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News release

London, Wednesday 29 September 2010
For immediate release

Annual results for the year ended 31 July 2010

	Headline* 2010 £m	Headline* 2009 £m	Growth	Underlying#	Statutory 2010 £m	Statutory 2009 £m
Continuing activities						
Sales	**2,770**	2,665	4%	0%	**2,770**	2,665
Operating profit	**492**	418	18%	14%	**436**	429
Operating margin	**17.8%**	15.7%	–	–	**15.7%**	16.1%
Pre-tax profit	**435**	371	17%	14%	**373**	371
Basic EPS	**84.6p**	72.4p	17%		**75.3p**	70.8p
Free cash-flow	**331**	256	29%			
Dividend	**34.0p**	34.0p			**34.0p**	34.0p
Return on capital employed	**16.6%**	14.7%				

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

#Organic growth at constant currency.

Highlights

- Strong financial performance – headline operating profit up 18% (14% underlying)
- Headline operating margin up 210 basis points to 17.8%
- Margins ahead in all divisions driven by operational efficiency initiatives
- Restructuring programme generated savings of £24m; £41m to date and ahead of plan
- Procurement initiatives delivered savings of £11m; £20m to date
- Company funded R&D increased by 5% to £93m
- Cash conversion grew to 115% (2009: 104%) of headline operating profit
- Free cash-flow increased 29% (£75m) to £331m

"We have delivered a strong performance in a tough economic environment. Our focus on operational improvement and restructuring continues to deliver significantly enhanced margins, which are now the highest for ten years. Headline operating profit is up strongly, driven primarily by organic growth across all divisions, as well as the benefit of recent acquisitions and favourable exchange rates. Sustained delivery on cash conversion supported a £75m increase in free cash-flow to £331m. Return on capital employed increased 190 basis points to 16.6%.

"Looking ahead, our priority is to deliver the additional cost savings due from our restructuring and other initiatives. Cash conversion and improving returns continue firmly in our sights, as we invest in the drivers of future growth including new product development, marketing, an enhanced sales infrastructure and targeted acquisitions. The uncertain economic outlook and constraints on government spending will continue to affect sales growth. However, we will concentrate on those opportunities within our control to improve performance further and enhance margins."

Philip Bowman
Chief Executive
Smiths Group plc

Divisional highlights*

Smiths Detection: Sales up 13% and headline operating profit up 40%; margin up to 15.7%

- Double digit sales growth driven by ports and borders and transportation markets
- Margins improved by 310 basis points to 15.7% with increased volumes and better overhead recovery
- Military business continues to benefit from long-term programmes such as JCAD
- Well-positioned for growth although stretched government finances may affect the order profile

John Crane: Sales down 5% and headline operating profit up 9%; margin up to 20.7%

- Margins improved by 260 basis points to 20.7%, benefiting from operational efficiency initiatives
- Restructuring initiatives delivered £12m savings in the year, raising the total to date to £19m
- Sales declined as customers reduced investment in OEM equipment
- Improving order book has delivered sales growth in the second half on the prior period

Smiths Medical: Sales flat and headline operating profit up 10%; margin up to 21.5%

- Excluding diabetes, sales grew 2%; hardware sales up 2% and disposable items up 3%
- Cost management and restructuring initiatives have expanded margins 180 basis points to 21.5%
- Portfolio profitability review has reduced complexity and is delivering price and margin benefits
- Supply chain and customer service improved by performance initiatives

Smiths Interconnect: Sales down 3% and headline operating profit up 3%; margin up to 18.2%

- Margins improved by 80 basis points through restructuring, manufacturing efficiencies and procurement savings
- Military and aerospace markets have returned to growth while wireless telecoms and other markets remain weak
- Launch of new broadband antenna for commercial aircraft helped second half sales
- Integration of Interconnect Devices, Inc. on track: expanding product offering and increasing exposure to China

Flex-Tek: Sales down 6% and headline operating profit up 6%; margin up to 11.1%

- Continued site rationalisation and tight cost control helped increase margins by 120 basis points
- US residential construction and household appliance markets improved in the second half but remain fragile
- Sales of components to the aerospace markets continued to be weak

**Figures are at constant currency and exclude the impact of acquisitions and disposals*

Statutory reporting

Statutory reporting takes account of all items excluded from headline performance. On a statutory basis, pre-tax profit from continuing operations was £373m (2009: £371m) and earnings per share were 75.3p (2009: 70.8p). The items excluded from headline performance comprise amortisation of acquired intangible assets of £42m (2009: £35m); £25m in connection with John Crane, Inc. asbestos litigation (2009: £22m); £8m (2009: £24m) in respect of restructuring; gains of £4m (2009: £70m) arising from changes to the post-retirement benefits; profit on disposal of businesses and property of £9m (2009: £15m), acquisition costs of £1m (2009: nil) and financing gains of £1m (2009: £4m loss).

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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 29 September. A recording of the webcast is available later that day. A live audio broadcast of the presentation is also available by dialling (no access code required):

UK: 0808 238 7385

International: +44 (0)20 7906 8535

US/Canada: 1 866 928 6046

An audio replay is available for seven days on the following numbers (access PIN 272804#):

UK: 0808 238 9699

International: +44 (0)20 3364 5943

US/Canada: 1 866 286 6997

Photography

Original high-resolution photography is available to the media from http://www.smiths.com/images.aspx.

Chief Executive's review

These strong results have been achieved in a tough economic environment and demonstrate our substantial progress in delivering operational improvements and generating strong cash-flows. We have also benefited from the strength and breadth of being a diversified-industrial company, with our portfolio of leading edge, technology-driven businesses serving a broad range of geographies and markets. The major restructuring programme and other cost saving initiatives that began some two years ago have delivered strong margin improvement despite the difficult sales environment. While we have been effective in cutting costs, we have also continued to invest in growth opportunities such as new product development and bolt-on acquisitions.

All businesses in the Group delivered margin improvement as a result of our actions to restructure and cut costs. The Group's focus on working capital management has also delivered strong free cash-flows. Smiths Detection has achieved double digit sales growth following difficult trading last year as it benefited from a good order flow from transportation, ports and borders and military customers. As a result, margins have rebounded rapidly with the higher volumes. Through its strong technology, Smiths Detection is well placed to take advantage of future market growth. Smiths Medical has benefited substantially from the performance improvement programme initiated over two years ago. The business has returned to growth, adjusting for the diabetes exit, and its margins are back in their target range at 21.5%. More importantly, the operational platform is now stable and provides a sound base from which to grow the business. John Crane has improved its underlying margins by 260 basis points to a record 20.7%. This was achieved through cost savings and despite the pressure on sales during the period. However, the order intake strengthened as the year progressed and second half sales were ahead by almost 4% on the prior year. Smiths Interconnect also delivered improved second half sales driven by the military and aerospace markets, while margins benefited from the restructuring programme. Flex-Tek is heavily exposed to the US housing and domestic appliances markets which, for the first time in several years, showed signs of growth during the second half. Flex-Tek increased margins through continued focus on cost reduction and site rationalisation.

Strategy

Our strategy is to continue to grow shareholder value by:

- Delivering sales growth through investment in organic drivers including new product development and expansion in high growth markets
- Enhancing margins through a relentless drive for operational improvement across all our businesses
- Generating strong cash-flows with better balance sheet management
- Implementing a rigorous approach to allocating capital across the businesses through active and disciplined portfolio management and a targeted acquisition strategy
- Improving returns on capital.

We made substantial progress towards these objectives during the last year. Clear opportunities remain, however, for Smiths Group to improve performance progressively and generate further value for shareholders.

Investing in new product development

A key driver of future sales and margin growth is the launch of new products which command higher margins and deliver superior returns. This commitment to innovation also sustains our technology leadership in many areas. We raised company-funded investment in R&D by 5% to £93m and were successful in securing a further £13m of customer-funded investment to bring our total spend to £106m, or 3.9% of sales. We launched a range of new products in John Crane, including a specialised bearing for power generation turbines and seals designed for the supercritical CO_2 sealing needs of the growing carbon capture and enhanced oil recovery markets. Sales in Smiths Medical benefited from the continued success of our ambulatory smart pump, CADD®-Solis, which is now being sold in additional markets. In Smiths Detection, we continue to develop eqo, our body image scanner, with airport and regulatory trials underway to improve security and passenger experience. In the past year, Smiths Detection also entered into development partnerships with Analogic, to design the next generation of checked baggage screening equipment, and with Novartis Diagnostics to develop a range of clinical tests for bacterial and viral pathogens using the established Bio-Seeq platform. Smiths Interconnect launched a new broadband antenna, KuStream™, for commercial aircraft, which is currently being installed by Row44 on the Southwest Airlines fleet to provide passengers with a variety of high data rate applications.

A focus on performance improvement

Across the Group, the major restructuring programme has generated further savings of £24m in the period, well ahead of our original plans. To date, we have delivered savings of £41m and have spent £36m, with £8m in the year. Together, the programmes are expected to produce annual savings of £50m when completed in 2011. The total cost of these programmes is expected to be £45m.

We have also enhanced the information flow in the business through significant investment in new information systems over recent years. The implementation of ERP systems at Smiths Detection, John Crane and Smith

Medical were all substantially completed during the year. The better data at Group and divisional levels has highlighted opportunities to leverage the Group's scale through Group-wide procurement initiatives. In the year, this programme generated £11m savings, principally from IT, raw materials, machine parts, utilities and freight. Overall, the programme has delivered £20m of savings to date.

We have identified a further tranche of cost savings to be realised from a rationalisation of certain 'back-office' functions to reduce overheads across the Group. This will also help to drive further efficiencies and benefits from the ERP systems now these have been implemented. This will be achieved by using shared service centres and removing duplication across these functions within divisions. The programme is estimated to deliver £20m of annual benefits by the financial year ending July 2013, at a cost of £19m, which will be treated as an exceptional item, with £13m of costs expected in the financial year ahead.

Efficient balance sheet management
During the year, we improved significantly our cash generation and strengthened the balance sheet. Following the successful issue of US dollar-denominated debt last year, the maturity profile was further extended through a €300m bond issue. These bonds have a seven-year maturity and were priced at a fixed coupon of 4.125%. Average debt maturity is now over six years, which gives the Group long-term certainty over its future financing.

Investing in growth and driving returns
We continued to enhance the portfolio through a targeted acquisition programme. Over the past three years, we have made 12 acquisitions. Six of them have extended our footprint in the faster growing Asian markets. The acquisition strategy seeks to add complementary technologies, to support geographic expansion in faster growth markets and to leverage existing infrastructure such as sales and service centres. In October 2009, Smiths Interconnect acquired Channel Microwave, a California-based microwave components business, focused on the defence and homeland security markets. In April 2010, Smiths Interconnect acquired for US$188m, Interconnect Devices, Inc., a leading connector company with an international presence, and a strong base in North America and China. The integration of both these acquisitions is substantially complete, with both performing ahead of expectations.

The Group has continued to focus on improving returns on capital by enhancing margins while operating an efficient capital base. This has delivered a significant improvement in headline return on capital employed, up 190 basis points to 16.6%.

Targeting performance improvement
In September 2008, we set out ranges for sales growth and margins for each of the divisions based on what we believed the businesses could achieve over the medium term in an economic environment consistent with that of recent years. Since then we have seen a fundamental deterioration in world economies and, although it will be harder to operate within these ranges in the near term, those targets remain in place. In the current environment it will take longer to achieve them; particularly sales growth, which will be harder to deliver than improved margins – where we have greater control over driving cost reductions and operating efficiencies. Nonetheless, we have made good progress this year, with three divisions delivering margins within their target ranges, and we remain focused on driving further improvements.

Dividend
The Board has recommended a final dividend in line with last year of 23.5p per share, making a total dividend for the year of 34.0p per share. The final dividend will be paid on 19 November to shareholders registered at the close of business on 22 October. The ex-dividend date is 20 October.

Since March 2008, the Board has pursued a policy to rebuild dividend cover to around 2.5 times over the medium term, a goal we have now almost reached. As a result, the Board intends to adopt a progressive dividend policy for future payouts while maintaining this prudent level of cover. We believe that this policy will enable us to retain sufficient cash-flow to finance our investment in the drivers of growth.

Outlook
The economic environment remains uncertain and delivering sales growth in the short to medium term is likely to remain challenging, although the Group is well positioned to benefit from a recovery whenever that occurs. Our focus for the year ahead is to drive margin enhancement through the further cost savings due from our restructuring and site rationalisation programmes. As we have already accelerated the delivery of some of the benefits from these programmes, however, the effect on the rate of future profit growth will be more muted in the coming year. We will also seek to maintain strong cash generation which will enable us to continue investing in the long-term growth drivers of new product development, acquisitions, and expansion in faster growing developing markets.

Business review

Sales

Sales increased by 4%, or £105m, to £2,770m. Currency translation gains on overseas sales totalled £59m and the net impact of acquisitions and disposals increased sales by £48m. On an underlying basis, excluding the effects of currency translation and acquisitions and disposals, sales fell by just £2m, despite strong growth in Smiths Detection (up £63m) caused by a rebound in orders from the ports and borders and transportation sectors. The decline in sales was a result of lower volumes across the other divisions: John Crane (down £44m); Flex-Tek (down £12m); Smiths Interconnect (down £8m); and Smiths Medical (down £1m).

The flat underlying sales performance reflects a decline in the first half of 5% followed by growth in the second half of 5%.

Profit

Headline operating profit rose £74m to £492m. Headline operating margin increased by 210 basis points to 17.8% (2009: 15.7%). The increase in headline operating profit comprises £8m from favourable currency translation, £8m from the net impact of acquisitions and disposals made during the year, and a £58m, or 14%, increase in underlying headline operating profit. All divisions contributed to the improvement with the main drivers being higher volumes and improved overhead recovery at Smiths Detection, up £26m; cost saving initiatives at the other divisions with Smiths Medical up £17m, John Crane up £13m. Smiths Interconnect up £1m, and Flex-Tek up £2m. Corporate centre costs were held in line with last year.

Operating profit on a statutory basis, after taking account of the items excluded from the headline figures, was £436m (2009: £429m).

The net interest charge on debt increased to £62m (2009: £52m) which reflects the higher coupon on bonds issued during the last two years as part of a programme to extend debt maturities. There was a reduced pensions financing gain of £2m (2009: £5m). As a result, headline profit before tax increased by £64m to £435m (2009: £371m). On an underlying basis, headline profit before tax grew by 14%.

On a statutory basis, after taking account of items excluded from the headline figure, the profit before tax increased £2m to £373m (2009: £371m).

The Group's tax rate on headline profit for the period was 24% (2009: 24%). Headline earnings per share increased by 17% to 84.6p (2009: 72.4p).

Cash generation

Strong cash generation this year resulted in free cash-flow of £331m (2009: £256m). Substantially improved headline operating cash of £565m (2009: £435m) represented 115% (2009: 104%) of headline operating profit. The improvement resulted from better working capital management, particularly inventories, and lower net capital expenditure. The strong cash generation reduced net debt by £48m to £837m, despite outflows of £133m for dividends and £133m for acquisitions.

Smiths Detection

	2010 £m	2009 £m	Reported growth	Underlying growth
Sales	**574**	501	15%	13%
Headline operating profit	**90**	63	43%	40%
Headline operating margin	**15.7%**	12.6%		
Statutory operating profit	**89**	63		
Return on capital employed	**13.3%**	9.5%		

Reported sales grew 15%, or £73m, reflecting an underlying increase in sales of £63m (13%) and a currency benefit of £10m. The underlying growth has come primarily from the ports and borders, transportation and military sectors, offset by a small decline in critical infrastructure and other segments. Smiths Detection has maintained its position as one of the world's largest suppliers of government-regulated CBRNE sensors and systems during the period.

The 310 basis point improvement in margins to 15.7% was driven by increased sales volumes and the associated enhancement in overhead cost recovery. We began a restructuring programme late last financial year to reduce the cost base and introduce more flexibility so we can respond more quickly to variations in order flow. This will be achieved through rationalising several manufacturing facilities. We expensed restructuring costs of around £2.2m in the year, which has generated savings in the current year of around £1.6m with further savings expected in 2011.

Underlying sales in transportation grew 19% following a strong performance in the second half. The business secured several large contracts including one for advanced X-ray systems to upgrade Canada's existing airport checkpoints; an order from the US Transportation Security Administration (TSA) to supply portable liquid detection scanners for its Bottle Liquid Scanner programme; and a contract to supply advanced X-ray and trace detection systems in the newly opened Terminal 3 in New Delhi's international airport. Many airports have been reviewing their security arrangements following the attempted terror attack on an aircraft on 25 December. This has led to increased orders for explosive trace equipment such as the Ionscan 500DT, including an $11m order from the TSA. This portable technology is highly effective at detecting minute traces of explosives and can be easily deployed at airports. Many governments and airports are also considering installing body imaging systems and we have deployed our millimetre-wave system, eqo, as part of a number of trials. eqo uses electronic, real-time imaging in a standard checkpoint layout to detect metal and non-metallic threats concealed under clothing without physical contact. We have also benefited from the investment in air cargo screening in the US to meet the target of 100% screening by 1 August 2010, a key requirement of the 9/11 Act. We now offer 16 different X-ray machines on the TSA's approved technology list, which meet a wide variety of applications.

Underlying sales in the ports and borders market rose 66% following a weak performance last year. The market experienced widespread contract delays during the previous financial year as government customers reviewed their expenditure plans against a backdrop of deteriorating economies and strained finances. Several new contract wins supported strong sales growth during the period, including projects in Saudi Arabia, Russia and Japan. For example, we won an order for 13 high-energy X-ray scanners in Saudi Arabia, to inspect inbound and outbound containers and trucks for contraband, weapons, explosives and narcotics. The long-term outlook for ports and borders remains strong as governments improve their border security. Our leading-edge technology positions us well to meet this demand.

Our military business grew underlying sales by 4%, largely through the success of the Lightweight Chemical Detector (LCD) in multiple programmes including Canadian and German contracts and most notably the Joint Chemical Agent Detector (JCAD) programme for the US Department of Defense. The LCD, an advanced chemical point detector that helps safeguard troops by automatically detecting chemical warfare agents and toxic industrial chemicals, has gained worldwide acceptance as the leading detector in its class. As expected, the sales profile flattened in the second half due to the phasing of orders. Sales of sensor instruments to the emergency responder market also continued to grow steadily, with new sales in Europe and Asia complementing the strong position in the US.

