smiths
bringing technology to life

ADVANCING TECHNOLOGY

Smiths Group plc
Annual Report 2017

WHAT'S INSIDE OUR REPORT?

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Chief Executive Andy Reynolds Smith talks about our strategy.

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HIGHLIGHTS 2017

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WE ARE PROUD TO BE SMITHS, PUSHING BOUNDARIES TO DELIVER INNOVATIVE SOLUTIONS FOR THE WORLD'S CHALLENGES. OUR AMBITION IS TO ESTABLISH SMITHS AS ONE OF THE WORLD'S LEADING TECHNOLOGY COMPANIES.

KEY HIGHLIGHTS

- Group underlying[1] revenue broadly in line with prior year, up 11% on a reported basis
- Underlying[2] headline operating profit up 3%, and up 16% on a reported basis
- Margin expansion in all divisions combined with increased investment
  - Total R&D increased to 4.6% of sales (2016: 4.0%)
- Operational excellence supporting strong cash conversion of 118%
- Significant portfolio upgrading:
  - c. 75% of the Group now well-positioned in growth markets;
  - increased investment in all divisions to drive future growth, up 60bps to 4.6% of sales;
  - four non-core businesses sold;
  - Morpho Detection acquisition integration on track
- Balance sheet remains strong, with further investment capacity for sustainable growth
- ROCE up 90bps with increases in all divisions
- Headline basic EPS up 15% at 97.6p per share
- Proposed final dividend of 29.70p per share. Full year dividend growth of 3%
- Statutory operating profit of £674m

This is our Annual Report for the financial year ended 31 July 2017.

1 Underlying excludes the impact of foreign exchange translation and acquisitions but includes divested businesses for the period they were owned in the reported financial year and adjusts prior financial year comparators as if the divested businesses were owned for the same period in those financial years to aid comparability statements

2 In addition to statutory reporting, Smiths Group reports its continuing operations on a headline basis. Definitions of headline metrics, and information about the adjustments to statutory measures are provided in the notes to the financial statements

REVENUE

£3,280M

2016: £2,949M

HEADLINE OPERATING PROFIT

£589M

2016: £510M

FREE CASH-FLOW

£370M

2016: £243M

HEADLINE EARNINGS PER SHARE

97.6P

2016: 85.2P

CONTINUING STATUTORY EARNINGS PER SHARE

144.1P

2016: 65.6P

ENABLING

With one of the largest global service footprints in the mechanical seal industry, John Crane's expert engineers and technicians work closely with customers to provide rapid onsite support – analysing root-cause failures, identifying areas for improvement and applying performance-based solutions to reduce equipment outages.

INDUSTRY

Our technologies and services help to increase reliability, improving equipment performance and maximising up-time for mission-critical components across process industries, including chemical, power generation, water and wastewater, and pulp and paper.

SMITHS AT A GLANCE

WE APPLY LEADING-EDGE TECHNOLOGY TO DESIGN, MANUFACTURE AND DELIVER MARKET-LEADING INNOVATIVE SOLUTIONS THAT MEET OUR CUSTOMERS' EVOLVING NEEDS. OUR PRODUCTS AND SERVICES TOUCH THE LIVES OF MILLIONS OF PEOPLE EVERY DAY

Our strategy

Our ambition is to establish Smiths as one of the world's leading technology companies. We will achieve this by outperforming our chosen markets and delivering world-class competitiveness and innovation, underpinned by our strong financial framework.

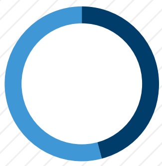
Our solutions

Our products and services are often critical to our customers' operations, while our proprietary technology and high service levels help create competitive advantage. Our solutions make a real impact on the world – from enabling industry, improving healthcare and enhancing security, to advancing connectivity and supporting new homes.

Our end markets and businesses

Today, we serve seven end markets through our divisions: John Crane, Smiths Medical, Smiths Detection, Smiths Interconnect and Flex-Tek. We are focusing our portfolio on the most attractive end markets, where we can sustain above-market growth.

REVENUE MIX



- Original equipment sales 45%
- Aftermarket/consumables 55%

REVENUE	HEADLINE OPERATING PROFIT
£3,280M	£589M
INVESTMENT IN NEW PRODUCT DEVELOPMENT	**FREE CASH-FLOW**
£150M	£370M

Our people
We employ around 22,000 people globally and are building a learning organisation that enables them to be the best that they can be.

Our values
We are united by our shared values, which guide our actions and behaviour every day, no matter our role.

INTEGRITY
OWNERSHIP
RESPECT
CUSTOMER FOCUS
PASSION

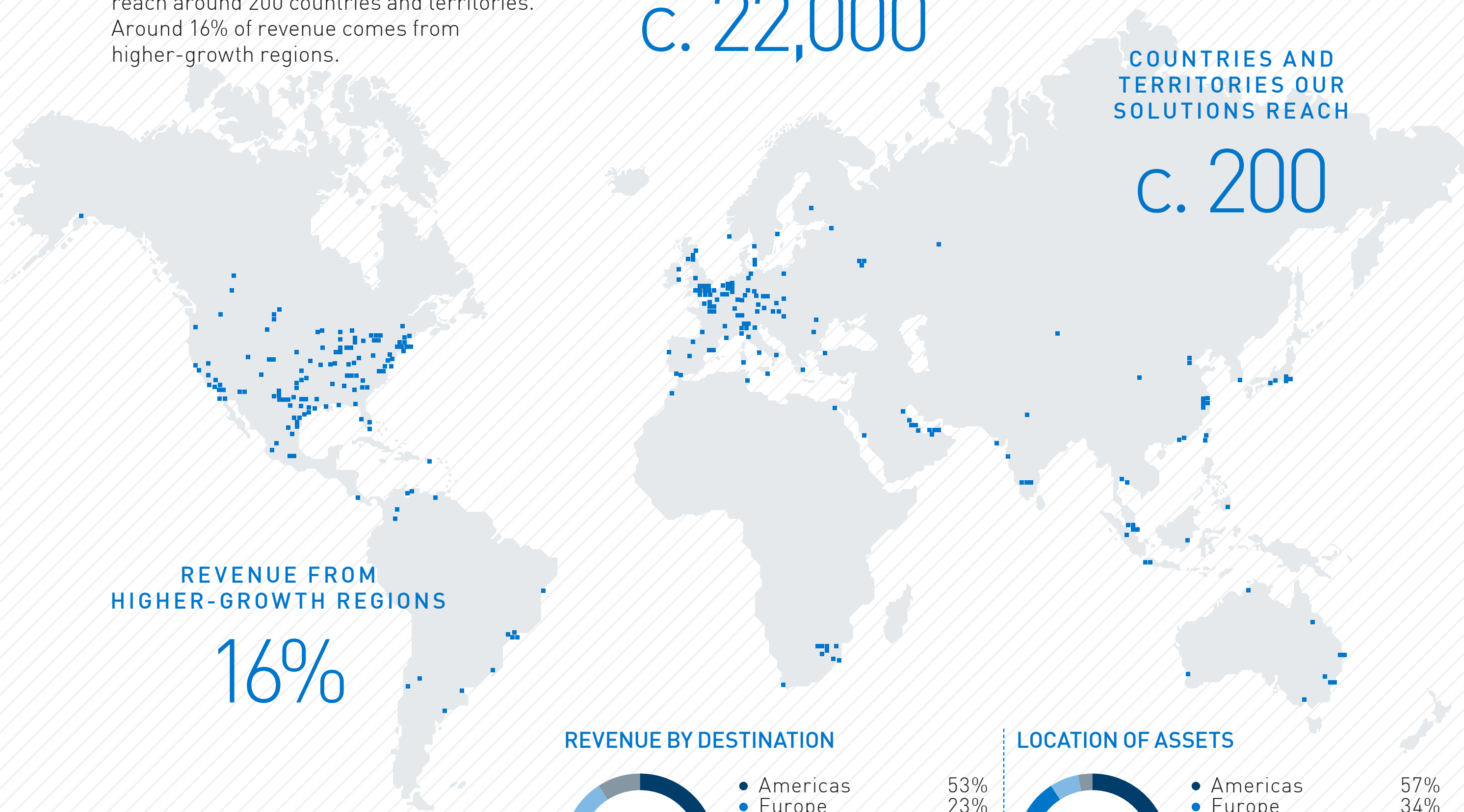
Where we operate
We have operations in more than 50 countries and our products and services reach around 200 countries and territories. Around 16% of revenue comes from higher-growth regions.

EMPLOYEES WORLDWIDE

c. 22,000

COUNTRIES AND TERRITORIES OUR SOLUTIONS REACH

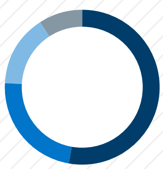
c. 200



REVENUE FROM HIGHER-GROWTH REGIONS

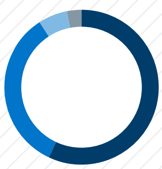
16%

REVENUE BY DESTINATION



Americas	53%
Europe	23%
Asia Pacific (APAC)	15%
Rest of World	9%

LOCATION OF ASSETS



Americas	57%
Europe	34%
APAC	6%
Rest of World	3%

SMITHS
OUR DIVISIONS

—

OUR DIVISIONS ARE EXPERTS IN THEIR MARKETS, WORKING CLOSELY WITH CUSTOMERS TO DELIVER INNOVATIVE SOLUTIONS TO MEET THEIR EVOLVING NEEDS.

DIVISIONAL REVENUE

John Crane	27%
Smiths Medical	29%
Smiths Detection*	21%
Smiths Interconnect	13%
Flex-Tek	10%

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DIVISIONAL HEADLINE OPERATING PROFIT**

John Crane	32%
Smiths Medical	33%
Smiths Detection*	16%
Smiths Interconnect	9%
Flex-Tek	10%

* Includes the results of Morpho Detection for the approximately four-month period since becoming part of the Group

** Excludes central costs

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JOHN CRANE

Mission-critical solutions for global energy and process industries

REVENUE

£885M

HEADLINE OPERATING PROFIT MARGIN

23.0%

COMPETITIVE STRENGTHS

- A market leader in mechanical seals
- Strong proprietary technology and expertise in applied engineering
- Strong aftermarket service offering, with around two-thirds of sales in aftermarket
- One of the largest global service networks in the mechanical seal industry, with c. 200 sales and service centres

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SMITHS MEDICAL

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

REVENUE

£951M

HEADLINE OPERATING PROFIT MARGIN

22.0%

COMPETITIVE STRENGTHS

- A category leader in our chosen markets
- Highly recognised and respected brands
- Category breadth and depth, including capital, consumable and software products
- Reputation for quality and safety
- Extensive global sales network

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SMITHS DETECTION

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

REVENUE

£687M

HEADLINE OPERATING PROFIT MARGIN

15.0%

COMPETITIVE STRENGTHS

- A market leader with a strengthened global position following the Morpho Detection acquisition
- Technologies leveraged across many markets and applications
- Operates in several regulated markets requiring product certification
- Growing aftermarket revenues (39% of total)

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SMITHS INTERCONNECT

Solutions for high-speed, secure connectivity in demanding applications

REVENUE

£419M

HEADLINE OPERATING PROFIT MARGIN

13.4%

COMPETITIVE STRENGTHS

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

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FLEX-TEK

Innovative components to heat and move fluids and gases

REVENUE

£338M

HEADLINE OPERATING PROFIT MARGIN

19.3%

COMPETITIVE STRENGTHS

- A market-leading performance in residential gas tubing
- High-performance flexible tubing products for aerospace
- Leading capability in the design and manufacture of heating solutions for bespoke applications
- Strong customer relationships

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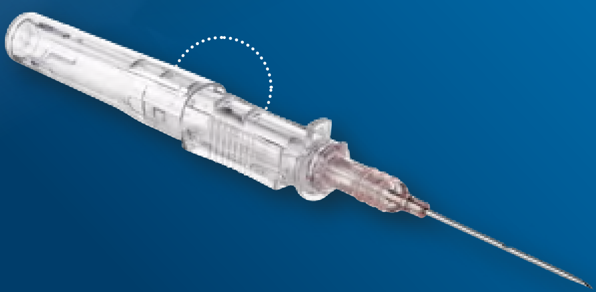
ENHANCING



Our ViaValve Safety IV Catheters are easy to use one-handed and incorporate an innovative valve in the catheter hub that prevents backflow of blood from a patient's vein on insertion – this blood-flow control protects clinicians and patients from the risk of infection and cross-contamination caused by blood exposure during IV starts.

HEALTHCARE

Our catheters are raising the standard for safety in a device used in around 90% of hospital in-patient treatments. They are supported by our dedicated team of nurses who train customers to use and maintain the devices safely and effectively.

CHAIRMAN'S STATEMENT

—

WE ARE CREATING A NEW FUTURE FOR SMITHS – ONE WHICH CREATES MORE VALUE FOR OUR SHAREHOLDERS AND MORE OPPORTUNITIES FOR OUR EMPLOYEES.

SIR GEORGE BUCKLEY
CHAIRMAN

As individuals or as companies, we can either create the future or we can be visited by it – and who is to say that if we just wait for it, whether we'll like that future visit when it arrives?

It's clear from the challenging experiences of many great companies in recent years, that unless we prepare properly for the future, the one we want probably won't be there when we need it. It reminds me of the old saying "the best time to replace the roof is when the sun is shining."

Choosing our future

There are, in fact, many possible 'futures' that can be created for a company. So it's far better that it's one we intentionally design ourselves, rather than an accidental one we may not like when it arrives. That's the fundamental job we have to do as a leadership team and as a Board, ie to create a new sustainable and viable future for Smiths, one which creates more value for our shareholders and more opportunities for our employees. By design, it will be one which is much better than if we had simply waited at the bus-stop of opportunity for something serendipitous – or not – to come along.

A fact which is rarely acknowledged by observers is that the core of every company is slowly dying. This includes even the most 'modern' companies such as those focusing on software, social media and the internet.

The core of every company is being constantly attacked by competition, by end-of-life technology, product substitution, regulation and cannibalisation, and also by changing customer preferences and performance expectations. The core of every company is trickling away like a melting ice cube in the hot sun.

The rate at which this decay or attrition happens can be surprisingly high, depending on the type of end market being served. So clearly, there is no way to succeed in the competitive game by simply standing still. The only way to overcome this natural attrition problem is by continually replacing the core business with new products, new customers, new technologies and new markets. If a company wants to grow faster than the market, it has to make this replacement at a rate which well exceeds the natural rate of core attrition. While this may seem to be an obvious statement, you'd be surprised by how few companies recognise this problem and address it head on. We will not make that mistake at Smiths.

So what do we want our company future to look like? First, we can observe that all great companies are innovative companies. A company cannot beat entrenched competition, and certainly cannot beat aggressive new market entrants, unless it's innovative. Operational excellence clearly has a big part to play in a company's competitiveness, although there is no amount of process excellence that can ever adequately substitute for a healthy dose of innovation. Nor is there an adequate substitute offered in productivity initiatives alone. As the saying goes, you can't save your way into prosperity. We can see this most clearly in electronics and software companies where the market, product and technology changes are easily the fastest. But exactly the same gradual attrition phenomena happens to industrial companies, consumer packaged goods companies, healthcare, transportation, energy and food. So while the rates of decline may be a little slower than in electronics markets, they are nevertheless there. Second, great companies grow faster than the markets they serve and, as a result, they steadily build market share each year. It also implies that their new product vitality index is high. High performance companies also have strong levels of employee satisfaction and customer satisfaction; they have best-in-class margins, and attractive and stable returns on capital investment. They are also inclusive of 'all-comers' – creative talent needs to come from everywhere – and they are places with a good employer brand where able people want to work. These companies also have good Environmental, Social and Governance scores.

In broad brush strokes, this is the kind of company and 'new future' we are determined to build. We have not changed or deviated from this mission one bit since I became the Chairman of Smiths, though I'm proud to say that under the dynamic leadership of our Chief Executive Andy Reynolds Smith and his team, we are now executing against this mission much faster.

Creating new value

In terms of new financial value creation, companies have only five levers they can pull to improve shareholder value creation. Higher sales growth, margin expansion, improved working capital turns, lower taxation rates and an improving P/E multiple. For most mature industrial companies, with their typical underlying characteristics of high margin and lower sales growth, the best method of creating new value for all stakeholders in the company is to drive higher levels of profitable organic growth. Achieving a point of sales growth usually exceeds the value creation of a point of margin improvement by several multiples. Plus, there are natural limits to profit margin that the laboratory of life teaches us are possible. If margins go too high, customers complain and even greater competition is enticed into your market. A strategy of only improving margin eventually runs out of runway. Growth never does.

We have scope for higher levels of growth at Smiths Group – along with huge opportunities for improving our working capital efficiency. Here and there, we also have opportunities for margin expansion in some of our businesses – particularly in Smiths Medical. So this essentially

NO MATTER WHAT THE COMPANY DOES, IT WILL ALWAYS BE WORLD-CLASS TALENT WHICH IS THE GREATEST NEED. NOTHING IN THE COMPANY EVER GETS DONE EXCEPT THROUGH PEOPLE.

CHAIRMAN'S STATEMENT
CONTINUED

THE WONDERFUL THING ABOUT GROWTH AND INNOVATION IS THAT IT'S AN 'EVERYBODY WINS' STRATEGY. INVESTORS WIN WITH BETTER RETURNS, EMPLOYEES WIN WITH GREATER CAREER OPPORTUNITIES, SUPPLIERS WIN WITH HIGHER VOLUME AND CUSTOMERS WIN WITH BETTER PRODUCTS.

INVESTMENT IN NEW PRODUCT DEVELOPMENT

£150M

NUMBER OF EMPLOYEES

c. 22,000

is the nub of the Group's strategic plan. A balanced combination of operational excellence and high levels of organic growth, driven mostly by innovation. Here and there, we may yet trim the portfolio in those places where we feel we can't create the kind of value-creating growth profile and company we want.

An everybody wins strategy

Yes, we will certainly continue to use acquisitions as an accelerant to growth, but in today's market of high purchase prices for companies, we will be selective and thoughtful about how to do this. We still have a mission of achieving sensible returns on investment well above our cost of capital.

Acquisitions can bring many positive things (and some negative ones if a company isn't careful), but done properly, one thing acquisitions always do is to bring speed of execution of the strategic plan. The wonderful thing we can observe about growth and innovation is that it's an 'everybody wins' strategy. Investors win with better returns, employees win with greater career opportunities, suppliers win with higher volume and customers win with better products. We have lots of opportunity too for improvements in working capital turns and again, like growth, this is already on the docket of things being done to substantially improve the Group.

Adapting for change

What might that new future look like for Smiths? If we think carefully, much of the general direction of technology and customer preferences can be forecast. The details no, but the generalities yes. So another element of a company's profile is that it must be a learning company and be agile and adaptable to changing circumstances. For change, these circumstances certainly will. For example, there's no reason to believe that border crossing and airport security challenges will become easier in the future than they are today. So executed properly, this will be a great business to be in long term. But more and more advanced detection technologies will need to be developed, expanding from sophisticated explosives detection to all forms of contraband detection at border crossings and inspection points. The same opportunities apply to medical businesses. People are living longer and that part of the world we refer to as higher-growth markets are demanding better healthcare, better education and communications, cleaner air and water, higher levels of food safety, better cars and better housing among others. The three large disease states of cancer, heart disease and diabetes can, and will, be improved by medical science and we will play our part in that. Energy needs, petrochemical-sourced feedstocks and electronics-oriented products will continue to be huge features of our daily life, in fact, ever more so. So this puts our John Crane and Interconnect businesses front and central in this new world.

BOARD CHANGES

We were delighted to welcome Noel Tata to the Board in January 2017 as an additional non-executive director and member of our Audit, Nomination and Remuneration Committees. We welcome Noel's extensive experience and expertise in higher-growth economies such as Asia and Africa. As I have said on previous occasions, the ability to manage change is a good indicator of a business' resilience. Following Chris O'Shea stepping down from his role as Chief Financial Officer in May, we were pleased that my Board colleague and Audit Committee Chairman Bill Seeger agreed to step into the Chief Financial Officer role on an interim basis while we seek a permanent replacement. We were also delighted that non-executive director Mark Seligman agreed to take on the Chair of the Audit Committee.

Higher growth market focus

We have decided to build a much stronger focus on growing in these higher growth regions. Arithmetically, if our portfolio had the same percentage of sales in these regions as do our peers, our organic growth rate would be about 100 basis points higher than it is today. That's a missed value creation opportunity lingering from the past. To help address this, we've assigned a top Smiths leader, Roland Carter, to that task, with operational control of Asia Pacific.

When I moved to live in the United States in 1978, one of the first projects I worked on was electric vehicles and the fundamental architecture of the drive system was more or less identical then to what we see in electric vehicles today. Yet it is only in recent times that they had become commercially viable. There is no question that electric vehicles, autonomous driving, artificial intelligence, robotics, advanced materials and nanotechnologies will all have their increasing place in this new world. Energy storage devices, electrostatic as well as galvanic, will see big changes. However, sometimes we have to temper our enthusiasm about the rate at which these things will be adopted, but gradually adopted they will be. I have no doubt.

Possibly the greatest impact inside the Group will come from that fastest moving area of technology, ie electronics and the internet, with its underlying, sensing, algorithmic, computational and software elements. Those will have tremendous effects on virtually every product we make over the next 10 years.

Embracing the digital future

Smiths is making significant upfront investments in digital, including in centres of excellence in the US and Europe, to make sure we are properly prepared to respond to this emerging opportunity. These technological ideas are altering the way people think about the products they buy, about marketing, communications, healthy eating, entertainment, transportation etc. In a not-too-distant future, virtually all products and their components will be tracked and traced and automation, robotics, linked intelligent self-diagnosing and self-correcting devices will be features of our daily lives. All companies need to be better prepared for the challenges of cyber security, since many of these devices are going to be connected to the Internet and communicate with us and with each other. We can either prepare for this future or be run over by it.

The solution to all creative problems requires a blend of optimism, curiosity, imagination and relentless execution. The optimism is needed to believe that something can be done, imagination is required to create it, and curiosity is required to identify it when it's finished and lastly, relentless execution is needed to achieve it. These factors will increasingly become features of our company culture. No matter what the company does, it will always be world-class talent which is the greatest need. Nothing in the company ever gets done except through people.

Repositioning our portfolio

In terms of progress along this pathway, the past year has seen steady execution towards building a vibrant and faster-growing Smiths, reminiscent of the high-growth innovative company which existed around a half a century or more ago. To this end, in FY2017 we've made one major acquisition in the detection business, Morpho Detection, and trimmed the company's portfolio by selling four other non-core pieces of the portfolio where the chance to drive strong growth seemed less obvious. This has resulted in the Group being about the same size as it was a year ago, but with much better growth prospects. We are investing in new product platforms everywhere and as these products are released to market, they will accelerate our growth and competitiveness.

We've also made improvements in our use of working capital, with a £85m reduction this past year. Much more has yet to be done here. We made excellent progress in our pension plan and in getting the kind of leadership we need in key places around the Group. As far as innovation is concerned, there's always a longer lead time than we'd like before we see the green shoots.

I know from past experience that if we continue down this innovation pathway the growth will come, additional value will be created and a much happier and better Group.

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

SIR GEORGE BUCKLEY
CHAIRMAN

IF WE CONTINUE DOWN THIS INNOVATION PATHWAY THE GROWTH WILL COME, ADDITIONAL VALUE WILL BE CREATED

CHIEF EXECUTIVE'S REVIEW

—

SUSTAINABLE GROWTH AND ATTRACTIVE RETURNS ARE WHAT WE'RE ABOUT. WE'VE MOVED FORWARD ON REPOSITIONING THE PORTFOLIO AND ESTABLISHING THE ORGANISATIONAL BUILDING BLOCKS TO DELIVER ON OUR AMBITION.

ANDY REYNOLDS SMITH
CHIEF EXECUTIVE

REVENUE
DOWN 1%

£3,280M

FREE CASH-FLOW

£370M

Smiths has seen a year of good progress, amidst a world of uncertainty and an unprecedented pace of technology development.

I set out my ambition of establishing Smiths as one of the world's leading technology companies in September 2016, and we've spent the past 12 months doing what we said we were going to do.

FY2017 performance

We delivered a good performance in FY2017, with underlying revenue broadly in line with the prior year. We saw growth across the portfolio offset by John Crane's oil & gas business and in Smiths Medical due to market challenges in John Crane and a delay in some new product launches in Smiths Medical. Group revenue grew 11% on a reported basis, benefiting from foreign exchange, and in particular the strength of the US dollar, partially offset by the impact of four divestitures and the acquisition of Morpho Detection.

The underlying quality of our businesses and the increasing impact of the Smiths Excellence System supported a strong headline operating profit performance of £589m, up 3% on an underlying[1] basis and up 16% on a reported basis. The Group's headline operating profit margin increased 70 basis points on a reported basis, with margin expansion in all divisions reflecting our focus on operational efficiency and the upgrading of the portfolio.

Strategy update

We've made good progress against our strategic objectives of outperforming our chosen markets and delivering world-class competitiveness, supported by our strong financial framework.

Sustainable growth and attractive returns are what we're about and we've moved forward on repositioning the portfolio and establishing the organisational building blocks to deliver on our ambition. This is helping to establish Smiths as a high-performing diversified Group with high-quality businesses that are well-positioned in growing markets, with active portfolio management, a clear operating model, and a culture of relentless execution and continuous improvement.

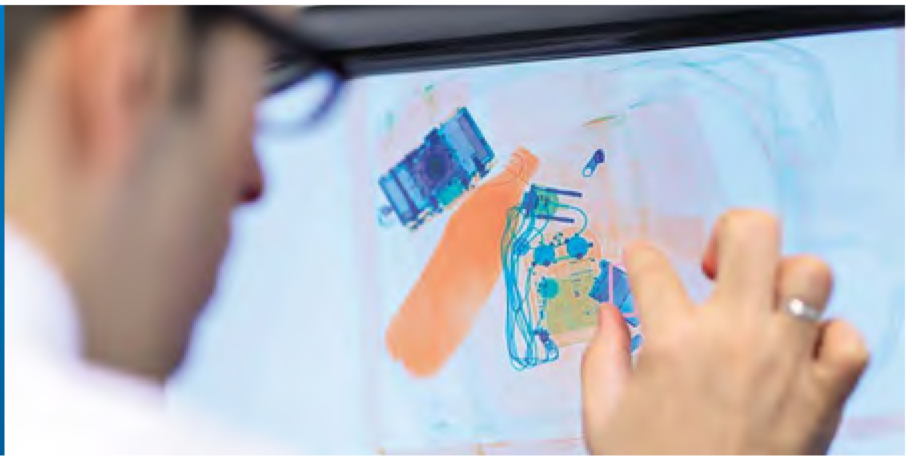
Outperforming our chosen markets

The repositioning of the business for growth through organic and inorganic investment is well underway and we have made excellent progress. With the sale of four non-core assets and the completion of the Morpho Detection acquisition – creating a true world leader in this market – around 75% of our portfolio is now well positioned by market and competitiveness, up from 60% eighteen months ago, and we expect further progress in the coming year.

Our goal is a portfolio of businesses that hold sustainable top three positions in attractive markets and demonstrates the key characteristics of a Smiths business: asset-light and competitive operations, technology differentiation, a high proportion of aftermarket revenues and increasing digitisation. Organic growth will always be my top priority but we expect to run a carefully considered parallel path of acquisition and divestiture to accelerate our repositioning globally.

An example of our work to reposition the portfolio is the focusing and restructuring of Smiths Interconnect.

AROUND 75% OF OUR PORTFOLIO IS NOW WELL-POSITIONED BY MARKET AND COMPETITIVENESS, UP FROM 60% EIGHTEEN MONTHS AGO



CHIEF EXECUTIVE'S REVIEW
CONTINUED

DEVELOPING A CULTURE OF INNOVATION WITH AN ECOSYSTEM TO DRIVE FASTER DEVELOPMENT AND COMMERCIALISATION OF NEW PRODUCTS IS CRUCIAL TO OUR SUCCESS TODAY AND TOMORROW

CONTINUING STATUTORY EARNINGS PER SHARE

144.1P

DIVIDEND

43.25P

We sold non-core assets representing around 40% of revenue and the remaining core is now positioned as a faster-growing leader in high-speed secure connectivity for demanding markets such as space, defence and commercial aerospace, and ready to develop further. There are similar examples elsewhere in the portfolio.

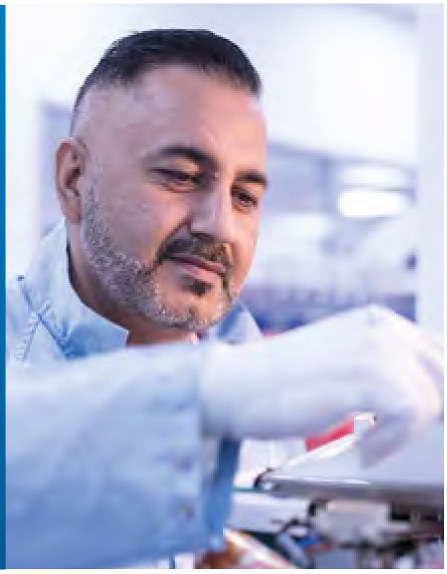
We have also increased our focus on key higher-growth regions, including relocating one of our Executive Committee members, Roland Carter, to Asia as Smiths Group President of Asia Pacific to head up our growth drive in the region.

Driving world-class competitiveness

As we increasingly focus the Group on the most attractive end markets with good long-term profitable growth prospects, it is critical that we establish the capabilities to ensure relentless execution. This has been a priority during the last year and we have been driving three areas: operational excellence, innovation and people. Many years in the hard-fought automotive world have taught me that all customers, whatever their industry, value speed and efficiency, and that's the essence of the Smiths Excellence System (SES).

SES gives us a shared operating model that will help us to apply best practice to drive speed, efficiency and a culture of continuous improvement, right across the Group. Results are already starting to come, with around £40m in procurement savings and an £85m reduction in working capital of which £52m is reduction in total stock over the past year, helping us to fund investment in growth. And I'm convinced there is more to follow over the next 12 months and beyond.

WE HAVE INCREASED OUR R&D SPEND TO 4.6% OF REVENUE AND CREATED A CENTRAL INNOVATION FUND TO BUILD DIGITAL CAPABILITY



Technology is moving faster than ever before and we're committed to being at the cutting edge. It's essential that we're technology leaders, defining new ways to bring value to our customers and developing new business models for the future.

Developing a culture of innovation with an ecosystem to drive faster development and commercialisation of new products is crucial to our success today and tomorrow. Our Group-wide innovation framework, i^3, will consistently drive increased, smarter investment in R&D and convert it into sales more quickly. I believe that it will differentiate us in our markets, make our customers happier and make us sustainable. We have already increased our R&D spend to 4.6% of revenue and created a central Innovation Fund to build digital and other disruptive technology capabilities – such as 3D printing and nano technology – and create critical mass where individual divisional efforts would be sub-scale.

We have announced two digital forges, with one in Silicon Valley and another planned in London, to help accelerate our digital transformation. These forges are global centres of excellence, helping us define new digital business models and build Group-wide capability in areas of focus including artificial intelligence, analytics and data security.

WE'VE MADE GOOD PROGRESS ON OUR JOURNEY TO ESTABLISH SMITHS AS ONE OF THE WORLD'S LEADING TECHNOLOGY COMPANIES

This is not just about planning for the future – we are already generating meaningful revenue from digital. Nor is it just digital technology to complement existing businesses – it's about defining new business models for the future and ensuring we are ahead on the capabilities they will require.

I was also pleased to announce our strategic partnership with Microsoft to further accelerate our market-leading artificial intelligence-based detection capability in the ports and borders market.

The final, critical area of focus for us is people – our one true source of sustainable competitive advantage.

Our people plan is aimed at building a learning organisation that attracts, retains, develops, engages and inspires the very best people around the world to deliver our ambition. We've made good progress during the year, including launching a new leadership development programme in partnership with UCLA Anderson Executive Education, a new approach to measuring employee engagement, a Group-wide communication plan to help everyone understand the part they play, and the adoption of our new 'Smiths Way' of working, including shared values and approaches to how we do things across the world.

Those shared values of integrity, respect, ownership, customer focus and passion underpin our commitment to doing the right thing, every time, no matter our role. Keeping our people safe is our top priority and I'm particularly proud of our performance this year, with our lowest ever Recordable Incident Rate. That said, I truly believe that any injury is one too many and we will continue to strive for our goal of zero harm.

Looking ahead

The progress delivered in executing our strategy through portfolio repositioning and disciplined organic and inorganic investment has ensured that we're well positioned for the Group to return to growth in FY2018. As in previous years, we expect Group performance in FY2018 to be weighted towards the second half. Growth in John Crane's non-oil and gas markets, as well as an increase in aftermarket activities, is expected to more than offset the challenging market conditions in oil and gas. We expect the introduction of new products during the year to support a gradual improvement in Smiths Medical. In Smiths Detection we anticipate a strong second half-driven by the transportation market, which will generate good growth for the year as a whole. In Smiths Interconnect, our focus on fewer, higher-growth end markets will support further good progress in this division, while Flex-Tek is expected to deliver continued steady growth.

We are increasingly confident that we're establishing the operating model for excellence and leadership capability to deliver long-term sustainable growth and attractive returns.

Dividend

The Board is recommending a final dividend per share of 29.70p, giving a total dividend for the year of 43.25p, an increase of 3% year-on-year. The final dividend will be paid on 17 November to shareholders registered at close of business on 20 October. The ex-dividend date is 19 October.

We've made good progress on our journey to establishing Smiths as one of the world's leading technology companies over the past year and I'd like to sincerely thank my 22,000 colleagues around the world for their dedication, contribution and absolute professionalism. I look forward to reporting further progress in the coming months.

ANDY REYNOLDS SMITH
CHIEF EXECUTIVE

CHIEF FINANCIAL OFFICER'S REVIEW

—

OUR FINANCIAL STRATEGY IS DESIGNED TO SUPPORT THE DELIVERY OF THE WIDER CORPORATE STRATEGY. THIS FRAMEWORK AIMS TO OPTIMISE CASH GENERATION AND ALLOCATE CAPITAL TO SUSTAINABLE GROWTH OPPORTUNITIES, ENABLING US TO GENERATE SUPERIOR RETURNS.

BILL SEEGER
CHIEF FINANCIAL OFFICER

At the core of our financial strategy is a financial framework to generate cash-flow:

- operate an asset-light profile, with targeted investments and efficient working capital;
  - deliver sustainable operating margins across our businesses; and
  - demonstrate strong financial discipline, maintaining a stable investment-grade credit rating.

With the cash we generate, we aim to create superior returns by ensuring capital is invested in value enhancing opportunities:

- invest for growth in new technologies and products in our existing businesses;
- execute value creative acquisitions and dispose of our non core assets;
- operate a progressive dividend policy, with the aim of increasing dividends in line with the long-term underlying[1] growth in earnings and cash-flow; and
- maintain a net debt/headline EBITDA ratio at two times or less.

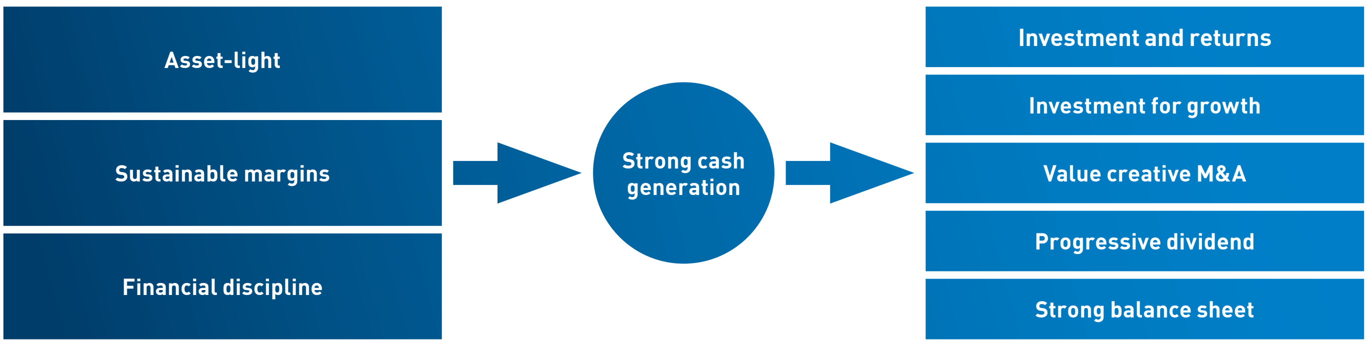
FY2017 performance overview

As a global business with a diversified portfolio, we are well placed to manage exposure to any specific sector or industry trend. This is reflected in our 2017 results, with a strong operating profit performance in four of our five divisions, offsetting the continued impact of the oil and gas market on John Crane. The Group headline operating profit margin increased 70 basis points to 18.0%.

Revenue

Reported revenue increased by £331m (11%) to £3,280m, including the positive effects of foreign currency translation (£421m) and the net impact of acquisitions and disposals (-£65m). On an underlying[1] basis, revenue declined 1% as growth in Smiths Detection (+£22m; 4%), Smiths Interconnect (+£4m; 1%) and Flex-Tek (+£11m; 3%) was offset by declines in John Crane (-£33m; -4%) and Smiths Medical (-£29m; -3%).

STRONG FINANCIAL FRAMEWORK



DIVISIONAL REVENUE

John Crane	27%
Smiths Medical	29%
Smiths Detection*	21%
Smiths Interconnect	13%
Flex-Tek	10%

DIVISIONAL HEADLINE OPERATING PROFIT**

John Crane	32%
Smiths Medical	33%
Smiths Detection*	16%
Smiths Interconnect	9%
Flex-Tek	10%

* Includes the results of Morpho Detection for the approximately four-month period since becoming part of the Group

** Excludes central costs

Operating profit

Headline operating profit of £589m was £79m higher than prior year (2016: £510m), including the positive effects of foreign currency translation (£71m) and the net impact of acquisitions and disposals (-£10m). On an underlying[1] basis operating profit increased 3%, with improvements in all divisions except John Crane. Headline operating margin increased by 70 basis points to 18.0% (2016: 17.3%), with improvements in all divisions reflecting operational efficiencies.

John Crane margin improved by 110 basis points to 23.0% (2016: 21.9%), benefiting from the disposal of the Artificial Lift business, favourable mix and operational efficiencies. Smiths Medical increased 60 basis points to 22.0% (2016: 21.4%) as the benefits of cost control, efficiencies and a medical device tax refund, offset lower revenue and pricing pressures. Smiths Detection delivered a 200 basis points improvement to 15.0% (2016: 13.0%), reflecting sales growth, increased focus on aftermarket and favourable mix. Morpho contributed £8m of operating profit in the period post acquisition. Smiths Interconnect improved operating margin by 30 basis points to 13.4% (2016: 13.1%) due to increased revenue, coupled with benefits from restructuring and a range of productivity and efficiency initiatives. Operating margins in Flex-Tek improved by 130 basis points to 19.3% (2016: 18.0%), reflecting the impact of increased revenue and efficiencies. Central costs increased by £13m including investment in corporate development activities, resources to support the Smiths Excellence System, and investment in people development, to build capabilities to support sustainable growth.

Operating profit on a statutory basis, after taking account of the items excluded from the headline figures, was £674m (2016: £387m) – see note 3 to the accounts for information on the excluded items. The increase was driven by the £175m profit on disposal of businesses during the year, coupled with a decrease in charges for legacy liabilities and no impairment charges being recorded in the current year.

Finance costs

Headline finance costs during the year totalled £61m, £2m higher than the previous year. This was principally due to adverse foreign exchange movements, partly offset by lower interest payable due to the repayment of the higher rate £150m 7.25% Eurobond which matured in June 2016. Statutory finance costs totalled £73m (2016: £41m).

Cash-flow and net debt

Operating cash generation remained strong, with headline operating cash-flow of £695m (2016: £520m), representing 118% (2016: 102%) of headline operating profit (see note 29 to the accounts for a reconciliation of headline operating cash and free cash-flow to statutory cash-flow measures). Net debt reduced from £978m to £967m.

We delivered a good financial performance in the year and our strong financial framework supports the optimisation of cash generation and capital allocation to focus on sustainable growth and superior returns. Further information on our financial performance is set out in the Financial Review on pages 52 to 57.

BILL SEEGER
CHIEF FINANCIAL OFFICER

1 Underlying excludes the effects of foreign exchange translation and acquisitions but includes divested business for the period they were owned in the reported financial year and adjusts the prior financial year comparator as if the divested business were owned for the same period in that financial year to aid comparability.

PIONEERING

Our advanced Checkpoint.Evo[plus] security screening and management platform integrates next-generation checkpoint scanners into a single, integrated and intelligent solution.

SECURITY

Our software streamlines security processes to increase passenger throughput, optimise resources, reduce operational costs, and improve security. It enables remote screening and directed search, as well as delivering valuable management data.

SMITHS BUSINESS MODEL

—

OUR BUSINESS MODEL ENABLES US TO DELIVER VALUE TO OUR STAKEHOLDERS ON A SUSTAINABLE BASIS

OUR AMBITION

OUR AMBITION IS TO ESTABLISH SMITHS AS ONE OF THE WORLD'S LEADING TECHNOLOGY COMPANIES.

OUR STRATEGY

We will achieve our ambition by outperforming our chosen markets and delivering world-class competitiveness and innovation, to deliver sustainable growth and attractive returns.

We actively manage our portfolio of businesses to ensure we are competitively positioned in attractive markets globally with strong long-term profitable growth prospects, where we can sustainably achieve a top three leadership position.

We will drive outperformance and competitiveness through innovation, our shared operating model that drives speed and efficiency across our value chain, and by building a learning organisation where our people can be the best they can be.

We are experts in our markets, with a strong understanding of customer needs.

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OUR DIVISIONS

Our divisions serve specialist technology markets worldwide and are unified by four common characteristics:

- sustainably competitive and asset-light
- technology differentiation
- increasing digitisation
- a high proportion of aftermarket services

JOHN CRANE

Mission-critical engineered solutions for global energy and process industries

SMITHS MEDICAL

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

SMITHS DETECTION

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

SMITHS INTERCONNECT

Solutions for high-speed, secure connectivity in demanding applications

FLEX-TEK

Innovative components to heat and move fluids and gases

P32-51

OUR

OUR SHARED VALUES OF INTEGRITY, RESPECT GUIDE OUR BEHAVIOUR, ACTIONS AND

OUR OPERATING MODEL

The Smiths Excellence System is our shared operating model. It helps us apply best practice across the Group to drive speed and efficiency on a sustainable basis, as we work to ensure consistent execution and a culture of continuous improvement.

CUSTOMER

We partner with our customers to steer our product innovation and technology development

PEOPLE

We work to attract, retain, engage, develop and inspire the best people to help us deliver results

TECHNOLOGY

We aim to bring innovative, differentiated solutions to market quickly

PRODUCTION

Our production processes drive efficiency, enhance safety and improve quality

PROGRAMME

We work to drive consistent and flawless execution across programmes

SUPPLY

We are building strong, strategic supplier relationships to ensure quality, efficiency and flexibility

FINANCIAL FRAMEWORK

Our strong financial framework provides the flexibility to enable us to create superior returns and invest in growth.

It helps us manage our business efficiently to optimise cash generation and allocate capital to the best organic and inorganic opportunities to create value.

We have a strong governance framework and robust approach to risk management and financial control.

P18

THE RESULT

As a globally aligned organisation that is committed to doing business responsibly, we generate value for a wide range of stakeholders around the world.

FINANCIAL VALUE

We generate superior shareholder returns on a sustainable basis, as well as delivering economic value where we operate around the world

SOCIAL VALUE

Our solutions meet customers' evolving needs and have a positive impact on the world, enhancing security, improving healthcare, advancing connectivity, driving efficiency and reliability, and reducing environmental impact.

We source components and materials from approximately 12,000 suppliers globally and expect our partners to meet our own high ethical standards.

We also support the communities in which we operate around the world

VALUE TO EMPLOYEES

We employ around 22,000 people in more than 50 countries, and give them the opportunity to be the best that they can be

VALUES

OWNERSHIP, CUSTOMER FOCUS AND PASSION DECISIONS EVERY DAY.

OUR STRATEGY

OUR AMBITION IS TO ESTABLISH SMITHS AS ONE OF THE WORLD'S LEADING TECHNOLOGY COMPANIES. WE WILL DO THIS BY DELIVERING ABOVE-MARKET SUSTAINABLE GROWTH IN OUR CHOSEN MARKETS AND WORLD-CLASS COMPETITIVENESS AND INNOVATION, SUPPORTED BY OUR STRONG FINANCIAL FRAMEWORK. DURING 2017 WE MADE SIGNIFICANT PROGRESS AGAINST OUR OBJECTIVES.

STRATEGIC OBJECTIVES

OUTPERFORMING OUR TARGET MARKETS

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

REVENUE £M/% growth

Year	£M	% growth
2017	3,280	(1)%
2016	2,949	(2)%
2015	2,897	(2)%

FOCUS

Reposition the portfolio for growth through organic investment and a highly disciplined approach to acquisitions and disposals

FY2017 PROGRESS

- Invested more and smarter in R&D and innovation
- Continued the realignment of the portfolio into profitable, higher-growth markets. Divestments included four non-core businesses – John Crane's Artificial Lift, Smiths Medical's Wallace product line, and Smiths Interconnect's Power and Microwave Telecoms
- Completed the acquisition of Morpho Detection, with integration on track, significantly enhancing our market-leading position and capabilities, without increasing net debt

FOCUS

Increase our focus on higher-growth regions

FY2017 PROGRESS

- Appointed a new Group President of Asia Pacific to accelerate our growth in the region
- Prioritised plans for growth, with a new operating model and leadership team for the region

DELIVERING WORLD-CLASS COMPETITIVENESS

Drive world-class competitiveness through:

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

We call this our Smiths Way of working.

FOCUS

Deliver the Smiths Excellence System (SES) – a shared operating model focused on continuous improvement, speed and efficiency

FY2017 PROGRESS

- Started the implementation of SES, with a focus on building capability to do what we do faster and better, whether it is designing new solutions, manufacturing, or getting products to our customers when they want it at the best levels of quality
- Good progress is being made on our key priorities across our six Excellence pillars of Customer, People, Technology, Production, Programme and Supply
- Reduced working capital, freeing up cash to invest in growth
- Continued to drive focus on safety, achieving our lowest annual Recordable Incident Rate (RIR) to date as we work towards a zero-harm workplace

WE USE A RANGE OF PERFORMANCE METRICS IN ORDER TO PROVIDE A CLEAR AND CONSISTENT MEASURE OF OUR UNDERLYING PERFORMANCE. WE FACE A NUMBER OF RISKS TO DELIVERING OUR STRATEGY AND OUR PRIORITIES SHOULD BE REVIEWED IN RELATION TO THESE. OUR PRINCIPAL RISKS AND MITIGATING ACTIONS ARE SET OUT ON PAGES 62 TO 67.

KEY PERFORMANCE INDICATORS	FY2018 PRIORITIES
PORTFOLIO POSITIONING 75% Around 75% of revenue now comes from well-positioned businesses in our attractive target markets (2016: 60%)	• Drive market share growth in the c. 75% of businesses that are well-positioned • Continue to improve or sell the remaining 25% of businesses • Move forward with the integration of the former Morpho Detection business • Maintain a disciplined approach to acquisitions that can materially enhance our capabilities and position
APAC REVENUE GROWTH AHEAD OF GROUP (0.9)% Incremental underlying growth in APAC less total underlying Group growth	• Continue to develop, embed and execute our new operating model and strategy for APAC
COST OF POOR QUALITY (COPQ) 2.1% COPQ includes the cost of waste, corrective work, warranty claims, returns and penalties, measured as a % of annual revenue. We are treating FY2017 as our baseline year for measuring COPQ using a common methodology across the Group **PROCUREMENT SAVINGS** £M/% £42M/3.4% Procurement savings measure the % saving achieved on potential spend during the year, including the cost impact of external market trends, negotiation with suppliers, changes in sourcing, value added value engineering and rebates	• Implement our top priority processes across each pillar • Continue to develop the next set of priorities across the pillars • Further enhance our safety culture and performance as we work towards a zero-harm culture

OUR STRATEGY CONTINUED

STRATEGIC OBJECTIVES	FOCUS	FY2017 PROGRESS
DELIVERING WORLD-CLASS COMPETITIVENESS (CONTINUED)	**Create a culture of innovation**	• i³, our Group-wide innovation framework, is fully operational and driving our innovation agenda • First projects approved under our central Innovation Fund to accelerate key projects to build technological capabilities that can be leveraged across Smiths • Completed 20-year horizon scans and roadmaps, developed key external partnership, and introduced a standardised New Product Introduction process across the Group • Appointed a new Group Head of Innovation and Chief Digital Officer
	Build a learning organisation	• Launched the Smiths Way to help embed a common way of working across Smiths • Launched a new leadership development programme in partnership with UCLA Anderson Executive Education to further enhance our leadership capabilities • Revised our incentive programmes to better align with our strategic priorities • Introduced a new approach to measuring employee engagement
STRONG FINANCIAL FRAMEWORK **Our strong financial framework underpins the delivery of our strategy and value creation by optimising cash generation and allocating capital to the best value creation opportunities.** **Our governance framework is supported by robust risk management and strong financial control to help maintain our investment-grade credit rating.**	**Deliver profitable growth with sustainable margins**	• Achieved operating profit margin increases in all divisions • The divestment of four non-core businesses and acquisition of Morpho Detection exchanged similar revenue that was declining for growing revenue with a higher margin • Drove operational excellence to protect margins and fund investment for growth
	Focus the portfolio on sustainably competitive and asset-light businesses	• Focus on cash generation and conversion enabled investment and value creation
	Apply strong financial discipline to the way we manage the business and invest	• Invested in value creation opportunities • Managed the balance sheet effectively, reducing working capital • Maintained an investment-grade credit rating • Morpho Detection acquisition was self-funded and will be accretive to growth, returns and EPS

KEY PERFORMANCE INDICATORS

INVESTMENT IN R&D AS A PERCENTAGE OF REVENUE %

2017	4.6
2016	4.0
2015	3.8

R&D expenditure includes the cost of projects that are being capitalised and customer-funded

FY2018 PRIORITIES

- Invest more and smarter in R&D, and convert it into new business faster
- Launch our first digital centre of excellence – or 'forge' – in the US, with a second planned in Europe, to accelerate our digital agenda across the Group
- Use the central Innovation Fund to support additional projects to drive technological differentiation
- Continue to build a culture of innovation through our i³ innovation framework

EMPLOYEE ENGAGEMENT

71

Employee engagement FY2017 My Say survey score, based on an average score for two questions assessing how happy employees are working at Smiths

- Continue to embed our values, strategy and operating model across Smiths, so that everyone understands their role
- Continue to progress on our people plan and improve attraction, retention and engagement through enhanced communication, development opportunities and employer branding
- Increase our focus on diversity and inclusion at all levels

HEADLINE OPERATING MARGIN %

2017	18.0
2016	17.3
2015	17.6

Operating margin is headline operating profit as a proportion of revenue. See note 3 to the accounts for the calculation of headline operating profit

REVENUE £M/% growth

2017	3,280	(1)%
2016	2,949	(2)%
2015	2,897	(2)%

Underlying excludes the effects of foreign exchange translation and acquisitions but includes divested business for the period they were owned in the reported financial year and adjusts the prior financial year comparator as if the divested business were owned for the same period in that financial year to aid comparability

CASH CONVERSION %

2017	118%
2016	102%
2015	95%

Cash conversion is headline operating cash-flow divided by headline operating profit

PORTFOLIO POSITIONING

75%

Around 75% of revenue now comes from well-positioned businesses in attractive target markets (2016: 60%)

RETURN ON CAPITAL EMPLOYED %

2017	16.2
2016	15.3
2015	16.0

The calculation of ROCE is defined in note 30 to the accounts

REDUCTION IN WORKING CAPITAL £M

2017	85
2016	9
2015	(38)

Cash generated from the change in working capital

CREDIT RATING

BBB+/Baa2

STABLE OUTLOOK

As issued by Standard and Poor's and Moody's

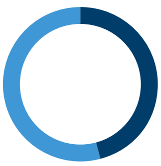
OUR MARKETS

WE SERVE SEVEN MAIN MARKETS WITH STRONG LONG-TERM PROFITABLE GROWTH PROSPECTS

Through our five divisions, we serve seven markets: medical technology, energy, security and defence, space and commercial aerospace, transportation, construction and general industrial.

Around half of our revenue is derived from servicing our customers' aftermarket needs or supplying consumables that are used as part of our customers' everyday procedures. This gives resilience to our revenues and provides strong cash-flows.

REVENUE MIX



- Original equipment sales 45%
- Aftermarket/ consumables 55%

MEDICAL TECHNOLOGY

Our largest single end market is medical technology. The majority of revenue comes from Smiths Medical, while both Smiths Interconnect and Flex-Tek supply components to medical device manufacturers. The medical technology market is driven over the long term by ageing populations, the increasing incidence of chronic diseases and increasing healthcare spending in developing countries. Some 82% of Smiths Medical's revenue is from single-use devices used in everyday hospital procedures. The remaining 18% of revenue is from capital equipment, such as infusion pumps.

SECURITY AND DEFENCE

Smiths Detection provides threat detection equipment that enhances safety and security for airports, ports and borders, urban security, military and emergency responder markets. Demand is driven in the medium term by growth in air travel and ongoing geopolitical unrest and associated terrorist and criminal threats, although there is considerable variation by geography and end market. The growing installed base creates opportunities for aftermarket and software upgrade revenues. The defence segment is served by both Smiths Detection and Smiths Interconnect, who provide a range of trace detection and mission-critical secure connectivity solutions respectively, and is primarily driven by spending on specific programmes in developed markets like the US.

ENERGY

This market is primarily served by John Crane, with oil and gas representing around 55% of its revenues. Long-term drivers include increasing global demand for energy and increasing environmental and safety requirements. John Crane's mechanical seals and seal support systems are primarily used in the process equipment found in downstream (eg refineries) and midstream (eg pipelines, gas storage, liquefied natural gas (LNG) transportation) applications. Demand for original equipment (36% of revenue) is affected by customer capital expenditure cycles, while aftermarket service (64% of revenue) depends on utilisation rates and equipment age. The drop in oil prices since late 2014 has reduced customer capital expenditure, but we have seen investment in growing areas such as LNG and pipelines and increased aftermarket demand due to pent-up maintenance and upgrade requirements.

SPACE AND COMMERCIAL AEROSPACE

Flex-Tek provides hydraulic hoses and fuel lines for airframes and aeroengines and Smiths Interconnect supplies connectors, microwave components and antenna systems for aircraft and satellite communications. Aerospace demand is driven by investment in new fuel-efficient aircraft and increasing passenger and freight traffic.

TRANSPORTATION

In the rail segment, Smiths Interconnect supplies cable solutions, ferrite components and connectors for communications, control command and signalling systems in autonomous trains. Growth is driven by increasingly sophisticated digital train systems, high data-rate connectivity for passengers and the distribution of high levels of electricity to support the power demand of these systems. In the automotive segment, Flex-Tek supplies hoses for fuel and brake fluid delivery.

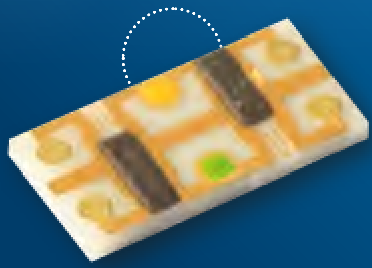
CONSTRUCTION

Flex-Tek manufactures a range of products such as flexible gas piping and ducting for Heating Ventilation and Air Conditioning (HVAC) applications that are used in the construction of homes and commercial buildings, primarily in the US. Demand for homes for families is driven by population growth.

GENERAL INDUSTRIAL

We serve a range of general industrial sectors including petrochemical, mining, pulp and paper, water treatment, semiconductor test, heating elements and automotive, through John Crane, Smiths Interconnect and Flex-Tek. There are different drivers for each of these markets but overall they tend to track GDP.

ADVANCING



Highly reliable and durable, our Thermopad attenuators help customers reach higher frequencies in the face of congestion in broadcast spectrums for wireless communications and when in orbit for communication satellites.

CONNECTIVITY

Our attenuators help ensure the reliability of mission-critical communications systems in telecoms, defence and space applications.

JOHN CRANE

MISSION-CRITICAL ENGINEERED SOLUTIONS FOR GLOBAL ENERGY AND PROCESS INDUSTRIES

CUSTOMERS
We serve process industries including oil and gas, chemical, power generation, and pulp and paper, as well as pump and compressor OEMs. Our customers include Chevron, International Paper, ExxonMobil, Shell, BASF, Sulzer, GE, and Siemens.

PRINCIPAL OPERATING REGIONS
We have operations in more than 50 countries, including around 200 sales and service centres, and manufacture in 14 countries.

COMPETITORS
Our main competitors are Flowserve and Eagle Burgmann (seals), Kingsbury and Waukesha (engineered bearings), Danaher and Hydac (filtration), and Rexnord (couplings).

SUPPLIERS
We align purchasing across our global supply chain to leverage regional suppliers. Direct sourcing includes metals, ceramics, and advanced materials and parts.

REVENUE BY SECTOR

- Oil and gas c.55%
- Non-oil and gas c.45%

REVENUE PERFORMANCE £M
£885M

Year	£M
2017	**885**
2016	830
2015	905

DID YOU KNOW...
Our Metastream couplings help rotating equipment run smoothly and have been used by the British Navy for nearly 60 years

REVENUE IN 2017
DOWN 4%[1]

£885M

HEADLINE OPERATING PROFIT
DOWN 4%[1]

£204M

STATUTORY OPERATING PROFIT

£190M

HEADLINE OPERATING MARGIN

23.0%

John Crane provides mission-critical solutions for pumps, compressors, and other rotating equipment across process industries.

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

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

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

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

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

We also have a significant and growing presence in other process industries (around 45% of revenue), including chemical, power generation, water and wastewater, and pulp and paper. We expect these verticals will continue to grow in the near term, helped by building demand in higher-growth regions. Although global industrial production forecasts remain cautious due to an uncertain macro-environment, drivers such as improved plant productivity, workforce safety and equipment reliability will continue to create growth opportunities over the medium to long term.

Around 64% of our sales stem from the aftermarket servicing and support of existing installed equipment, which has proven resilient. We continue to expand our footprint through opening new service centres in selected higher-growth markets.

GROWTH DRIVERS

- Need for operational improvements in non-oil and gas process industries
- Pent-up demand for maintenance and upgrades in oil and gas and petrochemical
- Expansion in high growth markets
- Disruptive innovations including materials science advancements and digital transformation of industry

COMPETITIVE STRENGTHS

- A market leader in mechanical seals
- Strong proprietary technology and expertise in applied engineering
- Market-leading aftermarket service offering, with around two-thirds of sales in aftermarket
- One of the largest global service networks in the mechanical seal industry, with c. 200 sales and service centres

JOHN CRANE
CONTINUED

WE HAVE A LEADING AFTERMARKET SERVICE OFFERING AND ONE OF THE LARGEST GLOBAL SERVICE NETWORKS IN THE MECHANICAL SEAL INDUSTRY

DID YOU KNOW...

Every year our upstream pumper seals for the chemical, oil, paper and water treatment industries help conserve up to 1.3 billion litres of water in the US alone

INVESTMENT IN NEW PRODUCT DEVELOPMENT
UP 17%

£10M

OUR STRATEGY

Strategy

Our strategy is to reinforce our global leadership in technologies and services for rotating equipment with a competitively differentiated offering that will deliver above-market long-term growth in the most attractive process industries. We will maintain differentiation by investing in product development, broadening our aftermarket value proposition, delivering operational excellence (with a particular focus on safety and quality), and accelerating growth through bolt-on acquisitions. We will also continue to diversify into non-oil and gas segments and higher-growth regions.

Progress in FY2017

- Investment in digital transformation technology for John Crane Sense, our predictive diagnostics platform, with around 30 field trials currently in operation
- Product development for non-oil and gas markets including launch of Single Use Seal
- Successful divestment of Artificial Lift business
- Continuous improvement and lean manufacturing initiatives reducing waste
- Integration of Asset Management business into Performance Plus aftermarket offering

Priorities for FY2018

- Continue expansion in selected process industries, leveraging sales, marketing and product development
- Develop new products and expand more into innovative digital technologies
- Maximise aftermarket performance and expand our service offering
- Build out selected high-growth markets
- Enhance productivity and cost competitiveness throughout the supply chain

FY2017 FINANCIAL PERFORMANCE

	2017 £m	2016 £m	Reported growth	Underlying growth
Revenue	**885**	830	7%	(4)%
Headline operating profit	**204**	181	12%	(4)%
Headline operating margin	**23.0%**	21.9%	110bps	
Statutory operating profit	**190**	151	26%	
Return on capital employed	**22.9%**	20.3%	260bps	

Performance

Growth in John Crane's non-oil and gas and aftermarket revenue was offset by declines in its oil and gas activities that were impacted by the difficult conditions throughout global energy markets. On an underlying[1] basis total revenue fell 4%. Reported revenue increased 7%, with favourable foreign exchange translation benefits partially offset by the impact of the divestment of the Artificial Lift business that refocused John Crane onto its core end markets and higher-margin businesses.

John Crane continued its expansion into non-oil and gas industries, which now represent c. 45% of total revenue, with sales up 2%, on an underlying[1] basis. This was offset by reduced oil and gas underlying[1] sales, down 7% reflecting the challenging market conditions. These market conditions also impacted total Original Equipment (OE) underlying[1] sales that fell 11% during the year. We remain focused on increased investment in OE projects and expanding the installed base with multiple new project agreements secured during the year, particularly in the Middle East. John Crane's large installed base and market-leading service offering ensured it is well positioned to satisfy the pent-up aftermarket requirements for repairs, maintenance and upgrades, driving 1% growth in underlying[1] aftermarket revenue. Aftermarket represented 64% of total revenue during the year (2016: 59%). A number of significant contract wins across oil and gas customers, as well as smaller retrofit and upgrades with municipal water companies and power plants led to an increased aftermarket order book.

Revenue from higher-growth regions represented 24% of sales, broadly in line with the prior year on an underlying[1] basis, despite lower activity in certain parts of Latin America.

Headline operating profit was down 4% on an underlying[1] basis, as lower sales and strategic investments in OE projects were only partially offset by operational efficiencies. Headline operating profit margin increased by 110 basis points to 23.0% benefiting from the disposal of Artificial Lift and continued operational efficiencies. The difference between statutory and headline operating profit primarily reflects £7m restructuring and £9m litigation costs net of the £4m gain on the sale of the Artificial Lift business.

Return on capital increased 260 basis points to 22.9%, principally due to reduced assets following the disposal of Artificial Lift.

The divestiture of the Artificial Lift business in November 2016 significantly reduced John Crane's exposure to the commoditised aspects of upstream oil and gas and was margin accretive. Prior to the sale in November, Artificial Lift sales were £12m, with an operating loss of £2m, and net assets were £24m. The business performance of Artificial Lift up to the date of divestiture is included within the financial summary and results presented above.

Research and development

Research and development expenditure increased by 17% to £10m resulting in several new product launches, including:

- the introduction of a range of high performance aftermarket replacement filter elements;
- an innovative new pipeline seal engineered to withstand the harsh abrasive and clogging fluid properties of crude oil; and
- two new coupling designs that enhance the protection of critical rotating equipment assets.

Active areas of research include: the use of nano-materials to enhance seal face performance, and investment in our dry gas seal development facilities enabling ultra-high pressure gas seal testing capability. We continue to further develop Sense, our predictive diagnostics platform, with the installed base of around 30 field trial units, which has grown from five units in 2016, demonstrating excellent performance results and a fast growing customer demand for additional units.

1 Underlying excludes the effects of foreign exchange translation and acquisitions but includes divested business for the period they were owned in the reported financial year and adjusts the prior financial year comparator as if the divested business were owned for the same period in that financial year to aid comparability

DRIVING DIVERSIFICATION

Leveraging our century of engineering expertise in mission-critical components and extensive global service footprint, FY2017 has seen John Crane successfully expand our presence in non-oil and gas markets around the world.

Through focused account management and partnerships with OEMs, we are helping customers across process industries including chemical, power generation, water and wastewater, and pulp and paper, among others, to improve reliability, maximise uptime and reduce operating costs. Non-oil and gas now accounts for c. 45% of revenue – with a strong aftermarket component – and further expansion is a core priority for FY2018.

SMITHS MEDICAL

HIGH-QUALITY, COST-EFFECTIVE MEDICAL DEVICES AND CONSUMABLES THAT ARE VITAL TO PATIENT CARE GLOBALLY

CUSTOMERS
Three-quarters of our revenue is derived from hospitals, while the remainder comes from surgery centres, clinics, home care providers and products sold to other OEMs.

PRINCIPAL OPERATING REGIONS
We sell our products in over 120 countries with operations in over 30, with manufacturing in North America, Europe and Asia.

REVENUE BY SECTOR

- Infusion Systems 32%
- Vascular Access 33%
- Vital Care and Specialty Products 35%

REVENUE PERFORMANCE £M
£951M

2017	951
2016	874
2015	836

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

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

DID YOU KNOW...
We pioneered safety devices including the first safety peripheral IV catheter and port for delivering chemotherapy.

