smiths
bringing technology to life

News release

London, Wednesday 17 September 2014
For immediate release

Annual results for the year ended 31 July 2014

	Headline*				Statutory†	
	2014 £m	2013 £m	Growth	Underlying#	**2014 £m**	2013 £m
Revenue	**2,952**	3,109	(5)%	0%	**2,952**	3,109
Operating profit	**504**	560	(10)%	(6)%	**378**	486
Operating margin	**17.1%**	18.0%	(90) bps	–	**12.8%**	15.7%
Pre-tax profit	**445**	498	(11)%	(6)%	**302**	396
Basic EPS	**81.8p**	92.7p	(12)%		**59.0p**	80.1p
Free cash-flow	**143**	237				
Dividend	**40.25p**	39.5p	2%		**40.25p**	39.5p
Return on capital employed	**15.7%**	16.6%	(90) bps			

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

† The statutory figures for 2013 have been restated for IAS 19 (revised 2011).

#Organic growth adjusting for foreign exchange translation.

Highlights

- Commercial market gains but challenging healthcare and homeland security markets
- John Crane, Smiths Interconnect and Flex-Tek increased underlying revenue and margins
- Smiths Medical returned to growth in H2 with improvement in infusion pumps
- Smiths Detection margins under pressure with tough trading and additional charges
- *Fuel for Growth* restructuring programme delivered £10m of savings
- FX impact of £43m on operating profit: translation of £27m and transaction of £16m
- Company-funded investment in new products up 5% underlying to £109m
- Headline operating cash conversion at 97%; dividend up 2%

“Underlying revenue and margins rose in John Crane, Smiths Interconnect and Flex-Tek but were offset by declines in Smiths Medical and Smiths Detection. Smiths Medical saw revenue grow in the second half driven by good growth in its infusion franchise. Smiths Detection’s performance was disappointing with a difficult trading environment and one-off charges of £30m in the year. Our overall results were significantly reduced by foreign exchange headwinds.

“Our strategy remains to accelerate medium-term growth and reposition the business through consistent investment in product innovation, sales effectiveness, and expansion in higher growth markets. This investment is funded by our *Fuel for Growth* programme, scheduled to generate £60m of annual savings by 2017 with initiatives underway across all divisions.

“Looking ahead, we remain well-placed to benefit from growth in energy demand, the need for new fuel-efficient aircraft, increased US residential construction and investment in wireless networks. However, we remain cautious about sectors such as healthcare, homeland security and defence, which are subject to government funding constraints, although there are signs that the defence market is beginning to stabilise.”

Philip Bowman
Chief Executive

Divisional highlights*

	% of Group revenue	Underlying revenue growth*	Underlying headline profit growth*	Headline operating profit margin		Headline return on capital employed	
				2014	2013	**2014**	2013
John Crane	32%	**2%**	**8%**	**24.9%**	23.4%	**26.7%**	25.7%
Smiths Medical	27%	**(1)%**	**(12)%**	**19.8%**	22.2%	**14.5%**	16.6%
Smiths Detection	17%	**(5)%**	**(57)%**	**4.8%**	10.4%	**3.9%**	8.8%
Smiths Interconnect	15%	**1%**	**9%**	**16.0%**	14.9%	**13.7%**	12.4%
Flex-Tek	9%	**3%**	**14%**	**18.9%**	17.1%	**34.0%**	30.8%
Group	100%	**0%**	**(6)%**	**17.1%**	18.0%	**15.7%**	16.6%

**All figures are on a headline basis. Revenue and profit growth are at constant currency and exclude the impact of acquisitions and disposals*

John Crane

- Revenue up 2% driven by both original equipment and aftermarket sales, particularly in oil and gas
- Excluding upstream energy services, revenue grew 4% on an underlying basis
- Margins improved 150 basis points to 24.9%, a new high; while new product investment rose 13%
- Well-positioned for future growth supported by a record order book

Smiths Medical

- Revenue down 1% driven by price pressure – particularly affecting consumables; return to revenue growth in H2
- Developed markets continued to be hit by constrained hospital budgets, slow procedure rates and adverse pricing
- Margins fell 240 basis points driven by adverse FX transaction, price pressure and US medical device tax
- Developed markets remain challenging; cost savings will largely be reinvested for growth initiatives

Smiths Detection

- Revenue down 5% against a strong comparator – weakness in transportation, ports & borders and military
- Margins reduced by working capital adjustments, adverse price/mix, additional programme costs and other charges
- New leadership is restructuring business and improving programme delivery capabilities
- Order book in line with last year; margins should improve against a weak comparator

Smiths Interconnect

- Revenue up 1% with a return to growth in H2 on strong demand from microwave customers
- Margins up 110 basis points reflecting productivity gains and better volumes
- Underlying investment in new products increased 5% while emerging market sales grew 15%
- Commercial markets are expected to see continued growth with defence stabilising

Flex-Tek

- Revenue up 3% driven primarily by US residential construction and heat solutions
- Improved volumes, mix and pricing helped push profit up 14% and margins up 180 basis points
- Aerospace and US construction sectors expected to support continued sales growth
- Margins geared to volume improvements across Flex-Tek's end markets

Contact details

Investor enquiries
Peter Durman, Smiths Group
+44 (0)20 7808 5535 or +44 (0)7825 145336
peter.durman@smiths.com

Media enquiries
Colin McSeveny, Smiths Group
+44 (0)20 7808 5534
colin.mcseveny@smiths.com

Anthony Cardew, Cardew Group
+44 (0)20 7930 0777
anthony.cardew@cardewgroup.com

Presentation

The presentation slides and a live webcast of the presentation to analysts are available at www.smiths.com/results at 09.00 (UK time) on Wednesday 17 September. A recording of the webcast is available later that day. A live audio broadcast of the presentation is also available by dialling (no access code required):

UK toll free: 0808 237 0062

International: +44 (0)20 3426 2890

US/Canada toll free: 1 877 841 4558

An audio replay is available for seven days on the following numbers (access PIN 649759#):

UK toll free: 0808 237 0026

International: +44 (0)20 3426 2807

US/Canada toll free: 1 866 535 8030

Photography

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

Statutory reporting

Statutory reporting takes account of all items excluded from headline performance. On a statutory basis, pre-tax profit from continuing operations was £302m (2013: restated £396m) and earnings per share were 59.0p (2013: restated 80.1p).