Progress was made during the period in the development of molecular diagnostics detection systems for biological identification applications. Agreement was reached with Novartis to develop these systems for application to the clinical diagnostics markets in future years.

Implementation of a new ERP system was completed on schedule at the end of calendar year 2009. This single system replaces 14 legacy business software systems and provides a common information platform to support data-driven decision-making. Investment totalled £25m and we have delivered annualised cost savings of £7m against our target of £8m and working capital efficiencies of £20m compared with a target of £11m.

Research and development

Smiths Detection has maintained its leadership in the sector through a consistent commitment to product innovation developed by in-house R&D, government-funded research and via partnerships and licences. Company funded R&D increased 3% to £36m or 6.2% of sales (2009: 6.9% of sales). This includes £11m of capitalised projects. Smiths Detection actively seeks customer and government support for R&D which totalled £8m in the period (2009: £10m). Total R&D spend was £44m (2009: £45m) or 7.6% of sales.

The main focus for R&D investment continues to be X-ray for a variety of applications, including baggage scanning at airports and cargo screening at ports and borders. In December 2009, we entered an agreement with Analogic to develop the next generation of high-speed Explosive Detection Systems (EDS) for screening checked airport baggage. The new system will incorporate the complementary expertise of each company in multi-energy X-ray technology and three-dimensional computed tomography (CT). The development cost will be absorbed within Smiths Detection's ongoing R&D spend over the next two years. The project has met all interim milestones and is progressing well.

We are also looking to enhance the privacy features of eqo by developing software upgrades that enable the system to alarm automatically on detecting any threat items beneath clothes, so greatly reducing the need for visual inspections. These upgrades could be easily installed in the eqo systems already deployed. eqo was one of the joint winners of the Equipment and Technology Award, sponsored by the UK's Aerospace, Defence and Security trade organisation.

Our global leadership in biological and chemical trace detection supported the development of several new products in the period. This included a new chemical sensor nose cone for the US Army's Raven unmanned aerial vehicle, which can provide effective standoff detection and identification to warn troops against a chemical attack. We also launched a new version of our portable bio-threat detector, SmartBio™Sensor, which can detect the presence of airborne biological microbes and bio-toxins. Other new product launches included HazMatID 360 for rapid in-field chemical analysis of unknown solids, gels and liquids; LCD-Nexus, a rugged chemical warfare agent and toxic industrial chemical detector that can be remotely networked and controlled; and HGVI LINX™, a pioneering software system to help emergency responders evaluate data from remote HGVI units (Hand-held, Multi-Sensor Gas & Vapor Identifier).

Outlook

Smiths Detection is well placed to benefit from future growth opportunities, although government finances remain under pressure in many markets which may affect the timing and profile of orders. We expect growth to come from the transportation and ports and borders markets, while the military market is likely to soften following a period of strong growth. Longer term, we expect continued demand for leading-edge technology solutions for threat detection and identification. Smiths Detection will continue to invest in new product development to maintain market leadership, while restructuring the business to cut costs and support margin improvement.

John Crane

	2010 £m	2009 £m	Reported growth	Underlying growth
Sales	**786**	790	(1)%	(5)%
Headline operating profit	**163**	143	14%	9%
Headline operating margin	**20.7%**	18.1%		
Statutory operating profit	**124**	106		
Return on capital employed	**22.2%**	20.4%		

John Crane margins improved to an all-time high of 20.7% with a 260 basis point increase against a 5% (£44m) decline in underlying sales. These margins demonstrate the cost saving benefits from the global restructuring programme, the implementation of an ERP system and procurement savings. The reduced underlying sales reflect lower orders for first-fit original equipment which offset a slight increase in aftermarket sales, driven primarily by a recovery in the oil, gas and petrochemical sectors. First half underlying sales declined by 15% but an improving order book, particularly in the aftermarket for rotating equipment (seals, bearings, and filtration), helped second half sales grow by 4% on the same period in the prior year. Reported sales fell 1% after a £19m benefit from currency translation and a £21m contribution from recent acquisitions.

Reported headline operating profit grew by 14%, driven primarily by a 9%, £13m, increase in underlying profit, as well as a £4m gain from currency translation and £3m from acquisitions. The underlying improvement in profitability stems from the benefits delivered from our cost-saving initiatives. The restructuring programme launched in August 2008 to create one global John Crane division is progressing on schedule. These changes are delivering improved customer service, quicker delivery, and lower costs. In the period, we spent £4m and delivered savings of £12m so that annualised savings to date now total £19m. Overall, the project is on track to deliver annual savings of £25m.

Overall aftermarket sales grew by 1% on an underlying basis. Aftermarket sales of rotating equipment increased 2% driven by the oil, gas and petrochemical, general industry and distribution sectors as spending started to recover and new distributors were added. The chemical and pharmaceutical sectors continued to decline for rotating equipment. Sales for John Crane Production Solutions, our energy services business, are all in the aftermarket and declined 10% due to lower activity levels in Romania and in US onshore gas and oil production. Going forward, John Crane Production Solutions won a major contract to upgrade and maintain Romania's oil wells by providing pump repair services and equipment for Petrom's 8000-plus wells. The contract for pump repair services began on 1 December 2009. This new contract is expected to generate annual revenues of about £14m.

First-fit original equipment sales declined by some 15% on an underlying basis as the recession prompted customers to curtail capital expenditure.

Our recent acquisitions to broaden our product offering in the areas of engineered bearings and specialist filtration have been integrated into the existing portfolio. These businesses have a greater exposure to the first-fit OEMs and are more exposed to the capital spending cycle until we fully realise aftermarket channels for these products. Progress was made within the year with several new accounts achieved for bearings and filtration. In line with our original plans, we expect to progressively build the aftermarket sales for these products over time by leveraging our existing global network of sales and service centres and our unrivalled expertise in aftermarket servicing.

Implementation of a new ERP system across Europe, Middle East, Africa and Asia completed on schedule in July 2010 and within the £24m budget. The project is expected to generate annual cost savings of £10m. To date, the project has realised £5m of savings.

Critical to continued expansion of our market-leading sales and service network, significant infrastructure enhancements were completed during this past year. The John Crane Asia Pacific headquarters were relocated to a new custom-built facility providing 'state-of-the-art' manufacturing, service and training capabilities. This centre now provides advanced design and development of seal support systems as well as regional technical support for all John Crane product lines including bearings and filtration. Service network enhancements include the opening of a new larger couplings facility in Houston, expansion of the largest North American service centre, also in Houston, and a new service centre in Auckland, New Zealand. In addition, a new service centre opened in Kwidzyn, Poland, strategically located near six major pulp and paper plants, establishing exceptional customer service response capability and a business growth opportunity.

Research and development

John Crane's commitment to technical leadership through investment in product research and development is the foundation to maintaining our industry-leading position. This past year John Crane spent £10m on the development of new wet and dry gas seals, advancement of coupling and bearing technologies, control monitoring systems and expansion of test capabilities. Addressing industry demands associated with gas transmission trends including CO_2 capture and re-injection, gas seal development programmes are ongoing including the launch of a new high-pressure gas seal design, new test rigs capable of extreme high pressures and advanced seal face materials development. Wet seal product developments include the introduction of a new high-performance split seal line approved for use on naval ships, unique high temperature non-contacting pump gas seal technology, a high solids-capable slurry seal for mining and flue gas desulphurisation applications and advancement of diamond coatings for seal faces. In addition, significant investment has been directed to the improvement of proprietary analysis tools that further enable our product development programmes and support customer service initiatives.

Outlook

John Crane's order rate has continued to improve. This should support sales growth in the coming year, subject to a sustained expansion in market economies and further customer investment in capital projects. Margins will benefit from the remainder of the cost saving initiatives in the coming year, although this will be offset by strategic investment in growth opportunities such as the expansion of our sales and service network and increasing our presence in growth markets. John Crane will capitalise on its market leadership in mechanical seals and continue to leverage its global sales and service network to promote the newly acquired products such as hydrodynamic bearings and specialist filtration systems whilst continuing to build the John Crane Production Solutions business.

Smiths Medical

	2010 £m	2009 £m	Reported growth	Underlying growth
Sales	**858**	834	3%	0%
Sales (excluding diabetes)	**844**	801	6%	2%
Headline operating profit	**184**	164	12%	10%
Headline operating margin	**21.5%**	19.7%		
Statutory operating profit	**172**	148		
Return on capital employed	**15.1%**	12.8%		

Underlying sales were flat due to our exit from diabetes which reduced revenue by £20m; excluding diabetes, underlying sales grew 2%. At reported exchange rates, Smiths Medical sales grew 3% (£24m), which reflects gains from currency translation (£23m) and acquisitions (£2m), while headline operating profit rose 12% (£20m). Headline operating margins increased by 180 basis points to 21.5%, reflecting a strong underlying growth in profit of £17m, a currency benefit of £2m, and profit from acquisitions of £1m. Margins benefited from the various cost saving initiatives to address overheads and material costs as well as other manufacturing efficiency measures. The portfolio profitability review begun last year delivered price improvements and better margins. The momentum established in the first half of the fiscal year continued, with underlying hardware sales up 2%, excluding diabetes, while sales of our disposable products grew 3%.

These results demonstrate the significant progress made through the performance improvement programme introduced two years ago to address the supply chain and operational challenges facing the business. Among many operational metrics, we have seen a marked improvement in on-time delivery and customer service, as well as reduced customer backorders. At the same time, there has been some recovery in the hardware market and stabilisation of disposable sales. This follows a tough period last year when the economic downturn squeezed hospital budgets and prompted significant distributor destocking. We have also seen a rise in accompanying disposable sales in line with hardware sales improvements.

In medication delivery, excluding diabetes, underlying revenue grew 5% from increased sales of our CADD®-Solis ambulatory smart pumps and continued strong sales of our Medfusion™ syringe pumps. Deferrals of purchases of our infusion systems by some large customers have continued, although we expect those sales to recover. Sales of CADD®-Solis pumps grew in North America and are expanding in other English-speaking markets. The European multi-language launch of CADD®-Solis pumps began in February, and early results show strong market acceptance. In addition, we recently announced a commercial collaboration with Hospira to co-promote infusion pump systems. As part of this agreement, the two companies have begun development of software for managing infusion safety medication. This is designed to enhance patient safety and simplify how clinicians work. This agreement will allow us to extend the use of our Medfusion syringe pumps with PharmGuard Medication Safety Software to more hospitals and care areas in the US and Canada.

Vital care underlying sales grew 2% mainly through a continued good performance by our temperature management franchise, which represents a positive turnaround. We benefited from growth in our respiratory products, particularly early in the year, partly due to preparations made by various organisations for potential H1N1 flu outbreaks. Our tracheostomy business also delivered strong growth in the period. The UniPerc® tracheostomy kit for people with large necks boosted this franchise after it won a prestigious Medical Design Excellence Award, attracting increased interest in the product. Our obstetrics and gynaecology products are also growing strongly as we benefit from our leading presence in a niche market.

Underlying sales of safety devices rose 1%, driven by several large orders in support of H1N1 preparation early in the year, and a significant OEM partnership. Interest in safety products remains high in developed markets, and is growing in developing markets like India. In May 2010, the European Commission adopted a Directive, with the aim of “achieving the safest possible working environment for healthcare workers through prevention from sharps injuries”. Countries across the continent are beginning to seek products that adhere to these guidelines, and Smiths Medical is in a strong position to capitalise on this opportunity.

We continued to manage our product portfolio aggressively to boost profitability and reduce complexity. By the end of October 2009, we had simplified our business by successfully eliminating some 3,000 SKUs; this has provided opportunities to convert customers to alternative products. In the second phase of our portfolio review, we are looking at our product line holistically. We will delete additional low-performing SKUs, as appropriate, while pursuing additional up-selling and cross-selling opportunities, and price increases. A more sophisticated global account management system is gaining traction and helping improve customer profitability. At the same time, our previously regional organisation was restructured to create global management teams for sales and marketing and product management. We have continued to optimise our manufacturing footprint to deliver an efficient supply chain.

During the year, we closed a manufacturing facility at Waukesha, Wisconsin, and transferred the BCI and SurgiVet production lines to our St Paul, Minnesota, facility. We also rationalised two distribution centres – in Otay Mesa, California, and Cherwell, UK – merging them into existing distribution centres. The restructuring of our North American operations has produced £3m of savings to date.

Implementation of our global ERP business systems was completed at the end of February. The new systems are already providing far greater transparency of key data across the business. This is enabling faster, data-driven decision-making that will improve our quality and customer satisfaction to support revenue and margin growth.

Research and development

We continued to increase the sales from products launched in the last three years, up 16% on last year. This metric demonstrates that we are directing our R&D investment more effectively and executing more of our product launches on time and within budget. Our R&D spend totalled £30m (2009: £29m) or 3.5% of sales (2009: 3.5%).

During the year, we extended the reach of a number of products into new markets, including CADD®-Solis and Medfusion™ pumps, the UniPerc® tracheostomy range, LockIt Plus™ catheter securement devices and SuctionPro™ 72 closed suction systems. We also completed a global launch of our new, full range of convective warming blankets, which have been well received in all of our key markets.

Outlook

Smiths Medical’s strategic imperatives for fiscal year 2011 are growth, globalisation and new products. We will continue to drive positive sales momentum, although growth will be constrained by the exit from diabetes. The potential impact of government cuts to healthcare budgets may also affect the rate of growth. We will continue to push through efficiencies to support planned increases in investment in R&D and sales and marketing. We expect sustained and significant sales expansion in China, with a rapid pick-up in growth in India, as our regional direct sales strategy gains momentum. Margins will benefit from the restructuring and cost reduction initiatives and from our ability to make data-driven decisions regarding portfolio and customer profitability.

Smiths Interconnect

	2010 £m	2009 £m	Reported growth	Underlying growth
Sales	**340**	318	7%	(3)%
Headline operating profit	**62**	56	12%	3%
Headline operating margin	**18.2%**	17.4%		
Statutory operating profit	**53**	51		
Return on capital employed	**17.3%**	18.4%		

Reported sales for Smiths Interconnect grew 7%, or £22m, reflecting gains from currency translation (£5m) and acquisitions (£25m) that offset a 3% (£8m) underlying fall in sales. The lower underlying figure was primarily due to slowing investment in wireless infrastructure and weaker sales of components to the rail, industrial and automation markets in Europe. However these markets have shown some recent signs of recovery. Overall revenue was boosted by sales growth in military and aerospace markets particularly towards the end of the year, such that underlying sales rose 3% in the second half compared with a first half decline of 9%.

Headline operating profit margins improved by 80 basis points to 18.2%. Reported headline operating profit increased 12%. Excluding the £1m benefit from currency translation and £4m from acquisitions, underlying headline profit grew 3%. The improved margins were driven by a combination of initiatives taken during the year as well as the benefits of restructuring actions from last year, including headcount reductions at multiple sites and short-time working in continental Europe. Gross margins improved because of restructuring savings, cost savings from the Group-wide procurement initiative, lower labour costs as more production was transferred to low-cost economies, and efficiency improvements in targeted product lines. Fixed costs continued to be tightly controlled.

On an underlying basis, sales into military, aerospace and space applications improved by 6% for the full year with a strong second half more than offsetting the 3% decline in the first half.

A key driver was the launch of the KuStream™ advanced broadband satellite antenna system, which enables airline passengers to access high data rate applications including internet, cell-phone services, live television and movies. The KuStream™ antenna was selected by Southwest Airlines and production deliveries of the $30m order started in the latter part of the year. The system is currently being considered by other airlines and we have also supplied initial development phase quantities for military applications.

The military market showed signs of becoming more challenging with some major programmes declining or being delayed. However our areas of focus, particularly C4ISR (command, control, communications, computers, intelligence, surveillance, and reconnaissance) and force protection applications, remained relatively robust. Our microwave and millimetre-wave businesses continued to support multiple secure military communications-on-the-move, sensor systems, and electronic warfare applications. These included completing the development phase of a significant shipboard communications programme for which the first phase of a six-year production contract is expected shortly.

Demand increased for transient voltage and RF protection for military communications systems and strategic facilities as customers' awareness of the effects of Electromagnetic Pulse (EMP) increased. Smiths Interconnect has been selected to supply various protection devices on several multi-year US military programmes including a tactical communications system, a maritime surveillance programme, and a missile defence sensor system.

For our specialist connector business, the military market remained positive, with continued strong demand on the Eurofighter programme. Although two other significant production programmes closed, we also had several new successes. These included being selected to supply high power connectors for hybrid electric drive applications for future combat vehicles programmes and the choice of our new SnapTac series of miniature circular connectors for several future soldier programmes.

Underlying sales to the wireless telecommunications market fell 13% as network operators limited capital investment in new infrastructure; and price pressures, particularly in emerging markets, were felt throughout the supply chain. With new investment constrained, operators focused on optimising performance of existing network infrastructure, boosting sales of our portable passive intermodulation test equipment in the US as well as notching up breakthroughs in new regions including Europe, India and China. In the second half of the year, sales started improving as operators began releasing funds for network enhancements and we saw an uptick in demand for both network optimisation filter products and power and RF protection devices.

The need for faster and higher bandwidth networks to support high data rate applications, as seen in booming sales of smart phones, is driving many network operators to prepare to invest in fourth generation (4G) wireless networks. Smiths Interconnect has already been selected by one major US carrier to provide both network enhancing filter products and RF and power surge protection devices. We also experienced continued sales growth of filters, protection products, and millimetre wave antennas in support of enhancing backhaul systems to meet the higher data rate requirements.

Sales to the medical, rail, automation and test markets declined 7% on an underlying basis although there were signs of stabilisation during the latter part of the year. In medical, we have strengthened our position supplying surge protection and connector products to leading oncology, cardiac mapping, and MRI scanner providers. We have also added new customers and broadened our product offering, most noticeably with our new contact used in implantable medical devices.

The rail market remained challenging throughout the year although there are signs of recovery with significant investment being planned for both infrastructure and rolling stock in the US, Europe and China. Safety and communication systems are high priority applications, ideally suited to Smiths Interconnect's product offerings of connectors, protection and microwave devices. Market conditions in automation only stabilised towards the end of the year, whereas in test the market rebounded strongly in the second half.