REVENUE IN 2017
DOWN 3%[1]

£951M

HEADLINE OPERATING PROFIT
UP 8%[1]

£209M

STATUTORY OPERATING PROFIT

£286M

HEADLINE OPERATING MARGIN

22.0%

Smiths Medical's portfolio incorporates established brands and strong positions in select segments of the Infusion Systems, Vascular Access and Vital Care markets.

A combination of capital equipment and consumables, as well as growing software and service offerings, provides diversity within our portfolio, and continuous access to customers.

Markets and trends
The medical device industry remains very attractive. The global market we serve is estimated to be £6bn and growing at about 3% annually, with long-term trends such as a growing, ageing global population, increasing incidence of chronic diseases, a growing middle-class in developing countries, and increased access to healthcare offsetting budget constraints in developed markets, pricing pressure, provider consolidation and growing regulatory requirements.

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

Our Vascular Access products protect healthcare workers and patients from the risk of infection. Our portfolio covers a range of functions, including drawing blood, infusing fluids via catheters, injecting vaccinations (Jelco and Portex), delivering chemotherapeutic agents (Deltec) and monitoring blood pressure for critically ill patients (Medex). The Vascular Access market is expected to grow due to safety legislation producing initiatives for the use of safety-engineered syringes to protect healthcare workers from needlestick injuries and the drive to reduce hospital-acquired infections, a growth we're well positioned to serve.

Our Vital Care products help to manage patient airways before, during and after surgery, alleviating breathing difficulties (Portex), improving bronchial hygiene (Acapella) and helping maintain body temperature (Level 1 and Equator). Drivers include the expansion of enhanced recovery after surgery and the prevalence of chronic obstructive pulmonary disease (COPD).

GROWTH DRIVERS

- Ageing populations with increasing life expectancy and quality of life expectations
- Growing incidence of chronic diseases
- Increasing need for interoperable and connected systems
- Growth of alternate site and home-based medical care
- Rising healthcare spend in developing markets, offsetting budget constraints in developed markets

COMPETITIVE STRENGTHS

- Category leadership in our chosen markets
- Highly recognised and respected brands
- Category breadth and depth, including capital, consumable and software products
- Reputation for quality and safety
- Extensive global sales network

SMITHS MEDICAL
CONTINUED

OUR GLOBAL MARKET IS ESTIMATED AT AROUND £6BN AND GROWING AT ABOUT 3% ANNUALLY

DID YOU KNOW...
Our tracheostomy tubes help patients as small as a premature baby weighing 1 kg to a rhinoceros weighing 2,000 kg

INVESTMENT IN NEW PRODUCT DEVELOPMENT
UP 16%

£61M

OUR STRATEGY

Strategy
Our objective is to achieve category leadership in the infusion systems segment and in selected vascular access and vital care segments. We will build on our reputation for high-quality, innovative solutions, creating a portfolio of leading products and services that drive sustained competitiveness and above-market growth in our chosen segments. We will achieve this primarily through a pipeline of innovative organic developments, including investment in product development, manufacturing and supply chain optimisation, and efficiency gains in marketing and distribution models. We will also continue to drive progress in higher-growth regions and new channels to market outside the hospital. We will continue to review opportunities to accelerate growth through acquisitions.

Progress in FY2017
- Divested the Wallace product line to sharpen portfolio focus
- Expanded presence in higher-growth regions
- Increased digital capabilities and initiatives
- Invested in differentiated technology development

Priorities for FY2018
- Launch differentiated new products in our priority categories
- Focus on building category leadership
- Enter higher-growth, adjacent categories
- Advance sales with alternate sites and homecare providers
- Increase penetration in higher-growth regions
- Consider inorganic opportunities to build category scale and competitiveness

FY2017 FINANCIAL PERFORMANCE

	2017 £m	2016 £m	Reported growth	Underlying growth[1]
Revenue	**951**	874	9%	(3)%
Headline operating profit	**209**	187	12%	8%
Headline operating margin	**22.0%**	21.4%	60bps	
Statutory operating profit	**286**	166	72%	
Return on capital employed	**16.7%**	15.7%	100bps	

Performance
During the year Smiths Medical made progress on the ongoing repositioning of its portfolio, and increased targeted investment in its key product categories to address the historic underperformance in its product portfolio to support core-market category leadership. Underlying[1] revenue was down 3%, driven by softer performances in Infusion Systems and Vascular Access, where the product portfolios are in the process of being revitalised and expanded. Reported revenue grew 9%, with favourable foreign exchange translation benefits partially offset by the impact of the divestment of the Wallace product line and the underlying revenue softness.

Underlying[1] revenue declined by 3% in Infusion Systems due to lower sales in hospital infusion hardware and disposables, and a slower than anticipated transition to advanced technology ambulatory pumps in the home infusion market. Vascular Access underlying[1] revenue declined by 4% as growth in cardio thoracic was offset by declines in sharps safety and peripheral intravenous catheters (PIVC). Underlying[1] revenue from Vital Care and Specialty Products was down 2%, with continued growth in tracheostomy and respiratory COPD products being offset by declines in temperature management and commoditised anaesthesia products.

Sales into higher-growth regions decreased 12% on an underlying[1] basis. This decrease was driven by a one-off regulatory situation in China which has now been resolved.

Headline operating profit grew 8% on an underlying[1] basis with operational efficiencies and a medical device tax refund more than offsetting the impact of the revenue declines and downward pricing pressure on older products. The headline operating margin of 22.0% was 60bps higher than the prior year. The difference between statutory and headline operating profit reflects £16m of restructuring charges, £6m amortisation of intangible assets, and a £100m gain on the sale of Wallace.

Return on capital employed increased 100bps to 16.7%, reflecting improved profitability that supported greater capital expenditure in new product development, capacity and manufacturing efficiency.

In November 2016 Smiths Medical divested the Wallace product line as part of an ongoing programme to focus the portfolio on scalable, technology-differentiated leadership positions in its chosen markets. Prior to the sale, Wallace revenue was £5m, with operating profit of £4m and net assets sold were £32m. The business performance of Wallace up to the date of divestiture is included within the financial summary and results presented above.

Research and development
During the year Smiths Medical increased investment in research and development to support future growth, with the development of innovative, commercially focused products across the portfolio generating a strong pipeline of products due to be launched in FY2018 and beyond. Research and development expenditure increased to £61m (2016: £52m), representing 6.4% of sales (2016: 6.0%). Specific developments included:

- within Infusion Systems, enhanced digital and information security capabilities, in particular wirelessly enabling the CADD line of ambulatory infusion pumps to connect to the PharmGuard server software, which received FDA clearance post year end;
- differentiated technology developments in Vascular Access including the Closed Blood Sampling System, the Jelco Seriva and ViaValve Winged Safety peripheral catheters and the Delta Ven Closed System catheter; and
- a strong pipeline of new products in Vital Care, particularly in the tracheostomy product lines.

1 Underlying excludes the effects of foreign exchange translation and acquisitions but includes divested business for the period they were owned in the reported financial year and adjusts the prior financial year comparator as if the divested business were owned for the same period in that financial year to aid comparability

BREATHING MORE EASILY

Patients come in all ages, shapes and sizes, so our Bivona tracheostomy tubes are fully customisable, providing the flexibility to fit each patient's unique requirements. By combining malleable, medical-grade silicone with spiral wire reinforcement, this innovative solution allows the tube to adapt to a patient's anatomy while also maintaining airway diameter.

Unique in a market of disposables, our Bivona tubes [for adult patients] can be cleaned and sanitised for reuse up to 10 times, giving a lifecycle of almost 11 months, a significant advantage in the homecare sector.

SMITHS DETECTION

A LEADER IN THE DETECTION AND IDENTIFICATION OF SECURITY THREATS AND CONTRABAND

CUSTOMERS
The majority of revenues are influenced by over 100 governments and their agencies. The acquisition of Morpho Detection significantly enhances our market-leading positions and expands the product portfolio.

PRINCIPAL OPERATING REGIONS
We sell our products to around 200 countries and territories, with manufacturing facilities in Germany, France, Malaysia, USA and the UK.

REVENUE BY SECTOR


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

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

REVENUE PERFORMANCE £M
£687M

DID YOU KNOW...
Our trace detectors can identify a billionth of a gram of explosives on a person's hands.

REVENUE IN 2017
UP 4%[1]
£687M

HEADLINE OPERATING PROFIT
UP 21%[1]
£103M

STATUTORY OPERATING PROFIT
£70M

HEADLINE OPERATING MARGIN
15.0%

Smiths Detection is a leader in its sector and produces equipment for customers in the air transportation, ports and borders, urban security and military end-use markets.

Markets and trends

Demand for our detection equipment and service is forecast to continue to grow at mid-single digits per annum over the near term, driven by ongoing geopolitical unrest and the resulting terrorist and criminal threats, but there is considerable variation by geography and end-use market. The majority of customers are government-funded so budget constraints affect market revenues. Nevertheless, our growing installed equipment base creates significant opportunities for aftermarket (service and support) and digital revenues through the sale of software upgrades.

The heavily regulated air transportation sector is our largest market. Rising passenger volumes, together with continuing security threats, a strong replacement cycle and increasing air freight volumes from continuing globalisation of trade are expected to continue to support market growth and new airport investment. Integrated, networked systems of screening equipment and airport information are being used to improve the efficiency and effectiveness of the security process, resulting in increased demand.

In the ports and borders market, continuing globalisation of trade, combined with increasing regulatory standards, will drive the growth in demand for security screening equipment and digital solutions that can integrate a disparate installed equipment base. Powerful technologies are required to address a variety of threats as governments become increasingly concerned about the smuggling of explosives, weapons and radiological materials, while continuing to recognise the strong revenue-generating potential from contraband detection.

The urban security market is large, but fragmented and unregulated. Growth in demand continues as public and private sector organisations seek to provide better protection for their assets and staff in response to a wide and ever-increasing range of threats.

Global demand for chemical warfare agent detection equipment and other threat-specific sensors required by the military is forecast to grow steadily in our key NATO-oriented markets.

GROWTH DRIVERS

- Persistent and evolving terror threats
- Changing security regulations for air cargo and passengers
- Equipment replacement cycle, typically 7–10 years
- Software-driven solutions providing functionality, networking and systems integration
- Growth of security infrastructure in emerging markets

COMPETITIVE STRENGTHS

- A market leader with a strengthened global position following the Morpho acquisition
- Operate in several regulated markets requiring product certification
- Technologies leveraged across many markets and applications
- Growing aftermarket revenues (39% of total)

SMITHS DETECTION
CONTINUED

ADVANCING TRANSPORT SECURITY

Airports, airlines and authorities around the world trust our deep expertise in designing and servicing integrated detection solutions. In the past twelve months, we have secured orders for hold baggage screening Explosives Detection Systems (EDS) worth over £80 million from airports in the Americas, Middle East and Europe.

Our next-generation scanners combine high-resolution X-ray technology, medical quality computed tomography and advanced detection algorithms to deliver exceptional levels of security and efficiency, while the ability to upgrade software to combat evolving threats helps to future-proof our customers' infrastructure investments.

OUR STRATEGY

Strategy

Customers choose to partner with us because we can equip them with high-integrity solutions that satisfy their security needs, while meeting broader commercial and operational requirements.

Highly targeted investment in products and software development should enable us to outperform our chosen markets. We continue to grow our aftermarket and digital solutions/upgrade offer – an increasingly important source of profitable revenue, which counteracts the volatility of prime contracting.

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

Progress in FY2017

- Focused investment in air transportation (hold baggage and checkpoint)
- Delivery of customer-oriented products and integrated, networked solutions
- Extending product certification in response to customer demand
- Implementation of lean standards, eliminating waste, improving flow and reducing working capital
- Key digital product launches: CORSYS, EDS CB upgrades and Checkpoint.Evo^{plus}

Priorities for FY2018

- Continue the integration of Morpho Detection and deliver planned phased savings
- Strengthen sales channels in all regions
- Drive R&D investment behind key product initiatives
- Deliver further growth in aftermarket and digital revenues
- Implement additional continuous improvement initiatives

FY2017 FINANCIAL PERFORMANCE

	2017 £m	2016 £m	Reported growth	Underlying growth
Revenue	**687**	526	31%	4%
Headline operating profit	**103**	69	50%	21%
Headline operating margin	**15.0%**	13.0%	200bps	
Statutory operating profit	**70**	63	12%	
Return on capital employed	**12.6%**	11.9%	70bps	

Performance

Smiths Detection's market-leading position in growing markets drove an underlying[1] revenue increase of 4%, in particular in the air transportation market and in the Asia Pacific region. Focus on aftermarket supported growth in revenue and aftermarket revenue now accounts for 39% of total revenue (2016: 37%). On a reported basis, revenue grew by 31%. This included £62m revenue from the acquisition of Morpho Detection (Morpho), which completed in April 2017 and is now being integrated, as well as favourable foreign exchange translation benefits.

Underlying[1] revenue in air transportation increased 9%, with strong growth in EMEA and Asia, including deliveries to Berlin Brandenburg Airport and revenue from long-term contracts in Abu Dhabi. Contract wins during the year include orders for 85 CT hold baggage scanners for Amsterdam Airport Schiphol, London Gatwick Airport, Cochin International Airport, EL AL Airlines and by the US Transportation Security Administration (TSA). Post year end we have also won two additional contracts for orders totalling 55 CT scanners for Frankfurt Airport and Narita International Airport. Future growth in air transportation was also underpinned by key regulatory certifications achieved in the period. Revenue from ports and borders decreased by 2% on an underlying[1] basis as growth in EMEA, including major deliveries in Africa, Italy and the Middle East, was offset by last year's strong comparator due to the completion of a number of key programmes. Underlying[1] revenue in military decreased by 2%, as a number of US military programmes started to wind down, partly offset by stronger growth in EMEA. Urban security revenues were flat on an underlying[1] basis with strong growth in Asia and sales to emergency responders in the US, offset by lower sales elsewhere. We continued to experience pressure on government budgets in all regions, which was most marked in the US due to the effect of the Continuing Budget Resolution.

Revenue from higher-growth regions represented 21% of sales, broadly in line with prior year on an underlying[1] basis.

Headline operating profit grew 21% on an underlying[1] basis, reflecting the strong sales growth, increased focus on aftermarket and improved business mix. This growth in profitability was despite continued competitive pricing pressure on large programme contracts and the ongoing challenge from lower-priced competitors in unregulated parts of the market. Headline operating margin increased by 200 basis points to 15.0%. Headline reported operating profit improved 50%, including £8m profit contribution from the Morpho acquisition and £10m of favourable foreign exchange translation benefit. The difference between statutory and headline operating profit includes a £4m restructuring charge, £8m amortisation of intangibles and the £18m costs of the acquisition of Morpho.

Return on capital employed improved 70 basis points to 12.6%, with higher profitability offsetting the dilutive impact of the acquisition of Morpho.

The acquisition of Morpho completed on 6 April 2017 and significantly enhances Smiths Detection's position in attractive growth markets and expands the product portfolio. Regulatory clearance for this acquisition was conditional on the post-completion divestment of Morpho's explosive trace detection business, which completed on 7 July 2017. For the four months since completion Morpho delivered headline revenue of £62m and headline operating profit of £8m with good air transportation sales during the second half of the year, including deliveries to the US TSA. The integration of Morpho is progressing well and we are confident that we will be able to drive even more benefits from the combination than initially anticipated and expect the acquisition to drive future margin expansion for the division overall.

Research and development

Smiths Detection increased its investment in research and development during the year, accounting for 7.1% of sales, or 6.0% excluding customer-funded R&D (2016: 5.2% and 4.7% respectively). Specific highlights include:

- for the air transportation market, x-ray machines capable of meeting the new EU/ECAC Standard C3, new versions of our Checkpoint.Evo remote screening software and faster CT machines for hold baggage screening;
- in the military market, the development of the next generation of chemical warfare detection devices;
- in ports and borders we launched CORSYS, our large-scale enterprise platform that connects an entire ports and border security operation and supports the need for digital expansion in this market; and
- we continue to focus on software development, building on the strengths of our existing business and Morpho's software expertise, as well as value engineering projects to deliver competitive products in cost-critical sectors, as well as country-specific versions of some of our most successful products.

1 Underlying excludes the effects of foreign exchange translation and acquisitions but includes divested business for the period they were owned in the reported financial year and adjusts the prior financial year comparator as if the divested business were owned for the same period in that financial year to aid comparability

SMITHS INTERCONNECT

SOLUTIONS FOR HIGH-SPEED, SECURE CONNECTIVITY IN DEMANDING APPLICATIONS

CUSTOMERS
Our blue-chip customers are prime contractors, OEMs, system suppliers and sub-system manufacturers. Examples include Raytheon, Lockheed Martin, BAE Systems, Huawei, NVIDIA and Biosense Webster.

PRINCIPAL OPERATING REGIONS
We sell products to over 50 countries, manufacture in nine and have offices across North and Central America, Europe and Asia.

COMPETITORS
Our competitors range from large multinationals through to small, more focused companies across our product portfolio. Examples include Amphenol, TE Connectivity, Yokowo and Cobham.

SUPPLIERS
We cultivate deep supplier partnerships that enable new technology developments, quality and efficiency, while ensuring we have no substantial dependencies on individual sources.

REVENUE BY SECTOR

Defence	28%
Semi-conductor	20%
Medical	8%
Space	5%
Commercial aerospace	10%
Rail, Industrial, Other	29%

REVENUE PERFORMANCE £M
£419M

2017	**419**
2016	435
2015	420

DID YOU KNOW...

Our in-flight antenna systems have given passengers more than 15 million hours of internet access on over 1,000 planes

REVENUE IN 2017
UP 1%[1]

£419M

HEADLINE OPERATING PROFIT
UP 5%[1]

£56M

STATUTORY OPERATING PROFIT

£124M

HEADLINE OPERATING MARGIN

13.4%

Smiths Interconnect provides high-reliability innovative connectivity solutions for the defence, aerospace, space, rail, medical and semiconductor test end markets.

Markets and trends

We provide a range of mission-critical products to the defence market, including microwave technology, and ruggedised and high-speed connector solutions. These are deployed in the most extreme environments, such as in sensors, communications equipment and next-generation radar systems. Global defence spending has been constrained in recent years, as governments maintained tight budget control. However, the current economic environment and increasing geopolitical uncertainty represent a platform for growth. New investment is focused on system upgrades in critical areas such as intelligence, surveillance and reconnaissance, force protection and force multipliers.

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

In the rail market, our cable solutions provide communications connectivity, while our ferrite components and connectors are used in applications such as control-command and signalling in autonomous train systems. Growth is driven by increasing demand for sophisticated digital train systems that improve safety and security, high data-rate connectivity for passengers, and the distribution of high levels of electrical power. Rail applications can be some of the harshest environments our products face and qualifying products can be challenging.

Our medical portfolio includes high-reliability enhanced signal integrity performance connectors for applications requiring higher bandwidth and data rates, including advanced imaging, augmented reality, and surgical robotics. A growing, ageing population and the rise in chronic diseases continue to drive growth for the global medical market, especially in China and India. Consumers demand improved accuracy, efficiency and cost-effectiveness in healthcare services, meaning aligning our technologies with the cost-control mindset of this market is a key consideration.

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

GROWTH DRIVERS

- Growth in high data rate applications
- Continued proliferation of electronics
- Demand for greater connectivity and mobility
- Increasing sophistication of customer needs in high-growth markets
- Increasing geopolitical uncertainty

COMPETITIVE STRENGTHS

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

SMITHS INTERCONNECT
CONTINUED

WE FOCUS ON CUSTOMERS WHO VALUE OUR INNOVATIVE, TECHNICALLY DIFFERENTIATED SOLUTIONS, AS WELL AS OUR AGILITY AND RESPONSIVENESS

DID YOU KNOW...

We are providing the entire Ethernet data cabling network for the Orion spacecraft that will one day fly astronauts to Mars

INVESTMENT IN NEW PRODUCT DEVELOPMENT

UP 7%

£28M

OUR STRATEGY

Strategy

We focus on customers who value our innovative, technically differentiated solutions, as well as our agility and responsiveness. Our offering includes both custom and platform solutions. We focus our portfolio and resources on the most attractive regions, such as Asia, and end markets, particularly defence, aerospace, space, rail, medical and semiconductor. We aim to outperform our end markets through customer-focused innovation, service, and sales and marketing initiatives, as well as attracting and retaining the best talent. Restructuring and efficiency initiatives, including lean and value engineering, drive competitiveness and provide funds for investment.

Progress in FY2017

- Restructured to create a functional organisation aligned around six markets
- Migrated all historical brands to Smiths Interconnect
- Established a key account management programme focused on deep relationships with technology seekers and partners
- Rationalised and simplified our distribution channels
- Enhanced programme management tools to improve execution and time to market
- Divested non-core businesses of Power and Microwave Telecoms

Priorities for FY2018

- Sharpen focus on strategic markets, customers and sales channels
- International expansion, particularly in Asia
- New product investments targeted at higher-growth end market segments
- Reduce costs through value engineering and scale efficiencies
- Attract, retain, develop, engage and inspire talent

FY2017 FINANCIAL PERFORMANCE

	2017 £m	2016 £m	Reported growth	Underlying growth
Revenue	**419**	435	(3)%	1%
Headline operating profit	**56**	57	(1)%	5%
Headline operating margin	**13.4%**	13.1%	30bps	
Statutory operating profit	**124**	26	372%	
Return on capital employed	**11.4%**	10.3%	110bps	

Performance

During the year Smiths Interconnect completed significant strategic and structural change to focus on fewer, higher-growth end markets. This included the divestments of the Power and Microwave Telecoms businesses and a major reorganisation of the business structure. In a period of considerable change the business was able to deliver an underlying[1] revenue increase of 1%, driven by growth in both the space and aerospace segments. On a reported basis, revenue declined by 3%, as favourable foreign exchange translation benefits were offset by the impact of the divestments. Isolating the performance of the remaining core business, underlying[1] revenue grew 3%.

Underlying[1] revenue grew by 20% in the space segment, driven by increased spending on Low Earth Orbit constellations and increased content of the next-generation high-throughput satellites using flexible digital payloads. In aerospace, underlying[1] revenue grew by 44%, driven by the continued deployment of our SATCOM antenna products and connector and component solutions on military and commercial airframes tied to new higher-efficiency engines. The strong, double-digit growth in both these segments was offset by small declines in the defence, semiconductor test and rail segments. Underlying[1] revenue decline in defence of 4% reflected a slowdown in deliveries on several key defence programmes approaching end of life that was not offset by revenues from new programme wins. The medical segment grew, with underlying[1] revenue up 4% tied to increased volume at one of our leading customers. Industry consolidation impacted the buying patterns of several of our key customers in the semiconductor test segment with underlying[1] revenue down 4%.

Operating profit grew 5% on an underlying[1] basis and the headline operating margin increased 30bps to 13.4%, driven by the benefits of restructuring activity in the prior year combined with a continued procurement and operational efficiency focus. The difference between statutory and headline operating profit primarily reflects a £72m profit on business disposals.

Return on capital employed increased 110 basis points to 11.4%, driven by the higher profitability during the year and the positive mix impact of the two disposals.

During the course of the year Smiths Interconnect disposed of both its Power and Microwave Telecoms businesses to concentrate on its remaining core with scalable, top three leadership positions in its chosen markets. Prior to the sale of the Power business in January 2017 sales were £47m, with headline operating profit of £7m and net assets were £157m. Prior to the sale of the Microwave Telecoms business in May 2017 sales were £55m, headline operating profit was £1m and net assets were £41m. The performance of both the Power and Microwave Telecoms businesses are included within the financial summary and results presented above.

Research and development

Total research and development expenditure of £28m was £2m higher than the prior year, representing 6.7% of revenue. During the year Smiths Interconnect's engineering function was realigned with our strategic market segments of defence, aerospace, space, rail, medical and semiconductor test, with significant emphasis on driving improved time to market for new product development and an increased focus on developing product platforms over bespoke solutions.

Product developments during the year included:

- for the space market, the development of the K2TVA Series to our Thermopad portfolio with an improved thick-film thermistor technology to enable more temperature compensation and mitigate the degradation at higher frequencies typical of this type of technology;
- in semiconductor test we introduced a higher performance version of our DaVinci test socket, which can now be used to test the most advanced CPU and GPU semiconductor devices; and
- we also expanded our Outrigger resistor line with the CRHB 1216 product series, improving the power-to-size ratio of our resistor line, which has applications in most of our core markets.

1 Underlying excludes the effects of foreign exchange translation and acquisitions but includes divested business for the period they were owned in the reported financial year and adjusts the prior financial year comparator as if the divested business were owned for the same period in that financial year to aid comparability

INCREASING DIGITAL RELIABILITY

As computers, mobiles and smart devices become more advanced, so must the integrated chips that support them. We're leading the way with our Volta semiconductor test solutions. Used for testing the integrated chip packages behind everything from Bluetooth and power management to digital displays, Volta significantly outperforms the competition in both durability and performance.

By developing new electrical contact technologies and integrating manufacturing and assembly processes, we opened up an attractive new market segment and demonstrated our commitment to continuously innovating to meet the changing needs of our customers.

FLEX-TEK

INNOVATIVE COMPONENTS TO HEAT AND MOVE FLUIDS AND GASES

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

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

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

SUPPLIERS
We source key materials from world-class companies selected to provide the quality, service and value needed for mission-critical components.

REVENUE BY SECTOR

- Construction Products 32%
- Fluid Management 24%
- Heat Solutions 25%
- Flexible Solutions 19%

REVENUE PERFORMANCE £M
£338M

2017	338
2016	284
2015	269

DID YOU KNOW...
Our heated hoses maintain a constant air temperature and are helping sleep apnoea patients breathe more easily at night

REVENUE IN 2017
UP 3%[1]
£338M

HEADLINE OPERATING PROFIT
UP 11%[1]
£65M

STATUTORY OPERATING PROFIT
£68M

HEADLINE OPERATING MARGIN
19.3%

Flex-Tek provides engineered components that heat and move fluids and gases for aerospace, consumer products, construction, medical and industrial applications.

Markets and trends

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

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

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

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

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

In aerospace, we are a market-leading provider of specialty, high-performance flexible and rigid Fluid Management tubing assemblies that provide reliable, efficient delivery of hydraulic fluids and jet fuel for commercial and military aircraft globally. The market for commercial aircraft remains strong, with an OEM order book of over 13,000 aircraft.

GROWTH DRIVERS

- Steady growth of the US housing construction market
- Continued increase in large commercial aircraft production
- Growth of medical devices and their increased use of flexible tubing
- Growing presence in Europe and Asia with further expansion potential

COMPETITIVE STRENGTHS

- A strong performance in residential gas tubing
- High-performance flexible tubing products for aerospace
- Leading capability in the design and manufacture of heating solutions for bespoke applications
- Strong customer relationships

FLEX-TEK
CONTINUED

WE DELIVERED ANOTHER STRONG PERFORMANCE, WITH REVENUE UP 4% ON AN UNDERLYING BASIS

DID YOU KNOW...
Our heaters are used to convert soy beans into sustainable biofuels

OUR STRATEGY

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

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

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

Progress in FY2017
- Heat Solutions total revenue grew 12%, largely in the engineered solutions segment
- Enhanced sales efforts in Europe and Asia
- Expanding range of applications for bespoke heating element solutions
- Fluid Management delivered first production orders of tubing for GE's GEnx jet engine platform

Priorities for FY2018
- Expansion of our Heat Solutions product application base through new technologies
- Growth of Gastite's natural gas tubing business in Europe
- New product development in Gastite
- Expansion of sales in Asia, especially China
- Delivery of new aerospace platform wins
- Complete the acquisition and integration of Osram's heating solutions business

FY2017 FINANCIAL PERFORMANCE

	2017 £m	2016 £m	Reported growth	Underlying growth
Revenue	**338**	284	19%	3%
Headline operating profit	**65**	51	28%	11%
Headline operating margin	**19.3%**	18.0%	130bps	
Statutory operating profit	**68**	37	85%	
Return on capital employed	**35.8%**	31.6%	420bps	

Performance

Flex-Tek delivered a strong performance, with revenue up 3% on an underlying[1] basis, driven by growth in all segments except Fluid Management. On a reported basis, foreign exchange translation benefits led to revenue growth of 19%.

Construction revenue grew 2% on an underlying[1] basis, with both Gastite and Thermaflex benefiting from growth in the US housing market and Gastite's increasing European presence. Heat Solutions revenue increased by 12% on an underlying[1] basis, principally due to growth in its engineered solutions. Flexible Solutions underlying[1] revenue growth of 3% was driven by increased demand from the medical sector, partially offset by a decline in the floor care segment. Fluid Management revenue was down 2% on an underlying[1] basis, primarily due to order timing issues associated with a specific customer. The aerospace market for components otherwise remained strong.

Headline operating profit increased 11% on an underlying[1] basis to £65m and the headline operating margin increased 130bps to 19.3%. Margins expanded in all segments with the exception of Thermaflex due to pricing pressure. Improvements in profitability were driven by positive mix in Heat Solutions, procurement savings in Gastite and Flexible Solutions, and continued strong operating cost control. The difference between statutory and headline operating profit is primarily due to the £4m release in the provision for Titeflex Corporation subrogation claims due to increasing US discount rates.

Return on capital employed increased 420 basis points to 35.8%, driven by improved profitability.

Since the year end Tutco LLC, part of the Heat Solutions business, has signed an agreement to purchase the heating element division of Osram, broadening its portfolio into faster-growing engineered heating solutions.

Research and development

Total research and development expenditure remained broadly consistent at 0.6% of sales, focused on market-leading innovative solutions to meet specific customer needs. In particular:

- the continued development of 5000psi aerospace tubing for a broader range of applications;
- in Gastite, the further development of its technology-leading FlashShield product to improve ease of installation;
- heat Solutions refocused development of flexible heaters, with a new production cell for this product now operational; and
- Flexible Solutions expanded the use of its heated wire hose technology in medical hose applications.

1 Underlying excludes the effects of foreign exchange translation and acquisitions but includes divested business for the period they were owned in the reported financial year and adjusts the prior financial year comparator as if the divested business were owned for the same period in that financial year to aid comparability

QUICK, CONTROLLABLE COMFORT

From hospitals and office spaces to indoor sports arenas, our new E-series duct heater technology is helping to control zone temperatures across a range of complex environments. With improved electrical efficiency, a wider range of watt densities, and symmetrical design to ensure versatility, our Tutco business line is driving innovation in the duct heater market.

Even with a fully custom design, we have reduced our lead time to as little as 24 hours – significantly less than the competition – allowing us to reach new customers in the fast-moving construction and product replacement markets.

FINANCIAL REVIEW

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OUR STRONG FINANCIAL FRAMEWORK PROVIDES THE FLEXIBILITY TO ENABLE US TO CREATE SUPERIOR RETURNS AND INVEST IN GROWTH. WE HAVE STRONG GOVERNANCE AND A ROBUST APPROACH TO RISK MANAGEMENT AND FINANCIAL CONTROL

CASH CONVERSION

118%

HEADLINE EARNINGS PER SHARE

97.6P

RETURN ON CAPITAL EMPLOYED

16.2%

Non-headline items relating to continuing activities excluded from headline profit before tax

These items amounted to a gain of £73m compared to a charge of £105m in 2016. They comprised:

- £175m gain on the four disposals made in the year: £4m on John Crane Artificial Lift, £100m on Smiths Medical Wallace, £22m on Smiths Interconnect Power and £50m on Smiths Interconnect Microwave Telecoms;
- £37m charge for restructuring (2016: £37m), which included £33m in respect of the Fuel for Growth programme which completed in the year (2016: £37m) and £4m of restructuring costs associated with the integration of Morpho Detection and the existing Smiths Detection business. The four-year Fuel for Growth programme has now concluded, with total spend of £185m and cumulative benefits to date totalling £70m. Ongoing restructuring costs will be recorded in headline operating profit in 2018;
- £19m charge for acquisition costs (2016: £6m);
- £9m net charge (2016: £7m) in connection with John Crane, Inc. asbestos litigation;
- £4m credit (2016: £11m charge) in connection with Titeflex Corporation litigation;
- £9m charge for changes to post-retirement benefits and administration costs (2016: £16m);
- £nil impairment of goodwill, property, plant and equipment and trade investments (2016: £31m);
- amortisation of intangible assets acquired in business combinations of £17m (2016: £15m). The ongoing amortisation charge relates principally to technology and customer relationships;
- £3m charge for the unwind of fair value uplift of inventory on the acquisition balance sheet (2016: £nil)
- £6m charge related to the unwind of discounts on provisions (2016: £5m)
- £nil fair value gain on contributing government bonds to a pension scheme (2016: £19m);
- £8m of financing losses (2016: £1m gain); and
- £2m gain on retirement benefit finance (2016: £3m gain).

Discontinued operations

Discontinued operations comprised the Morpho Detection explosive trace business generating a loss after tax of £8m in the year (2016: £nil).

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

The headline tax charge for 2017 of £140m (2016: £113m) represented an effective rate of 26.5% on the headline profit before taxation (2016: 25.0%). On a statutory basis, the tax charge on continuing activities was £29m (2016: £85m), representing an effective tax rate of 4.8% (2016: 24.6%), impacted by the recognition of UK deferred tax assets and gains on sale of businesses which were either non-taxable or sheltered by previously unrecognised losses.

The Group aims to utilise global manufacturing, research and development and other tax incentives, to allocate its capital in the most tax-efficient manner where the regulatory environment allows, and to ensure the effective and timely management of its tax filings and compliance.

In 2017, the Group paid £82m in direct corporate tax on profits (2016: £62m) and £116m in employment and other taxes (2016: £105m). The Group additionally collected £224m on behalf of tax authorities, primarily from employees but also other indirect taxes such as VAT (2016: £210m). The total amount of tax paid over to tax authorities during the year totalled £422m (2016: £377m).

A rate of between 29.5% and 30.0% is expected in the year ending 31 July 2018.

Earnings per share
Basic headline earnings per share from continuing activities were 97.6p (2016: 85.2p). The reported 15% increase was driven by favourable foreign exchange movements and higher operating profit partly offset by an increase in the effective tax rate to 26.5% from 25.0% in 2016.

EARNINGS PER SHARE PENCE

On a statutory basis, the basic earnings per share from continuing activities was 144.1p (2016: 65.6p), reflecting the profit on disposal of businesses of £175m and lower non headline costs compared to 2016.

Cash generation and net debt
Operating cash generation remained strong, with headline operating cash-flow of £695m (2016: £520m), representing 118% (2016: 102%) of headline operating profit (see note 29 to the accounts for a reconciliation of headline operating cash and free cash-flow to statutory cash-flow measures). Movement in working capital was an inflow of £85m (2016: inflow of £9m), reflecting a reduction in inventory and receivables.

CASH CONVERSION %

Total free cash-flow, stated after all legacy costs, interest and taxes but before acquisitions, divestitures and dividends, increased by £127m to £370m (2016: £243m), reflecting the higher operating cash generated and reduced pension payments. Continued strong cash generation is expected in FY2018.

On a statutory basis, net cash inflow from operations was £479m (2016: £358m).

NET DEBT £M

Net debt at 31 July 2017 was £967m, a decrease of £11m in the year. On an underlying basis, excluding the impact of foreign exchange movements, net debt reduced by £72m, reflecting strong operational cash generation and the Morpho acquisition being largely financed from business disposals.

At the end of the period, the Group had gross debt of £1,749m (2016: £1,409m) and cash reserves of £782m (2016: £431m). Of this gross debt, £151m (2016: £270m) falls due for repayment within one year including the $175m 7.37% Notes due in February 2018. On 11 August 2017, the Group prepaid these Notes in full from cash resources.

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

2018 – £133m ($175m 7.37% bond)*
2019 – £189m ($250m 7.20% bond)
2022 – £301m ($400m 3.625% bond)
2023 – £533m (€600m 1.25% bond)
2027 – £574m (€650m 2.00% bond)

* prepaid in August 2017

Dividend
The Board has a progressive dividend policy for future payouts, with the aim of increasing dividends in line with the long-term underlying growth in earnings. This policy will enable us to retain sufficient cash-flow to finance our investment in the drivers of growth and to meet our financial obligations.

In setting the level of dividend payments, the Board will take into account prevailing economic conditions and future investment plans, along with the objective to maintain minimum dividend cover of around 2.0.

As part of our disciplined approach to balance sheet management, we seek to maintain a strong investment-grade credit rating with a net debt:EBITDA ratio of two time, or lower over the medium term. We would be willing to temporarily exceed this upper limit in the case of acquisitions, provided there were clear actionable plans to return to the upper limit of 2.0 within an acceptable timeframe. For more information see note 25 to the accounts.

Dividends paid in the year on ordinary shares amounted to £167m (2016: £163m). The Board has recommended a final dividend of 29.70p per share to be paid on 17 November 2017 to shareholders on the register at close of business on 20 October. When added to the 2017 interim dividend of 13.55p per share paid on 28 April 2017, the 2017 full year dividend of 43.25p represents an increase of 3.0% on the 2016 full year dividend of 42.0p per share.

Acquisitions and disposals
On 6 April 2017 we completed our acquisition of Morpho Detection for final consideration of £590m. A condition of this transaction receiving regulatory approval, was the subsequent disposal of Morpho Detection's explosive trace detection business. This was sold to OSI Systems, Inc. on 7 July 2017 for £63m.

The Group has completed the disposal of a number of non-core businesses: our Artificial Lift business in John Crane for £29m in November 2016; our Wallace business in Smiths Medical for £132m in November 2016; our Power business in Smiths Interconnect for £164m in January 2017; and our Microwave Telecoms business in Smiths Interconnect for £85m in May 2017.

FINANCIAL REVIEW
CONTINUED

Other financial information

Retirement benefits

As required by International Financial Reporting Standards (IFRS), the balance sheet reflects the net surplus or deficit in retirement benefit plans, taking assets at their market values at 31 July 2017 and evaluating liabilities at period-end AA corporate bond interest rates.

The tables below disclose the net status across a number of individual plans. Where any individual plan shows a surplus under IAS 19, this is disclosed on the balance sheet as a retirement benefit asset. The IAS 19 surplus of any one plan is not available to fund the IAS 19 deficit of another plan. The net pension position has improved to a surplus of £224m at 31 July 2017 from a surplus of £80m at 31 July 2016, benefitting from £105m of cash contributions in the year, the matching level between assets and liabilities, and changes in UK and US mortality assumptions.

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

The retirement benefit position is shown below:

	31 July 2017	31 July 2016
Funded plans		
UK plans – funding status	**111%**	109%
US plans – funding status	**91%**	69%
Other plans – funding status	**81%**	88%
Total – funding status	**109%**	105%

	31 July 2017	31 July 2016
Surplus/(deficit)		
Funded plans	**354**	217
Unfunded plans	**(130)**	(137)
Total surplus/(deficit)	**224**	80
Retirement benefit assets	**390**	328
Retirement benefit liabilities	**(166)**	(248)
	224	80

The approximate pension membership for the three main schemes at 31 July 2017 is set out in the table below:

Pension scheme members as at 31 July 2017	SIPS	TIGPS	US plans	**Total**
Deferred active	276	161	2,090	**2,527**
Deferred	9,880	11,496	2,922	**24,298**
Pensioners	13,023	15,761	384	**29,168**
Total	23,179	27,418	5,396	**55,993**

Goodwill and intangibles

Goodwill from acquisitions has been capitalised since 1998. Until 1 August 2004 it was amortised over a maximum 20-year period. Under IFRS goodwill is no longer amortised but instead is subject to annual reviews to test for impairment.

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

Return on capital employed

The return on capital employed (ROCE) is calculated over a rolling 12-month period and is the percentage that headline operating profit comprises of monthly average capital employed. Capital employed comprises total equity adjusted for goodwill recognised directly in reserves, post-retirement benefit-related assets and liabilities net of tax, litigation provisions relating to exceptional items net of tax, and net debt. ROCE increased 90 basis points to 16.2% (2016: 15.3%), as a result of increased profitability across the Group.

Policies and judgements

Accounting policies

The accounts in this report are prepared under IFRS, as adopted by the European Union (EU). The accounting policies used in preparing these accounts are set out on pages 141 to 147.

Significant judgements, key assumptions and estimates

Applying accounting policies requires the use of certain judgements, assumptions and estimates. The most important of these are set out on pages 141 to 142.

Essential contracts

The divisional reviews describe our main customer and supplier relationships and the 'Risks and uncertainties' section outlines the risk management aspects of our contractual arrangements. Smiths Group has a wide range of suppliers and customers and, while the loss of, or disruption to, certain of these arrangements could temporarily affect the operations of an individual division, no single contract is considered essential to the Group.

Financial controls

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

The Internal Audit Department completes site-based reviews of reporting units, as set out in a risk-based audit plan reviewed and approved by the Chief Financial Officer and Audit Committee. Further information regarding the Group's risk management procedures is set out in the Risk management section on pages 60 to 61 and the Corporate governance statement on pages 82 to 102.

Exchange rates

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

	31 July 2017	31 July 2016	
Average rates:			
US dollar	**1.27**	1.46	Dollar strengthened 13%
Euro	**1.16**	1.32	Euro strengthened 12%
Year-end rates:			
US dollar	**1.32**	1.32	No change
Euro	**1.12**	1.19	Euro strengthened 6%

Treasury

The Board maintains a Treasury Risk Management Policy, which governs the treasury operations of the Group and its subsidiary companies and the consolidated financial risk profile to be maintained. A report on treasury activities, financial metrics and compliance with the Policy is prepared monthly. This is circulated to the Chief Financial Officer each month and to the Audit Committee on a semi-annual basis.

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

Centrally directed cash management systems exist globally to manage overall liquid resources efficiently across the divisions. The Group uses financial instruments to raise financing for its global operations, to manage related interest rate and currency financial risk and to hedge transaction risk within subsidiary companies.

The Group does not speculate in financial instruments. All financial instruments hedge existing business exposures and all are recognised on the balance sheet.

The Policy defines four treasury risk components and for each component a set of financial metrics to be measured and reported monthly compared against pre-agreed objectives.

Credit quality

The Group's strategy is to maintain a solid investment-grade rating to ensure access to the widest possible sources of financing at the right time and to minimise the resulting cost of debt capital. The credit ratings at the end of July 2017 were BBB+ / Baa2 (both stable) from Standard & Poor's and Moody's respectively. An essential element of an investment-grade rating is consistent and robust cash-flow metrics. The Group's objective is to maintain a net debt/headline EBITDA ratio at two times or lower over the medium term.

Debt and interest rate management

Debt financing is managed centrally. At 31 July 2017 net debt was £967m (2016: £978m). The Group's strategy is to finance the majority of its debt from long-term bond markets and at 31 July 2017 £1,730m of bonds were outstanding (2016: £1,392m). On 17 October 2016 the Group signed a €2.5bn Euro Medium Term Note Programme and on 23 February 2017 issued from it a €650m 2% bond with a maturity in 2027. The core backstop financing for the Group is provided by a $800m committed revolving credit facility provided by a group of ten global banking partners. This facility has a maturity in February 2021. The Group remains in full compliance with all covenants within its external debt agreements. The Group's risk management objectives are to ensure that over time funding drawn from the bank market is less than 30% of net debt, the average maturity profile of gross debt is at or greater than four years and over 55% of gross debt is at fixed rates. At 31 July 2017, these measures were 0% (2016: 0%); 5.9 years (2016: 4.5 years) and 57% (2016: 47%).

Liquidity management

At 31 July 2017, the $800m committed bank facility was undrawn (2016: undrawn). The Group's objective is to ensure that at any time undrawn committed facilities net of short-term overdraft financing are greater than £200m and that committed facilities have at least 18 months to run until maturity. At 31 July 2017, these measures were £607m (2016: £605m) and 43 months (2016: 55 months). At 31 July 2017, cash resources were £782m (2016: £431m). These resources included funds received from the 2017 €650m Notes issuance to prefund the repayment of the 7.37% $175m Notes in August 2017.

The Group aims to ensure that these resources are placed on deposit with highly-rated relationship bank counterparties at short-notice availability. Credit exposure to every approved bank is defined by the Treasury Risk Management Policy, with counterparty limits established by reference to their Standard & Poor's long-term debt rating and CDS trading levels. At 31 July 2017, 98% (2016: 98%) of cash resources were on deposit with the ten global banking partners. Of these resources £82m (2016: £90m) was invested with counterparties rated less than A+.

Currency management

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

The Group is an international business with the majority of its net assets denominated in foreign currency. We protect our balance sheet and reserves from adverse foreign exchange movements by financing our foreign currency assets where appropriate in the same currency and targets that, where the value of net asset exposure is over £30m equivalent, over 50% of those assets are matched with the same currency liability. At 31 July 2017, 45% (2016: 50%) of total foreign currency assets were matched by related currency liabilities.

Litigation

Smiths Group faces different types of litigation in different jurisdictions. The high level of activity in the US, for example, exposes the Company to the likelihood of various types of litigation, such as 'mass tort' and 'class action' litigation, legal challenges to the scope and validity of patents and product liability and insurance subrogation claims. These types of proceedings (or the threat of them) are also used to create pressure to encourage negotiated settlement of disputes.

John Crane, Inc. litigation

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

The litigation involves claims for a number of allegedly asbestos-related diseases, with awards for mesothelioma tending to be larger than those for the other diseases. JCI's ability to defend mesothelioma cases successfully is, therefore, likely to have a significant impact on its annual aggregate adverse judgment and defence costs.

JCI continues to actively monitor the conduct and effect of its current and expected asbestos litigation, including the effective presentation of its 'safe product' defence, and intends to resist these asbestos cases based on this defence. Approximately 273,000 claims against JCI have been dismissed before trial over the last 38 years. JCI is currently a defendant in cases involving approximately 50,000 claims. Despite these large numbers of claims, since the inception of litigation JCI has had final judgments against it in 138 cases, and has had to pay awards amounting to approximately $160m.

At 31 July 2017, the aggregate provision for JCI asbestos litigation, including for adverse judgments and defence costs, amounted to £237m (2016: £252m) expressed at the then current exchange rate. In deciding upon the amount of the provision, JCI has relied on independent expert advice from a specialist. The provision is based on past history and published tables of asbestos incidence projections and uses a 10-year time horizon. We consider that to forecast beyond ten years requires the litigation environment to remain largely unchanged with regard to estimating future asbestos expenditures. Historically this has not been the case with a significant change occurring more often than every ten years and therefore a 10-year time horizon has continued to be applied. Sensitivities around the provision time period have been included in note 22 to the accounts. In establishing this provision no account has been taken of any recoveries from insurers as their nature and timing are subject to pending litigation. Because of the significant uncertainty associated with the future level of asbestos claims and of the costs arising out of the related litigation, there is no guarantee that the assumptions used to estimate the provision will result in an accurate prediction of the actual costs that may be incurred.

Titeflex Corporation litigation

Titeflex Corporation, a subsidiary of the Group in the Flex-Tek division, has received a number of claims in recent years from insurance companies seeking recompense on a subrogated basis for the effects of damage allegedly caused by its flexible gas piping products being energised by lightning strikes. It has also received a number of product liability claims relating to this product, some in the form of purported class actions. Titeflex Corporation believes that its products are a safe and effective means of delivering gas when installed in accordance with the manufacturer's instructions and local and national codes; however some claims have been settled on an individual basis without admission of liability.

At 31 July 2017, provision of £84m (2016: £94m) has been made for the costs which the Group expects to incur in respect of these claims. Because of the significant uncertainty associated with the future level of claims and of the costs arising out of the related litigation, there is no guarantee that the assumptions used to estimate the provision will result in an accurate prediction of the actual costs that may be incurred.

VIABILITY STATEMENT

In accordance with the requirements of the 2016 revision of the UK Corporate Governance Code, the directors have assessed the longer-term prospects of the Group, taking into account the current position of the Group and a range of internal and external factors, including the principal risks detailed on pages 60 to 67 (the 'viability assessment').

The directors have determined that a three-year period to 31 July 2020 is an appropriate time frame for the viability assessment. The selected period is considered to be appropriate as, based on the historic performance of the Group, a three-year outlook represents an optimum balance of long-term projection and acceptable forecasting accuracy. This time period also takes into account considerations such as the maturity of the Group's borrowing facilities and the cyclicality of the performance of the Group's underlying markets.

In making this viability assessment, the directors have considered the current financial position and prospects of the Group, including the current year business performance, the detailed budget for 2018 and the Strategic Plan. Against these financial projections the directors took into account the principal risks (as outlined on pages 60 to 67 to develop a set of plausible scenarios with potentially high-impact outcomes including:

- product liability and litigation;
- programme delivery;
- supply chain disruption and business continuity;
- fraud and corruption; and
- compliance with laws and regulations.

Consideration was then given to the magnitude of the gross risks and their potential impact, directly or indirectly, on the Group's future performance and liquidity. The assessment included stress testing of the Group's financial capacity to absorb the impact of such adverse events, either individually or in combination, and what mitigating actions the Group could take to respond to them in order to protect its business. The directors also considered the Group's ability to raise additional liquidity. In performing this assessment the directors have taken comfort from the diversity of the Group's businesses across different markets, industries, geographies, products and customers.

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

DELIVERING

Our complex fuel manifolds deliver leading-edge fluid management at extreme pressures and temperatures in aircraft engines.

EFFICIENCY

Used in next-generation aeroplane engines, our fuel manifolds are making airliners more fuel-efficient and environmentally friendly.

RISK MANAGEMENT

WE OPERATE ACROSS A RANGE OF MARKETS AND GEOGRAPHIES AND ARE PREPARED TO ACCEPT CERTAIN LEVELS OF RISK IN PURSUING OUR AMBITION OF ESTABLISHING SMITHS AS ONE OF THE WORLD'S LEADING TECHNOLOGY COMPANIES.

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

Risk governance

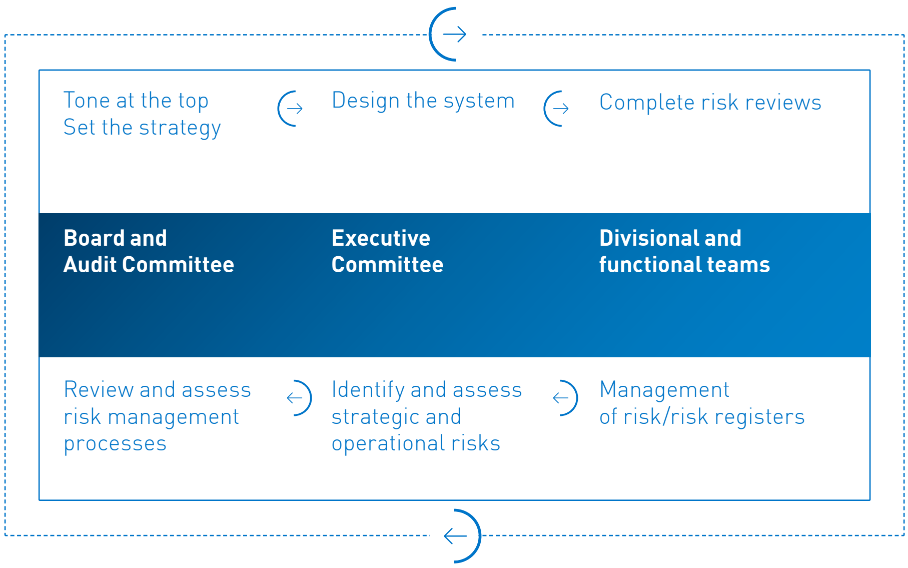
The Board and its committees set the 'tone at the top' and approve the strategy of the business. The Board ensures appropriate oversight and monitoring through a number of mechanisms including strategy reviews, committee meetings, management reports and focused reviews of selected risk areas.

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

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

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

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



HOW WE MANAGE RISKS

Within this governance framework, we operate a 'three lines of defence approach' to ensure clarity around roles and responsibilities and effective risk management. This model ensures the three layers – management control, risk and compliance, and independent assurance – are clearly defined and work effectively within our wider governance structures to manage the risks identified through our ERM.

The ERM process

Running any business involves constant risk management – it is an integral and often implicit part of day-to-day operations. Our ERM process is designed to ensure a constant feedback loop between the Board and Audit Committee, the Executive Committee, divisions, functions and sites, to enable us to manage and monitor the risks that threaten the successful execution of our strategy. This framework ensures our strategic, financial and operational risks are appropriately considered by the Executive Committee and the Board.

During 2017, a risk workshop was facilitated by the Director of Internal Audit at the Executive Committee. The workshop resulted in an update to the principal risk register which was presented to the Audit Committee. In addition, the Executive Committee selected three of the principal risks – a significant ethical breach, cyber security and quality at Smiths Medical – for deep dive reviews at both the Executive and Audit Committees.

A further 44 risk workshops were facilitated at key sites during the year to gather a 'bottom-up' view of risk. To ensure alignment, a summary of these was mapped to divisional risk registers and the Group's principal risks and uncertainties.

The Board has reviewed the effectiveness of the risk management process, considering the principal risks and uncertainties, actions taken by management to manage those risks and the Board's risk appetite in respect of each risk. The Board considers the risk management process to be effective. It recognises this is an ongoing process and work will continue in FY2018.

BOARD AND AUDIT COMMITTEE

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

EXECUTIVE COMMITTEE AND SENIOR MANAGEMENT

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

FIRST LINE OF DEFENCE

Risk ownership and mitigation – operational teams

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

SECOND LINE OF DEFENCE

Monitoring and compliance – risk and compliance functions

- Financial controls
- Operational controls
- Risk management
- Security
- Quality
- Health and Safety

THIRD LINE OF DEFENCE

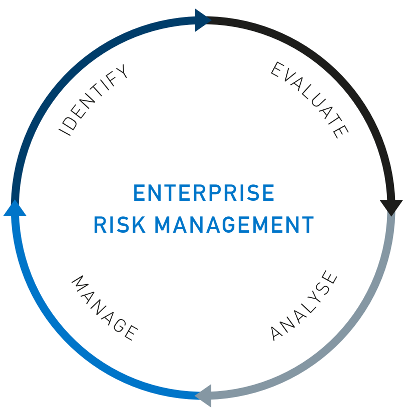
Independent assurance – Internal Audit

Providing assurance on:

- Internal controls
- Programme controls
- System controls
- Risk management processes

REGULATORS AND EXTERNAL AUDIT

HOW WE MANAGE RISK



PRINCIPAL RISKS AND UNCERTAINTIES

We maintain a register of principal risks and uncertainties covering the strategic, operational, financial and compliance risks faced by the Group. We rate them according to likelihood of occurrence, potential impact and the likely 'velocity' of each risk. This measure reflects the expected time we would have to react were a risk to materialise. The 'trend' metric reflects the net position of a risk-taking into consideration both external factors and internal risk mitigation activities, when compared to the same time last year. We consider our current and target exposure to each risk, which defines our risk appetite.

We updated our register of principal risks and uncertainties following our Executive Committee workshop held during FY2017 and made the following adjustments to the principal risks disclosed in the 2016 Annual Report:

- 'Financial' risk has been removed. We consider the diversified nature of our global operations and the financial strength of the Group provide appropriate mitigation such that this risk does not require a standalone disclosure.
- 'Pension Funding' risk has been removed. We consider the increased strength of the funding level of the Group's defined benefit pension arrangements and the actions agreed on 17 November 2015 and 1 March 2016 in order to address potential funding shortfalls in the Smiths Industries Pension Scheme and TI Group Pension Scheme.

While we continue to monitor and manage a wider range of risks, the table below summarises those we feel most likely to have the greatest impact on the business if they were to materialise and the key mitigating actions taken to address them.

RISK AND POTENTIAL IMPACT

TECHNOLOGY DISRUPTION BY EXISTING OR FUTURE COMPETITOR

RISK APPETITE

Current | Target

POTENTIAL IMPACT

High

TREND

Increased

VELOCITY

Low

Developing differentiated new products and services is critical to our success. We may be unable to maintain technological differentiation or meet customers' needs, and face more effective or disruptive innovation by a competitor.

Potential impact

- Loss of market share and competitive advantage
- Materially adverse effect on profitable growth
- Erosion of our reputation as a leader in our markets and ability to attract and retain talent
- Increased speed of innovation in certain markets may lead to shorter product lifecycles, which would increase the level of R&D spend needed to maintain sales growth

KEY MITIGATING CONTROLS

- Our diversified technology portfolio serves a range of sectors and geographies, mitigating our exposure to any one sector or area
- We are actively repositioning the portfolio around our most attractive markets, where we consider we can sustainably hold a top three position based on technology leadership
- Increased and smarter investment in R&D (2017: 4.6% of revenue, 2016: 4.0%), focused on our most attractive markets
- New Group-wide innovation framework – i^3 – focused on building a culture of innovation. Focus areas include process enhancements to improve innovation effectiveness, horizon-scanning to develop long-range technology roadmaps for each division and driving digitisation
- New central Innovation Fund to leverage our critical mass and accelerate key areas – first projects approved and underway
- New Head of Innovation and Group Digital Director appointed in FY2017 to spearhead the agenda
- Aligned New Product Introduction (NPI) process rolled out across divisions to accelerate time to market

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RISK AND POTENTIAL IMPACT		KEY MITIGATING CONTROLS
PEOPLE RISK APPETITE Current | Target POTENTIAL IMPACT Medium TREND No change VELOCITY Low	People are our only truly sustainable source of competitive advantage, and competition for key skills is intense, especially around science, technology, engineering and mathematics (STEM). We may not be successful in attracting, retaining, developing, engaging and inspiring the right people with the right skills to ensure organisational effectiveness and achieve our growth ambitions. **Potential impact** • The inability to attract key talent could lead to a loss of competitive advantage and materially affect our growth prospects • In acquisitions, losing key personnel from the newly-acquired business or making the wrong leadership appointments could significantly impact performance and value	• Building a learning organisation is a key part of our growth strategy, with a focus on culture, reward and recognition, HR infrastructure, and learning and development • Talent and succession plan reviews are held at least annually to balance internal management continuity with external recruitment • Remuneration packages are evaluated regularly against market trends • The Chief Executive annually assesses the top leadership team and presents development and succession plans to the Board • Annual performance management reviews are carried out for the majority of employees, using best practice processes such as 360 degree feedback surveys • A clearly defined people integration plan for acquisitions ensures an effective approach to appointments and organisation design • Launched a new leadership development programme in partnership with UCLA Anderson Executive Education in FY2017 P72
WRONG ACQUISITIONS AND POOR INTEGRATION RISK APPETITE Current | Target POTENTIAL IMPACT Medium TREND No change VELOCITY Medium	We are focusing the portfolio around the most attractive markets where we can sustainably achieve a top three leadership position. The success of our acquisition strategy depends on identifying suitable targets, obtaining necessary authorisations and financing, and successfully integrating newly-acquired businesses. **Potential impact** • Newly-acquired products and solutions may deliver less value, fewer synergies, or require more investment than anticipated • The Group's return on capital employed may fall if acquisition hurdle rates are not met • The Group's financial performance may suffer from goodwill or other acquisition-related impairment charges • Insufficient allowance for potential claims arising from indemnities and warranties given on a business disposal may detrimentally affect our financial position • Changes to disposal provisions will affect the income statement and settlement will utilise Group funds	• Detailed due diligence and integration work is undertaken and reviewed in accordance with Group policy • A new Acquisition and Disposals Policy has been developed for the entire transaction cycle • Due diligence includes an assessment of the acquisition target's talent and competencies. • Monthly reviews of the acquisition pipeline and a stage-gated M&A process ensure strong focus on and oversight of the pipeline • The Acquisitions & Divestments sub-Committee of the Board has authority to approve smaller acquisitions and divestments, whereas larger transactions can only be approval by the full Board • The Board reviews post-acquisition performance and integration P24

RISK MANAGEMENT CONTINUED

RISK AND POTENTIAL IMPACT

NOT OPERATING IN THE RIGHT MARKETS

RISK APPETITE

Current | Target

POTENTIAL IMPACT

Medium

TREND

No change

VELOCITY

Low

We are repositioning the portfolio around our most attractive markets where we can deliver above-market growth on a sustainable basis. A significant proportion of the Group's revenue comes from the US and other mature western markets, with a notable proportion coming from western governments. Failure to select the right markets and geographies could impact our strategic progress and financial performance.

Potential impact

- Smiths Detection, Smiths Medical and Smiths Interconnect frequently tender for government contracts both directly and indirectly. Any significant disruption in government budgets could result in fewer contracts being awarded and lower revenues for Smiths
- Our growth strategy places emphasis on expanding our operations in higher-growth end markets and regions that are currently underserved, including Asia, and China in particular

KEY MITIGATING CONTROLS

- A diversified portfolio of businesses mitigates exposure to any one country, sector or customer
- The Group's Government Relations function works to inform policy and collaborate with colleagues across the business to advise on developments
- Some of our government-related businesses have a services or consumables component, which can be more resilient during an economic downturn, when customers' capital expenditures on original equipment may be more constrained
- Appointment of a Group President of Asia Pacific – a new role – to help accelerate our growth in the region

P24

ECONOMIC OUTLOOK AND GEOPOLITICAL ENVIRONMENT

RISK APPETITE

Current | Target

POTENTIAL IMPACT

High

TREND

No change

VELOCITY

Medium

- Global economic and financial market conditions have stabilised after the turmoil following the 2008 financial crisis, in large part due to the various impacts of quantitative easing and austerity measures. However, there remains continued uncertainty arising from a range of geopolitical and economic issues across the world. Smiths operates in more than 50 countries and is affected by global economic and political conditions. The business is affected by government spending priorities, in particular in the US and UK, and the willingness of governments to commit substantial resources to homeland security and defence.
- The impact of the UK's decision to withdraw from the EU (Brexit) remains uncertain. Potential effects of Brexit applicable to many businesses include economic and operational uncertainty, volatility of currency exchange, regulatory changes and the imposition of tariffs on trade between the UK and the Eurozone.
- Global security concerns continue to drive uncertainty. These include the continuing situation in Syria and the Middle East, and recent events in North Korea.
- The global oil price continues to trade at levels below the average of the past few years, which impacts the medium-term capital expenditure plans of a number of our customers, predominantly within the John Crane division.

KEY MITIGATING CONTROLS

- The Group has a diversified portfolio of businesses that mitigates exposure to any one country or sector
- The divisions monitor their order flows and other leading indicators, where available, so that they may respond quickly to deteriorating trading conditions
- The Group monitors the ongoing negotiations between the UK and the EU in order to assess the potential impact of Brexit and any transitional arrangements that may be agreed
- Maintaining our competitiveness and continually improving our product offering for our customers ensures we remain resilient and well placed to take advantage of commercial opportunities

RISK AND POTENTIAL IMPACT		KEY MITIGATING CONTROLS
INTERRUPTION TO SUPPLY CHAIN – MANUFACTURING CONCENTRATION **RISK APPETITE** Current | Target **POTENTIAL IMPACT** Low **TREND** Decreased **VELOCITY** High	Timely, efficient supply of raw materials and purchased components is critical to our ability to deliver to our customers, and drive our growth. **Potential impact** • Our manufacturing continues to be exposed to the risk of a number of external events which could have significant adverse consequences. These include natural catastrophes, disease pandemics and terrorist attacks. We are also affected by the social, economic, regulatory and political conditions where we operate • The concentration of manufacturing in lower-cost countries, in particular in Mexico, increases the length of the supply chain and means an adverse event could have more significant consequences for our ability to supply customers on time	• Supply Excellence is one of the six pillars of our SES operating model, providing an increased focus on efficient, resilient and cost-effective supply • Business continuity and disaster recovery plans are in place and tested for critical locations • We regularly evaluate our key sites for a range of risk factors using externally benchmarked assessments • Business interruption and property damage insurance is in place P23
INTERRUPTION TO SUPPLY CHAIN – SOLE SOURCE OF SUPPLY **RISK APPETITE** Current | Target **POTENTIAL IMPACT** Low **TREND** Decreased **VELOCITY** High	We rely on sole source component suppliers to provide raw materials or purchased components for some of our products. Any failure on their part or unforeseen adverse consequences in the region or market in which they operate would impact our ability to deliver solutions to customers and drive growth. **Potential impact** • Disruption to a sole-source supplier could impact our ability to deliver solutions to customers, impacting our financial performance and reputation	• We identify sole-source supplier risks and dual source where possible • The Procurement Leadership Team (PLT) continues to identify and monitor high-risk sole-source suppliers and puts in place mitigation plans, including qualification of alternative sources of supply where appropriate • Our PLT is also developing a risk management system based on Failure Modes Effect Analysis in order to understand the risk of occurrence and mitigation solutions P23

RISK AND POTENTIAL IMPACT		KEY MITIGATING CONTROLS
PRODUCT QUALITY ISSUE – RECALL / LITIGATION / CATASTROPHIC EVENT **RISK APPETITE** Current | Target **POTENTIAL IMPACT** Medium **TREND** Decreased **VELOCITY** High	In the ordinary course of business we are subject to litigation such as product liability claims and lawsuits, including potential class actions, alleging that our products have resulted or could result in an unsafe condition or injury. The mission-critical nature of many of our solutions makes the potential consequences of failure worse than would otherwise be the case. **Potential impact** • Manufacturing flaws, component failures and/ or design defects could require us to recall products, many of which are used in critical applications where the consequences of a failure could be extremely serious and, in some cases, potentially catastrophic • The Group, in particular Smiths Detection and Smiths Medical, may potentially be exposed to losses in the event of a cyber security breach relating to the Group's products. These include not only customers' losses, but also those of a potentially large class of third parties • Our businesses are active in markets and product areas that are known to be of interest to cyber criminals	• We have insurance cover for product liability. • The US SAFETY Act provides legislative protection for certain Smiths Detection products in the US; and we support efforts to implement similar legislation in other markets (eg ongoing 'third party limitation' lobbying seeks mirror legislation in the EU) • Quality assurance processes embedded in manufacturing locations for critical equipment, supporting compliance with industry regulations (eg FAA, FDA, API, etc.) • Material litigation is managed under the oversight of the Group General Counsel • Our Group-wide Quality Council drives standard definitions, identifies and shares best practice, and reduces the cost of poor quality • Risk analysis and mitigation processes relating to product cyber resilience are embedded in the product lifecycle process. Proactive steps are taken to ensure product cyber-related risks are continually monitored and managed P56, P180
FAILING TO MEET CONTRACTUAL OBLIGATIONS **RISK APPETITE** Current | Target **POTENTIAL IMPACT** Low **TREND** Decreased **VELOCITY** High	There is a risk that we may fail to deliver, in a timely fashion, or at all, the products and services that we are obliged to deliver, or fail in our contractual execution due to delays or breaches by our suppliers or other counterparties. **Potential impact** • There may be differences between the estimated costs in our medium and long-term contracts and actual costs, due to factors such as production delays and cost overruns • Some of our contracts, particularly those with governments, may include terms that provide for unlimited liabilities on our part or allow the government body or counterparty to terminate unilaterally, reduce or modify the relevant contracts or seek alternative sources of supply at our expense	• Contracts are managed and delivered by programme management teams that regularly review risks and take appropriate action • A review and approval process for significant and higher-risk contracts is in place at Group and divisional levels • The diversified nature of the Group mitigates the exposure to any single contract • We are working to enhance the contract review process across the business to increase the uniformity of process, risk tolerance (where appropriate), personnel, and contract management • In relation to government contracting in particular, legal functional policy deployment improvement targets include a specific action to determine and roll out best practice

RISK AND POTENTIAL IMPACT

SIGNIFICANT ETHICAL OR COMPLIANCE BREACH

RISK APPETITE
Current | Target

POTENTIAL IMPACT
Low

TREND
No change

VELOCITY
High

We operate in highly regulated markets, as well as in countries where the risks of bribery, corruption and modern slavery are high. There is a risk that a significant ethical or compliance breach may occur.