The items excluded from headline performance totalled £143m and comprised:

- amortisation and impairment of acquired intangible assets of £39m (2013: £47m);
- £54m in connection with John Crane, Inc. asbestos litigation (2013: £17m);
- £11m associated with Titeflex Corporation litigation (2013: £8m);
- £29m of exceptional restructuring costs (2013: £8m);
- £9m for retirement benefit finance charge (2013: restated charge of £23m);
- £6m of legacy retirement benefit administration costs (2013: restated £7m);
- £3m profit on disposal of property and businesses (2013: £6m);
- £1m cost of acquisitions, disposals and aborted transactions (2013: £3m);
- £2m gain on legal settlements and diabetes royalty payments (2013: £1m);
- £2m gain on reassessed contingent consideration provided on acquisitions (2013: £2m); and
- £1m of financing losses (2013: £2m).

In the period to 31 July 2013, in addition to the above, a £4m gain on changes to pension plans was also excluded from headline performance.

Chief Executive's review

Results summary

Smiths Group made progress, with John Crane, Smiths Interconnect and Flex-Tek all delivering organic revenue growth and headline operating margin improvement. Disappointingly, these advances were offset by Smiths Medical and Smiths Detection as the healthcare and defence/security sectors continued to see challenging market conditions. However, both Smiths Medical and Smiths Interconnect returned to growth in the second half, with growth in Interconnect's commercial markets outpacing pressures on its defence revenues. Profitability at Smiths Detection was affected by working capital adjustments, adverse price/mix, additional programme delivery costs and charges associated with price audits for certain historical supply arrangements. The other significant headwind to the business this year has been foreign exchange, due to the relative strength of sterling, particularly against the US dollar. Adverse foreign exchange translation and transaction impacts totalled £43m, or almost 8% of headline operating profit. As a result, Group revenue and headline operating profit both declined.

Our drive to reposition the Group to accelerate revenue growth continued. This includes investing in product innovation, increasing our presence in high-growth markets, sales and marketing effectiveness, driving a culture of growth across the organisation, and expanding our non-governmental business. Frustratingly, the benefits of this repositioning have been largely obscured by the headwinds we continue to face in healthcare and homeland security. We are part way through a medium-term programme to reposition the business for growth and, while this will take time, this is the right approach to drive future shareholder value. These initiatives will be funded by a relentless focus on operational excellence.

John Crane delivered revenue growth with healthy demand both from first-fit OEM customers and energy aftermarket services. Growth was constrained by declines in upstream energy services. Excluding upstream, overall revenues increased in line with our medium-term guidance. Margins have been boosted by higher volumes and the restructuring benefits which have more than offset cost inflation and investment in growth. We expect to increase our investment in growth initiatives in the coming year. Smiths Medical saw a return to revenue growth during the second half, albeit against a weak comparator. This followed first half declines caused by weak procedure volumes, price pressure and the impact of a distributor destock in the USA, all of which had an impact on profitability. Medical also had to manage the inevitable disruption caused by the approach last year to acquire the business. As expected, Smiths Detection saw declines in revenues against a strong comparator period, primarily reflecting weaker demand in cargo screening and transportation. Profitability fell as we incurred additional costs on the delivery of existing programmes and with working capital adjustments as we adopted new divisional policies. A new divisional president has taken charge and is focusing on driving operational improvements, as well as addressing the shortcomings in programme delivery. These initiatives to tackle low-margin programmes and other ongoing productivity initiatives are likely to take another year to 18 months. Smiths Interconnect saw a return to revenue growth in the second half, with strong demand from wireless telecom and test and measurement customers. Productivity gains helped enhance margins, despite the lower volumes. Flex-Tek grew revenues with gains in the construction and heating element markets, increasing margins to recent highs as a result of its operational gearing.

Strategy

Our strategy is to grow shareholder value and transform Smiths into a world-class organisation by:

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

We have continued to pursue these objectives and some recent examples are set out below. The area where we see greatest opportunity is revenue growth. This is the key focus for the Group as we continue to reposition the business.

Engineered for growth – product innovation

A key driver of future revenue and value growth is product innovation. Our technology leadership stems from our long-standing commitment to new product investment. Company-funded investment in R&D increased 5% at constant currencies to £109m, with increases across most divisions. Customer-funded investment fell to £8m (2013: £9m) as governments reduced funding; this took our total spend to £117m, or 4.0% of revenue (2013: 3.8%). We have completed several important new product launches through this long-term investment.

John Crane was granted a patent for technology that will monitor the condition of a gas seal to improve product performance, extend lifespan and aid emission reduction in operations across the energy sector. Smiths Medical's

CADD-Solis PIB (Programmable Intermittent Bolus) pump, launched in the US this year, provides continued growth opportunities, particularly in labour and delivery wards. Another exciting new product is EchoGlo, a catheter specially designed to appear in ultrasound scans to help local anaesthetic procedures. Smiths Detection has unveiled two advanced handheld identifiers that provide quick and accurate field analyses – one for explosives and the other for a range of illicit drugs. Smiths Interconnect is introducing higher density semiconductor test sockets to enable testing of packaged chips to their full limits. Flex-Tek is now marketing a tailor-made hose to exploit the growing market in compressed natural gas as companies seek cheaper alternatives to oil.

Engineered for growth – high-growth markets

We have continued to invest to expand our presence in emerging markets to improve the Group's growth profile over the medium term. During the year, revenue from emerging markets was maintained, representing about 16% of Group sales. Increases in John Crane and Smiths Interconnect were offset by declines in Smiths Detection and Smiths Medical. We recognise that it takes time to establish a local sales presence through recruitment, training and brand building. In addition, there are also product registration processes in many markets. However, we believe that this is the right strategy for the Group to accelerate its growth profile and generate improved returns in the medium term. In Smiths Interconnect, we saw good growth in Asia in their connector business and secured contracts in data centres in India and Brazil. John Crane continued to build infrastructure in select markets and to invest in local technical service capabilities. For example Tianjin in China is now home to John Crane's third and newest global R&D centre, reflecting our commitment to innovation and new technologies for the global market.

Fuel for Growth – funding the growth initiatives

We are funding investment in these growth initiatives through our *Fuel for Growth* programme, which is expected to generate £60m of annual savings for reinvestment in sales, marketing and new product development. The programme is expected to cost £120m over a three-year period, which will be treated as an exceptional item. There will also be some accompanying capital expenditure. This restructuring is focusing on three areas: site rationalisation with a particular concentration on manufacturing footprint to support future growth while lowering costs; organisational effectiveness through delayering and broadening management spans of control; and the upgrading of information systems – particularly in John Crane – to improve decision-making and to support the next stage of globalisation. In the year, we incurred costs of £27m across the programme, which delivered savings of £10m in the period. In the coming year, we expect to achieve a cumulative savings run-rate of £20m a year and incur £38m of costs which will be treated as exceptional.

