News release
London, Wednesday 16 March 2016
For immediate release

Interim results for the six months ended 31 January 2016

	Headline*				Statutory	
	2016 £m	2015 £m	Reported growth	Underlying growth#	**2016 £m**	2015 £m
Revenue	**1,372**	1,416	(3)%	(3)%	**1,372**	1,416
Operating profit	**217**	232	(6)%	(6)%	**183**	164
Operating margin	**15.8%**	16.4%	(60) bps	(60) bps	**13.3%**	11.6%
Pre-tax profit	**189**	208	(9)%	(9)%	**168**	131
Basic EPS	**35.2p**	38.5p	(9)%		**32.8p**	21.8p
Headline free cash-flow	**174**	132	32%			
Dividend	**13.25p**	13.00p	2%		**13.25p**	13.00p
Return on capital employed	**15.4%**	15.4%	- bps			

*In addition to statutory reporting, Smiths Group reports its continuing operations on a headline basis. Headline profit is before material non-recurring items or items considered non-operational in nature. Definitions of headline free cash-flow and return on capital employed, and information about items treated as non-headline, are provided in note 14 to the Interim report.

#Organic growth adjusting for foreign exchange translation.

Key points

- Revenue and headline operating profit down in line with expectations
- John Crane impacted by challenging oil and gas markets, although aftermarket revenues proved more resilient; operating margin down 330bps to 19.9%
- Continued growth at Smiths Medical; operating margin up 150bps to 20.5%
- Good profit growth at Smiths Detection; operating margin up 210bps to 12.4%
- Cash conversion strong at 101%; headline free cash flow up 32% to £174m
- Pension trustee negotiations concluded; £50m cash flow improvement from FY17
- Interim dividend increased 2% to 13.25 pence per share

Smiths Group Chief Executive **Andy Reynolds Smith** said:

“In my first six months at Smiths Group, I have visited many of our sites around the world, meeting over a thousand colleagues and listening to our customers. I have been highly impressed by our cutting edge technologies, our market leading positions, the depth of experience and expertise of our people and the strength of our customer relationships. I am confident that we can unlock substantial value through improving our operational efficiency, which will generate resources to invest in growth. Overall, the Group will drive simplification and speed to promote adaptability and innovation.

“From a trading perspective, this is a solid set of results. Group performance in the first six months of the year demonstrated the benefits of our range of end market exposures. As expected, John Crane was down in the first half, in persistently tough oil and gas end markets, but we benefited from growth in profits at Smiths Medical and Smiths Detection. Good progress has been made to improve Smiths Detection’s competitive positioning through initiatives on value engineering, programme management and aftermarket servicing, which are clearly having a positive impact on the bottom line. Against a tough prior year comparator, Smiths Medical delivered another strong performance as it benefited from consumables sales for its expanded installed base of infusion pumps. Performance at Smiths Interconnect and Flex-Tek was in line with expectations.

"As previously stated, Group performance is anticipated to be slightly more weighted to the second half than usual. We expect global energy markets to remain challenging in the second half of the year, and are taking action to ensure that John Crane remains well positioned in an uncertain environment. I expect Smiths Medical to deliver a similar revenue performance in the second half, driven by growth in Infusion Systems and Vital Care. Smiths Medical's margins should benefit further from the effect of operational efficiencies and restructuring actions. Smiths Detection's strong order book underpins anticipated higher levels of sales growth in the second half, although the margins seen in the first half will moderate somewhat given contract mix and investment in new business capabilities. Our expectations for the full year remain unchanged."

Andy Reynolds Smith
Chief Executive

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Presentation

The presentation slides and a live webcast of the presentation to analysts are available at www.smiths.com/results at 09.00 (UK time) on Wednesday 16 March. A recording of the webcast is available later that day. A live audio broadcast of the presentation is also available by dialling (no access code required):

UK toll free: 0808 237 0062

International: +44 (0)20 3426 2890

US/Canada toll free: +1 877 841 4558

An audio replay is available for seven days on the following numbers (access PIN 668251#)

UK toll free: 0808 237 0026

International: +44 (0)20 3426 2807

US/Canada toll free: +1 866 535 8030

Photography

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

Statutory reporting

Statutory reporting takes account of all items excluded from headline performance. On a statutory basis, pre-tax profit from continuing operations was £168m (2015: £131m) and earnings per share were 32.8p (2015: 21.8p).

See note 14 to the interim report for the reconciliation of headline and statutory profit measures.

Chief Executive's review

Results overview

Smiths Group delivered a resilient performance, reflecting the intrinsic benefits of its range of end market exposures. Group underlying revenue and headline operating profit were in line with expectations, with strong profitable growth at Smiths Detection and continued growth at Smiths Medical. Maintaining the trend seen towards the end of the prior year, John Crane was impacted by persistently challenging oil and gas end markets, with aftermarket revenues continuing to prove more resilient than sales to first-fit customers. John Crane also experienced a £11m headwind in foreign exchange translation, although for the Group as a whole this was offset in other divisions. Performance at Smiths Interconnect and Flex-Tek was broadly similar to the prior year, and in line with expectations. Group operating margins fell slightly.

Against the backdrop of continued challenging market conditions in some parts of the energy segment, John Crane's underlying revenue declined with first-fit customers and, to a lesser extent, with aftermarket customers. While the order book declined against prior year, the decline was lower than the rate of sales decline. Action is underway to position the business in the current environment by addressing fixed costs and by investing in the expansion of the installed base. Smiths Medical saw continued revenue growth against a strong prior year comparator, as a result of its strategy to invest in infusion pumps in recent years, with the increased installed base for ambulatory infusion pumps driving greater demand for associated disposables. Vital Care revenues also grew, fuelled by differentiated product offerings. Margins grew on higher volumes and efficiency gains. Smiths Detection delivered good profit growth, driven by increased sales volumes, particularly in the ports and borders segment, and by further progress in the implementation of business improvement initiatives. Increased aftermarket sales continued to be an important growth driver. Revenue declined slightly at Smiths Interconnect, although margins improved, in part due to management action on restructuring and cost controls. Revenue and margins declined slightly on an underlying basis at Flex-Tek, due to pricing and product mix.

Initial observations

Since joining Smiths at the end of September 2015, Chief Financial Officer Chris O'Shea and I have visited multiple divisional sites across Europe, the United States and China. We have met well over a thousand of our Smiths Group colleagues, and have been impressed by their depth of experience and expertise. We have met with customers to understand their perspective and the strength of our relationships. We have reviewed Group and divisional strategies for growth, and assessed technology capabilities across the business.

Our focus is to take Smiths Group to the next level as a technology-led company with leading positions in structurally attractive markets, disciplined execution and above-market growth. We will aim to increase spend in R&D and ensure that it is deployed in a more focused and commercial way. We have five high quality businesses and we will invest in areas which create long-term value. We will prioritise investment in attractive growth markets by supplying the right customers in the right market segments with a wider geographical mix. We will broaden and deepen our customer offering by increasing content through the life cycle, including aftermarket and service, and higher levels of customer intimacy. It is clear that we need to do more in high-growth economies, which account for around 15% of revenues, and especially in China, which currently represents only 4% of Group revenues.

In summary, we start from a solid base with a good financial platform. There are significant areas of opportunity for greater operational efficiency and consistency of execution which will release additional free cash flow for investment in growth.

Research & development

Investment in research and development (R&D) is crucial to our future organic growth. In the period we invested a total of £55m in R&D (2015: £56m), equivalent to 4.0% of revenue (2015: 3.9%). We are committed to improving how we target and focus our investment in R&D in order to drive innovation-led growth above the market.

R&D highlights in the period included:

- Progress with field testing of John Crane's Predictive Diagnostics platform. Test units are now installed at a number of John Crane customer locations and are providing actionable rotating equipment performance information. The technology is based on a nerve centre providing real-time health assessments and predictive diagnostics for seals, which are critical components to the reliable, efficient and safe operation of rotating equipment.
- John Crane completed the launch of the next generation of gas seal technology with the introduction of Aura 180 and Aura 100, to cover the most common applications in compression. The business remains focused on bringing to market a number of new products this year, many of which will address proposed regulations aimed at reducing both methane and CO2 emissions.

- Smiths Medical introduced a number of new products, including the Medfusion interoperability platform (including PharmGuard 2.0), which enables automated charting and reporting for our Medfusion 4000 syringe pumps; the CADD Solis VIP pump internationalisation programme which opens seven new international language markets; and the CADD Solis wireless pump that brings wireless connectivity.
- The Graseby F6 syringe pump, developed by Smiths Medical's R&D team in Shanghai, was also launched in China, contributing to 9% growth in that market.
- Smiths Detection launched the HI-SCAN 6040C for the critical infrastructure segment. This has been designed to optimise user experience in the screening of bags and packages at security checkpoints in public buildings. Offering the best image quality in its class, the HI-SCAN 6040C is the first system in Detection's new conventional X-ray checkpoint range, which will replace older generation systems over the next three to five years.

Dividend

The Board has declared an interim dividend of 13.25p per share (2015: 13.00p per share). The interim dividend will be paid on 22 April to shareholders registered at the close of business on 29 March. The ex-dividend date is 24 March.

Outlook

As previously stated, Group performance is anticipated to be slightly more weighted to the second half than usual. We expect global energy markets to remain challenging in the second half of the year, and are taking action to ensure that John Crane remains well positioned in an uncertain environment. We expect Smiths Medical to deliver a similar revenue performance in the second half, driven by growth in Infusion Systems and Vital Care. Smiths Medical's margins should benefit further from the effect of operational efficiencies and restructuring actions. Smiths Detection's strong order book underpins anticipated higher levels of sales growth in the second half, although the margins seen in the first half will moderate somewhat given contract mix and investment in new business capabilities. Our expectations for the full year remain unchanged.