Potential impact

- A failure to comply with export regulations could lead to significant fines and a loss of export privileges
- A significant proportion of revenue stems from government contracts with strict conditions attached. Failure to meet those conditions, particularly in the US, can have serious financial and reputational consequences
- We operate in a number of relatively consolidated markets, which increases the risk of illegal anti-competitive activity such as collusion with competitors. US fines and penalties imposed for price fixing, bid rigging and other cartel type activities can exceed $100m per violation
- Any breach could seriously harm our reputation and impact our financial performance, customer relationships and ability to attract and retain talent

KEY MITIGATING CONTROLS

- We have a network of trade compliance officers across the Group to oversee import and export activities
- Medical has dedicated staff who maintain close contact with the FDA and other key regulators
- The Group General Counsel and divisional General Counsels monitor legislative changes and report and monitor actions as necessary
- We have adopted a set of shared values across Smiths and have a comprehensive ethics and compliance programme that supports our Ethics Code. It is overseen by a dedicated Ethics and Compliance function and Business Ethics Council. We conduct Group-wide training programmes and regularly hold ethics conferences around the world
- We operate an Alertline for reporting concerns, and have strong reporting and investigation mechanisms
- A new Anti-Modern Slavery Policy and procedures are being rolled out to reduce the risk of modern slavery in Smiths and our supply chain
- Competition law training programmes have been developed to educate employees
- We regularly review our Ethics and Compliance programme to address evolving risks

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CYBER SECURITY

RISK APPETITE
Current | Target

POTENTIAL IMPACT
High

TREND
Increased

VELOCITY
High

Cyber-crime levels continue to rise around the world and we operate in markets and product areas that are known to be of interest to cyber criminals. Our information assets and the systems we depend on are exposed to risks that could result in theft, corruption or breach of confidentiality.

Potential impact

- Cyber attacks could compromise the confidentiality, integrity and availability of our assets, impacting our ability to deliver to customers and ultimately, financial performance and reputation
- The Group, and especially Smiths Detection and Smiths Medical, is exposed to significant losses in the event of a cyber security breach relating to the Group's security or medical products. These include not only customers' losses, but also those of a potentially large class of third parties

- The Board provides oversight of our approach to cyber risks. We have a proactive ongoing focus on information and cybersecurity risks and have a sophisticated information security programme, which is supported by a strong governance framework
- Group-wide assessment of our most critical information assets and protection to enhance security. This follows a risk-based approach and includes information classification and handling rules
- Information Security Awareness programme, including online e-compliance training to educate employees
- Management of user privileges to ensure that users only have access to appropriate information and programmes
- Security monitoring to provide early detection of hostile activity on Smiths networks and an incident management process
- Partnership and monitoring arrangements are in place with critical third parties, including our communications service provider
- Risk analysis and mitigation processes relating to product cyber resilience are embedded in the product lifecycle process. Proactive steps are taken to ensure product cyber-related risks are continually monitored and managed

OUR APPROACH TO RESPONSIBLE BUSINESS

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PROMOTING A CULTURE OF RESPONSIBLE BUSINESS IS FUNDAMENTAL TO ACHIEVING OUR VISION OF DELIVERING INNOVATIVE SOLUTIONS FOR THE WORLD'S CHALLENGES – AND TO HELPING US BECOME ONE OF THE WORLD'S LEADING TECHNOLOGY COMPANIES

At Smiths, being a responsible business is firmly embedded in the ways we think and operate.

With around 22,000 people working in more than 50 countries, it is important that we maintain the highest standards of corporate responsibility. Behaving ethically, working safely, providing high-quality innovative solutions, reducing our environmental impact, developing and engaging our people, and contributing to our communities is fundamental to our long-term success.

Many of our products and services deliver valuable benefits to society and the environment, helping to reduce harm, keep people safe, improve efficiency and minimise environmental impact.

As a global technology company operating in highly regulated sectors, operating responsibly also helps us create long-term value by:

- Enhancing our reputation with our people, customers, suppliers and investors
- Winning business from customers who value responsible business performance
- Improving efficiency and reducing costs
- Providing a safe and ethical work environment that supports health and productivity, and reduces the risk of an ethical breach
- Attracting and retaining key talent in an increasingly competitive market

Our Responsible Business governance framework

Strong governance is essential to embedding responsible business practices across the Group. Our Board of directors oversees our approach to responsible business, including our Code of Business Ethics (the 'Code'). The Board sets our strategic and financial objectives, establishes high ethical standards and robust risk management frameworks, and monitors succession planning.

The Audit Committee monitors how we implement and comply with the Code. It reports to the Board on the effectiveness of our internal controls and processes to identify, evaluate and manage significant business risks, including potential violations of the Code.

The Chief Executive and Executive Committee are responsible for delivering our responsible business strategy. They champion the strategy within the business, setting and continually reinforcing the 'tone from the top'. This includes ensuring the Code is upheld, implementing supporting policies, setting targets and reviewing performance across key areas.

Our corporate centre helps foster our sustainable business culture. It sets governance and risk management frameworks, and develops tools, policies and programmes that help to embed a strong culture of responsible behaviour and continuous improvement across the Group (including the Smiths Excellence System). Our divisions tailor these programmes to reflect their specific business needs and local regulations.

Identifying our responsible business priorities

We use our strategy, risk management and stakeholder engagement processes to identify focus areas. We engage with a wide range of stakeholders – including our employees, customers, investors, industry bodies and suppliers – around the world on an ongoing basis and use their insights and feedback to help shape our activities and communication.

We also use a range of external sources to identify potential issues. These include regulatory guidelines and legislation; peer reviews; sustainability standards and guidelines; and experts and consultants.

Through this process we have identified a number of material issues, grouped under our five focus areas – Ethics; Health, Safety and Environment; People; Products; and Communities.

Our responsible business strategy

Our Group-wide responsible business strategy sets out our approach to these focus areas, underpinned by a robust governance framework and management approach.

We set Group performance targets across a number of areas of responsibility, and our sites and divisions regularly report their performance.

ETHICS

Integrity is one of our core values and underpins our commitment to doing business the right way. It supports our ambition to establish Smiths as one of the world's leading technology companies.

Being ethical means applying our shared values to our everyday actions and decisions. Acting with integrity helps to protect our reputation, business and people, safeguard our shareholders' investment and support our ambition to become one of the world's leading technology companies.

We are continuously improving our approach and strengthening our ethical culture, so that everyone knows what is expected of them, where they could face exposure to ethical risks, how to ask for help and where to report concerns.

The Board is ultimately responsible for the ethical conduct of the Group and our employees. On behalf of the Board, the Audit Committee assesses the ethical risks to our reputation and performance, monitors the implementation of the Code, and reviews reports and investigations from our Ethics Alertline.

They are supported by our cross-divisional Business Ethics Council and Ethics and Compliance team, who design and implement our compliance programme, manage our Ethics Alertline, investigate breach allegations and promote the Code across the Group. They are supported by internal teams including HR, Legal and Internal Audit.

We aim to continuously reinforce a strong ethical culture and enhance our compliance programmes to address evolving areas of risk. In FY2017, our principal compliance programmes included modern slavery risks; trade compliance; supplier conduct; anti-bribery and corruption; antitrust; and data protection.

Culture

Our shared values underpin a culture of doing the right thing, every time, while the Code provides more detailed guidance on our expectations of employees. Our Chief Executive and Executive Committee champion our values and the Code, and set the tone through communications and interactions with employees and stakeholders.

We give everyone a copy of the Code when they join us. We support it with an online training course and refresher training every two years. Both the Code and the training come in our top 19 operating languages.

We want everyone to feel confident about speaking up if they have a concern. We offer an independently operated, confidential Ethics Alertline for those who feel uncomfortable with raising an issue with their manager. In FY2017, 182 issues were reported via the Alertline, all of which were thoroughly investigated and disciplinary action was taken in 26 instances.

Education and compliance

We regularly review and update our ethics training materials in line with changes to risks and regulations. Our training programmes cover risk areas such as competition and antitrust, anti-bribery and corruption, modern slavery, and trade and export controls.

Throughout the year we arrange global forums to deepen our managers' understanding of the ethical challenges facing the business. In FY2017, we held regional events in growth markets such as Dubai, Indonesia, Thailand and China, as well as our Global Business Ethics Forum in San Diego, California.

During FY2017, we continued to align and strengthen our global compliance programme across the business, further enhancing our central policies, training and oversight, including establishing a global centre of excellence for trade compliance and launching a new Gifts, Meals and Entertainment Policy.

We are committed to upholding all internationally recognised human rights standards wherever we operate. We do not tolerate any use of child or forced labour within our facilities or those of our suppliers. During FY2017, we rolled out a policy and risk assessment to help address modern slavery risks. This can be found on www.smiths.com.

Our Supplier Code of Business Ethics, informs our suppliers, contract manufacturers and other third parties exactly what we expect of them in terms of ethics, compliance, human rights, and social and environmental issues.

As a global organisation we have to comply with numerous local and regional laws. To support this, we revised our Export and Import Controls Policy to provide better corporate oversight. We also conduct regular site-based reviews of trade activity to identify and manage any areas of risk.

FY2018 priorities

- Refresh and roll out our Code of Business Ethics and associated training
- Upgrade the Ethics Alertline operating system and raise employee awareness
- Hold regional ethics conferences in India and Eastern Europe
- Continue to enhance our risk management tools to better assess ethical risks, site by site
- Refresh and roll out our Supplier Code of Business Ethics and continue to embed our pre-qualification questionnaire for new suppliers
- Oversee the ongoing implementation of our Anti-Modern Slavery Policy

DOING THE RIGHT THING

Integrity is one of our core values and 'doing the right thing' is at the heart of what it means to work at Smiths – and it was the theme of our FY2017 Business and Ethics conference, which brought together 100 leaders from across the organisation to consider the ethical issues we face at Smiths.

HEALTH, SAFETY AND ENVIRONMENT

At Smiths we are determined to achieve world-class health, safety and environmental (HSE) performance. Wherever we operate, we aim to provide injury-free and environmentally responsible workplaces.

We are committed to protecting our people, communities, customers and the environment. This commitment is demonstrated by our comprehensive HSE Policy (available at www.smiths.com) and our HSE governance framework. Together, we are creating a culture that prioritises the health and wellbeing of our people and minimises our impact on the environment.

Our Chief Executive has ultimate oversight of HSE across the Group. Working closely with the Executive Committee, he is responsible for executing our Group-wide HSE strategy, implementing our policies and processes, and meeting our HSE targets. To ensure these principles are fully and effectively embedded, the president of each division sets HSE programmes specific to their business. They are supported by the HSE Technical Committee who track performance, and identify areas for improvement.

By developing a shared approach to HSE across the Group, we manage our safety and environmental risks more effectively and provide better protection for our employees, our communities, the environment and shareholder value.

HSE management and compliance

Our management systems help us identify and prioritise HSE risks across the Group. They drive continuous improvement and provide the externally verified framework behind a consistent, best-practice approach to HSE management. Our HSE performance against Group targets is tracked on a site-by-site basis using dedicated HSE management software, and is reviewed by the Executive Committee.

We use external auditors to check compliance at sites, often as part of their management system certification. Audit findings drive corrective action plans and are shared with other sites to promote best practice.

Environmental performance

To ensure we are using energy and natural resources efficiently, we implement world-class production processes that decrease waste and energy consumption. We also invest in low-carbon technologies and environmental management systems that drive improvement in our performance.

In FY2013 we set new five-year environmental targets, having exceeded previous targets two years early. Using FY2013 as the baseline, our targets are to achieve a reduction of energy usage, Greenhouse Gas (GHG) emissions and waste generation of 15%, and water usage of 10% by FY2018, all normalised to revenue. By installing more energy-efficient equipment, implementing water reuse programmes and focusing on green energy contracts, we have made good progress against these objectives.

Compared to our baseline year of FY2013, we have achieved good progress in reducing our environmental metrics, with GHG and non-recycled waste already exceeding our five-year goal and water consumption on target. During FY2017, our overall environmental performance continued its long-term improvement trend with normalised reductions in energy, water usage and GHG emissions, while non-recycled waste remained broadly in line. Absolute environmental metrics reduced in 2017 with 4% energy, 9% water usage, 7% GHG, and 2% non-recycled waste.

See our 2017 Responsible Business Report or our website (www.smiths.com) for a detailed review of environmental performance.

Energy and greenhouse gas

We measure and monitor energy consumption at a site level using our tracking software, which provides a consolidated view of overall performance across the Group. Our Energy and Greenhouse Gas Policy

GHG EMISSIONS

Emission		**FY2017**	FY2016	FY2015
Absolute values				
Scope 1 (direct emissions)	t CO_2e	**11,000**	12,000	14,000
Scope 2 (indirect emissions)	t CO_2e	**62,000**	69,000	81,000
Total	t CO_2e	**73,000**	81,000	95,000
Normalised values				
Scope 1 (direct emissions)	t CO_2e/£m revenue	**3.74**	3.95	4.54
Scope 2 (indirect emissions)	t CO_2e/£m revenue	**20.83**	22.56	26.08
Total	t CO_2e/£m revenue	**24.57**	26.51	30.62

(see www.smiths.com) sets out our approach to managing the impacts of our business, and action plans and best practices are shared across the Group.

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

Workplace health and safety

Our people are our most important asset and we are committed to protecting their health, safety and wellbeing and delivering a culture of zero harm. To achieve this, we are rolling out a series of Group-wide initiatives that drive continual improvements in our safety culture and shape our behaviours, while reducing exposure to risks.

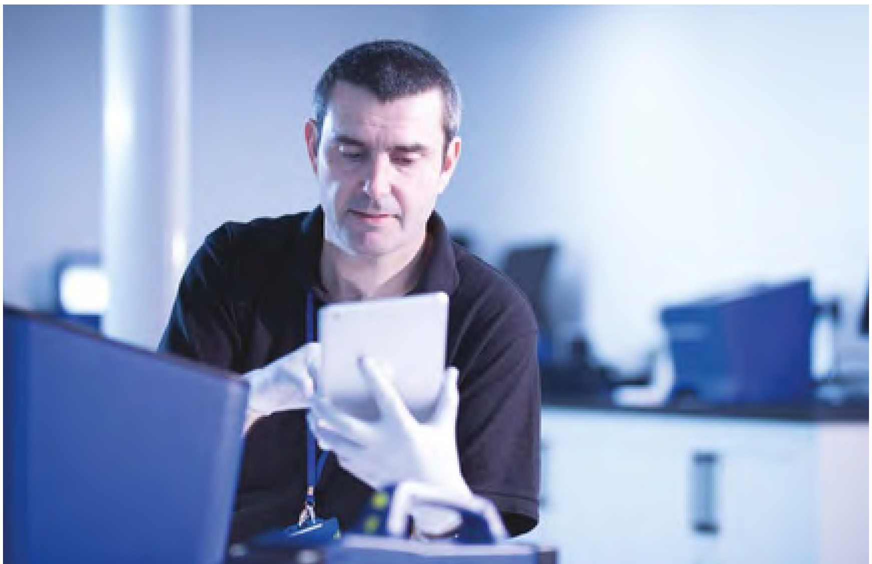
We monitor various leading and lagging measures for health and safety. Safety Leading Indicator Activities assess initiatives undertaken by sites to improve performance and are established as a company KPI. We also monitor the Recordable Incident Rate (RIR) and Lost Time Incident Rate (LTIR) across the Group, measured per 100 employees per year. Since 2004, we have cut our RIR from 4.6 to 0.36, achieving our lowest RIR in FY2017. Our LTIR increased slightly to 0.16 in FY2017.

FY2018 priorities

- Continue to improve our safety performance and draw ever closer to our target of zero injuries
- Develop a new set of environmental goals for our next commitment period

WORKPLACE HEALTH AND SAFETY

		FY2017	FY2016	FY2015
Recordable incident rate Where employees require medical attention beyond first aid	(per 100 employees per year)	**0.36**	0.47	0.55
Lost time incident rate Where employee is unable to work the day following an incident	(per 100 employees per year)	**0.16**	0.14	0.22



TAKING OWNERSHIP OF HEALTH AND SAFETY

With service teams often working in external environments outside our direct control, their ability to recognise unsafe conditions and act accordingly is critical. Smiths Detection has launched a new online training tool and web-based/mobile risk assessment platform that's giving both leadership and field service engineers a better understanding of how to stay safe when working off-site. We encourage everyone at Smiths to take ownership of both their own health and safety and that of their colleagues, and this tool is helping our service teams do just that.

RECORDABLE INCIDENT RATE PER 100 EMPLOYEES

0.36

PEOPLE

People are our one truly sustainable source of competitive advantage and critical to our growth strategy. We are passionate about helping them fulfil their potential so we can reach ours.

Our people strategy is focused on building a learning organisation that attracts, retains, engages, develops and inspires the very best people. We do this by focusing on four key areas – culture, leadership and learning, reward and recognition, and infrastructure.

Culture, engagement and communication

We are building a culture based on our shared values of integrity, respect, ownership, customer focus and passion – and we are doing this through the Smiths Way, which we launched in April 2017. As well as using our shared values to guide our decisions and behaviours, we are aligning globally on key initiatives and a shared operating model to make us a bigger, better, more focused Smiths.

We use regular surveys to measure engagement and gather insights into our employees' experience and perceptions. A new survey – My Say – was launched in FY2017 to encourage an ongoing, two-way dialogue across the Group, with a refreshed set of questions that better align with our new strategy and culture, more granular reporting, and increased frequency. We achieved a participation rate of 82% and an employee engagement score of 71 across the Group in our latest survey. The data and insights gathered will be used to identify global priorities for FY2018.

Leadership and learning

Providing our employees with the best learning and development opportunities is a vital aspect of our people plan. Line managers and HR professionals work with employees to identify their skills, areas for improvement and development opportunities. These personal development plans form a key part of our annual performance review process.

Competition for talent is increasing so it is essential we can identify and engage with our leaders through world-class development programmes. In FY2017 we launched an executive development programme in partnership with UCLA Anderson Executive Education. The programme currently has two streams – leadership and strategy, and finance – and has been successfully piloted with a cohort of our senior leaders, with three further cohorts set to participate in FY2018. These programmes challenge and engage our team and enhance their core leadership capabilities.

Reward and recognition

Recognising and rewarding our employees in a fair and transparent way ensures that our people feel incentivised to succeed, that strong performance is recognised, and that individuals are differentiated based on abilities and results. To reinforce this, a global grading project is being rolled-out to help identify distinct career paths for all employees. Initially focusing on our leadership population, the programme will be rolled out to the wider organisation during FY2018.

During the year, we introduced new incentive plans for some of our employees that align individual objectives with the delivery of our growth strategy, such as Smiths Excellence System and sales targets. Incentive plans are adapted each year as specific focus areas change.

Diversity and inclusion

Respect is one of our core values and we aim to provide an inclusive, collaborative culture where respecting diversity is woven into everything we do. We ensure that equal opportunities are practiced when interviewing, recruiting and promoting employees with decisions made based on skills and expertise first and foremost.

In FY2017 we introduced a Group Culture and Diversity function to increase our focus on diversity and inclusiveness across the business. Specific diversity-focused questions were added to the engagement survey, and an online training course addressing unconscious bias was piloted across several business functions.

SMITHS EXCELLENCE AWARDS

We believe that recognition is broader than reward and compensation and the Smiths Excellence Awards recognise the highest levels of achievement across our six pillars of Excellence, as well as outstanding contributions to Health and Safety and our communities.

This year, we expanded the programme to celebrate success more widely and further embed Excellence across the business by rolling out a tiered scheme, with divisional winners being rolled up into an overarching Group scheme. The winning teams were celebrated at a gala dinner and received a $1,000 contribution to a charity of their choice.

We are committed to broadening the diversity of our workforce and are developing programmes such as our global Women's Leadership Network that increase the diversity of candidates for senior positions. At the end of FY2017, 38% of our global workforce and 14% of our senior managers were women. In addition, two of our Board directors are women, representing 22% of the Board as at 31 July 2017.

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

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

FY2018 priorities

- Continue to embed the Smiths Way of working, including our shared values
- Integrate workforce planning with talent development to ensure we develop the right people to drive our strategy
- Develop and implement our unique employer brand to help attract and retain the best talent
- Continue the roll-out of our global job-grading programme to support the creation of new job opportunities, career paths, and aligned remuneration across Smiths

DIVERSITY PERFORMANCE

	Male	Female	**Total**
Board of directors	7	2	**9**
Senior managers*	218	36	**254**
Employees (total)	13,600	8,300	**21,900**

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

IMPROVING MOTIVATION ON THE SHOP FLOOR

Recognising the key role supervisors play in employee engagement and operational performance, John Crane launched a Supervisor Development Programme in Bangalore, India. By building the knowledge and skillset of site supervisors, the programme has increased motivation and engagement among shop floor production teams, as well as creating a new passion for learning.

Sathishbabu Palani, Continuous Improvement Manager at John Crane said: "The scheme has been really successful – it's enabling our people to become better coaches to their teams and ultimately improve safety, productivity and team engagement."

OUR RESPONSIBLE BUSINESS
CONTINUED

PRODUCTS

By developing leading-edge, mission-critical solutions, we help to drive safety, security, health, productivity, reliability, connectivity and progress around the world, every day. Our solutions enable customers to operate in safe, efficient and environmentally-friendly ways, and we ensure that our products meet the highest standards of quality and safety.

From Smiths Medical's products which are vital to patient care globally; and Smiths Detection's security scanners, which play a vital role in enhancing security around the world; to John Crane's seals, which help its customers reduce their environmental impact – we provide innovative solutions to some of the world's toughest challenges.

INVESTMENT IN NEW PRODUCT DEVELOPMENT

£150M

Many of our solutions play a mission-critical role in our customers' operations and ensuring consistently high standards of quality and safety through their manufacture, distribution and end use is essential to our reputation and long-term success.

The Smiths Excellence System drives our approach to quality, both within Smiths operations and throughout our supply chain, ensuring consistent best practice across the business. We are also committed to using materials that are ethically and safely sourced. Where possible, we look for ways to 'design out' or replace less sustainable materials and chemicals used in our manufacturing processes with more sustainable alternatives.

Technological differentiation is critical to outperforming in our chosen markets on a sustainable basis and innovation is a key part of our growth strategy. Our New Product Introduction process assesses the current and future needs of customers and considers health, safety, security and environmental outcomes when determining and developing the solutions that make up the pipeline.

PROTECTING THE ENVIRONMENT

John Crane's non-contacting gas seal technology has been helping to protect the environment for nearly 40 years. This innovation helped slash methane emissions from centrifugal compressor shaft seals by a factor of 10 – helping natural gas processing and transmission companies reduce their carbon footprint across the world. Gas Seal technology is now the de facto standard on new equipment and can be readily retrofit into most existing equipment in the field.

PROTECTING PEOPLE FROM DANGEROUS SUBSTANCES

The threat of fentanyl, a highly dangerous pain relief drug that can be absorbed through the skin, is on the rise and Smiths Detection has adapted its leading-edge technology to detect and identify it – helping protect the security and health professionals coming into contact with this dangerous substance in emergency situations. And the ReachBackID 24/7 hotline service has been enhanced so first responders using our products in the field can speak directly to PhD scientists to help them better analyse situations and reduce risk.

COMMUNITIES

Supporting the communities in which we operate helps drive prosperity locally – providing jobs, boosting the economy and supporting local initiatives – as well as enhancing both employee engagement and our reputation as an employer.

Given the diversity of our business, we manage our community relationships and charitable programmes at a local level, so each business can focus on its own markets and communities. We also offer Group-level support to charities and organisations that can show how a donation will increase the wellbeing of people through improvements to their education, health, welfare or environment.

In FY2017 the Group made charitable donations of £348,000. In addition, our employees donated and raised money for a number of good causes, through a range of fundraising initiatives across the business.

Our global footprint means we generate financial value for a wide range of communities. As well as paying wages and benefits to our c. 22,000 employees worldwide, we contribute to local economies through taxes, duties, infrastructure investment, and purchase of local goods and services.

We encourage our people to get involved in their local communities as it promotes employee engagement and builds a sense of pride in our business. We celebrate the best of these initiatives through our Excellence Awards scheme. The ten winning teams from across our Excellence pillars also receive $1,000 to donate to a charity of their choice.

Strategic report
The Strategic report was approved by the Board on 21 September 2017.

By order of the Board

ANDY REYNOLDS SMITH
CHIEF EXECUTIVE

FUNDING FOR CLEAN WATER

Clean water is in short supply in many parts of the world. In the developing nations people have to walk around 5km each day to collect water that's often dirty and contaminated.

To help raise funds for clean water, Smiths Medical organised a global sponsored water walk across its sites. In total, more than 1,800 employees from 26 sites took part in 5km walks. Together they walked 10,000km, donated 25,000 litres of water through water collection drives and raised money for the Red Cross and other charities.

COMMUNITY GIVING IN COSTA RICA

The team at Smiths Interconnect, Costa Rica, ran a wide-ranging community programme during the year. The team supported projects ranging from sponsoring a shelter for at-risk teenagers and young mothers – providing food, clothing and baby supplies , as well as helping with building repairs and maintenance – through to a re-forestation project in the local national park.

The team of volunteers showed real passion for the initiative and were recognised at our 2017 Smiths Excellence Awards as an outstanding example of supporting local communities where we operate.

GOVERNANCE

GOVERNANCE

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smiths interconnect

BOARD OF DIRECTORS

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SIR GEORGE BUCKLEY
CHAIRMAN

Committee membership N R

Appointed:
1 August 2013 (non-executive director and Deputy Chairman);
19 November 2013 (Chairman)

Relevant skills and experience:
Sir George was Chairman, President and CEO of 3M, a US-based global technology company, until 2012, and he brings his extensive experience of large, global, multi-industry businesses to the Board. Sir George has a PhD in Electrical Engineering and spent most of his long and successful career in the US, including as Chairman and CEO of Brunswick Corporation and President of Mercury Marine. His previous experience also includes Chief Technology Officer for appliances, motors and controls at Emerson Electric Company. Sir George's track record in strategic transformation, engineering and innovation are invaluable to the Group and support his effective Chairmanship of the Board.

Other significant appointments:
- Stanley Black & Decker, Inc. (Chairman)
- Hitachi, Ltd. (non-executive director)
- PepsiCo, Inc. (non-executive director)

ANDY REYNOLDS SMITH
CHIEF EXECUTIVE

Appointed:
25 September 2015

Relevant skills and experience:
Andy has extensive experience in driving business strategy, technological innovation and operational excellence. Before joining Smiths Group he was CEO of GKN Automotive, serving on the Board since 2007. Andy joined GKN in 2002 and held several senior positions across the Group, including leading the Driveline, Powder Metallurgy and Land Systems divisions. In previous roles Andy was Managing Director Europe for Ingersoll Rand's Bearings and Components business, Vice President International Operations at Invensys, and UK Country Director and Global Customer Director (Japan) for Delphi Automotive Systems. His past experience includes Chairman of the CBI Manufacturing Council, membership of HM Government's Ministerial Advisory Group for Manufacturing and Green Economy Council, and as non-executive director of Morgan Advanced Materials plc.

BILL SEEGER
INTERIM CHIEF FINANCIAL OFFICER

Appointed:
12 May 2014 (non-executive director);
19 May 2017 (Interim Chief Financial Officer)

Relevant skills and experience:
Bill has an established career in finance in the engineering sector, in addition to an in-depth knowledge of global markets, long term contracts and strategy execution, supporting his effective contribution to the work of the Board. Bill has an MBA and a BA in Economics, and was previously Chief Financial Officer at GKN plc, retiring in 2014. Prior to his role at GKN, Bill held a number of senior finance posts during a 28-year career with TRW, a US-based automotive and aerospace group. Bill chaired the Smiths Group Audit Committee for almost three years, and was well placed to assume the role of Interim Chief Financial Officer in May 2017. Bill stepped down as Chair of the Audit Committee following this appointment.

Other significant appointments:
- Spectris plc (non-executive director)

Committee membership key

A	Audit Committee
N	Nomination Committee
R	Remuneration Committee
●	Denotes Chair of the Committee

BRUNO ANGELICI
NON-EXECUTIVE DIRECTOR

Committee membership A N R

Appointed:
1 July 2010

Relevant skills and experience:
Bruno has an MBA from Kellogg School of Management and has held senior management roles in global medical device and pharmaceutical companies throughout his career. Bruno has extensive international experience, including at Baxter, a US-based global supplier of medical devices. At AstraZeneca he held the role of Executive Vice President, International and was responsible for Europe, Japan, Asia Pacific, Latin America, Middle East and Africa. Bruno provides the Board with valuable global experience of both the medical device and pharmaceutical industries.

Other significant appointments:
- Vectura Group plc (Chairman)
- Wolters Kluwer nv (Supervisory Board member)

TANYA FRATTO
NON-EXECUTIVE DIRECTOR

Committee membership A N R

Appointed:
1 July 2012

Relevant skills and experience:
Tanya has a BSc in Electrical Engineering and her executive career includes 20 years at GE. She brings knowledge of manufacturing and operations to the Board, in addition to experience of sales and marketing across a range of sectors. Most recently she was CEO of Diamond Innovations Inc., a manufacturer of products for the material removal industry. In 2017 Tanya was appointed non-executive director at Mondi Group, an international packaging and paper business, and her exposure to a global industrial company further strengthens the contribution she makes to the Smiths Group Board.

Other significant appointments:
- Advanced Drainage Systems, Inc. (non-executive director)
- Ashtead Group plc (non-executive director)

BOARD OF DIRECTORS

ANNE QUINN CBE
NON-EXECUTIVE DIRECTOR

Committee membership A N R

Appointed:
1 August 2009

Relevant skills and experience:
Anne has extensive global experience in the oil and gas sector, enjoying a 25-year career with Standard Oil of Ohio and BP. Anne has a BCom from Auckland University and an MSc in Management Science from the Massachusetts Institute of Technology. At BP she held a number of executive positions, including Group Vice President in the US, UK, Belgium, and Colombia. Following her career at BP Anne was Managing Director of Riverstone LLP, an energy private equity group. Anne's experience and knowledge of the oil and gas industry is particularly valuable when the Board is debating strategy for John Crane, as a provider of products and services to global energy services customers. Anne also brings extensive experience as chair of remuneration committees.

MARK SELIGMAN
NON-EXECUTIVE DIRECTOR

Committee membership A N R

Appointed:
16 May 2016

Relevant skills and experience:
Mark is a Chartered Accountant and has an MA in Philosophy, Politics and Economics. Mark was previously Chairman of UK Investment Banking for Credit Suisse, and his career in investment banking brings a deep understanding of investment strategy and corporate finance to the Board. Mark has non-executive experience serving on Audit Committees, which has been valuable to the Board in 2017 as he has been appointed Chair of the Audit Committee following Bill Seeger's appointment as Interim Chief Financial Officer.

Other significant appointments:
- Kingfisher plc (Senior Independent Director)
- Royal Bank of Scotland Group plc (non-executive director)
- Panel on Takeovers and Mergers (Alternate Member)

NOEL TATA
NON-EXECUTIVE DIRECTOR

Committee membership A N R

Appointed:
1 January 2017

Relevant skills and experience:
Noel has a BA in Economics and is currently Managing Director of Tata International Limited, a global trading and distribution company and a trading arm of the Tata Group, the privately-owned multinational holding company headquartered in Mumbai, India. Noel has a successful career in global business, and his executive role within the Tata Group of companies provides him with current contacts and experience in high growth economies, including Asia and Africa, which is valuable as the Smiths Group continues to grow in these regions.

Other significant appointments:
- Tata Investment Corporation* (Chairman)
- Kansai Nerolac Paints Ltd* (non-executive director)
- Trent Ltd* (non-executive director)
- Titan Company Ltd* (non-executive director)
- Voltas Ltd* (non-executive director)

* Listed on the Bombay and Indian National Stock Exchanges

Committee membership key

A	Audit Committee
N	Nomination Committee
R	Remuneration Committee
●	Denotes Chair of the Committee

Additional biographical information for each of the directors can be found online at www.smiths.com.

SIR KEVIN TEBBIT KCB, CMG
SENIOR INDEPENDENT DIRECTOR

Committee membership A N R

Appointed:
14 June 2006 (non-executive director); 17 November 2015 (Senior Independent Director)

Relevant skills and experience:
Sir Kevin brings considerable experience in the security and defence sectors to the Board, as well as his expertise and depth of knowledge of Government. This is particularly important when the Board considers Smiths Detection. Sir Kevin has a BA in History, and over his career has held posts in the Ministry of Defence (MoD), the Foreign and Commonwealth Office and NATO. His roles have included Defence and European Counsellor at the British Embassy in Washington, Director of Government Communications Headquarters (GCHQ) and Permanent Under Secretary at the MoD.

Other significant appointments:
- Executive Vice President AECOM UK (Government and Defence)
- Institute of Security Science and Technology, Imperial College London (Advisory Board Member)

MEL ROWLANDS
COMPANY SECRETARY AND DEPUTY GROUP GENERAL COUNSEL

Appointed:
29 May 2015

Relevant skills and experience:
Mel holds an MA in Law from Oxford University and is a qualified solicitor. She joined Smiths in 2013, having previously held senior roles in BG Group plc and Linde AG. Most recently, she was the General Counsel of British Gas and Legal & HR Director of Edwards Group.

CORPORATE GOVERNANCE STATEMENT
CHAIRMAN'S INTRODUCTION

SIR GEORGE BUCKLEY
CHAIRMAN

During 2017 the Smiths leadership team have continued on the path of building our 'new future'.

Elsewhere in this Annual Report you will read about our story – how we are creating a more vibrant, faster growing and innovative company and how this will benefit our investors, employees and other stakeholders alike. In this Corporate Governance Review you will read about the part your Smiths Board of Directors has played during the year and our plans for the future.

The building blocks of any great company include ensuring there is a strong framework of company governance. This should never be done with a 'tick box' mindset; it needs to be engaged, thoughtful and effective. Boards need to take the lead to set a positive culture and to make sure that good governance forms a firm foundation for decision making throughout the company. The Smiths Way was launched in 2017 and this framework provides our shared set of values, a common approach to strategy, and a commitment to excellence across all our businesses.

Our ambition for Smiths is one with innovation and growth in its DNA, but also where colleagues act with integrity and respect towards each other and keep each other safe. It is often said that the true test of integrity is that you do the right thing – even when no one is watching, and I can assure you that the Board gives a great deal of focus to corporate governance in its widest and deepest sense. The Audit Committee reviewed the Group's ethics and compliance programme during the year, which has led to a number of significant improvements. We also strengthened our anti-slavery compliance programme and published an updated Smiths Modern Slavery Statement which affirms our commitment not to tolerate this in any part of our business or supply chain.

Another fundamental and vital building block is people. The Nomination Committee of the Board sponsored the new Group-wide process for talent and succession planning across Smiths and we continue to work to achieve an appropriate balance of experience, skills, domain knowledge and background in both the Boardroom and at senior leadership levels of the Group. We are mindful of the reports from Sir Philip Hampton and (the late) Dame Helen Alexander and from Sir John Parker in the areas of women in leadership positions and ethnic diversity respectively, and are committed to staffing diverse Board and senior leadership teams. We firmly believe that diversity improves our performance as it produces better ideas.

Board succession and composition continues to be a priority for the Board and I was delighted that Noel Tata was appointed to the Board as an additional non-executive director in January 2017. Noel brings a very valuable and distinct contribution to Smiths with his current experience and connections in those economies where we are focusing on higher levels of growth. In May 2017 Chris O'Shea stepped down as Chief Financial Officer to pursue his career outside the Group. I was delighted that Bill Seeger agreed to take on the role of Interim Chief Financial Officer whilst we carried out a search for a replacement. I was also delighted that Mark Seligman agreed to take on a key non-executive role as Audit Committee Chair. I am personally grateful to Bill and to Mark, and to Anne Quinn as Chair of the Remuneration Committee, for all the support they have shown to me and to Andy over recent months. As further detailed in its report, the Nomination Committee continues to keep Board composition and succession plans under regular review, but with an eye to maintaining a good measure of stability and continuity during a time of significant change for the Group.

As Chairman I am responsible for leading an effective Board and I am pleased to report that your Board has been effective during the year. Details of the annual appraisal process and the actions and improvements that we agreed to drive through 2017 are set out on pages 89 and 90 of this Report. I want to take this opportunity to record my thanks to all members of the Board for their hard work and support throughout the year. I hope you find this report interesting and enlightening as it details the work the Board and its Committees have carried out on your behalf during the year. I strongly urge you to attend this year's shareholders Annual General Meeting and take the opportunity to engage with us in person.

SIR GEORGE BUCKLEY
CHAIRMAN

UK Corporate Governance Code (the 'Code')

As the Company is listed on the London Stock Exchange we comply with the Code. A copy of the Code published in 2016, and applying to financial years beginning on or after 17 June 2016, can be found at www.frc.org.uk. For the year ended 31 July 2017, and at the date of this report, we applied the main principles and complied with the provisions of the Code.

Disclosure Guidance and Transparency Rules

This corporate governance statement is incorporated into the Directors' Report by reference and is compliant with the corporate governance statement requirements of the FCA's Disclosure Guidance and Transparency Rules.

BOARD STATEMENTS

Requirement	Board Statement	Where to find further information
Compliance with the UK Corporate Governance Code	For the year ended 31 July 2017, and at the date of this report, the Company has been in full compliance with the 2016 UK Corporate Governance Code.	Page 83
Going concern basis of accounting	The directors continue to adopt the going concern basis of accounting in preparing the annual accounts of the Company and the Group.	Page 124
Viability statement	The directors have assessed the longer-term prospects of the Group and they have a reasonable expectation the Group will remain viable for the period being assessed, and will continue to operate and meet its liabilities as they fall due.	Page 57
Robust assessment of the principal risks facing the Group	The Board carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency and liquidity.	Page 93
Annual review of systems of risk management and internal control	The Audit Committee, on behalf of the Board, monitored, reviewed and assessed the effectiveness of the Group's risk management and internal control systems.	Page 93
Fair, balanced and understandable	The Board considers the 2017 Annual Report to present a fair, balanced and understandable overview of the Group's position and performance.	Page 97

BOARD ACTIVITIES DURING FY2017

Principles of the UK Corporate Governance Code	Activity in FY2017
Leadership	• Held a Board strategy week to set Smiths' vision for five years • Oversight of M&A, including acquisition of Morpho Detection and its integration with Smiths Detection • Board members attended Smiths Global Leadership Conference at UCLA • Sponsored the launch of the Smiths Way, culture and values for the Group • Nomination Committee sponsored a new Group-wide process for talent, succession and strategic workforce planning
Effectiveness	• Actioned the Board evaluation improvements • Appointed a new non-executive director Noel Tata • Reviewed the Board skills matrix and discussed succession planning for the Board • Search for a new Chief Financial Officer
Accountability	• Held a risk-focused Audit Committee meeting • Agreed the Audit Tender timetable • Added cyber security to the Audit Committee terms of reference • Reviewed the financial statements to ensure they are fair, balanced and understandable • Monitored the work programme for managing modern slavery risks in the Group's business and supply chain, and approved the updated Smiths Modern Slavery Statement
Remuneration	• Considered and approved annual incentive plan payouts and set targets for the new financial year • Approved the salary proposal for the Chief Executive, members of the Executive Committee and reviewed fees for the Chairman • Determined Chris O'Shea's arrangements on stepping down from the Board, and agreed Bill Seeger's package for assuming the role of Interim Chief Financial Officer
Relations with shareholders	• Held the 2016 AGM • Met with shareholders and brokers regarding director changes • Sponsored and reviewed the 2017 investor survey • Held a number of investor roadshows and conferences

LEADERSHIP

The Board of directors is collectively responsible for ensuring the long-term success of Smiths. This includes reviewing and approving strategy in order to create sustainable value for the shareholders, as well as setting the Company's culture and values. This is underpinned by a strong framework of good governance, including the Board's responsibility for setting risk appetite.

Governance structure

In order to fulfil their collective responsibility effectively, the Board of directors has established the Audit, Nomination and Remuneration Committees. Each Committee has authority delegated to it by the Board, and their responsibilities, activities and membership are described in this corporate governance statement. The full terms of reference for each Board Committee have been approved by the Board and are available online at www.smiths.com.

There is a clear division of responsibilities between the Board and the Executive Committee and senior management, who are responsible for the day-to-day management of the business, including the execution of strategy set by the Board.

The role of the Board

The directors are responsible for the long-term success of the Group, and in order to retain control over decision-making there is a formal schedule of matters which have been reserved for the decision of the Board, as opposed to those matters that are delegated to management. These matters include approval of the following:

- Group strategy, business plans and budgets
- half-yearly financial reports and the Annual Report and Accounts
- acquisition or divestment of significant companies or businesses
- remuneration policy for directors and other senior executives
- changes to the structure, size and composition of the Board
- the issuance of Smiths Group plc shares

GOVERNANCE MODEL

Board and Board Committees

BOARD

Responsible for ensuring the Group's long-term success by creating sustainable shareholder value.

NOMINATION COMMITTEE

Reviews and makes recommendations to the Board on the structure, size and composition of the Board and Board Committees, and succession planning for directors and senior management.
See page 91 for more information

REMUNERATION COMMITTEE

Makes recommendations to the Board on the remuneration framework, including the remuneration of the Chairman, executive directors and senior management.
See page 103 for more information

AUDIT COMMITTEE

Monitors the integrity of financial statements, risk management and internal control systems, and internal and external audit.
See page 94 for more information

Executive Management structure*

EXECUTIVE COMMITTEE

Develops and recommends strategy to the Board, recommends budgets and plans to the Board, executes strategy, and drives performance to budget and plans.

INVESTMENT COMMITTEE

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

DISCLOSURE COMMITTEE

Advises the Chief Executive and the Board in accordance with the Disclosure Policy. Makes recommendations concerning the identification of inside information and the timing and method of disclosure.

ACQUISITIONS AND DIVESTMENTS COMMITTEE

Approves mergers, acquisitions, disposals and joint ventures within the parameters delegated by Board.

* In addition to the above there are a number of functional committees which include the Environmental Health and Safety Steering Committee, i³ (Smiths innovation forum), and the Business Ethics Council.

Only the Board has the authority to approve any changes to the formal matters reserved for its decision-making. The full list was reviewed in July 2017 and can be found online at www.smiths.com. To ensure that they continue to operate effectively the directors have at least six formal Board meetings a year. Board meeting agendas have been reshaped during the year to include more time to focus on the long term, and less on backward-looking financial information and performance. Board agendas include a review of elements of the Group strategy and its execution at each meeting, in addition to the meetings focused on strategy which take place in May each year. Regular matters for review by the Board, including the Group's financial performance, divisional business plans and progress against them, budgets, mergers and acquisitions, material investments, large projects, the people plan and possible threats to the business, are all considered by the Board under the framework of the agreed strategy. The Board also assesses the implementation of strategy within a framework of prudent and effective controls; a key part of ongoing risk management is ensuring that the strategy in place remains fit for purpose.

The Board is responsible for steering our culture and our shared values of integrity, ownership, respect, customer focus and passion. The Board sets the tone from the top and oversees key programmes, including ethics and compliance, health and safety and our people plan. In 2017 the Board supported the launch of the Smiths Way, a shared way of working that includes our values, operating model and strategy. As part of this we celebrate the best examples of excellence in Smiths with our annual Excellence Awards, and members of the Board attended the gala dinner for winners in April 2017.

Division of responsibilities

While the Board is collectively responsible for the success of the Group, there is a clear division of responsibilities between running the Board and the executive responsibility for running the business. The Board recognises the importance of ensuring that no one individual should have unfettered powers of decision-making, and has clearly defined roles for the Chairman and the Chief Executive which have been agreed by the Board. A summary of the responsibilities of the Board are identified in the adjacent table.

In order to fulfil his role effectively the Chief Executive is supported by the Executive Committee. The Committee normally meets once a month, and includes the five divisional Presidents, the Asia President and the functional heads. The Committee's responsibilities include ensuring the Group's continued financial performance, day-to-day management of the Company's business and the implementation and delivery of the strategy set by the Board.

Chairman
Responsibilities include:

- leading the Board, including ensuring constructive relations between executive and non-executive directors
- the Board's continued effectiveness and integrity
- promoting high standards of corporate governance
- ensuring effective communication with shareholders

Chief Executive
Responsibilities include:

- developing and recommending strategy to the Board
- setting and embedding an appropriate culture for the Group and communicating the 'tone from the top', with a focus on ethical behaviour and health and safety
- leading the Executive Committee
- ensuring strategic and financial objectives and business KPIs are met
- effectively managing stakeholders, including shareholders, customers and employees

Senior Independent Director
Responsibilities include:

- acting as a sounding board for the Chairman
- being available to shareholders where their concerns cannot be resolved by the Chairman or executive management
- if necessary, acting as an intermediary for directors

Non-executive directors
Responsibilities include:

- helping to formulate strategy
- providing constructive challenge in Board discussions
- assessing whether the systems of internal control and risk management are sufficiently robust
- as members of the Board Committees, fulfilling the responsibilities of those Committees set out in their terms of reference

Company Secretary
Responsibilities include:

- maintaining the Group's governance framework and advising on matters of governance and legislative and regulatory developments
- ensuring that the directors are provided with all relevant information in a timely manner
- facilitating new director inductions and ongoing director training

EFFECTIVENESS

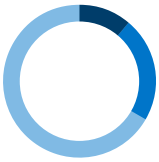
Board composition
The Board composition as at 22 September 2017 is detailed in the attendance table on page 88, and the relevant skills and experience each director brings to the Board are described in their biographies on pages 78 to 81.

In order to operate effectively the Board and its Committees must be comprised of a suitable balance of tenure, skills, experience, knowledge and independence. The Board and the Nomination Committee keep this under regular review, and in 2017 concluded that the range of experience and diversity of skills has allowed the Board to effectively discharge its duties and responsibilities.

Diversity
The directors believe that a mix of experience, interests and personalities ensures the effective functioning of a Board in which the dialogue is both challenging and constructive. The Board currently has no quota in place to achieve diversity.

The diagrams below illustrate the independence of the Board and also its composition and balance as at 22 September 2017. In particular, the tenure of longer standing Board members and more recent appointments, ensuring both continuity and fresh perspectives, and the diversity in gender and nationality on the Board.

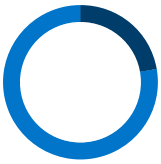
EXECUTIVE BALANCE



Chairman	1 (11%)
Executive directors*	2 (22%)
Non-executive directors	6 (67%)

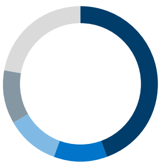
* This includes Bill Seeger, Chief Financial Officer

GENDER BALANCE



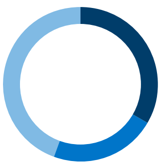
Female	2 (22%)
Male	7 (78%)

NATIONALITY BALANCE



UK	4 (45%)
New Zealand	1 (11%)
France	1 (11%)
India	1 (11%)
US	2 (22%)

TENURE OF THE BOARD



1-2 years	3 (33%)
3-5 years	2 (22%)
Over 5 years	4 (45%)

Time commitment
Each of the directors must be able to allocate sufficient time to the work of the Board in order to discharge their responsibilities effectively. The current directorships in listed companies and other significant commitments of the Chairman and the non-executive directors are shown on pages 78 to 81. Ahead of his appointment as non-executive director in January 2017, the Board assessed Noel Tata's other commitments and agreed that, as many of his other appointments are as part of his employment in the Tata Group, he is able to commit sufficient time to the work of the Smiths Board.

The Board considers the external appointments of each of the directors twice yearly, and for 2017 it is confirmed that the Chairman and the non-executive directors have sufficient time to fulfil their commitments to Smiths, and that no executive director holds more than one non-executive directorship of another FTSE 100 company.

Independence
As identified in the table on page 88, over the financial year at least half of the Board members (excluding the Chairman) were independent non-executive directors. Sir George Buckley was considered to be independent on appointment as Chairman. The Board keeps the independence of its members under continued review and in July 2017 the Nomination Committee assessed the independence of each of the non-executive directors and concluded that all of them were independent. More information on the work of the Board regarding succession planning and director tenure can be found in the Report of the Nomination Committee on page 92. Specific points for Board consideration over the past financial year are set out below:

Bill Seeger
Following his appointment as Interim Chief Financial Officer, Bill Seeger is no longer considered an independent non-executive director. A search for a new Chief Financial Officer is underway and the Board expects Bill Seeger's appointment to be for a short period. When a new Chief Financial Officer is appointed, Bill Seeger will resume his role as a non-executive director, and the Board will review his independence in light of the guidance in the UK Corporate Governance Code and criteria for independence determined by the Board.

Sir Kevin Tebbit
As Sir Kevin Tebbit has served on the Board for 11 years a rigorous review of his performance was undertaken. The Board concluded that Sir Kevin continues to demonstrate the qualities of objectivity and independence, and to contribute to constructive challenge and debate at meetings, and therefore should continue as Senior Independent Director. Through a year of significant change on the Board Sir Kevin fulfilled an important role, supporting the Chairman and making himself available to investors and the other directors.

Conflicts of interest
Directors must avoid situations where they have a direct or indirect interest that conflicts or may possibly conflict with the Company's interests. The Company's Articles of Association allow the Board to authorise conflicts and potential conflicts where appropriate, and there are procedures in place for directors to report any potential or actual conflicts to the other members of the Board for their authorisation.

EFFECTIVENESS
CONTINUED

A Register of Conflicts and Potential Conflicts is maintained by the Company Secretary and the directors are advised of the requirement to seek Board approval for any new situations which may present a conflict as they arise. In September and March the Board formally reviews the Conflicts Register, considering the conflicts disclosed and authorisations given, including any conditions determined by the Board. In the past financial year there was a temporary cross-directorship when Tanya Fratto joined the Mondi Group Board on 1 January 2017, as Anne Quinn was a serving non-executive director. The Smiths Board did not consider this cross-directorship a conflict of interest, or an independence issue, as neither director held an executive position on the Mondi Board. Anne Quinn retired from the Mondi Board on 11 May 2017.

Board meetings and visits

The table below shows the directors attendance at Board meetings held during the financial year ended 31 July 2017. In order to discharge their responsibilities effectively all directors should be able to allocate sufficient time to Smiths, and the table discloses the number of meetings that each director attended out of those that each was eligible to attend.

			Board meeting attendance	
	Role	Independent	Attended	Eligible to attend
Current directors				
Sir George Buckley	Chairman		7	7
Andy Reynolds Smith	Chief Executive		7	7
Bill Seeger	Interim Chief Financial Officer		7	7
Bruno Angelici	Non-executive director	✓	7	7
Tanya Fratto	Non-executive director	✓	7	7
Anne Quinn	Non-executive director	✓	7	7
Mark Seligman	Non-executive director	✓	7	7
Noel Tata[1]	Non-executive director	✓	3	4
Sir Kevin Tebbit	Senior Independent Director and non-executive director	✓	7	7
Former director				
Chris O'Shea[2]	Former Chief Financial Officer		5	6

1 Noel Tata was unable to attend one meeting due to a prior commitment arranged before he joined the Board
2 Chris O'Shea did not attend a meeting at which his retirement from the Board as Chief Financial Officer was on the agenda

The directors attend additional meetings outside the formal meeting schedule, as well as making site visits to the various global divisions. To ensure that the Board is kept up to date with senior management priorities and challenges, and in order to gauge the culture embedded within the business, invitations to Board meetings are regularly extended to divisional presidents, business managers, heads of functions and external advisers. During the year the Board had a number of opportunities to meet and hear from Smiths employees, including at Board dinners and during Board and individual director visits to sites.

To ensure the continued effectiveness of the Board, and to allow different members to fulfil their separate responsibilities, after each Board meeting the Chairman meets the non-executive directors without the executive directors present. He also has separate meetings with the Senior Independent Director and the Chairs of the Audit and Remuneration Committees. In addition, the Senior Independent Director meets the other non-executive directors without the Chairman present at least annually.

BOARD VISIT TO SMITHS DETECTION SITE, NEWARK, USA

In 2017 the directors travelled to Palo Alto, USA. Their itinerary included visiting the Smiths Detection Site (formerly Morpho Detection) in Newark, San Francisco, where they spent time with the senior management team and met other employees informally.

In addition they toured the site's operations and were given presentations on a number of matters including the integration of the legacy Morpho Detection business with the Smiths Detection business, the Morpho business and its products, customers and financial performance.

Appointments to the Board

The Nomination Committee has a formal, rigorous and transparent process in place for the appointment of new directors to the Board. Appointments are made based on the merit of the individual, having due regard for the benefits of diversity in its broadest sense, including gender, ethnicity, nationality, age and experience. Matters considered by the Board prior to all appointments include the following:

- agreed Group strategy;
- the Board skills matrix;
- satisfaction that the director is able to allocate sufficient time to their responsibilities to Smiths; and
- existing succession plans.

Following their appointment to the Board directors undergo an induction programme to ensure that they have the necessary knowledge and understanding of the Group to contribute to Board discussion and decision-making. Each director's individual experience and background is taken into account, and a programme is developed which is tailored to their own requirements. This will include meeting senior individuals in the business, receiving copies of previous Board papers, and visits to operational sites. The appointment of Noel Tata was approved in 2016, and he joined the Board on 1 January 2017. More information about his appointment process can be found in the Report of the Nomination Committee on page 92.

Information and training provided to the Board

In addition to the induction programme for new directors, the Board recognises the importance of ongoing training, and directors are given the opportunity to continue to update their skills and knowledge on a regular basis throughout their time on the Board. Ongoing training includes receiving twice-yearly governance briefings and technical updates on regulatory developments. The Board is regularly presented with updates from each of the divisions to ensure the directors remain aware of their priorities and challenges, and the Board committees are provided with relevant material by external advisers. The suitability of external courses is kept under review by the Company Secretary, who ensures that these are sent to Board members regularly.

Following feedback from the Board evaluation in FY2016 a number of improvements were made to the quality and timeliness of information received by the directors. Clearer guidance and procedures have been put in place to ensure that information received is presented in an appropriate format and contains the level of detail required for directors to fulfil their responsibilities effectively. The Company Secretary and her team assist the Chairman and Chief Executive in ensuring that the Board is provided with all relevant information in a timely manner.

Advice and insurance

All directors have access to the advice and services of the Company Secretary, and a procedure is in place for them to take independent professional advice at the Group's expense, should this be required. The directors and officers of the Smiths Group and its subsidiaries have the benefit of a directors' and officers' liability insurance policy.

Re-election

It is Company practice for all directors to stand for shareholder election at the first Annual General Meeting (AGM) following their appointment. In addition, the Board has resolved that all directors who are willing to continue in office will stand for annual re-election by the shareholders at each AGM. Non-executive directors are appointed for a specified term of three years, subject to annual re-election at the AGM, and re-appointment for a second three-year term is not automatic. At the 2017 AGM the shareholders will be asked to approve a change to the Company's Articles of Association to reflect the annual re-election of directors. Any term for a non-executive director beyond six years is subject to a particularly rigorous review.

The Chairman has confirmed that, following the performance reviews undertaken in 2017, the performance of each of the directors standing for re-election at this year's AGM continues to be effective and that they each continue to demonstrate commitment to their respective roles, and dedicate the time necessary to perform their duties.

Board performance evaluation

The Board undertakes an annual evaluation of its own performance as well as that of its committees and directors. The appraisal process provides an opportunity for Board members to take a step back from the day-to-day board business and consider the Board's effectiveness and to identify areas for further development and find any ways of working more efficiently.

In accordance with the Code, an external evaluation is carried out every three years. Sheena Crane carried out an external review of the Board for FY2015. Sheena Crane is independent to the Company and to the directors. For FY2016 the Board conducted a review with the support of Lintstock Limited (Lintstock also provides the software which Smiths uses to manage its insider lists, however Lintstock is determined to be independent). Together with the Chairman and the Company Secretary, Lintstock designed a structured set of questionnaires. The questionnaires focused on areas of specific relevance to Smiths and also checked on progress against matters identified in the previous evaluation. Topics addressed included the composition of the Board and its committees, Board dynamics, time management, Board support and efficiency, the Board's oversight of strategy, risk management and internal controls, succession planning, people issues and priorities for change.

Using online questionnaires, Lintstock produced an anonymised report which was presented to the Board for discussion at its meeting in November 2016. Overall, the results were positive and a number of actions were agreed. Progress made against these actions was reviewed by the Board at its meetings in March and September 2017.

EFFECTIVENESS
CONTINUED

The Board evaluation for 2017 is underway and is being supported by Lintstock again in order to build on the previous evaluation. Questionnaires have been provided to the directors and the Company Secretary covering the previous year's topics and providing a deeper dive into some key areas. In addition, a number of priorities were identified during the previous evaluation in terms of improving performance of the Board in FY2017 and these have also been addressed in the survey. Some of the key areas identified and actions taken or underway are set out below.

2017 Board evaluation actions

Evaluation topic	Actions
Board composition	Refreshed Board skills matrix to reflect the updated Smiths strategy Held a Board discussion on succession for key non-executive director roles
Board support and efficiency	Improvements made to length, focus and clarity of Board papers
Strategic oversight and priorities for change	Redesigned Board and Board committee agendas to focus more meeting time on key areas of: strategy and execution, M&A and portfolio changes and innovation and technology
Culture, people and succession planning	Increased Board oversight of people, talent and succession planning, and strengthened link between strategy and people planning processes Increased opportunities for Board members to meet with senior managers and wider population of Smiths employees
Risk	Introduced more regular deep dives into ethics and compliance

Director evaluation
During the year the Chairman provided feedback on the performance of individual Board members in one-to-one meetings. In addition the Senior Independent Director led an evaluation of the Chairman's performance on behalf of the non-executive directors. Details on executive director performance and remuneration are set out on page 113.

Following this it is confirmed that each Director continues to make an effective and valuable contribution to the Board and to demonstrate the required commitment to their role.

NOMINATION COMMITTEE

SIR GEORGE BUCKLEY
CHAIRMAN OF THE NOMINATION COMMITTEE

At the start of the financial year the Nomination Committee refreshed its assessment of Board capability against the five-year skills analysis that the Committee had discussed in 2016.

We considered the future profile of the Group from the perspective of end markets, geographic focus and strategic priorities. It was clear that the Board would benefit from an additional non-executive director who had a current executive role working in higher growth economies where Smiths is accelerating its growth agenda. I was delighted that we were able to bring Noel Tata on to our Board from the start of the 2017 calendar year. As Managing Director of Tata International Limited and a board member of various Tata Group companies he has brought a wealth of market knowledge and makes a distinct contribution to the Board.

In May we announced that Chris O'Shea was stepping down from the Board to pursue his career outside the Group. The Nomination Committee was pleased to have Bill Seeger on the Board with his recent experience as a Chief Financial Officer of a FTSE 100 company, who agreed to step in as Interim Chief Financial Officer whilst we conducted a search for Chris O'Shea's successor.

In view of his interim assignment Bill was no longer able to chair the Audit Committee, and the Nomination Committee was pleased that Mark Seligman agreed to take on this key non-executive role. Mark is well placed to do this with his finance background and previous experience of chairing audit committees.

This report sets out further details of the work done by the Nomination Committee during the year.

Committee membership and meeting attendance

Membership and meeting attendance during the year is set out in the table below:

Director	Attendance: Attended	Attendance: Eligible to attend
Sir George Buckley (Chairman)	3	3
Bruno Angelici	3	3
Tanya Fratto	3	3
Anne Quinn	3	3
Bill Seeger[1]	2	2
Mark Seligman	3	3
Noel Tata (appointed 1 January 2017)	2	2
Sir Kevin Tebbit	3	3

1 Bill Seeger was not a member of the Committee from the date he stepped into the Interim Chief Financial Officer role (19 May 2017).

The Committee holds one scheduled meeting each year when it conducts its annual review of senior management talent and succession plans with a view to ensuring a strong and robust plan exists in all parts of the Group. Otherwise during the year it meets as and when required.

The Chief Executive is normally invited to attend the Nomination Committee and has attended each of this year's meetings. The HR Director and the Director of Talent have also attended some meetings in order to advise the Committee.

Role and responsibilities

The Nomination Committee's terms of reference are available on the website, www.smiths.com. The Committee leads the process for identifying candidates for appointment as directors of the Company and as its Company Secretary. It also leads the process for their removal or retirement (giving full consideration to succession planning and leadership needs). It makes recommendations to the Board on the composition of the Nomination Committee and the composition and chairmanship of the Audit and Remuneration Committees. It reviews the structure, size and composition of the Board, including the balance of skills, knowledge and experience and the independence of the non-executive directors, and makes recommendations to the Board with regard to any changes. The Committee also holds an annual review of the succession plans and talent pipeline for senior management roles. In doing this the Committee takes account of the current and future needs, challenges and opportunities relating to the Group (with knowledge of the strategic and commercial issues affecting Smiths and the markets in which we operate). The Committee has access to information and advice both from within Smiths and externally, at the cost of the Group. This may include the appointment of recruitment consultants.

The Committee conducts annual reviews of its terms of reference and effectiveness and recommends any changes to the Board. The annual review of the Committee's terms of reference was conducted in July and certain changes were approved with effect from 1 August 2017. This included ensuring the Committee's commitment to considering diverse candidates for appointments, including a clear reference to ethnic origin in addition to diversity of gender and experience. The Committee conducted a review of its performance to ensure compliance with appropriate corporate governance guidelines and obligations, and the performance of the Committee was considered as part of the wider Board evaluation process. It was confirmed that the Committee continues to operate effectively.

The Board continues to support Lord Davies' aspiration for female board representation, but this presents a particular challenge for a small board. The Nomination Committee and the Board remain committed to ensuring diversity is included within the remit for appointments to the Board. This commitment extends to appointments at all levels in Smiths, as evidenced by the appointment of a senior leader with responsibility for culture and diversity. Further information on diversity is provided in the Strategic report.

Committee activities during 2017

The Board commenced the search for a new non-executive director in 2016, and following an evaluation of the skills, knowledge, experience and diversity on the Board, the Nomination Committee identified a role profile. External recruitment consultants were engaged to assist with the search for a candidate with current experience of working in higher-growth regions. Noel Tata was appointed as a non-executive director of the Company on 1 January 2017 using external search firm Buchanan Harvey & Co. (whose only connection to Smiths is to provide recruitment services) and following interviews with the Chairman, the Senior Independent Director, the Remuneration Committee Chair and meetings with the Chief Executive and the Chief Financial Officer. Buchanan Harvey & Co. is a member of the Voluntary Code of Conduct for executive search firms. The Committee also considered Noel Tata's experience and commitments elsewhere and was satisfied that he would have time available to discharge his responsibilities effectively. The terms of his appointment are set out in a formal Letter of Appointment.

Chris O'Shea stepped down from his role as Chief Financial Officer and as a director of the Company on 19 May 2017 and commenced a period of garden leave. His exit was overseen by the Nomination Committee. Chris O'Shea's employment is expected to end on 18 November 2017 but may end at an earlier date on payment in lieu of notice. Full details are set out in the Directors' remuneration report on page 103.

The Nomination Committee considered the succession plan and recommended that an external search process was undertaken and that during this process the Board appoint Bill Seeger as Interim Chief Financial Officer. In making the recommendation, the Committee considered his skills, knowledge and experience. The Committee considered he had excellent credentials to step into this interim role, having joined Smiths in May 2014 as a non-executive director and having chaired the Company's Audit Committee for almost three years. In addition, he was previously Chief Financial Officer of GKN plc.

