detection US, LLC	United States	Ord \$1		100
Smiths Detection Security Systems LLC	Abu Dhabi	UAE Dirhams150,000 (Reg Capital)		49
Smiths Detection Veecon Systems Private Limited	India	Class A equity shares INR 10; Class B equity shares INR 10		100
Smiths Detection-Watford Limited	United Kingdom	Ord £1		100
Smiths Finance Limited	United Kingdom	Ord £1; Redeemable US\$1		100
Smiths Finance Luxembourg Sarl	Luxembourg	Ord US\$0.01		100
Smiths Group (Gibraltar) Limited	Gibraltar	Ord US\$ 1.56		100
Smiths Group Deutschland GmbH	Germany	1 share of €1,491,400; 1 share of €3,478,400; 1 share of €995,500		100
Smiths Group Holdings Netherlands BV	Netherlands	Ord		100
Smiths Group Insurance Limited	Guernsey	Ord £1		100
Smiths Group International Holdings Limited	United Kingdom	Ord £1	100	100
Smiths Group Italia Srl	Italy	Ord €1		100
Smiths Group Luxembourg Sarl	Luxembourg	Ord US\$1.00		100
Smiths Group Services Corp.	United States	Common stock \$0.01		100
Smiths Healthcare Limited	United Kingdom	ORD 1p	100	100
Smiths Healthcare Manufacturing, S.A. de C.V.	Mexico	Series B 10 pesos; series B-1 pesos 10		100