Business review

	% of Group revenue		Headline operating profit margin*		Headline return on capital employed*	
	2016	**2015**	**2016**	2015	**2016**	2015
John Crane	**29%**	32%	**19.9%**	23.2%	**22.7%**	26.5%
Smiths Medical	**30%**	29%	**20.5%**	19.0%	**14.9%**	15.1%
Smiths Detection	**17%**	16%	**12.4%**	10.3%	**10.9%**	3.1%
Smiths Interconnect	**14%**	14%	**9.7%**	9.2%	**9.2%**	12.0%
Flex-Tek	**10%**	9%	**17.6%**	18.1%	**32.3%**	33.7%
Group	**100%**	100%	**15.8%**	16.4%	**15.4%**	15.4%

John Crane

John Crane is a leading provider of mission-critical equipment in challenging operating environments. John Crane's revenue is currently comprised of 58% aftermarket sales. Approximately 60% of revenue is derived from the energy sector (Downstream, Midstream and Upstream Oil & Gas, Power Generation) with approximately 40% coming from other industries including Chemicals, Pharmaceuticals and Pulp & Paper.

	2016 £m	2015 £m	Reported growth	Underlying growth
Revenue	**393**	453	(13)%	(11)%
Headline operating profit	**78**	105	(26)%	(24)%
Headline operating margin	**19.9%**	23.2%	(330) bps	
Statutory operating profit	**72**	61	17%	
Return on capital employed	**22.7%**	26.5%	(380) bps	

Performance

John Crane's underlying revenue declined 11% against a backdrop of continued difficult market conditions in some parts of the energy segment. Reported revenue, including £11m of adverse foreign exchange translation and £2m related to the net effect of a small acquisition and a divestiture, declined 13%. Underlying revenue reflects declining sales in both the first-fit and aftermarket business. While the order book declined year-over-year, the book-to-bill ratio at the end of the period stood at 102% (2015: 104%).

Headline operating profit margin fell to 19.9%. Reported headline operating profit declined 26% (£27m), on the back of a £25m, or 24%, fall in underlying profit and adverse currency translation of £2m. The underlying decline was driven by lower volumes, and by costs relating to investment in key first-fit strategic projects which reduced margins by 90 basis points in the period. Cost control actions and revenue mix helped offset these adverse items to some extent. Return on capital employed declined 380 basis points to 22.7%, principally due to lower profitability.

Aftermarket revenues declined 7% on an underlying basis. Continued economic uncertainty and the high capacity loading of refineries has broadly led to facilities postponing operating expenditure on upgrades and retrofits, although we view current activity levels as unsustainable. Latin America and the Middle East and Africa regions continue to be areas of relative strength, and we have maintained investment in extending our service centre footprint with the opening of facilities in Angola and Oman**.** Elsewhere, recent notable contract wins include a contract in Asia Pacific with a major oil and gas company for aftermarket seals and seal management services to ensure the effective operation of rotating equipment, and a large multi-site agreement with a major international company in the pulp and paper segment.

Underlying sales to first-fit customers fell 15%, as market pressures caused by the continued fall in energy prices affected our business broadly across all geographies. Our overall investment in strategic first-fit projects is higher than any prior period, reflecting a continued effort to expand the installed base. We continue to see delays in oil and gas projects which have yet to secure funding, coupled with an increase of bidding activity, primarily driven by rebidding on existing projects. First-fit sales were also affected by declines in the upstream energy services business, with revenue at John Crane Production Solutions falling on an underlying basis as a result of challenging market conditions in upstream oil and gas in the United States. In market segments not exposed to energy, John Crane was awarded a biotechnology project in the pharmaceutical segment.

Revenue from emerging markets also declined 16% and now represents 24% of John Crane sales (2015: 25%), with the main decrease resulting from the declining Chinese market.

Smiths Medical

Smiths Medical is 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. 81% of Smiths Medical's sales are from consumable and disposable products.

	2016 £m	2015 £m	Reported growth	Underlying growth
Revenue	**411**	406	1%	1%
Headline operating profit	**84**	78	9%	4%
Headline operating margin	**20.5%**	19.0%	150 bps	
Statutory operating profit	**72**	68	7%	
Return on capital employed	**14.9%**	15.1%	(20) bps	

Performance

Smiths Medical's revenue grew 1%, on a reported and underlying basis. Growth was driven by the Infusion Systems and the Vital Care business units, partially offset by Vascular Access and Specialty Products.

Underlying profit grew 4%, driven mainly by higher underlying revenue, tight cost controls, and the benefits of restructuring programs carried out last year, which more than offset downward pressure on gross margins. Gross margins were compressed due to adverse price and transactional FX impacts, partly offset by operational efficiencies. Headline operating profit grew 9% on a reported basis, resulting in a 150 basis point increase in operating margins to 20.5%. Return on capital employed declined 20 basis points to 14.9%, as a result of capitalised R&D associated with the increased emphasis on product development, along with higher inventory and increased capital spending to implement restructuring programmes. R&D as a percentage of sales rose 50 basis points to 5.8% with key product launches in Europe, China and Japan.

Infusion Systems continued to grow, despite tough comparisons from strong sales of ambulatory infusion pumps in the prior year, as utilisation of those pumps accelerated demand for associated disposables. Strong sales of hospital syringe pumps, particularly in the U.S., also contributed to the growth. Vital Care grew across most of the portfolio, most notably in tracheostomy and respiratory chronic obstructive pulmonary disease (COPD) products, where differentiated products fuelled demand. Vascular Access delivered solid growth in sharps safety and cardiothoracic products, offset by continued slight declines in peripheral intravenous catheters (PIVC), ports, and huber needles. Specialty Products delivered strong growth in animal health, offset by declines in emergency medicine and monitoring.

Emerging market sales increased 1%, as the fall in the price of oil and the strength of the U.S. dollar impacted the timing of exports to key markets in the Middle East and South America. We expect the situation to improve in the second half, following tendering gains in UAE and elsewhere. China delivered growth of 9%, despite the economic slowdown, as new product introductions and prior sales channel realignments continued to gain traction. India continued to perform well, growing 20%, as our direct presence continued to drive positive results. Sales to distributor markets in South East Asia also performed well, growing 11% year over year.

Smiths Detection

Smiths Detection is a world-leading designer and manufacturer of technology solutions that detect and identify explosives, narcotics, weapons, chemical agents, biohazards, nuclear and radioactive material and contraband. 38% of Smiths Detection's sales are from the aftermarket.

	2016 £m	2015 £m	Reported growth	Underlying growth
Revenue	**240**	231	4%	4%
Headline operating profit	**30**	24	25%	38%
Headline operating margin	**12.4%**	10.3%	210 bps	
Statutory operating profit	**28**	14	101%	
Return on capital employed	**10.9%**	3.1%	780 bps	

Performance

Revenue increased 4% on an underlying and reported basis. Weakness in Transportation and Critical Infrastructure was more than offset by an encouraging performance in Ports & Borders and continuing progress in Military. Regionally, pressure on government budgets in the Americas was reflected in lower activity in transportation, although a major contract was won with a U.S. Government customer for the aTiX product. The aftermarket, accounting for 38% of total revenue, is an important growth driver, with an 11% increase in sales in the first half as we continue to focus on driving service attach rate and selling premium service contracts

Headline operating profit increased 38% on an underlying basis, driven by increased sales volumes, business mix and aftermarket growth despite continued competitive pricing pressure in some end use markets. Headline operating margin of 12.4% was 210 basis points higher than the same period last year as a result of the successful implementation of business improvement measures on value engineering and programme management, and positive revenue mix. Including £2m of adverse foreign exchange translation, reported headline operating profit improved 25%. Return on capital improved 780 basis points as a result of the higher profitability over the past 12 months.

Transportation sales fell 8% on an underlying basis. Nevertheless, the benefit of large orders received from London Heathrow and Abu Dhabi Airport in FY15 is building as deliveries are made under both contracts. The Middle East continues to be an important market for Smiths Detection, with major Ports & Borders wins in Kuwait and Transportation wins in Saudi Arabia (GACA). A number of key contracts were also renewed or extended in the Americas, including a major service contract with Leidos. In Asia Pacific, Smiths Detection won its first HI-SCAN 180180 XCT scanner order at Hokkaido airport, as well as orders to supply checkpoint equipment at Incheon Terminal 2 and hand baggage scanning systems for the Airport Authority of India.

Revenue from Ports & Borders was especially strong, rising 124% on an underlying basis. Sales in the U.S. grew by 100%, principally as a result of increased orders from U.S. Customs and Border Protection to supply a range of products including ScanVans and Cargo Inspection Systems.

Underlying Military revenues were up 28%, with the increase most noticeable in the U.S. and Germany as a result of increased aftermarket sales and the ongoing benefit of sales under a number of long term contracts. Underlying revenue in Critical Infrastructure declined 18% against a strong comparator period. Ongoing pressure from lower-priced competitors makes trading challenging in some parts of this segment.

Smiths Interconnect

Smiths Interconnect is 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.

	2016 £m	2015 £m	Reported growth	Underlying growth
Revenue	**196**	198	(1)%	(3)%
Headline operating profit	**19**	18	4%	- %
Headline operating margin	**9.7%**	9.2%	50 bps	
Statutory operating profit	**13**	7	89%	
Return on capital employed	**9.2%**	12.0%	(280) bps	

Performance

Underlying revenue declined 3%, or £7m. Reported revenue, including £5m of foreign exchange translation benefit, declined 1%. Reported headline operating profit was up 4%, which include a foreign exchange gain of £1m. Margins improved by 50 basis points to 9.7%, led by expansion in both the Connectors and Power business units. The benefit of restructuring and cost controls, coupled with a focus on lean and procurement, more than offset unfavourable mix within the Microwave business.

Connectors underlying revenue was broadly flat, with selected markets and customer growth offset by a challenging semiconductor market. Medical sales grew. Commercial aerospace improved due to the timing of a key programme in the half and new product introductions. Investment continues in new product development with launches to serve the rail, semiconductor and medical markets.

Underlying revenues in the Microwave business declined 8%, or £8m, due to programme timing and challenging market conditions with some defence and telecoms customers. Current product development and sales initiatives are focused on significant defence and space programmes, and generating growth in Asia.

In Power, underlying revenue increased 2% on continued strength with key customers for U.S. data centres. New product development continues to address the increased need for flexibility in the market.