	Programme to date		Total programme expectations	
	Costs in FY 2014	Savings in FY2014	Total costs by end FY 2017	Full annual benefits by end FY 2017
John Crane	7	7	25	13
Smiths Medical	10	-	49	23
Smiths Detection	5	-	34	14
Smiths Interconnect	5	3	9	7
Flex-Tek	-	-	3	3
Total	**27**	**10**	**120**	**60**

Towards a world-class organisation

The successful implementation of our strategic initiatives depends on us having the talent in place throughout the organisation. Our processes to foster and retain the necessary skills have been reinforced at all levels across the Group. Jeff McCaulley joined in March to lead Smiths Medical into its next phase of development. Richard Ingram started at Smiths Detection in May and brings valuable experience in delivering complex programmes. We have also increased our focus on driving growth and value through the appointment of Brian Jones as Group Commercial Director and Silvio Bracone as Group Strategy Director, Both roles will strengthen and enhance the co-ordination of the Group's growth initiatives. To drive the growth agenda throughout the organisation, we held a senior management conference in May 2014 – with the top 120 managers across the Group. The theme of the conference was *Engineered for Growth*. Featuring internal and external speakers, we explored how we could operate differently to accelerate revenue growth. As part of this programme, we have identified four specific growth priorities: innovation, driving growth in China, sales excellence and quality improvement. These initiatives are just beginning and we will provide updates in future reports.

Promoting responsibility

We continued to make good progress on our safety and environmental metrics. The recordable incident rate improved again in the year to a new record low.

We have also undertaken several initiatives during the year to promote our Code of Business Ethics. We built on the anti-bribery and corruption course that we launched last year by updating the training on international trade compliance and competition & anti-trust. We also recognise the growing importance of the emerging markets and the challenges of operating in these markets. Following on from the success of the global ethics forum held in Brazil last year, we hosted our third forum in Dubai in October 2013. These events highlight the importance of our Code and enable the Group to share best practice and experiences.

Cash generation and balance sheet

We experienced another year of good operating cash conversion. Headline operating cash of £490m represented a headline operating cash conversion of 97% (2013: 98%). Free cash-flow was lower as a result of higher exceptional cash costs.

Our balance sheet remains strong. We refinanced our existing revolving credit facility with a US$800m five-year facility which matures in February 2019 with two one-year extension options.

Dividend

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

The Board has recommended a final dividend of 27.5p per share giving a total for the year of 40.25p, an increase of 2%. The final dividend will be paid on 21 November to shareholders registered at the close of business on 24 October. The ex-dividend date is 23 October.

Outlook

We remain well placed to benefit from growth in energy demand, the need for new fuel-efficient aircraft, increased US residential construction and investment in wireless networks. We are cautious about sectors such as healthcare and homeland security, which are subject to government funding constraints, although there are signs that the defence market is beginning to stabilise.

Our priority is to drive operational improvements and efficiencies across our business that will fund additional investment in high-growth markets and new product development to accelerate medium-term revenue growth.

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

Philip Bowman
Chief Executive

Operational review

Revenue

On an underlying basis, revenue was up £2m on last year. However, adverse foreign exchange translation of 5%, or £157m, and the impact of a small disposal in Smiths Interconnect (£2m) resulted in reported revenues of £2,952m, down 5%. The underlying performance, excluding currency translation, was driven primarily by growth in John Crane (up £17m), Flex-Tek (up £8m) and Smiths Interconnect (up £6m), which offset underlying revenue declines in Smiths Detection (£25m) and Smiths Medical (£4m).

Profit

Headline operating profit at £504m was reduced by £27m from foreign exchange translation and an underlying decline of £29m or 6%. This underlying reduction was the net effect of higher volumes and productivity efforts at John Crane (up £17m), higher volumes at Flex-Tek (up £6m), better volumes and cost savings at Smiths Interconnect (up £5m) more than offset by the impact of foreign exchange transaction, adverse pricing and the impact of the medical device tax at Smiths Medical (down £23m) and working capital adjustments, adverse price/mix, additional programme delivery costs and other provisions at Smiths Detection (down £32m). Corporate centre costs increased by £2m reflecting increased investment in growth initiatives such as sales excellence; a trend which we expect to continue. Headline operating margin declined by 90 basis points to 17.1% (2013: 18.0%) reflecting reduced profitability at Smiths Medical and Smiths Detection.

Operating profit on a statutory basis, after taking account of the items excluded from the headline figures, was £378m (2013: restated £486m). The decline was in large part a result of increased exceptional costs (see note 4). Statutory profit for 2013 has been restated to take account of the reporting requirement of IAS 19 (revised 2011).

The net interest charge on debt decreased slightly to £60m (2013: £62m). The reduction reflects lower interest rates on debt during the year.

The Group's tax rate on headline profit for the period was 27% (2013: 26.5%). Headline earnings per share declined by 10.9p, or 12%, to 81.8p (2013: 92.7p).

On a statutory basis, profit before tax decreased £94m to £302m (2013: restated £396m); it is stated after taking account of increased exceptional costs, a pensions finance charge of £9m (2013: restated charge of £23m) and other items excluded from the headline measure.

Cash generation

Operating cash generation remained strong with headline operating cash-flow of £490m (2013: £548m), representing 97% (2013: 98%) of headline operating profit (see note 27 to the accounts for a reconciliation of headline operating cash and free cash-flow to statutory cash-flow measures). Looking ahead, we expect cash conversion to be in the range of 85-95%, reflecting our plans for increased capital expenditure to support site restructuring and capacity expansion.

Free cash-flow decreased by £94m to £143m (2013: £237m), reflecting lower operating profit and higher exceptional costs. Free cash-flow is stated after all legacy costs, interest and taxes but before acquisitions and dividends.

On a statutory basis, net cash inflow from continuing operations was £256m (2013: £353m).

Dividends paid in the year on ordinary shares amounted to £275m (2013: £152m) which includes the annual dividend of £157m and the special dividend of £118m, declared with the final results last year.

Net debt at 31 July 2014 was £804m, an increase of £60m from the £744m at 31 July 2013. This increase in net debt reflects the impact of the special dividend paid (£118m) in November 2013 offset by translation gains on foreign currency denominated debt (£70m).

John Crane

	2014 £m	2013 £m	Reported growth	Underlying growth
Revenue	**941**	986	(5)%	2%
Headline operating profit	**234**	231	2%	8%
Headline operating margin	**24.9%**	23.4%	150 bps	
Statutory operating profit	**166**	206		
Return on capital employed	**26.7%**	25.7%	100 bps	

Performance

John Crane delivered strong profit improvement on the back of higher underlying revenues and ongoing productivity initiatives. Reported headline operating profit grew 2% (£3m), driven by an 8% (£17m) underlying increase offset by adverse currency translation of £14m. The order book at the end of the year was at a record high. Headline operating margin increased by 150 basis points to 24.9%, also a record.

The difference between statutory and headline operating profit reflects the cost of John Crane, Inc. asbestos litigation of £49m, amortisation of acquired intangible assets of £12m and restructuring costs of £7m. Return on capital employed improved 100 basis points to 26.7% because of increased profitability.