Research and development

Total R&D spend rose 17% to £21m or 6.3% of sales (2009: £18m or 5.8% of sales). The customer-funded portion remained flat at £5m or 1.5% of sales (2009: £5m) and acquisitions contributed £1m with the underlying company-funded portion increasing to £15m or 4.8% of sales (2009: £13m or 4.2% of sales).

During the year, the proportion of non-US based engineering resources increased significantly to 30%, providing scope for new product development in emerging markets. We are also focusing R&D resources more on projects that create long-term value. Specific investments included the launch of the KuStream antenna, passive intermodulation test solutions, new filtering products to support 4G networks, microwave subsystems for counter-IED systems, and next-generation timing systems for military tactical communication networks.

Business developments

Smiths Interconnect completed two acquisitions which, combined with the full year effect of the Dowin acquisition in April 2009, contributed a total of £25m of sales and £4m of headline operating profit.

In April 2010, we acquired Interconnect Devices, Inc. (IDI), a leading designer and manufacturer of highly engineered, application-specific connectors using a proprietary spring probe contact technology. It focuses on mission-critical applications for semiconductor and circuit-board testing, and connectors for military, medical, homeland security and industrial test markets. With a major plant in Suzhou, China, IDI complements and extends Smiths Interconnect's connector product portfolio and its geographic reach. The transaction allows Smiths Interconnect to leverage existing scale, particularly in Europe, and provides customers with a far wider range of solutions. Integration of IDI is essentially complete and, buoyed by the resurgent circuit-board and semiconductor test markets, the business is performing ahead of expectations. In October, we completed the acquisition of Channel Microwave, a small microwave components company that complements our Lorch and TRAK businesses.

Outlook

The military sector is expected to become more challenging as budgetary pressures mount. However we expect continued sales growth in military and aerospace due to the increasing demand for the KuStream™ antenna, our focus on high priority areas for defence spending, our existing positions on several major US military programmes, and new programme wins. In wireless telecommunications, network operators are currently preparing for significant capital investment in higher speed next-generation technologies which will drive demand. Semiconductor and circuit-board test applications are expected to continue to grow, spurred by the increasing demand for and sophistication of electronic devices such as smart phones, tablet computers and web-enabled televisions. We expect further margin improvement from volume increases, restructuring benefits, and ongoing cost saving initiatives.

Flex-Tek

	2010 £m	2009 £m	Reported growth	Underlying growth
Sales	**212**	222	(5)%	(6)%
Headline operating profit	**24**	22	7%	6%
Headline operating margin	**11.1%**	9.9%		
Statutory operating profit	**21**	18		
Return on capital employed	**18.4%**	16.7%		

Flex-Tek's reported sales declined 5%, or £10m, because of a £12m (6%) drop in underlying sales which was offset by £2m from currency translation. This decline primarily reflects a downturn in sales of components to the OEM aerospace market. Sales to the US residential construction and domestic appliance markets began the year with declining sales but began to show an improving trend during the second half. As a result, overall sales grew in the second half by 3% on an underlying basis driven by improving sales from the Flexible Solution and Heat Solutions groups.

Headline operating profit margins increased by 120 basis points to 11.1% as a result of the further progress in cutting costs and site rationalisation. The underlying increase in operating profit of £2m was caused by the net effect of lower volumes (£4m) offset by cost saving benefits (£6m) driven by lower costs in materials, freight and overheads as well as some improvement in targeted pricing.

Sales of components to aerospace customers began to decline at the beginning of the period with a weakness primarily in the market for regional aircraft and business jets. Although sales were down 16%, margins declined only slightly with the lower volumes being partially offset by production efficiency gains and cost cutting.

Heat Solutions underlying sales fell 3%, mainly due to declines in sales of gas piping and HVAC ducting in the US construction market during the first six months. Sales grew in the second half, reflecting an improvement in underlying housing starts which began to show some growth from November 2009. This improvement was supported by the Homebuyer Tax Credit Program, particularly as builders increased housing inventories to support demand ahead of the expiry of the tax credit at the end of April 2010. The improving trend stabilised during the summer following withdrawal of the tax credit. Sales of heating elements to appliance manufacturers were slightly down. Against this challenging trading environment, Heat Solutions sales fell at a lower rate than the market, pointing to an increase in market share. In addition, a sharper focus on low-cost manufacturing and combined product marketing programmes has helped preserve margins. We have recently launched a new product for the US construction market – FlashShield™ - which offers leading-edge lightning protection for corrugated stainless steel tubing used in residential gas piping.

Underlying sales of flexible hose assemblies from the Flexible Solutions division were flat. This reflects weak demand in the US floorcare and general industrial markets in the first half which was offset by growth in the second half. In addition, we saw success with new product introductions to the natural gas vehicle market in the US.

Flex-Tek has continued to rationalise its manufacturing portfolio and deliver efficiency improvements. The programme is part of the wider Group restructuring and is expected to deliver annualised savings of £9m. In the year, we delivered a further £3m of savings which bring the cumulative annualised savings to £8m. Flex-Tek remains on plan to achieve the rationalisation of two facilities in Massachusetts.

Outlook

The outlook for the US residential construction, household appliance and industrial markets is still uncertain, with a mixed flow of economic and housing data from the US. The aerospace sector is likely to remain challenging. Flex-Tek will benefit from the savings generated through site rationalisation and cost cutting programmes, which will help preserve margins. Flex-Tek is strongly leveraged to a recovery in US housing.

Financial review

Earnings per share
Basic headline earnings per share from continuing activities were 84.6p (2009: 72.4p), a growth of 17%. This reflects an increased headline operating profit partially offset by higher interest costs on the refinanced debt and a lower pensions financing credit.

On a statutory basis, the basic earnings per share from continuing activities were 75.3p (2009: 70.8p).

Exceptional and other items relating to continuing activities excluded from headline profits
These items amounted to a charge of £62m compared to last year when they had no net impact. They comprised:

- Amortisation of intangible assets acquired in business combinations of £42m (2009: £35m). The amortisation relates principally to technology and customer relationships;
- A charge of £25m (2009: £22m) in connection with John Crane, Inc. asbestos litigation;
- A charge of £8m (2009: £24m) in respect of restructuring. This is part of a programme which is expected to cost approximately £45m by the end of 2011;
- Profit on disposal of businesses and property of £9m (2009: £15m);
- Gains of £4m arising from the closure of the principal UK defined benefit pension schemes. In 2009, there was a gain of £70m arising from changes to the US pension and post-retirement healthcare plans;
- Acquisition costs of £1m. These costs are now charged to profit following the implementation of IFRS3 (Revised); and
- Financing gains of £1m (2009: £4m loss). These represent exchange movements on derivatives and other financing instruments not hedge accounted under IFRS.

Cash generation and net debt
Strong cash generation in the period resulted in a free cash-flow of £331m (2009: £256m) based on cash-flow after interest and tax but before acquisitions, financing activities and dividends. Substantially improved headline operating cash of £565m (2009: £435m) represented 115% (2009: 104%) of headline operating profit. The improvement was a result of reduced investment in working capital, particularly inventories, and lower net capital expenditure.

On a statutory basis, net cash inflow from continuing operations was £410m (2009: £332m).

Dividends paid in the year on ordinary shares amounted to £133m, compared with £132m in 2009.

Net debt at 31 July 2010 was £837m, down from £885m at 31 July 2009. The decrease in net debt reflects strong cash generation despite outflows of £133m for dividends and £133m for acquisitions.

Interest and other financing costs
Interest payable on debt, net of interest earned on cash deposits, was £62m compared with £52m in 2009. This increase reflects the higher cost of refinancing long-term debt. Interest costs were covered 8 times by headline operating profits.

The Group accounts for pensions using IAS19. As required by this standard, a finance credit is recognised reflecting the expected return on pension scheme assets and a finance charge is recognised reflecting the unwinding of the discount on the future pension liability. The net financing credit was £2m in 2010 (2009: £5m credit).

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

Smiths invested a total of £106m in R&D on continuing operations, equivalent to 3.9% of sales. Of that total, £93m was funded by the Company compared with £90m in 2009, an increase of 5%. We actively seek funding from customers to support R&D and this amounted to £13m (2009: £15m). Under IFRS, certain of these development costs are capitalised, and this amounted to £24m in the year (2009: £23m). The gross capitalisation is shown as an intangible asset. Where customers contribute to the costs of development, the contribution is included as deferred income and disclosed within trade and other payables.

Taxation
The headline tax charge of £104m for 2010 represented an effective rate of 24% on the headline profit before taxation - unchanged from last year. On a statutory basis, the tax charge on continuing activities was £79m (2009: £95m).

The Group continues to take advantage of global manufacturing, research and development and other tax incentives, the tax-efficient use of capital and tax compliance management. However, our increased profitability, particularly in profits derived from the US where there are higher rates of corporation tax, will cause the headline tax rate to increase over time with a rate of between 26-27% expected in the year ending 31 July 2011.

Return on capital employed

The return on capital employed (ROCE) 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, net post-retirement benefit assets and liabilities and net debt (see note 1 to the accounts).

The ROCE was 16.6% (2009: 14.7%). The comparative ROCE has been adjusted from that reported previously to reflect a revised method of calculating capital employed.

Retirement benefits

As required by IFRS the balance sheet reflects the net surplus or deficit in retirement benefit plans, taking assets at their market values at 31 July 2010 and evaluating liabilities at period-end AA corporate bond interest rates.

We have taken action to reduce the Company's liabilities in respect of retirement benefits. From 31 October 2009, the UK-defined benefit pension schemes were closed to future accrual. The principal US defined benefit pension plan was closed with effect from 30 April 2009, after which no further benefits have accrued. In addition, future benefits accruing under the US and UK post-retirement healthcare schemes were substantially reduced; for most members, the Company has capped its contributions at 50% of the 2009/10 premium.

The retirement benefit position was:

	31 July 2010	30 January 2010	31 July 2009
Funded plans			
UK plans – funding status	**98%**	98%	95%
US plans – funding status	**71%**	73%	72%
Other plans – funding status	**69%**	76%	75%

	31 July 2010 £m	30 January 2010 £m	31 July 2009 £m
Surplus/(deficit)			
Funded plans	**(216)**	(208)	(254)
Unfunded plans	**(89)**	(86)	(85)
Total surplus/(liability)	**(305)**	(294)	(339)

In July, we reached 10-year funding agreements with the Trustees of the two major UK pension schemes. The funding agreements are structured to provide certainty to the Trustees while maximising the flexibility for the Company. Full details of the retirement benefits and funding agreements are shown in note 10 to the accounts.

Exchange rates

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

	31 July 2010	**31 July 2009**		30 January 2010
Average rates:				
US dollar	**1.57**	1.58	Dollar strengthened 1%	1.63
Euro	**1.14**	1.16	Euro strengthened 2%	1.12
Period end rates:				
US dollar	**1.57**	1.67	Dollar strengthened 6%	1.60
Euro	**1.20**	1.17	Euro weakened 3%	1.15

Financial information

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

The statutory accounts for the year ended 31 July 2009 have been filed with the Registrar of Companies. The auditors have reported on those accounts and on the statutory accounts for the year ended 31 July 2010, which will be filed with the Registrar of Companies following the Annual General Meeting. Both the audit reports were unqualified and did not contain any statement under section 498 of the Companies Act 2006.

Consolidated income statement

	Notes	Year ended 31 July 2010 £m	Year ended 31 July 2009 £m
Continuing operations			
Revenue	1	**2,769.6**	2,664.6
Cost of sales		**(1,476.3)**	(1,447.5)
Gross profit		**1,293.3**	1,217.1
Sales and distribution costs		**(369.7)**	(370.5)
Administrative expenses		**(491.0)**	(419.7)
Profit on disposal of businesses	4	**3.3**	1.6
Operating profit	2	**435.9**	428.5
Comprising			
– headline operating profit	3	**492.4**	417.5
– exceptional items, amortisation of acquired intangibles	3	**(56.5)**	11.0
		435.9	428.5
Interest receivable		**3.6**	2.1
Interest payable		**(65.1)**	(54.4)
Other financing losses		**(5.4)**	(10.9)
Other finance income – retirement benefits		**2.3**	5.1
Finance costs	5	**(64.6)**	(58.1)
Share of post-tax profits of associated companies	14	**1.8**	0.4
Profit before taxation		**373.1**	370.8
Comprising			
– headline profit before taxation	3	**435.0**	370.7
– exceptional items, amortisation of acquired intangibles and other financing gains and losses	3	**(61.9)**	0.1
		373.1	370.8
Taxation	6	**(78.9)**	(94.9)
Profit after taxation – continuing operations		**294.2**	275.9
Profit/(loss) – discontinued operations	7	**16.4**	(5.9)
Profit for the year		**310.6**	270.0
Attributable to			
Smiths Group shareholders		**310.0**	269.5
Non-controlling interests		**0.6**	0.5
		310.6	270.0
Earnings per share	9		
Basic		**79.5p**	69.3p
Basic – continuing operations		**75.3p**	70.8p
Diluted		**78.9p**	68.6p
Diluted – continuing operations		**74.8p**	70.1p

Consolidated statement of comprehensive income

	Notes	**Year ended 31 July 2010 £m**	Year ended 31 July 2009 £m
Profit for the period		**310.6**	270.0
Exchange gains		**81.4**	189.2
Actuarial losses on retirement benefits	10	**(15.2)**	(429.9)
Taxation recognised on actuarial movements	6	**12.2**	94.3
Fair value gains/(losses)			
– on available for sale financial assets		**0.2**	
– deferred in the period on cash-flow and net investment hedges		**(41.6)**	(66.6)
– reclassified to income statement		**(0.3)**	8.4
Total comprehensive income		**347.3**	65.4
Attributable to			
Smiths Group shareholders		**345.9**	63.9
Non-controlling interests		**1.4**	1.5
		347.3	65.4

Consolidated balance sheet

	Notes	2010 £m	2009 £m
Non-current assets			
Intangible assets	12	**1,638.6**	1,500.3
Property, plant and equipment	13	**302.7**	318.0
Investments accounted for using the equity method	14	**13.6**	11.2
Financial assets – other investments	15	**27.0**	7.8
Retirement benefit assets	10	**80.3**	39.2
Deferred tax assets	6	**194.2**	164.7
Trade and other receivables	17	**33.8**	21.3
Financial derivatives	22	**10.8**	13.9
		2,301.0	2,076.4
Current assets			
Inventories	16	**390.0**	413.6
Trade and other receivables	17	**578.9**	553.6
Cash and cash equivalents	18	**172.9**	91.7
Financial derivatives	22	**15.5**	40.7
		1,157.3	1,099.6
Total assets		**3,458.3**	3,176.0
Non-current liabilities			
Financial liabilities			
– borrowings	20	**(995.0)**	(752.2)
– financial derivatives	22	**(1.1)**	(6.7)
Provisions for liabilities and charges	23	**(230.8)**	(226.5)
Retirement benefit obligations	10	**(385.6)**	(378.2)
Deferred tax liabilities	6	**(77.8)**	(66.5)
Trade and other payables	19	**(27.3)**	(25.1)
		(1,717.6)	(1,455.2)
Current liabilities			
Financial liabilities			
– borrowings	20	**(14.7)**	(224.4)
– financial derivatives	22	**(14.9)**	(38.9)
Provisions for liabilities and charges	23	**(70.4)**	(77.2)
Trade and other payables	19	**(428.2)**	(399.8)
Current tax payable		**(112.7)**	(117.7)
		(640.9)	(858.0)
Total liabilities		**(2,358.5)**	(2,313.2)
Net assets		**1,099.8**	862.8
Shareholders' equity			
Share capital	26	**146.5**	145.9
Share premium account		**315.3**	306.6
Capital redemption reserve		**5.8**	5.8
Revaluation reserve		**1.7**	1.7
Merger reserve		**234.8**	234.8
Retained earnings	27	**519.5**	251.3
Hedge reserve	27	**(128.8)**	(87.1)
Total shareholders' equity		**1,094.8**	859.0
Non-controlling interest equity		**5.0**	3.8
Total equity		**1,099.8**	862.8

Consolidated statement of changes in equity

	Notes	Share capital and share premium £m	Other reserves £m	Retained earnings £m	Hedge reserve £m	Equity shareholders' funds £m	Non-controlling Interest £m	Total equity £m
At 31 July 2009		452.5	242.3	251.3	(87.1)	859.0	3.8	862.8
Profit for the year				310.0		310.0	0.6	310.6
Other comprehensive income								
Exchange gains				80.4	0.2	80.6	0.8	81.4
Actuarial losses on retirement benefits net of tax				(3.0)		(3.0)		(3.0)
Fair value gains/(losses)				0.2	(41.9)	(41.7)		(41.7)
Total comprehensive income for the year				387.6	(41.7)	345.9	1.4	347.3
Transactions relating to ownership interests								
Exercises of share options		9.1		0.6		9.7		9.7
Taxation recognised on share-based payment	6			2.4		2.4		2.4
Purchase of own shares		0.2		(0.2)				
Dividends								
– equity shareholders	8			(132.5)		(132.5)		(132.5)
– non-controlling interest							(0.2)	(0.2)
Share-based payment	30			10.3		10.3		10.3
At 31 July 2010		**461.8**	**242.3**	**519.5**	**(128.8)**	**1,094.8**	**5.0**	**1,099.8**

	Notes	Share capital and share premium £m	Other reserves £m	Retained earnings £m	Hedge reserve £m	Equity shareholders' funds £m	Non-controlling Interest £m	Total equity £m
At 31 July 2008		449.1	242.3	253.7	(29.2)	915.9	2.3	918.2
Profit for the year				269.5		269.5	0.5	270.0
Other comprehensive income								
Exchange gains				187.9	0.3	188.2	1.0	189.2
Actuarial losses on retirement benefits net of tax				(335.6)		(335.6)		(335.6)
Fair value losses					(58.2)	(58.2)		(58.2)
Total comprehensive income for the year				121.8	(57.9)	63.9	1.5	65.4
Transactions relating to ownership interest								
Exercises of share options		1.5		2.6		4.1		4.1
Taxation recognised on share-based payment	6			(4.0)		(4.0)		(4.0)
Purchase of own shares		0.2		(0.2)				
Conversion of B shares		1.7				1.7		1.7
Dividends paid to equity shareholders	8			(132.0)		(132.0)		(132.0)
Share-based payment	30			9.4		9.4		9.4
At 31 July 2009		**452.5**	**242.3**	**251.3**	**(87.1)**	**859.0**	**3.8**	**862.8**