Flex-Tek

Flex-Tek is a global provider of engineered components that heat and move fluids and gases for the aerospace, medical, industrial, construction and domestic appliance markets.

	2016 £m	2015 £m	Reported growth	Underlying growth
Revenue	**132**	128	3%	(1)%
Headline operating profit	**23**	23	- %	(5)%
Headline operating margin	**17.6%**	18.1%	(50) bps	
Statutory operating profit	**30**	22	36%	
Return on capital employed	**32.3%**	33.7%	(140) bps	

Performance

Flex-Tek revenues for the first half were £132m, down 1% on an underlying basis. Sales were down for Heat Solutions by 5% as a result of passing through the effect of lower nickel prices to customers, although this was without negative impact to profits. Construction Group sales were up 3%, while easing of orders from industrial customers caused Titeflex commercial sales to decline by 2%. The market for aircraft components remains strong, with a healthy order backlog of commercial aircraft for major airframers. The U.S. housing market continued growing in the first half, helping both Gastite and Thermaflex.

Flex-Tek operating profit was £23m, down 5% on an underlying basis. Operating margin was 17.6%, down 50 basis points from last year, primarily related to a product transition on flexible gas piping. Margins in the Titeflex Commercial business were also down on lower volume from industrial customers. Heat Solutions, Thermaflex, and Flexible Solutions improved profits and margins over last year.

Flex-Tek sales are primarily based in North America, where unit sales showed moderate improvement overall, despite some industrial segment weakness. Sales in China continued with double digit growth.

Fluid Management showed moderate growth over last year. Recent wins on new aerospace engine platforms, including the Boeing 787, Airbus A320neo, and the GEnx engine, are expected to impact positively in the second half of the year and in future years. Sales grew in Construction Group as the U.S. housing market improved and our businesses continued to gain with wholesalers. Heat Solutions continued to grow profits in the Specialty side of the business, and Flexible Solutions benefited from increased sales to the medical sector.

Financial review

Revenue

Revenue declined 3%, or £42m, on an underlying basis to £1,372m. Including the impact of acquisitions and disposals of £2m, overall reported revenue declined £44m (3%). The £42m underlying decrease was driven by declines at John Crane (£47m), Smiths Interconnect (£7m) and Flex-Tek (£1m), which was partially offset by growth in Smiths Detection (£9m) and Smiths Medical (£4m).

Profit

Headline operating profit saw an underlying reduction of 6% (£16m) to £217m. On a reported basis headline operating profit fell £15m (6%) including foreign exchange translation gains of £1m. Headline operating margin fell to 15.8% (2015: 16.4%), mainly due to challenging trading conditions in John Crane. The main drivers of the underlying margin reduction were increased efficiencies at Smiths Detection (+£8m) and positive mix at Smiths Medical (+£3m), which were more than offset by lower volumes at John Crane (-£25m), adverse mix at Flex-Tek (-£1m) and higher corporate costs (-£1m). Smiths Interconnect was flat year on year.

Operating profit on a statutory basis, after taking account of the items excluded from the headline figures, was £183m (2015: £164m) – see note 14 for information on the excluded items. The increase was driven mainly by lower litigation costs and reduced charges for goodwill and acquired intangible assets offsetting the reduced headline operating profit.

The difference between statutory and headline operating profit primarily reflects Fuel for Growth restructuring of £9m in Smiths Medical and £4m in John Crane, amortisation of acquired intangible assets at Smiths Medical (£3m) and Smiths Interconnect (£6m), John Crane, Inc. asbestos litigation of £2m, a £7m provision release for Flex-Tek on Titeflex Corporation subrogation claims and £15m pension settlement and administration costs taken centrally.

The net interest charge on debt increased to £28m (2015: £24m). Headline profit before tax decreased £19m to £189m (2015: £208m) primarily driven by decreased profits at John Crane.

The Group’s tax rate on headline profit for the period was 26.0% (2015: 25.5%). Headline earnings per share decreased by 9% to 35.2p (2015: 38.5p). The statutory tax rate for the period was 22.4% (2015: 33.6%).

On a statutory basis, profit before tax increased £37m to £168m (2015: £131m); it is stated after taking account of restructuring, legacy product litigation, amortisation and impairment of goodwill and acquired intangible assets, gains and losses relating to closed pension schemes and other items excluded from the headline measure.

Earnings per share

Basic headline earnings per share from continuing activities were 35.2p (2015: 38.5p), a decline of 9%. This reflects the lower headline operating profit.

On a statutory basis, the basic earnings per share from continuing activities were 32.8p (2015: 21.8p) reflecting the £26m impairment charge in the prior period.

Items relating to continuing activities excluded from headline profit before tax

These items amounted to a charge of £21m compared to a charge of £77m in 2015. They comprised:

– Amortisation of intangible assets acquired in business combinations of £9m (2015: £18m) and in 2015 a £26m 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;

– £4m charge (2015: £14m) in connection with John Crane, Inc. asbestos litigation;

– £6m gain (2015: £2m charge) in connection with Titeflex Corporation litigation;

– £15m charge for restructuring (2015: £19m) in respect of the ‘*Fuel for Growth*’ programme;

– £10m loss on changes to post-retirement benefits (2015: £13m gain);

– £19m fair value gain realised on contributing government bonds to a post-retirement benefit scheme;

– £1m charge for retirement benefit finance (2015: £4m);

– £5m charge for legacy retirement benefit administration (2015: £5m); and

– £2m of financing gains/losses (2015: £2m).

Cash generation and net debt

	2016 £m	2015 £m
Headline operating cash-flow	218	204
Headline operating cash-flow as a percentage of headline operating profit	101%	88%
Headline free cash-flow	174	132
Statutory net cash inflow from operating activities	121	112
Dividends	111	108
Net debt	986	929

Operating cash generation remained strong with headline operating cash of £218m (2015: £204m), representing 101% (2015: 88%) of headline operating profit (see note 14 to the accounts for a reconciliation of headline operating cash and headline free cash-flow to statutory cash-flow measures). Headline free cash-flow increased £42m to £174m (2015: £132m), benefiting from higher headline operating cash-flow and lower tax payments. Headline free cash-flow is stated after interest and tax, but before cash-flow on non-headline items, pension deficit payments, acquisitions, financing activities and dividends.

On a statutory basis, net cash inflow from continuing operations was £121m (2015: £112m) reflecting £84m pension contributions and £26m cash outflow in respect of restructuring and litigation.

Dividends paid in the period on ordinary shares amounted to £111m (2015: £108m).

Net debt at 31 January was £986m, up from £818m at 31 July 2015. The increase in net debt reflects outflows from dividends (£111m), foreign exchange movements (£93m) and pension funding (£85m).

Headline interest and other financing costs

Interest payable on debt, net of interest earned on cash deposits, was £28m (2015: £24m). Headline interest costs were covered 7.7 (2015: 9.7) times by headline operating profits.

The Group accounts for pensions using IAS 19. As required by this standard, a finance charge of £1m (2015:£4m) is recognised reflecting the unwinding of the discount on the net pension liability.

Research and development

The Group invested £55m in R&D (2015: £56m), equivalent to 4.0% of revenue (2015: 3.9%). Of that, £52m was funded by the Company compared with £53m in 2015, a decrease of 1%. The Group actively seeks funding from customers to support R&D and this amounted to £3m (2015: £3m). Under IFRS, certain development costs are capitalised, and this amounted to £9m in the period (2015: £9m). The gross capitalisation is shown as an intangible asset. Where customers contribute to the costs of the development, the contribution is included as deferred income and disclosed within trade and other payables.

‘Fuel for Growth’ programme

The ‘Fuel for Growth’ programme was established to generate annual savings for reinvestment in sales, marketing and new product development. The programme is expected to cost £120m over a three year period to the end of FY17, excluded from underlying profit measures, and to generate annualised savings of £60m.

Taxation

The headline tax charge of £49m (2015: £55m) represented an effective rate of 26.0% on the headline profit before taxation, the expected rate for the full year (2015: full year rate 25.5%). On a statutory basis, the tax charge on continuing activities was £38m (2015: £44m).

The Group continues to benefit from global manufacturing, research and development and other tax incentives, the tax-efficient use of capital and tax compliance management.

Return on capital employed

The return on capital employed (ROCE) is calculated over a rolling 12-month period and is the percentage that headline operating profit comprises of monthly average capital employed. Capital employed comprises total equity adjusted for goodwill recognised directly in reserves, post-retirement benefit assets and liabilities net of tax, litigation provisions relating to exceptional items net of tax, and net debt. The ROCE was unchanged at 15.4% (2015: 15.4%).

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 January 2016 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 position has improved to a surplus of £129m at 31 January 2016 from a deficit of £108m at 31 July 2015.

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

The retirement benefit position was:

	31 January 2016	31 July 2015	31 January 2015
Funded plans			
UK plans – funding status	**111%**	104%	99%
US plans – funding status	**61%**	78%	73%
Other plans – funding status	**85%**	86%	80%

	31 January 2016 £m	31 July 2015 £m	31 January 2015 £m
Surplus / (Deficit)			
Funded plans	**249**	7	(224)
Unfunded plans	**(120)**	(115)	(114)
Total surplus / (deficit)	**129**	(108)	(338)
Retirement benefit assets	**361**	170	158
Retirement benefit liabilities	**(232)**	(278)	(496)
	129	(108)	(338)

Since the year end the Group concluded negotiations with both the SIPS and the TIGPS Trustees regarding the triennial valuations of the respective schemes. The next triennial valuations are expected in 2018. Following the transfer of all current pensioners to Voya Retirement Insurance and Annuity Company in August 2015, around 60% of the gross liabilities of the US scheme are insured through a buy-out contract. See note 5 for information on pension transactions. The Group's ongoing pension contributions are set out in the table below:

Year to 31 July	**2015**	**2016**	**2017**	**2018**
Annual contributions (£m)				
SIPS	60	39	24	24
TIGPS	16	11	3	3
US	27	74	23	23
Total	**103**	**124**	**50**	**50**

The approximate pension membership for the three main schemes in January 2016 is set out in the table below:

Pension scheme membership	**SIPS**	**TIGPS**	**US plans**	**Total**
Deferred active	350	230	2,470	**3,050**
Deferred	10,650	12,850	3,060	**26,560**
Pensioners	13,000	16,730	170	**29,900**
Total	**24,000**	**29,810**	**5,700**	**59,510**

At 31 July 2015, the U.S. schemes had 11,120 members. The reduction is due to the buyout arrangement for U.S. pensioners in August 2015.