Underlying revenue grew 2% (£17m), offset by £62m of adverse foreign exchange translation, leaving reported revenue down 5%. The underlying improvement reflects increased revenue in the aftermarket and first-fit rotating equipment business, offset by declining sales in our upstream oil services segment. Excluding this upstream segment, revenues showed a 4% underlying increase.

Overall aftermarket revenues grew 1% on an underlying basis. However, excluding sales from our upstream oil services business, sales grew 4% on the back of strong demand from energy services customers across the Middle East, Latin America and North America. Key renewals and new aftermarket service contracts signed with global customers such as Shell, Chevron, Valero, Colombia-based Ecopetrol Reficar, and Brazil-based Suzano Pulp and Paper, should contribute to steady mid-term growth. Additional wins with BP Rumalia, Petrochina, and Pemex Refinery Pipelines in Mexico contributed to the record order book.

John Crane is benefiting from the reopening of dormant refineries on North America's East Coast to meet growing infrastructure needs, driven by increased production from unconventional sources. Customer investments in shale development have remained steady and are expected to continue so in North America in the near term. In addition, the push to invest in clean fuels is increasing the need to retrofit pipelines. To continue strengthening aftermarket customer support capabilities in the US, a new 'super' service centre opened in Texas to support the oil and gas turbine and compressor markets. In Canada, the expansion of the Edmonton service centre supports the growing demand from the Canadian oil industry.

Our upstream oil services business, reported as part of our aftermarket revenue, experienced a sharp decline this year before showing recent signs of stabilising on a monthly sequential basis. The decline was mainly due to an increasingly competitive US operating environment and severe winter weather in North America.

Underlying sales of first-fit original equipment rose 4%, with demand fuelled by original equipment manufacturers exporting to high-growth regions such as the Middle East. This was illustrated by contract wins for the Zadco oil and gas project and Adco Bab field in the United Arab Emirates, Jizan refinery in Saudi Arabia, and Zubair Oil Field in Iraq. Additionally, China experienced double-digit first-fit revenue growth. Overall, we continue to see customer confidence in the oil and gas pump segment, whereas the power generation turbomachinery segment remains challenging.

Revenue from emerging markets rose 6% and now represents 22% of John Crane sales. Revenue increased 9% year over year in ASEAN countries, 16% in Saudi Arabia, 10% in India, and 6% in China. Market demands in China were behind the opening of a new service centre in Dalian and a second in Chengdu, increasing the number of service centres in the region to eight. Combined with several other investments in our Tianjin, China facility – a new global R&D centre, improvements in the training centre, and increased manufacturing capacity – we have significantly strengthened customer service capabilities in the region. John Crane also strengthened capabilities in Australia and ASEAN countries, highlighted by a new service centre in Gladstone, Australia, and a new sales and service office in Kuala Lumpur, Malaysia.

Profit growth during the period resulted from both increased underlying revenues and ongoing productivity efforts, some of which are part of our *Fuel for Growth* programme. This programme is expected to deliver £13m of annualised savings by 2017 on an investment of £25m, which will be reported as exceptional. £7m of exceptional items under this programme were incurred during this period. Reinvestments from the programme are successfully repositioning the business towards growth and value creation. They span several areas: factory and service centre network optimisation, information system infrastructure improvements, and new product innovation. John Crane is also investing in manufacturing capacity to support the strong order book.

Research and development

John Crane increased investment in R&D by 13% compared to the prior year, again illustrating its commitment to address future market needs. Our focus remains on developing engineered solutions that address customers' growing processing demands while supporting reduced environmental impact and improved energy efficiency. Operating conditions are ever more challenging as customers face increasingly higher pressure and speed requirements while exploring more difficult environments.

During the period, John Crane launched the Type 3740XL seal, a next-generation, larger mechanical split seal. This new model is used for large, difficult-to-maintain pumps, mixers and rotating equipment. Its split seal technology can reduce costs for customers by potentially cutting installation time by more than 50% in challenging operating environments. John Crane was also awarded a patent for a breakthrough technology that will monitor the condition of a gas seal to improve product performance, extend average product lifespan and aid emission reduction in operations across the energy sector. John Crane was issued 26 new patents in fiscal year 2014 and, in total, has more than 230 patents and patent applications.

To support growth from new product development and generate new product ideas, we have established a Scientific Advisory Board comprising external academics and thought leaders.

Outlook

John Crane's record high order book is expected to support sales growth from the mid- and downstream segment in the first half of fiscal year 2015. However, we foresee revenue growth below our medium-term operating range in the first half because of the challenging upstream market conditions and some manufacturing constraints. We anticipate these conditions will improve slightly as the year progresses. We expect operating margins for the year to continue to be at the top end of the guidance provided, with further expansion in the near term being limited due to increased investment in growth initiatives.

Smiths Medical

	2014 £m	2013 £m	Reported growth	Underlying growth
Revenue	**804**	850	(5)%	(1)%
Headline operating profit	**159**	189	(16)%	(12)%
Headline operating margin	**19.8%**	22.2%	(240) bps	
Statutory operating profit	**142**	179		
Return on capital employed	**14.5%**	16.6%	(210) bps	

Performance

Revenue declined 5%, or £46m, representing an underlying fall in revenue of £4m (1%) and adverse currency translation of £42m. First half revenues fell due to tough trading conditions in developed markets, compounded by US distributor destocking, and continued underperformance in emerging markets. Second half revenues increased 3%, albeit against a weak comparator, on sequential improvement in every product franchise and every geographical region. Medication delivery saw especially strong sales. For the year, hardware revenue grew 4%, driven by ambulatory infusion pump sales, which were up 16%. Consumables, which comprise almost 85% of total revenue, were down 2% due to price pressure on peripheral intravenous catheter (PIVC) in developed markets, distributor market pressures and channel destocking in US.

Headline operating profit declined 16% (£30m) and headline operating margin fell 240 basis points to 19.8%. Foreign exchange translation accounted for £7m of the decline while underlying profit fell 12%, or £23m. Underlying profit was hit by price erosion (£9m), foreign exchange transaction impacts (£10m), the incremental effect of US medical device tax (£3m), and non-recurrence of 2013 insurance credits (£6m), partially offset by productivity savings.

The difference between statutory and headline operating profit reflects amortisation of acquired intangible assets of £9m and restructuring costs of £10m.

Return on capital employed fell 210 basis points to 14.5% as a result of the reduced profitability and increased capital expenditure, which included investment in new product development, manufacturing tooling and upgrade of our Oracle ERP system.