Consolidated cash-flow statement

	Notes	Year ended 31 July 2010 £m	Year ended 31 July 2009 £m
Net cash inflow from operating activities	28	**410.5**	332.1
Cash-flows from investing activities			
Expenditure on capitalised development		**(24.3)**	(22.5)
Expenditure on other intangible assets		**(7.6)**	(17.4)
Purchases of property, plant and equipment		**(47.0)**	(57.4)
Disposals of property, plant and equipment		**24.8**	19.8
Investment in financial assets		**(25.3)**	(6.6)
Acquisition of businesses	29	**(132.7)**	(103.3)
Disposal of Aerospace	7	**19.9**	(1.9)
Disposals of businesses		**1.1**	(0.2)
Net cash-flow used in investing activities		**(191.1)**	(189.5)
Cash-flows from financing activities			
Proceeds from exercise of share options		**9.7**	4.1
Dividends paid to equity shareholders	8	**(132.5)**	(132.0)
Dividends paid to non-controlling interests		**(0.2)**	
Cash outflow from matured derivative financial instruments		**(1.5)**	(89.9)
Increase in new borrowings		**466.8**	495.8
Reduction and repayment of borrowings		**(408.4)**	(357.9)
Net cash-flow used in financing activities		**(66.1)**	(79.9)
Net increase in cash and cash equivalents		**153.3**	62.7
Cash and cash equivalents at beginning of year		**19.7**	(40.0)
Exchange differences		**(0.8)**	(3.0)
Cash and cash equivalents at end of year	18	**172.2**	19.7
Cash and cash equivalents at end of year comprise			
– cash at bank and in hand		**136.3**	84.0
– short-term deposits		**36.6**	7.7
– bank overdrafts		**(0.7)**	(72.0)
		172.2	19.7
Included in cash and cash equivalents per the balance sheet		**172.9**	91.7
Included in overdrafts per the balance sheet		**(0.7)**	(72.0)
		172.2	19.7

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

Accounting policies

Basis of preparation

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

The accounting policies adopted are consistent with those of the previous financial year except that the Group has adopted:

- amendment to 'IAS 23: Borrowing costs' which requires borrowing costs which are directly attributable to the acquisition or construction of assets that take a substantial period of time to get ready for use or sale to be capitalised as part of the cost of that asset. This represents a change in accounting policy. However the revised standard only applies to qualifying assets for which the commencement date for capitalisation is on or after 1 August 2009, and it has not materially affected the reported position or performance.
- amendment to 'IFRS 2: Share-based payment' which clarifies that vesting conditions are service conditions and performance conditions only, and specifies that all cancellations, whether by the entity or by other parties, should receive the same accounting treatment. This change has had no material effect on reported performance or equity.
- 'IFRS 3: (Revised) business combinations' and 'IAS 27: (Revised) consolidated and separate financial statements', which have required changes to the recognition of goodwill, acquisition costs and contingent consideration relating to acquisitions made after 1 August 2009. Acquisition costs of £1.3m have been expensed in the current year as a result of these changes. IAS 27 (Revised) requires a different accounting treatment for non-controlling interests. This has not affected the reported financial position or performance.
- 'IAS 1: (Revised) Presentation of financial statements', which has required changes to the presentation of the primary financial statements, in particular the consolidated statement of changes in equity has been presented as a primary financial statement.
- 'IFRIC 15: Agreements for the construction of real estate' which clarifies the scope of contract accounting for real estate transactions. The same principles have been applied to contract accounting for transactions undertaken by the Group. This has not materially affected reported financial position or performance.
- amendment to 'IFRS 7: Financial instruments: Disclosures' which requires enhanced disclosures about fair value measurement and liquidity risk. The amendment requires disclosure of fair value measurements by reference to a fair value measurement hierarchy. The amendment is concerned with disclosure only and has no impact on reported financial position or performance.

Significant judgements, key assumptions and estimates

The preparation of the accounts in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the accounts and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from these estimates. The key estimates and assumptions used in these consolidated financial statements are set out below.

Revenue recognition

The timing of revenue recognition on long-term funded contracts depends on the assessed stage of completion of contract activity at the balance sheet date. This assessment requires the expected total contract revenues and costs to be estimated based on the current progress of the contract.

Revenue of £23.6m (2009: £46.9m) has been recognised in respect of contracts in progress at the year end with a total expected value of £116.2m (2009: £145.6m). A 5% increase in the proportion of the contract activity recognised in the current year would have increased operating profit by an estimated £0.4m (2009: £0.2m).

Impairment

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

Provisions for liabilities and charges

The consolidated financial statements include a provision for litigation of £191.4m (2009: £185.4m).

As previously reported, John Crane, Inc., a subsidiary of the Group, is currently one of many co-defendants in litigation relating to products previously manufactured which contained asbestos. Provision has been made for the future defence costs which the Group is expected to incur and the expected costs of future adverse judgments against John Crane, Inc. However, because of the significant uncertainty associated with the future level of asbestos claims and of the costs arising out of the related litigation, there can be no guarantee that the assumptions used to estimate the provision will result in an accurate prediction of the actual costs that may be incurred and, as a result, the provision may be subject to potentially material revisions from time to time if new information becomes available as a result of future events. John Crane, Inc. takes account of the advice of an expert in asbestos liability estimation in quantifying the expected costs of future adverse judgments. See note 23 for details.

Retirement benefits

The consolidated financial statements include costs in relation to, and provision for, retirement benefit obligations. The costs and the present value of any related pension assets and liabilities depend on such factors as life expectancy of the members, the returns that plan assets generate and the discount rate used to calculate the present value of the liabilities. The Group uses previous experience and impartial actuarial advice to select the values of critical estimates. The estimates, and the effect of variances in key estimates, are disclosed in note 10.

Taxation

The Group has recognised deferred tax assets relating to UK losses of £117m (2009: £111m). The recognition of assets pertaining to these losses 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 deferred tax assets will be realised, including appropriate taxable temporary timing differences and it has been concluded that there are sufficient taxable profits in future periods to support recognition.

Further detail on the Group's deferred taxation position is included in note 6.

Accounting policies

Basis of consolidation

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

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

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

Foreign currencies

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

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

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

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

Revenue

Revenue from the sale of goods is recognised when the risks and rewards of ownership have been transferred to the customer, which is usually when title passes.

Revenue from services is recognised in accounting periods in which the services are rendered, by reference to completion of the specific transaction, assessed on the basis of the actual service provided as a proportion of the total services to be provided.

Revenue is measured at the fair value of the consideration received, net of trade discounts and sales taxes.

Long-term funded contracts

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

Employee benefits

Pension obligations and post-retirement benefits

The Group has both defined benefit and defined contribution plans.

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

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

The Group also has certain post-retirement healthcare schemes which are accounted for on a similar basis to the defined benefit plans.

Share-based compensation

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

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

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

Exceptional items

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

- profits/(losses) on disposal of businesses and costs of acquisitions;
- spend on the integration of significant acquisitions and other major restructuring programmes;
- significant goodwill or other asset impairments;
- income and expenditure relating to John Crane, Inc. asbestos litigation; and
- other particularly significant or unusual items.
- Exceptional items are excluded from the headline profit measures used by the Group. The basis of calculation of these measures is explained in note 3.

Discontinued operations

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

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

Assets and businesses held for sale

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

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

Intangible assets

Goodwill

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

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

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

Research and development

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

- amounts recoverable from third parties; and
- expenditure incurred in respect of the development of major new products where the outcome of those projects is assessed as being reasonably certain as regards viability and technical feasibility. Such expenditure is capitalised and amortised straight line over the estimated period of sale for each product, commencing in the year that sales of the product are first made.
- The cost of development projects which are expected to take a substantial period of time to complete, and commenced after 1 August 2009, includes attributable borrowing costs.

Intangible assets acquired in business combinations

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

The estimated useful lives are as follows:

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

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

Property, plant and equipment

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

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

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

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

Leases

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

Inventories

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

Trade and other receivables

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

Cash and cash equivalents

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

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

Provisions

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

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

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

Taxation

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

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

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

Deferred tax liabilities and assets are not discounted.

Financial assets

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

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

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

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

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

Financial liabilities

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

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

Derivative financial instruments and hedging activities

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Financial guarantees
Financial guarantees are initially recognised at the fair value of the consideration received.

At each subsequent balance sheet date an estimate is made of the payments which will be required under the guarantee in accordance with 'IAS 37: Provisions, contingent liabilities and contingent assets'. The guarantee is then valued at the higher of its initial value less revenue recognised to date and the best estimate of the total payments which will be required under the contract.

Any gains or losses on the contract are recognised in the income statement.

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

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

- Amendment to IFRIC 14, IAS 19 – Prepayments of a minimum funding requirement
- Amendment to 'IAS 24: Related party disclosures'
- Amendment to 'IAS 32: Financial instruments: Presentation on classification of rights issues'
- 'IFRIC 19: Extinguishing financial liabilities with equity instruments'
- 'IFRS 2: Share-based payment' – Group cash-settled share-based payment transactions
- 'IFRS 9: Financial instruments'

A review of the impact of these standards and interpretations is being undertaken, and the impact of adopting them will be determined once this review has been completed. Based on the work completed to date, none of the changes are expected to have a material impact on the Group's reported position or performance.

Notes to the accounts

1 Segment information

Analysis by operating segment

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

- Smiths Detection – sensors that detect and identify explosives, narcotics, weapons, chemical agents, biohazards and contraband;
- John Crane – mechanical seals, seal support systems, engineered bearings, power transmission couplings and specialist filtration systems;
- Smiths Medical – medication delivery systems, vital care products and safety devices that prevent needlestick injuries and reduce cross-infection;
- Smiths Interconnect – specialised electronic and radio frequency components and sub-systems that connect, protect and control critical systems;
- Flex-Tek – engineered components that heat and move fluids and gases, flexible hosing and rigid tubing.

The position and performance of each division is reported monthly to the Board of Directors. This information is prepared using the same accounting policies as the consolidated financial information except that the Group uses headline operating profit to monitor divisional results and operating assets to monitor divisional position. See note 3 for an explanation of which items are excluded from headline measures.

Intersegment sales and transfers are charged at arm's length prices.

						Year ended 31 July 2010
	Smiths Detection £m	John Crane £m	Smiths Medical £m	Smiths Interconnect £m	Flex-Tek £m	Total £m
Revenue	**574.1**	**786.1**	**857.6**	**339.9**	**211.9**	**2,769.6**
Divisional headline operating profit	**89.9**	**162.7**	**184.2**	**61.9**	**23.5**	**522.2**
Corporate headline operating costs						**(29.8)**
Headline operating profit	**89.9**	**162.7**	**184.2**	**61.9**	**23.5**	**492.4**
Divisional exceptional operating items (note 4)	**(0.3)**	**(22.3)**	**5.4**	**(0.9)**	**(2.3)**	**(20.4)**
Corporate exceptional operating items (note 4)						**6.0**
Amortisation of acquired intangible assets	**(0.4)**	**(16.2)**	**(17.3)**	**(8.2)**		**(42.1)**
Operating profit	**89.2**	**124.2**	**172.3**	**52.8**	**21.2**	**435.9**
Exceptional finance costs – adjustment to discounted provision (note 4)		**(7.0)**				**(7.0)**
Net finance costs – other						**(57.6)**
Share of post-tax profits of associate companies	**1.8**					**1.8**
Profit before taxation						**373.1**

						Year ended 31 July 2009
	Smiths Detection £m	John Crane £m	Smiths Medical £m	Smiths Interconnect £m	Flex-Tek £m	Total £m
Revenue	500.9	789.8	833.5	318.1	222.3	2,664.6
Divisional headline operating profit	63.1	142.8	163.9	55.5	21.9	447.2
Corporate headline operating costs						(29.7)
Headline operating profit	63.1	142.8	163.9	55.5	21.9	417.5
Divisional exceptional operating items (note 4)		(23.8)	0.5		(4.4)	(27.7)
Corporate exceptional operating items (note 4)						73.3
Amortisation of acquired intangible assets	(0.5)	(13.3)	(16.6)	(4.2)		(34.6)
Operating profit	62.6	105.7	147.8	51.3	17.5	428.5
Exceptional finance costs – adjustment to discounted provision (note 4)		(7.1)				(7.1)
Net finance costs – other						(51.0)
Share of post-tax profits of associate companies	0.4					0.4
Profit before taxation						370.8

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

							Year ended 31 July 2010
	Smiths Detection £m	John Crane £m	Smiths Medical £m	Smiths Interconnect £m	Flex-Tek £m	Reconciling items £m	Total £m
Depreciation	**9.7**	**14.9**	**27.6**	**7.8**	**4.8**	**0.9**	**65.7**
Amortisation	**11.2**	**3.0**	**10.0**	**0.5**	**0.2**	**42.7**	**67.6**
Other non-cash items							

– share-based payment	**2.5**	**(0.2)**	**3.3**	**0.6**	**0.5**	**4.6**	**11.3**
– goodwill and other asset impairments						**(2.1)**	**(2.1)**

							Year ended 31 July 2009
	Smiths Detection £m	John Crane £m	Smiths Medical £m	Smiths Interconnect £m	Flex-Tek £m	Reconciling items £m	Total £m
Depreciation	8.8	12.8	28.7	6.5	4.5	0.9	62.2
Amortisation	7.6	2.9	8.8	0.7	0.1	35.1	55.2
Other non-cash items							
– share-based payment	0.6	2.5	0.7	0.1	0.1	4.0	8.0
– goodwill and other asset impairments			0.6			3.4	4.0

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

The capital expenditure for each division is:

	Smiths Detection £m	John Crane £m	Smiths Medical £m	Smiths Interconnect £m	Flex-Tek £m	Reconciling items £m	Total £m
Capital expenditure year ended 31 July 2010	**21.4**	**16.2**	**28.1**	**10.3**	**2.6**	**0.3**	**78.9**
Capital expenditure year ended 31 July 2009	26.6	19.0	33.7	7.3	4.7	6.0	97.3

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

						31 July 2010
	Smiths Detection £m	**John Crane £m**	**Smiths Medical £m**	**Smiths Interconnect £m**	**Flex-Tek £m**	**Total £m**
Property, plant, equipment, development projects and other intangibles	**103.8**	**101.4**	**170.1**	**35.6**	**25.0**	**435.9**
Investments in associates	**13.6**					**13.6**
Working capital assets	**269.0**	**288.0**	**256.6**	**117.9**	**65.8**	**997.3**
Operating assets	**386.4**	**389.4**	**426.7**	**153.5**	**90.8**	**1,446.8**
Derivatives, tax and retirement benefit assets						**300.8**
Goodwill and acquired intangibles						**1,502.4**
Corporate assets						**35.4**
Cash						**172.9**
Total assets						**3,458.3**
Working capital liabilities	**(136.5)**	**(139.4)**	**(100.5)**	**(47.9)**	**(34.2)**	**(458.5)**
Corporate and non-headline liabilities						**(298.2)**
Derivatives, tax and retirement benefit liabilities						**(592.1)**
Borrowings						**(1,009.7)**
Total liabilities						**(2,358.5)**
Average divisional capital employed	**674.8**	**733.3**	**1,219.0**	**358.0**	**127.4**	**3,112.5**
Average corporate capital employed						**(154.0)**
Average total capital employed						**2,958.5**

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

Capital employed is a non-statutory measure of invested resources. It comprises statutory net assets adjusted to add goodwill recognised directly in reserves in respect of subsidiaries acquired before 1 August 1998 of £815.2m (2009: £815.2m) and eliminate post-retirement benefit assets and liabilities, net of related tax, and net debt.

						31 July 2009
	Smiths Detection £m	John Crane £m	Smiths Medical £m	Smiths Interconnect £m	Flex-Tek £m	Total £m
Property, plant, equipment, development projects and other intangibles	101.9	101.0	180.9	30.0	26.6	440.4
Investments in associates	11.2					11.2
Working capital assets	300.2	266.2	262.3	96.3	58.9	983.9
Operating assets	413.3	367.2	443.2	126.3	85.5	1,435.5
Derivatives, tax and retirement benefit assets						258.5
Goodwill and acquired intangibles						1,373.5
Corporate assets						16.8
Cash						91.7
Total assets						3,176.0
Working capital liabilities	(141.5)	(115.7)	(100.0)	(47.2)	(25.8)	(430.2)

Corporate and non-headline liabilities						(298.4)
Derivatives, tax and retirement benefit liabilities						(608.0)
Borrowings						(976.6)
Total liabilities						(2,313.2)
Average divisional capital employed	667.0	700.4	1,276.6	301.2	131.3	3,076.5
Average corporate capital employed						(226.2)
Average total capital employed						2,850.3

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

Capital employed is a non-statutory measure of invested resources. It comprises statutory net assets adjusted to add goodwill recognised directly in reserves in respect of subsidiaries acquired before 1 August 1998 of £815.2m and eliminate post-retirement benefit assets and liabilities, net of related tax, and net debt.