Exchange rates

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

	31 January 2016	31 January 2015	Strength / weakness compared to 31 January 2015	31 July 2015	Strength / weakness compared to 31 July 2015
Average rates:					
US dollar	**1.51**	1.59	Dollar strengthened 5%	1.56	Dollar strengthened 3%
Euro	**1.37**	1.27	Euro weakened 8%	1.33	Euro weakened 4%
Period end rates:					
US dollar	**1.42**	1.50	Dollar strengthened 5%	1.56	Dollar strengthened 9%
Euro	**1.31**	1.33	Euro strengthened 1%	1.42	Euro strengthened 8%

The normal full year translational foreign exchange impact is as follows:

A 10 cent movement in U.S. Dollar would have a £15m effect on profit.

A 10 cent movement in the Euro would have a £5m effect on profit.

Risk management

The principal risks and uncertainties affecting the business activities of the Group and relevant mitigating activities were set out on pages 58-64 of the Annual Report for the year ended 31 July 2015, a copy of which is available at the Company's website at www.smiths.com.

Developments since the Annual Report

In the view of the Board, the risks and uncertainties affecting the Group for the remaining six months of the financial year continue to be those set out briefly below and more fully in the Annual Report.

The key risks and uncertainties are summarised below:

Economic outlook and geo-political environment

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

Compliance with legislation and regulations

A complex legislative and regulatory environment applies to the Group's activities such that failure to comply could have a significant impact on the financial results.

Pension funding

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

Financial risks

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

Product liability and litigation

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

Global supply chain and business/process transformation

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

Government customers

Over 35% of revenues are from governments or influenced by governments. Many such governments are reducing expenditure in the present economic environment with consequential risks to revenue.

Technology and innovation

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

Talent and succession planning

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

Programme delivery

Failure to deliver products and services according to contractual obligations may lead to higher costs, liquidated damages or other penalties.

Acquisitions and disposals

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

Information technology and cyber-security

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

Statement of directors' responsibilities

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

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

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

Having reassessed the principal risks, the directors consider it appropriate to adopt the going concern basis of accounting in preparing the Interim report.

The directors of Smiths Group plc are listed in the Smiths Group plc Annual Report for the year ended 31 July 2015, except for the following changes to the membership of the board have occurred since the Annual Report was approved on 22 September 2015:

- On 24 September 2015 Philip Bowman stepped down from his role as Chief Executive and resigned from the board;
- On 25 September 2015 Andy Reynolds Smith was appointed to the board as Chief Executive; and
- On 17 November 2015 David Challen resigned as a director.

For and on behalf of the Board of Directors:

Andy Reynolds Smith
Chief Executive

Chris O'Shea
Chief Financial Officer

15 March 2016

Independent review report to Smiths Group plc

Report on the condensed interim financial statements

Our conclusion

We have reviewed Smiths Group plc's condensed interim financial statements (the "condensed interim financial statements") in the Interim report of Smiths Group plc for the six month period ended 31 January 2016. Based on our review, nothing has come to our attention that causes us to believe that the condensed interim financial statements are not prepared, in all material respects, in accordance with International Accounting Standard 34, 'Interim Financial Reporting' as adopted by the European Union and the Disclosure Rules and Transparency Rules of the United Kingdom's Financial Conduct Authority.

What we have reviewed

The condensed interim financial statements comprise:

- ·the consolidated balance sheet as at 31 January 2016;
- ·the consolidated income statement and consolidated statement of comprehensive income for the period then ended;
- ·the consolidated cash-flow statement for the period then ended;
- ·the consolidated statement of changes in equity for the period then ended; and
- ·the explanatory notes to the condensed interim financial statements.

The condensed interim financial statements included in the Interim report have been prepared in accordance with International Accounting Standard 34, 'Interim Financial Reporting', as adopted by the European Union and the Disclosure Rules and Transparency Rules of the United Kingdom's Financial Conduct Authority.

As disclosed in note 1 to the condensed interim financial statements, the financial reporting framework that has been applied in the preparation of the full annual financial statements of the Group is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

Responsibilities for the condensed interim financial statements and the review

Our responsibilities and those of the directors

The Interim report, including the condensed interim financial statements, is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the Interim report in accordance with the Disclosure Rules and Transparency Rules of the United Kingdom's Financial Conduct Authority.

Our responsibility is to express a conclusion on the condensed interim financial statements in the Interim report based on our review. This report, including the conclusion, has been prepared for and only for the company for the purpose of complying with the Disclosure Rules and Transparency Rules of the United Kingdom's Financial Conduct Authority and for no other purpose. We do not, in giving this conclusion, 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 a review of condensed interim financial statements involves

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410, 'Review of Interim Financial Information Performed by the Independent Auditor of the Entity' issued by the Auditing Practices Board for use in the United Kingdom. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures.

A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK and Ireland) and, consequently, does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

We have read the other information contained in the Interim report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed interim financial statements.

PricewaterhouseCoopers LLP
Chartered Accountants
London

15 March 2016

(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 condensed interim financial statements since they were initially presented on the website.

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

Consolidated income statement (unaudited)

Year ended 31 July 2015 Total £m		Notes	Period ended 31 January 2016 Headline £m	Period ended 31 January 2016 Non-headline (note 14) £m	Period ended 31 January 2016 Total £m	Period ended 31 January 2015 Headline £m	Period ended 31 January 2015 Non-headline (note 14) £m	Period ended 31 January 2015 Total £m
	Continuing operations							
2,897	Revenue	2	1,372		1,372	1,416		1,416
(1,564)	Cost of sales		(749)		(749)	(776)		(776)
1,333	Gross profit		623		623	640		640
(406)	Sales and distribution costs		(192)		(192)	(202)		(202)
(533)	Administrative expenses		(214)	(34)	(248)	(206)	(68)	(274)
394	**Operating profit**		**217**	**(34)**	**183**	**232**	**(68)**	**164**
3	Interest receivable		2		2	1		1
(55)	Interest payable		(30)		(30)	(25)		(25)
(9)	Other financing gains/(losses)			14	14		(5)	(5)
(8)	Other finance charges – retirement benefits			(1)	(1)		(4)	(4)
(69)	Finance costs		(28)	13	(15)	(24)	(9)	(33)
325	**Profit before taxation**		**189**	**(21)**	**168**	**208**	**(77)**	**131**
(77)	Taxation	4	(49)	11	(38)	(55)	11	(44)
248	**Profit for the period**		**140**	**(10)**	**130**	**153**	**(66)**	**87**
	Attributable to							
246	Smiths Group shareholders		139	(10)	129	152	(66)	86
2	Non-controlling interests		1		1	1		1
248			**140**	**(10)**	**130**	**153**	**(66)**	**87**
	Earnings per share	3						
62.4p	Basic				32.8p			21.8p
61.8p	Diluted				32.5p			21.6p
	Dividends per share (declared)	11						
13.00p	– interim				13.25p			13.00p
28.00p	– final							
41.00p					**13.25p**			**13.00p**

Consolidated statement of comprehensive income (unaudited)

Year ended 31 July 2015 £m		Notes	Period ended 31 January 2016 £m	Period ended 31 January 2015 £m
248	**Profit for the period**		**130**	**87**
	Other comprehensive income			
60	Actuarial gains/(losses) on retirement benefits	5	33	(120)
21	Taxation recognised on actuarial movements		1	32
81	**Other comprehensive income and expenditure which will not be reclassified to the consolidated income statement**		**34**	**(88)**
	Other comprehensive income which will be, or has been, reclassified			
9	Exchange gains		196	127
	Fair value gains/(losses) and reclassification adjustments			
11	– on available for sale financial assets		(22)	15
(6)	– deferred in the period on cash-flow and net investment hedges		(113)	(64)
1	– reclassified to income statement on cash-flow and net investment hedges		(1)	2
96	**Total other comprehensive income**		**94**	**(8)**
344	**Total comprehensive income**		**224**	**79**
	Attributable to			
343	Smiths Group shareholders		222	78
1	Non-controlling interests		2	1
344			**224**	**79**

Consolidated balance sheet (unaudited)

	Notes	31 January 2016 £m	31 January 2015 £m	31 July 2015 £m
Non-current assets				
Intangible assets	6	1,642	1,606	1,518
Property, plant and equipment	7	280	275	259
Financial assets – other investments		10	146	156
Retirement benefit assets	5	361	158	170
Deferred tax assets		226	238	218
Trade and other receivables		35	41	40
Financial derivatives		12	9	4
		2,566	**2,473**	**2,365**
Current assets				
Inventories		490	487	454
Current tax receivable		36	43	30
Trade and other receivables		639	596	616
Cash and cash equivalents	8	461	178	495
Financial derivatives		14	24	20
		1,640	**1,328**	**1,615**
Total assets		**4,206**	**3,801**	**3,980**
Non-current liabilities				
Financial liabilities				
– borrowings	8	(1,267)	(1,084)	(1,150)
– financial derivatives		(1)	(5)	(6)
Provisions for liabilities and charges	10	(264)	(275)	(253)
Retirement benefit obligations	5	(232)	(496)	(278)
Deferred tax liabilities		(79)	(64)	(71)
Trade and other payables		(25)	(29)	(24)
		(1,868)	**(1,953)**	**(1,782)**
Current liabilities				
Financial liabilities				
– borrowings	8	(180)	(23)	(163)
– financial derivatives		(18)	(15)	(12)
Provisions for liabilities and charges	10	(87)	(89)	(79)
Trade and other payables		(460)	(437)	(466)
Current tax payable		(53)	(74)	(50)
		(798)	**(638)**	**(770)**
Total liabilities		**(2,666)**	**(2,591)**	**(2,552)**
Net assets		**1,540**	**1,210**	**1,428**
Shareholders' equity				
Share capital		148	148	148
Share premium account		351	348	349
Capital redemption reserve		6	6	6
Revaluation reserve		1	1	1
Merger reserve		235	235	235
Retained earnings		966	583	743
Hedge reserve		(177)	(120)	(63)
Total shareholders' equity		**1,530**	**1,201**	**1,419**
Non-controlling interest equity		10	9	9
Total equity		**1,540**	**1,210**	**1,428**