We are simplifying our manufacturing footprint and fixed cost base as part of the *Fuel for Growth* restructuring programme, and expect to deliver £23m of savings by the end of FY17. We have incurred costs to date of £10m. In the year, we announced the closure of our Rossendale and Rockland facilities as activities are consolidated in our network. Production started at our newly established Czech facility.

Developed market trading conditions remained soft with sales impacted by price erosion, capital spending constraints, and relatively flat procedure growth rates. Against this backdrop, underlying sales in developed markets grew 3% in the second half to end the year flat following declines in the first half. Infusion sales in these markets showed good growth through strong competitive positioning of ambulatory pumps in the second half. Safety sales were hit in the first half by PIVC share losses, but stabilised in the second half. Marketing initiatives to retain and grow the business gained traction and OEM sales improved in the second half. Vital care sales also stabilised following the 3% decline in the first half, which reflected channel inventory movements particularly in our respiratory products. Second half performance reflects a focus on airway and temperature management service-level improvements. End-user sales performance of our bronchial hygiene distribution arrangement in the US has also been strong.

Emerging market performance declined 5%. China revenues declined 7% as infusion performance held back sales pending the introduction of new products. However, second half sales stabilised as the business refocused on driving growth from other franchises. We saw challenging conditions in many smaller markets with currency controls in Venezuela, slow government payments in South Africa, and the adverse impact on distributor exports from weakening currencies. In India, the transition of business from our former distributor to our onshore India operation was completed in October and direct management of the channel has driven sales growth of 137% in the second half (up 74% for the year). Brazil continued to deliver double digit growth (up 12%) following the salesforce expansion last year.

Medication delivery underlying revenue grew by 7% with continued success of our CADD-Solis pumps and disposables globally, including CADD-Solis PIB and CADD-Solis VIP launched recently in the US. Medfusion pump systems business was robust in the US, with strong second half growth following a soft start.

Vital care underlying revenue ended down 2%, reflecting sluggish procedure volumes and pricing pressures, compounded by distributor destocking in the US. Tracheostomy and assisted reproduction both grew, offset by declines in respiratory, general anaesthesia, temperature management and patient monitoring. Our US respiratory business was particularly hit by channel inventory movements; however, underlying demand for our products remains robust.

Safety devices underlying revenue declined 4% for the year, reflecting an improved second half (down 1%) as marketing activities and pricing actions mitigated first half declines of 7%. In developed markets, competition is increasing in safety devices as customers convert from conventional products, resulting in pricing pressures and share loss.

Research and development

Investment in new product development remains a priority, growing to 4.8% of revenue (2013: 4.4%) with total R&D spend of £38m (2013: £38m). Continuing our initiative to streamline the organisation, upgrade talent and improve processes in R&D, we have appointed a new Chief Technology Officer. We continue to invest in emerging market R&D and now have an established product development team in Shanghai with particular focus on infusion for the China market. We have also increased our investment in clinical research to deliver evidence of the effectiveness and economic benefit of our products.

Our vitality index, measured as sales from products launched in the last three years, improved to 7% (2013: 5%). This primarily reflects strong sales of ambulatory infusion products during the second half of the year. Launches during the year included Medfusion 3500 v6 (US) and CADD-Solis PIB (US and other markets).Our recently launched ViaValve safety IV catheter (North America) and Jelco IntuitIV safety IV catheter (Europe) are both gaining traction in their respective markets, despite strong price competition. In emerging markets, the broadening of portfolios through registration of existing products is starting to bear fruit, particularly in Brazil and India.

Outlook

Trading conditions in developed markets are likely to remain challenging in the medium term due to healthcare cost controls and pricing pressures. We expect to see continued robust performance in infusion on the strength of product launches over the past couple of years and strong marketing programmes. Additionally, the introduction of new products to refresh our infusion range in China in 2015 will improve our competitiveness in this important market.

We will drive cost savings through variable and fixed cost productivity initiatives as well as site rationalisation. These cost savings will be largely reinvested in revenue growth drivers.

Smiths Detection

	2014 £m	2013 £m	Reported growth	Underlying growth
Revenue	**512**	559	(8)%	(5)%
Headline operating profit	**25**	58	(58)%	(57)%
Headline operating margin	**4.8%**	10.4%	(560) bps	
Statutory operating profit	**23**	52		
Return on capital employed	**3.9%**	8.8%	(490) bps	

Performance

Revenue at Smiths Detection declined 5% (or £25m) on an underlying basis against a strong comparator period. Foreign exchange translation had a further £22m impact, reducing reported revenues by £47m to £512m. Customer budgets, notably those of many national governments, remained constrained, resulting in aggressive pricing strategies by many direct competitors.

In a tough trading environment, demand weakened in the transportation, ports and borders, and military markets. There was little compensating growth in the critical infrastructure and emergency responders sectors which remained broadly flat.

In May we announced that, following an assessment of all major contracts and programmes, we had concluded a review of working capital requirements. This review, combined with the adoption of new divisional policies, resulted in an additional charge of £15m for the associated adjustments to inventory and receivables. During the year, we have also incurred additional programme delivery costs of £8m for certain long-running large contracts. We also incurred a charge of £7m in connection with price audits of overhead cost recovery charges associated with certain historical supply agreements. Together, these have resulted in one-off costs in the year of £30m.

Profitability was also affected by volume declines (£8m), adverse price/mix (£8m) and an increase in the level of expensed research and development costs (£8m). Together, these more than offset operational efficiencies (£7m). Foreign exchange transaction losses totalled £4m. In the prior year, we also incurred costs of £19m largely associated with programme delivery costs, working capital and restructuring. The net impact of these movements was a 57% underlying decline in headline operating profit; margins fell 560 basis points to 4.8%.

The difference between statutory and headline operating profit includes exceptional restructuring costs (£7m), gains on adjustment to deferred consideration (£2m) and profit on disposal of business (£3m). Return on capital declined 490 basis points to 3.9%, reflecting the reduced profitability. Detection's operating environment has undergone major changes in the past five years with contracts becoming more programme-based – often requiring additional services such as infrastructure enabling works and networking. We have been slow to adapt to these changes but we have strengthened the management team to address these shortcomings. Richard Ingram, the new divisional president, has a strong background in programme management and long experience of driving operational improvements and manufacturing efficiencies. We expect that these initiatives to tackle low-margin programmes and other ongoing productivity initiatives will take another year to 18 months to deliver results.

Under *Fuel for Growth*, Smiths Detection started a comprehensive business improvement programme towards the end of the period and has identified a number of priority areas to stabilise and grow the business. It will deliver annual savings of some £14m at an expected total cost of £34m by the end of FY16/17. Costs of £5m were incurred in the year.

A reduction in the number of manufacturing facilities is among the early initiatives to cut costs and restore competitiveness. During 2015, three sites in North America will be closed and their activities consolidated at existing facilities in the US and UK. Production of small X-ray systems at our Malaysia facility will be increased to exploit their existing manufacturing efficiencies.