The Committee approved the role description for the recruitment of the permanent position of Chief Financial Officer, ensuring that the criteria were objective and would enable candidates from a wide range of backgrounds, having due regard for the benefits of diversity in its broadest sense. The Nomination Committee has commenced a search for the replacement Chief Financial Officer using Buchanan Harvey & Co.

In July 2017 the Committee considered the appointment and re-appointment of certain members of the Audit, Remuneration and Nomination Committees and the appointment of the Chairs of those committees. It recommended the appointment and re-appointment of members and Chairs as set out in more detail in the relevant sections of this report. In particular, the Committee considered and recommended to the Board that Mark Seligman replace Bill Seeger as Chair of the Audit Committee. The Committee considered Mark Seligman as having excellent credentials to step into this key non-executive role with his finance background and experience of chairing audit committees and having been a member of the Board and Audit Committee for over 12 months.

In July 2017 the Committee met with the Group HR Director and the Director of Talent to carry out its annual review of the Smiths Group talent pipeline and succession planning process. During 2017 it has sponsored the creation and implementation of a Group-wide process for talent, succession and strategic workforce planning, which is now being embedded. The aim is to have a formal, rigorous and transparent approach to identifying and developing a talent pipeline with the knowledge, skills and potential to fill key business leadership positions in the Company. Succession planning increases the availability and development opportunities for our talent pipeline, which is prepared to assume these roles as they become available.

During the year the Committee received advice from the Company Secretary concerning the corporate governance trends in respect of board evaluation and board succession planning. The Committee reviewed the size and composition of the Board and its succession plan in the light of the outcomes of the Board strategy reviews in May 2017 and the future profile of the Group from the perspective of end markets, geographic focus and strategic priorities. Succession planning is seen as a constant requirement. Over the next two years two non-executive Directors, Anne Quinn and Bruno Angelici, will have completed nine years on the Board and, in recognition of the Code's guidance in respect of independence, we are looking to establish a pipeline of potential candidates who could succeed them. As set out on page 87, the independence of Sir Kevin Tebbit is kept under frequent review. The Committee also reviewed the composition and balance of skills of the Board and has drawn up a succession plan that takes into account the desirability of maintaining a good balance of director tenure and the need to ensure there is a succession for key non-executive director roles as well as executive positions.

ACCOUNTABILITY

Corporate reporting

The Board is responsible for promoting the long-term success of the Company and is accountable to the Group's various stakeholders for doing so. When reporting externally the Board aims to present a fair, balanced and understandable assessment of the Company's position and prospects, and the Board is satisfied that, when taken as a whole, the 2017 Annual Report is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's position and performance, business model and strategy.

During the year the Group has had internal control and risk management arrangements in place to support the financial reporting process:

- requiring the divisions to certify that their reported information gives a true and fair view of the results for the period;
- supporting record keeping to accurately and fairly reflect transactions and the disposal of assets; and
- providing reasonable assurance that transactions are recorded to permit the preparation of financial statements in accordance with International Financial Reporting Standards ('IFRS').

For the year ended 31 July 2017:

- the Audit Committee considered, on behalf of the Board, the John Crane Inc. asbestos litigation disclosure. In order to assist with disclosure in the financial statements the Committee received advice from Bates White LLC, Economic Consultants, regarding the appropriate provisioning for the risk of litigation. More information, including disclosure regarding the FRC Corporate Reporting Review, can be found in the Audit Committee report on page 98
- Smiths strengthened its anti-modern slavery compliance programme. A new Anti-Modern Slavery Policy was introduced, and the Board approved the Smiths Anti-Modern Slavery Statement. The Ethics and Compliance team conducted a risk assessment to identify the three greatest modern slavery risk areas in the Smiths business, and has since introduced programmes to reduce risk in these areas. Further detail in relation to our anti-modern slavery activities is included in Smiths Modern Slavery and Human Trafficking Statement, which is available on the Group website, www.smiths.com

Internal control and risk management

The Board is responsible for determining the nature and extent of the principal risks it is willing to take to achieve its objectives, and for ensuring that there are sound risk management and internal control systems in place to safeguard shareholders' investments and the Group's assets.

The Board's explanation of the basis on which the Group generates and preserves value over the longer term, and its strategy for delivering the Company's objectives, can be found in the Strategic report on page 24.

The Board Statements table on page 83 of this corporate governance statement signpost where various director confirmations, statements and assessments can be found.

The internal control system is based on an assessment of risk, and a framework of control procedures to manage risks and monitor compliance with procedures. The Group's internal control systems are designed to meet Smith's particular needs and the risks to which it is exposed, however they can provide only reasonable, not absolute, assurance against material loss to the Group or material misstatement in the financial statements. The Executive Committee is responsible for designing the Enterprise Risk Management ('ERM') system and ensuring it is effectively deployed throughout the Group, more detail can be found on page 61.

Over the year ended 31 July 2017 the Audit Committee, on behalf of the Board and with the assistance of the Internal Audit function, monitored, reviewed and assessed the effectiveness of the Group's risk management and internal control systems in the context of the Group's strategy and business model. The review covered material financial, operational and compliance controls. In 2016 the Audit Committee annual calendar was updated to include an additional meeting in order to facilitate its increased focus on risk management. This meeting was maintained in the 2017 calendar with the May 2017 Audit Committee meeting. Each divisional president attended and presented their respective risk register to the Audit Committee which included a risk dashboard, the process each division uses to identify and evaluate risk, and their internal controls and procedures to mitigate any identified risk. In addition, the Executive Committee selected three principal risks for 'deep dive' reviews at the Audit Committee meeting – a significant ethical breach, cyber security and product quality at Smiths Medical – and the owner of each risk attended to discuss the risk with the Board.

The Investment Committee assists the Board with practical risk management, meeting approximately 10 times a year to consider high-risk and high-value proposals that are either beyond the authority delegated to divisional presidents, or prior to Board approval. This can include capital and special revenue expenditure or asset disposals. By reviewing the details in advance the Investment Committee assesses the risks, and reviews investment papers ahead of their presentation to the Board for approval, thereby helping to manage the associated risk.

Principal risks

During the year the Board carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency and liquidity. In 2017 the Internal Audit function ran a global programme of risk workshops at divisional sites in order to ensure that risk is being identified from the bottom up. At the workshops local business controls and the likelihood and potential impact of risks were reviewed. Following this exercise the Executive Committee were presented with a refreshed list of principal risks for the Group, and agreed a top 10 to be presented to the Board. On consideration of the principal risks and uncertainties facing the Group, and the actions taken by management to manage those risks, the directors then determined the Group's risk appetite, and the nature and extent of the risks the Board is willing to take. The Executive Committee ensures the Board's risk appetite is understood by risk owners and decision-makers in the business. A description of the principal risks facing the Company can be found on pages 62-67. The Board takes these into account when considering the Company's viability, as set out on page 57.

AUDIT COMMITTEE

MARK SELIGMAN
CHAIR OF THE AUDIT COMMITTEE

The 2017 financial year was a busy year for the Audit Committee and I am pleased to share with you an insight into some of the matters the Committee considered.

As a member and then Chair of the Committee, I would firstly like to extend my thanks to Bill Seeger. Bill led the Committee through the majority of the year under review and has helped me settle into the role of Committee Chair whilst maintaining a high degree of professionalism throughout. I remain confident in the Finance function and that Bill will lead the team in an effective manner until a permanent Chief Financial Officer is appointed.

In addition to reviewing the financial statements and related fiscal matters, the Committee has focused on the risks and internal controls exercised throughout the Group. As the Chairman mentions in his report on page 82, the Committee paid particular attention to the Group's ethics and compliance programme, reviewing the existing processes and enhancing areas where the Committee felt more could be done to emphasise our core value of integrity. The Committee also reviewed the Group's position on Anti-Modern Slavery, and more information on this can be found on the Smiths website (www.smiths.com).

The analysis of risk forms a growing part of the Committee's agenda, both in the context of examining future threats and opportunities to the Group and also in identifying and assessing the controls in place to mitigate those identified risks. The Committee held a dedicated meeting in May to discuss and review those risks identified by management. The process for determining those risks is set out in the Risk management section on page 60 which formed the basis for the Viability Statement on page 57. Whilst discussing the deep dive on cyber security, the Committee agreed to amend its forward agenda to add a review of the Group's cyber security measures biannually and to specifically add this review to the Committee's Terms of Reference. This is a growing area of threat to the Group and the Committee will continue to monitor the Group's response and preventative measures.

I am pleased to be able to report that the FRC's review of the Groups' 2015 Annual Report has been closed and the Board has agreed to make further disclosures in respect of the asbestos litigation provisioning as described on page 98.

The Committee has also agreed a timetable for an audit tender with a view to appointing a new auditor for the 2020 audit. The process will begin in earnest in early 2018. The Committee has been fully briefed on its responsibilities and expects to approve the tender document setting out the Group's requirements, having consulted with shareholders and other stakeholders as appropriate. This will form a key focus point for the Committee over the next 12 to 18 months. Having conducted a thorough evaluation of PwC's audit in respect of the previous financial year and the current half year, the Committee remains satisfied that PwC are both effective and retain a degree of professional scepticism in conducting their audit. A recommendation to appoint PwC as auditor for the FY2018 audit will be presented to shareholders at the AGM to be held in November.

As the FY2018 financial year progresses, the Committee expects to review the Group's position in respect of its tax risks and opportunities and specifically in respect of the strategy as global uncertainty on tax rates continues. In addition, uncertainty around Brexit remains and the Board as a whole will keep this area under review.

Committee membership and meeting attendance

Membership and meeting attendance during the year is set out in the table below:

Director	Attendance: Attended	Attendance: Eligible to attend
Bill Seeger[1] (Chair until 18 May 2017)	3	3
Mark Seligman (Chair from 19 May 2017)	4	4
Bruno Angelici	4	4
Tanya Fratto	4	4
Anne Quinn	4	4
Noel Tata[2] (appointed 1 January 2017)	2	3
Sir Kevin Tebbit	4	4

1 Bill Seeger was not a member of the Committee from the date he stepped into the Interim Chief Financial Officer role (19 May 2017).
2 Noel Tata was unable to attend one meeting due to a prior commitment arranged before he joined the Board.

The Committee met four times during the 2017 financial year, with three meetings timed to align with the financial reporting and audit cycles of the Group, namely: the approval of the Annual Report in September; the approval of the half-year report in March; and the presentation of the pre-year-end 'early warnings' report from the external auditor, PwC, in July. A meeting was also held in May 2017 at which the Committee reviewed the risk management reports of the Group's five divisions. All the members of the Committee at the time attended the AGM in November 2016.

All members of the Committee who served during the year are, in the view of the Board, independent non-executive directors and have recent and relevant financial, accounting and sector experience gained from their respective international business activities. In particular, Bill Seeger was Chief Financial Officer of GKN plc, a post he had held for over six years before his retirement in 2014; and Mark Seligman has a long history in corporate finance, as well as being a qualified accountant. Tanya Fratto, Anne Quinn and Bruno Angelici have extensive senior management experience in international oil and gas, engineering and medical devices industries, respectively; Sir Kevin Tebbit has substantial knowledge of international governmental relationships; and Noel Tata has had a successful career in global business, with extensive experience in high-growth economies.

As part of his induction programme as a director of the Company (which included a detailed overview of the Group's business model, strategy and risk profile), Noel Tata was provided with relevant material on the responsibility and working of the Committee and copies of recent papers and presentations. Upon becoming Chair of the Audit Committee Mark Seligman was provided with a short structured induction programme, which included meetings with senior members of the Finance team, the external auditor PwC, the Internal Audit team and other senior executives in the business.

Further details of the qualifications and experience of the members of the Committee are contained in the biographies of the directors on pages 78 to 81. There have been no changes to the membership of the Committee since the financial year end.

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

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

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

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

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

The Committee receives briefing notes from the Group and PwC on all relevant developments in company law, governance standards, and international and domestic financial accounting practices and regulations.

Outside of the formal meetings schedule, the Chairs of the Audit Committee met separately with senior management representatives of PwC to discuss the Group's financial reporting, internal control and governance.

AUDIT COMMITTEE
CONTINUED

Role and responsibilities

The primary role of the Audit Committee is to ensure the integrity of the financial reporting and audit processes and the maintenance of sound internal control and risk management systems. This includes responsibility for monitoring and reviewing:

- the integrity of the Group's financial statements; the significant reporting issues and judgements contained therein; and the reports of the external and internal auditors;
- the bases for the Board's statement on the adoption of the 'going concern' basis of accounting; its assessment of the long-term viability of the Company; and its description of the information contained in the Annual Report as enabling a 'fair, balanced and understandable' assessment of the Group;
- the consistency of the Annual Report and the annual financial statements;
- financial announcements released by the Company and any reports or returns made by the Group to financial regulators;
- the appropriateness of the Group's relationship with the external auditor, including auditor independence and objectivity; auditor compliance with relevant ethical and professional standards and guidance; audit fees; and provision of non-audit services;
- the terms of engagement of the external auditor;
- the scope of the annual external audit plan and the quality and experience of the external audit team assigned to its execution;
- the reports of the external auditor, including any major issues or reservations and significant accounting and audit judgements highlighted therein;
- the effectiveness of the external audit process, making recommendations to the Board on the appointment or re-appointment or the removal of the external auditor;
- the remit and effectiveness of the Internal Audit function and the appropriateness of the resources available thereto;
- the effectiveness of the Group's policies on internal control and risk management systems in the evaluation and management of significant business risk;
- statements on the assessment and management of risks and on internal controls;
- the Group's implementation of its Code of Business Ethics and Business Ethics programme, including the Group's arrangements for its employees to raise any issues of concern (whistleblowing) and the process for the investigation and resolution of any such issues;
- the Group's procedures for detecting fraud and systems and controls for preventing bribery; and
- the Group's risks associated with the internal and external threats to, and the resilience of, the Smiths IT enterprise, information, operations and products relating to 'cyber security'.

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

Financial and narrative reporting

During the financial year, the Committee has:

- considered information presented by management on key matters of accounting judgements and policies, adopted in respect of the 2016 Annual Report and 2017 half-year report, and relevant changes to accounting standards and agreed their appropriateness;
- discussed with PwC the firm's audit reports and noted the key accounting matters and significant judgements highlighted by PwC in respect of each set of financial statements;
- reviewed documentation prepared to support the statement on internal control in the 2016 Annual Report and was satisfied that the Company was operating an effective system of internal controls to manage risk;
- reviewed documentation prepared to support the going concern judgement in the 2016 Annual Report and concluded that the accounts had been properly prepared on a going concern basis;
- assessed the processes and activities undertaken by the Group in order to ensure that the 2016 Annual Report, taken as a whole, would be 'fair, balanced and understandable' and concluded that the quality and range of information provided in the Annual Report was sufficient to enable shareholders to assess properly the Group's position, performance, business model and strategy;
- examined key points of disclosure and presentation to ensure the adequacy, clarity and completeness of the 2016 Annual Report and 2017 half-year report and the preliminary announcement of the annual results;
- reported to the Board its views on significant financial reporting issues and judgements applied to the 2016 Annual Report, the 2017 half-year report and the associated information releases (including matters communicated to the Committee by the external auditor);
- evaluated the bases for and the content of the Strategic report, the operational review and the corporate governance statement contained in the 2016 Annual Report;
- satisfied itself that the 2016 Annual Report was consistent within itself and that the 'front half' and the 'back half' of the publication were thoughtfully cohesive;
- reviewed documentation prepared to support the going concern judgement in the 2017 half-year report, including the review of the principal risks for the second half of the financial year, and concluded that the accounts had been properly prepared on a going concern basis;
- in addition to the press releases for the preliminary annual results for 2016 and the 2017 half-year results, reviewed the Company's press releases and announcements containing price-sensitive material and reports made to financial regulators during the year; and
- analysed the methodology and processes presented by the management for the assessment in the 2017 Annual Report of the prospects of the Company over the longer term ('long-term viability assessment') and agreed that a three-year period is appropriate for this purpose, taking into consideration the Company's various business cycles and forecasting models. The Committee considered scenario-based stress testing models, prepared by the Company, to assess the impact on Group cash and finances if one or more of the Group's principal risks occurred. The Committee concurred with the conclusion that the Group's balance sheet and ability to raise cash were more than sufficient to withstand such occurrences comfortably for at least the three-year period under review.

Subsequent to the end of FY2017, the Committee has also reviewed and reported to the Board on the reports and information supplied by management and by PwC on the judgements and policies adopted for the 2017 Annual Report and the content of that document. The Committee considered that the quality and range of the material included within the 2017 Annual Report was sufficient to provide shareholders with the necessary information for them to assess properly the Group's position, performance, business model and strategy and that the report was presented in such a way as could be considered 'fair, balanced and understandable'. The Committee reviewed the statement on risk management and internal controls; the going concern statement; the assessment of the long-term viability of the Group; and the content of the announcement of the financial results for 2017.

In assessing the fairness, balance and understandability of the 2017 Annual Report, the Committee considered:

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

Following its review of the 2017 Annual Report, the Committee was of the opinion that it is representative of the year and presents a fair, balanced and understandable overview, providing the necessary information for shareholders to assess the Group's position, performance, business model and strategy.

Significant judgements and issues

An important responsibility of the Audit Committee is to review and agree the most significant management judgements and issues. To satisfy this responsibility, the Committee requests a written formal update from the Chief Financial Officer three times a year; the Group Director of Tax and Treasury twice a year; and reports from the external auditor at each Committee meeting. The Committee carefully considers the content of these reports and the most significant issues and areas of judgement raised. The key areas of judgement in the year were as follows:

Revenue recognition

The Committee reviewed the key judgements on revenue recognition. Attention was given to large, multi-faceted and non-standard contracts in Smiths Detection and to contracts where 'percentage of completion' accounting was used in Smiths Detection and Smiths Interconnect. The Committee reviewed the accounting treatment of three programmes in Smiths Detection where management assessed the portion of revenue to be attributed and the anticipated profit margin and concluded that the revenue judgements made were appropriate. The Committee also reviewed 'bill and hold' transactions in Smiths Detection and were satisfied with the adopted accounting treatment.

Impairment

The Committee considered the Group's intangible assets and the assumptions used to justify the carrying values of these assets, including 'fair value less costs to sell'. Particular attention was given to Morpho Detection which was tested on a fair value less cost to sell basis. A sensitivity is included in note 11 of the financial statements. The Committee reviewed the carrying value of Medical capitalised development and was satisfied that the treatment was reasonable due to the new product launches planned for FY2018 and FY2019. The Committee agreed that the projected future cash-flows from these assets supported the carrying value. The Committee reviewed the disclosures contained in the financial statements and agreed that they appropriately reflect the sensitivity of the judgements made. Details of impairment testing and sensitivities are included in note 11 of the financial statements.

Acquisitions and divestments

The Committee reviewed the judgement and accounting treatment of the acquisition of Morpho Detection. Particular attention was paid to the opening balance sheet judgements concerning the valuation of acquired assets and the resulting calculation of goodwill. The Committee also considered the treatment of costs between headline and non-headline. The Committee agreed that the judgements made and the accounting treatment were appropriate. The Committee also reviewed the judgements and accounting treatment relating to the divestments of Smiths Interconnect Power, John Crane Artificial Lift, Smiths Interconnect Telecoms and the Smiths Medical Wallace and Morpho Trace businesses, and the gains (losses) on disposal. The Committee was satisfied that these disposals have been appropriately reflected in the Annual Report and Accounts 2017, and the treatment of Morpho Trace as a discontinued operation in the income statement.

Working capital

The Committee considered the key judgements within working capital and, in particular, the level of provisions and overdue receivables in emerging markets. The Committee determined that the judgements made were appropriate to justify the working capital provision levels at 31 July 2017.

Provisions for liabilities and charges

The Committee continued to monitor carefully the expert assessments of the financial exposure of the Group to the John Crane, Inc. asbestos litigation and to the Titeflex Corp. CSST claims. In particular, the Committee considered the treatment of potential liabilities and the changes to the assumptions made in calculating the provisions, including the re-assessment of the time period for the Titeflex Corp. CSST provision and the continued appropriateness of the ten-year time period for John Crane, Inc. asbestos litigation. In the case of the John Crane, Inc. asbestos litigation, the Committee also agreed the judgement that litigation is extremely rare such that a sufficiently reliable estimate cannot be made to cover the full period over which it is expected that costs will be incurred. In both these cases, it was determined that the assumptions fairly reflect the position at 31 July 2017. Further details of the assumptions used are included in note 22 of the financial statements.

AUDIT COMMITTEE
CONTINUED

Taxation
The Committee assessed the appropriateness of the Group's assumptions and judgements in relation to the estimates of the assets and liabilities to be recognised in income and deferred tax, as well as the treatment of losses in the UK. Particular focus was given to the recognition of UK deferred tax assets which we now judge to be recoverable (see note 6); deferred tax assets relating to the John Crane, Inc. asbestos provision; and the Titeflex Corp. CSST provision. In reviewing projected profit streams the Committee was satisfied that, where appropriate, the relevant entities will generate sufficient future taxable profits to utilise the assets recognised. Further details on movements in tax balances are set out in note 6 of the financial statements.

Post-retirement benefits
The Committee reviewed and agreed the methods, assumptions and benchmarks used by the actuaries to calculate the position of the UK and US schemes at 31 July 2017, which have now moved to a net surplus position. The Committee agreed the treatment and the corresponding disclosures on these matters. More detail on post-retirement benefits is contained in note 8 of the financial statements.

FRC Corporate Reporting Review
In August 2017 the FRC Conduct Committee closed its enquiry into the Company's 2015 Annual Report. During 2017 the Committee continued to monitor the dialogue between the Company and the FRC and discuss the matters raised with the external auditor. As a result of the enquiry, the Annual Report 2017 includes enhanced disclosures for the John Crane, Inc. litigation provision. Disclosures have been amended to explain why the Company judged that the circumstances of this provision are "extremely rare", to provide more context on the judgement to use a ten-year time horizon to calculate the provision, and to include additional sensitivities around an extended time horizon. To support the provision time period and recommended judgement the Committee received advice from Bates White LLC, Economic Consultants. The enhanced disclosures can be found in note 22 on pages 180 to 183 . Expanded disclosures in respect of provisions, revenue, tax, inventory provisioning and post-retirement benefits arising from the enquiry were included in the Annual Report 2016.

The Committee, after receiving the reports on the significant issues and areas of judgement, was content that the judgements made were appropriate and are correctly reflected in the Annual Report 2017.

Corporate governance
During the year, the Audit Committee has reviewed the Company's compliance with its governance obligations. In particular, the Committee has:

- monitored the changes introduced by the Company to ensure full compliance with the requirements of the 2016 edition of the UK Corporate Governance Code (the 'Code'); and The Large & Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations;
- considered the amendments to and developments in the International Financial Reporting Standards that affected the 2017 and 2018 financial years, including the adoption of IFRS 9, 15 and 16;
- taken account of the Competition & Markets Authority's Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014 (the 'CMA Order'); and
- reviewed the changes in the Financial Reporting Council's 2016 Guidance to Audit Committees and Ethical Standards for Auditors, reflecting the implementation in the UK of the EU Audit Directive and Regulation.

The CMA Order first applied to the Company's 2016 financial year and the Group has complied with it during the 2017 financial year. Under the transitional provisions of the order, the competitive audit tendering regulations require the Company to put the external auditor role out to tender by 2023. The Committee decided not to recommend a competitive tender this year given the change to Chief Financial Officer. The Committee's proposal for a competitive audit tender and auditor rotation is described in the External Auditor effectiveness and reappointment section below.

External audit
In relation to the activities of the external auditor, during the financial year, the Committee:

- considered PwC's audit report on the 2016 Annual Report; its review of the 2017 half-year results; and its 'Early Warning' report on the 2017 audit;
- monitored PwC's execution of the audit plans for 2016 and 2017;
- discussed all major issues identified by PwC during the course of the audits, including the key accounting and audit judgements taken by management and management's responses to the audit findings;
- agreed materiality and de minimis levels with PwC;
- considered the draft letter of representation from the Company to PwC in connection with the audit of the 2016 financial statements;
- reviewed the non-audit fees paid to PwC and found them to have been incurred in accordance with the policy on the provision of non-audit services;
- conducted the annual review of the independence and objectivity of PwC and was satisfied that PwC's behaviour had been professional in both respects;
- conducted an internal survey on the effectiveness of PwC as external auditor; and determined that PwC remained effective in its role as external auditor; and
- recommended to the Board that PwC be proposed for re- appointment as external auditor at the 2016 AGM for a further year.

Subsequent to the financial year end, the Committee has considered and approved the same items in respect of the 2017 audit and the preparation of the 2017 Annual Report. Subsequently, the Committee has also recommended that PwC be proposed for reappointment as external auditor at the 2017 AGM.

The Committee considered that each of the directors had taken all necessary steps to ensure that he or she was aware of all pertinent audit information and that such information had been properly communicated to PwC in a timely manner.

External audit plan
PwC presented its Group Audit Plan for the financial year ending 31 July 2017. The Committee discussed with PwC:

- its risk matrix and the factors affecting the various audit risk assessments; the proposed audit scope, taking into consideration statutory audit requirements, financially significant components and significant risk components and central programme testing;
- materiality levels;

- the accounting for the acquisition of Morpho Detection Inc and the sale of the Morpho Trace Detection business;
- the movement in working capital relating to aged inventory and receivables; and
- the impact of senior management changes within the business.

The Committee noted the focus on the audit risks associated with revenue recognition; certain litigation risks; impairment of goodwill; and management override of controls. PwC's proposal to increase the overall materiality level to £20m (approximately 3.5% of headline operating profit) (2016: £17m) and a de-minimis reporting threshold of £1m (2016: £0.5m) was accepted as prudent and appropriate. The Committee considered the resources proposed by PwC, including the qualities, seniorities and experience of the audit team members, to be consistent with the scope of the audit. It was noted that the Audit Plan had been discussed and co-ordinated with Internal Audit. Through a combination of full-scope audits, specified audit procedures and local GAAP statutory audits, business units producing 78% (2016: 79%) of the Group's forecast headline operating profit for 2017 would be audited by PwC under the 2017 Audit Plan.

The fee structure and terms of the audit engagement letter, which had been agreed with management, and PwC's assessment of its independence were considered appropriate for the work proposed and were approved.

Non-audit services

In order to safeguard auditor independence, the Committee has monitored compliance with the Group policy on the engagement of external audit firms for non-audit work. Non-audit services were divided into three categories in relation to the incumbent external auditor:

- Pre-approved (but subject to the Chief Financial Officer's approval for projects likely to exceed £10,000) – where the threat to auditor objectivity and independence is considered low, such as regulatory compliance work; limited tax advisory work; and low-level acquisition work;
- Permitted (but subject to the approval of the Audit Committee for projects over £10,000 and competitive tendering for projects over £100,000) – such as larger acquisitions; corporate reorganisation; and IT risk and security; and
- Not permitted – such as book keeping; financial system design; actuarial services; management functions; and internal audit.

The Committee recognises that non-audit services falling in the Pre-approved category can be purchased more cost-effectively from and completed more efficiently by the incumbent auditor due to the audit firm's existing knowledge of the Group and its systems. The Committee is satisfied that the non-audit work performed by PwC during the financial year had been properly assessed and authorised in accordance with the Group policy.

On 17 June 2016, the EU Audit Directive and Regulation came into force and the FRC published a revised Ethical Standard for Auditors in respect of audits of financial years beginning on or after that date. As a consequence of the new regulation and standard, the Committee reviewed and approved changes to the Group policy on the engagement of audit firms for non-audit work in order to take account of the prohibited list of non-audit services that an incumbent auditor is not permitted to provide in the EU under the regulation and the cap on the level of permitted non-audit services that can be billed.

External auditor independence

The Committee is responsible for the development, implementation and monitoring of the Group's policies on external audit, which are designed to maintain the objectivity and independence of the external auditor. These policies also regulate the appointment by the Group of former employees of PwC and set out the approach to be taken when using the external auditor for non-audit work.

The external auditor is not permitted to provide services which could result in:

- the external auditor auditing its own firm's work;
- the external auditor making management decisions for the Group;
- a mutuality of interests being created; or
- the external auditor being put in the role of advocate for the Group.

The Committee's review of the independence of the external auditor included:

- examining written confirmation from PwC that they remained independent and objective within the context of applicable professional standards;
- considering the tenure of the audit engagement partner, who is required to rotate every five years in line with ethical standards;
- monitoring the ratio between the fees for audit work and non-audit services; and
- checking that management confirmed compliance with the Group's policies on the employment of former employees of PwC and the use of PwC for non-audit work.

As a result of this review, the Committee concluded that PwC remained appropriately independent in the role of external auditor.

Details of the fees paid to PwC for the year ended 31 July 2017 can be found in note 2 on page 152. Non-audit fees incurred during this period amounted to £0.3m ,which related principally to work on cyber security and audit-related assurance services in connection with the interim report. Non-audit fees as a percentage of audit fees totalled 7%. All such activities remained within the policy approved by the Board.

External auditor effectiveness and reappointment

The Committee's review of the performance of PwC and the effectiveness of the external audit process included conducting a survey to take into consideration the views of the executive directors, senior management and the divisional finance teams, views and opinions of PwC's effectiveness in a number of areas. The survey included questions on PwC's independence and objectivity, audit strategy and planning, conduct and communication, audit findings and feedback, and expertise and resourcing. The results were positive and confirmed that both PwC and its audit process were appropriate and effective; and that the relationships between the audit teams and the Company's businesses continued to provide effective and objective challenge. The Committee recognised the challenges in ensuring consistency in the audit process across the whole Group and the need to continue to improve communication at local and divisional levels.

Independence Letters, sent by PwC in September 2016 in respect of its 2016 audit and September 2017 in respect of the 2017 audit, were also considered and the Committee concurred with PwC's opinion that it had complied with all relevant regulatory and professional requirements and that the firm's objectivity had not been compromised.

The Committee noted the findings in the FRC's June 2017 Audit Quality Inspection report on PwC. It evaluated a summary of PwC's internal quality control procedures and noted that the lead engagement partner, Andy Kemp, is accountable directly to the Committee for the execution of the audit. The Committee satisfied itself that the quality of the work exhibited by the firm and its commitment to improvements were of a high standard.

PwC has been the Company's external auditor since its formation in 1998, although a predecessor organisation of PwC held office as sole auditor in 1997. There has been no external audit tender since PwC's appointment. In determining whether to recommend PwC for re-appointment as auditor in 2017, the Audit Committee took into consideration the following factors:

- the length of PwC's appointment and the guidance on the audit firm rotation regulations and proposals;
- the results of the effectiveness review detailed above;
- the qualities and experience of the audit partner, and
- the changes in the executive management team during 2017, in particular the appointment of Bill Seeger as Interim Chief Financial Officer, who took up his post on 19 May 2017.

Taking these elements into account and acknowledging that it would take some time to stage a competitive audit tender from initial planning to final selection, the Committee concluded that it would not be practical to put the auditor appointment for 2018 out to competitive tender, and that it was appropriate to recommend to the Board that the re-appointment of PwC as the Company's auditor for a further year be proposed to shareholders at the 2017 AGM.

Recognising the various requirements in the Code, the CMA Order and the Statutory Auditors and Third Country Auditors Regulations 2016 (implementing the EU's June 2014 Audit Directive and Regulation), the Committee reviewed its decision and concluded that it would remain in the best interests of the Company to plan for a competitive audit tender for the rotation of the external auditor for the 2020 audit. This would coincide with the end of the current PwC audit partner's five-year term. The Committee has reviewed and agreed a timetable for placing a competitive audit tender and will be starting the process during 2018. PwC will not be invited to participate in the tender. However, the Committee will keep the performance of the incumbent audit firm under annual review. The Board has considered and adopted the Committee's recommendations to propose the re-appointment of PwC as auditor in 2017 and to plan for a competitive audit tender and auditor rotation for the 2020 audit. There are no contractual obligations restricting the Group's choice of external auditor.

Internal control and risk management

In fulfilling its responsibilities, the Committee:

- reported to the Board on its evaluation of the Group's risk assurance framework and embedded risk management processes, based on consideration of the reports by PwC on the Group's control environment and ERP systems and on fraud risk; the audits undertaken by Internal Audit; and the risk management reports presented by and discussed with each of the divisions and BIS; and
- reviewed management's plans to mitigate and remedy the failings and weaknesses in the Company's internal financial and risk controls that were identified by PwC and Internal Audit and has monitored their effectiveness. The Committee did not view any of the issues that had been identified and addressed as significant.

The Committee has reviewed the effectiveness of the identification and management of risk at the Group level. Each division also presents an analysis of its own business strategic risks to the Committee on an annual basis.

Further information on the Group's systems of internal control and risk management is given on page 60.

Internal Audit

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

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

The Committee oversees the performance of the Internal Audit function through the Director of Internal Audit's attendance at Committee meetings and a review of agreed KPIs which are reported to the Committee three times per year. In addition, during 2018 an independent third party review of the function's effectiveness will be undertaken. The review will be overseen by the Committee.

During the financial year the Committee:

- received progress reports on the execution of the 2017 Internal Audit Plan;
- discussed the recommendations made by the internal auditors;
- noted the progress being made by management in reducing the numbers of aged outstanding recommendations;
- reviewed the effectiveness of Internal Audit as a part of the Company's risk management process;
- considered the remit of Internal Audit, its budget and resources and the nature and extent of the outsourcing to KPMG; and
- approved the 2018 Internal Audit Plan, including the proposed audit scope, approach, coverage and allocation of resources.

Treasury and tax

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

Ethics

During the financial year, the Committee reviewed the annual report of the Group's Business Ethics Council on the Group-wide Ethics programme. The report included details of the investigations into allegations of non-compliance with the Code of Business Ethics and whistleblowing events, including bribery and corruption, and the Council's work programme to support the initiatives of the businesses and monitor compliance with both the Group's Code of Business Ethics and the various applicable national regulations. The Committee received a report on the first phase of an external review of compliance with Group and divisional ethical policies and procedures. The Committee considered that the Company's processes and arrangements for staff to report concerns about any improprieties were both appropriate and effective. The Committee also considered that the Company's investigation of such reports and consequential actions (where required) were timely and effective. No issues were raised that required the Committee's action.

Constitution

The Committee conducts an annual review of its terms of reference and effectiveness and recommends any changes to the Board. During 2017 the Board approved changes to the Committee's terms of reference to include cyber security and the revised terms of reference are available on our website at www.smiths.com.

Performance evaluation

An annual evaluation of the performance of the Committee is conducted as part of the annual evaluation of the performance of the Board. Following the conclusion of the evaluation it was determined that the Committee continues to operate effectively.

Discharge of responsibilities

During the year, the Committee has monitored its discharge of responsibilities. In addition to the actions reported in the sections above, the Committee has:

- observed the induction and on-boarding of the new Committee Chairman and Interim Chief Financial Officer; and
- welcomed Noel Tata as a new member.

The Committee has enjoyed a positive relationship with the Board throughout the year and has no contentious or unresolved issues to report.

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

Advice

The Committee has independent access to the services of Internal Audit and to the external auditor and may obtain outside professional advice, at the expense of the Group, as it sees fit, in the performance of its duties.

MARK SELIGMAN
CHAIR OF THE AUDIT COMMITTEE

RELATIONS WITH STAKEHOLDERS

Relations with shareholders and other capital providers

During financial year 2017, senior management and the investor relations team had contact with over 200 investors and analysts.

Contact with investors/analysts

United Kingdom	50%
US and Canada	30%
Rest of Europe	15%
Rest of World	5%

Dialogue with shareholders

During 2017 the Chief Executive, the Chief Financial Officer and the Investor Relations Director communicated with institutional investors through analysts' briefings and extensive investor roadshows in the UK, US and Europe. The executive directors regularly met with shareholders to maintain a two-way communication on business performance and long-term strategy, and the Chairman and non-executive directors were available to meet with investors to discuss issues as and when they arose, for example to hear views around strategy and management change. The investor relations programme for the past year is detailed in the activities timeline, and a programme for the FY2018 financial year is being developed.

Members of the Board, and in particular non-executive directors, are kept informed of investors' views, mainly through distribution of analysts' and brokers' briefings and the Chief Executive's written updates. At least twice a year a detailed written report is provided to the Board on the number and types of meetings between Smiths and institutional shareholders. The Board is confident that this process enables the non-executive directors to maintain a balanced understanding of the views and concerns of major shareholders.

In 2017 an investor perception study was carried out by Makinson Cowell, the results of which were presented to the Board at their September 2017 meeting. Some key messages in the report include that investors believe that the Group comprises some high-quality, high-margin and high-returns businesses, with a strong senior management team. Smiths is generally rated as a strong communicator with investors, who believe that they have sufficient access to senior management and that there is a clear articulation of the near-term strategy. The report also identifies some development points, including that a deeper understanding of the business could be facilitated by greater access to divisional management and a Capital Markets Day. A Capital Markets Day for FY2018 is being held in London in December 2017.

Dialogue with other capital providers

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

Investor relations activities timeline

	Roadshows/conferences	Presentations
September 2017		Annual results
July 2017	Sweden and Denmark equity	
June 2017	European Capital Goods CEO conference	
April 2017	US equity	
March 2017	UK equity	Interim results
December 2016	Canada equity	
December 2016	UK private client brokers	
November 2016	UK private client brokers Best of British conference Best Ideas conference	AGM
October 2016	UK, US, Europe equity	
September 2016		Annual results

Annual General Meeting (AGM)

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

At the 2016 AGM all directors in post, including the Senior Independent Director and the Chairs of the Audit, Nomination and Remuneration Committees, were available to answer shareholders' questions. The directors were also available after the meeting for informal discussion with shareholders. The notice of the AGM and related papers were sent to shareholders at least 20 working days before the meeting.

The 2017 AGM will be held on 14 November 2017 and is an opportunity for shareholders to vote on certain aspects of Group business in person. It is intended that there will be a poll vote on each resolution at the 2017 AGM. The audited, final results of the poll votes will be released to the market and published on the Company's website, www.smiths.com, as soon as is practicable after the conclusion of the AGM.

DIRECTORS' REMUNERATION REPORT

ANNE QUINN, CBE
CHAIR OF THE REMUNERATION COMMITTEE

On behalf of the Board, I am pleased to present the report of the Remuneration Committee for the year to 31 July 2017.

This report is split into three parts:

- the Annual Statement;
- the policy report, which presents the Group's forward-looking Directors' remuneration policy; and
- the Annual Report on Remuneration, which details how our remuneration policy was implemented during the year to 31 July 2017 and how we intend to apply our policy in the year to 31 July 2018.

Following the approval of the Policy at the 2015 AGM, there are no proposed changes to the Policy this year.

As highlighted by the Chairman and Chief Executive in their annual statements on pages 10 to 17 of this Annual Report, the operating environment continued to be challenging in the year to 31 July 2017. However, four of the five divisions reported growth in headline operating profit. As expected, John Crane continued to face tough global energy market conditions, leading to an anticipated decline in operating profit. However, the Board was encouraged that, along with the other four divisions, John Crane reported improved margin performance. Group performance in cash conversion was strong at 118%. Taking into consideration EPS performance and each director's performance against their personal objectives, the annual bonus outcome was just below maximum. ROCE, at 16.2%, remains well ahead of the Group's weighted average cost of capital and resulted in the maximum matching under the final CIP award cycle in which Andy Reynolds Smith and Chris O'Shea did not participate. 3-year EPS growth, relative TSR performance and average cash conversion warranted vesting of 62.6% of the 2014 LTIP awards that will vest later this year following the end of the performance period on 31 July 2017. Andy Reynolds Smith and Chris O'Shea did not participate in this LTIP cycle as it pre-dates their appointment. The Committee recognises the importance of close alignment of remuneration with Group performance and we consider the incentive outcomes for this year to demonstrate this link (further details of which are disclosed in this year's Annual Report on Remuneration).

During the year, the Committee also considered and agreed the implications on the remuneration of Chris O'Shea stepping down from the Board of Directors in May 2017. He will leave the Company in November 2017. As set out in the RNS of 23 May 2017, the Committee operated within the provisions of its Policy to determine that, in addition to contractual payments, Chris O'Shea would remain eligible for a pro-rated annual bonus payment in relation to the financial year ended 31 July 2017, and retain a pro-rated interest in outstanding LTIP awards. His retained interests in the LTIP will vest on the normal vesting date to the extent warranted by performance at the end of the normal performance period. Any awards vesting to Chris O'Shea before 18 November 2017 are unaffected by his stepping down from the Board.

In addition, the Committee determined the package for Bill Seeger on his appointment as Interim Chief Financial Officer. The arrangements for Bill Seeger (further details of which are set out in the Annual Report on Remuneration) reflect the short term interim nature of his appointment, and are in line with the Remuneration Policy currently in force.

On behalf of the Board, I would like to thank shareholders for their continued support.

ANNE QUINN, CBE
CHAIR OF THE REMUNERATION COMMITTEE

Performance highlights
- Increased profit performance
- Strong cash conversion performance
- Group wide operating margin improvement

DIRECTORS' REMUNERATION REPORT
CONTINUED

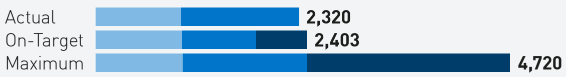
REMUNERATION AT A GLANCE

Key activities

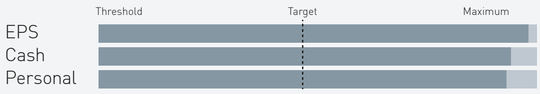
Salary and annual incentive plan	• Approve salary proposal for Chief Executive, members of the Executive Committee and reviewed fees for the Chairman • Considered and approved annual incentive plan payouts and set targets for the new financial year
Long Term Incentive Arrangements	• Agreed performance measures for 2017 LTIP awards • Determined vesting levels for 2014 CIP and LTIP awards
Executive Director Changes	• Determined Chris O'Shea's arrangements on stepping down from the Board • Agreed Bill Seeger's package for assuming the role of Interim Chief Financial Officer

Remuneration for the year ended 31 July 2017

ANDY REYNOLDS SMITH
TOTAL REMUNERATION VS OPPORTUNITY (£000)

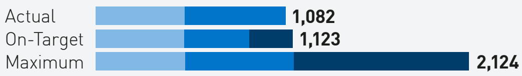


ANNUAL INCENTIVE PLAN OUTTURN (% OF SALARY)



LTIP OUTTURN (VALUE OF AWARDS £000S)
No LTIP awards eligible to vest in 2017

CHRIS O'SHEA
TOTAL REMUNERATION VS OPPORTUNITY (£000)
(Pro-rated to Chris O'Shea's leaving date of 18 May 2017)



ANNUAL INCENTIVE PLAN OUTTURN (% OF SALARY)

LTIP OUTTURN (VALUE OF AWARDS £000S)
No LTIP awards eligible to vest in 2017

Fixed Pay   AIP   LTIP   Extent to which AIP performance targets have been met

Note: During the year, Bill Seeger served as Interim Chief Financial Officer from 19 May 2017 to 31 July 2017. Mr Seeger's remuneration comprises a fixed salary only (recognising the interim nature of his appointment) and is not shown here

Committee details, activities and performance

Membership and meeting attendance during the year is set out in the table below:

Director	Attendance: Attended	Attendance: Eligible to attend
Anne Quinn (Chair)	4	4
Sir George Buckley	4	4
Bill Seeger*	3	3
Bruno Angelici	4	4
Tanya Fratto	4	4
Mark Seligman	4	4
Noel Tata† (appointed 1 January 2017)	2	3
Sir Kevin Tebbit	4	4

* Bill Seeger was not a member of the Committee from the date he stepped into the Interim Chief Financial Officer role (19 May 2017)
† Noel Tata was unable to attend one meeting due to a prior commitment arranged before he joined the Board

The Chief Executive is normally invited to attend Remuneration Committee meetings, except when his own remuneration is under discussion. The Group HR Director, the Director of Reward, and external remuneration advisers Mercer | Kepler have also attended meetings in order to advise the Committee, as and when required.

The Committee's activities and focus during the year are described in the following Directors' Remuneration Report. The Committee reviews its terms of reference annually and recommends to the Board any changes required as a result. The latest annual review of the Committee's terms of reference was conducted in July 2017, when they were updated to reflect current Committee practice regarding the annual review of the remuneration policy and ongoing contact with principal shareholders. The terms of reference can be found on the Smiths website, www.smiths.com.

An evaluation of the performance of the Committee is included in the annual Board evaluation and following the conclusion of the evaluation it was determined that the Committee continues to operate effectively.

The Directors' remuneration report is presented to shareholders by the Board. The report complies with Regulation 11 and Schedule 8 of the Large and Medium-Sized Companies and Groups (Accounts and Reports) Regulations 2008 (the 'Regulations'). As required by the Regulations, the Annual Report on Remuneration will be put to an advisory shareholder vote at the Annual General Meeting on 14 November 2017. The Committee also continues to comply with the provisions of the UK Corporate Governance Code relating to directors' remuneration, except as disclosed in the Corporate governance statement on page 82.

Remuneration policy report

This section of the report sets out our remuneration policy for directors, which shareholders approved at the AGM on 16 November 2015 and is effective for a period of three years from the date of the 2015 AGM. The only amendments to this policy report from the version approved by shareholders in 2015 are to update the data used in the pay-for-performance scenarios and to add page references.

Remuneration policy for the executive directors

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

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

DIRECTORS' REMUNERATION REPORT
CONTINUED

Element and link to strategy	Operation	Opportunity	Performance measures
Annual bonus Incentivises short-term cash management and profit growth, as well as annually defined non-financial goals.	Annual bonus payments are determined based upon performance against measures and targets set by the Committee at the start of each financial year. After the end of the financial year, to the extent that the performance criteria have been met, up to 67% of the earned annual bonus is paid in cash. The balance is deferred into shares and released after a further period of three years, subject to continued employment only. The Committee may use its discretion to adjust payout of the annual bonus to executive directors, within the range of the minimum to maximum opportunity. Such discretion will only be used where the Committee believes that performance against the prescribed targets does not accurately reflect the Company's underlying performance, In addition, cash and deferred share bonuses awarded for performance in 2015/16 onwards will be subject to malus and/or clawback for a period of three years from the end of the relevant performance year in case of misconduct or material misstatement in the published results of the Group.	The maximum annual bonus opportunity for executive directors is up to 180% of salary. The annual bonus opportunities for the year under review and the coming year are disclosed in the Annual Report on Remuneration. Under the financial element of the annual bonus, threshold performance must be exceeded before any annual bonus becomes payable. The percentage payout then increases according to the level of achievement against targets.	Based on a combination of financial and non-financial performance measures linked to short-term objectives. Financial performance will account for no less than 70% of the bonus opportunity and may include, but is not limited to, profit and cash measures.

Element and link to strategy	Operation	Opportunity	Performance measures
Long-Term Incentive Plan (LTIP) Incentivises long-term value creation for shareholders, sustainable profit growth and effective management of the balance sheet.	Awards of conditional shares are granted annually and vest after a performance period of at least three years, subject to the achievement of performance targets set by the Committee at the start of each cycle. For awards made in 2016 onwards, vested shares may also be subject to a post vesting holding period. Details of any such holding period will be disclosed in the Annual Report on Remuneration for the year in which the relevant award is made. To the extent that the performance targets are not met over the performance period, awards will lapse. No retesting of awards under any performance condition is permitted. Dividends accrue and are paid in cash at the end of the vesting period, on shares that vest. The Committee may use its discretion to adjust payout of the LTIP to executive directors, within the limits of the Plan rules. Such discretion will only be used where the Committee believes that performance against the prescribed targets does not accurately reflect the Company's underlying performance. Awards are also subject to clawback for a period of five years from the date of grant in case of misconduct or material misstatement in the published results of the Group.	The maximum LTIP award opportunity for executive directors is up to 400% of salary. LTIP award sizes for the year under review and the coming year are disclosed in the Annual Report on Remuneration. At threshold performance against each measure, up to 25% of the award subject to that measure vests, increasing on a straight-line basis to 100% for achieving stretch targets.	Based on measures of performance that are aligned with the Group's strategy. To ensure continued alignment with the Company's strategic priorities, the Committee may, at its discretion, vary the measures and their weightings from time to time (but will consult shareholders before making significant changes to the performance measures).

DIRECTORS' REMUNERATION REPORT CONTINUED

Element and link to strategy	Operation	Opportunity	Performance measures
Benefits To provide market-competitive benefits to executive directors.	Benefits comprise car allowance, life assurance and private healthcare insurance, and other such benefits as the Committee may from time to time determine are appropriate. These include, but are not limited to, relocation allowances, as well as any other future benefits made available either to all employees globally or all employees in the region in which the executive director is employed.	Benefits vary by role and individual circumstances. Benefits in respect of the year under review are disclosed in the Annual Report on Remuneration. It is not anticipated that the costs of benefits provided will increase significantly in the financial years over which this policy will apply, although the Committee retains discretion to approve a higher cost in exceptional circumstances (eg to facilitate recruitment, relocation, expatriation, etc) or in circumstances where factors outside the Group's control have changed materially (eg market increases in insurance costs).	Not applicable

Element and link to strategy	Operation	Performance measures
Sharesave Encourages ownership of shares in the Company and alignment with shareholder interests.	All UK employees (including executive directors) may save up to a maximum monthly savings limit (as determined by UK legislation, or other such lower limit as the Committee may determine at its discretion) for three or five years. At the end of the savings period, participants may use their savings to exercise options to acquire shares, which may be granted at a discount of up to 20% to the market price on grant. The Company intends to look into introducing all-employee share schemes to some non-UK countries on a basis consistent with local laws and market practice.	Not applicable
Shareholding guidelines Encourages ownership of shares in the company and alignment with shareholder interests.	Executive directors must build a minimum shareholding of two times base salary within five years of appointment to the Board. 50% of any net vested share awards (after sales to meet tax liabilities) must be retained until the minimum shareholding requirements are met.	Not applicable

Existing grants or entitlements

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

Performance measure selection and approach to target setting

Annual bonus measures are selected to reflect the Company's short-term financial and non-financial priorities. At its discretion, the Committee may vary these measures at the start of each financial year to maintain close alignment between executive incentives and the annual business plan.

The measures used in the Long-Term Incentive Plan are selected to reflect Smiths prevailing strategy and to reinforce the key drivers of value creation highlighted elsewhere in this Annual Report: operating margin, cash conversion and delivering sustainable return on capital.

Annual bonus and LTIP targets are reviewed annually, and take into account the Company's strategic plan, analyst forecasts for Smiths and its sector comparators and external expectations for Smiths key markets. The Committee sets targets that it considers to be challenging but attainable and aligned to the Company's business objectives over the short term, as reflected in the annual business plan, and longer term, consistent with the strategic plan. On top of aligning strategy with incentives, targets are designed to ensure that participants are aligned with the interests of shareholders.

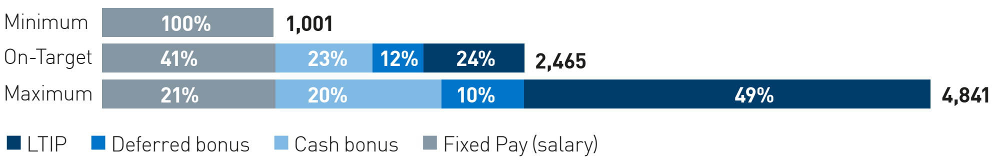
Difference in policy between executive directors and other employees

The reward policy for other senior employees is broadly consistent with that for executive directors, and the Company does not currently operate any incentive plans in which only executive directors participate. The Committee reviews each year the all-employee pay and incentive trends and takes these into account in setting executive director pay levels. The principles of remuneration packages being market related, performance sensitive and driven by business needs are applied at all levels and geographies in the Group.

Pay scenarios

The graphs below provide estimates of the potential future reward opportunity for the CEO, and the potential mix between the different elements of remuneration under three different performance scenarios; 'Minimum', 'On-Target' and 'Maximum'.

ANDY REYNOLDS SMITH (£000)



Potential opportunities illustrated above are based on the Policy, which will apply in the 2018 financial year, applied to the annualised base salary in force from 1 August 2017 for Andy Reynolds Smith. For the annual bonus, the amounts illustrated are those potentially receivable in respect of performance for 2018. It should be noted that any awards granted under the LTIP in a year do not normally vest until at least the third anniversary of the date of grant. This illustration is intended to provide further information to shareholders on the relationship between executive pay and performance. Please note, however, that actual pay delivered will further be influenced by factors such as share price appreciation or depreciation and the value of dividends paid. The following assumptions have been made in compiling the above chart:

CEO	Minimum	On-Target	Maximum
Base salary		Annual base salary	
Pension		Company pension allowance	
Other benefits		Taxable value of annual benefits provided	
Cash bonus	0% of salary	72% of salary	120% of salary
Deferred bonus	0% of salary	36% of salary	60% of salary
LTIP	0% of salary	75% of salary	300% of salary

Chairman and non-executive directors

The policy for the remuneration of the Chairman and non-executive directors at Smiths is summarised in the table below:

Element and link to strategy	Operation	Opportunity	Performance measures
Annual fee To attract, motivate and retain non-executive directors with the required skills and expertise.	Fees may be paid in cash or a combination of cash and shares and are reviewed annually (but not necessarily increased) to ensure they compare appropriately to fees payable at companies of similar size and complexity to Smiths. Additional fees are paid to the chairs of the Remuneration, Nomination and Audit Committees and to the Senior Independent Director to reflect the additional time commitment of these roles. The additional fee paid to the Chairman of the Board is determined by the Committee, absent the Chairman, while the fees for all non-executive directors are agreed by the Chairman and executive directors.	Fees are adjusted according to the outcome of the annual reviews. The basic fee for non-executive directors is subject to the maximum aggregate annual fee of £750,000, as approved by shareholders in 2006 in the Company's Articles of Association.	Not applicable.
Other The Chairman and non-executive directors are not eligible for benefits. The Chairman and the non-executive directors are not eligible for bonuses or participation in share schemes or any pension provision. They are paid an attendance allowance for each overseas meeting attended in addition to the annual fee and are reimbursed for actual expenses incurred (transportation, hotels etc.).			

Approach to recruitment remuneration

External appointments

The Committee approves the remuneration of each executive director on their appointment. In setting the remuneration during the recruitment of external appointments, the Committee will apply the following policy:

External appointments

Pay element	Policy on recruitment
Salary	Salary on recruitment is determined based on the same principles as the annual salary review, as outlined in the policy table.
Pension	As described in the policy table.
Benefits	As described in the policy table.
Annual Bonus	As described in the policy table and typically pro-rated for the proportion of year served. Maximum annual award opportunity: 180% of salary with mandatory deferral of 33% into shares.
LTIP	May be considered for an award under the LTIP on similar terms to other executives. Maximum annual award opportunity: 400% of salary.
Other	The Committee may make an award in recognition of incentive arrangements forfeited on leaving a previous employer. Any such award will take account of relevant factors including the fair value of awards forfeited, any performance conditions attached, the likelihood of those conditions being met and the proportion of the vesting period remaining. For the purposes of making such awards, but for no other reason, the Committee may avail itself of Listing Rule 9.4.2R. The Committee may also make payments to cover reasonable expenses in recruitment and relocation, and any other miscellaneous expenses including but not limited to housing, tax and immigration support.

Internal promotions
In cases of appointing a new executive director by way of internal promotion, the policy will be consistent with that for external appointees, as detailed above. Any commitments made prior to an individual's promotion will continue to be honoured even if they would not otherwise be consistent with the policy prevailing when the commitment is fulfilled, although the Company may, where appropriate, seek to revise an individual's existing service contract on promotion to ensure it aligns with other executive directors and prevailing market best practice.

Disclosure on the remuneration structure of any new executive director (external or internal), including details of any exceptional payments, will be disclosed in the RNS notification made at the time of appointment and in the Annual Report on Remuneration for the year in which the recruitment occurred.

Non-executive directors
In recruiting a new non-executive director, the Committee will use the policy as set out in the table on page 110.

Service contracts
The Company's policy is that executive directors are normally employed on terms which include a one-year rolling period of notice and provision for the payment of a predetermined sum in the event of termination of employment in certain circumstances (but excluding circumstances where the Company is entitled to dismiss without compensation). In addition to payment of basic salary, pension allowance and benefits in respect of the unexpired portion of the one-year notice period, the predetermined sum would include annual bonus and share awards only in respect of the period they have served, payable following the end of the relevant performance period and subject to the normal performance conditions. Existing service contracts or other applicable agreements are available for viewing at the Company's Registered Office.

Andy Reynolds Smith
Andy Reynolds Smith is employed under a service contract with the Company dated 6 July 2015 and effective from 25 September 2015. It may be terminated by 12 months' notice given by the Company or six months' notice given by Andy Reynolds Smith. The Company may elect to terminate the contract by making a payment in lieu of notice equal to Andy Reynolds Smith's base salary and benefits (including pension allowance) in respect of any unserved period of notice. The service contract contains specific provisions enabling a reduction in any phased payments in lieu of notice, in the event that Andy Reynolds Smith finds alternative employment during the notice period.

Chris O'Shea
Chris O'Shea is employed under a service contract with the Company dated 30 April 2015 and effective from 18 September 2015. It may be terminated by 12 months' notice given by the Company or six months' notice given by Chris O'Shea. The service contract contains specific provisions enabling a reduction in any phased payments in lieu of notice, in the event that Chris O'Shea finds alternative employment during the notice period. Chris O'Shea ceased to be a director on 19 May 2017 and will cease to be employed by the Company on 18 November 2017. Up to that date he will continue to be entitled to base salary (£507,375 per annum), benefits and pension allowance in accordance with terms of existing employment contract.

Bill Seeger
Bill Seeger is employed under an extended letter of agreement with the Company dated 22 June 2017 and effective from 19 May 2017 in the role of Chief Financial Officer for an interim period. It is anticipated that Bill Seeger will return to his Non-Executive Director position at the earlier of the appointment of a new Chief Financial Officer, or 1 January 2018. The agreement can be terminated on one month's notice by the Company or by Bill Seeger.

Chairman and non-executive directors
The Chairman and the non-executive directors serve the Company under letters of appointment and do not have contracts of service or contracts for services. Except where appointed at a general meeting, directors stand for election by shareholders at the first AGM following appointment. Although the Articles of Association only require directors to stand for re-election at every third AGM (or such earlier AGM as the Board may determine) thereafter (under Article 49), the Board has resolved that all directors who are willing to continue in office will stand for re-election by the shareholders each year at the AGM. Either party can terminate the appointment on one month's written notice and no compensation is payable in the event of an appointment being terminated early.

Non-executive director	Date of appointment	Expiry of current term	Date of election/ last re-election
Bruno Angelici	1 July 2010	2017	15 November 2016
Sir George Buckley	1 August 2013	2017	15 November 2016
Tanya Fratto	1 July 2012	2017	15 November 2016
Anne Quinn	1 August 2009	2017	15 November 2016
Bill Seeger	12 May 2014	2017	15 November 2016
Mark Seligman	16 May 2016	2017	15 November 2016
Sir Kevin Tebbit	14 June 2006	2017	15 November 2016
Noel Tata	1 January 2017	2018	N/A

Leaving and change-of-control provisions

For those individuals regarded as 'bad leavers' (eg voluntary resignation or dismissals for cause), annual bonus awards are forfeited, and outstanding matching awards under the CIP and outstanding awards under the LTIP automatically lapse.

A 'good leaver' will typically remain eligible for a pro-rated annual bonus award to be paid after the end of the financial year and LTIP awards will typically vest at the normal vesting date to the extent that the associated performance conditions are met, but will normally be pro-rated on the basis of actual service within the performance period. In cases of death or disability, individuals are automatically deemed to be good leavers under the plan rules of the LTIP. All other good leavers will be defined at the discretion of the Committee on a case-by-case basis.

In the event of a change of control, LTIP awards will vest to the extent that each of the performance conditions is met based on the Committee's assessment of performance over the performance period to the date of change of control. For internal performance measures, the Committee may exercise its judgment in determining the outcome based on its assessment of whether or not the performance conditions would have been met to a greater or lesser extent at the end of the full performance period. Awards will also normally be pro-rated to reflect the time that has elapsed between the grant of the award and the date of change of control.

The Committee retains discretion to vary these provisions on a case-by-case basis.

In connection with the termination of an executive director's contract, the Company may make a payment on account of accrued but untaken leave and may pay outplacement and legal fees for support provided to the individual.

External appointments

Subject to the overriding requirements of the Company, the Committee allows executive directors to accept external appointments where it considers that such appointments will contribute to the director's breadth of knowledge and experience. Directors are permitted to retain fees associated with such appointments.

Consideration of employment conditions

The Committee always takes into account pay and employment conditions elsewhere in the Company. We do not consult directly with employees regarding executive director pay. Each year the Committee is provided with information on pay trends and ratios of the wider employee population across the Group.

Consideration of shareholder views

The Committee has actively consulted with major shareholders whenever there have been changes to the remuneration policy in a manner that is receptive to and respectful of shareholder views.

Annual Report on Remuneration

This section of the remuneration report details how our Policy was implemented in the year ended 31 July 2017.

Committee members and meeting attendance in 2017

The members of the Committee are Anne Quinn (Chair of the Committee), Sir George Buckley, Sir Kevin Tebbit, Bruno Angelici, Tanya Fratto, Bill Seeger (until he resigned following his appointment as Chief Financial Officer on an interim basis on 19 May 2017), Mark Seligman and Noel Tata (from his appointment on 1 January 2017). Their attendance at meetings held during the year is set out on page 104.

Sir George Buckley is absent when his own remuneration as Chairman of the Company is under consideration. The Chief Executive attends meetings of the Committee by invitation but he is not involved in the determination of his own remuneration.

Advisers to the Committee

During the year, the Committee received material assistance and advice from the Chief Executive, the HR Director, the Group Director of Reward, Mercer | Kepler (the Committee's appointed independent remuneration adviser) and Freshfields Bruckhaus Deringer LLP. The Company Secretary has been secretary to the Committee since May 2016.

The Company paid a total annual fee of £49,950 to Mercer | Kepler in relation to remuneration advice to the Committee during the year. Fees were determined on the basis of time and expenses. During 2017, Mercer | Kepler provided the Committee with benchmarking analysis of executive and non-executive directors' pay, information on market trends, drafting support for this and last year's Directors' remuneration report, and other relevant assistance on determining directors' remuneration. Kepler was reappointed by the Committee via competitive tender in 2013. Mercer | Kepler is a founding member of the Remuneration Consultants Group and a signatory to its Code of Conduct. Kepler's parent company, Mercer, provides unrelated services to the Group in the areas of all-employee reward and retirement benefits. However, the Committee is satisfied that the advice provided by Mercer | Kepler is objective and independent and that they do not have connections with the company that may impair their independence. Freshfields Bruckhaus Deringer LLP was appointed by the Company to advise the Group on various legal matters during the year.

Main activities during the year

During the year under review, the Committee's main activities included:

- further aligning remuneration arrangements to the new business strategy;
- consideration of market trends and pay levels for the executive directors and the Chairman;
- the exit arrangements of the Chief Financial Officer
- review of all senior executive salary and bonus payments;
- target setting for both the Annual Incentive Plan and Long-Term Incentive Plan;
- performance review of the executive directors against the targets for the financial year; and
- other activities including the appointment terms of key senior executive roles.

Summary of shareholder binding vote on Directors' Remuneration Policy (2015)

The resulting voting outcome in 2015 for Directors' Remuneration Policy was as follows:

Votes for	% of votes cast for	Votes against	% of votes cast against	Total votes cast	Votes withheld (abstentions)
278,345,426	96.4%	10,397,058	3.6%	288,742,484	22,481,558

Summary of shareholder advisory vote on Directors' Remuneration Report (2016)

The resulting voting outcome for last year's Directors' Remuneration Report was as follows:

Votes for	% of votes cast for	Votes against	% of votes cast against	Total votes cast	Votes withheld (abstentions)
269,575,472	97.8%	6,021,703	2.2%	275,597,175	11,129,864

Directors' single figure of annual remuneration (auditable)

Executive directors

	Salary/fees		Benefits[6]		Annual bonus[7]		Long-term incentives		Payments in lieu of pension contribution		Other[8]		Total	
	2017 £000	2016 £000	2017 £000	2016 £000	2017 £000	2016 £000	2017 £000	2016 £000	2017 £000	2016 £000	2017 £000	2016 £000	2017 £000	2016 £000
Andy Reynolds Smith	780	650	1	1	1,344	1,038	–	–	195	163	–	1,112	2,320	2,964
Chris O'Shea	405	430	1	1	575	572	–	–	101	108	–	751	1,082	1,862
Bill Seeger[1]	205		63										268	–

Chairman and non-executive directors

	Salary/fees		Benefits[6]		Annual bonus		Long-term incentives		Payments in lieu of pension contribution		Other		Total	
	2017 £000	2016 £000	2017 £000	2016 £000	2017 £000	2016 £000	2017 £000	2016 £000	2017 £000	2016 £000	2017 £000	2016 £000	2017 £000	2016 £000
Sir George Buckley[2]	423	413	98	105									521	518
Sir Kevin Tebbit[3]	89	82											89	82
Anne Quinn[4]	89	88											89	88
Bruno Angelici	69	68	13	7									82	75
Tanya Fratto	82	80	58	40									140	120
Bill Seeger[1]	84	100	65	56									149	156
Mark Seligman[5]	73	14											73	14
Noel Tata	45	–	18										63	–

1 Bill Seeger was appointed as Chief Financial Officer on an interim basis on 19 May 2017, having served as a non-executive director (and chairing the Audit Committee) prior to that date.
2 Sir George Buckley's fee comprised his non-executive director's fee; an additional fee for being Chairman and his additional fee for chairing the Nomination Committee.
3 Sir Kevin Tebbit's fees comprised his non-executive director's fee and his additional fee payable to the Senior Independent Director from November 2015.
4 Anne Quinn's fees comprised her non-executive director's fee and her additional fee for Chairing the Remuneration Committee.
5 Mark Seligman's fees for 2016 are for a part year following his appointment on 16 May 2016. His fees for 2017 include his additional fee for Chairing the Audit Committee from 19 May.
6 Benefits for executive directors include car allowance, life assurance and private healthcare insurance. For the Chairman and non-executive directors, this value relates to reimbursed travel-related expenses, which is grossed-up for the UK income tax and National Insurance contributions paid by the company on their behalf.
7 Andy Reynolds Smith and Chris O'Shea each deferred 33% of their 2017 and 2016 bonus earned into Smiths shares. The total bonus paid during the year, including deferral, is captured under 'annual bonus' above. The deferral is for a three-year period and is not subject to any further performance conditions.
8 'Other' includes the face values of restricted share awards made to Andy Reynolds Smith and Chris O'Shea to reflect outstanding awards forfeited on their joining Smiths Group and a cash payment made to Andy Reynolds Smith to reflect the pro-rated 2015 annual bonus foregone in respect of his former employment. These values also include amounts received from the Company's Sharesave Scheme in 2016. Full details of the buyout arrangements were disclosed in last year's Annual Report on Remuneration.