Consolidated statement of changes in equity (unaudited)

	Notes	Share capital and share premium £m	Other reserves £m	Retained earnings £m	Hedge reserve £m	Equity shareholders' funds £m	Non-controlling Interest £m	Total equity £m
At 31 July 2015		497	242	743	(63)	1,419	9	1,428
Profit for the period				129		129	1	130
Other comprehensive income								
Exchange gains				195		195	1	196
Actuarial gains on retirement benefits and tax				34		34		34
Fair value gains/(losses)				(22)	(114)	(136)		(136)
Total comprehensive income for the period				**336**	**(114)**	**222**	**2**	**224**
Transactions relating to ownership interests								
Exercises of share options		2				2		2
Purchase of own shares				(7)		(7)		(7)
Dividends								
– equity shareholders	11			(111)		(111)		(111)
– non-controlling interests							(1)	(1)
Share-based payment				5		5		5
At 31 January 2016		**499**	**242**	**966**	**(177)**	**1,530**	**10**	**1,540**

	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 period				86		86	1	87
Other comprehensive income								
Exchange gains				127		127		127
Actuarial losses on retirement benefits and tax				(88)		(88)		(88)
Fair value gains/(losses)				15	(62)	(47)		(47)
Total comprehensive income for the period				**140**	**(62)**	**78**	**1**	**79**
Transactions relating to ownership interests								
Exercises of share options		2				2		2
Taxation recognised on share options				(1)		(1)		(1)
Purchase of own shares				(11)		(11)		(11)
Dividends								
– equity shareholders	11			(108)		(108)		(108)
Share-based payment				4		4		4
At 31 January 2015		**496**	**242**	**583**	**(120)**	**1,201**	**9**	**1,210**

Consolidated cash-flow statement (unaudited)

Year ended 31 July 2015 £m		Notes	Period ended 31 January 2016 £m	Period ended 31 January 2015 £m
266	**Net cash inflow from operating activities**	12	**121**	**112**
	Cash-flows from investing activities			
(18)	Expenditure on capitalised development		(8)	(8)
(18)	Expenditure on other intangible assets		(5)	(8)
(59)	Purchases of property, plant and equipment		(29)	(28)
11	Disposals of property, plant and equipment		1	2
(27)	Investment in financial assets		(8)	(13)
	Acquisition of businesses		(8)	
2	Disposals of businesses			
(109)	**Net cash-flow used in investing activities**		**(57)**	**(55)**
	Cash-flows from financing activities			
3	Proceeds from exercise of share options		2	2
(11)	Purchase of own shares		(7)	(11)
(160)	Dividends paid to equity shareholders		(111)	(108)
4	Cash inflow/(outflow) from matured derivative financial instruments		3	(3)
568	Increase in borrowings		1	91
(257)	Reduction and repayment of borrowings		(1)	(53)
147	**Net cash-flow used in financing activities**		**(113)**	**(82)**
304	**Net (decrease)/increase in cash and cash equivalents**		**(49)**	**(25)**
189	Cash and cash equivalents at beginning of the period		495	189
2	Exchange differences		12	13
495	**Cash and cash equivalents at end of the period**		**458**	**177**
	Cash and cash equivalents at end of the period comprise			
104	– cash at bank and in hand		130	105
391	– short-term deposits		331	73
	– bank overdrafts		(3)	(1)
495			**458**	**177**

Reconciliation of net cash-flow to movement in net debt

Year ended 31 July 2015 £m		Notes	Period ended 31 January 2016 £m	Period ended 31 January 2015 £m
(804)	**Net debt at start of period**	8	**(818)**	**(804)**
304	Net (decrease)/increase in cash and cash equivalents		(49)	(25)
(568)	Increase in borrowings		(1)	(91)
257	Reduction and repayment of borrowings		1	53
(7)	**Movement in net debt resulting from cash-flows**		**(49)**	**(63)**
(1)	Capitalisation, interest accruals and unwind of capitalisation of fees		(10)	(9)
7	Movement in fair value hedging		(16)	(6)
(13)	Exchange differences		(93)	(47)
(14)	**Movement in net debt in the period**		**(168)**	**(125)**
(818)	**Net debt at end of period**	8	**(986)**	**(929)**

Notes to the Interim report (unaudited)

1 Basis of preparation

The condensed interim financial statements cover the six month period ended 31 January 2016 and has been prepared under International Financial Reporting Standards (IFRS) as adopted by the European Union, in accordance with International Accounting Standard 34 'Interim Financial Reporting' and the Disclosure and Transparency Rules of the Financial Services Authority. It is unaudited but has been reviewed by the auditors and their report is attached to this document.

The interim financial information does not constitute statutory accounts within the meaning of Section 434 of the Companies Act 2006. It should be read in conjunction with the statutory accounts for the year ended 31 July 2015, which were prepared in accordance with IFRS as adopted by the European Union and have been filed with the Registrar of Companies. The auditors' report on these statutory accounts was unqualified and did not contain a statement under Section 498(2) or (3) of the Companies Act 2006.

Accounting policies

The condensed interim financial information has been prepared on the basis of the accounting policies applicable for the year ending 31 July 2016.

These accounting policies are consistent with those applied in the preparation of the financial statements for the year ended 31 July 2015 except for a change in the presentation of material operating items excluded from underlying profit measures. Items previously reported as exceptional are now highlighted as adjustments to non-statutory performance measures, as the directors believe this presentation format is easier to understand for the users of this information. See note 14 for details of these measures. No restatement has been required, since this change does not affect the calculation of any statutory or non-statutory performance measures.

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 £24m (31 July 2015: £39m) has been recognised in the period in respect of contracts in progress at the period end with a total expected value of £153m (31 July 2015: £137m). 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 (31 July 2015: 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 accrual for rebates payable at 31 January 2016 was £23m (31 July 2015: £21m).

Taxation

The Group has recognised deferred tax assets of £37m (31 July 2015: £28m) relating to losses and £103m (31 July 2015: £99m) 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 will be sufficient taxable profits in future periods to support recognition.

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 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.

At 31 January 2016 there is a retirement benefit asset of £361m (31 July 2015: £170m) which arises from the rights of the employers to recover the surplus at the end of the life of the scheme. The schemes in surplus are mature, with a duration averaged over all scheme participants of 16.5 years. However 23% of the liabilities of these schemes are expected to be paid after 2041.

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 January 2016 the carrying value of inventory incorporates provisions of £79m (31 July 2015: £72m) and the net inventory balance covered 109 days cost of sales (31 July 2015: 102 days). The level of inventory varies across the divisions. At 31 January 2016 Smiths Medical held 131 days of inventory (31 July 2015: 117 days), while Smiths Detection levels had dropped to 107 days (31 July 2015: 128 days).

At 31 January 2016 the gross value of receivables partly provided for or more than 3 months overdue was £69m (31 July 2015: £57m) and there were provisions of £27m (31 July 2015: £22m) against these receivables which were carried at a net value of £42m (31 July 2015: £35m).

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 in the Annual Report 2015. 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 the Annual Report 2015 for details of the critical assumptions made in the impairment tests for Smiths Detection, Smiths Interconnect Power and Smiths Interconnect Microwave Components and disclosures on the sensitivity of the impairment testing to these key assumptions.

At 31 January 2016 the CGUs have been reviewed for indications of impairment. After reviewing current and forecast trading performance, indications of value in use and fair value less costs to sell, the directors consider that no new sensitivity disclosures are required.

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 £229m (31 July 2015: £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. 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 £70m (31 July 2015: £71m) 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.

2 Segment information

Analysis by operating segment

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

- John Crane – mechanical seals, seal support systems, engineered bearings, power transmission couplings and specialist filtration systems;
- Smiths Medical – 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 14 for an explanation of which items are excluded from headline measures. Intersegment sales and transfers are charged at arm's length prices.

Segment trading performance

							Period ended 31 January 2016
	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Corporate costs £m	Total £m
Revenue	393	411	240	196	132		1,372
Divisional headline operating profit	78	84	30	19	23		234
Corporate headline operating costs						(17)	(17)
Headline operating profit/(loss)	**78**	**84**	**30**	**19**	**23**	**(17)**	**217**
Items excluded from headline measures (note 14)	(6)	(12)	(2)	(6)	7	(15)	(34)
Operating profit/(loss)	**72**	**72**	**28**	**13**	**30**	**(32)**	**183**

							Period ended 31 January 2015
	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Corporate costs £m	Total £m
Revenue	453	406	231	198	128		1,416
Divisional headline operating profit	105	78	24	18	23		248
Corporate headline operating costs						(16)	(16)
Headline operating profit/(loss)	**105**	**78**	**24**	**18**	**23**	**(16)**	**232**
Items excluded from headline measures (note 14)	(44)	(10)	(10)	(11)	(1)	8	(68)
Operating profit/(loss)	**61**	**68**	**14**	**7**	**22**	**(8)**	**164**

							Year ended 31 July 2015
	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Corporate costs £m	Total £m
Revenue	905	836	467	420	269		2,897
Divisional headline operating profit	225	166	55	49	50		545
Corporate headline operating costs						(34)	(34)
Headline operating profit/(loss)	**225**	**166**	**55**	**49**	**50**	**(34)**	**511**
Items excluded from headline measures (note 14)	(60)	(24)	(10)	(21)	(9)	7	(117)
Operating profit/(loss)	**165**	**142**	**45**	**28**	**41**	**(27)**	**394**