Subsidiary	Country	Security	Direct (%)	Total (%)
Smiths Heimann Del Ecuador SA	Ecuador	Ordinary shares of \$1.00 each		100
Smiths Heimann GmbH	Germany	Ord		100
Smiths Heimann Limited	United Kingdom	Ord £1	100	100
Smiths Heimann Rus LLC	Russian Federation	Ord		100
Smiths Heimann S.A.S.	France	Shares of €6 each		100
Smiths Industries GmbH	Germany	Ordinary	100	100
Smiths Industries Industrial Group Limited	United Kingdom	Ord £1		100
Smiths Industries Limited	United Kingdom	7% non cum pref; Ord £1	100	100
Smiths Interconnect Australia Pty Ltd	Australia	Ord \$1 AUS		100
Smiths Interconnect Connectors UK	United Kingdom	Ordinary		100
Smiths Interconnect Connectors, Inc.	United States	Common		100
Smiths Interconnect Group Limited	United Kingdom	Ord £1		100
Smiths Interconnect Microwave Components, Inc.	United States	Common stock		100
Smiths Interconnect Power Management, Inc.	United States	Common stock \$0.01		100
Smiths Interconnect Power Management UK	United Kingdom	Ordinary		100
Smiths Interconnect, Inc.	United States	Common stock		100
Smiths Medical (Beijing) Co. Ltd	China	Ordinary shares \$1		100
Smiths Medical (Hong Kong) Limited	Hong Kong	Ord HK\$1		100
Smiths Medical (Portugal), Unipessoal Lda	Portugal	1 Share of €505,000		100
Smiths Medical (South Africa) (Pty) Ltd	South Africa	Shares of R1 each		100
Smiths Medical ASD Inc.	United States	Common stock of \$1		100
Smiths Medical Australasia Pty Ltd	Australia	Ord		100
Smiths Medical Belgium NV	Belgium	Reg		100
Smiths Medical Canada Ltd	Canada	Common shares		100
Smiths Medical Czech Republic A.S	Czech Republic	Ordinary		100
Smiths Medical Danmark ApS	Denmark	Shares of DKK100 each		100
Smiths Medical Deutschland GmbH	Germany	1 share of €1,000; 1 share of €27,000; 1 share of €5,000		100
Smiths Medical Distribution Limited	United Kingdom	Ord £1		100
Smiths Medical Do Brasil Produtos Hospitalares LTDA	Brazil	Ord R\$1		100
Smiths Medical Espana S.L.	Spain	Shares €1		100
Smiths Medical France SAS	France	Shares of €7.7 each		100
Smiths Medical Group Limited	United Kingdom	Ord A £1; Ord B £1; Ord C £1		100
Smiths Medical India Private Limited	India	Ord 1 INR		100
Smiths Medical Instrument (Zhejiang) Co. Ltd	China	Ordinary shares of RMB		100
Smiths Medical International Limited	United Kingdom	Ord £1; Pref €2		100
Smiths Medical Italia Srl	Italy	Ord €1		100
Smiths Medical Japan Ltd	Japan	Common stock		100
Smiths Medical Limited	United Kingdom	Ord £1		100
Smiths Medical Nederland B.V.	Netherlands	Shares NLG100		100
Smiths Medical Osterreich GmbH	Austria	Ord €1		100
Smiths Medical Schweiz AG	Switzerland	Shares of CHF 10.00 each		100
Smiths Medical Singapore Pte. Limited	Singapore	Ordinary shares		100
Smiths Medical Sverige AB	Sweden	Shares of SEK100 each		100
Smiths Medical UK	United Kingdom	Ord US\$1		100
Smiths Medical US, Inc	United States	Common stock of \$0.01		100
Smiths Nominees Limited	United Kingdom	Ord £1	100	100
Smiths Pensions Limited	United Kingdom	Ord £1	100	100
Smiths Power UK Limited	United Kingdom	Ord GBP1		100
Smiths Tubular Systems-Laconia, Inc	United States	Ordinary shares \$1		100
Smiths Wolverhampton Limited	United Kingdom	Ord 25p		100
Stewart Hughes Limited	United Kingdom	Ord 1p	100	100
STS Titeflex India Pvt Ltd	India	Ordinary shares INR 100		100
TECOM Industries, Incorporated	United States	Common stock \$1		100
TI Global Limited	United Kingdom	Ord £1	100	100
TI Group Automotive Systems (Argentina) SA	Argentina	Ord \$1 ARS		100
TI Group Limited	United Kingdom	Ord 25p	100	100
TI Interest Limited	United Kingdom	Ord A £1, Ord B £1, Floating Rate Cum Red Pref C £1	100	100
TI SA (France)	France	Ord		100
TIGrup No. 14 Limited	United Kingdom	Ord 20p		100
TIGrup No.7 Limited	United Kingdom	Ord £1	100	100
Titeflex Commercial, Inc.	United States	Ord \$0.01		100
Titeflex Corporation	United States	Ordinary shares \$1		100
Titeflex Europe SAS	France	Ord \$1		100
TRAK Microwave Corporation	United States	Common stock		100
TRAK Microwave Limited	United Kingdom	Ordinary shares		100
Transtector Systems, Inc.	United States	Common stock		100
TriasX (Hong Kong) Limited	Hong Kong	Ord HKD \$1		100
TriasX (Suzhou) Telecommunications Co. Ltd.	China	Ord \$1		100
Turbo Components & Engineering Inc	United States	Common shares		100
Tutco De Mexico S de RL de CV	Mexico	Ordinary shares \$1.00		100
Tutco, Inc	United States	Ordinary shares \$1		100
XD Communications Limited	United Kingdom	Ord £1		100
XDG Limited	United Kingdom	Ord 50p	100	100
Zamor KG	Germany	Ordinary shares €1		49
Associates	Country	Security	Direct (%)	Total (%)
LLC John Crane Iskra	Russian Federation	Ord 1 RUB		50
STI Security Training International GMBH	Germany	Ordinary shares €1		34

# Financial calendar

2015	
Announcement of results for 2014/15	23 September
Ordinary shares final dividend ex-dividend date	22 October
Ordinary shares final dividend record date	23 October
Annual General Meeting	17 November
Ordinary shares final dividend payment date	20 November

2016	
2015/16 interim results announced	16 March (provisional)
Ordinary shares interim dividend ex-dividend date	24 March (provisional)
Ordinary shares interim dividend record date	25 March (provisional)
Ordinary shares interim dividend payment date	22 April (provisional)
Smiths Group financial year-end	31 July
Announcement of results for 2015/16	28 September (provisional)
Ordinary shares final dividend ex-dividend date	20 October (provisional)
Ordinary shares final dividend record date	21 October (provisional)
Annual General Meeting	15 November (provisional)
Ordinary shares final dividend payment date	18 November (provisional)

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).

The 2015 Annual General Meeting will be held at the Northcliffe House Auditorium of the law firm, Freshfields Bruckhaus Deringer, 26-28 Tudor Street, London EC4Y 0BQ on 17 November 2015 at 10:30am.

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## Auditor

PricewaterhouseCoopers LLP

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# smiths

bringing technology to life

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