Analysis of revenue

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

Smiths Detection	Transportation £m	Ports and borders £m	Military £m	Emergency responders £m	Critical infrastructure £m	Non-security £m	Total £m
Revenue year ended 31 July 2010	**220.7**	**90.9**	**138.0**	**24.7**	**59.0**	**40.8**	**574.1**
Revenue year ended 31 July 2009	181.9	53.1	131.6	27.5	67.4	39.4	500.9

	Original equipment manufacture				Aftermarket	Total
John Crane	£m	Oil, gas and petrochemical £m	Chemical and pharmaceutical £m	Distributors £m	General industry £m	£m
Revenue year ended 31 July 2010	**287.5**	**298.6**	**69.4**	**52.0**	**78.6**	**786.1**
Revenue year ended 31 July 2009	295.6	296.1	71.8	48.6	77.7	789.8

Smiths Medical	Medication delivery £m	Vital care £m	Safety devices £m	Total £m
Revenue year ended 31 July 2010	**235.0**	**351.8**	**270.8**	**857.6**
Revenue year ended 31 July 2009	237.3	335.2	261.0	833.5

Smiths Interconnect	Telecom £m	Military and Aerospace £m	Rail, Medical Automation, Test £m	Total £m
Revenue year ended 31 July 2010	**91.1**	**170.2**	**78.6**	**339.9**
Revenue year ended 31 July 2009	95.9	154.8	67.4	318.1

Flex-Tek	Aerospace £m	Flexible Solutions £m	Heat Solutions £m	Total £m
Revenue year ended 31 July 2010	**51.0**	**49.4**	**111.5**	**211.9**
Revenue year ended 31 July 2009	59.7	49.0	113.6	222.3

Analysis of revenue continued

The Group's statutory revenue is analysed as follows:

	Year ended 31 July 2010 £m	Year ended 31 July 2009 £m
Sale of goods	**2,535.4**	2,460.9
Contracts	**71.8**	67.4
Services	**162.4**	136.3
	2,769.6	2,664.6

Analysis by geographical areas

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

	Revenue		Intangible assets, property plant and equipment and investments accounted for using the equity method	
	Year ended 31 July 2010 £m	Year ended 31 July 2009 £m	**2010 £m**	2009 £m
United Kingdom	**118.4**	115.8	**150.4**	143.9
Germany	**149.7**	148.4	**317.9**	335.7
France	**97.6**	98.2	**16.5**	15.1
Other European	**323.6**	333.9	**89.8**	126.4
United States of America	**1,274.1**	1,287.6	**1,211.8**	1,056.8
Canada	**142.2**	98.9	**15.4**	15.5
Mexico	**20.1**	24.5	**7.5**	6.8

Japan	**120.0**	106.1	**20.9**	19.8
China	**82.9**	70.6	**73.5**	74.0
Rest of the World	**441.0**	380.6	**51.2**	35.5
	2,769.6	2,664.6	**1,954.9**	1,829.5

2 Operating profit is stated after charging

	Year ended 31 July 2010 £m	Year ended 31 July 2009 £m
Research and development expense	**69.2**	66.7
Operating leases		
– land and buildings	**24.4**	21.7
– other	**10.2**	9.4

	Year ended 31 July 2010 £m	Year ended 31 July 2009 £m
Audit services		
Fees payable to the Company's auditors for the audit of the parent company and consolidated accounts	**0.5**	0.5
Fees payable to the Company's auditors and its associates for other services		
– the audit of the Company's subsidiaries, pursuant to legislation	**3.4**	3.4
– other services pursuant to legislation	**0.1**	0.1
	4.0	4.0
Tax services		
– advisory services	**0.3**	0.2
All other services	**0.3**	0.3

Other services relate to one-off projects.

3 Headline profit measures

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

The following items have been excluded from the headline measure:

- exceptional items, including income and expenditure relating to John Crane, Inc. asbestos litigation;
- amortisation of intangible assets acquired in a business combination – the amortisation charge is a non-cash item, 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.

	Notes	**Year ended 31 July 2010 £m**	Year ended 31 July 2009 £m
Operating profit		**435.9**	428.5
Exclude			
– exceptional operating items	4	**14.4**	(45.6)
– amortisation of acquired intangible assets	12	**42.1**	34.6
Non-headline items in operating profit		**56.5**	(11.0)
Headline operating profit		**492.4**	417.5
Finance costs		**(64.6)**	(58.1)
Exclude			
– exceptional finance costs	4	**7.0**	7.1
– other financing gains and losses	5	**(1.6)**	3.8
Non-headline items in finance costs		**5.4**	10.9
Headline finance costs		**(59.2)**	(47.2)
Profit before taxation		**373.1**	370.8
Non-headline items in operating profit		**56.5**	(11.0)
Non-headline items in finance costs		**5.4**	10.9
Headline profit before taxation		**435.0**	370.7
Profit after taxation – continuing operations		**294.2**	275.9

	Notes		
Exclude			
– non-headline items in profit before taxation		**61.9**	(0.1)
– tax on excluded items	6	**(25.4)**	6.1
		36.5	6.0
Headline profit after taxation – continuing operations		**330.7**	281.9

4 Exceptional items

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

	Year ended 31 July 2010 £m	Year ended 31 July 2009 £m
Operating items		
Restructuring of corporate headquarters and divisional reorganisation	**(8.2)**	(23.7)
Gains on changes to post-retirement benefits	**3.9**	70.3
Profit on disposal of businesses	**3.3**	1.6
Profit on disposal of property	**5.5**	12.6
Costs of acquisitions	**(1.3)**	
Litigation		
– provision for John Crane, Inc. asbestos litigation (note 23)	**(17.6)**	(15.2)
	(14.4)	45.6
Financing items		
Exceptional finance costs – adjustment to discounted provision (note 23)	**(7.0)**	(7.1)
	(21.4)	38.5

Year ended 31 July 2010

In the current year £8.2m has been charged in respect of the restructuring of corporate centre and divisional reorganisation. This cost has been reduced by a partial reversal of the impairment loss recognised in 2009. The total costs are expected to amount to approximately £45m.

The UK defined benefit pension schemes were closed with effect from 31 October 2009 and the curtailment gain of £3.6m arising has been reflected in the income statement. There was also a net gain of £0.3m due to the closure of a small US scheme.

The profit on disposal of businesses includes £3.8m in respect of additional consideration relating to the Group's disposal of its automotive seals manufacturing business to Cyclam Holdings LLC on 31 July 2007. This consideration was contingent on the acquirer successfully restructuring the business.

Property disposals include £5.5m arising from the grant of planning permission in respect of a property sold in the previous year.

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

The operating charge of £17.6m in respect of John Crane, Inc. asbestos litigation comprises £8.1m in respect of increased provision for adverse legal judgments, £5.2m arising from movements in the discounting due to changes in US interest rates and £4.3m in respect of legal fees in connection with litigation against insurers and defence strategy.

Year ended 31 July 2009

On 3 June 2008 the Company announced a number of changes to its corporate centre and divisional organisation. The total cost of this restructuring, including redundancy, relocation and consolidation of manufacturing, was considered exceptional by virtue of its size. In the year ended 31 July 2009 £23.7m was charged in respect of this restructuring, including an impairment charge of £3.1m in respect of affected properties.

The Group closed the US defined benefit pension plan with effect from 30 April 2009, and recognised a curtailment gain of £19.4m. In addition the cost of post-retirement healthcare provision in both the UK and US was reduced by requiring greater beneficiary contributions, generating a past service benefit of £50.9m.

The operating charge of £15.2m in respect of John Crane, Inc. asbestos litigation comprised £10.6m in respect of increased provision for adverse legal judgments, £2.5m arising from movements in the discounting due to changes in US interest rates and £2.1m in respect of legal fees in connection with litigation against insurers.

5 Net finance costs

	Year ended 31 July 2010 £m	Year ended 31 July 2009 £m
Interest receivable	**3.6**	2.1
Interest payable		
– bank loans and overdrafts	**(7.7)**	(17.4)
– other loans	**(57.4)**	(37.0)
Interest payable	**(65.1)**	(54.4)
Other financing gains/(losses)		
– fair value losses on hedged debt	**(2.9)**	(5.6)
– fair value gains on fair value hedge	**2.9**	5.6
– net foreign exchange gains/(losses)	**1.6**	(3.8)

– exceptional finance costs – adjustment to discounted provision	**(7.0)**	(7.1)
Other financing losses	**(5.4)**	(10.9)
Retirement benefits		
– return on plan assets	**183.7**	204.1
– interest cost	**(181.4)**	(199.0)
Retirement benefits	**2.3**	5.1
Net finance costs	**(64.6)**	(58.1)

6 Taxation

	Continuing Year ended 31 July 2010 £m	Continuing Year ended 31 July 2009 £m	**Discontinued Year ended 31 July 2010 £m**	Discontinued Year ended 31 July 2009 £m
The taxation charge for the year comprises				
– current taxation	**81.1**	65.7		
– deferred taxation	**(2.2)**	29.2		0.2
Total taxation expense in the income statement	**78.9**	94.9		0.2
Current taxation				
– UK corporation tax				
– foreign tax	**81.1**	65.7		
	81.1	65.7		

Reconciliation of the total tax charge

The tax expense on the profit for the period is different from the standard rate of corporation tax in the UK of 28% (2009: 28%). The difference is reconciled as follows:

	Continuing Year ended 31 July 2010 £m	Continuing Year ended 31 July 2009 £m	**Discontinued Year ended 31 July 2010 £m**	Discontinued Year ended 31 July 2009 £m
Profit before tax	**373.1**	370.8	**16.4**	(5.7)
Notional taxation expense at UK rate of 28% (2009: 28%)	**104.5**	103.8	**4.6**	(1.6)
Effect of overseas taxation	**14.7**	10.6		
Compliance benefits	**(15.2)**	(16.8)		
Local incentives	**(16.9)**	(8.8)		
Tax effect of other non-headline items	**(8.2)**	6.1		
Tax effect of Aerospace sale			**(4.6)**	1.8
	78.9	94.9		0.2
Comprising				
– taxation on headline profit	**104.3**	88.8		
– tax on non-headline profit/(loss)	**(25.4)**	6.1		
– tax on sale of discontinued operations				0.2
Total taxation expense in the income statement	**78.9**	94.9		0.2

	Year ended 31 July 2010 £m	Year ended 31 July 2009 £m
Tax on items charged/(credited) to equity		
Deferred tax charge/(credit)		
– retirement benefit schemes	**(12.2)**	(94.3)
– share-based payment	**(2.4)**	4.0
	(14.6)	(90.3)

Deferred taxation

	Excess tax depreciation on fixed assets and goodwill £m	Share-based payment £m	Retirement benefit obligations £m	Capitalised development expenditure £m	Other £m	Total £m
At 31 July 2008	(64.3)	12.2	(10.5)	(12.0)	106.5	31.9
Credit/(charge) to income statement	8.0	(4.3)	(35.8)	(4.0)	6.7	(29.4)
Credit/(charge) to equity		(4.0)	94.3			90.3
Other	(4.1)					(4.1)
Exchange adjustments	(8.0)		3.0	(1.6)	16.1	9.5
At 31 July 2009	(68.4)	3.9	51.0	(17.6)	129.3	98.2
Deferred tax assets	(4.9)	3.9	50.6	(8.9)	124.0	164.7

Deferred tax liabilities	(63.5)		0.4	(8.7)	5.3	(66.5)
At 31 July 2009	(68.4)	3.9	51.0	(17.6)	129.3	98.2
Credit/(charge) to income statement	22.0	2.8	0.7	(3.8)	(19.5)	2.2
Credit/(charge) to equity		2.4	12.2			14.6
Business combinations	(3.5)					(3.5)
Exchange adjustments	(3.7)		3.2	(1.0)	6.4	4.9
At 31 July 2010	**(53.6)**	**9.1**	**67.1**	**(22.4)**	**116.2**	**116.4**
Deferred tax assets	18.0	9.1	65.2	(2.3)	104.2	194.2
Deferred tax liabilities	(71.6)		1.9	(20.1)	12.0	(77.8)
At 31 July 2010	**(53.6)**	**9.1**	**67.1**	**(22.4)**	**116.2**	**116.4**

Included in Other above is a deferred tax liability of £4.0m (2009: £4.0m) relating to unremitted overseas earnings. No additional tax liabilities have been recognised because the Group is in a position to control the timing of other temporary differences and it is probable that such differences will not reverse in the future. Other deferred tax also includes the tax benefits of losses carried forward amounting to £31.9m (2009: £31.3m).

The Group has not recognised deferred tax assets relating to tax losses of £92.4m (2009: £78.3m) and pensions and other long term liabilities of £194.5m (2009: £240.6m) due to uncertainty as to their recoverability.

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

Restricted losses

	2010 £m	**Expiry of losses**	2009 £m	Expiry of losses
Territory				
– Americas	**13.9**	**2019-2025**	10.7	2019-2025
– Asia	**2.5**	**2014-2017**		
Total restricted losses	**16.4**		10.7	
Unrestricted losses:				
– operating losses	**76.0**	**No expiry**	67.6	No expiry
Total	**92.4**		78.3	

7 Discontinued operations

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

Profit/(loss) on disposal of operation

	Year ended 31 July 2010 £m	Year ended 31 July 2009 £m
Consideration	**19.9**	
Provisions and disposal costs	**(3.5)**	(5.7)
Pre-tax profit/(loss) on disposal	**16.4**	(5.7)
Cash received from disposal of Aerospace operations	**19.9**	0.2
Disposal costs		(2.1)
Net cash inflow/(outflow) on disposal	**19.9**	(1.9)

The further consideration of £19.9m recognised in the year was received following settlement of prior year tax filings. The loss of £3.5m in provisions and disposal costs comprises exchange gains and losses.

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

Results from discontinued operations

	Year ended 31 July 2010 £m	Year ended 31 July 2009 £m
Profit/(loss) on disposal	**16.4**	(5.7)
Attributable tax charge (note 6)		(0.2)
Profit/(loss) for the period	**16.4**	(5.9)
Earnings per share from discontinued operations – pence		
Basic	**4.2p**	(1.5p)

Diluted	**4.1p**	(1.5p)

Cash-flows from discontinued operations

	Year ended 31 July 2010 £m	Year ended 31 July 2009 £m
Profit/(loss) before taxation (including profit on disposal of Aerospace operations)	**16.4**	(5.7)
Profit/(loss) on disposal of discontinued operations	**(16.4)**	5.7
Net cash inflow from operating activities		

	Year ended 31 July 2010 £m	Year ended 31 July 2009 £m
Investing activities	**19.9**	(1.9)
Net cash inflow/(outflow) from investing activities	**19.9**	(1.9)

8 Dividends

The following dividends were declared and paid in the period:

	Year ended 31 July 2010 £m	Year ended 31 July 2009 £m
Ordinary final dividend of 23.50p for 2009 (2008: 23.50p) paid 20 November 2009	**91.6**	91.1
Ordinary interim dividend of 10.5p for 2010 (2009: 10.5p) paid 23 April 2010	**40.9**	40.9
	132.5	132.0

The final dividend for the year ended 31 July 2010 of 23.5p per share was declared by the Board on 28 September 2010 and will be paid to shareholders on 19 November 2010, subject to approval by the shareholders. This dividend has not been included as a liability in these accounts and is payable to all shareholders on the register of Members at close of business on 22 October 2010.

9 Earnings per share

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

	Year ended 31 July 2010 £m	Year ended 31 July 2009 £m
Profit attributable to equity shareholders for the year		
– continuing	**293.6**	275.4
– total	**310.0**	269.5
Average number of shares in issue during the year	**390,034,777**	388,786,063

Diluted earnings per share are calculated by dividing the profit attributable to ordinary shareholders by 392,773,151 (2009: 392,591,613) ordinary shares, being the average number of ordinary shares in issue during the year adjusted by the dilutive effect of employee share schemes. For the year ended 31 July 2010 options over 1,729,551 (2009: 5,017,907) shares were excluded from this calculation because their effect was anti-dilutive for continuing operations.

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

	Year ended 31 July 2010		Year ended 31 July 2009	
	£m	EPS (p)	£m	EPS (p)
Profit attributable to equity shareholders of the Parent Company	**293.6**	**75.3**	275.4	70.8
Exclude				
Non-headline items and related tax (note 3)	**36.5**	**9.3**	6.0	1.6
Headline	**330.1**	**84.6**	281.4	72.4
Headline EPS – diluted (p)		**84.0**		71.7

10 Post-retirement benefits

Smiths operates a number of defined benefit plans throughout the world. The principal schemes are in the United Kingdom and in the United States and assets are held in separate trustee-administered funds. These schemes are closed, and no further benefits are being accrued. The Group also provides defined contribution plans for its UK and US employees.

The UK defined benefit pension plans were closed with effect from 31 October 2009 and the US defined benefit pension plan was closed with effect from 30 April 2009. In 2009 future benefits accruing under the US and UK post-retirement healthcare schemes were substantially reduced.

Pension costs are assessed in accordance with the advice of independent, professionally-qualified actuaries. The most recent actuarial valuations of the two principal UK schemes were performed using the Projected Unit Method as at 31 March 2009. The most recent valuations of the six principal US pension and post-retirement healthcare plans were performed at 1 January 2008. These valuations have been updated by independent qualified actuaries in order to assess the liabilities of the schemes as at 31 July 2010. Scheme assets are stated at their market values. Contributions to the schemes are made on the advice of the actuaries with the objective that the benefits be fully funded during the scheme members' average working lives.