Segment assets and liabilities

Segment assets

							31 January 2016
	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Corporate and non-headline £m	Total £m
Property, plant, equipment, development projects, other intangibles and investments	101	193	83	43	26	17	463
Inventory, trade and other receivables	370	266	268	160	88	12	1,164
Segment assets	**471**	**459**	**351**	**203**	**114**	**29**	**1,627**

							31 July 2015
	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Corporate and non-headline £m	Total £m
Property, plant, equipment, development projects, other intangibles and investments	96	175	84	38	22	167	582
Inventory, trade and other receivables	351	247	260	160	83	9	1,110
Segment assets	**447**	**422**	**344**	**198**	**105**	**176**	**1,692**

Segment liabilities

							31 January 2016
	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Corporate and non-headline £m	Total £m
Divisional liabilities	(125)	(106)	(174)	(62)	(29)		(496)
Corporate and non-headline liabilities						(340)	(340)
Segment liabilities	**(125)**	**(106)**	**(174)**	**(62)**	**(29)**	**(340)**	**(836)**

							31 July 2015
	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Corporate and non-headline £m	Total £m
Divisional liabilities	(141)	(108)	(156)	(64)	(37)		(506)
Corporate and non-headline liabilities						(316)	(316)
Segment liabilities	**(141)**	**(108)**	**(156)**	**(64)**	**(37)**	**(316)**	**(822)**

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

Reconciliation to segment assets and liabilities to statutory assets and liabilities

	Assets		Liabilities	
	31 January 2016 £m	31 July 2015 £m	31 January 2016 £m	31 July 2015 £m
Segment assets and liabilities	**1,627**	**1,692**	**(836)**	**(822)**
Goodwill and acquired intangibles	1,469	1,351		
Derivatives	26	24	(19)	(18)
Current and deferred tax	262	248	(132)	(121)
Retirement benefit assets and obligations	361	170	(232)	(278)
Cash and borrowings	461	495	(1,447)	(1,313)
Statutory assets and liabilities	**4,206**	**3,980**	**(2,666)**	**(2,552)**

Segment capital employed

Capital employed is a non-statutory measure of invested resources. It comprises statutory net assets adjusted to add goodwill recognised directly in reserves in respect of subsidiaries acquired before 1 August 1998 of £815m (31 July 2015: £815m) and eliminate post-retirement benefit assets and liabilities and litigation provisions relating to non-headline items, both net of related tax, and net debt. See note 14 for additional details.

The 12-month rolling average capital employed by division, which Smiths use to calculate divisional return on capital employed, is set out below:

31 January 2016	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Total £m
Average divisional capital employed	873	1,155	566	542	154	3,290
Average corporate capital employed						(61)
Average total capital employed						**3,229**

31 July 2015	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Total £m
Average divisional capital employed	872	1,126	577	535	148	3,258
Average corporate capital employed						(61)
Average total capital employed						**3,197**

Analysis of revenue

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

John Crane	First-Fit £m	Aftermarket: Oil, gas and petrochemical £m	Aftermarket: Chemical and pharmaceutical £m	Aftermarket: Distributors £m	Aftermarket: General industry £m	Total £m
Revenue period ended 31 January 2016	167	122	39	31	34	393
Revenue period ended 31 January 2015 (restated)	203	134	39	35	42	453

Smiths Medical	Infusion systems £m	Vascular access £m	Vital care £m	Specialty products £m	Total £m
Revenue period ended 31 January 2016	129	136	111	35	411
Revenue period ended 31 January 2015 (restated)	125	138	108	35	406

Smiths Detection	Transportation £m	Ports and borders £m	Military £m	Critical infrastructure £m	Non-security £m	Total £m
Revenue period ended 31 January 2016	106	42	42	50		240
Revenue period ended 31 January 2015 (restated)	116	19	32	61	3	231

Smiths Interconnect	Connectors £m	Microwave £m	Power £m	Total £m
Revenue period ended 31 January 2016	70	87	39	196
Revenue period ended 31 January 2015 (restated)	70	92	36	198

Flex-Tek	Fluid Management £m	Flexible Solutions £m	Heat Solutions £m	Construction £m	Total £m
Revenue period ended 31 January 2016	33	25	29	45	132
Revenue period ended 31 January 2015	33	25	29	41	128

The allocation of Smiths Interconnect revenue for the period ended 31 January 2015 has been restated following a reorganisation which moved a business from Power to Microwave.

As disclosed in Annual Report 2015 John Crane revenue for the period ended 31 January 2015 has been restated for the reclassification of the upstream energy services business, Smiths Medical revenue has been restated for the realignment of their product portfolio and Smiths Detection has included sales to emergency responders in military sales reflecting the similar product technology.

3 Earnings per share

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

	Period ended 31 January 2016 £m	Period ended 31 January 2015 £m	Year ended 31 July 2015 £m
Profit attributable to equity shareholders for the year – total	129	86	246
Average number of shares in issue during the year	395,061,486	394,695,781	394,742,972

Diluted earnings per share are calculated by dividing the profit attributable to ordinary shareholders by 398,130,311 (period ended 31 January 2015: 398,359,970; year ended 31 July 2015: 398,552,818) ordinary shares, being the average number of ordinary shares in issue during the year adjusted by the dilutive effect of employee share schemes.

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

	Period ended 31 January 2016 £m		Period ended 31 January 2015 £m		Year ended 31 July 2015 £m	
	£m	EPS (p)	£m	EPS (p)	£m	EPS (p)
Profit attributable to equity shareholders of the Parent Company	129	32.8	86	21.8	246	62.4
Exclude						
Non-headline items and related tax (note 14)	10	2.4	66	16.7	94	23.7
Headline profit attributable to equity shareholders of the Parent Company	139	35.2	152	38.5	340	86.1
Statutory EPS – diluted (p)		32.5		21.6		61.8
Headline EPS – diluted (p)		34.9		38.2		85.3

4 Taxation

The interim tax charge of 22.4% is calculated by applying the estimated effective headline tax rate of 26.0% for the year ending 31 July 2016 to headline profit before tax and then taking into account the tax effect of non-headline items in the interim period.

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

	Period ended 31 January 2016 £m		Period ended 31 January 2015 £m		Year ended 31 July 2015 £m	
	Continuing operations £m	Tax rate	Continuing operations £m	Tax rate	Continuing operations £m	Tax rate
Profit before taxation	168		131		325	
Taxation	(38)	22.4%	(44)	33.6%	(77)	23.7%
Adjustments						
Non-headline items excluded from profit before taxation (note 14)	21		77		134	
Taxation on non-headline items	(11)		(11)		(40)	
Headline						
Headline profit before taxation	189		208		459	
Taxation on headline profit	(49)	26.0%	(55)	26.5%	(117)	25.5%

The changes in the value of the net tax liability in the period were:

	Current tax £m	Deferred tax £m	Net tax balance £m
At 31 July 2015	(20)	147	127
Foreign exchange gains and losses	2	14	16
(Charge)/credit to income statement	(24)	(14)	(38)
Credit to reserves		1	1
Business combinations		(1)	(1)
Tax paid	25		25
At 31 January 2016	**(17)**	**147**	**130**

The deferred tax credit to reserves relates to actuarial losses on the US pension plans. No deferred tax has been recognised in respect of the actuarial gains on the UK pension plans, because the deferred tax has not been recognised due to uncertainty as to its recoverability.

5 Post retirement benefits

Smiths provides post retirement benefits to employees in a number of countries throughout the world. The arrangements include defined benefit and defined contribution plans and, mainly in the United Kingdom (UK) and United States of America (US), post-retirement healthcare. The principal defined benefit pension plans are in the UK and in the US and these have been closed so that no future benefits are accrued.

Where any individual scheme shows a surplus under IAS 19, this is disclosed on the balance sheet as a retirement benefit asset. The IAS 19 surplus of any one scheme is not available to fund the IAS 19 deficit of another scheme. The retirement benefit asset arises from the rights of the employers to recover the surplus at the end of the life of the scheme. The schemes in surplus are mature, with a duration averaged over all scheme participants of 16.5 years. However 23% of the liabilities of these schemes are expected to be paid after 2041.

The amounts recognised in the balance sheet were as follows:

	31 January 2016 £m	31 January 2015 £m	31 July 2015 £m
Market value of funded plan assets	3,766	4,118	4,017
Present value of funded scheme liabilities	(3,517)	(4,342)	(4,010)
Unfunded pension plans	(100)	(94)	(96)
Postretirement healthcare	(20)	(20)	(19)
Net retirement benefit asset/(liability)	**129**	**(338)**	**(108)**
Retirement benefit assets	361	158	170
Retirement benefit obligations	(232)	(496)	(278)
Net retirement benefit asset/(liability)	**129**	**(338)**	**(108)**

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

	31 January 2016		31 January 2015		31 July2015	
	UK	US	UK	US	UK	US
Rate of increase for active deferred members	3.9%	n/a	3.6%	n/a	4.1%	n/a
Rate of increase in pensions in payment	3.0%	n/a	2.7%	n/a	3.2%	n/a
Rate of increase in deferred pensions	3.0%	n/a	2.7%	n/a	3.2%	n/a
Discount rate	3.6%	4.40%	2.9%	3.65%	3.5%	4.35%
Inflation rate	3.0%	n/a	2.7%	n/a	3.2%	n/a
Healthcare cost increases	4.7%	n/a	5.0%	n/a	4.7%	n/a

The methods for setting the mortality assumptions for the UK and US schemes are consistent with the 31 July 2015 valuation. The US assumptions have been updated to reflect the MP-15 mortality improvement scale, which was published in the period.

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

	31 January 2016 £m			31 July 2015 £m		
	SIPS	TIGPS	US schemes	SIPS	TIGPS	US schemes
Present value of funded scheme liabilities						
– Active deferred members	(87)	(72)	(112)	(92)	(76)	(102)
– Deferred members	(717)	(572)	(136)	(756)	(625)	(130)
– Pensioners	(944)	(787)	(11)	(995)	(823)	(336)
Present value of funded scheme liabilities	(1,748)	(1,431)	(259)	(1,843)	(1,524)	(568)
Market value of scheme assets	1,916	1,623	159	1,813	1,693	445
Surplus/(deficit)	**168**	**192**	**(100)**	**(30)**	**169**	**(123)**

The present value of liabilities relating to pensioners in the US schemes has fallen £325m following the $527m buy-out of retiree liabilities completed on 14 August 2015 which transferred the obligation to pay these pensions to Voya Retirement Insurance and Annuity Company. A settlement loss of £10m crystallised on this transaction.