The focus on price competitiveness has been partly driven by evidence of price deflation in some markets, notably for certain X-ray screening systems. Among our responses, we have implemented a number of value engineering projects, not only to deliver savings in the design and manufacturing processes but also to enhance product appeal in key markets. This will increase sales margins and drive long-term value from the portfolio.

Opportunities presented by higher growth economies are being vigorously pursued, with China becoming a principal focus for 2015, following the appointment of two new distributors. The recent strengthening of local support for Middle East sales is delivering results with new contract wins.

Transportation revenue fell 5% underlying in the face of strong competitive activity in all regions and limited investment in new airports. Major contracts included two orders from the US Transportation Security Administration, totalling almost $70m, for automatic explosives scanners and a system to identify hazardous liquids in bottles.

An underlying fall in revenues of 16% in the ports and borders market reflected lower contract activity. A review of the product portfolio of high-value cargo X-ray scanners, under the *Fuel for Growth* programme, will simplify the product offering for a large majority of market opportunities.

Critical infrastructure, covering public and commercial buildings and key installations, is both diverse and unregulated. Underlying revenues rose 11%, despite an increasingly competitive environment.

An underlying fall of 10% in military sales continued the trend of a variable annual cycle of activity in a largely contract-driven sector. The overall trend is downwards as pressure on government defence budgets leads to fewer replacement programmes for those long-term projects now coming to an end. However, under the US JCAD program for chemical agent detectors, a further $20m follow-on production order was received from the Department of Defense.

Across all sectors, aftermarket revenues have delivered underlying growth of 10% and now represent 30% of sales. Planned business improvements will capitalise on the steady income potential of this activity, in order to generate further growth.

Research and development

Smiths Detection remains committed to investing in the development of its main technologies and new products, to maintain its competitive position, through investment which increasingly will be specifically targeted to support a streamlined product range. Company-funded R&D was £37m or 7.3% of revenue (2013: £36m or 6.5%). This includes £10m of capitalised projects (2013: £16m), which reduced from last year as the mix of projects changed with the completion of developments such as the HI-SCAN 10080 XCT. In addition, customer and government support for R&D totalled £4m in the period (2013: £6m). Looking ahead, we expect to focus our investment more tightly on fewer projects, which will result in lower spend.

Main developments in the period included the launch of a light vehicle scanner for checkpoints and two new portable identifiers, one for illicit drugs and the other to analyse explosive substances. Following the launch of the HI-SCAN 10080 XCT explosives detection system for hold baggage, after a three-year development programme, the first contracts were received for installation in airports at Santiago, Bremen, and Marrakesh, Morocco.

Outlook

The order book is at a similar level to last year which is expected to deliver flat revenues in the coming year, although we expect a bias to the second half. The trading environment is still challenging: government capital spending remains constrained and pricing is increasingly competitive. Margins should improve against a weak comparator. Pricing pressures are expected to be partially mitigated by the benefits of our recently announced productivity initiatives and as other cost savings bear fruit over the next 12-18 months.

Smiths Interconnect

	2014 £m	2013 £m	Reported growth	Underlying growth
Revenue	**445**	461	(3)%	1%
Headline operating profit	**71**	69	4%	9%
Headline operating margin	**16.0%**	14.9%	110 bps	
Statutory operating profit	**49**	49		
Return on capital employed	**13.7%**	12.4%	130 bps	

Performance

Reported revenue declined 3%, or £16m, due mainly to a £20m foreign exchange headwind and a minor divestment (£2m). Excluding these, underlying revenue rose 1%, or £6m. Strong performance in the Microwave business in the second half, particularly in commercial markets, offset a modest decline in Connectors. Power was flat.

Reported headline operating profit increased 4%, or £2m despite a foreign exchange hit of £3m. Underlying headline operating profit grew by 9% or £5m.

The difference between statutory and headline operating profit reflects amortisation of acquired intangible assets of £17m and exceptional restructuring costs of £5m.

Margins grew in all three business units contributing to a 110 basis points improvement for the division. Significant benefits came from improvements in productivity, restructuring, increased volumes and procurement savings. Collectively these more than offset pricing pressure and labour inflation, and supported continued reinvestment in growth enablers, particularly new product development and geographic expansion within Connectors.

Return on capital improved by 130 basis points to 13.7%, mostly driven by the increase in profitability.

The Connectors business unit continued to face tough market conditions in Western Europe and the Americas with continued delays and cancellations of major defence projects, particularly the reduced Eurofighter production rate. This led to a decline in underlying revenue of 2%. A focus on commercial markets such as aerospace, medical and semiconductor test provided pockets of growth. Several new products performed well, including an ultra-fine pitch socket for testing semiconductor chips used in gaming and networking applications; a spring probe-based connector for a disposable catheter application; and a high-speed connector being used on a Chinese commercial aerospace project. Geographically, we continued to build our capabilities in Asia by adding resources and establishing an entity in Singapore to provide local customer service and engineering support. Operationally, Connectors significantly reduced manufacturing in California and the UK as part of the ongoing process of consolidating production capabilities.

In Microwave, a similar but more pronounced story of growth in commercial markets and contraction in defence markets delivered underlying revenue growth of 5%. Lower defence budgets and the US withdrawal from Afghanistan cut demand for some of our products including unmanned aerial vehicle datalinks and ground vehicle self-protection radar systems. After appropriate restructuring measures were taken, our defence businesses have now stabilised. We continue to support several ongoing defence programmes that are less susceptible to budget changes whilst also focusing on redirecting resources to commercial applications and the more strategically important sectors within defence such as ISR (Intelligence, Surveillance, and Reconnaissance). In commercial aerospace sales declined as the primary customer for our current airborne antenna system did not secure any significant new airline orders. However we continue to pursue new opportunities with alternative customers and next-generation product development activities. In wireless telecoms, the combination of new products and healthy demand drove exceptional growth. There was strong global demand for the next-generation version of our PIM (passive intermodulation) test equipment, particularly from US operators to support long-term evolution (LTE) network build-outs. Sales of our Lab-Flex high-performance cable assemblies also increased significantly, with the highest demand in production test applications for wireless devices such as smartphones and tablets.