Incentive outcomes for 2017 (auditable)

2017 annual bonus outcome for Andy Reynolds Smith and Chris O'Shea

The table below summarises the structure of the 2017 annual bonus, our performance and the resulting annual bonus payout for each of the executive directors

Director	Measure	Weighting	Maximum Opportunity (% of salary)	Earned bonus[1] Performance Level	(% of max. bonus)	(% salary)	£000
Andy Reynolds Smith	EPS	50%	90%	Just Below Maximum	98.0%	88.2%	688
	Cash Conversion	20%	36%	Just Below Maximum	94.0%	33.8%	264
	Personal Objectives	30%	54%	See below	93.0%	50.2%	392
Total		100%	180%		95.7%	172.3%	1,344
Chris O'Shea	EPS	50%	75%	Just Below Maximum	98.0%	73.5%	297
	Cash Conversion	20%	30%	Just Below Maximum	94.0%	28.2%	114
	Personal Objectives	30%	45%	See below	90.0%	40.5%	164
Total		100%	150%		94.8%	142.2%	575

1 The annual bonus earned by Chris O'Shea is pro-rated to 18 May 2017 when he stepped down from the Board.

Personal Objectives

Challenging personal objectives are set for each Executive Director to reinforce the Company's annual and strategic plans. For 2017, these targets included: focus on the Group's portfolio shape, building organisation and leadership excellence, and several targeted financial priorities.

In determining the outcomes of this element of the AIP, the Committee took into consideration the following achievements:

- Strong execution of strategic initiatives, including portfolio reshaping. The successful acquisition of Morpho provides global strength in our Detection business and was an important step in growing Smiths, and the portfolio has been reshaped further by focussing on attractive market segments and divesting four businesses. The Group has also successfully introduced a new product innovation process.
- Significant implementation of the Smiths Way, to clarify the Group's culture, vision and values, and build the capabilities and bench strength of our senior leadership team
- Strong execution of financial priorities, including: reducing working capital to mobilise funds to support growth, steady progress during the year in our performance on inventory turns, and improvement in quality management. The Group has also continued to manage its pension liabilities to ensure obligations are met without long-term over funding.

Incentive outcomes for 2016 (auditable)

As disclosed last year, the Committee will disclose annual bonus targets at such time as these are considered to be no longer commercially sensitive. In line with this commitment, the table below summarises the financial targets and the Company's actual performance against these for the 2016 annual bonus. Andy Reynolds Smith and Chris O'Shea both achieved 92% of their personal objectives after delivering significant improvement in free cash flow and executing on the important acquisition and divestiture strategy. Andy Reynolds Smith had personal objectives focused on the strategic direction of the Group, including bringing greater financial stability and earnings growth as well as driving measurable improvements in commercial and programme management. Chris O'Shea's personal objectives focused on building strong functional capability as well as developing plans for improved reporting across the Group in the areas of financial performance and New Product Introduction.

		Performance Targets and Actual Performance			
Measure		Threshold	Target	Maximum	Actual
EPS		78.9p	85.9p	88.0p	85.2p
Cash Conversion[1]	Q1	–	55%	–	>55%
	Q2	–	85%	–	>85%
	Q3	–	85%	–	>85%
	Q4	–	85%	–	>85%
	FY	–	85%	–	102%

1 Maximum payout requires the meeting or exceeding of all quarterly targets and the full year target.

2014 CIP outcome

Matching awards granted under the CIP in 2014 were subject to the following performance condition:

			Vesting schedule		Actual performance	
Measure	Weighting	Performance period	ROCE performance	% match	ROCE	% match
Group ROCE	100%	1 August 2014 to 31 July 2017	< WACC+1% p.a.	0%	>WACC+3% p.a.	200%
			WACC+1% p.a.	100%		
			WACC+1% to 3% p.a.	100%		
			≥ WACC+3% p.a.	200%		

Andy Reynolds Smith and Chris O'Shea did not participate in the 2014 CIP.

2014 CIP outcome for past Directors

2014 CIP	Interests held	Vesting %	Interests vesting	Date of vesting	Market price[1]	Value £000
Philip Bowman[2]	51,203	100%	51,203	Oct 2017	£16.11	825

1 Based on the average share price over the three months to 31 July 2017 of £16.11
2 Philip Bowman was formerly the Chief Executive Officer and an executive director of the Company. He ceased to be an employee on 31 December 2015

2014 LTIP outcome

Awards granted under the LTIP in 2014 were subject to the following performance conditions:

Measure	Weighting	Performance period	Vesting schedule: Performance	Vesting schedule: % vesting	Actual performance: Outturn	Actual performance: % vesting
Group EPS growth	50%	1 August 2014 to 31 July 2017	< 4% p.a.	0%	6.4% p.a.	23.7%
			4% p.a.	12.5%		
			≥ 12% p.a.	50.0%		
			Straight-line vesting between these points			
Total Shareholder Return rank vs. FTSE 100 companies (excluding financial services)	30%	1 August 2014 to 31 July 2017	Below median	0%	Ranked 63rd	18.9%
			Median	7.5%		
			Upper quartile or above	30.0%		
			Straight-line vesting between these points			
Average cash conversion	20%	1 August 2014 to 31 July 2017	< 85%	0%	103.1%	20.0%
			85%	5.0%		
			≥ 100%	20.0%		
			Straight-line vesting between these points			
Total						62.6%

Andy Reynolds Smith and Chris O'Shea did not participate in the 2014 LTIP.

2014 LTIP outcome for past Directors

2014 LTIP	Interests held	Vesting %	Interests vesting	Date of vesting	Market price[1]	Value £000
Philip Bowman[2]	200,796	62.6%	125,697	Oct 2017	£16.11	2,025

1 Based on the average share price over the three months to 31 July 2017 of £16.11

2 Philip Bowman was formerly the Chief Executive Officer and an executive director of the Company. He ceased to be an employee on 31 December 2015 and his share awards were preserved as previously disclosed to shareholders

Scheme interests awarded in 2017 (auditable)

2016 LTIP

During the year ended 31 July 2017, the executive directors were awarded conditional share awards under the LTIP details of which are summarised in the table below:

Executive	Form of award	Date of grant	Number of shares awarded	Face value: Award price[1]	Face value: £'000	% of salary	Date of vesting
Andy Reynolds Smith	Conditional shares	8 Nov 2016	167,741	£13.95	2,340	300%	Oct 2019
Chris O'Shea	Conditional shares	8 Nov 2016	90,927	£13.95	1,268	250%	Oct 2019

1 The closing price on 7 November 2016.

GOVERNANCE

The performance conditions attached to these 2016 LTIP awards are as follows:

Measure	Weighting	Performance period	Vesting schedule: Performance	Vesting schedule: % vesting
Group EPS growth	35%	1 August 2016 to 31 July 2019	< 3% p.a.	0%
			3% p.a.	8.75%
			≥ 12% p.a.	35.0%
			Straight-line vesting between these points	
Return on Capital Employed	35%	1 August 2016 to 31 July 2019	< 15%	0%
			15%	8.75%
			≥ 18%	35.0%
			Straight-line vesting between these points	
Average cash conversion	30%	1 August 2016 to 31 July 2019	< 85%	0%
			85%	7.5%
			≥ 100%	30.0%
			Straight-line vesting between these points	

2016 Deferred Bonus Award

During the year ended 31 July 2017, the executive directors were awarded conditional shares as deferred bonus awards, details of which are summarised in the table below. The only performance condition is continued employment.

Executive	Form of award	Date of grant	Number of shares awarded	Face value: Award price[1]	Face value: £'000	Date of vesting
Andy Reynolds Smith	Conditional shares	8 Nov 2016	24,546	£13.95	342	8 Nov 2019
Chris O'Shea	Conditional shares	8 Nov 2016	13,519	£13.95	186	8 Nov 2019

1 The closing price on 7 November 2016.

SAYE

Andy Reynolds Smith and Chris O'Shea became participants in the Smiths Group Sharesave Scheme in the year ending in 31 July 2016 and as they chose to participate at the maximum level they did not participate in the scheme in the year ending in 31 July 2017. Andy Reynolds Smith has 2,078 share options under the scheme and Chris O'Shea has 3,464 share options under the scheme.

Buyout awards

As disclosed in last year's Annual Report on Remuneration, Andy Reynolds Smith and Chris O'Shea were made certain buyout awards to replicate the structure and fair value of incentives forfeited by each director as a consequence of their joining Smiths Group.

Andy Reynolds Smith received an award of 86,893 restricted shares, the grant value of which was captured in the 2016 single figure. 30,412 shares vested on the 30 June 2016, with the remaining 56,481 restricted shares vesting on 30 June 2017 (at a share price of 1,597p). Andy Reynolds Smith also received awards of 79,806, 26,602 and 26,602 conditional shares which vest, subject to performance conditions, in October 2018, 2019 and 2020 respectively, subject to the achievement of performance conditions. To the extent these awards vest, their value will be reflected in the 2018, 2019 and 2020 single figures of remuneration for Andy Reynolds Smith.

Chris O'Shea received 71,938 restricted shares, the grant value of which was captured in the 2016 single figure. 35,969 shares vested on 18 September 2016 (at a share price of 1,345p) and the remaining 35,969 shares vested on 18 September 2017 (at a share price of 15.91p).

Percentage change in remuneration from 2015/16 to 2016/17

	Salary	Benefits	Bonus
CEO remuneration	0.0%	0%	29.5%
Average of all employees	2.8%	0%	37.3%

'All employees' is defined as the global senior management population of approximately 60 individuals who are eligible to participate in the same incentive arrangements as the Chief Executive.

Relative importance of spend on pay

The table below shows shareholder distributions (i.e. dividends and share buybacks) and total employee pay expenditure for the financial years ended 31 July 2016 and 31 July 2017, and the percentage change.

	2017 £m	2016 £m	Change
Shareholder distributions	167	163	2.5%
Employee costs	978	872	12.2%

Payments to past directors (auditable)

Other than those disclosed in the single figure of annual remuneration table on page 113 and on page 111 in relation to Chris O'Shea, the only payment is a contribution of £10,000 to Chris O'Shea's legal fees in conjunction with his stepping down arrangements.

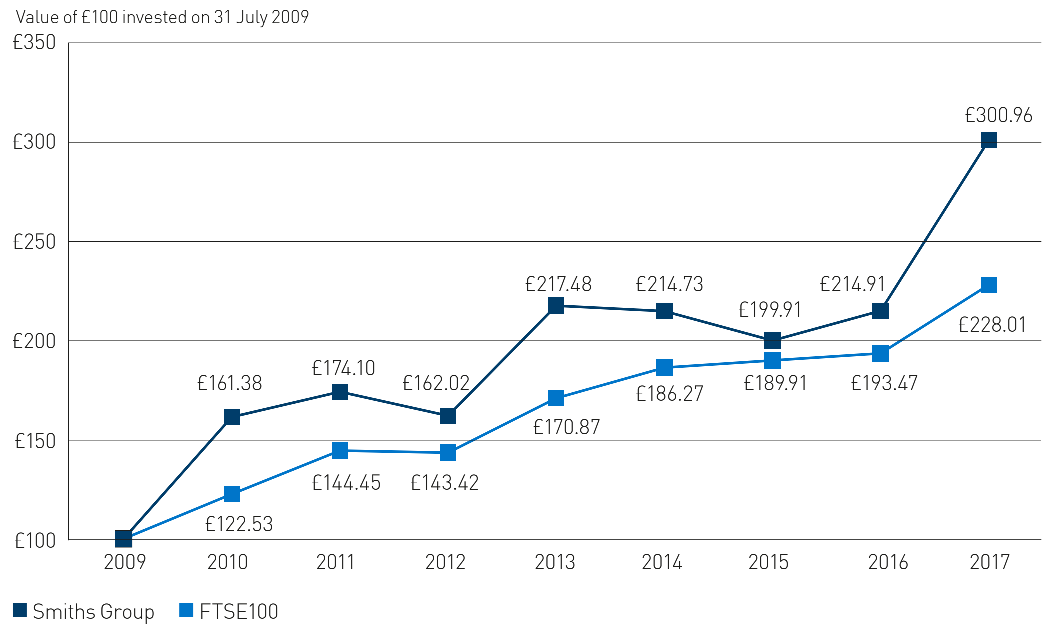
Payments for loss of office (auditable)

No exit payments were made during the year ending 31 July 2017.

TSR performance

The following graph shows the Company's total shareholder return (TSR) performance over the past eight years compared to the FTSE 100 Index. The FTSE 100 Index, of which the Company has been a member throughout the period, has been selected to reflect the TSR performance of other leading UK-listed companies. The values of hypothetical £100 investments in the FTSE 100 Index and Smiths Group plc shares were £228.01 and £300.96 respectively.

TOTAL SHAREHOLDER RETURN



DIRECTORS' REMUNERATION REPORT
CONTINUED

CEO remuneration for the last eight years

CEO	2010 P Bowman	2011 P Bowman	2012 P Bowman	2013 P Bowman	2014 P Bowman	2015 P Bowman	2016 P Bowman	2016 A Reynolds Smith	2017 A Reynolds Smith
CEO total remuneration £000	3,399	4,776	5,026	3,864	3,912	4,195	1,602	2,964	2,320
Annual bonus outcome (% max)	95%	64%	79%	39%	43%	80%	88%	89%	96%
CIP outcome (% max)	n/a	100%	100%	100%	100%	100%	100%	n/a	n/a
2007 PSP outcome (% max)[1]	46%	33%	n/a	n/a	n/a	n/a	n/a	n/a	n/a
LTIP outcome (% max)					18%	17%	18%	n/a	n/a

1 The 2007 PSP outcome shown for 2010 represents the outcome under the EPS element of that award only (2/3 of the award). The 2007 PSP outcome shown for 2011 represents the outcome under the TSR element of that award (1/3 of the award) as TSR performance was measured over a three-year period commencing on the date of the grant.

Note: VSP outcome as a percentage of maximum is not shown in table above as award opportunity was uncapped. Awards received are included in the CEO total remuneration table above and the values are: £1,453,000 for 2011 (150,694 shares at a price of £9.64); £1,899,000 for 2012 (175,193 shares at a price of £10.84); and £364,000 for 2013 at (25,885 shares at a price of £14.06).

Statement of implementation of remuneration policy in 2018

Base salary and benefits

Salaries are reviewed (but not necessarily increased) annually and benchmarked against comparable roles at other FTSE 100 companies of similar market capitalisation, revenues and complexity. Having considered a number of important factors including individuals' performance and experience, the relative performance of the Company and the remuneration policy within the Company, the Committee has determined the following annualised salaries for executive directors for 2018:

Executive director	2016/17	2017/18
Andy Reynolds Smith	£780,000	£800,000

Bill Seeger was appointed Chief Financial Officer on an interim basis on 19 May 2017 after it was announced that Chris O'Shea would be stepping down. In this role, Bill Seeger is paid a monthly salary of £83,333. Bill Seeger does not receive any pension contribution (or allowance in lieu), and he is not eligible to participate in the annual bonus or the LTIP.

Pension and benefits

Andy Reynolds Smith will continue to receive a cash allowance in lieu of pension of 25% of his base salary and Chris O'Shea will also continue to do so until he leaves the Company on 18 November 2017. The executive directors do not have a prospective entitlement to a defined benefit pension.

Annual bonus

For 2018, Andy Reynolds Smith will continue to have a maximum bonus opportunity of 180% of salary. Annual bonus measures (and their weightings) will remain unchanged from 2017. 33% of any bonus earned will be deferred into shares for three years. Specific targets cannot be disclosed at this time due to the commercially sensitive nature of these objectives, but they will be disclosed at such a time as the Committee deems them to no longer affect the commerciality of the Company, likely to be within two years of the end of the performance period.

Long-Term Incentive Plan

The LTIP is a conventional share plan under which an award over a capped number of shares will vest if demanding performance conditions are met. LTIP awards of conditional shares are granted to selected senior executives (including the executive directors) with face values of up to 400% of salary. Under the LTIP, the normal annual grants are 300% of salary for the Chief Executive and 250% of salary for the Finance Director.

The LTIP award granted to Andy Reynolds Smith in 2017/18 (at the normal annual grant level of 300% of salary) will vest on the achievement of the following performance conditions:

Performance measure	Weighting	Threshold performance target	Maximum performance target (full vesting of element)
3-year EPS growth	35%	3% p.a.	12% p.a.
3-year average return on capital employed	35%	15%	18%
3-year average annual cash conversion	30%	90%	105%

This represents no change to the LTIP for the 2017/18 cycle. The Committee believes that the current structure provides an appropriate balance between earnings growth, returns and cash. The Committee recognises that this balance of Group's performance measures remains very important for many of our largest shareholders. As previously stated, the scorecard will be reviewed at the start of each future LTIP cycle to ensure it continues to reflect the Group's strategic priorities.

For performance between 'threshold' and 'maximum', awards vest on a straight-line sliding scale.

Non-executive director fees

NED fees paid for 2017 and to be paid in 2018 are shown below:

	2017	2018
NED base fee	£66,200	£67,850
Additional fee payable to the Chairman of the Board	£336,636	£345,050
Additional fee payable to the Senior Independent Director	£20,000	No change
Additional fees for Audit, Nomination and Remuneration Committee Chairs	£20,000	No change
Attendance allowance for meetings outside the NED's home continent	£3,000 per meeting	£4,000 per meeting

Share ownership guidelines

Executive directors are required, over time, to acquire a shareholding with a value equal to at least two years' base salary. Executive directors are required to retain at least 50% of any net vested share awards (after sales to meet tax liabilities) until those guidelines are achieved. Bill Seeger is not subject to this requirement, reflecting the interim nature of his appointment as CFO.

There is no shareholding policy for non-executive directors.

Directors' shareholdings (auditable)

The table below shows the shareholding of each director (or past director) and for executive directors the shareholding against their respective shareholding requirement as at 31 July 2017.

	Shareholding requirement (% 2016/17 salary)	Shares owned outright	Shares subject to performance	Performance tested but unvested shares	Shares subject to CIP deferral	Save As You Earn (SAYE)	Current shareholding (% 2016/17 salary)	Guideline met[1]
Andy Reynolds Smith	200%	148,649	527,275			2,078	293%	Yes
Chris O'Shea	200%	39,840	210,723			3,464	124%	No
Bruno Angelici		2,000						
Sir George Buckley		10,000						
Tanya Fratto		1,500						
Anne Quinn		1,024						
Bill Seeger		5,000						
Mark Seligman		5,000						
Sir Kevin Tebbit		1,000						
Noel Tata		0						

1 Executive directors have five years from the date of appointment to meet the required personal shareholding.

In accordance with a binding commitment entered into on 19 July 2017, pursuant to which the Chairman purchases Ordinary Shares on a quarterly basis using a fixed proportion (20%) of the after-tax fees he receives from the Company, Sir George Buckley acquired 431 Ordinary Shares on 1 August 2017. There have been no other changes in the interests of the directors and their connected persons between 31 July 2017 and the date of this report.

Share scheme dilution limits

The Company complies with the guidelines laid down by the Investment Association. These restrict the issue of new shares under all the Company's share schemes in any 10-year period to 10% of the issued ordinary share capital and under the Company's discretionary schemes to 5% in any 10-year period. As at 31 July 2017, the headroom available under these limits was 7.69% and 3.22%, respectively.

Auditable part

The directors' single figure of annual remuneration and accompanying notes on page 113; the incentive outcomes for 2016 and 2017 on pages 113 and 114; the scheme interests awarded in 2017 and accompanying notes on page 115; the payments to past directors and payments for loss of office on page 117; the directors' shareholdings on page 119 and the directors' share options and long-term plans table on page 120 have been audited.

The Directors' remuneration report has been approved by the Board and signed on its behalf by:

ANNE QUINN, CBE
CHAIR OF THE REMUNERATION COMMITTEE
21 September 2017

Directors' share options and long-term share plans (Auditable)

Director and Plans	Options and awards held on 31 July 2017 Number	Options and awards held on 31 July 2016 Number	Option and award data: Perfor-mance test	Exercise price	Grant date	Vesting date*	Expiry date**	Exercise/ vesting date	Number	Exercise price	Awards vested 2016/17: Market price at date of grant#	Market price at date of exercise##
Andy Reynolds Smith (appointed 25 September 2015)												
Restricted Share Award	0	56,481		n/a	26/11/15	30/06/17	30/06/17	30/06/17	60,360	n/a	1033.00p	1593.00p
Performance Share Award	79,806	79,806	A	n/a	26/11/15	Oct 2018						
	26,602	26,602		n/a	26/11/15	Oct 2019						
	26,602	26,602		n/a	26/11/15	Oct 2020						
LTIP 2015	226,524	226,524	A	n/a	26/11/15	Oct 2018						
	167,741	0	B	n/a	08/11/16	Oct 2019						
Deferred Bonus Award	24,546	–	–	n/a	08/11/16	08/11/19						
SAYE	2,078	2,078	–	866.00p	11/05/16	01/08/19	01/02/20					
Chris O'Shea (stepped down 18 May 2017)												
CFO Restricted Share Award	0	35,969		n/a	26/11/15	18/09/16		30/09/16	37,371	n/a	1033.00p	1453.27p
	35,969	35,969		n/a	26/11/15	18/09/17	18/09/17					
LTIP 2015	119,796	119,796	A	n/a	26/11/15	Oct 2018						
	90,927	0	B	n/a	08/11/16	Oct 2019						
Deferred Bonus Award	13,519	–	–	n/a	08/11/16	08/11/19						
SAYE	3,464	3,464	–	866.00p	11/05/16	01/08/21	01/02/22					

Key

CEO Restricted Share Award	Under the terms of his contract of employment on joining the Company, Andy Reynolds Smith was granted a buy-out restricted share award over 86,893 shares of which 35% vested on 30 June 2016 and 65% vested on 30 June 2017. The terms of the award provide that additional shares are awarded on vesting to a value equivalent to the notional dividends that would have been earned on the number of shares that vest. Andy Reynolds Smith received 3,879 additional shares on 30 June 2017 in respect of the notional dividends on the tranche of his award that vested on this date.
Performance Share Award	Under the terms of his contract of employment on joining the Company, Andy Reynolds Smith was also granted a buy-out conditional award over 133,010 shares of which up to 60% are expected to vest in October 2018 (subject to the performance tests applicable to awards granted under LTIP 2015 in 2015); up to 20% are expected to vest in October 2019 (subject to performance tests applicable to awards granted under long-term incentive plans in 2016); and up to 20% are expected to vest in October 2020 (subject to the performance tests applicable to awards granted under long-term incentive plans in 2017). The terms of the award provide that additional shares are awarded on vesting to a value equivalent to the notional dividends that would have been earned on the number of shares that vest.
CFO Restricted Share Award	Under the terms of his contract of employment on joining the Company, Chris O'Shea was granted a buy-out restricted share award over 71,938 shares of which 50% vested on 18 September 2016 (or at the end of any closed period in force at the time and subject to Chris O'Shea remaining an employee of the Company) and 50% will vest on 18 September 2017 (or at the end of any closed period in force at the time and subject to Chris O'Shea remaining an employee of the Company). The terms of the award provide that additional shares are awarded on vesting to a value equivalent to the notional dividends that would have been earned on the number of shares that vest. Chris O'Shea received 1,402 additional shares on 30 September 2016 in respect of the notional dividends on the tranche of his award that vested on that day.
LTIP 2015	The Smiths Group Long Term Incentive Plan 2015
SAYE	The Smiths Group Sharesave Scheme
*	The Vesting Dates shown above in respect of awards made under CIP and the LTIPs are subject to the relevant performance test(s) being passed.
**	The Expiry dates shown above apply in normal circumstances. No Expiry date is shown if the option or award was exercised or vested or lapsed prior to 19 September 2017.
#	Mid-market closing price of a Smiths share on the business day preceding the date of grant. Note: the exercise price of an option under the SAYE is set at 20% less than the mid-market closing price of a Smiths share on the business day immediately preceding the day on which employees are invited to participate in the grant.
##	Actual sale price of shares sold on date of exercise of an option or the vesting of an award or the mid-market closing quotation on the date of exercise when no shares are sold.

Performance tests

A	LTIP 2015 awards – 30% subject to revenue growth; 30% subject to EPS element; 20% subject to cash conversion; 20% subject to return on capital employed
B	LTIP 2016 awards- 35% subject to EPS element; 35% subject to return on capital employed; 30% subject to cash conversion
–	There are no performance criteria for the Deferred Bonus Shares awards or SAYE

Notes

The high and low market prices of the ordinary shares during the period 1 August 2016 to 31 July 2017 were 1238p and 1685p respectively.
The mid-market closing price on 31 July 2016 was 1263p and on 31 July 2017 was 1535p.
The mid-market closing prices of a Smiths share on the dates of the awards made to directors in the 2016/17 financial year was 1404p (8 November 2016)
The options over 5,542 shares granted to and held by the directors under SAYE at 31 July 2017 were granted at exercise prices below the market price of a Smiths Group share on 23 September 2016 (1420p).
None of the options or awards listed above was subject to any payment on grant
No other directors held any options over the Company's shares during the period 1 August 2016 to 31 July 2017.
No options or awards have been granted to or exercised by directors or have lapsed during the period 1 August to 19 September 2017.
At 31 July 2017, the trustee of the Employee Share Trust held 766 shares (none of the directors had an interest in these shares at 31 July 2017). The market value of the shares held by the trustee on 31 July 2017 was £11,758 and dividends of approximately £324 were waived in the year in respect of the shares held by the trustee during the year.
Special provisions permit early exercise of options and vesting of awards in the event of retirement; redundancy; death; etc.

DIRECTORS' REPORT

The Strategic report is a requirement of the Companies Act 2006 (the 'Act') and can be found on pages 1 to 75. The Company has chosen, in accordance with section 414 C(11) of the Act, and as noted in this Directors' Report, to include certain matters in its Strategic report that would otherwise be disclosed in this Directors' Report. Other information that is relevant to the Directors' Report, and which is incorporated by reference into this report, including information required in accordance with the Act and Listing Rule 9.8.4R of the Financial Conduct Authority's Listing Rules, can be located as follows:

Disclosure	Page
Likely future business developments	24-51
Research and Development activities	32-51
Employment of disabled persons and employee involvement	73
Greenhouse gas emissions	70
Financial instruments	55
Independent auditors report	129-135

Corporate governance statement

The corporate governance statement is on pages 78 to 125 and is incorporated by reference into this Directors' Report.

PricewaterhouseCoopers LLP has reviewed the Company's statements as to compliance with the UK Corporate Governance Code, to the extent required by the UK Listing Authority Listing Rules. The results of its review are set out in the independent auditors' report on pages 129-135.

Results and dividends

The results for the financial year ended 31 July 2017 are set out in the consolidated income statement. Revenue for the year amounted to £3,280m (2016: £2,949m). The profit for the year after taxation and discontinued operations amounted to £564m (2016: £261m). An interim dividend of 13.55p per ordinary share of 37.5p ('ordinary share') was paid on 28 April 2017. The directors recommend for payment on 17 November 2017 a final cash dividend of 29.70p per ordinary share, making a total dividend of 43.25p for the financial year. The Group's dividend policy is described in the Financial review on page 53.

Waiver of dividends

The following waived all dividends payable in the year, and all future dividends, on their shareholdings in the Company:

- Wealth Nominees Limited (Smiths Industries Employee Share Trust)
- Reuter File Limited

Directors

The membership of the Board and biographical details of the directors are given on pages 78 to 81. The following directors served as directors of the Company throughout the year ended 31 July 2017:

Name	Role on the Board
Sir George Buckley	Chairman
Andy Reynolds Smith	Executive director
Bill Seeger	Executive director
Bruno Angelici	Non-executive director
Tanya Fratto	Non-executive director
Anne Quinn CBE	Non-executive director
Mark Seligman	Non-executive director
Sir Kevin Tebbit, KCB, CMG	Non-executive director

The following table discloses directorate changes during the year:

Name	Role on the Board	Date of appointment/resignation
Noel Tata	Non-executive director	Appointed on 1 January 2017
Chris O'Shea	Executive director	Resigned on 19 May 2017

Details of directors' beneficial and non-beneficial interests in the shares of the Company are shown on page 119. In accordance with section 430(2B) of the Act, details of the arrangements made in respect of the retirement of Philip Bowman and the resignation of Chris O'Shea are available on the Smiths website (www.smiths.com).

Appointment and replacement of directors

The rules regarding the appointment and replacement of directors are determined by the Company's Articles of Association and the Act. The Articles of Association can only be amended by a special resolution of the shareholders. In accordance with the UK Corporate Governance Code all the directors, apart from Noel Tata, will retire voluntarily from office at the 2017 Annual General Meeting ('AGM') and seek re-election by the shareholders. The directors may appoint a person to be a director, but under the Articles of Association they shall only hold office until the next AGM, when they shall be eligible for election by the shareholders. Accordingly, Noel Tata will retire and seek election at the 2017 AGM.

Directors' interests in contracts

Details of the executive directors' service contracts are disclosed in the service contracts section of the Directors' remuneration report on page 111. Details of the interests of the executive directors in the Company's share option schemes and plans are shown in the Directors' remuneration report on page 120.

Qualifying third-party indemnity provisions (as defined by section 234 of the Act) have remained in force for the directors of the Company, and certain other employees in respect of their directorships of some subsidiary companies, during the financial year ended 31 July 2017 and, at the date of this report, are in force for the benefit of the current directors, and certain other employees who are directors of some subsidiary companies, in relation to certain losses and liabilities which they may incur (or may have incurred) to third parties in the course of their professional duties for the Company, or a subsidiary company, as applicable.

Apart from the exceptions referred to above, no director had an interest in any significant contract to which the Company or its subsidiaries was a party during the year.

Post balance sheet events
The $175m private placement 2018 was repaid early in August 2017.

Interests in voting rights
As at 31 July 2017 the Company had been notified pursuant to the Disclosure Guidance & Transparency Rules (DTRs) of the Financial Conduct Authority (FCA), or had received disclosures pursuant to the Act, of shareholding interests of the following holdings of voting rights in shares:

	Number of shares	Percentage of issued ordinary share capital	Date of notification or disclosure
Ameriprise Financial	19.5m	4.9%	8 June 2017
BlackRock	27.8m	7.0%	21 September 2016
Dodge & Cox	28.4m	7.2%	12 August 2016
Harris Associates LP	19.1m	4.8%	11 October 2016
Jupiter Asset Management	14.8m	3.8%	22 September 2016

During the period 1 August to 15 September 2017 the Company has received the following notifications or disclosures:

	Number of shares	Percentage of issued ordinary share capital	Date of notification
Dodge & Cox	19.5m	4.9%	24 August 2017

Corporate responsibility
The Company operates a Code of Business Ethics and has Group policies on environmental, employee and health and safety matters. The Company seeks to minimise, as far as is reasonably practicable, any detrimental effects on the environment of its operations and products. Further information on environmental, employee and health and safety matters is contained in the Responsible Business section on pages 68 to 75. The full Responsible Business report is available online at www.smiths.com.

Branches
The Company does not operate through any branches. Some Group subsidiary companies have established branch operations outside the UK.

Share capital

As at 31 July 2017, the Company's issued share capital was 395,476,662 ordinary shares, with a nominal value of £148,303,748. The ordinary shares are listed and admitted to trading on the Main Market of the London Stock Exchange. The Company has an American Depositary Receipt (ADR) programme for which J.P. Morgan acts as Depositary and transfer agent. One ADR equates to one ordinary share, and the programme trades 'over-the-counter' as a level 1 ADR programme. As at 31 July 2017, 7,059,489 ordinary shares were held by the nominee of the programme depositary in respect of the same number of ADRs in issue at that time.

The holders of ordinary shares are entitled to receive the Company's reports and accounts, to attend and speak at general meetings of the Company, to appoint proxies and to exercise voting rights.

There are no restrictions on transfer, or limitations on the holding, of any class of shares. There are no requirements for prior approval of any transfers. None of the shares carry any special rights with regards to control of the Company. There are no restrictions on the voting rights attaching to the ordinary shares (other than a 48 hour cut-off for the casting of proxy votes prior to a general meeting). There are no arrangements of which the directors are aware under which financial rights are held by a person other than the holder of the shares, and no known agreements relating to, or restrictions on, share transfers or voting rights.

Shares acquired through Company share schemes and plans rank pari passu with the shares in issue and have no special rights. The Company operates an employee benefit trust, with an independent trustee, to hold shares pending employees becoming entitled to them under the Company's share schemes and plans. On 31 July 2017 the trust held 766 ordinary shares in the Company. The trust waived its dividend entitlement on its holding during the year, and the trust abstains from voting the shares at general meetings.

Powers of the directors

The powers of the directors are determined by the Act and the Articles of Association of the Company. The directors have been authorised to issue and allot shares, and to buy back shares. These powers are subject to annual shareholder approval at the Annual General Meeting (AGM), and at the 2017 AGM shareholders will be asked to renew and extend the authority, given to the directors at the last AGM, to allot shares in the Company, or grant rights to subscribe for, or to convert any security into, shares in the Company for the purposes of section 551 of the Act (the 'Allotment Resolution').

The authority in the first part of the Allotment Resolution will allow the directors to allot new shares in the Company, or to grant rights to subscribe for, or convert any security into, shares in the Company up to a nominal value which is equivalent to approximately one-third of the total issued ordinary share capital of the Company.

The authority in the second part of the Allotment Resolution will allow the directors to allot new shares in the Company, or to grant rights to subscribe for, or convert any security into, shares in the Company, only in connection with a rights issue, up to a nominal value which is equivalent to approximately an additional third of the total issued ordinary share capital of the Company. This is in line with corporate governance guidelines.

There are no present plans to undertake a rights issue or to allot new shares other than in connection with the Company's share schemes and plans. The directors intend to take note of relevant corporate governance guidelines on the use of such powers in the event that the authority is exercised.

The Company did not repurchase any shares during the financial year ended 31 July 2017. As at 15 September 2017 the Company had an unexpired authority to repurchase ordinary shares up to a maximum of 39,540,648. As at 15 September 2017, the Company did not hold any shares in treasury. Any ordinary shares purchased may be cancelled or held in treasury.

Change of control

The Company has in place credit facility agreements under which a change in control would trigger prepayment clauses. The Company also has bonds in issue, the terms of which would allow bondholders to exercise put options and require the Company to buy back the bonds at their principal amount plus interest if a rating downgrade occurs at the same time as a change of control takes effect. The Company's share plans (including the buy-out awards granted to the executive directors on their appointments) contain clauses which may cause options and awards to vest on a change in control, in some cases subject to the satisfaction of performance conditions at that time. The Company is not party to any other significant agreements that would take effect, alter or terminate upon a change of control following a takeover.

No director or employee is contractually entitled to compensation for loss of office or employment as a result of a change in control, except that provisions in the Company's share schemes may cause options and awards granted to employees under such schemes to vest on a change in control, in some cases subject to the satisfaction of performance conditions at that time.

Remuneration policy

Details of the Directors' remuneration policy, as approved at the AGM in 2015, is shown on pages 105 to 108 of the Directors' remuneration report. Under the regulations which now form part of the Act, the remuneration policy must be put to a binding shareholder vote at least once every three years. All payments to former and current directors must comply with the terms of the policy, unless specifically approved by shareholders in general meeting.

DIRECTORS' REPORT
CONTINUED

Political donations
The Group made contributions to non-EU political parties totaling $58,500 (£46,000) during the year. The political contributions were made on a bi-partisan basis in the US, in accordance with US state and federal election laws, in order to raise awareness and to promote the interests of the Company. The Group has a number of key manufacturing sites and approximately 8,100 employees in the US.

Going concern
The Group's business activities, together with the factors likely to affect its future development, performance and position are set out in the Strategic report on pages 1 to 75. The financial position of the Company, its cash-flows, liquidity position and borrowing facilities are described in the Financial review on pages 52 to 57. In addition, the notes to the accounts include the Company's objectives, policies and processes for managing its capital, financial risk management objectives, details of its financial instruments and hedging activities, and its exposures to credit risk and liquidity risk.

In October 2016, the Company established a €2.5bn Euro Medium Term Note Programme (the 'Programme'). In February 2017, pursuant to the Programme, the Company issued €650m of new long-term public debt securities with a maturity in 2027. On 5 May 2017 the Group repaid €300m debt under long-term public debt securities issued in 2010. The new issuance and repayment resulted in an increase in the average maturity of gross debt to 5.9 years (from 4.5 years at 31 July 2016).

At 31 July 2017 the net debt of the Group was £967m, a £11m decrease from 31 July 2016. At the end of July the Group had available cash and short-term deposits of £782m. These liquid resources are immediately available with 98% invested with the Group's global banking partners.

The Group maintains a core US$800m committed revolving credit facility from these banks which was undrawn at 31 July 2017. This committed facility matures in February 2021. This facility has certain financial covenants however these are not expected to prevent utilisation at the Group's discretion if required.

This financial position and debt maturity profile provides confidence that the Group has sufficient financial resources for the foreseeable future. As a consequence, the directors believe that the Company is well placed to manage its business and its liabilities as they fall due. In coming to this conclusion, the directors have taken account of the Group's risk management process described on pages 60 to 61, and have paid particular attention to the financial and pension funding risks and their mitigation (see page 62).

The directors, having made appropriate enquiries, have a reasonable expectation that the Company and the Group have adequate resources to continue in operation for the foreseeable future and for a period of at least 12 months from the date of this report. Thus they continue to adopt the going concern basis of accounting in preparing the annual accounts of the Company and the Group.

Long term Viability Statement
The directors have assessed the longer-term prospects of the Group, taking into account the current position of the Group and a range of internal and external factors. The assessment is described in the Strategic report on page 57.

Disclosure of information to the auditor
As at the date of this report, as far as each director is aware, there is no relevant audit information of which the Company's auditor is unaware. Each director has taken all the steps he or she should have taken as a director in order to make himself or herself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

Annual General Meeting (AGM)
The 2017 AGM will be held on Tuesday, 14 November 2017 at 11:00 am. The Notice of the AGM will be published on the Company's website, www.smiths.com, on or around Tuesday, 10 October 2017. Electronic copies of the Annual Report 2017 and the Notice of AGM will be posted on the Company's website.

Further information about the AGM and the Registrar can be found on page 215.

By order of the Board

MEL ROWLANDS
COMPANY SECRETARY
Smiths Group plc
4th Floor, 11-12 St James's Square
London, SW1Y 4LB
21 September 2017

Disclosure table pursuant to Listing Rule LR9.8.4R

Listing Rule	Information to be included	Disclosure
9.8.4(1)	Interest capitalised by the Group	£2.4m interest was capitalised as part of the costs of development projects. £0.6m of tax relief has been recognised as current tax relief in the period
9.8.4(2)	Unaudited financial information	The supplementary US dollar financial statements on pages 190 to 195 The Group financial record 2013-2017 on page 189
9.8.4(4)	Long-term incentive scheme only involving a director	No disclosure for the year ended 31 December 2017
9.8.4(5)	Directors' waivers of emoluments	None
9.8.4(6)	Directors' waivers of future emoluments	None
9.8.4(7)	Non pro-rata allotments for cash (issuer)	Shares have been issued and allotted pursuant to the exercise options awarded under shareholder-approved schemes. See page 184 for more information.
9.8.4(8)	Non pro-rata allotments for cash (major subsidiaries)	None
9.8.4(9)	Listed company is a subsidiary of another company	Not applicable
9.8.4(10)	Contracts of significance involving (a) a director or (b) a controlling shareholder	(a) None (b) Not applicable
9.8.4(11)	Contracts for the provision of services by a controlling shareholder	Not applicable
9.8.4(12)	Waivers of dividends	See page 121
9.8.4(13)	Waivers of future dividends	See page 121
9.8.4(14)	Agreement with a controlling shareholder	Not applicable

Additional information pursuant to LR9.8.6

Listing Rule	Information to be included	Disclosure
9.8.6(1)	Directors' (and their connected persons') interests in Smiths shares at year-end and at not more than one month prior to date of the Notice of AGM	See page 119
9.8.6(2)	Interests in Smiths shares disclosed under DTR5 at year-end and not more than one month prior to date of the Notice of AGM	See pages 122
9.8.6(3)(a)	Directors' going concern statement	See page 124
9.8.6(3)(b)	Directors' assessment of the Company's prospects	See page 57
9.8.6(4)(a)	Amount of the authority to purchase own shares available at year-end	Authority available in full at year-end
9.8.6(4)(b)	Off-market purchases of own shares during the year	None
9.8.6(4)(c)	Off-market purchases of own shares post year-end	None
9.8.6(4)(d)	Non pro-rata sales of treasury shares during the year	None
9.8.6(5)	Compliance with the main principles of the UK Corporate Governance Code	See the Corporate governance statement on page 83
9.8.6(6)(b)	Details of non-compliance with UK Corporate Governance Code and reasons	None
9.8.6(7)	Re directors proposed for re-election: the unexpired term of any director's service contract and a statement about directors with no service contracts	Details of the executive directors' service contracts are given in the Directors' remuneration report on page 111 The Chairman and the non-executive directors serve under letters of appointment – see page 111

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STATEMENT OF DIRECTORS' RESPONSIBILITIES

The directors are responsible for preparing the Annual Report and the Group and Parent Company financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare accounts for each financial year. Under company law the directors must not approve the accounts unless they are satisfied that they give a true and fair view of the state of affairs of the Group and the Company and of the profit or loss of the Group for that period. In preparing these accounts, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether the consolidated accounts comply with International Financial Reporting Standards ("IFRS"), and the Parent Company accounts comply with applicable UK Accounting Standards, subject to any material departures disclosed and explained in the accounts; and
- prepare the accounts on the going concern basis unless it is inappropriate to presume that the Group and the Company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Group's and the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Group and the Company and enable them to ensure that the accounts and the Directors' remuneration report comply with the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation. They are also responsible for safeguarding the assets of the Group and the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Directors' responsibility statement

The directors consider that the Annual Report, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy.

Each of the directors (who are listed on pages 78 to 81) confirms that to the best of his or her knowledge:

- the Group's financial statements have been prepared in accordance with IFRS as adopted by the European Union and give a true and fair view of the Group's assets, liabilities and financial position as at 31 July 2017 and of its profit for the financial year then ended; and
- the Group directors' report and Strategic report include a fair review of the development and performance of the business and the position and performance of the Group, together with a description of the principal risks and uncertainties that the Group faces.

Signed on behalf of the Board of directors:

Andy Reynolds Smith
Chief Executive
21 September 2017

Bill Seeger
Chief Financial Officer

Report on the audit of the financial statements

Opinion

In our opinion:

- Smiths Group plc's Group financial statements and Company financial statements (the "financial statements") give a true and fair view of the state of the Group's and of the Company's affairs as at 31 July 2017 and of the Group's profit and cash flows for the year then ended;
- the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the Company financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards, comprising FRS 101 "Reduced Disclosure Framework", and applicable law); and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

We have audited the financial statements, included within the Annual Report, which comprise: the consolidated balance sheet and Company balance sheet as at 31 July 2017; the consolidated income statement and consolidated statement of comprehensive income for the year then ended; the consolidated cash-flow statement for the year then ended; the consolidated statement of changes in equity and the Company statement of changes in equity for the year then ended; and the notes to the financial statements, which include a description of the significant accounting policies.

Our opinion is consistent with our reporting to the Audit Committee.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

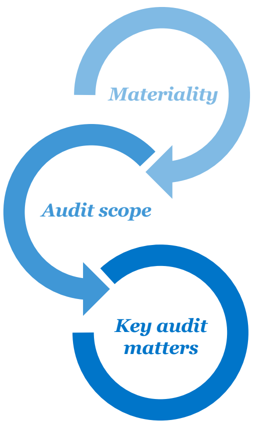
We remained independent of the Group in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard as applicable to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

To the best of our knowledge and belief, we declare that non-audit services prohibited by the FRC's Ethical Standard were not provided to the Group or the Company.

Other than those disclosed in note 2 to the financial statements, we have provided no non-audit services to the Group or the Company in the period from 1 August 2016 to 31 July 2017.

Our audit approach

Overview



Materiality
- Group financial statements: £20 million (2016: £17 million), based on 3.5% of headline operating profit.
- Company financial statements: £18 million (2016: £15 million), based on 0.5% of total assets.

Audit scope
- We conducted full scope audits at 22 reporting units across 12 countries.
- In addition, we performed the audit of specific balances and transactions at 18 reporting units across North America and Canada.
- During the year, the Group engagement team visited multiple reporting sites in North America and Europe and attended the year end clearance meetings for each division.

Key audit matters
- Revenue recognition, together with accounting for complex programmes and contract accounting in the Smiths Detection and Smiths Interconnect Divisions (Group)
- Acquisition accounting (Group)
- Accounting for disposals (Group)
- Product litigation provisions for asbestos in John Crane, Inc. and flexible gas piping product in Titeflex Corporation (Group)
- Working capital and associated provisions (Group)
- Taxation provisions and the recognition of deferred tax assets (Group)
- Goodwill and intangible asset impairment assessments (Group)
- Defined benefit pension plan net assets and liabilities (Group and Company)

The scope of our audit

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements. In particular, we looked at where the directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. As in all of our audits we also addressed the risk of management override of internal controls, including evaluating whether there was evidence of bias by the directors that represented a risk of material misstatement due to fraud.

Key audit matters

Key audit matters are those matters that, in the auditors' professional judgement, were of most significance in the audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by the auditors, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters, and any comments we make on the results of our procedures thereon, were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. This is not a complete list of all risks identified by our audit.

Key audit matter	How our audit addressed the key audit matter
Revenue recognition (occurrence), together with accounting for complex programmes and contract accounting in the Smiths Detection and Smiths Interconnect Divisions (Group) *Refer also to Accounting Policies* We focused on revenue recognition for all divisions in the Group to check that revenue has been appropriately recognised upon fulfilment of obligations. In the Smiths Detection and Smiths Interconnect divisions we focused on the accounting for complex programmes and contract accounting. The recognition of revenue is largely dependent on the terms of the underlying contract with the customer, including the nature of separate deliverables within the contract, achieving milestones within those contracts and the mechanisms in the contract by which risks and rewards of goods and services are transferred to the customer. These contracts are usually long term in nature, sometimes spanning a number of reporting periods. This means that the final profitability of a contract, which will be based upon forecast revenues and costs to complete, can be uncertain during the earlier phases. Judgement must therefore be applied in order to estimate the profit margins to recognise the revenue that is recorded. Changes in conditions and circumstances over time can result in variations to the original contract terms or to the overall profitability of the contract. This can include cost overruns which require further negotiation and settlements resulting in the need for provisions.	For all the divisions we assessed whether the Group's revenue recognition policies complied with IFRSs as adopted by the EU and tested the implementation of those policies. Specifically we considered whether revenue was recognised based on the transfer of the risks and rewards of ownership of goods to the customer or the accounting period in which services were rendered by testing a sample of revenue items to contract and shipping documents, with a specific focus, particularly on major programmes where revenue was recorded close to the year-end. Where appropriate we evaluated the relevant IT systems and tested the operating effectiveness of the internal controls over the recording of revenue in the correct period. We also tested journal entries posted to revenue accounts to identify any unusual or irregular items, and the reconciliations between the systems used by the Group and its financial ledgers. In the case of the Smiths Detection and Smiths Interconnect divisions, for a sample of contracts, we read extracts of the relevant customer agreements and tested the accounting for separate deliverables and contractual milestones. This testing included evaluating customer acceptance of the work done to establish whether contractual milestones had been achieved, assessing the impact of any ongoing disputes, and assessing the reasonableness of the directors' estimates of costs to complete the contract by comparing them to actual historical costs incurred on comparable contracts. We did not identify any material exceptions from the audit work performed and we found estimates to be in line with our expectations.
Acquisition accounting (Group) *Refer also to note 26 and 27* The Group completed its acquisition of Morpho Detection from Safran SA on the 6th April 2017, resulting in the recognition of £240m of acquired intangibles, £210m of goodwill and £140m of net assets. A key condition of the acquisition was the disposal of Morpho Detection's explosive trace detection business ("Trace"), which resulted in this business being classified as a discontinued business. Judgement was required in identifying and valuing these acquired intangibles and goodwill, determining the valuation of the other assets and liabilities acquired and the classification of the Trace business. In addition, the disclosure requirements in respect of acquisitions are extensive. Due to the quantum and complexity of the judgements, we focussed on this area.	We obtained and read the Morpho Sale and Purchase Agreement (SPA) to gain an understanding of the key terms of the acquisition. In testing this acquisition and related Trace disposal, we considered whether the identified intangible assets were appropriate by reference to the SPA, due diligence reports and other supporting documentation. We obtained the calculation of the fair value of intangible assets acquired, and where material, assessed the methodology employed, involving experts and corroborated the inputs and assumptions to supporting evidence. We noted no exceptions through performing these procedures. We also checked that the material fair value adjustments to the net assets were consistent with the accounting standard requirements. Based on the evidence obtained, we did not identify any indications that the fair value adjustments identified by management were inappropriate. We read the disclosures in the financial statements to satisfy ourselves that they are in line with the requirements of the relevant accounting standards.

Key audit matter	How our audit addressed the key audit matter
Accounting for disposals (Group) *Refer also to note 28* We focussed on this area as the Group recorded significant profit on disposals (£175m) following the divestment of its Artificial lift, Interconnect Power and Microwave Telecoms businesses during the year, along with its Wallace product line (disclosed in note 28 to the financial statements) Judgement arose in determining the value of goodwill allocated to the Wallace product line. In addition the calculation of the disposal gains was complex, particularly around the recycling of accumulated currency translation reserves.	We obtained and read the relevant clauses within all the related sale and purchase agreements (SPAs) to obtain an understanding of the perimeter and requirements of the disposal. We assessed the recycling of the currency reserve, tested the allocation of Wallace assets, including goodwill, and verified the mathematical accuracy of the disposal calculation. We also tested the consideration received to supporting evidence Finally, we read the disclosures within the financial statements to ensure these met the presentation requirements of the relevant accounting standards. We noted no exceptions through performing these procedures.
Product litigation provisions for asbestos in John Crane, Inc. and flexible gas piping product in Titeflex Corporation (Group) *Refer also to note 22* John Crane, Inc., a US based subsidiary of the Group, is currently one of many co-defendants in litigation relating to products previously manufactured which contained asbestos. A provision of £237m has been made for the future defence costs which the Group is expected to incur and the expected costs of future adverse judgments against John Crane, Inc. Titeflex Corporation, another US based subsidiary of the Group, has received a number of claims from insurance companies seeking recompense on a subrogated basis for the effects of damage allegedly caused by lightning strikes in relation to its flexible gas piping product. It has also received a number of product liability claims regarding this product, some in the form of purported class actions. A provision of £84m has been made for the costs which the Group is expected to incur in respect of these claims. We focused on these areas because there is significant judgement involved in the assumptions used to estimate the provisions, in particular those relating to the US litigation environment such as the future level of claims and the cost of defence. As a result the provision may be subject to potentially material revisions from time to time.	In John Crane, Inc. we used our own internal experts to challenge management's assumptions underlying the adverse judgment and defence cost provisions. This included an examination of the model maintained by management's valuation expert and evaluation of the work of the expert, by considering the appropriateness of the methodology used, the reasonableness of assumptions (including the use of a rolling 10 year horizon) and considering alternative outcomes, particularly the sensitivity calculations performed. In addition we tested the mathematical accuracy of the underlying calculations and agreed input data to source documents. We challenged management's underlying assumptions supporting its Titeflex provision. This included an evaluation of the valuation model, by testing the mathematical accuracy of the underlying calculations and the input data such as the average amount of settlements, the number of future settlements and the period over which expenditure can be reasonably estimated by testing them to historic claims. We also discussed these matters with the Company's internal legal counsel, obtained letters from external counsel and evaluated the appropriateness of the disclosures made in the Group financial statements. We found the assumptions to be consistent and in line with historical claims. We read the disclosures and found them to be consistent with the information we have obtained during the course of our audit.
Working capital and associated provisions (Group) *Refer also to notes 13 and 14* We focused on this area because inventory provisions include subjective estimates and are influenced by assumptions concerning future selling prices and the level of sales activity, and the Group also has material levels of trade receivables that are overdue and not impaired (as disclosed in note 14 to the financial statements). We focused in particular on inventory levels in those parts of the business experiencing challenging trading environments. We also focused on divisions with inherent judgements associated with large programmes and complex contractual terms. The key associated risks were recoverability of billed and unbilled trade receivables and the valuation of inventory.	Where appropriate, we evaluated the directors' forecasted sales for each significant category of slow moving inventory by comparing them to historical sales and orders for future sales. We compared the historical provision for bad debts to the actual amounts written off, to determine whether the directors' estimation techniques were reasonable and considered the adequacy of provisions for bad debts for significant customers at reporting unit level, taking into account specific credit risk assessments. We did not identify any material exceptions from our audit work.

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF SMITHS GROUP PLC CONTINUED

Key audit matter	How our audit addressed the key audit matter
Taxation provisions and the recognition of deferred tax assets (Group) *Refer also to note 6* The Group has recognised £272m deferred tax assets on the balance sheet, the recognition of which involves judgement by management as to the likelihood of the realisation of these deferred tax assets. The expectation that the benefit of these assets will be realised is dependent on a number of factors, including appropriate taxable temporary timing differences, and whether there will be sufficient taxable profits in future periods to support recognition. In the current year the Group recognised a £69 million deferred tax asset in the UK in respect of past losses following a reassessment of the future profitability of the Group's activities in the UK. The Group has recognised provisions against uncertain tax positions, the valuation of which is an inherently judgemental area. The Group has a wide geographic footprint and is subject to tax laws in a number of jurisdictions.	We evaluated the directors' assessment as to whether there will be sufficient taxable profits in future periods to support the recognition of deferred tax assets by evaluating the directors' future cash flow forecasts, and the process by which they were drawn up, including testing the underlying calculations and comparing the forecasts to historical performance. We also used our tax specialists to assess management's assumptions underlying the provisions for uncertain tax positions. We discussed with management the known uncertain tax positions and read communications from taxation authorities to identify uncertain tax positions. We did not identify any material exceptions from our audit work.
Goodwill and intangible asset impairment assessments (Group) *Refer also to notes 10 and 11* The Group holds significant amounts of goodwill and intangible assets on the balance sheet, as detailed in note 10 to the financial statements. The risk is that these balances are overstated. Goodwill must be tested for impairment on at least an annual basis. The determination of recoverable amount, being the higher of value-in-use and fair value less costs to dispose, requires judgement in both identifying and then valuing the relevant cash generating units (CGUs). The impairment assessment for these assets involves subjective judgements about future business performance, with key assumptions including cash flows, the overall long-term growth rates, discount rates used and to the extent relevant, the fair value less costs to dispose. The Group also holds capitalised development costs, where the risk of inappropriate capitalisation or impairment may arise. The key judgements relate to the commercial viability of the products under development and related assumptions used within the related impairment assessments.	We evaluated the directors' future cash flow forecasts, and the process by which they were drawn up, including testing the underlying calculations and comparing them to the latest Board approved divisional budgets. We challenged: • the directors' key assumptions for long term growth rates in the forecasts by comparing them to historical results, and economic and industry forecasts; and • the discount rate by assessing the cost of capital for the Group. We evaluated the reasonableness of the directors' forecast performance by performing a sensitivity analysis around the key drivers of the cash flow forecasts. We found the assumptions to be consistent and in line with our expectations. We also tested the directors' assessment of the fair value less costs of disposal by comparing it to external analyst valuations. We evaluated the appropriateness of the related disclosures in note 11 of the financial statements, including sensitivities provided with respect to the Morpho Detection CGU. To address the risks around capitalised development costs we assessed the business cases supporting commercial viability, tested key assumptions within the impairment assessments, and performed sensitivity analysis. We did not identify any material exceptions from our audit work.
Defined benefit pension plan net assets and liabilities (Group and Company) *Refer also to note 8* The Group has defined benefit pension plans with net post-retirement assets of £390m and net post-retirement liabilities of £166m, which are significant in the context of the overall balance sheet of the Group and Company. The valuation of the pension liabilities requires some judgement and technical expertise in choosing appropriate assumptions. A number of the key assumptions (including salary increases, inflation, discount rates and mortality) can have a material impact on the calculation of the liability. The pension assets include significant pension asset investments and the fair value measurement of which includes judgement. The recognition of post-retirement plan net assets for accounting purposes is dependent on the rights of the employers to recover the surplus at the end of the life of the scheme.	We evaluated the directors' assessment of the assumptions made in relation to the valuations of the liabilities and assets in the pension plans and the assumptions around salary increases and mortality rates by comparing them to national and industry averages. We also focussed on the valuation of pension plan liabilities and the pension assets as follows: • We agreed the discount and inflation rates used in the valuation of the pension liability to our internally developed benchmarks. • We obtained third party confirmations on ownership and valuation of pension assets. • We checked that the recognition of post retirement plan net assets complies with the Group's investment principles. • Where there was no new census data in the year we assessed the assumptions used by the actuaries. • We tested the basis of recognition of the UK pension surplus through the reading of scheme rules. We did not identify any material exceptions from our audit work.

How we tailored the audit scope
We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the structure of the Group and the Company, the accounting processes and controls, and the industry in which they operate.

The Group is organised into five divisions: John Crane, Smiths Medical, Smiths Detection, Smiths Interconnect and Flex-Tek and is a consolidation of over 250 units.

In establishing the overall approach to the Group audit, we determined the type of work that needed to be performed at the reporting units by us, as the Group Engagement team, or component auditors within PwC UK and from other PwC network firms operating under our instruction. Where the work was performed by component auditors, we determined the level of involvement we needed to have in the audit work at those reporting units to be able to conclude whether sufficient appropriate audit evidence had been obtained as a basis for our opinion on the financial statements as a whole.

The Group's operating reporting units vary significantly in size and we identified 22 reporting units that, in our view, required an audit of their complete financial information, due to their size or risk characteristics. Specific audit procedures over certain balances and transactions were performed at a further 18 reporting units, to give appropriate coverage of material balances at both divisional and Group levels. Of these, one reporting unit has been determined to be financially significant based on its contribution to Group revenue or headline operating profit. We conducted work in 12 countries and the Group engagement team visited reporting sites in North America and Europe, and participated in each of the divisional audit clearance meetings. Together, the reporting units subject to audit procedures accounted for 75% (2016: 75%) of the Group's revenues and 78% (2016: 79%) of the Group's headline operating profit.

Further specific audit procedures over IT controls, central functions such as treasury and areas of judgement, including the accounting for acquisitions and disposals, taxation, goodwill, post-retirement benefits and material litigation, were performed at the local headquarters of each of the divisions and at the Group's Head Office.

Materiality
The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

	Group financial statements	Company financial statements
Overall materiality	£20 million (2016: £17 million).	£18 million (2016: £15 million).
How we determined it	3.5% of headline operating profit.	0.5% of total assets.
Rationale for benchmark applied	Consistent with last year, we applied this benchmark because, in our view, this is the metric against which the performance of the Group is most commonly measured	Consistent with last year, we applied this benchmark because, in our view, we consider a net asset measure to reflect the nature of the Company, which primarily acts as a holding company for the Group's investments and holds certain liabilities on the balance sheet.

For each component in the scope of our Group audit, we allocated a materiality that is less than our overall Group materiality. The range of materiality allocated across components was between £0.5 million and £18 million. Certain components were audited to a local statutory audit materiality that was also less than our overall Group materiality.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £1 million (Group audit) (2016: £0.5 million) and £1 million (Company audit) (2016: £0.5 million) as well as misstatements below those amounts that, in our view, warranted reporting for qualitative reasons.

Going concern
In accordance with ISAs (UK) we report as follows:

Reporting obligation	Outcome
We are required to report if we have anything material to add or draw attention to in respect of the directors' statement in the financial statements about whether the directors considered it appropriate to adopt the going concern basis of accounting in preparing the financial statements and the directors' identification of any material uncertainties to the Group's and the Company's ability to continue as a going concern over a period of at least twelve months from the date of approval of the financial statements.	We have nothing material to add or to draw attention to. However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Group's and Company's ability to continue as a going concern.
We are required to report if the directors' statement relating to Going Concern in accordance with Listing Rule 9.8.6R(3) is materially inconsistent with our knowledge obtained in the audit.	We have nothing to report.

Reporting on other information
The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

With respect to the Strategic Report and Group directors' report, we also considered whether the disclosures required by the UK Companies Act 2006 have been included.

Based on the responsibilities described above and our work undertaken in the course of the audit, the Companies Act 2006, (CA06), ISAs (UK) and the Listing Rules of the Financial Conduct Authority (FCA) require us also to report certain opinions and matters as described below (required by ISAs (UK) unless otherwise stated).

Strategic Report and Group directors' report
In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic Report and Group directors' report for the year ended 31 July 2017 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements. (*CA06*)

In light of the knowledge and understanding of the Group and Company and their environment obtained in the course of the audit, we did not identify any material misstatements in the Strategic Report and Group directors' report. (*CA06*)

The directors' assessment of the prospects of the Group and of the principal risks that would threaten the solvency or liquidity of the Group
We have nothing material to add or draw attention to regarding:

- The directors' confirmation on page 61 of the Annual Report that they have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity.
- The disclosures in the Annual Report that describe those risks and explain how they are being managed or mitigated.
- The directors' explanation on page 57 of the Annual Report as to how they have assessed the prospects of the Group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

We have nothing to report having performed a review of the directors' statement that they have carried out a robust assessment of the principal risks facing the Group and the statement in relation to the longer-term viability of the Group. Our review was substantially less in scope than an audit and only consisted of making inquiries and considering the directors' process supporting their statements; checking that the statements are in alignment with the relevant provisions of the UK Corporate Governance Code (the "Code"); and considering whether the statements are consistent with the knowledge and understanding of the Group and Company and their environment obtained in the course of the audit. (*Listing Rules*)

Other Code Provisions
We have nothing to report in respect of our responsibility to report when:

- The statement given by the directors, on page 97, that they consider the Annual Report taken as a whole to be fair, balanced and understandable, and provides the information necessary for the members to assess the Group's and Company's position and performance, business model and strategy is materially inconsistent with our knowledge of the Group and Company obtained in the course of performing our audit.
- The section of the Annual Report on pages 97 and 98 describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.
- The directors' statement relating to the Company's compliance with the Code does not properly disclose a departure from a relevant provision of the Code specified, under the Listing Rules, for review by the auditors.

Directors' Remuneration
In our opinion, the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006. (CA06)

Responsibilities for the financial statements and the audit

Responsibilities of the directors for the financial statements
As explained more fully in the Statement of directors' responsibilities set out on page 128, the directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the Group's and the Company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Group or the Company or to cease operations, or have no realistic alternative but to do so.

Auditors' responsibilities for the audit of the financial statements
Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditors' report.

Use of this report
This report, including the opinions, has been prepared for and only for the Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Other required reporting

Companies Act 2006 exception reporting
Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the Company, or returns adequate for our audit have not been received from branches not visited by us; or
- certain disclosures of directors' remuneration specified by law are not made; or
- the Company financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

Appointment
Following the recommendation of the Audit Committee, we were appointed by the members on 19 November 1996 to audit the financial statements for the year ended 31 July 1997 and subsequent financial periods. The period of total uninterrupted engagement is 21 years, covering the years ended 31 July 1997 to 31 July 2017.