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

	31 January 2016 £m	31 January 2015 £m	31 July 2015 £m
At beginning of period	(108)	(242)	(242)
Exchange adjustment	(15)	(15)	(3)
Reclassification of small unfunded obligations			(2)
Current service cost	(2)	(1)	(3)
Scheme administration costs	(5)	(5)	(8)
Past service cost, curtailments and settlements	(10)	13	14
Finance charges – retirement benefits	(1)	(4)	(8)
Contributions by employer	237	36	84
Actuarial gain/(loss)	33	(120)	60
Net retirement benefit asset/(liability)	**129**	**(338)**	**(108)**

Actuarial gains are principally due to the slightly higher discount rate and lower inflation used to value the UK scheme liabilities, net of asset remeasurement losses.

Contributions

Company contributions to the funded defined benefit pension plans totalled £234m (31 January 2015: £36m). This comprised regular contributions of £20m to SIPS, £8m to TIGPS, £16m to US schemes, £5m to other schemes and additional contributions of $50m to fund the buyout arrangement for US pensioners in August 2015 and the contribution of £152m of UK government bonds previously held as available for sale financial assets to the Smiths Industries Pension Scheme in December 2015.

Following the new funding agreement with the TIGPS trustees announced on 1 March 2016, contributions in the second half of the year are expected to be: £12m to SIPS; £3m to TIGPS and £18m to other plans, including the US defined benefit schemes.

6 Intangible assets

	Goodwill £m	Development costs £m	Acquired intangibles £m	Software, patents and intellectual property £m	Total £m
Cost					
At 1 August 2015	1,421	237	403	177	2,238
Exchange adjustments	126	21	37	7	191
Business combinations	5		3		8
Additions		9		5	14
Disposals		(3)		(1)	(4)
At 31 January 2016	**1,552**	**264**	**443**	**188**	**2,447**
Amortisation					
At 1 August 2015	115	121	358	126	720
Exchange adjustments	11	11	33	5	60
Charge for the period		12	9	8	29
Disposals		(3)		(1)	(4)
At 31 January 2016	**126**	**141**	**400**	**138**	**805**
Net book value at 31 January 2016	**1,426**	**123**	**43**	**50**	**1,642**
Net book value at 31 January 2015	1,370	123	62	51	1,606
Net book value at 31 July 2015	1,306	116	45	51	1,518

7 Property, plant and equipment

	Land and buildings £m	Plant and machinery £m	Fixtures, fittings, tools and equipment £m	Total £m
Cost or valuation				
At 1 August 2015	181	536	199	916
Exchange adjustments	15	46	14	75
Additions	4	17	8	29
Disposals	(1)	(8)	(3)	(12)
At 31 January 2016	**199**	**591**	**218**	**1,008**
Depreciation				
At 1 August 2015	97	403	157	657
Exchange adjustments	9	35	11	55
Charge for the period	4	14	7	25
Disposals		(7)	(2)	(9)
At 31 January 2016	**110**	**445**	**173**	**728**
Net book value at 31 January 2016	**89**	**146**	**45**	**280**
Net book value at 31 January 2015	93	136	46	275
Net book value at 31 July 2015	84	133	42	259

8 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 January 2016 £m	31 January 2015 £m	31 July 2015 £m
Cash and cash equivalents			
Net cash and deposits	**461**	**178**	**495**
Short-term borrowings			
Bank overdrafts	(3)	(1)	
£150m 7.25% Sterling Eurobond 2016	(150)		(150)
Bank and other loans	(1)	(1)	(1)
Interest accrual	(26)	(21)	(12)
	(180)	**(23)**	**(163)**
Long-term borrowings			
£150m 7.25% Sterling Eurobond 2016		(150)	
€300m 4.125% Eurobond 2017	(232)	(230)	(214)
$175m 7.37% US$ Private placement 2018	(123)	(116)	(112)
$250m 7.20% US$ Guaranteed notes 2019	(175)	(166)	(159)
Revolving Credit Facility 2020		(155)	
$400m 3.625% US$ Guaranteed notes 2022	(281)	(265)	(253)
€600m 1.25% Eurobond 2023	(454)		(410)
Bank and other loans	(2)	(2)	(2)
	(1,267)	**(1,084)**	**(1,150)**
Borrowings	**(1,447)**	**(1,107)**	**(1,313)**
Net debt	**(986)**	**(929)**	**(818)**

Under the terms of the US$800m Revolving Credit Facility dated 19 February 2014, Smiths Group has the option to request that the revised maturity date of 19 February 2020 be extended by 12 months. This option was duly exercised and agreed with the lending banks on 3 February 2016.

Movements in net debt

	Net cash and cash equivalents £m	Other short-term borrowing £m	Long-term borrowings £m	Net debt £m
At 31 July 2015	495	(163)	(1,150)	(818)
Foreign exchange gains and losses	12		(105)	(93)
Net cash inflow/(outflow)	(49)			(49)
Repayment and drawdown of borrowings		1	(1)	
Capitalisation, interest accruals and unwind of capitalised fees		(10)		(10)
Fair value movement from interest rate hedging		(4)	(12)	(16)
Change in maturity analysis		(1)	1	
At 31 January 2016	**458**	**(177)**	**(1,267)**	**(986)**

9 Fair value of financial instruments

	Carrying value 31 January 2016 £m	Fair value 31 January 2016 £m	Carrying value 31 January 2015 £m	Fair value 31 January 2015 £m	Carrying value 31 July 2015 £m	Fair value 31 July 2015 £m
Level 1 valuations						
Financial assets – other investments			139	139	147	147
Level 2 valuations						
Financial derivatives - assets	26	26	33	33	24	24
Borrowings	(1,447)	(1,486)	(1,107)	(1,183)	(1,313)	(1,358)
Financial derivatives - liabilities	(19)	(19)	(20)	(20)	(18)	(18)
Level 3 valuations						
Financial assets – other investments	10	10	7	7	9	9

Investments in comparative periods with level 1 valuations comprise quoted government bonds.

Derivatives are valued at the net present value of the future cash-flows calculated using market exchange rates and yield curves at the balance sheet date. Borrowings are valued at the net present value of the future cash-flows using credit spreads and yield curves derived from market data.

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.

10 Provisions and contingent liabilities

	Trading	Non-headline and legacy			Total
		John Crane, Inc. litigation	Titeflex Corporation litigation	Other	
	£m	£m	£m	£m	£m
At 31 July 2015	26	216	71	19	332
Exchange adjustments	2	21	6	1	30
Provision charged	12			7	19
Provision released	(2)	(2)	(7)		(11)
Unwind of provision discount		2	1		3
Utilisation	(6)	(8)	(1)	(7)	(22)
At 31 January 2016	**32**	**229**	**70**	**20**	**351**
Current liabilities	26	29	17	15	87
Non-current liabilities	6	200	53	5	264
At 31 January 2016	**32**	**229**	**70**	**20**	**351**

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

Trading

The trading provision includes warranties and product liabilities provisions of £30m (31 July 2015: £24m) and £1m (31 July 2015: £1m) in connection with ongoing price audits of overhead cost recovery charges associated with certain historical supply agreements.

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.

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.

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 244,000 claims (31 July 2015: 242,000 claims) against JCI have been dismissed before trial over the last 36 years. JCI is currently a defendant in cases involving approximately 75,000 claims (31 July 2015: 76,000 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 only 135 cases (31 July 2015: 133 cases) over the period, and has had to pay awards amounting to approximately US$153m (31 July 2015: US$153m). 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 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. Set out below is the gross, discounted and post-tax information relating to this provision:

	31 January 2016 £m	31 January 2015 £m	31 July 2015 £m
Gross provision	247	249	236
Discount	(18)	(17)	(20)
Discounted pre-tax provision	**229**	**232**	**216**
Deferred tax	(76)	(78)	(72)
Discounted post-tax provision	**153**	**154**	**144**

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 expenditure will fall between £231m and £261m (31 July 2015: between £221m and £248m), compared to the gross provision value of £247m (31 July 2015: £236m).

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 subrogation claims have been settled on an individual basis without admission of liability. Equivalent third-party products in the US marketplace face similar challenges.

Titeflex Corporation litigation provision

The continuing progress of claims and the pattern of settlement, together with the recent market place activity, provide sufficient evidence to recognise a liability in the accounts. Therefore provision has been made for the costs which the Group is expected to incur in respect of future claims to the extent that such costs can be reliably estimated. Titeflex Corporation sells flexible gas piping with extensive installation and safety guidance (revised in 2008) designed to assure the safety of the product and minimise the risk of damage associated with lightning strikes.

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

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

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 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.

	31 January 2016 £m	31 January 2015 £m	31 July 2015 £m
Gross provision	75	71	77
Discount	(5)	(5)	(6)
Discounted pre-tax provision	**70**	**66**	**71**
Deferred tax	(27)	(25)	(27)
Discounted post-tax provision	**43**	**41**	**44**

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 non-headline and legacy

Legacy provisions comprise provisions relating to former business activities and properties no longer used by Smiths. Non-headline provisions comprise all provisions which were disclosed as non-headline items when they were charged to the income statement.

These provisions cover non-headline reorganisation, vacant properties, disposal indemnities and litigation in respect of old products and discontinued business activities. The £7m charge in the period relates to projects in the Fuel for Growth programme.

11 Dividends

The following dividends were declared and paid in the period:

	Period ended 31 January 2016 £m	Period ended 31 January 2015 £m	Year ended 31 July 2015 £m
Ordinary final dividend of 28.00p for 2015 (2014: 27.50p) paid 20 November 2015	111	108	108
Ordinary interim dividend of 13.00p for 2015 paid 24 April 2015			52
	111	**108**	**160**

An interim dividend of 13.25p per share was declared by the Board on 15 March 2016 and will be paid to shareholders on 22 April 2016. 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 29 March 2016.