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

	2010 UK	2010 US	2010 Other	2009 UK	2009 US	2009 Other
Rate of increase in salaries	**n/a**	**n/a**	**3.0%**	3.8%	n/a	3.1%
Rate of increase for active deferred members	**4.1%**	**n/a**	**n/a**	n/a	n/a	n/a
Rate of increase in pensions in payment	**3.2%**	**n/a**	**1.4%**	3.3%	n/a	1.4%
Rate of increase in deferred pensions	**3.2%**	**n/a**	**0.6%**	3.3%	n/a	0.6%
Discount rate	**5.4%**	**5.2%**	**5.2%**	5.9%	6.0%	5.9%
Inflation rate	**3.2%**	**n/a**	**1.8%**	3.3%	n/a	1.7%
Healthcare cost increases	**5.0%**	**n/a**	**3.0%**	5.0%	n/a	3.0%

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

The mortality assumptions used in the principal UK schemes are based on the SAPS All Birth year tables with relevant scaling factors based on recent actual mortality experience of members within each. They allow for future improvements in life expectancy in line with 80% and 60% of the long cohort for males and females respectively with an annual 1% underpin. The mortality assumptions used in the principal US schemes are based on the most recent mortality study table produced for retired pensioners in the US (RP 2000 table). The table selected allows for future mortality improvements and applies an adjustment for job classification (blue collar versus white collar). The assumptions give the following:

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

The assets in the scheme and the expected rates of return as at 31 July 2010 were:

2010	UK schemes Long-term rate of return	UK schemes Value £m	US schemes Long-term rate of return	US schemes Value £m	Other countries Long-term rate of return	Other countries Value £m	Total £m
Equities	**8.2%**	**1,361.2**	**8.8%**	**222.7**	**9.4%**	**16.1**	**1,600.0**
Government bonds	**4.2%**	**268.9**	**3.8%**	**91.5**	**5.8%**	**8.1**	**368.5**
Corporate bonds	**5.4%**	**272.7**	**5.2%**	**58.5**	**3.7%**	**0.9**	**332.1**
Insured liabilities	**5.4%**	**488.0**	**5.2%**	**2.0**			**490.0**
Property	**7.2%**	**155.9**			**3.7%**	**0.4**	**156.3**
Other	**4.6%**	**69.6**	**3.0%**	**11.9**	**4.0%**	**14.7**	**96.2**
Total market value		**2,616.3**		**386.6**		**40.2**	**3,043.1**
Present value of funded scheme liabilities		**(2,658.0)**		**(543.4)**		**(57.1)**	**(3,258.5)**
Deficit		**(41.7)**		**(156.8)**		**(16.9)**	**(215.4)**
Unfunded pension plans		**(37.3)**		**(6.1)**		**(22.6)**	**(66.0)**
Post-retirement healthcare		**(8.0)**		**(14.4)**		**(0.8)**	**(23.2)**
Present value of unfunded obligations		**(45.3)**		**(20.5)**		**(23.4)**	**(89.2)**
Unrecognised asset due to surplus restriction						**(0.7)**	**(0.7)**
Net pension liability		**(87.0)**		**(177.3)**		**(41.0)**	**(305.3)**
Post-retirement assets		**80.3**					**80.3**
Post-retirement liabilities		**(167.3)**		**(177.3)**		**(41.0)**	**(385.6)**
Net pension liability		**(87.0)**		**(177.3)**		**(41.0)**	**(305.3)**

2009	UK schemes Long-term rate of return	UK schemes Value £m	US schemes Long-term rate of return	US schemes Value £m	Other countries Long-term rate of return	Other countries Value £m	Total £m
Equities	8.2%	1,113.1	8.8%	198.6	9.3%	7.8	1,319.5
Government bonds	4.5%	242.5	4.3%	68.5	4.6%	3.5	314.5
Corporate bonds	5.9%	267.1	6.0%	44.2	7.7%	2.5	313.8
Insured liabilities	5.9%	490.1	6.0%	1.8	n/a		491.9
Property	7.2%	137.8	n/a		2.9%	0.2	138.0
Other	5.0%	163.1	3.0%	21.4	5.0%	12.9	197.4
Total market value		2,413.7		334.5		26.9	2,775.1
Present value of funded scheme liabilities		(2,531.8)		(462.6)		(33.2)	(3,027.6)
Deficit		(118.1)		(128.1)		(6.3)	(252.5)
Unfunded pension plans		(36.0)		(4.9)		(18.7)	(59.6)

Post-retirement healthcare	(6.2)	(18.0)	(0.7)	(24.9)
Present value of unfunded obligations	(42.2)	(22.9)	(19.4)	(84.5)
Unrecognised asset due to surplus restriction			(2.0)	(2.0)
Net pension liability	(160.3)	(151.0)	(27.7)	(339.0)
Post-retirement assets	39.2			39.2
Post-retirement liabilities	(199.5)	(151.0)	(27.7)	(378.2)
Net pension liability	(160.3)	(151.0)	(27.7)	(339.0)

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

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

Amounts recognised in the income statement

	Year ended 31 July 2010				Year ended 31 July 2009			
	Funded defined benefit pension schemes			Unfunded pension/post-retirement healthcare plans	Funded defined benefit pension schemes			Unfunded pension/post-retirement healthcare plans
	UK £m	US £m	Other £m	£m	UK £m	US £m	Other £m	£m
Amounts (credited)/charged to operating profit								
Current service cost	**2.8**	**0.3**	**1.6**	**1.4**	9.4	7.4	1.6	2.5
Past service cost		**0.1**		**0.3**				(51.5)
Curtailment (gains)/losses	**(3.7)**	**(0.3)**		**0.1**		(19.4)		
Total (credit)/charge	**(0.9)**	**0.1**	**1.6**	**1.8**	9.4	(12.0)	1.6	(49.0)
Amounts (credited)/charged to finance costs								
Expected return on pension scheme assets	**(156.4)**	**(25.0)**	**(2.3)**		(174.0)	(28.3)	(1.8)	
Interest on pension scheme liabilities	**144.8**	**28.8**	**3.0**	**4.8**	158.8	30.0	2.2	8.0
Net return	**(11.6)**	**3.8**	**0.7**	**4.8**	(15.2)	1.7	0.4	8.0
Total charge/(credit) to income statement	**(12.5)**	**3.9**	**2.3**	**6.6**	(5.8)	(10.3)	2.0	(41.0)

The actual return on scheme assets was a profit of £351.2m (2009: loss of £141.3m).

The 2009 past service gain of £51.5m included £41.9m related to benefit changes in the US post-retirement healthcare plans, £9.0m related to benefit changes in the UK post-retirement healthcare plans and £0.6m related to the withdrawal of a UK Christmas bonus scheme. £50.9m of this gain was recorded under exceptional operating items in the income statement.

The curtailment gains of £3.9m (2009: £19.4m) relate to the closure of the UK and US defined benefit schemes.

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

	Year ended 31 July 2010 £m	Year ended 31 July 2009 £m
Cost of sales	**3.4**	4.0
Sales and distribution costs	**2.6**	3.3
Administrative expenses	**0.5**	13.0
Exceptional operating items	**(3.9)**	(70.3)

Amounts recognised directly in the consolidated statement of comprehensive income

Actuarial losses of £15.2m (2009: losses of £429.9m) have been reported in the statement of comprehensive income. This includes a gain of £1.3m (2009: loss of £0.5m) in respect of unrecognised assets owing to surplus restriction. Cumulative actuarial losses from 1 August 2004 reported in the statement of comprehensive income are £558.3m (2009: cumulative losses of £543.0m).

Changes in present value of defined benefit obligations

	Year ended 31 July 2010				Year ended 31 July 2009			
	Funded defined benefit pension schemes			Unfunded pension/post-retirement healthcare plans	Funded defined benefit pension schemes			Unfunded pension/post-retirement healthcare plans
	UK £m	US £m	Other £m	£m	UK £m	US £m	Other £m	£m
At beginning of period	**(2,531.8)**	**(462.6)**	**(33.2)**	**(84.5)**	(2,468.8)	(357.0)	(30.7)	(112.4)
Reclassification of Irish pension scheme	**11.6**		**(11.6)**					
Current service cost	**(2.8)**	**(0.3)**	**(1.6)**	**(1.4)**	(9.4)	(7.4)	(1.6)	(2.5)
Interest on obligations	**(144.8)**	**(28.8)**	**(3.0)**	**(4.8)**	(158.8)	(30.0)	(2.2)	(8.0)
Employee contributions			**(0.4)**		(0.2)		(0.1)	
Past service cost		**(0.1)**		**(0.3)**				51.5
Actuarial (loss)/gain on liabilities	**(126.7)**	**(46.3)**	**(6.4)**	**(4.7)**	(31.7)	(45.4)	3.5	(10.4)

Curtailment gain	3.7	0.3		(0.1)		19.4		
Exchange adjustments		(29.5)	(2.2)	(1.2)	(0.7)	(64.6)	(3.9)	(12.1)
Benefits paid	132.8	23.9	1.3	7.8	137.8	22.4	1.8	9.4
At end of period	**(2,658.0)**	**(543.4)**	**(57.1)**	**(89.2)**	(2,531.8)	(462.6)	(33.2)	(84.5)

Changes in present value of scheme assets

	Year ended 31 July 2010				Year ended 31 July 2009			
	Funded defined benefit pension schemes			Unfunded pension/post-retirement healthcare plans	Funded defined benefit pension schemes			Unfunded pension/post-retirement healthcare plans
	UK £m	US £m	Other £m	£m	UK £m	US £m	Other £m	£m
At beginning of period	2,413.7	334.5	26.9		2,618.4	316.5	25.0	
Reclassification of Irish pension scheme	(6.7)		6.7					
Expected return on assets	156.4	25.0	2.3		174.0	28.3	1.8	
Actuarial gain/(loss) on scheme assets	150.6	16.9			(279.6)	(61.9)	(3.9)	
Employer contributions	35.1	12.7	3.0	7.8	38.0	12.6	2.5	9.4
Employee contributions			0.4		0.2		0.1	
Exchange adjustments		21.4	2.2		0.5	61.4	3.2	
Benefits paid	(132.8)	(23.9)	(1.3)	(7.8)	(137.8)	(22.4)	(1.8)	(9.4)
At end of period	**2,616.3**	**386.6**	**40.2**		2,413.7	334.5	26.9	

Cash contributions

Company contributions to the funded defined benefit pension plans for 2010 totalled £50.8m (2009: £53.1m). Company contributions in 2010 included special covenant payments of £13.1m (2009: £13.1m).

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

- Cash contributions to SIPS of £36m a year for 10 years.
- An initial investment of £25m in index-linked gilts which will be held in an escrow account with further ongoing monthly investments of £2m for nine years commencing in July 2011. The escrow account remains an asset of the Group (see note 15) until 2020. At that time the assets in escrow are allocated subject to the funding position of SIPS. In addition, the escrow account may revert to the Group, should there be a surplus at an intervening triennial review.
- A conditional cash contribution to the TIGPS of up to £50m is payable in May 2012, with further biannual payments of £8m thereafter. These payments may not be made, or paid only in part, subject to the funding position of the Scheme in the six months ending 5 April 2012.

In addition to the funding plans referred to above, the Group agreed to make cash contributions in respect of any future service cost based on actuarial advice. In 2011 payments to the Group's principal defined benefit schemes are expected to total approximately £65m.

History of schemes

	2010 £m	2009 £m	2008 £m	2007 £m	2006 £m
Balance sheet					
Present value of defined benefit obligation	**(3,347.7)**	(3,112.1)	(2,968.9)	(3,132.9)	(3,162.6)
Fair value of scheme assets	**3,043.1**	2,775.1	2,959.9	3,318.9	3,111.0
Unrecognised asset due to surplus restriction	**(0.7)**	(2.0)	(1.5)	(2.4)	(0.5)
(Deficit)/surplus	**(305.3)**	(339.0)	(10.5)	183.6	(52.1)
Post-retirement assets	**80.3**	39.2	174.2	333.7	183.7
Post-retirement liabilities	**(385.6)**	(378.2)	(184.7)	(150.1)	(235.8)
(Deficit)/surplus	**(305.3)**	(339.0)	(10.5)	183.6	(52.1)

	Year ended 31 July 2010 £m	Year ended 31 July 2009 £m	Year ended 31 July 2008 £m	Period ended 31 July 2007 £m	Period ended 5 August 2006 £m
Experience gains/(losses)					
Experience gains/(losses) on scheme liabilities	**31.5**	100.5	(6.4)	(57.6)	17.6
Experience gains/(losses) on scheme assets	**167.5**	(345.4)	(350.0)	95.7	76.6
Movement on restricted surplus	**1.3**	(0.5)	0.9	(1.9)	(0.5)

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

Sensitivity

Valuation of post-retirement schemes involves judgements about uncertain future events. Sensitivities in respect of the key assumptions used to measure the principal pension schemes as at 31 July 2010 are set out below. These sensitivities show the hypothetical impact of a change in each of the listed assumptions in isolation, with the exception of the sensitivity to inflation which incorporates the impact of certain correlating assumptions. While each of these sensitivities holds all other assumptions constant, in practice such assumptions rarely change in isolation and the impacts may offset to some extent.

	Profit before tax for year ended 31 July 2011 £m	Increase/ (decrease) in scheme assets £m	(Increase)/ decrease in scheme liabilities £m
Rate of mortality – 1 year increase in life expectancy	(3.5)	24.3	(90.6)
Rate of mortality – 1 year decrease in life expectancy	3.7	(24.8)	92.9
Rate of inflation – 0.25% increase	(3.7)	8.5	(78.8)
Discount rate – 0.25% increase	(0.8)	(11.2)	117.6
Expected return on scheme assets – 0.25% increase	5.4		
Market value of scheme assets – 2.5% increase	4.3	63.3	(0.1)
Healthcare cost trends – 1% increase			(0.4)
Healthcare cost trends – 1% decrease	0.1		0.4

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

Defined contribution plans

The Group operates a number of defined contribution plans. The total expense recognised in the income statement in respect of these plans was £27.1m (2009: £15.6m).

11 Employees

	Year ended 31 July 2010 £m	Year ended 31 July 2009 £m
Staff costs during the period		
Wages and salaries	**686.1**	660.2
Social security	**82.0**	79.5
Share-based payment (note 30)	**11.3**	8.0
Pension costs (including defined contribution schemes) (note 10)	**33.8**	35.1
	813.2	782.8

The average number of persons employed was:

	Year ended 31 July 2010	Year ended 31 July 2009
Smiths Detection	**2,400**	2,400
John Crane	**6,700**	6,600
Smiths Medical	**8,400**	7,400
Smiths Interconnect	**4,000**	3,350
Flex-Tek	**2,000**	2,000
Corporate	**50**	50
	23,550	21,800

Key management

The key management of the Group comprises Smiths Group plc Board directors and Executive Committee members. Their aggregate compensation is shown below.

	Year ended 31 July 2010 £m	Year ended 31 July 2009 £m
Key management compensation		
Salaries and short-term employee benefits	**10.3**	7.2
Cost of post-retirement benefits	**0.1**	0.6
Cost of share-based incentive plans	**2.4**	1.0

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

	Year ended 31 July 2010		Year ended 31 July 2009	
	Number of instruments '000	**Weighted average price**	Number of instruments '000	Weighted average price
CIP	**315**		340	
ESOS	**220**	**£8.73**	170	£8.44
PSP	**241**		598	
VSP	**753**		949	
SAYE	**5**	**£6.45**	8	£6.90

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

Related party transactions

The Group has a service contract with a company connected to a member of the Executive Committee. Costs of £0.2m (2009: £0.2m) were incurred in respect of this arrangement.

12 Intangible assets

	Goodwill £m	Development costs £m	Acquired intangibles (see table on next page) £m	Software, patents and intellectual property £m	Total £m
Cost					
At 1 August 2008	1,071.8	73.5	212.8	94.3	1,452.4
Exchange adjustments	145.1	10.2	32.4	6.2	193.9
Business combinations	50.3		45.0		95.3
Adjustments to prior year business combinations	(0.7)				(0.7)
Additions		22.5		17.4	39.9
Disposals				(1.6)	(1.6)
At 31 July 2009	1,266.5	106.2	290.2	116.3	1,779.2
Exchange adjustments	48.7	5.4	13.8	3.0	70.9
Business combinations	64.1		51.5		115.6
Adjustments to prior year business combinations	0.2				0.2
Additions		24.3		7.6	31.9
Disposals		(0.7)		(2.0)	(2.7)
At 31 July 2010	**1,379.5**	**135.2**	**355.5**	**124.9**	**1,995.1**
Amortisation					
At 1 August 2008	82.1	18.8	50.6	47.7	199.2
Exchange adjustments	9.9	2.6	6.0	7.4	25.9
Charge for the year		10.8	34.6	9.8	55.2
Adjustments to prior year business combinations		0.2			0.2
Disposals				(1.6)	(1.6)
At 31 July 2009	92.0	32.4	91.2	63.3	278.9
Exchange adjustments	3.1	2.0	4.2	2.3	11.6
Charge for the year		13.8	42.1	11.7	67.6
Disposals				(1.6)	(1.6)
At 31 July 2010	**95.1**	**48.2**	**137.5**	**75.7**	**356.5**
Net book value at 31 July 2010	**1,284.4**	**87.0**	**218.0**	**49.2**	**1,638.6**
Net book value at 31 July 2009	1,174.5	73.8	199.0	53.0	1,500.3
Net book value at 1 August 2008	989.7	54.7	162.2	46.6	1,253.2

In addition to goodwill, the acquired intangible assets comprise:

	Patents, licences and trademarks £m	Technology £m	Customer relationships £m	Total acquired intangibles £m
Cost				
At 1 August 2008	53.3	77.1	82.4	212.8
Exchange adjustments	9.1	13.5	9.8	32.4
Business combinations (note 28)	1.9	3.8	39.3	45.0
At 31 July 2009	64.3	94.4	131.5	290.2
Exchange adjustments	4.4	5.3	4.1	13.8
Business combinations (note 28)		22.8	28.7	51.5
At 31 July 2010	**68.7**	**122.5**	**164.3**	**355.5**
Amortisation				
At 1 August 2008	8.5	19.2	22.9	50.6
Exchange adjustments	0.4	2.5	3.1	6.0
Charge for the year	4.9	10.6	19.1	34.6
At 31 July 2009	13.8	32.3	45.1	91.2
Exchange adjustments	0.9	2.0	1.3	4.2
Charge for the year	5.3	11.7	25.1	42.1
At 31 July 2010	**20.0**	**46.0**	**71.5**	**137.5**
Net book value at 31 July 2010	**48.7**	**76.5**	**92.8**	**218.0**
Net book value at 31 July 2009	50.5	62.1	86.4	199.0
Net book value at 1 August 2008	44.8	57.9	59.5	162.2

Significant cash generating units

Goodwill is not amortised but is tested for impairment at least annually. Value in use calculations are used to determine the recoverable amount of goodwill held within each cash generating unit (CGU). Value in use is calculated as the net present value of the projected risk-adjusted post-tax cash-flows of the CGU, applying a discount rate based on the Group's post-tax weighted average cost of capital adjusted where appropriate for risks specific to the CGU. This approximates to applying a pre-tax discount rate to pre-tax cash-flows. These forecast cash-flows are based on approved budgets and represent a best estimate of future performance.

The assumptions used in the discounted cash-flow forecasts incorporate past performance, historical growth rates and margins achievable in our key markets. The assumptions used in the impairment testing of significant CGUs are as follows:

	Smiths Medical Critical Care		Smiths Detection Civil	
	2010	2009	**2010**	2009
Net book value of goodwill (£m)	**398.3**	374.3	**311.5**	316.0
Discount rate	**8.0%**	8.0%	**8.5%**	8.0%
Period covered by management projections	**5 years**	5 years	**5 years**	5 years
Growth rates	**2.25%**	2.25%	**2.25%**	2.25%
Other key assumptions	– future sales prices and volumes – operating margins – cost structure and productivity			

The first five years of the cash-flow forecasts are based on our annual planning and strategic planning processes. The growth rates used to estimate future performance beyond this period do not exceed the long-term average growth rates for the underlying markets and do not reflect long-term planning assumptions used by the Group for investment planning.

Sales projections are made with reference to specific customer relationships and product lines.

Sensitivity analysis performed around the base case assumptions has indicated that no reasonable changes in key assumptions would cause the carrying amount of the Smiths Medical Critical Care and Smiths Detection Civil CGUs to exceed their respective recoverable amounts.

The balance of the goodwill represents smaller individual amounts which have been allocated to specific operating companies and smaller CGUs. These amounts are tested for impairment at this level. Sensitivity analysis was also performed for these CGUs, and no reasonable changes in the key assumptions would have caused an impairment.