Andrew Kemp (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
21 September 2017

- The maintenance and integrity of the Smiths Group plc website is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.
- Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

CONSOLIDATED INCOME STATEMENT

	Notes	Year ended 31 July 2017 Headline £m	Year ended 31 July 2017 Non-headline (note 3) £m	Year ended 31 July 2017 Total £m	Year ended 31 July 2016 Headline £m	Year ended 31 July 2016 Non-headline (note 3) £m	Year ended 31 July 2016 Total £m
Continuing operations							
Revenue	1	3,280		3,280	2,949		2,949
Cost of sales		(1,755)		(1,755)	(1,600)		(1,600)
Gross profit		1,525		1,525	1,349		1,349
Sales and distribution costs		(449)		(449)	(403)		(403)
Administrative expenses		(487)	(90)	(577)	(436)	(139)	(575)
Other operating income						16	16
Profit on business disposal	28		175	175			
Operating profit	2	**589**	**85**	**674**	**510**	**(123)**	**387**
Interest receivable		5		5	3		3
Interest payable		(66)		(66)	(62)		(62)
Other financing (losses)/gains			(14)	(14)		15	15
Other finance income – retirement benefits	8		2	2		3	3
Finance costs	4	(61)	(12)	(73)	(59)	18	(41)
Continuing operations – Profit before taxation		**528**	**73**	**601**	**451**	**(105)**	**346**
Taxation	6	(140)	111	(29)	(113)	28	(85)
Continuing operations – Profit for the year		**388**	**184**	**572**	**338**	**(77)**	**261**
Discontinued operations							
(Loss)/profit – discontinued operations	27		(8)	(8)			
Profit for the year		**388**	**176**	**564**	**338**	**(77)**	**261**
Profit for the year attributable to							
Smiths Group shareholders – continuing operations		386	184	570	336	(77)	259
Smiths Group shareholders – discontinued operations			(8)	(8)			
Non-controlling interests in respect of continuing operations		2		2	2		2
		388	**176**	**564**	**338**	**(77)**	**261**
Earnings per share	5						
Basic				142.1p			65.6p
Basic – continuing				144.1p			65.6p
Diluted				140.3p			64.9p
Diluted – continuing				142.3p			64.9p

References in the consolidated income statement, consolidated statement of comprehensive income, consolidated balance sheet, consolidated statement of changes in equity and consolidated cash-flow statement relate to notes on pages 141 to 188, which form an integral part of the consolidated accounts.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

	Notes	Year ended 31 July 2017 £m	Year ended 31 July 2016 £m
Profit for the period		**564**	**261**
Other comprehensive income			
Actuarial gains/(losses) on retirement benefits	8	55	(40)
Taxation recognised on actuarial movements	6	(13)	10
Other comprehensive income and expenditure which will not be reclassified to the consolidated income statement		**42**	**(30)**
Other comprehensive income which will be reclassified and reclassifications			
Exchange gains		25	420
Cumulative exchange gains recycled on business disposals		(41)	
Fair value gains/(losses) and reclassification adjustments			
– deferred on available for sale financial assets		1	(2)
– reclassified to income statement on available for sale financial assets	4		(19)
– deferred in the period on cash-flow and net investment hedges		(14)	(238)
– reclassified to income statement on cash-flow and net investment hedges		25	
Taxation recognised on fair value gains	6	(1)	
Total other comprehensive income		**37**	**131**
Total comprehensive income		**601**	**392**
Attributable to			
Smiths Group shareholders		600	386
Non-controlling interests		1	6
		601	**392**

FINANCIALS

CONSOLIDATED BALANCE SHEET

	Notes	31 July 2017 £m	31 July 2016 £m
Non-current assets			
Intangible assets	10	2,015	1,742
Property, plant and equipment	12	315	315
Financial assets – other investments	16	21	9
Retirement benefit assets	8	390	328
Deferred tax assets	6	272	246
Trade and other receivables	14	57	51
Financial derivatives	19	56	29
		3,126	**2,720**
Current assets			
Inventories	13	452	478
Current tax receivable	6	62	62
Trade and other receivables	14	722	745
Cash and cash equivalents	17	782	431
Financial derivatives	19	13	13
		2,031	**1,729**
Assets of business held for sale	27		24
Total assets		**5,157**	**4,473**
Non-current liabilities			
Financial liabilities			
– borrowings	17	(1,598)	(1,139)
– financial derivatives	19	(2)	(1)
Provisions for liabilities and charges	22	(283)	(305)
Retirement benefit obligations	8	(166)	(248)
Deferred tax liabilities	6	(111)	(95)
Trade and other payables	15	(26)	(29)
		(2,186)	**(1,817)**
Current liabilities			
Financial liabilities			
– borrowings	17	(151)	(270)
– financial derivatives	19	(10)	(19)
Provisions for liabilities and charges	22	(85)	(94)
Trade and other payables	15	(576)	(536)
Current tax payable	6	(45)	(72)
		(867)	**(991)**
Liabilities of business held for sale	27		(5)
Total liabilities		**(3,053)**	**(2,813)**
Net assets		**2,104**	**1,660**
Shareholders' equity			
Share capital	23	148	148
Share premium account		355	352
Capital redemption reserve		6	6
Revaluation reserve		1	1
Merger reserve		235	235
Retained earnings		1,634	1,205
Hedge reserve	25	(290)	(301)
Total shareholders' equity		**2,089**	**1,646**
Non-controlling interest equity		15	14
Total equity		**2,104**	**1,660**

The accounts on pages 136 to 188 were approved by the Board of Directors on 21 September 2017 and were signed on its behalf by:

Andy Reynolds Smith
Chief Executive

Bill Seeger
Chief Financial Officer

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Notes	Share capital and share premium £m	Other reserves £m	Retained earnings £m	Hedge reserve £m	Equity shareholders' funds £m	Non-controlling Interest £m	Total equity £m
At 31 July 2016		500	242	1,205	(301)	1,646	14	1,660
Profit for the period				562		562	2	564
Other comprehensive income								
Actuarial gains on retirement benefits and related tax				42		42		42
Exchange losses				(15)		(15)	(1)	(16)
Fair value gains/(losses) and related tax					11	11		11
Total comprehensive income for the period				**589**	**11**	**600**	**1**	**601**
Transactions relating to ownership interests								
Exercises of share options	23	3				3		3
Taxation recognised on share options	6			3		3		3
Purchase of own shares	25			(10)		(10)		(10)
Dividends								
– equity shareholders	24			(167)		(167)		(167)
Share-based payment	9			14		14		14
At 31 July 2017		**503**	**242**	**1,634**	**(290)**	**2,089**	**15**	**2,104**

	Notes	Share capital and share premium £m	Other reserves £m	Retained earnings £m	Hedge reserve £m	Equity shareholders' funds £m	Non-controlling Interest £m	Total equity £m
At 31 July 2015		497	242	743	(63)	1,419	9	1,428
Profit for the year				259		259	2	261
Other comprehensive income								
Actuarial losses on retirement benefits and related tax				(30)		(30)		(30)
Exchange gains				416		416	4	420
Fair value losses				(21)	(238)	(259)		(259)
Total comprehensive income for the year				**624**	**(238)**	**386**	**6**	**392**
Transactions relating to ownership interests								
Exercises of share options	23	3				3		3
Purchase of own shares	25			(8)		(8)		(8)
Dividends								
– equity shareholders	24			(163)		(163)		(163)
– non-controlling interest							(1)	(1)
Share-based payment	9			9		9		9
At 31 July 2016		**500**	**242**	**1,205**	**(301)**	**1,646**	**14**	**1,660**

CONSOLIDATED CASH-FLOW STATEMENT

	Notes	Year ended 31 July 2017 £m	Year ended 31 July 2016 £m
Net cash inflow from operating activities	29	**479**	**358**
Cash-flows from investing activities			
Expenditure on capitalised development		(37)	(23)
Expenditure on other intangible assets	10	(8)	(11)
Purchases of property, plant and equipment	12	(62)	(74)
Disposals of property, plant and equipment		9	1
Investment in financial assets	16, 27	(18)	(9)
Acquisition of businesses	26	(580)	(8)
Disposals of businesses – continuing operations	28	399	
Disposals of businesses – discontinued operations	27	63	
Net cash-flow used in investing activities		**(234)**	**(124)**
Cash-flows from financing activities			
Proceeds from exercise of share options	23	3	3
Purchase of own shares	25	(10)	(8)
Dividends paid to equity shareholders	24	(167)	(163)
Cash inflow/(outflow) from matured derivative financial instruments			(14)
Increase in new borrowings	17	546	1
Reduction and repayment of borrowings	17	(256)	(151)
Net cash-flow used in financing activities		**116**	**(332)**
Net increase/(decrease) in cash and cash equivalents		**361**	**(98)**
Cash and cash equivalents at beginning of year		430	495
Exchange differences		(10)	33
Cash and cash equivalents at end of year	17	**781**	**430**
Cash and cash equivalents at end of year comprise			
– cash at bank and in hand		226	161
– short-term deposits		556	270
– bank overdrafts		(1)	(1)
		781	**430**
Included in cash and cash equivalents per the balance sheet		782	431
Included in overdrafts per the balance sheet		(1)	(1)
		781	**430**

Reconciliation of net cash-flow to movement in net debt

	Notes	Year ended 31 July 2017 £m	Year ended 31 July 2016 £m
Net debt at start of year	17	**(978)**	**(818)**
Net increase/(decrease) in cash and cash equivalents		361	(98)
Increase in borrowings		(546)	(1)
Reduction and repayment of borrowings		256	151
Movement in net debt resulting from cash-flows		**71**	**52**
Capitalisation, interest accruals and unwind of capitalisation fees		(4)	(2)
Movement from fair value hedging		5	(23)
Exchange differences		(61)	(187)
Movement in net debt in the year		**11**	**(160)**
Net debt at end of year	17	**(967)**	**(978)**

Basis of preparation

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

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

Significant judgements, key assumptions and estimates

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

Revenue recognition

The timing of revenue recognition on contracts depends on the assessed stage of completion of contract activity at the balance sheet date. This assessment requires the expected total contract revenues and costs to be estimated based on the current progress of the contract. Revenue of £24m (2016: £42m) has been recognised in the period in respect of contracts in progress at the period end with a total expected value of £48m (2016: £175m) and cumulative revenue recognised to date of £36m (2016: £137m). A 5% reduction in the proportion of the contract activity recognised in the current period would have reduced operating profit by less than £1m for both Smiths Detection and Smiths Interconnect (2016: less than £1m).

Smiths Detection also has multi-year contractual arrangements for the sale of goods and services. Where these contracts have separately identifiable components with distinct patterns of delivery and customer acceptance, revenue is accounted for separately for each identifiable component. Judgement is applied in the identification of the components of the contract, and the allocation of contract revenue to each component.

Smiths Medical has rebate arrangements in place with some distributors in respect of sales to end customers where sales prices have been negotiated by Smiths Medical. Rebates are estimated based on the level of discount derived from sales data from distributors, the amount of inventory held by distributors and the time lag between the initial sale to the distributor and the rebate being claimed. The rebate accrual at 31 July 2017 was £27m (2016: £28m).

Contract profitability

Smiths Detection has multi-year contractual arrangements for the sale of goods and services. Margins achieved on these contracts can reflect the impact of commercial decisions made in different economic circumstances. In addition, contract delivery is subject to commercial and technical risks which can affect the outcome of the contract. At 31 July 2017 there was £nil (2016: £4m) balance sheet liability in respect of ongoing onerous contracts and no other contracts had been assessed as at significant risk of becoming onerous.

Taxation

The Group has recognised deferred tax assets of £129m (2016: £87m) relating to losses and £112m (2016: £120m) relating to the John Crane, Inc. and Titeflex Corporation litigation provisions. The recognition of assets pertaining to these items involves judgement by management as to the likelihood of realisation of these deferred tax assets. This is based on a number of factors, which seek to assess the expectation that the benefit of these assets will be realised, including expected future levels of operating profit, expenditure on litigation, pension contributions and the timing of the unwind of other tax positions. It has been concluded that there are sufficient taxable profits in future periods to support recognition. A 5% reduction in expected future operating profits would reduce the level of deferred tax recognised by £8m (2016: £9m), and a 5% increase in expected future operating profits would increase the level of deferred tax recognised by £11m (2016: £11m). Further detail on the Group's deferred taxation position is included in note 6.

Retirement benefits

The consolidated financial statements include costs in relation to, and provision for, retirement benefit obligations. The costs and the present value of any related pension assets and liabilities depend on such factors as life expectancy of the members, the returns that plan assets generate and the discount rate used to calculate the present value of the liabilities. The Group uses previous experience and independent actuarial advice to select the values of critical estimates. The estimates, and the effect of variances in key estimates, are disclosed in note 8.

At 31 July 2017 there is a retirement benefit asset of £390m (2016: £328m), principally relating to UK schemes, which arises from the rights of the employers to recover the surplus at the end of the life of the scheme. If the pension schemes were wound up while they still had members, the schemes would need to buy out the benefits of all members. The buyouts would cost significantly more than the present value of the scheme liabilities calculated in accordance with IAS 19: Employee benefits.

Receivables provisions

If the carrying value of any receivable is higher than the fair value, the Group makes provisions writing down the balance to its fair value. The fair value of receivables is considered individually for each customer and incorporates past experience and progress with collecting receivables.

At 31 July 2017 the gross value of receivables partly provided for or more than three months overdue was £73m (2016: £83m) and there were provisions of £33m (2016: £31m) against these receivables. Consequently, these receivables were carried at a net value of £40m (2016: £52m). See note 14 for disclosures on credit risk and ageing of trade receivables.

Inventory provisions
The calculation of inventory provisions requires judgement by management of the expected value of future sales. If the carrying value of inventory is higher than the expected recoverable value, the Group makes provisions writing inventory down to its net recoverable value. Inventory is initially assessed for impairment by comparing inventory levels to recent utilisation rates and carrying values to historical selling prices. A detailed review is completed for inventory lines identified in the initial assessment considering sales activity, order flow, customer contracts and current selling prices.

At 31 July 2017, there were provisions of £55m (2016: £70m) against gross inventory of £507m (2016: £548m). See note 13 for a breakdown of inventory.

A 10% increase in the proportion of raw materials provided for would increase the provision by £17m (2016: £20m) and a 10% increase in the proportion of finished goods provided for would increase the provision by £22m (2016: £23m).

Impairment
Goodwill is tested at least annually for impairment and other assets, including intangible assets acquired in business combinations, are tested if there are any indications of impairment, in accordance with the accounting policy set out below. The recoverable amounts of cash generating units and assets are determined based on value in use calculations unless future trading projections cannot be adjusted to eliminate the impact of a major restructuring. The value in use calculations require the use of estimates including projected future cash-flows and other future events.

See note 11 for details of the critical assumptions made, including the forecast earnings and valuation multiples for Morpho Detection and disclosures on the sensitivity of the impairment testing to these key assumptions, including details of the changes in assumptions which would be required to trigger an impairment in Morpho Detection.

Provisions for liabilities and charges
As previously reported, John Crane, Inc. ("JCI"), a subsidiary of the Group, is currently one of many co-defendants in litigation relating to products previously manufactured which contained asbestos. Provision of £237m (2016: £252m) has been made for the future defence costs which the Group is expected to incur and the expected costs of future adverse judgments against JCI. Whilst well-established incidence curves can be used to estimate the likely future pattern of asbestos related disease, JCI's claims experience is significantly impacted by other factors which influence the US litigation environment. These can include: changing approaches on the part of the plaintiffs' bar; changing attitudes amongst the judiciary at both trial and appellate levels; and legislative and procedural changes in both the state and federal court systems. Therefore, because of the significant uncertainty associated with the future level of asbestos claims and of the costs arising out of the related litigation, there can be no guarantee that the assumptions used to estimate the provision will result in an accurate prediction of the actual costs that may be incurred.

JCI takes account of the advice of an expert in asbestos liability estimation in quantifying the expected costs. The following judgements were made in preparing the provision calculation:

- the period over which the expenditure can be reliably estimated is judged to be ten years, based on past experience regarding significant changes in the litigation environment that have occurred every few years and on the amount of time taken in the past for some of those changes to impact the broader asbestos litigation environment. See note 22 for a sensitivity showing the impact on the provision of reducing or increasing this time horizon;
- the future trend of legal costs; the rate of future claims filed; the rate of successful resolution of claims; and the average amount of judgments awarded have been projected based on the past history of JCI claims and well-established tables of asbestos incidence projections, since this is the best available evidence. Claims history from other defendants is not used to calculate the provision because JCI's defence strategy generates a significantly different pattern of legal costs and settlement expenses. See note 22 for a sensitivity showing the range of expected future spend.

As previously reported, Titeflex Corporation, a subsidiary of the Group in the Flex-Tek division, has received a number of claims from insurance companies seeking recompense on a subrogated basis for the effects of damage allegedly caused by lightning strikes in relation to its flexible gas piping product. It has also received a number of product liability claims regarding this product, some in the form of purported class actions. Titeflex Corporation believes that its products are a safe and effective means of delivering gas when installed in accordance with the manufacturer's instructions and local and national codes; however some claims have been settled on an individual basis without admission of liability. Provision of £84m (2016: £94m) has been made for the costs which the Group is expected to incur in respect of these claims. In preparing the provision calculation, judgements were made about the impact of safe installation initiatives on the level of future claims. See note 22 for a sensitivity showing the impact on the provision of reducing or increasing the expected impact. However, because of the significant uncertainty associated with the future level of claims, there can be no guarantee that the assumptions used to estimate the provision will result in an accurate prediction of the actual costs that may be incurred.

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

All provisions may be subject to potentially material revisions from time to time if new information becomes available as a result of future events.

Presentation of results

Non-statutory performance measures, described as 'headline', are presented to give a clear and consistent presentation of the performance of the Group's ongoing trading activity. These measures are used by management to measure and monitor performance. Headline measures exclude amounts relating to costs of acquisitions and disposals, amortisation of acquisition fair value adjustments, including the recognition of acquired intangibles, impairments, legacy liabilities, significant restructuring, material one-off items and certain re-measurements. Smiths Group plc presents its results in the income statements with items excluded from headline measures in a separate column. See note 1 for divisional headline operating profit, note 3 for a breakdown of the items excluded from headline operating profit and headline finance costs and note 30 for information on the calculation of return on capital employed and credit metrics.

In addition, the Group reports underlying growth rates for sales and profit measures, which exclude the impact of acquisitions and divestments and the effects of foreign exchange translation, by making the following adjustments:

- Retranslate the comparative to current year exchange rates before calculating growth measures
- Exclude acquisitions from the current period for the first 12 months of ownership; and
- Exclude the divested businesses performance after the date of disposal from comparative period.

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

Accounting policies

Basis of consolidation

The consolidated accounts incorporate the financial statements of Smiths Group plc (the 'Company') and its subsidiary undertakings, together with the Group's share of the results of its associates. A list of the subsidiaries of Smiths Group plc is provided on pages 207 to 214.

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

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

Foreign currencies

The Company's presentational currency is sterling. The financial position of all subsidiaries and associates that have a functional currency different from sterling are translated into sterling at the rate of exchange at the date of that balance sheet, and the income and expenses are translated at average exchange rates for the period. All resulting exchange differences are recognised as a separate component of equity.

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

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

Revenue

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

When the Group enters into complex contracts with multiple, separately identifiable components, the terms of the contract are reviewed to determine whether or not the elements of the contract should be accounted for separately. If a contract is being split into multiple components, the contract revenue is allocated to the different components at the start of the contract. The basis of allocation depends on the substance of the contract. The Group considers relative stand-alone selling prices, contractual prices and relative cost when allocating revenue.

Sale of goods

Revenue from the sale of goods is recognised when the risks and rewards of ownership have been transferred to the customer, the amount of revenue can be measured reliably and recovery of the consideration is probable. For established products with simple installation requirements, revenue is recognised when the product is delivered to the customer in accordance with the agreed delivery terms. For products which are technically innovative, highly customised or require complex installation, revenue is recognised when the customer has completed its acceptance procedures.

Services

Revenue from services is recognised in accounting periods in which the services are rendered, by reference to completion of the specific transaction, assessed on the basis of the actual service provided as a proportion of the total services to be provided. Depending on the nature of the contract, revenue will be recognised on the basis of the proportion of the contract term completed, the proportion of the contract costs incurred or the specific services provided to date.

Construction contracts

Contracts for the construction of substantial assets are accounted for as construction contracts if the customer specifies major structural elements of the design, including the ability to amend the design during the construction process. These projects normally involve installing customised systems with site-specific integration requirements.

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

Leases

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

Taxation

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

Current income tax assets and liabilities are measured at the amount expected to be recovered from or paid to taxation authorities. Tax benefits are not recognised unless it is likely that the tax positions are sustainable. Once considered to be likely, tax benefits are reviewed to assess whether a provision should be made based on prevailing circumstances. Tax provisions are included in current tax liabilities, including any anticipated interest & penalties. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted, at the reporting date in the countries where the Group operates and generates taxable income.

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

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

Deferred tax liabilities and assets are not discounted.

Employee benefits

Share-based compensation

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

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

Pension obligations and post-retirement benefits

The Group has defined benefit plans, defined contribution plans and post-retirement healthcare schemes.

For defined benefit plans and post-retirement healthcare schemes the liability for each scheme recognised in the balance sheet is the present value of the obligation at the balance sheet date less the fair value of any plan assets. The obligation is calculated annually by independent actuaries using the projected unit credit method. The present value is determined by discounting the estimated future cash outflows using interest rates of AA-rated corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related liability. Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are recognised in full in the period in which they occur, outside of the income statement, and are presented in the statement of comprehensive income. Past service costs are recognised immediately in the income statement.

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

Intangible assets

Goodwill

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

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

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

Research and development

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

- amounts recoverable from third parties; and
- expenditure incurred in respect of the development of major new products where the outcome of those projects is assessed as being reasonably certain as regards viability and technical feasibility. Such expenditure is capitalised and amortised over the estimated period of sale for each product, commencing in the year that sales of the product are first made. Amortisation is charged straight line or based on the units produced, depending on the nature of the product and the availability of reliable estimates of production volumes.

The cost of development projects which are expected to take a substantial period of time to complete includes attributable borrowing costs.

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

Patents, licences and trademarks	up to 20 years
Technology	up to 13 years
Customer relationships	up to 11 years

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

Software, patents and intellectual property
The estimated useful lives are as follows:

Software	up to 7 years
Patents and intellectual property	shorter of the economic life and the period the right is legally enforceable

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

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

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

The cost of any assets which are expected to take a substantial period of time to complete includes attributable borrowing costs.

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

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

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

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

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

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

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

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

Discontinued operations
A discontinued operation is either:

- a component of the Group's business that represents a separate major line of business or geographical area of operations that has been disposed of, has been abandoned or meets the criteria to be classified as held for sale; or
- a business acquired solely for the purpose of selling it.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

'IFRS 13: Fair value measurement' requires fair value measurements to be classified according to the following hierarchy:

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

See note 20 for information on the methods the Group uses to estimate the fair values of its financial instruments.

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

Recent accounting developments

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

- 'IFRS 9: Financial instruments'
- 'IFRS 15: Revenue from contracts with customers'
- 'IFRS 16: Leases'

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. Smiths will adopt IFRS 9 and IFRS 15 on 1 August 2018 and IFRS 16 on 1 August 2019 unless developments in the relationship between the UK and the EU change the reporting requirements for UK companies.

IFRS 9: Financial instruments
Adopting IFRS 9 will impact hedge accounting and receivables provisioning. The basis of documentation and effectiveness testing of hedges under the new standard will be linked more closely to the risk management objectives, which may generate different levels of ineffectiveness than the current testing under IAS 39. Receivables provisioning will move from an incurred to an expected loss model. The Group's largest exposure is trade receivables, which had a gross value of £716m at 31 July 2017. No impact is anticipated for high credit quality balances settled on agreed terms. However, the new model will impact the timing and value of provision recognition on higher risk balances. Under the current methodology, provisions of £33m have been recognised on £73m of receivables which are more than three months overdue or considered to be high risk.

IFRS 15: Revenue from contracts with customers
The review of the impact of 'IFRS 15: Revenue from contracts with customers' requires an assessment at contract level to confirm the full impact of adopting this standard.

Based on the analysis completed to date, we consider that the new standard is unlikely to have a material impact on revenue recognition for the following business activities, which had revenue of circa £1.7bn this year:

- Smiths branded products sold under basic PO terms;
- Customer specific products where the Group is manufacturing at risk with no contractual rights to recovery;
- Smiths Interconnect military contracts accounted for on a percentage of completion basis using proportion of costs incurred;
- Smiths Detection programmes currently accounted for as multi-element contracts with consideration allocated on the relative fair value of the components; and
- Spares and ad hoc service callouts to repair or replace equipment.

The basis of revenue recognition may change for the following revenue streams:

- Customer specific products where the contractual terms include rights to payment for work performed to date. Revenue for most of these contracts is expected to be recognised rateably over the manufacturing period, depending on the specific rights in the contract;
- Product development contracts where revenue is recognised on reaching development milestones. Revenue for recognition for some of these contracts is expected to move to a percentage of completion basis using proportion of costs incurred; and
- John Crane has service contracts, which include bonuses and penalties based on the performance of the asset being maintained. Depending on the evidence available to estimate the levels of performance achieved, bonuses may be recognised earlier under IFRS 15.

IFRS 16: Leases
The review of this standard is at an early stage. This standard will require a lease liability and corresponding asset to be recognised on the balance sheet for leases currently classified as operating leases and not recognised on the balance sheet. IFRS 16 can require changes to the valuation of lease liabilities. However, preliminary work has not identified any material leases with contingent rentals. The total value of operating lease commitments at 31 July 2017 was £140m (2016: £146m).

Parent Company

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

The accounts of the Parent Company, Smiths Group plc, have been prepared in accordance with UK GAAP, applying Financial Reporting Standard 101, "Reduced Disclosure Framework". The Company accounts are presented in separate financial statements on pages 196 to 206. The principal subsidiaries of the Parent Company are listed in the above accounts.

1 Segment information

Analysis by operating segment

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

- John Crane – mechanical seals, seal support systems, engineered bearings, power transmission couplings and specialised filtration systems;
- Smiths Medical – infusion systems, vascular access products (including safety needles), patient airway and temperature management equipment and specialised devices in areas of diagnostics and emergency patient transport;
- Smiths Detection – sensors and systems that detect and identify explosives, narcotics, weapons, chemical agents, biohazards and contraband;
- Smiths Interconnect – specialised electronic and radio frequency board-level and waveguide devices, connectors, cables, test sockets and sub-systems used in high-speed, high reliability, secure connectivity applications;
- Flex-Tek – engineered components flexible hosing and rigid tubing that heat and move fluids and gases.

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

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

Segment trading performance

							Year ended 31 July 2017
	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Corporate costs £m	Total £m
Revenue	885	951	687	419	338		3,280
Divisional headline operating profit	204	209	103	56	65		637
Corporate headline operating costs						(48)	(48)
Headline operating profit/(loss)	**204**	**209**	**103**	**56**	**65**	**(48)**	**589**
Items excluded from headline measures (note 3)	(17)	(23)	(33)	(4)	3	(16)	(90)
Profit on disposal of businesses	3	100		72			175
Operating profit/(loss)	**190**	**286**	**70**	**124**	**68**	**(64)**	**674**

							Year ended 31 July 2016
	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Corporate costs £m	Total £m
Revenue	830	874	526	435	284		2,949
Divisional headline operating profit	181	187	69	57	51		545
Corporate headline operating costs						(35)	(35)
Headline operating profit/(loss)	**181**	**187**	**69**	**57**	**51**	**(35)**	**510**
Items excluded from headline measures (note 3)	(30)	(21)	(6)	(31)	(14)	(21)	(123)
Operating profit/(loss)	**151**	**166**	**63**	**26**	**37**	**(56)**	**387**

Divisional headline operating profit is stated after charging the following items:

	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Reconciling items £m	Total £m
							Year ended 31 July 2017
Depreciation	15	21	8	8	4	1	57
Amortisation of capitalised development		14	13				27
Amortisation of software, patents and intellectual property	2	5	4	2		5	18
Amortisation of acquired intangibles						17	17
Share-based payment	3	2	1	1	1	7	15

	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Reconciling items £m	Total £m
							Year ended 31 July 2016
Depreciation	15	20	6	8	3	1	53
Amortisation of capitalised development		14	12				26
Amortisation of software, patents and intellectual property	2	4	3	2		6	17
Amortisation of acquired intangibles						15	15
Impairment of goodwill						23	23
Impairment of trade investments						2	2
Impairment of property, plant and equipment						6	6
Share-based payment	1	2	1	1	1	4	10

The reconciling items are central costs and charges that are treated as non-headline (see note 3).

Segment assets and liabilities

Segment assets

	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Corporate and non-headline £m	Total £m
							31 July 2017
Property, plant, equipment, development projects, other intangibles and investments	96	233	107	40	35	20	531
Inventory, trade and other receivables	337	256	389	118	104	27	1,231
Segment assets	**433**	**489**	**496**	**158**	**139**	**47**	**1,762**

	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Corporate and non-headline £m	Total £m
							31 July 2016
Property, plant, equipment, development projects, other intangibles and investments	100	221	95	46	33	15	510
Inventory, trade and other receivables	364	280	316	189	99	26	1,274
Segment assets	**464**	**501**	**411**	**235**	**132**	**41**	**1,784**

1 Segment information continued
Analysis by operating segment continued
Segment assets and liabilities continued
Segment liabilities

31 July 2017	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Corporate and non-headline £m	Total £m
Divisional liabilities	(124)	(120)	(246)	(48)	(39)		(577)
Corporate and non-headline liabilities						(393)	(393)
Segment liabilities	**(124)**	**(120)**	**(246)**	**(48)**	**(39)**	**(393)**	**(970)**

31 July 2016	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Corporate and non-headline £m	Total £m
Divisional liabilities	(124)	(121)	(196)	(78)	(37)		(556)
Corporate and non-headline liabilities						(408)	(408)
Segment liabilities	**(124)**	**(121)**	**(196)**	**(78)**	**(37)**	**(408)**	**(964)**

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

Reconciliation of segment assets and liabilities to statutory assets and liabilities

	Assets		Liabilities	
	31 July 2017 £m	31 July 2016 £m	31 July 2017 £m	31 July 2016 £m
Segment assets and liabilities	**1,762**	**1,784**	**(970)**	**(964)**
Goodwill and acquired intangibles	1,820	1,556		
Derivatives	69	42	(12)	(20)
Current and deferred tax	334	308	(156)	(167)
Retirement benefit assets and obligations	390	328	(166)	(248)
Cash and borrowings	782	431	(1,749)	(1,409)
Assets and liabilities of business held for sale		24		(5)
Statutory assets and liabilities	**5,157**	**4,473**	**(3,053)**	**(2,813)**

Segment capital expenditure
The capital expenditure on property, plant and equipment, capitalised development and other intangible assets for each division is:

	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Reconciling items £m	Total £m
Capital expenditure year ended 31 July 2017	12	58	22	10	6	1	**109**
Capital expenditure year ended 31 July 2016	14	53	19	12	9	3	**110**

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

Segment capital employed

Capital employed is a non-statutory measure of invested resources. It comprises statutory net assets adjusted to add goodwill recognised directly in reserves in respect of subsidiaries acquired before 1 August 1998 of £787m (31 July 2016: £815m) and eliminate post-retirement benefit assets and liabilities and litigation provisions relating to non-headline items, both net of related tax, and net debt. See note 30 for a reconciliation of net assets to capital employed.

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

31 July 2017

	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Total £m
Average divisional capital employed	890	1,257	820	492	182	3,641
Average corporate capital employed						(2)
Average total capital employed						**3,639**

31 July 2016

	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Total £m
Average divisional capital employed	895	1,190	578	549	162	3,374
Average corporate capital employed						(50)
Average total capital employed						**3,324**

Analysis of revenue

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

John Crane	Original equipment £m	Aftermarket £m	Total £m
Revenue year ended 31 July 2017	314	571	**885**
Revenue year ended 31 July 2016	338	492	**830**

John Crane original equipment revenue was previously described as "First Fit". This has been changed to provide a description relevant to a broader range of end markets, as John Crane expands its non-oil and gas revenues.

Smiths Medical	Infusion systems £m	Vascular access £m	Vital care £m	Specialty products £m	Total £m
Revenue year ended 31 July 2017	302	318	273	58	**951**
Revenue year ended 31 July 2016	273	289	240	72	**874**

Smiths Detection	Air transportation £m	Ports and borders £m	Military £m	Urban security £m	Total £m
Revenue year ended 31 July 2017	355	100	94	138	**687**
Revenue year ended 31 July 2016	235	89	79	123	**526**

Smiths Detection previously reported its air transportation revenue as "transportation". The description has been expanded to avoid any confusion with the "Transportation" market discussed on page 29, since Smiths Detection operates in the Security and defence market. Smiths Detection previously reported its urban security revenue as "critical infrastructure". This has been changed to reflect the range of opportunities developing in this area.

Smiths Interconnect	Connectors £m	Microwave £m	Power £m	Total £m
Revenue year ended 31 July 2017	177	195	47	**419**
Revenue year ended 31 July 2016	155	192	88	**435**

Flex-Tek	Fluid Management £m	Flexible Solutions £m	Heat Solutions £m	Construction Products £m	Total £m
Revenue year ended 31 July 2017	81	64	84	109	**338**
Revenue year ended 31 July 2016	72	54	66	92	**284**

1 Segment information continued

Analysis of revenue continued

The Group's statutory revenue is analysed as follows:

	Year ended 31 July 2017 £m	Year ended 31 July 2016 £m
Sale of goods	2,865	2,607
Services	394	312
Contracts qualifying as construction contracts	21	30
	3,280	**2,949**

Analysis by geographical areas

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

	Revenue		Intangible assets and property plant and equipment	
	Year ended 31 July 2017 £m	Year ended 31 July 2016 £m	31 July 2017 £m	31 July 2016 £m
United Kingdom	118	114	92	129
Germany	160	131	363	325
France	96	85	16	17
Other European	355	291	72	70
Total European	**729**	**621**	**543**	**541**
United States of America	1,531	1,396	1,627	1,349
Canada	114	106	13	14
Other North American	33	33	12	10
Total North American	**1,678**	**1,535**	**1,652**	**1,373**
Japan	119	101	19	21
China (excluding Hong Kong)	93	95	49	63
Rest of the World	661	597	67	59
	3,280	**2,949**	**2,330**	**2,057**

2 Operating profit is stated after charging

	Year ended 31 July 2017 £m	Year ended 31 July 2016 £m
Research and development expense	98	87
Operating leases		
– land and buildings	34	30
– other	8	8

	Year ended 31 July 2017 £m	Year ended 31 July 2016 £m
Audit services		
Fees payable to the Company's auditors for the audit of the Company's annual financial statements	4	3
Fees payable to the Company's auditors and its associates for other services		
– the audit of the Company's subsidiaries	2	2
	6	**5**
All other services	1	

Other services comprise audit-related assurance services £0.2m (2016: £0.1m), tax advisory services £0.1m (2016: £0.1m), one-off IT and consulting projects £0.2m (2016: £nil) and other services £nil (2016: £0.1m). Total fees for non-audit services comprise 8% (2016: 6%) of audit fees. Audit-related assurance services include the review of the Interim Report.

3 Non-statutory profit measures

Headline profit measures

The Company seeks to present a measure of trading performance which is not impacted by material non-recurring items or items considered non-operational in nature. This measure is described as 'headline' and used by management to measure and monitor performance. See the disclosures on presentation of results in accounting policies for an explanation of the excluded items, which are referred to as 'non-headline'.

Headline revenue

The agreement to sell Smiths Medical's Wallace product line included an obligation to continue manufacturing products for the acquirer for 12 months after the date of disposal. In the Interim results to 31 January 2017, revenue arising from this activity was treated as non-headline because it was not expected to contribute to Smiths Medical's ongoing business. This treatment was reviewed in response to developments in the commercial relationship with CooperSurgical, Inc. and the activity is now being reported within headline activity.

Headline operating profit

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

	Notes	Year ended 31 July 2017 £m	Year ended 31 July 2016 £m
Restructuring programmes		(37)	(37)
Acquisition costs		(19)	(6)
Provision for Titeflex Corporation subrogation claims	22	4	(11)
Provision for John Crane, Inc. asbestos litigation	22	(15)	(23)
Cost recovery for John Crane, Inc. asbestos litigation		6	16
Post-retirement benefits changes to schemes and administration costs	8	(9)	(16)
Impairment of goodwill, property, plant and equipment and trade investments			(31)
Amortisation of acquired intangible assets	10	(17)	(15)
Unwind of fair value uplift of inventory on the acquisition balance sheet		(3)	
Profit on disposal of businesses	28	175	
Non-headline items in operating profit		**85**	**(123)**

Items for the year ended 31 July 2017

Restructuring costs include £33m in respect of Fuel for Growth. This programme, which involves redundancy, relocation and consolidation of manufacturing, is considered a material non-recurring item by virtue of its size. No further costs are expected in respect of this program. In addition, there are £4m of initial costs in respect of the integration of Morpho Detection and the existing Smiths Detection business. The integration is expected to take two years. The total costs over the two years are projected to be material and non-recurring.

Acquisition costs have been treated as non-headline because they depend on the level of acquisition activity in the year. Only incremental costs directly linked to the transaction are reported as non-headline. They do not include the costs of the employees working on transactions.

See note 22 for details of the costs, and cost recoveries relating to Titeflex Corporation subrogation claims and John Crane, Inc asbestos litigation. These costs and recoveries have been treated as non-headline because the provision were treated as non-headline when they were originally recognised and the subrogation claims and litigation relate to products that the Group no longer sells in these markets.

Post-retirement benefit changes and costs relate to closed schemes, so the costs are a legacy of previous employee pension arrangements.

The impacts of business combination fair value adjustments, including amortisation of intangible assets, impairment or unwinding, have been excluded from headline measures on the basis that these charges result from acquisition accounting and do not relate to current trading activity.

See note 28 for a breakdown of the profit by transaction. It is non-headline since the profit and cash impact is material and non-recurring.

Items for the year ended 31 July 2016

Restructuring costs comprise £37m in respect of Fuel for Growth. This programme, which involves redundancy, relocation and consolidation of manufacturing, is considered a material non-recurring item by virtue of its size.

The £9m charge relating to post-retirement benefits comprises the £10m settlement cost for the buy-out of retiree liabilities completed by the US pension scheme on 14 August 2015, net of a £1m settlement gain on closing a small scheme in Holland.

Impairments comprise £23m goodwill write-downs (see note 11), £6m on property plant and equipment and £2m on trade investments.

3 Non-statutory profit measures continued

Headline profit measures continued

Headline finance costs

The non-headline items included in finance costs are as follows:

	Notes	Year ended 31 July 2017 £m	Year ended 31 July 2016 £m
Adjustment to discounted provisions	22	(6)	(5)
Fair value gain realised on contributing government bonds to Smiths Industries Pension Scheme	4		19
Other financing (losses)/gains		(8)	1
Other finance income – retirement benefits	8	2	3
Non-headline (losses)/gains in finance costs		**(12)**	**18**

The unwind of discounting on provisions has been excluded from headline finance costs because these provisions were originally recognised as non-headline and this treatment has been maintained for ongoing costs and credits.

The fair value gain realised on contributing government bonds to Smiths Industries Pension Scheme was excluded from headline finance costs because it was a large, one-off item relating to funding previous employee pension arrangements.

Other financing gains and losses represent the potentially volatile gains and losses on derivatives, loans inside the group and other financial instruments which are not hedge accounted under IAS 39. They have been excluded from headline finance costs because they do not accurately reflect the aggregate risks of the group, since offsetting gains have been recognised in reserves or deferred in assets and liabilities which are not held at fair value.

Financing credits relating to retirement benefits are excluded from headline finance costs because the ongoing costs and credits are a legacy of previous employee pension arrangements.

4 Net finance costs

	Notes	Year ended 31 July 2017 £m	Year ended 31 July 2016 £m
Interest receivable		**5**	**3**
Interest payable			
– bank loans and overdrafts, including associated fees		(9)	(8)
– other loans		(57)	(54)
Interest payable		**(66)**	**(62)**
Other financing gains/(losses)			
– fair value gains/(losses) on hedged debt		6	(23)
– fair value on (losses)/gains fair value hedges		(6)	23
– fair value gain realised on contributing government bonds to Smiths Industries Pension Scheme			19
– net foreign exchange (losses)/gains		(8)	1
– adjustment to discounted provisions		(6)	(5)
Other financing (losses)/gains		**(14)**	**15**
Net interest income on retirement benefit obligations	8	**2**	**3**
Net finance costs		**(73)**	**(41)**

The government bonds contributed to the Smiths Industries Pension Scheme in December 2015 were accounted for as available for sale financial assets, and cumulative fair value gains of £19m on these assets were recycled from other comprehensive income to the income statement.

5 Earnings per share

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

	Year ended 31 July 2017 £m	Year ended 31 July 2016 £m
Profit attributable to equity shareholders for the year		
– continuing	570	259
– total	562	259
Average number of shares in issue during the year	395,422,421	395,095,591

Diluted earnings per share are calculated by dividing the profit attributable to ordinary shareholders by 400,518,049 (2016: 398,957,837) 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 2017, zero options (2016: 223,993) 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 2017		Year ended 31 July 2016	
	£m	EPS (p)	£m	EPS (p)
Profit attributable to equity shareholders of the Parent Company	570	144.1	259	65.6
Exclude				
Non-headline items and related tax	(184)	(46.5)	77	19.6
Headline profit attributable to equity shareholders for the year	386	97.6	336	85.2
Statutory earnings per share – diluted (p)		142.3		64.9
Headline earnings per share – diluted (p)		96.3		84.3

6 Taxation

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

	Year ended 31 July 2017 £m	Year ended 31 July 2016 £m
The taxation charge in the consolidated income statement for the year comprises		
Continuing operations		
– current income tax charge	58	56
– current tax adjustments in respect of prior periods	3	
Current taxation	**61**	**56**
– deferred taxation	(32)	29
Total taxation expense – continuing operations	**29**	**85**
Discontinued operations		
– current income tax credit	(9)	
– deferred taxation	6	
Total taxation expense in the consolidated income statement	**26**	**85**

	Year ended 31 July 2017 £m	Year ended 31 July 2016 £m
Tax on items charged/(credited) to equity		
Deferred tax charge/(credit)		
– retirement benefit schemes	13	(10)
– cash flow hedge accounting	1	
– share options	(3)	
	11	**(10)**

The net retirement benefit charge to equity includes £6m (2016: £4m credit) relating to UK schemes and £5m (2016: £4m credit) relating to US schemes.

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6 Taxation continued

Reconciliation of the tax charge

The tax expense on the profit for the year for continuing operations is different from the standard rate of corporation tax in the UK of 19.7% (2016: 20.0%). The difference is reconciled as follows:

	Year ended 31 July 2017 £m	Year ended 31 July 2016 £m
Profit before taxation	**602**	**346**
Notional taxation expense at UK rate of 19.7% (2016: 20.0%)	118	69
Different tax rates on non-UK profits and losses	55	24
Non-deductible expenses	14	16
Tax credits and non-taxable income	(15)	(11)
Non-headline recognition of UK deferred tax	(69)	
Other adjustments to unrecognised deferred tax	(23)	2
Current and deferred benefits from closed financing arrangement	(19)	(15)
Effect of non-taxable profits on business disposals	(35)	
Prior year true-up	3	
Tax on discontinued activities	(3)	
	26	**85**
Comprising		
– taxation on headline profit	140	113
– tax on non-headline loss	(27)	(34)
– change in deferred tax recognition treated as non-headline	(84)	6
– taxation on discontinued operation	(3)	
Taxation expense in the consolidated income statement	**26**	**85**

The head office of Smiths Group is domiciled in the UK, so the tax charge has been reconciled to UK tax rates.

In recent years, Smiths has made substantial payments to its UK defined benefit pension plans, which generated significant UK tax losses. This resulted in the non-recognition of deferred tax on UK losses and other temporary differences. The current position of the UK pension schemes has significantly improved and the pension contributions envisaged going forwards are significantly reduced. Reduced pension contributions and increased trading and investing profits have made the UK tax group structurally profitable, resulting in the recognition of all UK deferred tax assets and generating a non-headline credit of £69m in the current year.

Included in other adjustments to unrecognised deferred tax is recognition of £17m deferred tax following the reorganisation of a US business.

As a result of changes in tax legislation and the reorganisation of finance activities, the credit for closed financing arrangements will not be repeated in future years.

Current taxation

	Current tax £m
At 1 August 2015	(20)
Foreign exchange gains and losses	4
(Charge)/credit to income statement	(56)
Tax paid	62
At 31 July 2016	(10)
Foreign exchange gains and losses	2
(Charge)/credit to income statement – continuing	(61)
(Charge)/credit to income statement – discontinued	9
Business combinations	(1)
Business disposals	(4)
Tax paid	82
At 31 July 2017	**17**
Current tax receivable	62
Current tax payable	(45)
At 31 July 2017	**17**

Provisions included in current tax liabilities are established based on reasonable estimates for the possible consequences of tax authority audits in the various countries in which the Group operates. Management judgement is used to determine the amount of such provisions based on an understanding of the relevant local tax law, taking into account the differences of interpretation that can arise on a wide variety of issues, depending on the prevailing circumstances, including the nature of current tax audits and the experience of previous enquiries.

Deferred taxation

	Property, plant and equipment and intangible assets £m	Employment benefits £m	Losses carried forward £m	Provisions £m	Other £m	Total £m
At 1 August 2015	(116)	61	28	126	48	147
Credit/(charge) to income statement	(7)	(72)	53	(10)	7	(29)
Credit/(charge) to equity		10				10
Business combinations	(1)					(1)
Exchange adjustments	(21)	9	6	24	6	24
At 31 July 2016	**(145)**	**8**	**87**	**140**	**61**	**151**
Deferred tax assets	(24)	8	84	134	44	246
Deferred tax liabilities	(121)		3	6	17	(95)
At 31 July 2016	**(145)**	**8**	**87**	**140**	**61**	**151**
Reallocation				4	(4)	
(Charge)/credit to income statement – continuing	11	(9)	43	(7)	(6)	32
(Charge)/credit to income statement – discontinued	(6)					(6)
Credit/(charge) to equity		(10)			(1)	(11)
Business combinations	(6)				2	(4)
Business disposals	(3)					(3)
Exchange adjustments	1	1	(1)	1		2
At 31 July 2017	**(148)**	**(10)**	**129**	**138**	**52**	**161**
Deferred tax assets	(4)	(10)	127	133	26	272
Deferred tax liabilities	(144)		2	5	26	(111)
At 31 July 2017	**(148)**	**(10)**	**129**	**138**	**52**	**161**

The deferred tax asset relating to losses carried forward has been recognised on the basis that evidence demonstrates a consistent pattern of improving results and the Group has implemented plans to support continuing improvements or the losses relate to specific, identified non-recurring events.

In 2012 UK deferred tax was written off as a deteriorating position in legacy pension plans made UK activities structurally loss making. As a result of an improvement in the UK pension position and restructuring financing activities, the UK is now expected to earn taxable profits and a £69m deferred tax asset has been recognised as a non-headline gain in the period. The closing deferred tax balance related to UK activities at 31 July 2017, including the benefit of losses brought forward and deferred tax liabilities on UK pension schemes, amounted to £64m.

Deferred tax relating to provisions includes £79m (2016: £84m) relating to the John Crane, Inc. litigation provision, and £33m (2016: £36m) relating to Titeflex Corporation. See note 22 for additional information on provisions; and

Included in other deferred tax balances above is a deferred tax asset of £14m (2016: £25m) relating to inventory where current tax relief is only available when the inventory is sold.

The Group has unrecognised deferred tax relating to deductible temporary differences in the UK amounting to £nil (2016: £402m) and non-UK losses amounting to £68m (2016: £93m).

The expiry date of operating losses carried forward is dependent upon the law of the various territories in which the losses arise. A summary of expiry dates for losses in respect of which deferred tax has not been recognised is set out below.

Restricted losses

	2017 £m	Expiry of losses	2016 £m	Expiry of losses
Territory				
– Americas			36	2019-2036
– Asia	12	2018-2024	11	2017-2023
Total restricted losses	**12**		**47**	
Unrestricted losses				
– operating losses	55	No expiry	211	No expiry
Total	**67**		**258**	

Franked Investment Income Group Litigation Order

Smiths Group is one of the companies enrolled in the FII GLO litigation against HMRC. The court cases and appeals are nearing the end and some claimants, with different fact patterns, have received payments. Smiths claims amount to around £30m (after deducting 45% withholding tax). However, there are further relevant legal actions that could impact the claims. The benefit of this claim has not been recognised in the current or previous financial statements due to the uncertainty of the eventual outcome.

7 Employees

	Year ended 31 July 2017 £m	Year ended 31 July 2016 £m
Staff costs during the period		
Wages and salaries	833	745
Social security	94	84
Share-based payment (note 9)	15	10
Pension costs (including defined contribution schemes) (note 8)	36	33
	978	**872**

The average number of persons employed, rounded to the nearest 50 employees, was:

	Year ended 31 July 2017	Year ended 31 July 2016
John Crane	6,050	6,550
Smiths Medical	7,700	7,600
Smiths Detection	2,450	2,050
Smiths Interconnect	3,250	3,400
Flex-Tek	2,100	2,050
Corporate	350	350
	21,900	**22,000**

Key management

The key management of the Group comprises Smiths Group plc Board directors and Executive Committee members. Their aggregate compensation is shown below. Details of directors' remuneration are contained in the report of the Remuneration Committee on pages 103 to 120.

	Year ended 31 July 2017 £m	Year ended 31 July 2016 £m
Key management compensation		
Salaries and short-term employee benefits	13.2	12.8
Cost of post-retirement benefits	0.1	0.1
Cost of share-based incentive plans	5.3	4.5

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 2017		Year ended 31 July 2016	
	Number of instruments '000	Weighted average exercise price	Number of instruments '000	Weighted average exercise price
CIP	204		468	
SEP	134			
LTIP	1,041		1,185	
Restricted stock	254		261	
SAYE	7	£10.87	15	£8.99

Related party transactions

The only related party transactions in the year ended 31 July 2017 were key management compensation (31 July 2016: key management compensation).

8 Post-retirement benefits

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

Defined contribution plans

The Group operates a number of defined contribution plans across many countries. In the UK a defined contribution plan has been offered since the closure of the UK defined benefit pension plans. In the US a 401k defined contribution plan operates. The total expense recognised in the consolidated income statement in respect of all these plans was £33m (2016: £30m).

Defined benefit and post-retirement healthcare plans

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

For all schemes, pension costs are assessed in accordance with the advice of independent, professionally qualified actuaries. These valuations have been updated by independent qualified actuaries in order to assess the liabilities of the schemes as at 31 July 2017. Scheme assets are stated at their market values. Contributions to the schemes are made on the advice of the actuaries, in accordance with local funding requirements.

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

	Year ended 31 July 2017 £m	Year ended 31 July 2016 £m
At beginning of period	80	(108)
Exchange adjustment	(6)	(31)
Reclassification of small unfunded obligations		
Current service cost	(4)	(3)
Scheme administration costs	(7)	(7)
Past service cost, curtailments, settlements	(1)	(9)
Finance income – retirement benefits	2	3
Contributions by employer	105	275
Actuarial gain/(loss)	55	(40)
Net retirement benefit asset	**224**	**80**

UK pension schemes

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

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

Smiths Industries Pension Scheme ("SIPS")

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

The most recent actuarial valuation of this scheme has been performed using the Projected Unit Method as at 31 March 2015, and experience gains and losses identified during this valuation have been incorporated into the IAS 19 valuation. Under the funding plan for SIPS agreed in November 2015 Smiths pays cash contributions of £2m a month until June 2020. As part of this agreement, Smiths contributed the index-linked gilts previously held in an escrow account. Under the governing documentation of the SIPS, any future surplus would be returnable to Smiths Group plc by refund, assuming gradual settlement of the liabilities over the lifetime of the scheme.

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

The duration of the SIPS liabilities is around 23 years (2016: 23 years) for active deferred members, 22 years (2016: 24 years) for deferred members and 11 years (2016: 12 years) for pensioners and dependants.

8 Post-retirement benefits continued

UK pension schemes continued

TI Group Pension Scheme ("TIGPS")

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

The most recent actuarial valuation of this scheme has been performed using the Projected Unit Method as at 5 April 2015. Under the funding plan for TIGPS agreed in March 2016 Smiths pays cash contributions of £3m a year until April 2018. Under the governing documentation of the TIGPS, any future surplus would be returnable to Smiths Group plc by refund, assuming gradual settlement of the liabilities over the lifetime of the scheme.

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

The duration of the TIGPS liabilities is around 24 years (2016: 25 years) for active deferred members, 22 years (2016: 24 years) for deferred members and 11 years (2016: 11 years) for pensioners and dependants.

US pension plans

The most recent valuations of the principal US pension and post-retirement healthcare plans were performed at 1 January 2017.

The pension plans were closed with effect from 30 April 2009 and benefits were calculated as at that date and are not revalued. Governance of the US pension plans is managed by a Settlor Committee appointed by Smiths Group Services Corp, a wholly owned subsidiary.

The duration of the liabilities for the largest US plan is around 19 years (2016: 20 years) for active deferred members, 19 years (2016: 20 years) for deferred members and 12 years (2016: 12 years) for pensioners and dependants.

Last year the US funded plans completed a buy-out of retiree liabilities for $527m, transferring the obligation to pay pensions to Voya Retirement Insurance and Annuity Company. A settlement loss of £10m was recognised on this transaction (see note 3).

Risk management

The pensions schemes are exposed to risks that:

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

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

TI Group Pension Scheme ("TIGPS")

TIGPS with a mature member profile, and a strong funding position, has been able to progress its matching strategy to the point where roughly 50% of liabilities are covered by matching annuities, eliminating investment return, longevity, inflation and funding risks.

Smiths Industries Pension Scheme ("SIPS")

In August 2014 SIPS adjusted the scheme investment strategy. The scheme has investments in diversified growth funds and a portfolio of exchange traded equity index futures managed by BlackRock. The risk and return characteristics of equity index futures are similar to physical equities, but provide the scheme with improved liquidity. As at 31 July 2017 the SIPS portfolio of exchange traded equity index futures generated a £73m (2016: £163m) exposure to equities.

Following the company contribution of £152m UK government bonds to SIPS in December 2015 and the resulting improvement in the funding position, the trustees have adopted a leveraged liability matching strategy. The scheme uses repurchase arrangements, total return swaps, inflation swaps and interest rate swaps to hedge the interest and inflation risks of the scheme liabilities. Repurchase agreements exchange government bonds held by the scheme for cash with an obligation to buy back the asset at a fixed future date and price. The cash is invested in liability matching assets, reducing funding risk. A total return swap exchanges the return on a specified asset (for example an index-linked bond) and an interest payment (fixed or floating). Contracts are spread across a panel of banks. To minimise the risk that counterparties fail to settle obligations, positions are collateralised. For repurchase agreements, collateral is the difference between the present value of the repurchase obligation and the value of the asset exchanged. For swaps, collateral is based on market values. At 31 July 2017 scheme assets were net of £773m (2016: £720m) repurchase obligations, and nominal exposure from interest rate swaps of £340m (2016: £293m), inflation swaps of £293m (2016: £263m) and total return swaps of £14m (2016: £14m).

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

	2017 UK	2017 US	2017 Other	2016 UK	2016 US	2016 Other
Rate of increase in salaries	n/a	n/a	2.8%	n/a	n/a	2.8%
Rate of increase for active deferred members	4.1%	n/a	n/a	3.6%	n/a	n/a
Rate of increase in pensions in payment	3.2%	n/a	1.5%	2.7%	n/a	1.6%
Rate of increase in deferred pensions	3.2%	n/a	0.1%	2.7%	n/a	0.1%
Discount rate	2.6%	3.85%	2.6%	2.3%	3.45%	2.8%
Inflation rate	3.2%	n/a	2.2%	2.7%	n/a	2.3%
Healthcare cost increases	4.2%	n/a	1.8%	4.2%	n/a	1.4%

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

Discount rate assumptions

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

Mortality assumptions

The mortality assumptions used in the principal UK schemes are based on the new "SAPS S2" All Birth year tables with relevant scaling factors based on the recent experience of the schemes. The assumption allows for future improvements in life expectancy in line with the 2016 CMI projections, blended to a long-term rate of 1.25%. The mortality assumptions used in the principal US schemes are based on the RP-2014 table adjusted backward to 2006 with MP-2014 and projected forward using MP-2016 as of 31 July 2017. The table selected allows for future mortality improvements and applies an adjustment for job classification (blue collar versus white collar).

	UK schemes				US schemes			
Expected further years of life	Male 31 July 2017	Female 31 July 2017	Male 31 July 2016	Female 31 July 2016	Male 31 July 2017	Female 31 July 2017	Male 31 July 2016	Female 31 July 2016
Member who retires next year at age 65	23	24	23	24	21	23	21	23
Member, currently 45, when they retire in 20 years' time	24	25	24	26	23	24	23	25

Sensitivity

Sensitivities in respect of the key assumptions used to measure the principal pension schemes as at 31 July 2017 are set out below. These sensitivities show the hypothetical impact of a change in each of the listed assumptions in isolation, with the exception of the sensitivity to inflation which incorporates the impact of certain correlating assumptions. In practice, such assumptions rarely change in isolation.

	Profit before tax for year ended 31 July 2017 £m	Increase/ (decrease) in scheme assets 31 July 2017 £m	(Increase)/ decrease in scheme liabilities 31 July 2017 £m	Profit before tax for year ended 31 July 2016 £m	Increase/ (decrease) in scheme assets 31 July 2016 £m	(Increase)/ decrease in scheme liabilities 31 July 2016 £m
Rate of mortality – 1 year increase in life expectancy	(3)	67	(177)	(3)	53	(183)
Rate of mortality – 1 year decrease in life expectancy	3	(66)	177	3	(53)	183
Rate of inflation – 0.25% increase	(2)	20	(97)	(2)	16	(119)
Discount rate – 0.25% increase	4	(27)	151	4	(19)	168
Market value of scheme assets – 2.5% increase	2	79		2	86	

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

Asset valuation

Liquidity funds, equities and bonds are valued using quoted market prices in active markets. Exchange traded equity index futures are valued at market prices.

Total return, interest and inflation swaps are bilateral agreements between counterparties and do not have observable market prices. These derivative contracts are valued using observable market inputs.

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

8 Post-retirement benefits continued

Retirement-benefit plan assets

	31 July 2017 £m				31 July 2016 £m			
	UK schemes	US schemes	Other countries	Total	UK schemes	US schemes	Other countries	Total
Cash and cash equivalents								
– cash	33	1	1	35	57	1		58
– liquidity funds	271			271	89			89
– cash collateral and liquidity funds held to support exchange traded futures	4			4	53			53
Equities								
– UK funds	1		3	4	111		3	114
– North American funds					124		2	126
– other regions and global funds	94		1	95	214		5	219
Government bonds								
– index-linked bonds	1,298			1,298	1,410			1,410
– fixed-interest bonds	393	81	3	477	599	70	20	689
Corporate bonds	1,048	184		1,232	861	145	5	1,011
Insured liabilities	1,050		1	1,051	802		1	803
Property	133		1	134	149		1	150
Other								
– diversified growth funds and scheme receivables	407		24	431	285		25	310
– repurchase obligations	(773)			(773)	(720)			(720)
Total market value	**3,959**	**266**	**34**	**4,259**	**4,034**	**216**	**62**	**4,312**

SIPS has a portfolio of exchange traded equity index futures, which are valued at market prices. These futures increase "leverage" in SIPS, creating additional asset exposure. At 31 July 2017, the gross equity exposure generated by these exchange traded futures was £73m (2016: £163m). At 31 July 2017 the aggregate value of this strategy, including cash received as collateral, was £3m (2016: £9m). The scheme was holding £10m (2016: £44m) in liquidity funds to meet potential future obligations to collateralise equity index futures.

UK other investments at 31 July 2017 included £70m (2016: £162m) of investments in diversified growth funds held by SIPS, £184m (2016: £107m) of investments in leveraged index linked UK government bond funds held by TIGPS and £12m (2016: £9m) SIPS interest and inflation swaps.

At 31 July 2017 SIPS assets were net of £773m (2016: £720m) repurchase obligations, and included £4m (2016: £11m) gains on interest rate swaps, £8m gains (2016: £2m losses) on inflation swaps and £1m gains (2016: £nil) on total return swaps. See risk management disclosures on page 160 for information on how the scheme is using repurchase arrangements and swap contracts to match the interest rate and inflation exposures of its assets to the interest rate and inflation exposures of the scheme liabilities. The scheme was holding £1m (2016: £45m) in liquidity funds to meet potential future obligations to collateralise repurchase arrangements or swap agreements.

The scheme assets do not include any property occupied by, or other assets used by, the Group. Equities include investments in broad-based equity indices, some of which hold ordinary equity shares in Smiths Group plc.

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

	31 July 2017 £m			31 July 2016 £m		
	SIPS	TIGPS	US schemes	SIPS	TIGPS	US schemes
Present value of funded scheme liabilities						
– Active deferred members	(81)	(92)	(101)	(82)	(82)	(124)
– Deferred members	(891)	(625)	(160)	(881)	(688)	(175)
– Pensioners	(1,053)	(809)	(31)	(1,086)	(869)	(16)
Present value of funded scheme liabilities	**(2,025)**	**(1,526)**	**(292)**	**(2,049)**	**(1,639)**	**(315)**
Market value of scheme assets	2,238	1,703	266	2,227	1,787	216
Surplus/(deficit)	**213**	**177**	**(26)**	**178**	**148**	**(99)**

Net retirement benefit obligations

	31 July 2017 £m				31 July 2016 £m			
	UK schemes	US schemes	Other countries	Total	UK schemes	US schemes	Other countries	Total
Market value of scheme assets	3,959	266	34	4,259	4,034	216	62	4,312
Present value of funded scheme liabilities	(3,571)	(292)	(42)	(3,905)	(3,709)	(315)	(70)	(4,094)
Surplus/(deficit)	**388**	**(26)**	**(8)**	**354**	**325**	**(99)**	**(8)**	**218**
Unfunded pension plans	(55)	(8)	(48)	(111)	(56)	(8)	(52)	(116)
Post-retirement healthcare	(6)	(11)	(2)	(19)	(8)	(12)	(1)	(21)
Present value of unfunded obligations	**(61)**	**(19)**	**(50)**	**(130)**	**(64)**	**(20)**	**(53)**	**(137)**
Unrecognised asset due to surplus restriction							(1)	(1)
Net pension asset/(liability)	**327**	**(45)**	**(58)**	**224**	**261**	**(119)**	**(62)**	**80**
Post-retirement assets	390			390	327		1	328
Post-retirement liabilities	(63)	(45)	(58)	(166)	(66)	(119)	(63)	(248)
Net pension asset/(liability)	**327**	**(45)**	**(58)**	**224**	**261**	**(119)**	**(62)**	**80**

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

Amounts recognised in the consolidated income statement

	Year ended 31 July 2017 £m	Year ended 31 July 2016 £m
Amounts charged to operating profit		
Current service cost	4	3
Settlement loss	1	9
Scheme administration costs	7	7
	12	**19**
The operating cost is charged as follows:		
Cost of sales	1	1
Sales and distribution costs	1	1
Headline administrative expenses	2	1
Non-headline administrative expenses	8	16
	12	**19**
Amounts (credited) to finance costs		
Net interest income	**(2)**	**(3)**

Amounts recognised directly in the consolidated statement of comprehensive income

	Year ended 31 July 2017 £m	Year ended 31 July 2016 £m
Actuarial gains/(losses)		
Difference between interest credit and return on assets	(31)	395
Experience gains on scheme liabilities	22	58
Actuarial gains arising from changes in demographic assumptions	69	47
Actuarial losses arising from changes in financial assumptions	(6)	(539)
Movements in surplus restriction	1	(1)
	55	**(40)**

8 Post-retirement benefits continued

Changes in present value of funded scheme assets

	31 July 2017 £m				31 July 2016 £m			
	UK schemes	US schemes	Other countries	Total	UK schemes	US schemes	Other countries	Total
At beginning of period	4,034	216	62	4,312	3,523	445	49	4,017
Interest on assets	91	9	2	102	124	9	3	136
Actuarial (loss)/gain on scheme assets	(15)	(14)	(2)	(31)	372	20	3	395
Employer contributions	27	67	5	99	199	68	2	269
Assets distributed on settlement			(32)	(32)		(360)		(360)
Scheme administration costs	(5)	(2)		(7)	(4)	(3)		(7)
Exchange adjustments		(1)	2	1		51	8	59
Benefits paid	(173)	(9)	(3)	(185)	(180)	(14)	(3)	(197)
At end of period	**3,959**	**266**	**34**	**4,259**	**4,034**	**216**	**62**	**4,312**

Changes in present value of funded defined benefit obligations

	31 July 2017 £m				31 July 2016 £m			
	UK schemes	US schemes	Other countries	Total	UK schemes	US schemes	Other countries	Total
At beginning of period	(3,709)	(315)	(70)	(4,094)	(3,385)	(568)	(57)	(4,010)
Current service cost			(2)	(2)			(1)	(1)
Interest on obligations	(83)	(11)	(3)	(97)	(115)	(12)	(2)	(129)
Actuarial gain/(loss) on liabilities	48	27	1	76	(389)	(31)	(3)	(423)
Liabilities extinguished on settlement			31	31		350	1	351
Exchange adjustments		(2)	(2)	(4)		(68)	(11)	(79)
Benefits paid	173	9	3	185	180	14	3	197
At end of period	**(3,571)**	**(292)**	**(42)**	**(3,905)**	**(3,709)**	**(315)**	**(70)**	**(4,094)**

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

	Assets		Obligations	
	Year ended 31 July 2017 £m	Year ended 31 July 2016 £m	Year ended 31 July 2017 £m	Year ended 31 July 2016 £m
At beginning of period			(137)	(115)
Reclassification of small unfunded obligations				
Current service cost			(2)	(2)
Interest on obligations			(3)	(4)
Actuarial gain/(loss)			9	(11)
Employer contributions	6	6		
Exchange adjustments			(3)	(11)
Benefits paid	(6)	(6)	6	6
At end of period			**(130)**	**(137)**

Cash contributions

Company contributions to the defined benefit pension plans and post-retirement healthcare plans for 2017 totalled £105m (2016: £275m). This comprised regular contributions to funded schemes of £24m (2016: £32m) to SIPS, £3m (2016: £11m) to TIGPS, £67m (2016: £34m) to funded US Schemes, £2m to other schemes and additional contributions of £3m to fund the closure of a scheme in Canada. In addition, £6m (2016: £6m) was spent on providing benefits under unfunded defined benefit pension and post-retirement healthcare plans.