12 Cash-flow from operating activities

Year ended 31 July 2015			Period ended 31 January 2016			Period ended 31 January 2015		
Total £m		Notes	Headline £m	Non-headline (note 14) £m	Total £m	Headline £m	Non-headline (note 14) £m	Total £m
394	Operating profit		217	(34)	183	232	(68)	164
71	Amortisation of intangible assets		20	9	29	17	17	34
27	Impairment of intangible assets						26	26
1	Loss on disposal of property, plant and equipment		2		2			
1	Loss on disposal of business							
49	Depreciation of property, plant and equipment		25		25	24		24
8	Share-based payment expense		5		5	4		4
(85)	Retirement benefits		1	(69)	(68)		(44)	(44)
(30)	(Increase)/decrease in inventories		(3)		(3)	(38)		(38)
11	Decrease/(increase) in trade and other receivables		29		29	60		60
(4)	(Decrease)/increase in trade and other payables		(41)	2	(39)	(48)	1	(47)
(22)	(Decrease)/increase in provisions		4	(18)	(14)	(5)	5	
421	**Cash generated from operations**		**259**	**(110)**	**149**	**246**	**(63)**	**183**
(66)	Interest paid		(20)		(20)	(19)		(19)
2	Interest received		1	16	17	1	1	2
(91)	Tax paid		(25)		(25)	(54)		(54)
266	**Net cash inflow from operating activities**		**215**	**(94)**	**121**	**174**	**(62)**	**112**

Retirement benefit contributions in the period comprise cash contributions of £85m and a non-cash transaction where £152m of financial assets were contributed to the Smiths Industries Pension Scheme. See note 5 for details.

Interest received in the period includes £16m cash inflows on foreign exchange contracts hedging exposures on intra-group loans.

The split of tax payments between headline and non-headline only considers the nature of payments made. No adjustment has been made for reductions in tax payments required as a result of tax relief received on non-headline items.

13 Related party transactions

The related party transactions in the period were consistent with the nature and size of transactions disclosed in the Annual Report for the year ended 31 July 2015.

14 Non-statutory performance measures

Headline profit measures

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

The following items have been excluded from the headline measure:

- items which are material either because of their size or their nature, including:
  - 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 asset impairments;
  - income and expenditure relating to material litigation in respect of products no longer in production; and
  - other particularly significant or unusual items.
- costs of operating retirement benefit schemes which have been closed so that no future benefits are accrued, which are referred to below as legacy schemes, and financing credits and charges relating to retirement benefits;
- impairment of goodwill and amortisation of intangible assets acquired in a business combination – the impairment and amortisation charges are non-cash items, and the directors believe that it should be added back to give a clearer picture of underlying performance; and
- other financing gains and losses, which represent the potentially volatile gains and losses on derivatives and other financial instruments which do not fall to be hedge accounted under IAS 39.

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

Headline operating profit

The non-headline items included in statutory operating profit are as follows:

	Notes	Period ended 31 January 2016 £m	Period ended 31 January 2015 £m	Year ended 31 July 2015 £m
Items excluded from headline operating profit				
– restructuring programmes		15	19	38
– changes to post-retirement benefits		10	(13)	(14)
– profit on disposal and acquisition and disposal costs				(2)
– provision for Titeflex Corporation subrogation claims		(7)	1	8
– provision for John Crane, Inc. asbestos litigation		2	12	19
– legacy retirement benefits administration costs	5	5	5	8
– impairment of goodwill	6		26	27
– amortisation of acquired intangible assets	6	9	18	33
Non-headline items in operating profit		**34**	**68**	**117**

Material items for the period ended 31 January 2016

Restructuring costs comprise £15m in respect of Fuel for Growth. This programme, which involves redundancy, relocation and consolidation of manufacturing, is considered a material non-recurring item by virtue of its size.

The £10m charge relating to post-retirement benefits comprises the settlement arising from the buy-out of retiree liabilities completed by the US pension scheme on 14 August 2015. See note 9 in the Annual Report 2015.

A provision release of £7m has been recognised 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. An £8m reduction in the expected gross cost has been offset by a charge of £1m arising from a reduction in the discount rate.

The operating charge in respect of John Crane, Inc. litigation comprises a credit of £4m in respect of a reduced provision for adverse judgments and legal defence costs, £4m in respect of litigation management, defence strategy and legal fees in connection with litigation against insurers, and a charge of £2m arising from the decrease in US risk free rates.

Headline finance costs

	Notes	Period ended 31 January 2016 £m	Period ended 31 January 2015 £m	Year ended 31 July 2015 £m
Items excluded from headline finance costs				
– adjustment to discounted provisions	10	3	3	5
– fair value gain realised on contributing government bonds to a pension scheme	5	(19)		
– other financing gains and losses		2	2	4
– other finance costs – retirement benefits	5	1	4	8
Non-headline items in finance costs		**(13)**	**9**	**17**

The government bonds were accounted for as available for sale financial assets, and the cumulative fair value gains of £19m on these assets were recycled from other comprehensive income to the income statement when the bonds were contributed to the pension scheme. See note 5 for details of the impact of this transaction on the pension funding position.

Headline profit after tax

The non-headline items included in statutory profit after tax are as follows

	Notes	Period ended 31 January 2016 £m	Period ended 31 January 2015 £m	Year ended 31 July 2015 £m
Items excluded from headline profit after taxation				
– restructuring programmes		15	19	38
– changes to post-retirement benefits (including recycling)		(9)	(13)	(14)
– profit on disposal and acquisition and disposal costs				(2)
– provision for Titeflex Corporation subrogation claims (including financing)		(6)	2	9
– provision for John Crane, Inc. asbestos litigation (including financing)		4	14	23
– legacy retirement benefits administration and finance costs	5	6	9	16
– impairment of goodwill	6		26	27
– amortisation of acquired intangible assets	6	9	18	33
– other financing gains and losses		2	2	4
– tax on excluded items	4	(11)	(11)	(40)
Non-headline items in profit after tax		**10**	**66**	**94**

Headline earnings before interest, tax depreciation and amortisation (Headline EBITDA)

Smiths monitor the ratio of net debt to Headline EBITDA. Headline EBITDA is calculated as follows:

	Notes	Period ended 31 January 2016 £m	Period ended 31 January 2015 £m	Year ended 31 July 2015 £m
Headline operating profit		**217**	**232**	**511**
Exclude				
– depreciation	7	25	24	49
– amortisation of development costs	6	12	10	23
– amortisation of software, patents and intellectual property	6	8	6	15
Headline EBITDA		**262**	**272**	**598**

Return on capital employed (ROCE)

Smiths ROCE is calculated over a rolling 12-month period and is the percentage that headline operating profit comprises of monthly average capital employed.

See note 2 for the divisional headline operating profit and average divisional capital employed used to calculate divisional ROCE.

Capital employed

Capital employed is a non-statutory measure of invested resources. It comprises statutory net assets adjusted to add goodwill recognised directly in reserves in respect of subsidiaries acquired before 1 August 1998 of £815m (31 July 2015: £815m) and eliminate post-retirement benefit assets and liabilities and litigation provisions relating to non-headline items, both net of related tax, and net debt.

	Notes	31 January 2016 £m	31 January 2015 £m	31 July 2015 £m
Net assets		**1,540**	**1,210**	**1,428**
Adjust for				
Goodwill recognised directly in reserves		815	815	815
Post-retirement benefit assets and liabilities	5	(129)	338	108
Tax related to post retirement benefit assets and liabilities		(48)	(76)	(55)
Investments related to post retirement benefit assets and liabilities			(138)	(147)
John Crane, Inc. litigation provisions and related tax	10	153	154	144
Titeflex Corporation litigation provisions and related tax	10	43	41	44
Net debt	8	986	929	818
Capital employed		**3,360**	**3,273**	**3,155**

Return on capital employed

	Notes	31 January 2016 £m	31 January 2015 £m	31 July 2015 £m
Headline operating profit for previous twelve months		496	491	511
Average capital employed	2	3,229	3,188	3,197
ROCE		**15.4%**	**15.4%**	**16.0%**

Headline cash measures

Headline operating cash-flow

	Period ended 31 January 2016 £m	Period ended 31 January 2015 £m	Year ended 31 July 2015 £m
Net cash inflow from operating activities	**121**	**112**	**266**
Exclude			
Interest	3	17	64
Tax paid	25	54	91
Cash outflow in respect of non-headline operating items	26	29	66
Pension deficit payments	84	34	84
Include			
Expenditure on capitalised development, other intangible assets and property, plant and equipment	(42)	(44)	(95)
Disposals of property, plant and equipment in the ordinary course of business	1	2	8
Headline operating cash-flow	**218**	**204**	**484**

Headline free cash-flow

	Period ended 31 January 2016 £m	Period ended 31 January 2015 £m	Year ended 31 July 2015 £m
Headline operating cash-flow	**218**	**204**	**484**
Interest paid	(20)	(19)	(56)
Interest received	1	1	2
Tax paid	(25)	(54)	(91)
Headline free cash-flow	**174**	**132**	**339**

Previously the Company has disclosed total free cash-flow, which included the net cash outflow in respect of non-headline items, non-headline disposals of property, plant and equipment and investment in financial assets relating to pensions financing. The total free cash-flow for the period ended 31 January 2016 was £72m (period ended 31 January 2015: £58m).

Reconciliation of headline free cash-flow to movements in cash and cash-equivalents

	Period ended 31 January 2016 £m	Period ended 31 January 2015 £m	Year ended 31 July 2015 £m
Headline free cash-flow	**174**	**132**	**339**
Net cash outflow in respect of non-headline items (note 12)	(94)	(62)	(160)
Non-headline disposals of property, plant and equipment			3
Investment in financial assets relating to pensions financing	(8)	(12)	(24)
Investment in other financial assets		(1)	(3)
Acquisition of businesses	(8)		
Disposal of businesses			2
Net cash-flow used in financing activities	(113)	(82)	147
Net (decrease)/increase cash and cash equivalents	**(49)**	**(25)**	**304**