Underlying revenue in Power was flat as modest growth in the second half offset the first half small decline. US data centre demand slowed as co-location providers cut spending to enable customer demand to catch up with capacity built out in the previous year, effectively choking the supply chain. However, project wins for our Busway products in international markets such as India and Brazil offset the US softness to provide overall growth in the global data centre market. Furthermore, Power was selected to provide equipment for a large new US government data centre project and there are early signs of an increase in build rates of enterprise data centres. Revenues into the industrial market also increased primarily due to a significant contract for furnace power controllers for LED crystal growth applications. Demand for our power protection products remained weak mainly because changes in our core wireless telecoms market reduced the need for our technology. Consequently, we exited the commoditised Chinese market, restructured our local presence into a low cost manufacturing facility servicing export markets, and we are closing our Bangalore facility. Although military sales of EMP (electromagnetic pulse) protection products also declined in the year, there are signs of a potential uptick as the US Department of Defense appears to be expanding the assets requiring protection to include ground vehicles, aircraft and helicopters. In addition, new potential markets for EMP or GMD (geomagnetic disturbance) protections such as utilities, data centres and financial institutions are under discussion.

Research and development

Total R&D of £27m increased as a proportion of revenue by 40 basis points to 6.1%. Company-funded R&D of £24m or 5.3% of revenue increased 5% on an underlying basis. New investment was targeted towards higher growth opportunities in commercial markets. Connectors' projects include new technology and products for medical, aerospace and oil and gas applications. In Microwave, the focus has remained on enhancing the features and capabilities of our market-leading PIM test equipment and next-generation airborne satellite communication antenna systems. Recognising the trend towards higher density data centres, Power extended its Busway and static transfer switch product lines with higher power variants and also launched JCOMM, a new branch circuit monitoring system that provides greater functionality, increases safety and reduces installation time.

Customer-funded R&D increased 30% to £3m, with funding for next-generation defence projects including ground-based satellite communications terminals and enhanced visual situational awareness systems for helicopters.

The vitality index, the proportion of revenue from products developed in the last three years, was maintained at over 30%.

Outlook

The defence market has stabilised but is expected to continue to be challenged by constrained budgets. Sustained growth is expected in commercial markets, particularly semiconductor, wireless telecoms and data centres but at lower rates as certain projects in the second half will not carry over. The drive towards emerging markets, especially Asia, will continue and is likely to support modest overall growth. Investments to support long-term growth are expected to suppress margins, but on an underlying basis margins should remain steady as ongoing and new productivity initiatives are expected to offset pricing and inflationary pressures. Normal seasonality in certain markets and the timing of benefits from investments will again bias performance towards the second half.

Flex-Tek

	2014 £m	2013 £m	Reported growth	Underlying growth
Revenue	**250**	253	(1)%	3%
Headline operating profit	**47**	43	9%	14%
Headline operating margin	**18.9%**	17.1%	180 bps	
Statutory operating profit/(loss)	**37**	36		
Return on capital employed	**34.0%**	30.8%	320 bps	

Performance

Flex-Tek revenues grew 3%, or £8m, on an underlying basis. Reported revenue was affected by £11m of foreign exchange translation which resulted in a decline of 1% to £250m. Continued revenue growth from sales to the reviving US residential construction market and growth of specialty heating elements and flexible hoses formed the basis for the improvement. Fluid Management revenues declined 2% from last year, as demand on new engine platform awards was deferred into next year. This segment also had some exposure to declines in defence spending, and reduced trading in the power generation segment. Headline operating margin rose 180 basis points to 18.9% with increased volumes and positive mix from specialty application solutions. The underlying increase in operating profit of 14% (£6m) stemmed from higher volumes, pricing and the improved sales for bespoke applications.

Return on capital employed rose to 34%, an increase of 320 basis points, on the back of the improved profitability.

The difference between statutory and headline operating profit principally reflects exceptional litigation costs of £10m.

In Fluid Management, the timing of initial shipments to aerospace customers for awards on new platforms versus ramp-downs for existing engine platforms affected this year's revenue, down 2%. Underlying demand remains strong, with major airframe manufacturers Airbus and Boeing and engine manufacturers Pratt & Whitney, GE, and Rolls-Royce placing new orders which have pushed the large commercial jet backlog to record levels. Our sales into automotive fuel and brake applications were up 21% over prior year.

Sales of our flexible gas piping and HVAC ducting to the construction market rose 8%. Revenue growth benefitted from industry consolidation among wholesalers and industry buying groups, as our customers acquired competitors. Increased volumes are expected to improve operational efficiency, while the concentration of buying power will potentially intensify pricing pressure. Our efforts to cross-sell our ducting, flexible gas piping and HVAC heating element product lines to the US distribution market continue to be successful as we gain market share. Our new sales efforts introducing our flexible gas piping into the UK market have met early success, with plans for expansion.

Heat Solutions underlying revenue grew 7% over the prior year, driven by a mix of sales growth in specialty heating elements and flat demand in the appliance sector. Prices for nickel, the primary component in electrical heating elements, remained stable for the year. Improved sales to distributors, via cross-selling efforts with ducting and gas piping, countered lower revenue from OEM HVAC equipment manufacturers. Revenues from our custom heating elements continue to grow and we have increased our R&D investments in new technologies. Sales in China exceeded last year's results by almost 21%.

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

Research and development

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

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

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

Outlook

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

Financial review

Earnings per share
Basic headline earnings per share from continuing activities were 81.8p (2013: 92.7p). This reflects a decline in headline operating profit.

On a statutory basis, the basic earnings per share from continuing activities were 59.0p (2013: restated 80.1p).

Exceptional and other items relating to continuing activities excluded from headline profit before tax
These items amounted to a charge of £143m compared to a charge of £102m in 2013. They comprised:

- £54m in connection with John Crane, Inc. asbestos litigation (2013: £17m);
- £11m associated with Titeflex Corporation litigation (2013: £8m);
- £29m of exceptional restructuring costs in respect of *Fuel for Growth* and the performance improvement programme in Smiths Detection (2013: £8m);
- £9m for retirement benefit finance charge (2013: restated charge of £23m);
- £6m of legacy retirement benefit administration costs (2013: restated £7m);
- £3m profit on disposal of property and businesses (2013: £6m);
- £1m cost of acquisitions, disposals and aborted transactions (2013: £3m);
- £2m gain on legal settlements and diabetes royalty payments (2013: £1m);
- £2m gain on reassessed contingent consideration provided on acquisitions (2013: £2m); and
- £1m of financing losses (2013: £2m).

During the year to 31 July 2013, in addition to the above, a £4m gain on changes to pensions plans was also excluded from headline performance.

Cash generation and net debt
Operating cash generation remained strong with headline operating cash-flow of £490m (2013: £548m), representing 97% (2013: 98%) of headline operating profit (see note 27 to the accounts for a reconciliation of headline operating cash and free cash-flow to statutory cash-flow measures). Free cash-flow decreased by £94m to £143m (2013: £237m). Free cash-flow is stated after all legacy costs, interest and taxes but before acquisitions and dividends.

On a statutory basis, net cash inflow from continuing operations was £256m (2013: £353m).

Dividends paid in the year on ordinary shares amounted to £275m (2013: £152m) which includes the annual dividend of £157m and the special dividend of £118m.