In 2018 the cash contributions to the Group's principal funded defined benefit schemes are expected to total about £50m, including £24m to SIPS and £3m to TIGPS, with the balance relating mainly to the US scheme. Group contributions in respect of the unfunded schemes and post-retirement healthcare are expected to be in line with 2017.

9 Employee share schemes

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

Long-Term Incentive Plan (LTIP)

The LTIP is a share plan under which an award over a capped number of shares will vest after the end of the three-year performance period if performance conditions are met. LTIP awards are made to selected senior executives, including the executive directors. Awards made prior to 2016 were made with different targets for corporate executives and divisional executives. Since 2016 all LTIP awards have had one set of targets.

LTIP performance conditions

Each performance condition has a threshold below which no shares vest and a maximum performance target at or above which the award vests in full. For performance between 'threshold' and 'maximum', awards vest on a straight-line sliding scale. The performance conditions are assessed separately, so performance on one condition does not affect the vesting of the other elements of the award. To the extent that the performance targets are not met over the three-year performance period, awards will lapse. There is no re-testing of the performance conditions.

Group LTIP awards have performance conditions relating to underlying revenue growth, growth in headline EPS adjusted to exclude tax, ROCE, cash conversion and, for awards made before 2015, TSR relative to the FTSE 100 (excluding financial services companies).

Divisional LTIP awards have performance conditions relating to divisional performance against headline KPIs, including underlying revenue and operating profit growth, operating margins, ROCE, operating cash conversion, employee engagement and quality metrics.

Smiths Group Co-Investment Plan (CIP) and Smiths Share Matching Plan (SMP)

In 2015 the CIP was replaced by the SMP. Under the CIP and SMP participants are required to invest between 25% and 50% of their post-tax bonus purchasing the Company's shares at the prevailing market price. At the end of a three-year period, if the executive is still in office and provided the performance test is passed, matching shares will be awarded in respect of any invested shares retained for that period. The number of matching shares to be awarded is determined by the Remuneration Committee at the end of the year in which the bonus is earned by reference to annual bonus, and other corporate financial criteria. The maximum award will not exceed the value, before tax, of the bonus or salary invested in shares by the executive.

For the CIP, vesting of matching shares will occur, and the matching shares will be released, at the end of the three-year period if the Group's Return on Capital Employed ('ROCE') over the performance period exceeds the Group's weighted average cost of capital ('WACC') over the performance period by an average margin of at least 1% per annum. If ROCE exceeds WACC by an average margin of 3% per annum, the enhanced performance condition is met, and a second matching share will be issued for every purchased share. For the SMP, vesting of matching shares will occur, and the matching shares will be released, at the end of the three-year period depending on the performance of the Group LTIP issued for the same performance period. The first matching share is awarded if the Group LTIP vests under any performance condition.

No future awards will be made under the CIP or SMP.

Smiths Excellence Plan (SEP)

In September 2016 the Smiths Excellence plan (SEP) was introduced. The SEP is designed to reinforce value creation over the medium term by focusing on specific objectives in key areas of operational performance. Awards vest after two years, depending on performance on the operational objectives during the first year and continued employment with the Group. There is no retesting of performance. However the Remuneration Committee has discretion to adjust vesting rates if material misstatements in reported performance are subsequently identified and awards are subject to clawback provisions in the event of mis-conduct.

Directors are not eligible to participate in the SEP.

Restricted stock

The restricted stock is used by the Remuneration Committee, as a part of the recruitment strategy, to make awards in recognition of incentive arrangements forfeited on leaving a previous employer. If an award is considered appropriate, the award will take account of relevant factors including the fair value of awards forfeited, any performance conditions attached, the likelihood of those conditions being met and the proportion of the vesting period remaining.

	SEP	CIP and SMP	Long-term incentive plans	Restricted stock	Other share schemes	Total	Weighted average exercise price £
Ordinary shares under option ('000)							
1 August 2015		1,369	2,649		1,494	5,512	£2.57
Granted		635	1,628	303	329	2,895	£0.99
Exercised		(530)	(199)	(30)	(380)	(1,139)	£2.95
Lapsed		(35)	(724)		(222)	(981)	£2.20
31 July 2016		1,439	3,354	273	1,221	6,287	£1.83
Granted	817		1,581	58	218	2,674	£1.06
Exercised		(339)	(198)	(119)	(259)	(915)	£2.77
Lapsed	(69)	(174)	(939)	(7)	(70)	(1,259)	£0.51
31 July 2017	**748**	**926**	**3,798**	**205**	**1,110**	**6,787**	**£1.64**

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9 Employee share schemes continued

Options were exercised on an irregular basis during the period. The average closing share price over the financial year was 1,499.95p (2016: 1,049.61p). There has been no change to the effective option price of any of the outstanding options during the period.

Range of exercise prices	Total shares under option at 31 July 2017 ('000)	Weighted average remaining contractual life at 31 July 2017 (months)	Total shares under option at 31 July 2016 ('000)	Weighted average remaining contractual life at 31 July 2016 (months)	Options exercisable at 31 July 2017 ('000)	Exercisable weighted average exercise price for options exercisable at 31 July 2017	Options exercisable at 31 July 2016 ('000)	Exercisable weighted average exercise price for options exercisable at 31 July 2016
£0.00 – £2.00	5,677	17	5,066	18				
£2.01 – £6.00			17	6				
£6.01 – £10.00	791	24	924	33	42	£9.20	60	£9.04
£10.01 – £14.00	319	32	280	13	90	£10.96	175	£10.95

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 2017 and 2016 are volatility of 20% to 25% (2016: 25% to 30%) and dividend yield of 3.50% (2016: 3.75%), based on historical data, for the period corresponding with the vesting period of the option. These generated a weighted average fair value for SEP of £12.86p (2016: no grant), LTIP of £12.68 (2016: £10.33), and restricted stock of £12.59 (2016: £10.03).

Included within staff costs is an expense arising from share-based payment transactions of £15m (2016: £10m), of which £14m (2016: £9m) relates to equity-settled share-based payment.

10 Intangible assets

	Goodwill £m	Development costs £m	Acquired intangibles (see table below) £m	Software, patents and intellectual property £m	Total £m
Cost					
At 1 August 2015	1,421	237	403	177	2,238
Exchange adjustments	253	43	71	17	384
Business combinations	5		3		8
Additions		25		11	36
Disposals		(3)		(6)	(9)
At 31 July 2016	**1,679**	**302**	**477**	**199**	**2,657**
Exchange adjustments	23	4	(2)	1	26
Business combinations (note 26)	210		240	6	456
Additions		39		8	47
Disposals		(15)		(5)	(20)
Business disposals (note 28)	(254)		(141)	(3)	(398)
At 31 July 2017	**1,658**	**330**	**574**	**206**	**2,768**
Amortisation					
At 1 August 2015	115	121	358	126	720
Exchange adjustments	24	22	65	11	122
Charge for the year		26	15	17	58
Impairment charge	23				23
Disposals		(3)		(5)	(8)
At 31 July 2016	**162**	**166**	**438**	**149**	**915**
Exchange adjustments	5	2	9	1	17
Charge for the year		27	17	18	62
Disposals		(15)		(5)	(20)
Business disposals (note 28)	(79)		(140)	(2)	(221)
At 31 July 2017	**88**	**180**	**324**	**161**	**753**
Net book value at 31 July 2017	**1,570**	**150**	**250**	**45**	**2,015**
Net book value at 31 July 2016	1,517	136	39	50	1,742
Net book value at 1 August 2015	1,306	116	45	51	1,518

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 2015	72	136	195	403
Exchange adjustments	13	24	34	71
Business combinations			3	3
At 31 July 2016	**85**	**160**	**232**	**477**
Exchange adjustments	2	(3)	(1)	(2)
Business combinations (note 26)		103	137	240
Business disposals (note 28)	(30)	(49)	(62)	(141)
At 31 July 2017	**57**	**211**	**306**	**574**
Amortisation				
At 1 August 2015	49	120	189	358
Exchange adjustments	9	22	34	65
Charge for the year	3	7	5	15
At 31 July 2016	**61**	**149**	**228**	**438**
Exchange adjustments	1	2	6	9
Charge for the year	3	8	6	17
Business disposals (note 28)	(29)	(49)	(62)	(140)
At 31 July 2017	**36**	**110**	**178**	**324**
Net book value at 31 July 2017	**21**	**101**	**128**	**250**
Net book value at 31 July 2016	24	11	4	39
Net book value at 1 August 2015	23	16	6	45

11 Impairment testing

Goodwill

Goodwill is not amortised but is tested for impairment at least annually. Value in use or fair value less cost to sell calculations are used to determine the recoverable amount of goodwill held allocated to each group of cash generating units (CGU). Value in use is calculated as the net present value of the projected risk-adjusted cash-flows of the CGU. These forecast cash-flows are based on the 2018 budget, the five-year strategic plan approved by the Board and detailed divisional strategic projections, where these have been prepared and approved by the Board. Fair value less cost to sell is calculated using available information on past and expected future profitability, valuation multiples for comparable quoted companies and similar transactions (adjusted as required for significant differences) and information on costs of similar transactions. Fair value less costs to sell models are used when trading projections in the strategic plan cannot be adjusted to eliminate the impact of a major restructuring.

Goodwill is allocated by division as follows:

	2017 £m	2017 Number of CGUs	2016 £m	2016 Number of CGUs
John Crane	111	1	108	3
Smiths Medical	561	1	591	1
Smiths Detection	629	2	410	1
Smiths Interconnect	242	2	381	5
Flex-Tek	27	2	27	2
	1,570	**8**	**1,517**	**12**

Following the disposal of the John Crane Artificial Lift business (see note 28) and a restructuring to integrate China into the global John Crane management structure, John Crane is now a single CGU. Impairment testing has been completed on this basis for 2017.

Morpho Detection was acquired in April 2017 (see note 26). At 31 July 2017 a single management team was in place covering Continuing Smiths Detection and Morpho Detection. However, the integration of the two businesses was not sufficiently advanced to support treating them as a single CGU for impairment testing. Based on the current integration plan, it is anticipated that there will be a single CGU in 2018.

Following the disposal of Smiths Interconnect Power and Smiths Interconnect Microwave Telecoms (see note 28) and the integration of Smiths Interconnect Connectors and Smiths Interconnect Microwave Components, Smiths Interconnect now has two CGUs, Smiths Interconnect Connectors and Components and Smiths Interconnect Microwave Subsystems.

11 Impairment testing continued

Goodwill continued

Impairment testing assumptions

John Crane and Smiths Medical have strong aftermarket and consumables businesses, with consistent sales trends. Smiths Detection and Smiths Interconnect have greater sales and margin volatility due to lower levels of recurring revenue and involvement in government-funded programmes, particularly defence, and customer-led technology innovation. The key assumptions used in value in use calculations are:

- Sales: projected sales are built up with reference to markets and product categories. They incorporate past performance, historical growth rates and projections of developments in key markets.
- Margins: projected margins reflect historical performance and the impact of all completed projects to improve operational efficiency and leverage scale. The projections do not include the impact of future restructuring projects to which the Group is not yet committed.
- Discount rate: the discount rates have been calculated based on the Group's weighted average cost of capital and risks specific to the CGU being tested. The discount rates disclosed incorporate risk adjustments where the projected sales and margins are affected by significant delivery risks. Pre-tax rates of 12.2% to 16.9% (2016: 11.0% to 14.3%) have been used for the impairment testing.
- Long-term growth rates: as required by IAS 36, growth rates for the period after the detailed forecasts are based on the long-term GDP projections of the primary market for the CGU. The average growth rate used in the testing was 2.1% (2016: 2.2%). These rates do not reflect the long-term assumptions used by the Group for investment planning.

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

						Year ended 31 July 2017
	John Crane	Smiths Medical	Smiths Detection		Smiths Interconnect	
			Original Smiths Detection	Morpho Detection	Microwave Subsystems	Connectors and Components
Net book value of goodwill (£m)	**111**	**561**	**429**	**200**	**75**	**167**
Basis of valuation	Value in use	Value in use	Value in use	Fair value less costs to sell	Value in use	Value in use
Discount rate	14.9%	12.2%	14.1%	n/a	12.2%	16.9%
Period covered by management projections	5 years	5 years	5 years	1 year	5 years	5 years
Long-term growth rates	2.2%	2.1%	2.0%	n/a	2.2%	2.1%

The discount rate for Smiths Interconnect Connectors and Components includes a risk adjustment.

						Year ended 31 July 2016
	John Crane	Smith Medical	Smiths Detection	Smiths Interconnect		
	Core Rotating Equipment		Original Smiths Detection	Microwave Subsystems	Connectors	Power
Net book value of goodwill (£m)	104	591	410	75	100	128
Basis of valuation	Value in use	Value in use	Value in use	Value in use	Value in use	Value in use
Discount rate	13.4%	11.0%	13.9%	11.8%	13.5%	11.7%
Period covered by management projections	5 years	5 years	5 years	5 years	5 years	5 years
Long-term growth rates	2.3%	2.1%	2.0%	2.3%	2.0%	2.3%

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

Sensitivity analysis

Morpho Detection explosive detection business

Morpho Detection's fair value less costs to sell exceeds its carrying value by £38m. Fair value was calculated using a level 3 valuation model. Sensitivity analysis performed around the base case assumptions has indicated that for Morpho Detection, the following changes in assumptions (in isolation), would cause the fair value less costs to sell to fall below the carrying value. The business was acquired in the year, so there are no comparatives.

	Year ended 31 July 2017 Change required to trigger impairment
Forecast earnings before interest, tax, depreciation and amortisation	8% reduction in EBITDA
Valuation multiple	0.9 reduction in multiple

Forecast earnings before interest, tax, depreciation and amortisation have been projected using:

- expected future sales, based on orders, projected sales under framework agreements, sales opportunities and current contract win rates;
- current cost structure and production capacity; and
- adjustments to profit which a market participant would normally make in assessing a business of this nature, including market participant synergies.

The valuation multiple has been estimated using current share prices for similar listed companies, multiples paid in recent transactions and advice on current market pricing.

Other CGUs

For the other CGUs, sensitivity analysis performed around the base case assumptions has indicated that no reasonable changes in key assumptions would cause the carrying amount of any of the CGUs to exceed their respective recoverable amounts.

Goodwill impairment

No impairment charges have been incurred (2016: £23m). In 2016 the following goodwill impairments were recognised: £5m for John Crane Production Solutions, £7m for Smiths Interconnect Microwave Components and £11m for Smiths Interconnect Microwave Telecoms. All three of these businesses were sold in the current year, see note 28.

Other intangible assets

The Group has no indefinite life intangible assets other than goodwill. During the year impairment tests were carried out for development projects which have not yet started to be amortised and acquired intangibles where there were indications of impairment. Value in use calculations were used to determine the recoverable values of these assets.

No impairment charges have been incurred (2016: £nil).

Property, plant and equipment

Impairment charges of £5m for John Crane Production Solutions, principally relating to property, and £1m for sites affected by the Fuel for Growth restructuring were recognised in 2016.

12 Property, plant and equipment

	Land and buildings £m	Plant and machinery £m	Fixtures, fittings, tools and equipment £m	Total £m
Cost or valuation				
At 1 August 2015	181	536	199	916
Exchange adjustments	31	91	30	152
Additions	19	42	13	74
Disposals	(2)	(35)	(21)	(58)
Transfers to disposal group held for sale at the year end	(6)	(3)	(1)	(10)
At 31 July 2016	**223**	**631**	**220**	**1,074**
Exchange adjustments	5	10	5	20
Business combinations (note 26)		7	1	8
Additions	6	44	12	62
Disposals	(24)	(42)	(24)	(90)
Business disposals (note 28)	(6)	(15)	(5)	(26)
At 31 July 2017	**204**	**635**	**209**	**1,048**
Depreciation				
At 1 August 2015	97	403	157	657
Exchange adjustments	16	68	24	108
Charge for the year	8	31	14	53
Impairments (note 11)	5	1		6
Disposals	(1)	(34)	(20)	(55)
Transfers to disposal group held for sale at the year end	(6)	(3)	(1)	(10)
At 31 July 2016	**119**	**466**	**174**	**759**
Exchange adjustments	2	8	4	14
Charge for the year	9	34	14	57
Disposals	(18)	(36)	(23)	(77)
Business disposals (note 28)	(5)	(11)	(4)	(20)
At 31 July 2017	**107**	**461**	**165**	**733**
Net book value at 31 July 2017	**97**	**174**	**44**	**315**
Net book value at 31 July 2016	104	165	46	315
Net book value at 1 August 2015	84	133	42	259

13 Inventories

	31 July 2017 £m	31 July 2016 £m
Inventories comprise		
Raw materials and consumables	148	174
Work in progress	86	102
Finished goods	218	202
	452	**478**

The Group consumed £1,470m (2016: £1,319m) of inventories during the period. In the year to 31 July 2017, £17m (2016: £16m) was charged for the write-down of inventory and £6m (2016: £4m) was released from inventory provisions no longer required.

Inventory provisioning

	31 July 2017 £m	31 July 2016 £m
Gross inventory carried at full value	**414**	**436**
Gross value of inventory partly or fully provided for	93	112
	507	**548**
Inventory provision	(55)	(70)
Inventory after provisions	**452**	**478**

14 Trade and other receivables

	31 July 2017 £m	31 July 2016 £m
Non-current		
Trade receivables	41	31
Accrued income	2	3
Prepayments		1
Other receivables	14	16
	57	**51**
Current		
Trade receivables	642	665
Accrued income	11	18
Prepayments	28	21
Other receivables	41	41
	722	**745**

Trade receivables include balances not yet due of £75m (2016: £47m) relating to multi-year Smiths Detection contracts, where revenue recognition does not align with the agreed payment schedule. The Group also has cash received of £78m (2016: £41m) deferred in trade and other payables relating to Smiths Detection contracts.

Trade receivables do not carry interest. Management considers that the carrying value of trade and other receivables approximates to the fair value. Trade and other receivables, including prepayments, accrued income and other receivables qualifying as financial instruments are classified as 'loans and receivables'. The maximum credit exposure arising from these financial assets is £720m (2016: £745m).

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

Credit risk is managed separately for each customer and, where appropriate, a credit limit is set for the customer based on previous experience of the customer and third party credit ratings. The Group has no significant concentration of credit risk, with exposure spread over a large number of customers. The largest single customer is the US Federal Government, representing less than 5% (2016: less than 5%) of Group revenue.

Ageing of trade receivables

	31 July 2017 £m	31 July 2016 £m
Trade receivables which are not impaired and not yet due	539	535
Trade receivables which are not impaired and less than three months overdue	104	109
Trade receivables which are not impaired and more than three months overdue	30	45
Gross value of partially and fully provided receivables	43	38
	716	**727**
Provision for bad and doubtful debts	(33)	(31)
Trade receivables	**683**	**696**

15 Trade and other payables

	31 July 2017 £m	31 July 2016 £m
Non-current		
Other payables	**26**	**29**
Current		
Trade payables	202	202
Other payables	17	11
Other taxation and social security costs	27	25
Accruals	247	231
Deferred income	83	67
	576	**536**

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

16 Financial assets

At 31 July 2017 £11m (2016: £nil) was held on deposit with banks as security for liabilities or letters of credit.

The Group invests in early stage businesses that are developing or commercialising related technology. In 2016, £2m was invested in Detection businesses.

17 Borrowings and net debt

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

	31 July 2017 £m	31 July 2016 £m
Cash and cash equivalents		
Net cash and deposits	**782**	**431**
Short-term borrowings		
Bank overdrafts	(1)	(1)
€300m 4.125% Eurobond 2017		(255)
$175m 7.37% US$ Private placement 2018	(133)	
Bank and other loans	(1)	(1)
Interest accrual	(16)	(13)
	(151)	**(270)**
Long-term borrowings		
$175m 7.37% US$ Private placement 2018		(132)
$250m 7.20% US$ Guaranteed notes 2019	(189)	(189)
$400m 3.625% US$ Guaranteed notes 2022	(301)	(304)
€600m 1.25% Eurobond 2023	(533)	(512)
€650m 2.00% Eurobond 2027	(574)	
Bank and other loans	(1)	(2)
	(1,598)	**(1,139)**
Borrowings	**(1,749)**	**(1,409)**
Net debt	**(967)**	**(978)**

The $175m 7.37% US$ Private placement 2018 was repaid early in August 2017.

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

Borrowings are accounted for at amortised cost and are categorised as other financial liabilities. See note 18 for a maturity analysis of borrowings.

Interest of £45m (2016: £47m) was charged to the consolidated income statement in this period in respect of public bonds.

Secured loans

Loans amounting to £2m (2016: £3m) were secured on plant and equipment with a book value of £3m (2016: £3m).

17 Borrowings and net debt continued

Net cash and cash equivalents

	31 July 2017 £m	31 July 2016 £m
Cash at bank and in hand	226	161
Short-term deposits	556	270
Cash and cash equivalents	**782**	**431**
Bank overdrafts	(1)	(1)
Net cash and cash equivalents	**781**	**430**

Netting

Cash and overdraft balances in interest compensation cash pooling systems are reported gross on the balance sheet. The cash pooling agreements incorporate a legally enforceable right of net settlement. However, there is no intention to settle the balances net, so these arrangements do not qualify for net presentation. At 31 July 2017 the total value of overdrafts on accounts in interest compensation cash pooling systems was £nil (2016: less than £1m). The balances held in zero balancing cash pooling arrangements have daily settlement of balances, so netting is not relevant.

Movements in net debt

	Net cash and cash equivalents £m	Other short-term borrowings £m	Long-term borrowings £m	Net debt £m
At 31 July 2016	430	(269)	(1,139)	(978)
Foreign exchange gains and losses	(10)	5	(56)	(61)
Net cash inflow	361			361
Repayment of borrowings		256		256
Drawdown of borrowings			(546)	(546)
Capitalisation, interest accruals and unwind of capitalised fees		(3)	(1)	(4)
Fair value movement from interest rate hedging		1	4	5
Change in maturity analysis		(140)	140	
At 31 July 2017	**781**	**(150)**	**(1,598)**	**(967)**

18 Financial risk management

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

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 14.

(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 2017				
	Sterling £m	US$ £m	Euro £m	Other £m	Total £m
Financial assets and liabilities					
Financial instruments included in trade and other receivables	55	351	143	171	720
Financial instruments included in trade and other payables	(57)	(214)	(69)	(72)	(412)
Cash and cash equivalents	5	512	80	184	781
Borrowings not designated as net investment hedges	1	(12)	(275)	(2)	(288)
	4	637	(121)	281	801
Exclude balances held in operations with the same functional currency	(5)	(220)	(102)	(195)	(522)
Exposure arising from intra-group loans		(352)	(85)	(83)	(520)
Impact of fair value hedging of exchange exposure	(269)		269		
Forward foreign exchange contracts	(88)	19	50	19	
	(358)	**84**	**11**	**22**	**(241)**

	At 31 July 2016 Sterling £m	US$ £m	Euro £m	Other £m	Total £m
Financial assets and liabilities					
Financial instruments included in trade and other receivables	38	391	136	180	745
Financial instruments included in trade and other payables	(48)	(203)	(72)	(79)	(402)
Cash and cash equivalents	189	129	41	72	431
Borrowings not designated as net investment hedges	1	(12)	(5)	(1)	(17)
	180	305	100	172	757
Exclude balances held in operations with the same functional currency	(180)	(188)	(101)	(167)	(636)
Exposure arising from intra-group loans		(165)	(70)	(77)	(312)
Forward foreign exchange contracts	(286)	112	119	55	
	(286)	**64**	**48**	**(17)**	**(191)**

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

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

	Impact on profit for the year 31 July 2017 £m	Gain/(loss) recognised in reserves 31 July 2017 £m	Impact on profit for the year 31 July 2016 £m	Gain/(loss) recognised in reserves 31 July 2016 £m
US dollar	(5)	(5)	3	2
Euro	(3)	2	(6)	(3)
Sterling	1	(1)	16	(2)

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 2017 contracts with a nominal value of £407m (2016: £393m) were designated as hedging instruments. In addition, the Group had outstanding foreign currency contracts with a nominal value of £243m (2016: £529m) which were being used to manage transactional foreign exchange exposures, but were not accounted for as cash-flow hedges. The fair value of the contracts is disclosed in note 19.

The majority of hedged transactions will be recognised in the consolidated income statement in the same period that the cash flows are expected to occur, with the only differences arising because of normal commercial credit terms on sales and purchases. Of the foreign exchange contracts designated as hedging instruments 86% are for periods of 12 months or less (2016: 91%).

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

	Year ended 31 July 2017 £m	Year ended 31 July 2016 £m
Brought forward cash-flow hedge reserve at start of year	(7)	3
Gains/(losses) on effective cash-flow hedges recognised in equity	3	(10)
Amounts removed from the hedge reserve and recognised in the following lines on the income statement		
– revenue	9	(1)
– cost of sales	(4)	1
Carried forward cash-flow hedge reserve at end of year	**1**	**(7)**

18 Financial risk management continued

(a) Foreign exchange risk continued

Translational currency exposure

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

Net investment hedges

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

					At 31 July 2017
	Sterling £m	US$ £m	Euro £m	Other £m	Total £m
Loans designated as net investment hedges		(621)	(840)		(1,461)
Cross-currency swap contracts	254	(568)	359		45
Currency swap contracts	109			(109)	
	363	**(1,189)**	**(481)**	**(109)**	**(1,416)**

					At 31 July 2016
	Sterling £m	US$ £m	Euro £m	Other £m	Total £m
Loans designated as net investment hedges		(625)	(767)		(1,392)
Cross-currency swap contracts		(358)	373		15
Currency swap contracts	111			(111)	
	111	**(983)**	**(394)**	**(111)**	**(1,377)**

At 31 July 2017 swap contracts hedged the Group's exposure to Canadian dollars, Japanese yen and Chinese renminbi (31 July 2016: Canadian dollars, Japanese yen and Chinese renminbi).

All the currency swap contracts designated as net investment hedges are current (2016: current). The cross-currency swap contracts are non-current. Swaps generating £327m of the US dollar exposure (2016: £358m) will mature in April 2023 and swaps generating £241m of the US dollar exposure (2016: £nil) will mature in February 2027.

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

	Year ended 31 July 2017 £m	Year ended 31 July 2016 £m
Brought forward net investment hedge reserve at start of year	(294)	(66)
Amounts removed from the hedge reserve and recognised in the income statement	20	
Amounts deferred in the period on effective net investment hedges	(17)	(228)
Carried forward net investment hedge reserve at end of year	**(291)**	**(294)**

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 2017 £m	Loss recognised in hedge reserve 31 July 2016 £m
US dollar	132	98
Euro	53	35

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

(b) Interest rate risk

The Group operates an interest rate policy designed to optimise interest cost and reduce volatility in reported earnings. The Group's current policy is to require interest rates to be fixed for greater than 70% of the level of gross debt. This is achieved through fixed rate borrowings and interest rate swaps. At 31 July 2017 57% (2016: 59%) of the Group's gross borrowings were at fixed interest rates, after adjusting for interest rate swaps and the impact of short maturity derivatives designated as net investment hedges. The Group monitors its fixed rate risk profile against both gross and net debt. For medium-term planning, it now focuses on gross debt to eliminate the fluctuations of variable cash levels over the cycle.

The weighted average interest rate on borrowings and cross-currency swaps at 31 July 2017, after interest rate swaps, is 3.52% (2016: 3.68%).

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

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

	Available for sale investments 31 July 2017 £m	Cash and cash equivalents 31 July 2017 £m	Borrowings 31 July 2017 £m	Fair value of borrowings 31 July 2017 £m	Available for sale investments 31 July 2016 £m	Cash and cash equivalents 31 July 2016 £m	Borrowings 31 July 2016 £m	Fair value of borrowings 31 July 2016 £m
Fixed interest								
Less than one year			(134)	(140)			(153)	(158)
Between one and five years			(190)	(206)			(322)	(362)
Greater than five years			(672)	(693)			(353)	(362)
Total fixed interest financial assets/(liabilities)			**(996)**	**(1,039)**			**(828)**	**(882)**
Floating rate interest financial assets/(liabilities)	6	711	(753)	(753)		390	(581)	(581)
Total interest-bearing financial assets/(liabilities)	**6**	**711**	**(1,749)**	**(1,792)**		**390**	**(1,409)**	**(1,463)**
Non-interest-bearing assets/(liabilities) in the same category	15	71			9	41		
Total	**21**	**782**	**(1,749)**	**(1,792)**	**9**	**431**	**(1,409)**	**(1,463)**

Interest rate hedging

At 31 July 2017 and 31 July 2016 the Group has designated the following hedges against variability in the fair value of borrowings arising from fluctuations in base rates:

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

At 31 July 2017 the Group has designated the following hedge against variability in the fair value of borrowings arising from fluctuations in base rates and exchange rates:

- the fixed/floating and € exchange exposure of €300m of €/US$ interest rate swaps which mature on 23 February 2027 partially hedging the € 2027 Eurobond.

The fair values of the hedging instruments are disclosed in note 19. The effect of the swaps is to convert £741m (2016: £552m) debt from fixed rate to floating rate.

Sensitivity of interest charges to interest rate movements

The Group has exposure to sterling, US dollar and euro interest rates. However the Group does not have a significant exposure to interest rate movements for any individual currency. Based on the composition of net debt and investments at 31 July 2017, and taking into consideration all fixed rate borrowings and interest rate swaps in place, a one percentage point (100 basis points) change in average floating interest rates for all three currencies would have less than £1m impact (2016: impact of £2m) on the Group's profit before tax.

18 Financial risk management continued

(c) Financial credit risk

The Group is exposed to credit-related losses in the event of non-performance by counterparties to financial instruments, but does not currently expect any counterparties to fail to meet their obligations. Credit risk is mitigated by the Board-approved policy of only placing cash deposits with highly rated relationship bank counterparties within counterparty limits established by reference to their Standard & Poor's long-term debt rating. In the normal course of business, the Group operates cash pooling systems, where a legal right of set-off applies.

The maximum credit risk exposure in the event of other parties failing to perform their obligations under financial assets, excluding trade and other receivables and derivatives, totals £803m at 31 July 2017 (2016: £440m).

	31 July 2017 £m	31 July 2016 £m
Cash in AAA+ liquidity funds	376	
Cash at banks with at least a AA- credit rating	226	215
Cash at banks with a A+ credit rating	98	126
Cash at other banks	82	90
Investments in bank deposits	11	
Other investments	10	9
	803	**440**

At 31 July 2017 the maximum exposure with a single bank for deposits and cash is £126m (2016: £97m), whilst the maximum mark to market exposure for derivatives is £20m (2016: £10m). These banks have AA- and AA- credit rating, respectively (2016: AA- and AA-).

(d) Liquidity risk

Borrowing facilities

The Board policy specifies the maintenance of unused committed credit facilities of at least £200m at all times to ensure it has sufficient available funds for operations and planned development, which is provided by a multi-currency revolving credit facility.

Smiths has a $800m Revolving Credit Facility that matures on 19 February 2021. At the balance sheet date, the Group had the following undrawn credit facilities:

	31 July 2017 £m	31 July 2016 £m
Expiring within one year		
Expiring between one and two years		
Expiring after more than two years	607	605
	607	**605**

Cash deposits

As at 31 July 2017, £556m (2016: £270m) of cash and cash equivalents was on deposit with various banks of which £83m (2016: £119m) was on deposit with UK banks, £375m (2016: £nil) was in liquidity funds and £11m (2016: £nil) of investments comprised bank deposits held to secure liabilities and letters of credit.

Gross contractual cash-flows for borrowings

	Borrowings (Note 17) 31 July 2017 £m	Fair value adjustments 31 July 2017 £m	Contractual interest payments 31 July 2017 £m	Total contractual cash-flows 31 July 2017 £m	Borrowings (Note 17) 31 July 2016 £m	Fair value adjustments 31 July 2016 £m	Contractual interest payments 31 July 2016 £m	Total contractual cash-flows 31 July 2016 £m
Less than one year	(151)	1	(38)	(188)	(270)	2	(39)	(307)
Between one and two years	(190)		(43)	(233)	(133)		(41)	(174)
Between two and three years			(29)	(29)	(190)	(1)	(32)	(223)
Between three and four years			(29)	(29)			(18)	(18)
Between four and five years			(29)	(29)			(18)	(18)
Greater than five years	(1,408)	(1)	(71)	(1,480)	(816)	8	(30)	(838)
Total	**(1,749)**		**(239)**	**(1,988)**	**(1,409)**	**9**	**(178)**	**(1,578)**

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 2017 £m	Payments 31 July 2017 £m	Net cash-flow 31 July 2017 £m	Receipts 31 July 2016 £m	Payments 31 July 2016 £m	Net cash-flow 31 July 2016 £m
Assets						
Less than one year	315	(310)	5	425	(415)	10
Greater than one year	710	(642)	68	378	(374)	4
Liabilities						
Less than one year	279	(287)	(8)	467	(485)	(18)
Greater than one year	51	(54)	(3)	28	(29)	(1)
Total	**1,355**	**(1,293)**	**62**	**1,298**	**(1,303)**	**(5)**

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 19.

Gross contractual cash-flows for other financial liabilities
The contractual cash-flows for financial liabilities included in trade and other payables are: £400m (2016: £388m) due in less than one year, £8m (2016: £9m) due between one and five years and £4m (2016: £5m) due after more than five years.

19 Derivative financial instruments

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

	At 31 July 2017			
		Fair value		
	Contract or underlying nominal amount £m	Assets £m	Liabilities £m	Net £m
Foreign exchange contracts (cash-flow hedges)	407	11	(10)	1
Foreign exchange contracts (not hedge accounted)	243	2	(1)	1
Total foreign exchange contracts	**650**	**13**	**(11)**	**2**
Currency swaps (net investment hedges)	**109**			
Cross currency swaps (fair value and net investment hedges)	569	56		56
Interest rate swaps (fair value hedges)	113		(1)	(1)
Total financial derivatives	**1,441**	**69**	**(12)**	**57**
Balance sheet entries				
Non-current	745	56	(2)	54
Current	696	13	(10)	3
Total financial derivatives	**1,441**	**69**	**(12)**	**57**

19 Derivative financial instruments continued

	At 31 July 2016			
		Fair value		
	Contract or underlying nominal amount £m	Assets £m	Liabilities £m	Net £m
Foreign exchange contracts (cash-flow hedges)	393	8	(15)	(7)
Foreign exchange contracts (not hedge accounted)	529	3	(4)	(1)
Total foreign exchange contracts	**922**	**11**	**(19)**	**(8)**
Currency swaps (net investment hedges)	**111**		**(1)**	**(1)**
Cross currency swaps (fair value and net investment hedges)	326	25		25
Interest rate swaps (fair value hedges)	214	6		6
Total financial derivatives	**1,573**	**42**	**(20)**	**22**
Balance sheet entries				
Non-current	473	29	(1)	28
Current	1,100	13	(19)	(6)
Total financial derivatives	**1,573**	**42**	**(20)**	**22**

Currency swaps not hedge accounted

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

Accounting for other derivative contracts

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

Netting

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

	Assets 31 July 2017 £m	Liabilities 31 July 2017 £m	Assets 31 July 2016 £m	Liabilities 31 July 2016 £m
Gross value of assets and liabilities	69	(12)	42	(20)
Related assets and liabilities subject to master netting agreements	(1)	1	(2)	2
Net exposure	**68**	**(11)**	**40**	**(18)**

20 Fair value of financial instruments

	Notes	Carrying value 31 July 2017 £m	Fair value 31 July 2017 £m	Carrying value 31 July 2016 £m	Fair value 31 July 2016 £m
Level 2 valuations					
Financial assets – other investments	16	11	11		
Financial derivatives – assets	19	69	69	42	42
Borrowings	17	(1,749)	(1,792)	(1,409)	(1,463)
Financial derivatives – liabilities	19	(12)	(12)	(20)	(20)
Level 3 valuations					
Financial assets – other investments	16	10	10	9	9

Investments in bank deposits are valued at the bank balance, adjusted for accrued interest.

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

Borrowings are valued at the net present value of the future cash-flows using credit spreads and yield curves derived from market data. Borrowings are carried on the balance sheet at amortised cost adjusted for fair value interest rate hedging. The fair value of fixed rate borrowings is only used for supplementary disclosures.

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

21 Commitments

Operating lease commitments – minimum lease payments

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

	31 July 2017		31 July 2016	
	Land and buildings £m	Other £m	Land and buildings £m	Other £m
Payments due				
– not later than one year	34	7	35	7
– later than one year and not later than five years	68	7	76	6
– later than five years	24		22	
	126	**14**	**133**	**13**

Other commitments

At 31 July 2017, commitments, comprising bonds and guarantees arising in the normal course of business, amounted to £186m (2016: £174m), including pension commitments of £54m (2016: £54m).

22 Provisions and contingent liabilities

	Trading	Non-headline and legacy			Total
	£m	John Crane, Inc. litigation £m	Titeflex Corporation litigation £m	Other £m	£m
Current liabilities	26	32	20	16	94
Non-current liabilities	6	220	74	5	305
At 31 July 2016	**32**	**252**	**94**	**21**	**399**
Exchange adjustments	1	1	1		3
Business combinations (note 26)	2				2
Provision charged	21	5	8	8	42
Provision released	(9)	(1)	(13)	(2)	(25)
Unwind of provision discount		4	2		6
Utilisation	(14)	(24)	(8)	(11)	(57)
Business disposals	(2)				(2)
At 31 July 2017	**31**	**237**	**84**	**16**	**368**
Current liabilities	25	30	21	9	85
Non-current liabilities	6	207	63	7	283
At 31 July 2017	**31**	**237**	**84**	**16**	**368**

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

Trading

Warranty provision and product liability

At 31 July 2017 there are warranty and product liability provisions of £28m (2016: £29m). Warranties over the Group's products typically cover periods of between one and three years. Provision is made for the likely cost of after-sales support based on the recent past experience of individual businesses.

Commercial disputes and litigation in respect of ongoing business activities

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

Contingent liabilities

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

The Group operates in some markets where the risk of unethical or corrupt behaviour is material and has procedures, including an employee 'Ethics Alertline', to help it identify potential issues. Such procedures will, from time to time, give rise to internal investigations, sometimes conducted with external support, to ensure that Smiths Group properly understands risks and concerns and can take steps both to manage immediate issues and to improve its practices and procedures for the future. The Group also co-operates with relevant authorities in investigating business conduct issues whenever requested to. The Group is not aware of any issues which are expected to generate material financial exposures.

Non-headline and legacy

John Crane, Inc.

John Crane, Inc. ("JCI") is one of many co-defendants in numerous lawsuits pending in the United States in which plaintiffs are claiming damages arising from alleged exposure to, or use of, products previously manufactured which contained asbestos. Until 2006, the awards, the related interest and all material defence costs were met directly by insurers. In 2007, JCI secured the commutation of certain insurance policies in respect of product liability. Provision is made in respect of the expected costs of defending known and predicted future claims and of adverse judgments in relation thereto, to the extent that such costs can be reliably estimated.

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

JCI continues to actively monitor the conduct and effect of its current and expected asbestos litigation, including the most efficacious presentation of its 'safe product' defence, and intends to continue to resist these asbestos claims based upon this defence. The table below summarises the JCI claims experience over the last 38 years since the start of this litigation:

	Year ended 31 July 2017	Year ended 31 July 2016	Year ended 31 July 2015	Year ended 31 July 2014	Year ended 31 July 2013
JCI claims experience					
Claims against JCI that have been dismissed	273,000	247,000	242,000	235,000	230,000
Claims JCI is currently a defendant in	50,000	74,000	76,000	80,000	81,000
Cumulative final judgments, after appeals, against JCI since 1979	138	137	133	131	121
Cumulative value of awards ($'m) since 1979	160	158	153	149	120

The number of claims outstanding at 31 July 2017 reflects the benefit of 26,000 claims being dismissed in the year.

JCI has also incurred significant additional defence costs. The litigation involves claims for a number of allegedly asbestos related diseases, with awards, when made, for mesothelioma tending to be larger than those for the other diseases. JCI's ability to defend mesothelioma cases successfully is, therefore, likely to have a significant impact on its annual aggregate adverse judgment and defence costs.

John Crane, Inc. litigation provision

The provision is based on past history of JCI claims and well-established tables of asbestos-related disease incidence projections. The provision is determined using advice from asbestos valuation experts, Bates White LLC. The assumptions made in assessing the appropriate level of provision include: the period over which the expenditure can be reliably estimated; the future trend of legal costs; the rate of future claims filed; the rate of successful resolution of claims; and the average amount of judgments awarded.

Established incidence curves can be used to estimate the likely future pattern of asbestos related disease. However, JCI's claims experience is also significantly impacted by other factors which influence the US litigation environment. These can include: changing approaches on the part of the plaintiffs' bar; changing attitudes amongst the judiciary at both trial and appellate levels in specific jurisdictions which move the balance of risk and opportunity for claimants; and legislative and procedural changes in both the state and federal court systems. The build-up of assets in trusts established by asbestos defendants in Chapter 11 restructuring ("524(g) trusts") will increase the influence of these trusts on the behaviour of claimants. Developments in the Garlock Sealing Technologies LLC Chapter 11 proceedings have provided additional data on plaintiff claims to 524 (g) trusts. Given the evidence that emerged of inconsistent duplicate claims, there is a significant likelihood that this will lead to changes in the pattern of claims made in the future, and the costs arising from claims.

The projections use a limited time horizon on the basis that Bates White LLC consider that there is substantial uncertainty in the asbestos litigation environment so probable expenditures are not reasonably estimable beyond this time horizon. Asbestos is the longest running mass tort litigation in American history which is constantly evolving in ways that cannot be anticipated. JCIs defence strategy also generates a significantly different pattern of legal costs and settlement expenses from other defendants, so JCI is in an extremely rare position, and evidence from other litigation cannot be used to improve the reliability of the projections. A ten year (2016: ten years) time horizon has been used based on past experience regarding significant changes in the litigation environment that have occurred every few years and on the amount of time taken in the past for some of those changes to impact the broader asbestos litigation environment, and recent events, like the Garlock Sealing Technologies LLC Chapter 11 proceedings, which may lead to further major changes.

The rate of future claims filed has been estimated using well-established tables of asbestos incidence projections to determine the likely population of potential claimants, and JCI's past experience to determine what proportion of this population will make a claim against JCI. The JCI products generally referred to in claims had industrial and marine applications. As a result, the incidence curve used for JCI projections excludes construction workers, and is a composite of the curves that predict asbestos exposure-related disease from shipyards and other occupations. This is consistent with JCI's litigation history.

The rate of successful resolution of claims and the average amount of any judgments awarded are projected based on the past history of JCI claims, since this is the best available evidence, given JCI's unusual strategy of defending all claims.

The future trend of legal costs is estimated based on JCI's past experience, adjusted to reflect the assumed levels of claims and trial activity, since the number of trials is a key driver of legal costs.

John Crane, Inc. litigation insurance recoveries

While JCI has excess liability insurance, the availability of such insurance and scope of the cover are currently the subject of litigation in the United States. Pending the outcome of that litigation, JCI has met defence costs directly. The calculation of the provision does not take account of any potential recoveries from insurers.

22 Provisions and contingent liabilities continued

Non-headline and legacy continued

John Crane, Inc. continued

John Crane, Inc. litigation provision history

The JCI asbestos litigation provision has developed over the last five years as follows:

	Year ended 31 July 2017 £m	Year ended 31 July 2016 £m	Year ended 31 July 2015 £m	Year ended 31 July 2014 £m	Year ended 31 July 2013 £m
John Crane, Inc. litigation provision					
Gross provision	260	267	236	227	233
Discount	(23)	(15)	(20)	(23)	(23)
Discounted provision	**237**	**252**	**216**	**204**	**210**
Operating profit charge/(credit)					
Increased provisions for adverse judgments and legal defence costs	17	8	14	49	23
Change in US risk free rates	(13)	7	1	(2)	(9)
Litigation management, legal fees in connection with litigation against insurers and defence strategy	11	8	4	1	
Recoveries from insurers	(6)	(16)			
Operating profit charge	9	7	19	48	14
Cash-flow					
Provision utilisation	(24)	(22)	(24)	(36)	(27)
John Crane, Inc. litigation spend	32	32	27	25	29

The reduction in 2017 is due to increasing US dollar discount rates, with no material movement in the gross provision.

The significant increase in the provision in 2016 is primarily due to the weakening of Smiths reporting currency against the US dollar (£39m increase in the provision) and lower US discount rates (£7m charge to the income statement).

The operating charge for John Crane, Inc. litigation comprises:

- a charge of £17m (2016: £8m) in respect of the net increased provision for adverse judgments and legal defence costs,
- a credit of £13m arising from an increase in US risk free rates (2016: charge of £7m), and
- £11m (2016: £8m) costs for litigation management, defence strategy and legal fees in connection with litigation against insurers.

In the year ended 31 July 2016 JCI recognised the recovery of £16m through a settlement with an insurer. This agreement does not provide any cover for future costs, so there is no material impact on the closing litigation provision. A further settlement was agreed in the current year.

John Crane, Inc. litigation provision sensitivities

The provision may be subject to potentially material revision from time to time if new information becomes available as a result of future events. There can be no guarantee that the assumptions used to estimate the provision will result in an accurate prediction of the actual costs that may be incurred because of the significant uncertainty associated with the future level of asbestos claims and of the costs arising out of related litigation.

Statistical reliability of projections over the ten year time horizon

In order to evaluate the statistical reliability of the projections, a population of outcomes is modelled using randomised verdict outcomes. This generated a distribution of outcomes with future spend at the 5th percentile of £231m and future spend at the 95th percentile of £304m (2016: £236m and £311m, respectively). Statistical analysis of the distribution of these outcomes indicates that there is a 50% probability that the total future spend will fall between £243m and £272m (2016: between £250m and £280m), compared to the gross provision value of £260m (2016: £267m).

Sensitivity of the projections to changes in the time horizon used

If the asbestos litigation environment becomes more volatile and uncertain, for example if defendants are successful in legal cases against plaintiff law firms and this impacts the nature of claims filed, the time horizon over which the provision can be calculated may reduce. Conversely, if the environment became more stable, or JCI changed approach and committed to long term settlement arrangements, the time period covered by the provision might be extended.

The projections use a 10 year time horizon. Reducing the time horizon by one year would reduce the provision by £17m (2016: £18m) and reducing it by five years would reduce the provision by £98m (2016: £107m).

We consider, after obtaining advice from Bates White LLC, that to forecast beyond ten years requires that the litigation environment remains largely unchanged with respect to the historical experience used for estimating future asbestos expenditures. Historically, the asbestos litigation environment has undergone significant changes more often than every ten years. If one assumed that the asbestos litigation environment would remain unchanged for longer and extended the time horizon by one year it would increase the provision by £14m (2016: £16m) and extending it by five years would increase the provision by £58m (2016: £67m). However, there are also reasonable scenarios that, given certain recent events in the US asbestos litigation environment, would result in no additional asbestos litigation for JCI beyond ten years. At this time, how the asbestos litigation environment may evolve beyond 10 years is not reasonably estimable.

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

Although the methodology used to calculate the JCI litigation provision can in theory be applied to show claims and costs for longer periods, the Directors consider, based on advice from Bates White LLC, that the level of uncertainty regarding the factors used in estimating future costs is too great to provide for reasonable estimation of the numbers of future claims, the nature of such claims or the cost to resolve them for years beyond the 10 year time horizon.

Titeflex Corporation
In recent years Titeflex Corporation, a subsidiary of the Group in the Flex-Tek division, has received a number of claims from insurance companies seeking recompense on a subrogated basis for the effects of damage allegedly caused by lightning strikes in relation to its flexible gas piping product. It has also received a number of product liability claims regarding this product, some in the form of purported class actions. Titeflex Corporation believes that its products are a safe and effective means of delivering gas when installed in accordance with the manufacturer's instructions and local and national codes; however some claims have been settled on an individual basis without admission of liability. Equivalent third-party products in the US marketplace face similar challenges.

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

The assumptions made in assessing the appropriate level of provision, which are based on past experience, include: the period over which expenditure can be reliably estimated; the number of future settlements; the average amount of settlements; and the impact of statutes of repose and safe installation initiatives on the expected number of future claims.

The provision of £84m (2016: £94m) is a discounted pre-tax provision using discount rates, being the risk-free rate on US debt instruments for the appropriate period. The deferred tax asset related to this provision is shown within the deferred tax balance (note 6).

	31 July 2017 £m	31 July 2016 £m
Gross provision	136	140
Discount	(52)	(46)
Discounted pre-tax provision	**84**	**94**
Deferred tax	(33)	(36)
Discounted post-tax provision	**51**	**58**

Titeflex Corporation litigation provision history
An additional provision of £8m (2016: £12m) has been recognised by Titeflex Corporation in respect of changes to the estimated cost of future claims from insurance companies seeking recompense for damage allegedly caused by lightning strikes. The offsetting provision release of £13m is principally due to increasing discount rates.

In 2016, a £1m overprovision for the costs of settling claims was released, generating a net charge for the year of £11m.

Titeflex Corporation litigation provision sensitivities
However, because of the significant uncertainty associated with the future level of claims and of the costs arising out of related litigation, there can be no guarantee that the assumptions used to estimate the provision will result in an accurate prediction of the actual costs that may be incurred and, as a result, the provision may be subject to potentially material revision from time to time if new information becomes available as a result of future events.

The projections incorporate a long-term assumption about the impact of safe installation initiatives on the level of future claims. If the assumed annual benefit of bonding and grounding initiatives was 0.5% higher the provision would be £5m (2016: £6m) lower, and if the benefit was 0.5% lower, the provision would increase by £5m (2016: £7m).

22 Provisions and contingent liabilities continued

Non-headline and legacy continued

Other non-headline and legacy

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

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

Reorganisation and property

At 31 July 2017 there were provisions of £8m (2016: £11m) related to *Fuel for Growth*, £3m (2016: £3m) related to onerous leases and dilapidations provisions, and £2m (2016: £2m) related to actual and potential environmental issues for sites which were no longer occupied by Smiths operations. The *Fuel for Growth* provisions are expected to be utilised in 2018.

Disposal

Other provisions include disposal provisions of £3m (2016: £3m) relating to warranties and other obligations in respect of the disposal of the Marine Systems and Aerospace businesses. Most of the balance is expected to be utilised within the next five years.

23 Share capital

	Number of shares	Issued capital £m	Consideration £m
Ordinary shares of 37.5p each			
Total share capital at 31 July 2015	394,860,004	148	
Exercise of share options	363,068		3
Total share capital at 31 July 2016	**395,223,072**	**148**	
Exercise of share options	253,590		3
Total share capital at 31 July 2017	**395,476,662**	**148**	

At 31 July 2017 all of the issued share capital was in free issue. All issued shares are fully paid.

24 Dividends

The following dividends were declared and paid in the period:

	Year ended 31 July 2017 £m	Year ended 31 July 2016 £m
Ordinary final dividend of 28.75p for 2016 (2015: 28.00p) paid 18 November 2016	114	111
Ordinary interim dividend of 13.55p for 2017 (2016: 13.25p) paid 28 April 2017	53	52
	167	**163**

The final dividend for the year ended 31 July 2017 of 29.70p per share was recommended by the Board on 21 September 2017 and will be paid to shareholders on 17 November 2017, 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 20 October 2017.

25 Reserves

Retained earnings include the value of Smiths Group plc shares held by the Smiths Industries Employee Benefit Trust. In the year the Company issued nil (2016: nil) shares to the Trust, and the Trust purchased 658,217 shares (2016: 760,218 shares) in the market for a consideration of £10m (2016: £8m). At 31 July 2017 the Trust held 766 (2016: 852) ordinary shares.

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

Capital management

Capital employed comprises total equity adjusted for goodwill recognised directly in reserves, net post-retirement benefit related assets and liabilities, net litigation provisions relating to non-headline items and net debt. The efficiency of the allocation of the capital to the divisions is monitored through the return on capital employed (ROCE). This ratio is calculated over a rolling 12-month period and is the percentage that headline operating profit comprises of monthly average capital employed. The ROCE was 16.2% (2016: 15.3%), see note 30.

The capital structure is based on the directors' judgement of the balance required to maintain flexibility while achieving an efficient cost of capital.

The ratio of net debt to headline EBITDA of 1.4 (2016: 1.6) is within the Group's stated policy of 2.0 or less over the medium term. The Group's robust balance sheet and record of strong cash generation is more than able to fund the immediate investment needs and other legacy obligations. See note 30 for the definition of headline EBITDA and the calculation of this ratio.

As part of its capital management the Group strategy is to maintain a solid investment grade credit rating to ensure access to the widest possible sources of financing and to minimise the resulting cost of capital. At 31 July 2017 the Group had a credit rating of BBB+/Baa2 (2016: BBB+/Baa2) with Standard & Poor's and Moody's respectively.

The Board has a progressive dividend policy for future payouts, with the aim of increasing dividends in line with the long-term underlying growth in earnings. In setting the level of dividend payments, the Board will take into account prevailing economic conditions and future investment plans, along with the objective to maintain minimum dividend cover of around 2.0.

Hedge reserve

	31 July 2017 £m	31 July 2016 £m
The hedge reserve on the balance sheet comprises		
– cash-flow hedge reserve	1	(7)
– net investment hedge reserve	(291)	(294)
	(290)	**(301)**

See transactional currency exposure risk management disclosures in note 18 for additional details of cash-flow hedges, and translational currency exposure risk management disclosure also in note 18 for additional details of net investment hedges.

26 Acquisitions

The Group acquired the Morpho Detection business from Safran S. A. on 6 April 2017. The terms of the competition clearance for this transaction required the Group to sell the Morpho Detection explosive trace detection business. Consequently, the Morpho Detection explosive trace detection business was treated as a business acquired for resale, and the trading result during the period of ownership and the loss on disposal have been reported in discontinued operations, see note 27.

The intangible assets recognised on this acquisition comprise technology, in process research and development, customer and service relationships and the order book on acquisition. Goodwill represents the potential future technology developments and the cost savings that can be realised by integrating Morpho Detection with the continuing Smiths Detection business. The goodwill recognised is expected to be deductible for tax purposes.

From the date of acquisition to 31 July 2017, Morpho Detection, excluding its explosive trace detection business, contributed £62m to revenue, £5m to headline profit before taxation and a loss of £24m to profit before taxation due to the unwind of inventory fair value adjustments £3m, the amortisation of acquired intangible assets £8m and integration and acquisition costs £18m. If Smiths had acquired Morpho Detection at the beginning of the financial period, the acquisition, excluding its explosive trace detection business, would have contributed £184m to revenue, £19m to headline profit before taxation and a loss of £22m to profit before taxation.

The provisional balance sheet of Morpho Detection on the date of acquisition is:

	Morpho Detection £m
Non-current assets	
– acquired intangible assets	240
– software	6
– plant and equipment	8
Current assets	
– inventory	50
– trade and other receivables	49
– cash and cash equivalent	12
Morpho Detection explosive trace detection business	68
Non-current liabilities	
– deferred taxation	(5)
Current liabilities	
– other current liabilities	(48)
Net assets acquired	**380**
Goodwill on current year acquisitions	210
Total consideration	**590**
Cash paid during the year	592
Recycling of cash-flow hedging on consideration	(2)
Total consideration	**590**

27 Discontinued operations and businesses held for sale

The Group acquired the Morpho Detection explosive trace detection business on 6 April 2017 after making commitments to the European Commission and the US Department of Justice to sell this business to an approved purchaser. The Group began marketing this business for sale once the terms of the competition clearance were known. Consequently, this business was treated as a business acquired for resale, and the assets and liabilities were classified as held for sale during the period the business was owned by the Group. The sale was completed on 7 July 2017 for a cash consideration of £63m.

A loss after tax of £8m (2016: £nil) was generated by discontinued operations, giving a loss per share from discontinued operations, basic and diluted, of 2.0p (2016: nil). Cash invested in financial assets includes £7m (2016: £nil) relating to discontinued operations.

There were no assets or businesses held for sale at 31 July 2017. At 31 July 2016 the assets and liabilities of the John Crane Artificial lift business were disclosed as held for sale. No impairment loss was recognised on writing these assets down to fair value less disposal costs although impairments were recognised earlier in the year relating to this business, see note 11.

	31 July 2016 £m
Current assets	
Inventories	17
Trade and other receivables	7
Total assets of business held for sale	**24**
Current liabilities	
Trade and other payables	(5)
Total liabilities of business held for sale	**(5)**

28 Disposals

In the year, the Group has sold the John Crane Artificial Lift business (US: 31 October 2016, Romania: 23 November 2016), Smiths Medical's Wallace product line (7 November 2016), the Smiths Interconnect Power business (25 January 2017) and Smiths Interconnect Microwave Telecoms (28 April 2017).

Smiths Medical's Wallace product line was fully integrated, so products will continue to be manufactured on behalf of the acquirer under a Manufacturing Transition Services Agreement while the acquirer is setting up their manufacturing capacity. This activity has been treated as ongoing trading activity.

	John Crane Artificial lift £m	Smiths Medical Wallace £m	Smiths Interconnect Power £m	Smiths Interconnect Microwave Telecoms £m	Other £m	Total £m
Consideration	30	134	170	91		425
Less: transaction costs	(1)	(2)	(6)	(6)		(15)
Net consideration received	**29**	**132**	**164**	**85**		**410**
Net assets disposed of:						
– intangible assets		(32)	(134)	(12)		(178)
– property, plant and equipment			(2)	(4)		(6)
– inventory	(17)		(12)	(16)		(45)
– trade and other receivables	(11)		(19)	(20)	(1)	(51)
– tax	(1)		(3)	(3)		(7)
– cash and cash equivalents			(5)	(6)		(11)
– liabilities	5		18	20		43
Net assets	**(24)**	**(32)**	**(157)**	**(41)**	**(1)**	**(255)**
Recycling of foreign exchange	(1)		15	6		20
Profit on disposals	**4**	**100**	**22**	**50**	**(1)**	**175**

29 Cash-flow

Cash-flow from operating activities

	Year ended 31 July 2017			Year ended 31 July 2016		
	Headline £m	Non-headline £m	Total £m	Headline £m	Non-headline £m	Total £m
Operating profit	589	85	674	510	(123)	387
Amortisation of intangible assets	44	18	62	43	15	58
Impairment of intangible assets					23	23
Impairment of trade investments					2	2
Depreciation of property, plant and equipment	57		57	53		53
Impairment of property, plant and equipment					6	6
Loss on disposal of property, plant and equipment	4		4	2		2
Profit on disposal of business		(175)	(175)			
Share-based payment expense	13	1	14	9		9
Retirement benefits	1	(94)	(93)	1	(104)	(103)
Decrease in inventories	52		52	30		30
Decrease/(increase) in trade and other receivables	31	8	39	(21)	(16)	(37)
Increase/(decrease) in trade and other payables	8	8	16	1		1
(Decrease)/Increase in provisions	(6)	(34)	(40)	(1)	3	2
Cash generated from operations	**793**	**(183)**	**610**	**627**	**(194)**	**433**
Interest paid	(65)		(65)	(61)		(61)
Interest received	5	11	16	3	45	48
Tax paid	(82)		(82)	(62)		(62)
Net cash inflow from operating activities	**651**	**(172)**	**479**	**507**	**(149)**	**358**

Interest received in the period includes £6m (2016: Interest received includes £41m cash inflows) on foreign exchange contracts hedging exposures on intra-group loans, and £5m exchange gains (2016: £4m exchange gains) realised on internal interest.

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

Retirement benefit contributions in 2016 included cash contributions of £123m and a non-cash transaction where £152m of financial assets were contributed to the Smiths Industries Pension Scheme

Headline cash measures

The Group measure of headline operating cash excludes interest and tax and includes capital expenditure supporting organic growth.

	Year ended 31 July 2017			Year ended 31 July 2016		
	Headline £m	Non-headline £m	Total £m	Headline £m	Non-headline £m	Total £m
Net cash inflow from operating activities	**651**	**(172)**	**479**	**507**	**(149)**	**358**
Include						
Expenditure on capitalised development, other intangible assets and property, plant and equipment	(107)		(107)	(108)		(108)
Disposals of property, plant and equipment	9		9	1		1
Investment in financial assets relating to operating activities and pensions financing	(5)	(6)	(11)		(8)	(8)
Free cash-flow	**548**	**(178)**	**370**	**400**	**(157)**	**243**
Exclude						
Investment in financial assets relating to operating activities and pensions financing outstanding at the balance sheet	5	6	11			
Interest paid	65		65	61		61
Interest received	(5)	(11)	(16)	(3)	(45)	(48)
Tax paid	82		82	62		62
Headline operating cash-flow	**695**	**(183)**	**512**	**520**	**(202)**	**318**

Reconciliation of headline free cash-flow to total movement in cash and cash-equivalents

	Year ended 31 July 2017 £m	Year ended 31 July 2016 £m
Free cash-flow	**370**	**243**
Investment in other financial assets	(7)	(1)
Acquisition of businesses	(580)	(8)
Disposal of businesses and discontinued operations	462	
Net cash-flow used in financing activities	116	(332)
Net increase/(decrease) cash and cash equivalents	**361**	**(98)**

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30 Non-statutory capital and credit metrics

In addition to the non-statutory profit measures explained in note 3, the Company calculates credit metrics and return on capital employed incorporating the same adjustments. See the disclosures on presentation of results in accounting policies for an explanation of the excluded items.

Return on capital employed (ROCE)

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

See note 1 for the divisional headline operating profit and average divisional capital employed used to calculate divisional ROCE.

Capital employed

Capital employed is a non-statutory measure of invested resources. It comprises statutory net assets adjusted to add goodwill recognised directly in reserves in respect of subsidiaries acquired before 1 August 1998 of £787m (31 July 2016: £815m) and eliminate post-retirement benefit assets and liabilities and litigation provisions relating to non-headline items, both net of related tax, and net debt.

	Notes	31 July 2017 £m	31 July 2016 £m
Net assets		**2,104**	**1,660**
Adjust for			
Goodwill recognised directly in reserves		787	815
Post-retirement benefit assets and liabilities	8	(224)	(80)
Tax related to post retirement benefit assets and liabilities		22	(4)
John Crane, Inc. litigation provisions and related tax	22	158	168
Titeflex Corporation litigation provisions and related tax	22	51	58
Net debt	17	967	978
Capital employed		**3,865**	**3,595**

Return on capital employed

	Notes	Year ended 31 July 2017 £m	Year ended 31 July 2016 £m
Headline operating profit for previous twelve months		589	510
Average capital employed	1	3,639	3,324
ROCE		**16.2%**	**15.3%**

Credit metrics

Smiths Group monitors the ratio of net debt to Headline EBITDA as part of its management of credit ratings, see note 25 for details. This ratio is calculated as follows.

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

	Notes	Year ended 31 July 2017 £m	Year ended 31 July 2016 £m
Headline operating profit		**589**	**510**
Exclude			
– depreciation	12	57	53
– amortisation of development costs	10	27	26
– amortisation of software, patents and intellectual property	10	17	17
Headline EBITDA		**690**	**606**

£1m of software amortisation was charged to restructuring projects, so treated as a non-headline cost.