13 Property, plant and equipment

	Land and buildings £m	Plant and machinery £m	Fixtures, fittings, tools and equipment £m	Total £m
Cost or valuation				
At 1 August 2008	171.4	389.9	189.2	750.5
Exchange adjustments	18.2	48.4	20.5	87.1
Reclassification	1.3	5.3	(6.6)	
Business combinations	0.5	8.3	0.2	9.0
Additions	9.4	30.1	17.9	57.4
Disposals	(9.5)	(27.4)	(18.3)	(55.2)
At 31 July 2009	191.3	454.6	202.9	848.8
Exchange adjustments	8.0	23.5	8.3	39.8
Business combinations		3.4	0.8	4.2
Additions	6.5	26.9	13.6	47.0
Disposals	(18.8)	(14.8)	(15.6)	(49.2)
At 31 July 2010	**187.0**	**493.6**	**210.0**	**890.6**
Depreciation				
At 1 August 2008	60.7	258.5	135.0	454.2
Exchange adjustments	10.0	29.9	14.7	54.6
Reclassification	0.7	4.6	(5.3)	
Charge for the year	7.2	34.9	20.1	62.2
Impairment charge	3.1	0.7		3.8
Disposals	(2.2)	(25.9)	(15.9)	(44.0)
At 31 July 2009	79.5	302.7	148.6	530.8
Exchange adjustments	3.8	15.9	6.2	25.9
Charge for the year	7.7	39.1	18.9	65.7
Reversal of impairment (note 4)	(2.1)			(2.1)
Disposals	(6.4)	(12.7)	(13.3)	(32.4)
At 31 July 2010	**82.5**	**345.0**	**160.4**	**587.9**
Net book value at 31 July 2010	**104.5**	**148.6**	**49.6**	**302.7**
Net book value at 31 July 2009	111.8	151.9	54.3	318.0
Net book value at 1 August 2008	110.7	131.4	54.2	296.3

14 Investments accounted for using the equity method

	2010 £m	2009 £m
Investments in associated companies		

At start of period	**11.2**	9.1
Exchange adjustment	**0.7**	1.7
Share of results after tax	**1.8**	0.4
Dividend received	**(0.1)**	
At end of period	**13.6**	11.2

The Group's share of the revenue of associates was £22.5m (2009: £19.3m). The total assets of associates are £43.1m (2009: £49.0m) and liabilities are £17.6m (2009: £16.8m). These figures principally represent the performance, assets and liabilities of Cross Match Technologies, Inc., incorporated in the United States. The share of these assets and liabilities attributable to Smiths Group is 35.6% (2009: 34%).

15 Financial assets

Available for sale financial assets include £25.2m UK government bonds. This investment forms part of the deficit funding plan agreed with the trustee of the one of the principal UK pension schemes. See note 10 for additional details.

16 Inventories

	2010 £m	2009 £m
Inventories comprise		
Raw materials and consumables	**129.3**	145.7
Work in progress	**72.4**	95.3
Finished goods	**190.5**	177.4
	392.2	418.4
Less: payments on account	**(2.2)**	(4.8)
	390.0	413.6

The Group consumed £1,262.2m (2009: £1,298.4m) of inventories during the period. £19.0m (2009: £14.9m) was recognised as an expense resulting from the write-down of inventory and £5.6m (2009: £2.0m) was released to the income statement from inventory provisions charged in earlier years but no longer required.

17 Trade and other receivables

	2010 £m	2009 £m
Non-current		
Trade receivables	**22.8**	13.1
Prepayments and accrued income	**6.0**	2.0
Other debtors	**5.0**	6.2
	33.8	21.3
Current		
Trade receivables	**535.3**	501.0
Other debtors	**13.1**	13.4
Prepayments and accrued income	**30.5**	39.2
	578.9	553.6

Trade receivables do not carry interest. Management considers that the carrying value of trade and other receivables approximates the fair value. Trade and other receivables, including prepayments, accrued income and other debtors qualifying as financial instruments are classified as 'loans and receivables'. The maximum credit exposure arising from these financial assets is £575.8m (2009: £533.3m).

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

Credit risk is managed separately for each customer and, where appropriate, a credit limit is set for the customer based on previous experience of the customer and third party credit ratings. The Group has no significant concentration of credit risk, with exposure spread over a large number of customers. The largest single customer is the US Federal Government, representing less than 8% (2009: 8%) of Group revenue.

Ageing of trade receivables

	2010 £m	2009 £m
Trade receivables which are not impaired and not yet due	**447.3**	414.9
Trade receivables which are not impaired and less than three months overdue	**75.7**	68.9
Trade receivables which are not impaired and more than three months overdue	**31.8**	25.0
Gross value of partially and fully provided debtors	**17.9**	19.8
	572.7	528.6
Provision for bad and doubtful debts	**(14.6)**	(14.5)
Trade receivables	**558.1**	514.1

18 Cash and cash equivalents

	2010 £m	2009 £m

Cash at bank and in hand – including impact of cash pooling gross up: £0.2m (2009: £44.0m)	**136.3**	84.0
Short-term deposits	**36.6**	7.7
Cash and cash equivalents	**172.9**	91.7
Bank overdrafts	**(0.7)**	(72.0)
Net cash and cash equivalents	**172.2**	19.7

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

19 Trade and other payables

	2010 £m	2009 £m
Non-current		
Other creditors	**27.3**	25.1
Current		
Trade creditors	**151.6**	130.3
Bills of exchange payable	**0.5**	0.4
Other creditors	**35.2**	40.8
Other taxation and social security costs	**21.2**	19.1
Accruals and deferred income	**219.7**	209.2
	428.2	399.8

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

20 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.

	2010 £m	2009 £m
Cash and cash equivalents		
Net cash and deposits (note 18)	**172.9**	91.7
Short-term borrowings		
Bank overdrafts including impact of cash pooling gross up: £0.2m (2009: £44.0m)	**(0.7)**	(72.0)
£139m 7.875% Sterling Eurobond 2010		(137.7)
Bank and other loans	**(1.3)**	(3.7)
Interest accrual	**(12.7)**	(11.0)
	(14.7)	(224.4)
Long-term borrowings		
£660m Revolving Credit Facility 2012		(36.9)
$250m 5.45% US$ Private placement 2013	**(169.1)**	(156.5)
$250m 6.05% US$ Guaranteed notes 2014	**(158.3)**	(148.5)
£150m 7.25% Sterling Eurobond 2016	**(149.1)**	(149.0)
€300m 4.125% Eurobond 2017	**(247.6)**	
$175m 7.37% US$ Private placement 2018	**(111.4)**	(104.7)
$250m 7.20% US$ Guaranteed notes 2019	**(158.0)**	(148.3)
Bank and other loans	**(1.5)**	(8.3)
	(995.0)	(752.2)
Borrowings	**(1,009.7)**	(976.6)
Net debt	**(836.8)**	(884.9)

Borrowings are accounted for at amortised cost and are categorised as other financial liabilities. See note 21 for a maturity analysis of borrowings. The repayment dates on borrowings repayable after five years range from 2016 to 2019.

Interest of £43.2m (2009: £27.7m) was charged to the consolidated income statement in this period in respect of public bonds.

Cash and overdraft balances in interest compensation cash pooling systems are reported gross on the balance sheet. This gross up increased cash and overdrafts by £0.2m at 31 July 2010 (2009: £44.0m).

Movements in net debt

	31 July 2009 £m	Foreign exchange gains and losses £m	Repayments of borrowings and net cash inflow £m	Drawdown of borrowings and net cash outflow £m	Capitalisation, interest accruals and unwind of capitalised fees £m	Fair value movements from interest rate hedging £m	Change in maturity analysis £m	**31 July 2010 £m**
Net cash and cash equivalents	19.7	(0.8)	153.3					**172.2**
Other short-term borrowings	(152.4)	(0.5)	141.6		(1.4)		(1.3)	**(14.0)**
Long-term borrowings	(752.2)	(40.7)	266.8	(466.8)	(0.5)	(2.9)	1.3	**(995.0)**

Net debt	(884.9)	(42.0)	561.7	(466.8)	(1.9)	(2.9)	**(836.8)**

The net cash inflow includes £0.3m of cash acquired with new subsidiary undertakings.

Secured loans

Loans amounting to £2.8m (2009: £3.4m) were secured on plant and equipment with a book value of £2.6m (2009: £3.3m).

At 31 July 2009 loans amounting to £6.5m were secured by charges on freehold properties with a book value of £11.5m. These loans have been repaid, and there are no borrowings at 31 July 2010 secured on property.

21 Financial risk management

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

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

(a) Foreign exchange risk

Transactional currency exposure

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

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

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

					At 31 July 2010
	Sterling £m	**US$ £m**	**Euro £m**	**Other £m**	**Total £m**
Financial assets and liabilities					
Financial instruments included in trade and other receivables	**34.5**	**280.3**	**138.8**	**122.2**	**575.8**
Financial instruments included in trade and other payables	**(36.3)**	**(143.1)**	**(66.2)**	**(51.1)**	**(296.7)**
Cash and cash equivalents	**30.4**	**30.6**	**19.0**	**92.9**	**172.9**
Borrowings not designated as net investment hedges	**(151.6)**	**(11.5)**	**(2.6)**	**(0.3)**	**(166.0)**
	(123.0)	**156.3**	**89.0**	**163.7**	**286.0**
Exclude balances held in operations with the same functional currency	**124.7**	**(103.9)**	**(87.1)**	**(159.0)**	**(225.3)**
Exposure arising from intra-group loans		**(36.0)**	**12.8**	**6.2**	**(17.0)**
Forward foreign exchange contracts	**(2.6)**	**30.0**	**11.2**	**(38.6)**	
	(0.9)	**46.4**	**25.9**	**(27.7)**	**43.7**

					At 31 July 2009
	Sterling £m	US$ £m	Euro £m	Other £m	Total £m
Financial assets and liabilities					
Financial instruments included in trade and other receivables	36.0	256.6	142.2	98.5	533.3
Financial instruments included in trade and other payables	(34.0)	(126.1)	(75.9)	(37.5)	(273.5)
Cash and cash equivalents	13.3	16.0	25.3	37.1	91.7
Borrowings not designated as net investment hedges	(306.5)	(22.7)	(33.4)	(19.1)	(381.7)
	(291.2)	123.8	58.2	79.0	(30.2)
Exclude balances held in operations with the same functional currency	294.0	(84.9)	(52.4)	(77.5)	79.2
Exposure arising from intra-group loans			(12.0)	23.2	11.2
Forward foreign exchange contracts	70.7	(82.3)	(2.4)	14.0	
	73.5	(43.4)	(8.6)	38.7	60.2

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

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

	Impact on profit for the year 31 July 2010 £m	**Gain/(loss) recognised in reserves 31 July 2010 £m**	Impact on profit for the year 31 July 2009 £m	Gain/(loss) recognised in reserves 31 July 2009 £m
US dollar	**1.5**	**(1.8)**	4.9	5.0
Euro	**1.0**	**2.9**	0.2	(1.2)

Sterling	**1.3**	**1.8**	1.8	5.1

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

Cash-flow hedging

The Group uses foreign currency contracts to hedge future foreign currency sales and purchases. At 31 July 2010 contracts with a nominal value of £292.7m (2009: £310.7m) were designated as hedging instruments. In addition, the Group had outstanding foreign currency contracts with a nominal value of £152.1m (2009: £121.7m) which were being used to manage transactional foreign exchange exposures, but were not accounted for as cash-flow hedges. The fair value of the contracts is disclosed in note 22.

The majority of hedged transactions will be recognised in the income statement in the same period that the cash-flows are expected to occur, with the only differences arising as a result of normal commercial credit terms on sales and purchases. Of the foreign exchange contracts designated as hedging instruments 99.6% are for periods of 12 months or less (2009: 99%).

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

	Year ended 31 July 2010 £m	Year ended 31 July 2009 £m
Brought forward cash-flow hedge reserve at start of year	**1.8**	1.1
Exchange adjustments	**0.2**	0.3
Gains and losses on effective cash-flow hedges recognised in equity	**(2.3)**	(8.0)
Amounts removed from the hedge reserve and recognised in the following lines on the income statement		
– revenue	**0.1**	9.6
– cost of sales	**0.9**	(2.8)
– administrative expenses	**(1.3)**	1.6
Carried forward cash-flow hedge reserve at end of year	**(0.6)**	1.8

Translational currency exposure

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

Net investment hedges

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

					At 31 July 2010
	Sterling £m	**US$ £m**	**Euro £m**	**Other £m**	**Total £m**
Loans designated as net investment hedges		**(587.0)**	**(248.1)**		**(835.1)**
Currency swap contracts	**206.7**	**(32.4)**	**(39.2)**	**(135.1)**	
	206.7	**(619.4)**	**(287.3)**	**(135.1)**	**(835.1)**

					At 31 July 2009
	Sterling £m	US$ £m	Euro £m	Other £m	Total £m
Loans designated as net investment hedges		(551.3)		(36.9)	(588.2)
Cross-currency swap contracts		59.9	(59.9)		
Currency swap contracts	380.8	(92.6)	(207.4)	(80.8)	
	380.8	(584.0)	(267.3)	(117.7)	(588.2)

At 31 July 2010 swap contracts hedged the Group's exposure to Australian dollars, Canadian dollars, Japanese yen and Chinese renminbi (2009: Japanese yen and Chinese renminbi). At 31 July 2009 currency loans in other currencies hedged the Group's exposure to Canadian dollars and Australian dollars.

Of the contracts designated as net investment hedges, 56% (2009: 53%) are current and the balance matures over the next three years (2009: four years).

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

	Year ended 31 July 2010 £m	Year ended 31 July 2009 £m
Brought forward net investment hedge reserve at start of year	**(88.9)**	(30.3)
Amounts deferred in the period on effective net investment hedges	**(39.3)**	(58.6)
Carried forward net investment hedge reserve at end of year	**(128.2)**	(88.9)

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

	Loss recognised in hedge reserve 31 July 2010 £m	Loss recognised in hedge reserve 31 July 2009 £m
US dollar	**61.8**	70.8
Euro	**26.0**	10.7

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

(b) Interest rate risk

The Group operates an interest rate policy designed to optimise interest cost and reduce volatility in reported earnings. The Group's current policy is to require interest rates to be fixed for 60% to 100% of the level of net debt. This is achieved primarily through fixed rate borrowings, and also through the use of interest rate swaps. At 31 July 2010 91.5% (2009: 73.9%) of the Group's net borrowings were at fixed interest rates, after adjusting for interest rate swaps and the impact of short maturity derivatives designated as net investment hedges.

The weighted average interest rate on borrowings and cross-currency swaps at 31 July 2010, after interest rate swaps, is 5.4% (2009: 5.8%).

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

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

	Cash and cash equivalents 31 July 2010 £m	Borrowings 31 July 2010 £m	Fair value of borrowings 31 July 2010 £m	Cash and cash equivalents 31 July 2009 £m	Borrowings 31 July 2009 £m	Fair value of borrowings 31 July 2009 £m
Fixed interest (adjusted for interest rate hedging)						
Less than one year		**(1.3)**	**(1.3)**		(141.4)	(146.8)
Between one and five years		**(223.5)**	**(244.3)**		(152.5)	(156.4)
Greater than five years		**(566.9)**	**(643.7)**		(406.4)	(430.6)
Total fixed interest financial assets/(liabilities) (adjusted for interest rate hedging)		**(791.7)**	**(889.3)**		(700.3)	(733.8)
Floating rate interest financial assets/(liabilities)	**156.4**	**(218.0)**	**(218.0)**	77.1	(276.3)	(268.9)
Total interest bearing financial assets/(liabilities)	**156.4**	**(1,009.7)**	**(1,107.3)**	77.1	(976.6)	(1,002.7)
Non-interest bearing assets/(liabilities) in the same category	**16.5**			14.6		
Total	**172.9**	**(1,009.7)**	**(1,107.3)**	91.7	(976.6)	(1,002.7)

Interest rate hedging

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

The fair values of the hedging instruments are disclosed in note 22. The effect of the swaps is to convert £195.3m (2009: £149.7m) debt from fixed rate to floating rate.

Sensitivity of interest charges to interest rate movements

The Group has exposure to sterling, US dollar and euro interest rates. However the Group does not have a significant exposure to interest rate movements for any individual currency. Based on the composition of net debt and foreign exchange rates at 31 July 2010, and taking into consideration all fixed rate borrowings and interest rate swaps in place, a one percentage point (100 basis points) change in average floating interest rates for all three currencies would have a £0.2m (2009: £2.2m) impact on the Group's profit before tax.

(c) Financial credit risk

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

The maximum credit risk exposure in the event of other parties failing to perform their obligations under financial assets, excluding trade and other receivables and derivatives, totals £199.9m at 31 July 2010 (2009: £99.5m).

	2010 £m	2009 £m
Cash held in interest compensation pools with a legal right of set-off	**0.2**	44.0
Cash at banks with at least a AA- credit rating	**120.8**	37.5
Cash at banks with a A+ credit rating	**47.3**	12.6
Cash at other banks	**4.7**	4.0
UK government bonds with a AAA credit rating (note 15)	**25.2**	
Other investments	**1.7**	1.4
	199.9	99.5

At 31 July 2010 the maximum exposure with a single bank for deposits and cash is £41.6m (2009: £24.1m), whilst the maximum mark to market exposure for derivatives is £6.8m (2009: £6.4m). These exposures were with the same bank, which has a AA credit rating.

(d) Liquidity risk

Borrowing facilities

The Board policy specifies the maintenance of unused committed credit facilities of at least £200m at all times to ensure it has sufficient available funds for operations and planned development. The principal £660m revolving credit facility matures in June 2012. At the balance sheet date the Group had the following undrawn credit facilities:

	2010 £m	2009 £m
Expiring within one year		
Expiring between one and two years	**660.0**	
Expiring after two years		622.8
	660.0	622.8

Cash deposits

As at 31 July 2010, £36.6m (2009: £7.7m) of cash and cash equivalents was on deposit with various banks of which £20.8m (2009: £5.9m) was on deposit in the UK.