Ratio of net debt to headline EBITDA

	Notes	Year ended 31 July 2017 £m	Year ended 31 July 2016 £m
Headline EBITDA		690	606
Net debt	17	967	978
Ratio of net debt to headline EBITDA		**1.4**	**1.6**

UNAUDITED GROUP FINANCIAL RECORD 2013-2017

	Year ended 31 July 2017 £m	Year ended 31 July 2016 £m	Year ended 31 July 2015 £m	Year ended 31 July 2014 £m	Year ended 31 July 2013 £m
Income statement metrics – headline					
Revenue	3,280	2,949	2,897	2,952	3,109
Headline operating profit	589	510	511	504	560
Headline profit before tax	528	451	459	445	498
Income statement metrics – statutory					
Operating profit	674	387	394	378	487
Profit before taxation	601	346	325	302	396
Profit after taxation	572	261	248	235	317
Balance sheet metrics					
Net borrowings	(967)	(978)	(818)	(804)	(744)
Shareholders' equity	2,089	1,646	1,419	1,237	1,486
Average capital employed	3,639	3,324	3,197	3,218	3,362
Ratios					
Headline operating profit: revenue (%)	18.0	17.3	17.6	17.1	18.0
Headline effective tax rate (%)	26.5	25.0	25.5	27.0	26.5
Return on capital employed (%)	16.2	15.3	16.0	15.7	16.6
Return on shareholders' funds (%)	14.5	14.3	15.8	14.9	17.8
Cash-flow					
Headline operating cash	695	520	484	490	548
Headline operating cash conversion (%)	118	102	95	97	98
Statutory free cash-flow	370	243	158	143	237
Statutory free cash-flow per share (p)	93.6	61.1	40.1	36.2	60.3
Earnings per share					
Headline earnings per share (p)	97.6	85.2	86.1	81.8	92.7
Dividends					
Pence per share	43.25	42.00	41.00	40.25	39.50
Special dividend					30.00
Headline dividend cover	2.3	2.0	2.1	2.0	2.3
Number of employees (000s)					
United Kingdom	1.5	1.5	1.7	1.8	1.9
Overseas	20.4	20.5	21.6	21.4	21.4
	21.9	22.0	23.3	23.2	23.3

UNAUDITED SUPPLEMENTARY CONSOLIDATED INCOME STATEMENT – US DOLLAR TRANSLATION

	Notes	Year ended 31 July 2017 Headline $m	Year ended 31 July 2017 Non-headline (note 3) $m	Year ended 31 July 2017 Total $m	Year ended 31 July 2016 Headline $m	Year ended 31 July 2016 Non-headline (note 3) $m	Year ended 31 July 2016 Total $m
Continuing operations							
Revenue	1	4,158		4,158	4,315		4,315
Cost of sales		(2,225)		(2,225)	(2,342)		(2,342)
Gross profit		1,933		1,933	1,973		1,973
Sales and distribution costs		(570)		(570)	(589)		(589)
Administrative expenses		(616)	(115)	(731)	(637)	(203)	(840)
Other operating income						23	23
Profit on business disposal	28		223	223			
Operating profit	2	**747**	**108**	**855**	**747**	**(180)**	**567**
Interest receivable		6		6	5		5
Interest payable		(84)		(84)	(91)		(91)
Other financing gains/(losses)			(18)	(18)		21	21
Other finance charges – retirement benefits	8		3	3		4	4
Finance costs	4	(78)	(15)	(93)	(86)	25	(61)
Continuing operations – Profit before taxation		**669**	**93**	**762**	**661**	**(155)**	**506**
Taxation	6	(178)	141	(37)	(165)	41	(124)
Continuing operations – Profit for the year		**491**	**234**	**725**	**496**	**(114)**	**382**
Discontinued operations							
(Loss)/profit – discontinued operations	27		(10)	(10)			
Profit for the year		**491**	**224**	**715**			
Attributable to							
Smiths Group shareholders – continuing operations		488	234	722	493	(114)	379
Smiths Group shareholders – discontinued operations			(10)	(10)			
Non-controlling interests in respect of continuing operations		3		3	3		3
		491	**224**	**715**	**496**	**(114)**	**382**
Earnings per share	5						
Basic				180.1c			95.9c
Basic – continuing				182.7c			95.9c
Diluted				177.8c			95.1c
Diluted – continuing				180.3c			95.1c

Assets and liabilities have been translated into US dollars at the exchange rate at the date of that balance sheet and income, expenses and cash-flows are translated at average exchange rates for the period. This reflects the accounting approach that Smiths Group plc would use if the Group moved to reporting in US dollars without making any changes to its Group structure or financing arrangements.

UNAUDITED SUPPLEMENTARY CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME – US DOLLAR TRANSLATION

	Notes	Year ended 31 July 2017 $m	Year ended 31 July 2016 $m
Profit for the period		**715**	**382**
Other comprehensive income			
Actuarial gains/(losses) on retirement benefits	8	70	(59)
Taxation recognised on actuarial movements	6	(16)	15
Other comprehensive income and expenditure which will not be reclassified to the consolidated income statement		**54**	**(44)**
Other comprehensive income which will be reclassified and reclassifications			
Exchange gains/(losses)		49	240
Cumulative exchange gains recycled on disposal		(52)	
Fair value gains/(losses) and reclassification adjustments			
– deferred on available for sale financial assets		1	(3)
– reclassified to income statement on available for sale financial assets	4		(28)
– deferred in the period on cash-flow and net investment hedges		(18)	(348)
– reclassified to income statement on cash-flow and net investment hedges		31	
Taxation recognised on fair value gains	6	(1)	
Total other comprehensive income		**64**	**(183)**
Total comprehensive income		**779**	**199**
Attributable to			
Smiths Group shareholders		778	192
Non-controlling interests		1	7
		779	**199**

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UNAUDITED SUPPLEMENTARY CONSOLIDATED BALANCE SHEET – US DOLLAR TRANSLATION

	Notes	31 July 2017 $m	31 July 2016 $m
Non-current assets			
Intangible assets	10	2,657	2,304
Property, plant and equipment	12	415	417
Financial assets – other investments	16	28	12
Retirement benefit assets	8	514	434
Deferred tax assets	6	359	326
Trade and other receivables	14	74	67
Financial derivatives	19	75	38
		4,122	**3,598**
Current assets			
Inventories	13	597	632
Current tax receivable	6	82	82
Trade and other receivables	14	952	986
Cash and cash equivalents	17	1,032	571
Financial derivatives	19	17	16
		2,680	**2,287**
Assets of businesses held for sale	27		**31**
Total assets		**6,802**	**5,916**
Non-current liabilities			
Financial liabilities			
– borrowings	17	(2,108)	(1,506)
– financial derivatives	19	(3)	(1)
Provisions for liabilities and charges	22	(374)	(403)
Retirement benefit obligations	8	(219)	(329)
Deferred tax liabilities	6	(146)	(126)
Trade and other payables	15	(35)	(38)
		(2,885)	**(2,403)**
Current liabilities			
Financial liabilities			
– borrowings	17	(199)	(359)
– financial derivatives	19	(12)	(23)
Provisions for liabilities and charges	22	(111)	(124)
Trade and other payables	15	(760)	(708)
Current tax payable	6	(60)	(95)
		(1,142)	**(1,309)**
Liabilities of businesses held for sale	27		**(7)**
Total liabilities		**(4,027)**	**(3,719)**
Net assets		**2,775**	**2,197**
Shareholders' equity			
Share capital	23	196	196
Share premium account		468	466
Capital redemption reserve		7	7
Revaluation reserve		2	2
Merger reserve		311	311
Retained earnings		2,155	1,594
Hedge reserve	25	(383)	(398)
Total shareholders' equity		**2,756**	**2,178**
Non-controlling interest equity		19	19
Total equity		**2,775**	**2,197**

UNAUDITED SUPPLEMENTARY CONSOLIDATED STATEMENT OF CHANGES IN EQUITY – US DOLLAR TRANSLATION

	Notes	Share capital and share premium $m	Other reserves $m	Retained earnings $m	Hedge reserve $m	Equity shareholders' funds $m	Non-controlling Interest $m	Total equity $m
At 31 July 2016		662	320	1,594	(398)	2,178	19	2,197
Profit for the period				712		712	3	715
Other comprehensive income								
Exchange (losses)/gains		(1)		(2)	2	(1)	(2)	(3)
Actuarial gains on retirement benefits and tax				54		54		54
Fair value gains/(losses)					13	13		13
Total comprehensive income for the period		**(1)**		**764**	**15**	**778**	**1**	**779**
Transactions relating to ownership interests								
Exercises of share options	23	3				3		3
Taxation recognised on share options	6			3		3		3
Purchase of own shares	25			(13)		(13)		(13)
Dividends								
– equity shareholders	24			(212)		(212)		(212)
– non-controlling interests							(1)	(1)
Share-based payment	9			19		19		19
At 31 July 2017		**664**	**320**	**2,155**	**(383)**	**2,756**	**19**	**2,775**

	Notes	Share capital and share premium $m	Other reserves $m	Retained earnings $m	Hedge reserve $m	Equity shareholders' funds $m	Non-controlling Interest $m	Total equity $m
At 31 July 2015		777	379	1,161	(98)	2,219	13	2,232
Profit for the year				379		379	3	382
Other comprehensive income								
Actuarial losses on retirement benefits and related tax				(44)		(44)		(44)
Exchange (losses)/gains		(120)	(59)	367	48	236	4	240
Fair value gains/(losses) and related tax				(31)	(348)	(379)		(379)
Total comprehensive income for the year		**(120)**	**(59)**	**671**	**(300)**	**192**	**7**	**199**
Transactions relating to ownership interests								
Exercises of share options	23	5				5		5
Purchase of own shares	25			(12)		(12)		(12)
Dividends								
– equity shareholders	24			(239)		(239)		(239)
– non-controlling interest							(1)	(1)
Share-based payment	9			13		13		13
At 31 July 2016		**662**	**320**	**1,594**	**(398)**	**2,178**	**19**	**2,197**

UNAUDITED SUPPLEMENTARY CONSOLIDATED CASH-FLOW STATEMENT – US DOLLAR TRANSLATION

	Notes	Year ended 31 July 2017 $m	Year ended 31 July 2016 $m
Net cash inflow from operating activities	29	**607**	**524**
Cash-flows from investing activities			
Expenditure on capitalised development		(47)	(34)
Expenditure on other intangible assets	10	(10)	(16)
Purchases of property, plant and equipment	12	(79)	(108)
Disposals of property, plant and equipment		11	1
Investment in financial assets	16, 27	(23)	(13)
Acquisition of businesses	26	(735)	(12)
Disposals of businesses – continuing operations	28	506	
Disposals of businesses – discontinued operations	27	80	
Net cash-flow used in investing activities		**(297)**	**(182)**
Cash-flows from financing activities			
Proceeds from exercise of share options	23	5	4
Purchase of own shares	25	(13)	(12)
Dividends paid to equity shareholders	24	(212)	(239)
Dividends paid to non-controlling interests		(1)	(1)
Cash (outflow)/inflow from matured derivative financial instruments			(19)
Increase in new borrowings	17	692	1
Reduction and repayment of borrowings	17	(324)	(221)
Net cash-flow used in financing activities		**147**	**(487)**
Net increase/(decrease) in cash and cash equivalents		**457**	**(145)**
Cash and cash equivalents at beginning of year		569	774
Exchange differences		4	(60)
Cash and cash equivalents at end of year	17	**1,030**	**569**
Cash and cash equivalents at end of year comprise			
– cash at bank and in hand		298	213
– short-term deposits		733	358
– bank overdrafts		(1)	(2)
		1,030	**569**
Included in cash and cash equivalents per the balance sheet		1,031	571
Included in overdrafts per the balance sheet		(1)	(2)
		1,030	**569**

Reconciliation of net cash-flow to movement in net debt

	Notes	Year ended 31 July 2017 $m	Year ended 31 July 2016 $m
Net debt at start of year	17	**(1,294)**	**(1,278)**
Net increase/(decrease) in cash and cash equivalents		457	(145)
Increase in borrowings		(692)	(1)
Reduction and repayment of borrowings		324	221
Movement in net debt resulting from cash-flows		**89**	**75**
Capitalisation, interest accruals and unwind of capitalisation fees		(4)	(3)
Movement from fair value hedging		6	(33)
Exchange differences		(72)	(55)
Movement in net debt in the year		**19**	**(16)**
Net debt at end of year	17	**(1,275)**	**(1,294)**

UNAUDITED GROUP US DOLLAR FINANCIAL RECORD 2013-2017

	Year ended 31 July 2017 $m	Year ended 31 July 2016 $m	Year ended 31 July 2015 $m	Year ended 31 July 2014 $m	Year ended 31 July 2013 $m
Income statement metrics – headline					
Revenue	4,158	4,315	4,525	4,849	4,866
Headline operating profit	747	747	798	828	876
Headline profit before tax	669	661	717	730	780
Income statement metrics – statutory					
Operating profit	855	567	616	620	762
Profit before taxation	762	506	509	496	620
Profit after taxation	715	382	388	385	496
Balance sheet metrics					
Net borrowings	(1,275)	(1,294)	(1,278)	(1,358)	(1,129)
Shareholders' equity	2,756	2,178	2,219	2,090	2,255
Average capital employed	4,800	4,864	4,994	5,287	5,263
Ratios					
Headline operating profit: revenue (%)	18.0	17.3	17.6	17.1	18.0
Headline effective tax rate (%)	26.5	25.0	25.5	27.0	26.5
Return on capital employed (%)	16.2	15.3	15.9	15.8	16.7
Return on shareholders' funds (%)	14.2	14.6	15.3	15.1	18.1
Cash-flow					
Headline operating cash	881	760	756	804	858
Headline operating cash conversion (%)	118	102	95	97	98
Statutory free cash-flow	469	356	247	235	371
Statutory free cash-flow per share (c)	118.6	89.4	62.6	59.5	94.4
Earnings per share					
Headline earnings per share (c)	123.6	124.6	134.5	134.4	145.1
Dividends					
Cents per share (c)	54.8	61.5	64.0	66.1	61.8
Special dividend (c)					49.3
Headline dividend cover	2.3	2.0	2.1	2.0	2.3
Number of employees (000s)					
United States of America	7.7	7.9	8.4	8.3	8.5
Rest of World	14.2	14.1	14.9	14.9	14.8
	21.9	22.0	23.3	23.2	23.3

COMPANY BALANCE SHEET

	Notes	31 July 2017 £m	31 July 2016 £m
Fixed assets			
Intangible assets	2		
Tangible assets	3	1	1
Investments and advances	4	3,573	3,487
Financial assets	5	7	
Deferred tax assets	6	17	
		3,598	**3,488**
Current assets			
Retirement benefit assets			
– amounts falling due after more than one year	12	390	327
Debtors			
– amounts falling due within one year	7	69	59
Cash at bank and on deposit	9	468	207
Financial derivatives			
– amounts falling due within one year	10	1	4
– amounts falling due after more than one year	10	56	29
		984	**626**
Creditors: amounts falling due within one year	8	(411)	(363)
Financial derivatives: amounts falling due within one year	10	(1)	(3)
Net current assets		**572**	**260**
Total assets less current liabilities		**4,170**	**3,748**
Creditors: amounts falling due after more than one year	9	(1,597)	(1,137)
Provisions for liabilities and charges	11	(2)	(2)
Retirement benefit liabilities	12	(62)	(65)
Financial derivatives: amounts falling due after more than one year	10	(1)	
Net assets including pension liabilities		**2,508**	**2,544**
Capital and reserves			
Called up share capital	13	148	148
Share premium account	13	355	352
Capital redemption reserve	13	6	6
Other reserves	13	181	181
Profit and loss account	13	1,818	1,857
Shareholders' equity		**2,508**	**2,544**

The accounts on pages 196 to 206 were approved by the Board of Directors on 21 September 2017 and were signed on its behalf by:

Andy Reynolds Smith
Chief Executive

Bill Seeger
Chief Financial Officer

Smiths Group plc – registered number 137013

COMPANY STATEMENT OF CHANGES IN EQUITY

	Share capital £m	Share premium £m	Capital redemption reserve £m	Other reserves £m	Retained profit £m	Shareholders' equity £m
At 31 July 2016	148	352	6	181	1,857	2,544
Profit for the period					96	96
Other comprehensive income						
Actuarial gain on retirement benefits					34	34
Taxation recognised on retirement benefits					(6)	(6)
Total comprehensive income					**124**	**124**
Transactions with owners						
Exercise of share options		3				3
Purchase of own shares					(10)	(10)
Dividends paid to equity shareholders					(167)	(167)
Share-based payment					14	14
Total transactions with owners recognised in equity		**3**			**(163)**	**(160)**
At 31 July 2017	**148**	**355**	**6**	**181**	**1,818**	**2,508**

	Share capital £m	Share premium £m	Capital redemption reserve £m	Other reserves £m	Retained profit £m	Shareholders' equity £m
At 31 July 2015	148	349	6	181	2,042	2,726
Profit for the period					17	17
Other comprehensive income						
Actuarial loss on retirement benefits					(21)	(21)
Taxation recognised on retirement benefits					4	4
Fair value losses on available for sale financial assets					(4)	(4)
Fair value gains reclassified to the income statement on available for sale financial assets					(19)	(19)
Total comprehensive income					**(23)**	**(23)**
Transactions with owners						
Exercise of share options		3				3
Purchase of own shares					(8)	(8)
Dividends paid to equity shareholders					(163)	(163)
Share-based payment					9	9
Total transactions with owners recognised in equity		**3**			**(162)**	**(159)**
At 31 July 2016	**148**	**352**	**6**	**181**	**1,857**	**2,544**

Basis of preparation

The accounts have been prepared in accordance with the Companies Act 2006 and Financial Reporting Standard 101, "Reduced Disclosure Framework" (FRS 101).

These accounts have been prepared on a going concern basis and under the historical cost convention modified to include revaluation of certain financial instruments, share options and pension assets and liabilities held at fair value.

As permitted by Section 408(3) of the Companies Act 2006, the Company's income statement and statement of comprehensive income have not been presented. As permitted by Section 408(2), information about the Company's employee numbers and costs is not presented.

Exemptions from the requirements of IFRS applied in accordance with FRS 101

The following exemptions from the requirements of IFRS have been applied in the preparation of these financial statements, in accordance with FRS 101:

- Paragraphs 45(b) and 46 to 52 of IFRS 2, 'Share-based payment' (details of the number and weighted-average exercise prices of share options, and how the fair value of goods or services received was determined)
- IFRS 7, 'Financial Instruments: Disclosures'
- Paragraphs 91 to 99 of IFRS 13, 'Fair value measurement' (disclosure of valuation techniques and inputs used for fair value measurement of assets and liabilities).
- Paragraph 38 of IAS 1, 'Presentation of financial statements' comparative information requirements in respect of:
  - paragraph 79(a)(iv) of IAS 1;
  - paragraph 73(e) of IAS 16 'Property, plant and equipment';
- The following paragraphs of IAS 1, 'Presentation of financial statements':
  - 10(d), (statement of cash flows),
  - 16 (statement of compliance with all IFRS),
  - 38A (requirement for minimum of two primary statements, including cash flow statements),
  - 38B-D (additional comparative information),
  - 111 (cash flow statement information), and
  - 134-136 (capital management disclosures)
- IAS 7, 'Statement of cash flows'
- Paragraph 30 and 31 of IAS 8 'Accounting policies, changes in accounting estimates and errors' (requirement for the disclosure of information when an entity has not applied a new IFRS that has been issued but is not yet effective)
- Paragraph 17 of IAS 24, 'Related party disclosures' (key management compensation)
- The requirements in IAS 24, 'Related party disclosures' to disclose related party transactions entered into between two or more members of a group.

Significant judgements, key assumptions and estimates

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

Taxation

The Company has recognised deferred tax assets of £55m (2016: £44m) relating to revenue losses brought forward. The recognition of these assets is dependent on the ability to recover them against the unwind of other tax positions and forecast UK taxable profits of the tax group. The treatment of these assets is reviewed regularly. Further detail on the Company's deferred taxation position is included in note 6.

Retirement benefits

The financial statements include costs in relation to, and provision for, retirement benefit obligations. The costs and the present value of any related pension assets and liabilities depend on such factors as life expectancy of the members, the returns that plan assets generate and the discount rate used to calculate the present value of the liabilities. The Company uses previous experience and independent actuarial advice to select the values of critical estimates. The estimates, and the effect of variances in key estimates, are disclosed in note 8 to the consolidated accounts.

At 31 July 2017 there is a retirement benefit asset of £390m (2016: £327m) which arises from the rights of the employers to recover the surplus at the end of the life of the scheme. If the pension schemes were wound up while they still had members, the schemes would need to buy out the benefits of all members. The buyouts would cost significantly more than the present value of the scheme liabilities calculated in accordance with IAS 19: Employee benefits.

Investment carrying value

Investments in subsidiary undertakings and loans due from subsidiaries are reviewed regularly, and tested if there are any indications of impairment, or problems with recoverability. The recoverable amounts of investments are determined based on valuations of the underlying trading operations. The recoverability of loans is assessed by looking at the credit quality of the subsidiary and any support available to the subsidiary. These calculations require the use of estimates including projected future cash-flows and other future events.

Foreign currencies

Foreign currency transactions are recorded at the exchange rate ruling on the date of transaction. Foreign exchange gains and losses resulting from the settlement of such transactions, and from the retranslation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies, are recognised in the profit and loss account.

Operating leases

Payments made under operating leases are charged to the profit and loss account as incurred over the term of the lease.

Where a leasehold property is vacant, or sub-let under terms such that the rental income is insufficient to meet all outgoings, provision is made for the anticipated future shortfall up to termination of the lease.

Property, plant and equipment

Depreciation is provided at rates estimated to write off the relevant assets by equal annual amounts over their expected useful lives. In general, the rates used are: Freehold and long leasehold property – 2%; Short leasehold property – over the period of the lease; Plant, machinery, etc. – 10% to 20%; Fixtures, fittings, tools and other equipment – 10% to 33%.

Investments in shares in Group companies

The Company's investments in shares in Group companies are stated at cost less provision for impairment. Any impairment is charged to the profit and loss account as it arises.

Financial instruments

The policies disclosed in the Group accounting policies on pages 143 to 147 for recognition, measurement and presentation of financial instruments are applied in the Company accounts.

Taxation
Deferred tax is provided using the balance sheet liability method. A deferred tax asset is recognised where it is probable that future taxable income will be sufficient to utilise the available relief.

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

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

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

Post-retirement benefits
The Company has both defined benefit and defined contribution plans.

For defined benefit plans the liability for each scheme recognised in the balance sheet is the present value of the defined benefit obligation at the balance sheet date less the fair value of plan assets. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of AA corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension liability. Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are recognised in full when they occur and presented in the statement of other comprehensive income.

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

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

Share-based payment
The Company operates a number of equity-settled and cash-settled share-based compensation plans.

The fair value of the shares or share options granted is recognised over the vesting period to reflect the value of the employee services received. The charge relating to grants to employees of the Company is recognised as an expense in the profit and loss account and the charge for grants to employees of other group companies is recognised as an investment in the relevant subsidiary.

The fair value of options granted, excluding the impact of any non-market vesting conditions, is calculated using established option pricing models, principally binomial models. The probability of meeting non-market vesting conditions, which include profitability targets, is used to estimate the number of share options that are likely to vest.

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

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

1 Audit fee

The audit fee for the Parent Company was £0.1m (2016: £0.1m).

2 Intangible assets

	Software £m
Cost or valuation	
At 31 July 2016 and 31 July 2017	**5**
Amortisation	
At 31 July 2016 and 31 July 2017	**5**
Net book value at 31 July 2017	
Net book value at 31 July 2016	

Intangible assets comprise computer software.

3 Tangible assets

	Plant and equipment £m
Cost or valuation	
At 31 July 2016	3
Additions	
At 31 July 2017	**3**
Depreciation	
At 31 July 2016	2
Disposals	
At 31 July 2017	**2**
Net book value at 31 July 2017	**1**
Net book value at 31 July 2016	1

Plant and equipment comprises plant, machinery, fixtures, fittings, tools and equipment, including computer hardware.

4 Investments and advances

	Shares in subsidiary undertakings £m	Loans due from subsidiaries £m	Total £m
Cost or valuation			
At 31 July 2016	2,397	1,101	3,498
Exchange adjustments		17	17
Contribution through share options	7		7
Increases in advances due from/(due to) subsidiaries		62	62
At 31 July 2017	**2,404**	**1,180**	**3,584**
Provision for impairment			
At 31 July 2016 and 31 July 2017	**10**	**1**	**11**
Net book value at 31 July 2017	**2,394**	**1,179**	**3,573**
Net book value at 31 July 2016	2,387	1,100	3,487

Loans due to subsidiaries are offset against loans due from subsidiaries to the extent that there is a legal right of set off and an intention to settle the balances net. At 31 July 2017 £2,088m of loans payable are offset against loans receivable (2016: £1,372m). The Company has large offsetting loan balances because it uses loans to reduce its foreign currency exposures and separately monitor net cash generated from trading activities.

The Company's subsidiaries are largely held according to business lines by the following holding companies, which are incorporated in England:
Smiths Group International Holdings Limited
Smiths Detection Group Limited
John Crane Group Limited
Smiths Medical Group Limited
Smiths Interconnect Group Limited

The principal subsidiaries and their countries of incorporation are:

England
Smiths Detection – Watford Ltd
Smiths Medical International Limited
John Crane UK Limited

Europe
Smiths Heimann SAS (France)
Smiths Heimann GmbH (Germany)
Smiths Medical France SA (France)
Smiths Medical Deutschland GmbH (Germany)
John Crane Italia SpA (Italy)

Other
Smiths Detection (Asia-Pacific) Pte Ltd (Singapore)
Smiths Medical Japan Limited (Japan)
John Crane Middle East FZE (UAE)

United States
Smiths Detection, Inc.
Smiths Medical ASD, Inc.
John Crane, Inc.
Titeflex Corporation
Flexible Technologies, Inc.
Tutco, LLC.
Hypertronics Corporation
Smiths Interconnect Americas, Inc.

Of the companies above, Smiths Group International Holdings Limited is 100% owned directly by the Company. The others are 100% owned through intermediate holding companies. Shareholdings are of ordinary shares or common stock. All subsidiaries operate in their country of incorporation.

See pages 207 to 214 for a complete list of subsidiary undertakings.

5 Financial assets

At 31 July 2017 £7m (2016: £nil) was held on deposit with banks as security for liabilities or letters of credit.

6 Deferred tax assets

The Company has recognised the following deferred tax assets and liabilities:

	Share-based payment £m	Retirement benefit obligations £m	Losses carried forward £m	Other £m	Total £m
At 31 July 2016	2	(48)	44	2	
Credit/(charge) to income statement	1	11	11	(1)	22
Charge to equity	1	(6)			(5)
At 31 July 2017	**4**	**(43)**	**55**	**1**	**17**

The Company is part of a UK tax group including all its UK-based subsidiaries. The Company has recognised deferred tax assets of £55m (2016: £44m) relating to revenue losses brought forward. The recognition of these assets is dependent on the ability to recover them against the unwind of other tax positions and forecast UK taxable profits of the tax group. The timing of the unwind of other tax positions depends on the impact of pension contributions on the UK tax base. The treatment of these assets is reviewed regularly.

At 31 July 2017 the Company has unrecognised deferred tax assets of £nil (2016: £19m relating to retirement benefit obligations).

7 Trade and other receivables

	31 July 2017 £m	31 July 2016 £m
Amounts falling due within one year		
Amounts owed by subsidiaries	59	55
Other receivables	10	4
	69	**59**

8 Creditors: amounts falling due within one year

	31 July 2017 £m	31 July 2016 £m
Amounts falling due within one year		
Term loans due within one year (note 9)	133	255
Amounts owed to subsidiaries	231	80
Other creditors	30	18
Accruals and deferred income	17	10
	411	**363**

9 Borrowings and net debt

	31 July 2017 £m	31 July 2016 £m
Cash at bank	8	7
Short term deposits	460	200
Cash and cash equivalents	**468**	**207**
Term loans due within one year (note 8)	(133)	(255)
Term loans due after more than one year	(1,597)	(1,137)
Borrowings	**(1,730)**	**(1,392)**
Net debt	**(1,262)**	**(1,185)**

Term loans

The currency and coupons for the term loans are disclosed in note 17 of the Group accounts.

	31 July 2017 £m	31 July 2016 £m
Less than one year	133	255
Between one and two years	189	132
Between two and three years		189
Between three and four years		
Between four and five years		
Greater than five years	1,408	816
Smiths Group plc term loans	**1,730**	**1,392**

See the liquidity risk disclosures in note 18 in the Group accounts for information on the cash and borrowing facilities available to the Group. The Company can borrow an additional $800m under the US$800m multi-currency revolving credit facility, which matures in February 2021.

10 Derivatives

The tables below set out the nominal amount and fair value of derivative contracts held by the Company:

	At 31 July 2017			
	Contract or underlying nominal amount			Fair value
	£m	Assets £m	Liabilities £m	Net £m
Foreign exchange contracts (not hedge accounted)	165	1	(1)	
Currency swaps (net investment hedges)	109			
Cross currency swaps (fair value and net investment hedges)	569	56		56
Interest rate swaps (fair value hedges)	113		(1)	(1)
Total financial derivatives	**956**	**57**	**(2)**	**55**
Balance sheet entries				
Non-current		56	(1)	55
Current		1	(1)	
Total financial derivatives		**57**	**(2)**	**55**

	At 31 July 2016			
	Contract or underlying nominal amount			Fair value
	£m	Assets £m	Liabilities £m	Net £m
Foreign exchange contracts (not hedge accounted)	437	2	(2)	
Currency swaps (net investment hedges)	111		(1)	(1)
Cross currency swaps (fair value and net investment hedges)	326	25		25
Interest rate swaps (fair value hedges)	214	6		6
Total financial derivatives	**1,088**	**33**	**(3)**	**30**
Balance sheet entries				
Non-current		29		29
Current		4	(3)	1
Total financial derivatives		**33**	**(3)**	**30**

11 Provisions for liabilities and charges

	At 31 July 2016 £m	Charged against profit £m	Utilisation £m	At 31 July 2017 £m
Disposals	2			2
	2			**2**

The closing disposal provision relates to warranties and other obligations in respect of a past disposal and is expected to be utilised within the next five years.

12 Post-retirement benefits

The Company is the principal employer for the two major defined benefit plans in the UK. The Company is accounting for all the UK defined benefit schemes (funded and unfunded) and virtually all of the post-retirement healthcare schemes.

The retirement benefit assets and liabilities comprise:

	31 July 2017 £m	31 July 2016 £m
Market value of scheme assets	3,959	4,034
Present value of funded scheme liabilities	(3,571)	(3,709)
Surplus	388	325
Unfunded pension plans	(55)	(56)
Post-retirement healthcare	(5)	(7)
Present value of unfunded obligations	(60)	(63)
Net pension asset/(liability)	**328**	**262**
Retirement benefit assets	390	327
Retirement benefit liabilities	(62)	(65)
Net pension asset/(liability)	**328**	**262**

See the disclosures for UK schemes in note 8 to the consolidated accounts for the circumstances of the major schemes, risk management, principal assumptions, assets and liabilities and the funding position of the two major schemes.

13 Share capital and reserves

Share capital

	Number of shares	Issued capital £m	Consideration £m
Ordinary shares of 37.5p each			
At 31 July 2016	395,223,072	148	
Exercise of share options	253,590		3
Total share capital at 31 July 2017	**395,476,662**	**148**	

At 31 July 2017, all of the issued share capital was in free issue. All issued shares are fully paid.

See note 9 to the consolidated accounts for information about share schemes, including total shares under options and options exercisable at the balance sheet date.

During the year, the Company received £3m (2016: £3m) on the issue of shares in respect of the exercise of options awarded under various share option schemes.

Smiths Industries Employee Benefit Trust

The retained earnings include the purchase of Smiths Group plc shares by the Smiths Industries Employee Benefit Trust, and the issue of these shares upon the exercise of share options. The consideration paid was £10m (2016: £8m) and £nil (2016: £nil) was received as a result of the issue of shares. At 31 July 2017 the Trust held 766 (2016: 852) ordinary shares.

Distributable profits

The Company's profit and loss reserve of £1,818m (2016: £1,857m) comprised £894m (2016: £913m) not available for distribution as a dividend and £924m (2016: £944m) available for distribution. See note 25 in the Group accounts for a discussion of capital management and the factors the Board consider when proposing dividends.

Other reserves

Other reserves arose from the cancellation of the share premium arising from an equity-funded acquisition in the year ended 30 July 1988.

14 Contingent liabilities

The Company has provided guarantees and arranged letter of credit facilities to support the Group's pension plans. The current amount outstanding under letters of credit is £54m (2016: £54m).

The Company has guaranteed the US$800m revolving credit facility available to a subsidiary.

15 Post balance sheet event

The directors propose a final dividend of 29.70p per share (totalling approximately £118m) for the year ended 31 July 2017. The dividend will be submitted for formal approval at the Annual General Meeting to be held on 14 November 2017.

These financial statements do not reflect this dividend payable, which will be accounted for in shareholders' equity as an appropriation of retained earnings in the year ending 31 July 2018. During the year ended 31 July 2017, a final dividend of 28.75p per share (totalling £114m) was paid in respect of the dividends declared for the year ended 31 July 2016.

SUBSIDIARY UNDERTAKINGS

In accordance with Section 409 of the Companies Act 2006 disclosed below is a full list of related undertakings of the Company. Related undertakings include subsidiaries, 'associated undertakings' and significant holdings in undertakings other than subsidiary undertakings. The registered office address, country of incorporation, classes of shares and effective percentage of equity owned by the Group is disclosed as at 31 July 2017.

Name	Security	Direct (%)	Total (%)
UNITED KINGDOM			
1 Sheldon Square, Paddington, London, W2 6TT			
Smiths Detection Group Limited	Ordinary £1		100
Smiths Detection Investments Limited	Ordinary £1		100
Smiths Detection Limited	Ordinary £1	100	100
Smiths Heimann Limited	Ordinary £1	100	100
Smiths Detection United Kingdom Limited	Ordinary £1		100
Smiths Group Finance EU Limited	Ordinary €1		100
Smiths Group Finance US Limited	Ordinary US$1		100
11-12 St James's Square, London, SW1Y 4LB			
Air Log Limited	Ordinary 1p		100
EIS Group Plc	Ordinary 25p	100	100
Flagtown Limited	Ordinary £1	100	100
Flightspares Limited	Ordinary £1; Ordinary 10p	100	100
Francis Shaw And Company (Manchester) Limited	Ordinary £1		100
Francis Shaw P L C	37% 2nd Pref Ordinary 10p; 5.25% Cum Pref £1; Def 20p; Ordinary 10p		100
Gastite Systems Limited	Ordinary £1		100
Graseby Limited	Ordinary 25p	100	100
Kontak Manufacturing Company Limited	Ordinary £1		100
Pyzotec Limited	Ordinary £1	75	75
Roof Units (Group) Limited	Ordinary 10p	100	100
S.I. Pension Trustees Limited	Ordinary £1	100	100
Sedding (No.3) Limited	Ordinary £1		100
SI Properties Limited	Ordinary 25p	100	100
SITI 1 Limited	Ordinary US$1		100
Smiths Aerospace Components Tyseley Limited	Ordinary £1	100	100
Smiths Aerospace Components-Burnley Limited	Ordinary £1		100
Smiths Aerospace Gloucester Limited	Ordinary 25p; Ordinary A 25p		100
Smiths Finance Limited	Ordinary £1; Red US$1		100
Smiths Group International Holdings Limited	Ordinary £1	100	100
Smiths Healthcare Limited	Ordinary 1p	100	100
Smiths Industries Limited	7% Non Cum Pref; Ordinary £1	100	100
Smiths Interconnect Power Management UK	Ordinary		100
Smiths Medical Distribution Limited	Ordinary £1	100	100
Smiths Medical Limited	Ordinary £1		99
Smiths Nominees Limited	Ordinary £1	100	100
Smiths Power UK Limited	Ordinary £1		100
Smiths Wolverhampton Limited	Ordinary 25p		100
TI Group Limited	Ordinary 25p	100	100
TI Guarantee Company Limited	Limited By Guarantee		100
TI Interest Limited	Ordinary A £1; Ordinary B £1; Floating Rate Cum Red Pref C £1	100	100
Tigrup No. 14 Limited	Ordinary 20p		100
Tigrup No.7 Limited	Ordinary £1	100	100
XD Communications Limited	Ordinary £1		100
XDG Limited	Ordinary 50P	100	100
3 Melville Street, Edinburgh, EH3 7PE			
George Maclellan Holdings Limited	Ordinary 5p; Def Ordinary 25p	100	100
13th Floor, 54 Hagley Road, Edgbaston, Birmingham, B16 8PE			
CVE Trustee Limited	Ordinary £1	100	100
Smiths Pensions Limited	Ordinary £1	100	100
1500 Eureka Park, Lower Pemberton, Ashford, Kent, TN25 4BF			
Smiths Medical UK	Ordinary US$1		100
Graseby Medical Limited	Ordinary £1		100
Medex Medical Limited	Ordinary £1		100
Pneupac Limited	Ordinary £0.50		100
SI Overseas Holdings Limited	Ordinary £1		100
Smiths Medical Group Limited	Ordinary A £1; Ordinary B £1; Ordinary C £1		100
Smiths Medical International Limited	Ordinary £1; Pref €2		100
29 Dunsinane Avenue, Dundee, DD2 3Qf, Scotland			
Flexible Ducting Limited	Ordinary £1		100
Trak Microwave Limited	Ordinary Shares		100
52, Grayshill Road, Westfield Industrial Area, Cumbernauld, G68 9HG			
Ashfield Medical Systems Limited	Ordinary £1		100

SUBSIDIARY UNDERTAKINGS CONTINUED

Name	Security	Direct (%)	Total (%)
UNITED KINGDOM			
Buckingham House, 361-366 Buckingham Avenue, Slough, Berkshire, SL1 4LU			
Flexibox International Limited	Ordinary £1		100
Flexibox Limited	Ordinary £1		100
Global TI Limited	Ordinary £1		100
John Crane Group Limited	Ordinary £1		100
John Crane International Limited	Ordinary £1		100
John Crane Investments Limited	Ordinary £1		100
John Crane UK Limited	Ordinary £1		100
Project Sugar Limited	Ordinary £1		100
Bond Dickinson LLP, St Ann's Wharf, 112 Quayside, Newcastle Upon Tyne, NE1 3DX			
OIE Services Limited	Ordinary £1		100
Century House, Maylands Avenue, Hemel Hempstead, Hertfordshire, HP2 7DE			
Smiths Detection-Watford Limited	Ordinary £1		100
C/o Bond Dickinson LLP, 13 Albyn Terrace, Aberdeen, AB10 1YP			
Subvenmar Limited	Ordinary £1		100
Venmar Limited	A Ordinary 10p; B Ordinary 10p; C Ordinary £1; Pref 10p		100
XPD8 Solutions Limited	Ordinary £1		100
First Floor, Building 7, Croxley Business Park, Hatters Lane, Watford, WD18 8PA			
Smiths Business Information Services Limited	Ordinary £1		100
Forsyth House, Cromac Square, Belfast, Co Antrim			
Flexibox (Northern Ireland) Limited	Ordinary £1		100
KPMG LLP, 8 Salisbury Square, London, EC4Y 8BB			
Lighthome Limited (in liquidation)	Ordinary £1	100	100
Unit 130 Centennial Park, Elstree, Hertfordshire, WD6 3TJ			
Hypertac Limited	Ordinary £1		100
Smiths Industries Industrial Group Limited	Ordinary £1		100
Smiths Interconnect Connectors UK	Ordinary £1		100
Smiths Interconnect Group Limited	Ordinary £1		100
ANGOLA			
Rue Kwamme Nkrumah, Torres Impor-Africa, 3 Andar, Apt A, Luanda			
John Crane (Angola) Prestacao De Services Ltd	Ordinary AOA 1		100
ARGENTINA			
Av. Leandro N. Alem 1110, 13 Floor, Baker Mackenzie Office, Buenos Aires			
John Crane Argentina SA	Common $1 ARS		100
TI Group Automotive Systems (Argentina) SA	Ordinary $1 ARS		100
AUSTRALIA			
549 – 551, Somerville Road, Sunshine, Melbourne, Vic 3020			
John Crane Australia Pty Limited	Ordinary AUS$1		100
Flexibox Pty Limited	Ordinary AUS$		100
Botany Grove Estate Unit 5, 14A Baker Street, Botany, NSW 2019			
Smiths Detection (Australia) Pty Ltd	Ordinary AUD$ 1		100
Suite 201, Level 2, 10 Norbrik Drive, Bella Vista, NSW 2153			
Smiths Medical Australasia Pty Ltd	Ordinary		100
AUSTRIA			
Campus 21, Europairing A 03 5 02, Brunn Am Gebirge, A-2345			
Smiths Medical Osterreich GmbH	Ordinary €1		100
AZERBAIJAN REPUBLIC			
House No 20, Ismayilbey Qutqasinli Street, Baku AZ, 1006			
John Crane Baku LLC	Ordinary US$10		100
BELGIUM			
Pegasuslaan 5, Diegem, 1831			
Smiths Medical Belgium NV	Registered Shares		100
Square De Meeus 18, Brussels, 1050			
John Crane Belgium NV	Ordinno Par Value		100
BRAZIL			
Av Paulista, 1048 1 Andar, Conj. 11, Bela Vista, Sao Paulo, 01310-100			
Smiths Medical Do Brasil Produtos Hospitalares LTDA	Ordinary R$1		100
Rua Tabapua 422 10 Andar, Conjuntos 101 A 104, Itaim Bibi, Sao Paulo, Cep 04533-001			
Smiths Detection Brasil Comérico De Equipamentos LTDA	Common		100
Industrial District of The City of Rio Claro, State of Sao Paulo, AV. Brasil Number 4.700, Cep 13505-600			
Smiths Brasil LTDA	Ordinary R$1		100

Name	Security	Direct (%)	Total (%)
CANADA			
301, Gough Road, Markham, Ontario, L3R 4Y8			
Smiths Medical Canada Ltd	Common Shares		100
3700, Stock Exchange Tower, P.O. Box 242, 800 Place Victria, Montreal, PQ, H4Z 1E9			
Smiths Detection Montreal Inc.	Class A Shares; Class B Shares		100
423, Green North Road, Stoney Creek, Ontario, L8E 3A1			
John Crane Canada Inc	Common $1		100
4610, Eastgate Parkway, Unit 3, Mississauga, Ontario, L4W 3W6			
Flexible Technologies (Canada) Inc.	Ordinary Shares $1		100
CHILE			
Americo Vespucio 2542, Complejo Empresarial El Cortijo, Conchali, Santiago			
John Crane Chile SA	Ordinary		100
CHINA			
Building 9, 333 Zhujian Road, Huachao Town, Shanghai, Minhang District			
Kaelus Interconnect (Shanghai) Co. Ltd.	Ordinary $1		100
No 255 Suhong Middle Road, Suzhou Industrial Park, Suzhou			
Antares Advanced Test Technologies (Suzhou) Co. Ltd	Ordinary $1		100
No. 26, The 3rd Avenue, Economic & Technological Development Area, Hangzhou			
Smiths Medical Instrument (Zhejiang) Co. Ltd	Ordinary Shares of RMB		100
No. 7, Factory Building, Maqiao Industrial Square, Changshu Economic Development Zone, Changshu, Jiangsu			
Changshu Flex-Tek Thermal Fluid Systems Manufacturer Co. Ltd	US$520,800 (Registered Capital)		100
No.9, No. 1, Haitai Huake Road, Huayuan Industrial District (Outside The Ring), Binhai Hi-Tech, Industrial Park, Tianjin			
John Crane Technology (Tianjin) Co Limited Co. Ltd	Ordinary US$1		100
Room 1668, No. 14F Floor 3 Datong Building, Huanghe Avenue, Nankai District, Tianjin			
John Crane China Co Limited	Ordinary CNY1		100
Room 923B, No 55, Xili Road, Shanghai, (China) Pilot Free Trade Zone			
Smo Detection Equipment (Shanghai) Co., Ltd	Ordinary		100
Unit 3018, South Tower, Beijing Kerry Centre, 1, Guanghua Road, Chaoyang District, Beijing			
Smiths Medical (Beijing) Co. Ltd	Ordinary Shares $1		100
COLOMBIA			
Calle 46A No 82-54 Int 14, Parque Empresarial San Cayetano, Bogota			
John Crane Colombia SA	Ordinary COP $1		100
COSTA RICA			
Central Avenue & 8Th, 33Rd St. Number 777 Barrio Francisco Peralta, San Jose			
Compania EMC Tecnologia S.A.	Ordinary US$1		100
CZECH REPUBLIC			
Jana Sigmunda 78, Lutin, 78349			
John Crane Sigma as	Ordinary CZK 1M		100
Olomoucka 306, Hranice I-Mesto, Hranice, 75301			
Smiths Medical Czech Republic A.S	Ordinary		100
DENMARK			
Orestads Boulevard 73, 2300 Kobenhavn S			
Smiths Medical Danmark Aps	DKK 100 Shares		100
DOMINICAN REPUBLIC			
Calle El Recodo, #2 Bella Vista, Santa Domingo			
John Crane Dominicana Sa	Ordinary DP$1		100
EGYPT			
139, Mogamaa El Masanea Street, El Amireya, Cairo			
John Crane Egypt LLC	Ordinary EGP 1		100
John Crane Egypt Sealing Systems LLC	Ordinary EGP 1		100
Nile City Towers, North Tower, 22nd Floor, Ramlet Boulaq, Nile Cournich, Cairo			
Detection Technologies Egypt	Quotas		100
FRANCE			
114, Rue Jules Ferry, B.p.35, Deville-Les-Rouen, 76250			
John Crane France S.A.S.	Ordinary €286		100
T I S A (France)	Ordinary		100
22, Avenue Maurice Chevalier, 77833 Ozoir-La-Ferriere, Paris			
Titeflex Europe S.A.S.	Ordinary $1		100
3/5 Rue Du Pont Des Halles, Batiment A, Rungis, 94150			
Smiths Medical France S.A.S.	€7.7 Shares		100
31 Rue Isidore Maille, Saint-Aubin-Les-Elbeuf, 76410			
Hypertac S.A.	Ordinary €76		100
36 Rue Charles Heller, Vitry Sur Seine, F-94400			
Smiths Heimann S.A.S.	€1 Shares		100

SUBSIDIARY UNDERTAKINGS CONTINUED

Name	Security	Direct (%)	Total (%)
FINLAND			
Pl 10 40951 Muurame			
Kiinteisto Oy Ainolantie 21	Ordinary		100
Po Box 10, Punasillantie 15, Muurame, 40950			
John Crane Safematic Oy	Ordinary		100
GERMANY			
Bretonischer Ring 3, Grasbrunn, 85630			
Smiths Group Deutschland GmbH	€1,491,400 Shares; €3,478,400 Shares; €995,500 Shares		100
Smiths Medical Deutschland GmbH	€1,000 Shares; €27,000 Shares; €5,000 Shares; €500 Shares		100
Flexschlauch Produktions GmbH, Reepschlager Str., 10B, Lubeck, 23556			
Flexschlauch Producktions GmbH	Ordinary		100
Heselstucken 3, Hamburg, 22453			
Smiths Detection Germany GmbH	Ordinary		100
Im Herzen 4, Wiesbaden, 65205			
Smiths Detection GmbH	€ 25,000 Share; €183,100 Share; €791,900 Share		100
Smiths Heimann Gmbh	Ordinary		100
Robert – Bosch – Breite 10, Gottingen, 37079			
John Crane Bearing Technology GmbH	Ordinary		100
Tolzer Strasse, 15 82031, Grunwald			
Zamor KG	Ordinary Shares €1		49
Ulrichsberger Strasse 17, Deggendorf, 94469			
Hypertac GmbH	Ordinary €1		100
Werner – Von – Siemens – Str.6, Fulda, 36041			
John Crane GmbH	Ordinary €1		100
GREECE			
3 Stratigou Tobre Street, Municipality Of Agia Paraskevi, Athens, 153 42			
John Crane Hellas – Engineered Sealing Systems Monoprosopi EPE	Ordinary €1		100
GUERNSEY			
Level 5, Mill Court, La Charroterie, St Peter Port, GY1 1EJ			
Smiths Group Insurance Limited	Ordinary £1		100
HONG KONG			
Room 401, Corn Yan Centre, 3 Juniper Street, North Point			
Smiths Detection Hong Kong Limited	Ordinary 1 HKD		100
Suite 1106-8, 11/F Tai Yau Building, No 181 Johnston Road, Wanchai			
Smiths Medical (Hong Kong) Limited	Ordinary HK$1		100
HUNGARY			
2040 Budaors, Gyar U. 2			
John Crane Hungary Kft	Ordinary €1		100
INDIA			
508/509, 5th Floor, Western Edge Ii, Western Express Highway, Borivali East, Mumbai, 400066			
Smiths Medical India Private Limited	Ordinary INR 1		100
D-196 Okhla Industrial Area, Phase-1, New Dehli, 110020			
Plenty India Limited	Ordinary Shares		100
No 10 B, 1st Phase, Peenya Industrial Area, Bangalore, 560058			
John Crane Flexibox India Private Limited	Ordinary INR 10		100
No 11, 1st Phase, Peenya, Industrial Area, Bangalore, 560058			
John Crane Sealol (India) Limited	Ordinary INR INR 10		100
No 38, Kiadb Industrial Area, Bangalor, 561203			
STS Titeflex India Pvt Ltd	Ordinary Inr 100		100
Vardhman Crown Mall, Unit No. 300 3rd Floor, Sector 19 Dwarka, New Delhi 110075			
Smiths Detection Veecon Systems Private Limited	Class A Equity Shares INR 10; Class B Equity Shares INR 10		100
INDONESIA			
Cilandak Commercial Estate Bldg 401A, Ji. Kko Cilandak, Jakarta, 12560			
Pt John Crane Indonesia	Ordinary IDR1,000		99
IRELAND			
Suite 3, One Earlsfort Centre, Earlsfort Terrace, Dublin 2			
Smiths Detection Ireland Limited	Ordinary €1.25; Ordinary B €1.269738; Ordinary D €1.25; Series C €1.25		100
Graseby Medical Ireland Limited	Ordinary €1.269738 Each		
T53/54, Shannon Industrial Estate, Shannon, Co. Clare			
John Crane (Ireland) Limited	Ordinary US$1		100

Name	Security	Direct (%)	Total (%)
ITALY			
Via Da Bissone 7A, Genova, 16153			
Hypertac SpA	Ordinary €5		100
Via Della Stazione, 2, 04013 Latina Scalo, Latina			
Smiths Medical Italia srl	Ordinary €1		100
Via Giotto 3, Muggio, 20835			
Smiths Detection Italia srl	Quota Value of Shares		100
John Crane Italia SpA	Ordinary €5.16		100
Smiths Group Italia Srl	Ordinary €1		100
JAPAN			
#2504, Kioicho Garden Tower, 3-10 Kioicho, Chiyoda-Ku, Tokyo			
Smiths Detection Japan Gk	Cash Contribution		100
2222, Kamitoyama Ritto City, Ritto-Shi, Shiga-Ken			
John Crane Japan Inc	Ordinary JYP 1,000		70
7-1-1, Akasaka, Minato-Ku, Tokyo			
Smiths Medical Japan Ltd	Common Stock		100
Hamamatsucho Ds Building, 27-16, Hamamatsucho 1-Chome, Minato-Ku, Tokyo			
Flexibox Japan Kk	Ordinary JYP 1,000		100
KAZAKHSTAN			
Atyrau Region, Gatyrau, Station K Arabathan, House Production Site 14, 060000			
John Crane Kazakhstan	Ordinary Equity		100
KOREA, REPUBLIC OF			
(Migeundong, Westgatetower 15F), 70 Chungjeong-Ro, Seodaemun-Gu, Seoul			
John Crane Korea Co Ltd	Ordinary Kwon 5,000		100
MALAYSIA			
207, Jalan Tun Razak, Suite 13.03, 13th Floor, Menara Tan & Tan, Kuala Lumpur, 50400			
John Crane Malaysia Sdn. Bhd.	Ordinary		100
Level 21, Suite 21.01, The Gardens South Tower, Mid Valley Centre, Lingkaran Syed Putra, 59200, Kuala Lumpur			
Flexible Ducting Malaysia Sdn Bhd	Ordinary $1		100
Suite 13.03, 13th Floor, Menara Tan & Tan, 207 Jalan Tun Razak, 50400, Kuala Lumpur			
Smiths Detection Malaysia Sdn Bhd	Share Of 1 Ringgit		100
MEXICO			
679, Poniente 152, Vallejo Delegacion Azcapotzalco, Mexico City, 2300			
Industrias John Crane Mexico S.A. de C.V.	Series A MXN 1; Series B MXN 1		100
Av. Primero De Mayo Lote 3 Edificio 1B, Prologis Park, Reynosa, 88780			
Tutco De Mexico S de RL de CV	Ordinary Shares $1.00		100
Ave Calidad No. 4, Parque Industrial, Internacional Tijuana, Tijuana, B.C., 22425			
Smiths Healthcare Manufacturing, S.A. de C.V.	Series B 10 Pesos; Series B-1 Pesos 10		100
Carretera Ciudad Victoria Matamoros, Km.173+600, Solonia San Fernando Centro, Tamaulipas, San Fernando, CP 87600			
John Crane Sociedad De Responsibilidad Limitada De Capital Variable	Ordinary MXN $1		100
Paseo De La Reforma 505, Col, Cuauhtemoc, 6500, Cudad De Mexico			
Smiths Detection Mexico S. de Rl de C.v.	Partes Sociales		100
NETHERLANDS			
Bergen 9 – 17, Barendrecht, Zuid, 2993LR			
John Crane Holland BV	Ordinary €1		100
Hydrograaf 25, Po Box 442, 6900 Ak Zevenaar, Duiven, 6921 RS			
Indufil BV	Ordinary		100
Jagersbosstraat 28, 5241Jt Rosmalen			
Smiths Medical Nederland B.V.	Shares NLG100		100
Buckingham House, 361-366 Buckingham Avenue, Slough, Berkshire, SL1 4LU, England			
Smiths Group Holdings Netherlands BV	Ordinary		100
NEW ZEALAND			
Quigg Partners, Level 7, 36 Brandon Street, Wellington, 6011			
Smiths Detection New Zealand Limited	Ordinary NZ$1		100
PERU			
Av. Guillermo Dansey 2124, Urbanizacion Industrial Conde, Lima			
John Crane Peru SAC	Common Shares		100
POLAND			
Warszawska 153, Bielsko – Biala, 43 – 300			
John Crane Poland Sp Z O.O.	Ordinary 50 PLN		100

SUBSIDIARY UNDERTAKINGS CONTINUED

Name	Security	Direct (%)	Total (%)
PORTUGAL			
Avenida Engenheiro Duarte Pacheco, Amoreiras, Torre 2, 15º A, Campo De Ourique, Lisboa, 1070-102			
Smiths Medical (Portugal), Unipessoal Lda	€505,000 Share		100
PUERTO RICO			
654 Plaza, Suite #933, 654 Munoz Rivera Ave, San Juan			
John Crane Caribe Ltd	Common Shares		100
RUSSIAN FEDERATION			
104 Build. 14 Oktyabrskaya Embankment, Saint-Petersburg, 193079			
Smiths Heimann Rus LLC	Ordinary		100
B.savvinsky Per, D.11, Moscow, 119435			
LLC John Crane Rus	Ordinary RUB 1		100
SAUDI ARABIA			
Dammam Industrial City, Dammam, 3243			
John Crane Saudi Arabia Ltd	Ordinary ZAR 1		100
Po Box 59490 Postal Code 11525, Riyadh			
Smiths Detection Saudi Arabia Ltd	1,000 Saudi Riyals Shares		100
SINGAPORE			
100 Beach Road #20-06 Shaw Towers, 189702			
Smiths Detection (Asia Pacific) Pte. Ltd	Ordinary S$1		100
Smiths Connectors Asia Pte. Ltd.	Ordinary S$1		100
80 Raffles Place, Uob Plaza 1, #32-01, 048624			
John Crane Singapore Pte Limited	Ordinary S$1		100
Smiths Medical Singapore Pte. Limited	Ordinary Shares		100
SLOVAKIA			
Michalska 2, Bratislava, 811 01			
John Crane Slovakia sro	Ordinary €1		100
SOUTH AFRICA			
2, Jansen Road, Nuffield Industrial Sites, Springs Gauteng, 1559			
Flexibox (Pty) Limited	Ordinary		100
John Crane Pty Ltd	Ordinary ZAR 1		100
3rd Floor, 54 Melrose Boulevard, Melrose Arch, 2196,			
Smiths Medical (South Africa) (Pty) Ltd	R1 Shares		100
SPAIN			
Av Diagonal, Num.635 P.1, Barcelona, 08028,			
Smiths Medical Espana S.L.	Shares €1		100
Cemento 1, Torrejon De Ardoz, Madrid			
John Crane Iberica SA	Ordinary €6.010121		100
SWEDEN			
Box 1143, 164 22 Kista			
Smiths Medical Sverige AB	SEKk100 Shares		100
Faltspatsgatan 4, Se-421 30 Vastra Frolunda			
John Crane Sverige AB	Ordinary		100
SWITZERLAND			
Freulerstrasse 4, 4127, Birsfelden			
John Crane (Switzerland) AG	Ordinary 1 CHF		100
Zurichstrasse 33, Adliswil, 8134			
Smiths Medical Schweiz AG	Shares of CHF 10.00 Each		100
TAIWAN			
324-4, Fong-Jen Road, Renwu District, Kaohsiung City 814			
John Crane Taiwan Co Ltd.	Ordinary T$1		100
THAILAND			
9/311, 31St Floor, Um Tower, Ramkhamhaeng Road, Suanluang District, Bangkok			
John Crane (Thailand) Limited	Ordinary THB 1; Preferred Shares		100
99/3 Moo 5, Kingkaew Road, Tambol Rajatheva, Amphoe Bangplee, Samutprakarn Province, 10540			
Smiths Detection (Thailand) Limited	Pre THB100; Ordinary Thb100		100
TUNISIA			
Zone Industrielle Route De Khniss, Monastir, 5000			
Smiths Connectors Tunisia Sarl	Ordinary 100 DT		100
TURKEY			
Istanbul Sariyer, Huzur Mahallesi, Ahmet Bayman Caddessi, Dis, Reklamcilik Apt No:17-19/1			
John Crane Endustriyel Sizdirmazlik Sistemleri Ltd	Ordinary TRY 25		100

Name	Security	Direct (%)	Total (%)
UNITED ARAB EMIRATES			
Building B07, Industrial Mussaffah, M44, Sector 15, Abu Dhabi			
Smiths Detection Security Systems LLC	AED 1,000		49
Dubai Airport Free Zone, W7, 2052			
Smiths Detection Middle East FZE	AED 1,000,000 Share		100
S20113, Jebel Ali Free Zone, 61040			
John Crane Middle East FZE	Ordinary AED 1		100
UNITED STATES			
111, Cedar Creek Road, Post Office Box 84, Grafton, W153024-0084			
Orion LLC	Ordinary US$0.01		100
116, Pine Street, 3Rd Floor, Suite 320, Harrisburg, PA 17101			
Tutco, LLC	Ordinary US$1		100
1200 South Pine Island Road, Plantation, FL, 33324			
Smiths Interconnect Microwave Components, Inc.	Common Stock		100
1209 Orange Street, Wilmington, DE, 19801			
Smiths Detection US, LLC	Ordinary US$1		100
John Crane Inc	Common US$0.01; Preferred US$0.10		100
John Crane Group, LLC	Ordinary		100
Powercam-Houdaille, Inc.	Common Shares		100
Flexible Technologies, Inc	Ordinary Shares US$0.01		100
John Crane Production Solutions Inc	Ordinary US$0.01		100
Smiths Interconnect Americas, Inc.	Common Stock		100
Smiths Interconnect Connectors, Inc.	Common Stock US$0.01		100
Smiths Interconnect, Inc.	Common Stock US$0.01		100
Trak Microwave Corporation	Common Stock US$10.00		100
Antares China Holdings, Inc	Common Stock US$0.01		100
Smiths Business Information Services, Inc.	Ordinary US$0.01		100
Smiths Group Services Corp.	Common Stock US$0.01		100
155 Federal Street, Suite 700, Boston, MA, 02110			
Hypertronics Corporation	Common Stock		100
208 S. Lasalle Street, Suite 814, Chicago, IL, 60604			
John Crane International Inc.	Common Shares		100
2850, Safran Drive, Grand Prairie, TX75052			
Smiths Detection International LLC	Equity Interests		100
330, Corporate Woods Parkway, Vernon Hills, IL, 60061			
Medex Cardio-Pulmonary, Inc	Common Stock of US$0.01		100
6000, Nathan Lane North, Minneapolis, MN, 55442			
Smiths Medical ASD Inc. Limited	Common Stock $1		100
8730, Meldrum, Houston, TX, 77075			
Turbo Components And Engineering LLC	Comon Shares		100
Corporation Service Company, 2711 Centerville Rd, Suite 400, Wilmington, DE, 19808			
Mdii Investments LLC	Ordinary		100
Smiths Detection LLC	Equity Interests		100
Smiths Detection US Holdings, LLC	Ordinary US$1		100
The Corporation Trust Company of Nevada, 6100 Neil Road, Suite 150, Reno NV, 89511			
Smiths Detection Inc	Common Stock Oof $0.0001		100
Ct Corporation System, 155 Federal Street, Suite 700, Boston, MA 02110			
Titeflex Commercial, Inc.	Ordinary US$0.01		100
Millitech, Inc.	Common Stock		100
Ct Corporation System, 818 West Seventh Street, 2nd Floor, Los Angeles, CA, 90017			
Sabritec	Ordinary Shares		100
Tecom Industries, Incorporated	Common Stock US$1		100
Ct Corporation System, 9 Capitol Street, Concord, Nh 03301			
Smiths Tubular Systems-Laconia, Inc	Ordinary Shares US$1		100
One Corporate Center, Hartord, Ct 06103-3220			
Titeflex Corporation	Ordinary US$1		100
Registered Agent Solutions, Inc., 1679 Dupont Highway, Suite 100, Dover, DE, 19901			
Smiths Medical US, Inc	US$0.01 Stock		100
VENEZUELA			
Carretera Vía A Perijá, Km 8 ½, Avenida 50, Local N° 185-72, Zona Industrial El Silencio, Maracaibo, 4001			
John Crane Venezuela CA	Class "A" BSF1; Class "B" BSF1; Common BSF1		100

ASSOCIATES		
GERMANY		
Borsigstrasse, 15 65205 Wiesbaden		
STI Security Training International GmbH	Ordinary Shares €1	34
RUSSIAN FEDERATION		
28, Academica Vedeneeva Street, Perm, Permskiy Region, 614038		
LLC John Crane Iskra	Ordinary RUB 1	50

The following new companies were incorporated after 31 July 2017:

- Smiths Detection Netherlands B.V., was incorporated in the Netherlands on 1 August 2017. Smiths Group plc indirectly owns the entire issued share capital and the new company will be consolidated as a subsidiary from the date of incorporation.
- Smiths Group Innovation Limited was incorporated in the United Kingdom on 8 September 2017. Smiths Group plc indirectly owns the entire issued share capital and the new company will be consolidated as a subsidiary from the date of incorporation.

FINANCIAL CALENDAR

	2017
Announcement of results for 2016/17	22 September
Ordinary shares final dividend ex-dividend date	19 October
Ordinary shares final dividend record date	20 October
Annual General Meeting	14 November
Ordinary shares final dividend payment date	17 November

	2018
2017/18 interim results announced	23 March (provisional)
Ordinary shares interim dividend ex-dividend date	5 April (provisional)
Ordinary shares interim dividend record date	6 April (provisional)
Ordinary shares interim dividend payment date	23 April (provisional)
Smiths Group financial year end	31 July
Announcement of results for 2017/18	21 September (provisional)
Ordinary shares final dividend ex-dividend date	18 October (provisional)
Ordinary shares final dividend record date	19 October (provisional)
Annual General Meeting	14 November (provisional)
Ordinary shares final dividend payment date	16 November (provisional)

The market value of an ordinary share of the Company on 31 March 1982 for the purposes of capital gains tax was 136.875p (taking into account the sub-division of 50p shares into 25p shares on 14 January 1985 and the subdivision and consolidation of 25p shares into 37.5p shares on 18 June 2007).

Registered Office
Smiths Group plc
4th Floor
11-12 St James's Square
London SW1Y 4LB, United Kingdom
T +44 (0)20 7004 1600
www.smiths.com

Incorporated in England
No. 137013

Auditor
PricewaterhouseCoopers LLP

Registrars
Equiniti Limited
Aspect House
Spencer Road
Lancing
West Sussex BN99 6DA, UK

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Lines open 8.30am to 5.30pm, Monday to Friday

T: +44 (0)121 415 7047 (International)
Textel: 0870 384 2255
www.shareview.co.uk
www.equiniti.com

Shareholding information
By accessing www.shareview.co.uk shareholders can view their personal shareholder information, as well as practical help on share transfers and changes of address. Shareholders wishing to change their election and receive documents in hard copy form can do so by contacting the Company's Registrar or by logging on to www.shareview.co.uk.

Annual General Meeting (AGM)
The Annual General Meeting of Smiths Group plc for 2017 will be held at 11:00 a.m. on Tuesday, 14 November 2017 at Linklaters LLP, One Silk Street, London, EC2Y 8HQ

If you are in any doubt as to what action you should take in relation to the resolutions being proposed at the AGM, you are recommended to consult your stockbroker, bank manager, solicitor, accountant or other independent professional adviser authorised under the Financial Services and Markets Act 2000.

Voting at the AGM
The Company continues to provide electronic proxy voting for this year's AGM. Shareholders who will not be able to attend the AGM in person are encouraged to vote their shares by appointing a proxy and issuing voting instructions. Electronic and paper proxy appointments and voting instructions must be received by the Company's Registrar not later than 48 hours before the AGM in order to be valid.

Shareholders who are not Crest members can appoint a proxy and vote online for or against (or consciously not vote on) the resolutions to be proposed at the AGM by visiting the website www.sharevote.co.uk.

Crest members, Crest personal members and other Crest-sponsored members should consult the Crest Manual or their sponsor or voting service provider for instructions on electronic proxy appointment and voting.

NOTES

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smiths

bringing technology to life

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