Gross contractual cash-flows for borrowings

	Borrowings (Note 20) 31 July 2010 £m	Fair value adjustments 31 July 2010 £m	Contractual interest payments 31 July 2010 £m	Total contractual cash-flows 31 July 2010 £m	Borrowings (Note 20) 31 July 2009 £m	Fair value adjustments 31 July 2009 £m	Contractual interest payments 31 July 2009 £m	Total contractual cash-flows 31 July 2009 £m
Less than one year	**(14.7)**	**1.3**	**(47.9)**	**(61.3)**	(224.4)	(0.2)	(58.4)	(283.0)
Between one and two years	**(1.0)**		**(59.2)**	**(60.2)**	(1.6)		(47.9)	(49.5)
Between two and three years	**(169.6)**	**9.8**	**(54.9)**	**(214.7)**	(38.2)		(47.7)	(85.9)
Between three and four years	**(158.3)**	**(1.0)**	**(50.5)**	**(209.8)**	(157.0)	6.8	(42.8)	(193.0)
Between four and five years			**(40.8)**	**(40.8)**	(149.0)	(1.2)	(36.7)	(186.9)
Greater than five years	**(666.1)**	**(4.0)**	**(102.0)**	**(772.1)**	(406.4)	(2.5)	(101.1)	(510.0)
Total	**(1,009.7)**	**6.1**	**(355.3)**	**(1,358.9)**	(976.6)	2.9	(334.6)	(1,308.3)

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

Gross contractual cash-flows for derivative financial instruments

	Receipts 31 July 2010 £m	Payments 31 July 2010 £m	Net cash-flow 31 July 2010 £m	Receipts 31 July 2009 £m	Payments 31 July 2009 £m	Net cash-flow 31 July 2009 £m
Assets						
Less than one year	**375.2**	**(354.0)**	**21.2**	592.2	(545.3)	46.9
Greater than one year	**78.7**	**(60.7)**	**18.0**	182.7	(217.7)	(35.0)
Liabilities						
Less than one year	**362.5**	**(377.8)**	**(15.3)**	460.2	(513.7)	(53.5)
Greater than one year	**30.2**	**(31.3)**	**(1.1)**	256.0	(232.7)	23.3
Total	**846.6**	**(823.8)**	**22.8**	1,491.1	(1,509.4)	(18.3)

This table presents the undiscounted future contractual cash-flows for all derivative financial instruments. For this disclosure, cash-flows in foreign currencies are translated using the spot rates at the balance sheet date. The fair values of these financial instruments are presented in note 22.

Gross contractual cash-flows for other financial liabilities

The contractual cash-flows for financial liabilities included in trade and other payables are: £284.5m (2009: £261.9m) due in less than one year, £8.2m (2009: £7.3m) due between one and five years and £4.0m (2009: £4.3m) due after more than five years.

22 Financial derivatives

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

				At 31 July 2010
	Contract or underlying nominal amount			Fair value
	£m	Assets £m	Liabilities £m	Net £m
Foreign exchange contracts (cash-flow hedges)	**292.7**	**5.2**	**(7.0)**	**(1.8)**
Foreign exchange contracts (not hedge accounted)	**152.1**	**1.2**	**(2.3)**	**(1.1)**
Total foreign exchange contracts	**444.8**	**6.4**	**(9.3)**	**(2.9)**
Currency swaps (net investment hedges)	**206.7**	**4.9**	**(0.8)**	**4.1**
Currency swaps (not hedge accounted)	**180.7**	**6.7**	**(5.6)**	**1.1**
Total currency swap contracts	**387.4**	**11.6**	**(6.4)**	**5.2**
Interest rate swaps (fair value hedges)	**195.3**	**8.3**	**(0.3)**	**8.0**
Total financial derivatives	**1,027.5**	**26.3**	**(16.0)**	**10.3**

Balance sheet entries				
Non-current		**10.8**	**(1.1)**	**9.7**
Current		**15.5**	**(14.9)**	**0.6**
Total financial derivatives		**26.3**	**(16.0)**	**10.3**

				At 31 July 2009
	Contract or underlying nominal amount			Fair value
	£m	Assets £m	Liabilities £m	Net £m
Foreign exchange contracts (cash-flow hedges)	310.7	10.2	(7.8)	2.4
Foreign exchange contracts (not hedge accounted)	121.7	2.3	(2.3)	
Total foreign exchange contracts	432.4	12.5	(10.1)	2.4
Currency swaps (net investment hedges)	470.6	32.6	(2.4)	30.2
Currency swaps (not hedge accounted)	436.7	3.3	(31.9)	(28.6)
Total currency swap contracts	907.3	35.9	(34.3)	1.6
Cross-currency swaps (net investment and fair value hedges)	59.9		(1.2)	(1.2)
Interest rate swaps (fair value hedges)	89.8	6.2		6.2
Total financial derivatives	1,489.4	54.6	(45.6)	9.0
Balance sheet entries				
Non-current		13.9	(6.7)	7.2
Current		40.7	(38.9)	1.8
Total financial derivatives		54.6	(45.6)	9.0

Currency swaps not hedge accounted

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

Accounting for other derivative contracts

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

Fair value hierarchy

All derivatives values are calculated using level 2 valuation methodologies.

23 Provisions for liabilities and charges

	At 31 July 2009 £m	Exchange adjustments £m	Provisions charged £m	Provisions released £m	Unwind of provision discount £m	Utilisation £m	**At 31 July 2010 £m**
Warranty provision and product liability	44.4	1.0	14.8	(6.6)		(16.1)	**37.5**
Reorganisation	15.7	0.9	5.4	(0.8)		(9.8)	**11.4**
Property	3.5		1.9	(0.1)		(0.6)	**4.7**
Disposal	54.7	3.1		(1.4)		(0.2)	**56.2**
Litigation	185.4	11.0	21.4	(3.9)	7.0	(29.5)	**191.4**
	303.7	16.0	43.5	(12.8)	7.0	(56.2)	**301.2**

Analysed as:

	2010 £m	2009 £m
Current liabilities	**70.4**	77.2
Non-current liabilities	**230.8**	226.5
	301.2	303.7

Warranty provision and product liability

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

Reorganisation

On 3 June 2008 the Company announced a number of changes to its corporate centre and divisional headquarters. The total cost of this restructuring, including redundancy, relocation and consolidation of manufacturing, is expected to amount to approximately £45m over the period to 2010, of which £5.4m has been charged in the current year.

Reorganisation provisions include £2.8m (2009: £4.8m) costs relating to restructuring supply arrangements following the automotive seals disposal. These costs are expected to be spread over the next six years.

Disposal

The disposal provision relates to warranties and other obligations in respect of the disposal of the Marine Systems and Aerospace businesses.

Most of the balance is expected to be utilised within the next five years.

Litigation

John Crane, Inc.

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

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

JCI is actively monitoring 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 all asbestos claims based upon this defence. Approximately 184,000 claims against JCI have been dismissed before trial over the last 31 years. JCI is currently a defendant in cases involving approximately 116,000 claims. Despite the large number of claims brought against JCI, it has had final judgments against it, after appeals, in only 100 cases over the period, and has had to pay awards amounting to approximately US$95m. JCI has also incurred significant additional defence costs and, whilst the number of claims being filed against JCI and other defendants has been declining, the proportion of mesothelioma claims has increased, and JCI's ability to defend these cases is likely to have a significant impact on its annual aggregate adverse judgment and defence costs.

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

- The periods over which the expenditure can be reliably estimated. Projections used range between 10 and 17 years.
- The future trend of legal costs, allowing for 3% cost inflation.
- The rate of future claims filed.
- The rate of successful resolution of claims.
- The average amount of judgments awarded.

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

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

	2010 £m	2009 £m
Gross provision	**214.5**	213.3
Discount	**(38.8)**	(46.7)
Discounted pre-tax provision	**175.7**	166.6
Deferred tax	**(47.4)**	(45.0)
Discounted post-tax provision	**128.3**	121.6

Other litigation

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

Apart from that relating to JCI, none of the other provisions is discounted.

24 Operating lease commitments – minimum lease payments

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

		2010		2009
	Land and buildings £m	**Other £m**	Land and buildings £m	Other £m
Payments due				
– not later than one year	**27.3**	**9.0**	25.0	9.1
– later than one year and not later than five years	**63.7**	**10.7**	57.8	9.4
– later than five years	**27.7**	**0.1**	27.0	0.1
	118.7	**19.8**	109.8	18.6

25 Contingent liabilities and commitments

John Crane, Inc.

As stated in note 23, John Crane, Inc. (“JCI”) is involved in numerous law suits pending in the United States in which plaintiffs are claiming damages arising from exposure to, or use of, products containing asbestos. The JCI products generally referred to in these cases are ones in which the asbestos fibres were encapsulated in such a manner that, according to tests conducted on behalf of JCI, the products were safe. JCI ceased manufacturing products containing asbestos in 1985.

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

Other contingent liabilities and commitments

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

At 31 July 2010, contingent liabilities, comprising bonds and guarantees arising in the normal course of business, amounted to £143.5m (2009: £202.1m), including pension commitments of £40.6m (2009: £116.1m). At 31 July 2009 the Parent Company had two letters of credit to support the Group’s pension plans, one for £100.0m and one for £50.0m, which were both partially utilised. Following the agreement of ten year funding plans with the Trustees of its two major UK pension schemes the first letter of credit has been cancelled, leaving only the £50.0m facility.

The Group is currently co-operating with the relevant authorities in investigating certain business conduct issues. Based on the work completed to date, these are not expected to give rise to any material financial exposure.

26 Share capital

	Number of shares	Issued capital £m	Consideration £m
Ordinary shares of 37.5p each			
At 31 July 2009	389,026,427	145.9	
Exercise of share options	1,701,616	0.6	9.1
Total share capital at 31 July 2010	**390,728,043**	**146.5**	

At 31 July 2010 all of the issued share capital was in free issue. All issued shares are fully paid.

27 Reserves

Retained earnings include the value of Smiths Group plc shares held by the Smiths Industries Employee Benefit Trust. In the year the Company issued 558,754 (2009: 682,922) shares to the Trust. At 31 July 2010 the Trust held 32,858 (2009: 105,932) ordinary shares with a market value of £0.4m (2009: £0.8m).

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

Capital management

The capital structure is based on the directors’ judgement of the balance required to maintain flexibility while achieving an efficient cost of capital. The Group has a target gearing, calculated on a market value basis, of approximately 20%. At the balance sheet date the Group had gearing of 19% (2009: 26%).

As part of this process the Group maintains its target of a solid investment grade credit rating by monitoring the factors utilised by ratings agencies and evaluating the impact of potential distributions and future funding requirements. At 31 July 2010 the Group had a credit rating of BBB+/Baa2 – negative outlook (2009: BBB+/Baa2 – negative outlook) with Standard & Poor’s and Moody’s respectively.

Hedge reserve

	2010 £m	2009 £m
The hedge reserve on the balance sheet comprises		
– cash-flow hedge reserve	**(0.6)**	1.8
– net investment hedge reserve	**(128.2)**	(88.9)
	(128.8)	(87.1)

See transactional currency exposure risk management disclosures in note 21 for additional details of cash-flow hedges and translational currency exposure risk management disclosure also in note 21 for additional details of net investment hedges.

28 Cash-flow from operating activities

	Year ended 31 July 2010 £m	Year ended 31 July 2009 £m
Operating profit – continuing	**435.9**	428.5
Operating profit – discontinued		

	435.9	428.5
Amortisation of intangible assets	**67.6**	55.2
Impairment of intangible assets		0.2
Profit on disposal of property, plant and equipment	**(3.1)**	(11.3)
Profit on disposal of business	**(3.3)**	(1.6)
Depreciation of property, plant and equipment	**65.7**	62.2
Impairment of property, plant and equipment	**(2.1)**	3.8
Share-based payment expense	**10.3**	9.4
Retirement benefits	**(56.1)**	(112.5)
Decrease in inventories	**46.1**	22.1
(Increase)/decrease in trade and other receivables	**(16.5)**	94.0
Increase/(decrease) in trade and other payables	**27.0**	(79.9)
Decrease in provisions	**(21.8)**	(24.9)
Cash generated from operations	**549.7**	445.2
Interest	**(52.8)**	(39.1)
Tax paid	**(86.4)**	(74.0)
Net cash inflow from operating activities	**410.5**	332.1

29 Acquisitions

During the period ended 31 July 2010, the Group acquired Channel Microwave (October 2009) and Interconnect Devices, Inc. ("IDI") (April 2010) on behalf of Smiths Interconnect.

IDI designs and produces highly engineered, application specific connectors using a proprietary spring probe contact technology. It focuses on mission critical applications for semiconductor and circuit-board testing, and high reliability connectors for military, medical, homeland security and industrial markets. The IDI acquisition expands the Smiths Interconnect product range and provides a significant Chinese base for the Connectors technology group.

From the date of acquisition to 31 July 2010, the acquisitions contributed £20.3m to revenue, £2.8m to headline profit before taxation and £(0.9)m to profit before taxation. If Smiths had acquired the businesses at the beginning of the financial period, the acquisitions would have contributed £52.1m to revenue and £7.2m to headline profit before tax.

The intangible assets recognised comprise £22.8m in respect of technology and £28.7m in respect of customer relationships and orders. Goodwill represents the value of synergies arising from the acquisitions and future growth opportunities. The goodwill recognised is not expected to be deductible for tax purposes. The adjustments to current assets and liabilities relate to valuation adjustments and are provisional, based on management's best estimates.

The values set out below are provisional pending finalisation of the fair values attributable, and will be finalised in the year ending 31 July 2011. Goodwill and other net assets in respect of prior year acquisitions, as previously reported, have been adjusted as a result of finalising their attributable fair values and changes in the estimated value of contingent considerations. Accordingly, goodwill has increased by £0.2m.

	Interconnect Devices, Inc.			Other acquisitions			
	Book value £m	Fair value adjustments £m	Provisional fair value £m	Book value £m	Fair value adjustments £m	Provisional fair value £m	Total £m
Non-current assets							
– intangible assets	38.1	11.9	**50.0**		1.5	**1.5**	**51.5**
– property, plant and equipment	4.2	(0.1)	**4.1**	0.1		**0.1**	**4.2**
– other assets	0.8	(0.8)					
Current assets							
– cash and cash equivalents	0.3		**0.3**				**0.3**
– other current assets	12.4	0.2	**12.6**	1.0	(0.2)	**0.8**	**13.4**
Non-current liabilities							
– other liabilities	(0.1)	(3.5)	**(3.6)**				**(3.6)**
Current liabilities							
– other current liabilities	(3.1)		**(3.1)**	(0.2)		**(0.2)**	**(3.3)**
Net assets acquired	**52.6**	**7.7**	**60.3**	**0.9**	**1.3**	**2.2**	**62.5**
Goodwill on current year acquisitions			**62.6**			**1.5**	**64.1**
Goodwill adjustments on prior year acquisitions							**0.2**
Total consideration			**122.9**			**3.7**	**126.8**
Cash paid during the period – current year acquisitions							**126.6**
Adjustments to deferred consideration on prior year acquisitions							**0.2**
Total consideration							**126.8**

30 Employee share schemes

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

Smiths Group Performance Share Plan (PSP)

The PSP was introduced in 2004 and replaced the 95 ESOS for executive directors and senior executives. Conditional awards of up to 1.5 times salary (and exceptionally three times salary) were granted annually. The awards are released following the third anniversary of the date of grant to the extent the PSP's performance tests have been met. One-third of the award is subject to a total shareholder return ('TSR') target relative to other FTSE 100 companies (excluding financial companies and investment trusts). For full vesting, the company's TSR must be at or above the 75th percentile over the three year performance period. 25% of the award will vest if the company's TSR is at median. Awards will vest on a straight-line pro-rata basis between median and 75th percentile. The remaining two-thirds of the award is subject to an earnings per share ('EPS') growth target (measured before exceptional items). Full vesting will occur if the compound annual growth in EPS is equivalent to 12% per annum. 25% vesting will occur if the compound annual growth in EPS is equivalent to 5% per annum, with vesting on a straight-line basis between 5% and 12%. The PSP has been replaced by the VSP, and the final award under the PSP will be released in December 2010.

Value Sharing Plan (VSP)

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

The participants in the VSP will not be eligible for awards under the Performance Share Plan in 2008/09 or 2009/10.

Smiths Group Co-Investment Plan (CIP)

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

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

	CIP	PSP and VSP	Other share schemes	Total	Weighted average price for option plans £
Ordinary shares under option ('000)					
1 August 2008	1,407	2,661	10,148	14,216	£6.23
Granted	305	1,604	647	2,556	£1.45
Exercised	(675)	(683)	(584)	(1,942)	£2.18
Lapsed	(47)	(243)	(1,191)	(1,481)	£6.75
31 July 2009	990	3,339	9,020	13,349	£5.83
Granted	412		248	660	£3.32
Update of estimates		(241)		(241)	£0.00
Exercised	(430)	(130)	(1,643)	(2,203)	£6.18
Lapsed	(95)	(1,198)	(1,193)	(2,486)	£5.53
31 July 2010	**877**	**1,770**	**6,432**	**9,079**	**£6.15**

Options were exercised on an irregular basis during the period. The average closing share price over the financial year was 1,000.61p (2009: 832.08p). There has been no change to the effective option price of any of the outstanding options during the period.

Range of exercise prices	Total shares under option ('000)	Weighted average remaining contractual life (months)	**Options exercisable at 31 July 2010 ('000)**	Options exercisable at 31 July 2009 ('000)	**Exercisable weighted average exercise price for options exercisable at 31 July 2010**
£0.00 – £2.00	2,647	14		1	**£0.00**
£2.01 – £6.00	602	50	**2**	5	**£5.69**
£6.01 – £10.00	4,433	52	**1,667**	2,879	**£8.19**
£10.01 – £14.00	1,397	88	**51**	116	**£10.97**

For the purposes of valuing options to arrive at the share-based payment charge, the Binomial option pricing model has been used for most schemes and the Monte Carlo method is used for schemes with total shareholder return performance targets. The key assumptions used in the models for 2010 and 2009 are volatility of 30% (2009: 23%) and dividend yield of 3.75% (2009: 3.75%). Assumptions on expected volatility and expected option term have been made on the basis of historical data, for the period corresponding with the vesting period of the option. These generated a weighted average fair value for CIP of £18.89 (2009: £6.96) and VSP/PSP of £11.21 (2009: £11.01).

Included within staff costs is an expense arising from share-based payment transactions of £11.3m (2009: £8.0m), of which £10.3m (2009: £9.4m) relates to equity-settled share-based payment.

At 31 July 2010 the creditor relating to cash-settled schemes is £0.9m (2009: £0.2m).