Net debt at 31 July was £804m, an increase of £60m from the £744m at 31 July 2013. This increase in net debt reflects the impact of the special dividend paid in November 2013 offset by continued strong cash generation and translation gains on foreign currency-denominated debt of £70m.

Interest and other financing costs
Interest payable on debt, net of interest earned on cash deposits, was £60m compared with £62m in 2013. This reduction primarily reflects lower interest rates on debt during the year. Interest costs were covered 8.7 times by headline operating profit.

The Group accounts for pensions using IAS 19. As required by this standard, a finance charge of £9m (2013: a charge of £23m restated for IAS 19) is recognised reflecting the unwinding of the discount on the net pension liability.

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

We invested a total of £117m in R&D (2013: £117m), equivalent to 4.0% of revenue (2013: 3.8%). Of that total, £109m was funded by the Company compared with £108m in 2013. However, at constant currencies, company-funded investment increased 5% on an underlying basis. We actively seek funding from customers to support R&D and this amounted to £8m (2013: £9m). Under IFRS, certain development costs are capitalised, and this amounted to £24m in the period (2013: £30m). The gross capitalisation is shown as an intangible asset. Where customers contribute to the costs of development, the contribution is included as deferred income and disclosed within trade and other payables.

Taxation
The headline tax charge for 2014 of £120m (2013: £132m) represented an effective rate of 27% on the headline profit before taxation (2013: 26.5%). On a statutory basis, the tax charge on continuing activities was £67m (2013: £79m).

The Group continues to take advantage of global manufacturing, research and development and other tax incentives, the tax-efficient use of capital and tax compliance management. A rate of between 26% and 27% is expected in the year ending 31 July 2015.

In the 2014 financial year, Smiths Group paid £95m in direct corporate tax and £78m in employer taxes. The Group also collected £197m on behalf of tax authorities from employee taxes and indirect taxes such as VAT. These amounts totalled £370m.

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 declined 90 basis points to 15.7% (2013: 16.6%) as a result of reduced profitability in Smiths Medical and Smiths Detection more than offsetting improved profitability in John Crane, Smiths Interconnect and Flex-Tek.

Retirement benefits
As required by IFRS the balance sheet reflects the net surplus or deficit in retirement benefit plans, taking assets at their market values at 31 July 2014 and evaluating liabilities at period-end AA corporate bond interest rates.

The tables below disclose the net status across a number of individual plans. Where any individual plan shows a surplus under IAS 19, this is disclosed on the balance sheet as a retirement benefit asset. The IAS 19 surplus of any one plan is not available to fund the IAS 19 deficit of another plan. The net pension deficit has reduced to £242m at 31 July 2014 from £254m at 31 July 2013. The deficit reduction reflects the benefit of asset returns and contributions offset by lower discount rates.

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

The retirement benefit position was:

	31July 2014	31 January 2014	31 July 2013
Funded plans			
UK plans – funding status	**99%**	99%	99%
US plans – funding status	**84%**	85%	81%
Other plans – funding status	**79%**	80%	80%

	31July 2014	31 January 2014	31 July 2012
Deficit			
Funded plans	**(135)**	(132)	(147)
Unfunded plans	**(107)**	(104)	(107)
Total deficit	**(242)**	(236)	(254)
Retirement benefit assets	**123**	102	121
Retirement benefit liabilities	**(365)**	(338)	(375)
	(242)	(236)	(254)

In the coming year, cash contributions to all the schemes are expected to total approximately £85m (2014: £88m). In addition, the Group will invest £24m in an escrow account as part of the funding plan agreed with the Smiths Industries Pension Scheme (SIPS).

The approximate pension membership for the three main schemes at around the end of July 2014 is set out in the table below:

Pension scheme members	SIPS	TIGPS	US plans	Total
Deferred active	470	260	3,120	**3,850**
Deferred	11,400	13,870	6,290	**31,560**
Pensioners	13,090	17,690	5,600	**36,380**
Total	**24,960**	**31,820**	**15,010**	**71,790**

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:

	31July 2014	31 July 2013		31 January 2014
Average rates:				
US dollar	**1.64**	1.57	Dollar weakened 4%	1.61
Euro	**1.21**	1.20	Euro weakened 1%	1.19
Year-end rates:				
US dollar	**1.69**	1.52	Dollar weakened 11%	1.65
Euro	**1.26**	1.14	Euro weakened 11%	1.22

Financial information

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

The statutory accounts for the year ended 31 July 2013 have been filed with the Registrar of Companies. The auditors have reported on those accounts and on the statutory accounts for the year ended 31 July 2014, which will be filed with the Registrar of Companies following the Annual General Meeting. Both the audit reports were unqualified and did not contain any statement under section 498 of the Companies Act 2006.

Consolidated income statement

	Notes	Year ended 31 July 2014 £m	Year ended 31 July 2013 (restated) £m
Continuing operations			
Revenue	1	**2,951.6**	3,108.6
Cost of sales		**(1,625.5)**	(1,694.0)
Gross profit		**1,326.1**	1,414.6
Sales and distribution costs		**(398.3)**	(425.6)
Administrative expenses		**(550.2)**	(502.5)
Operating profit	2	**377.6**	486.5
Comprising			
– headline operating profit	3	**504.4**	559.7
– exceptional items, amortisation of acquired intangibles	3	**(126.8)**	(73.2)
		377.6	486.5
Interest receivable		**2.6**	2.6
Interest payable		**(62.4)**	(64.3)
Other financing losses		**(7.4)**	(6.1)
Net finance charges – retirement benefits	9	**(8.4)**	(23.0)
Finance costs	5	**(75.6)**	(90.8)
Profit before taxation		**302.0**	395.7
Comprising			
– headline profit before taxation	3	**444.6**	498.0
– exceptional items, amortisation of acquired intangibles and other financing gains and losses	3	**(142.6)**	(102.3)
		302.0	395.7
Taxation	7	**(67.4)**	(79.1)
Profit after taxation – continuing operations		**234.6**	316.6
Profit – discontinued operations		**0.1**	
Profit for the year		**234.7**	316.6
Attributable to			
Smiths Group shareholders		**232.8**	315.0
Non-controlling interests		**1.9**	1.6
		234.7	316.6
Earnings per share	6		
Basic		**59.0p**	80.1p
Diluted		**58.4p**	79.3p

Consolidated statement of comprehensive income

	Notes	Year ended 31 July 2014 £m	Year ended 31 July 2013 (restated) £m
Profit for the period		**234.7**	316.6
Other comprehensive income			
Actuarial (losses)/gains on retirement benefits	9	**(76.9)**	326.6
Taxation recognised on actuarial movements	7	**5.8**	(39.0)
Other comprehensive income and expenditure which will not be reclassified to the consolidated income statement		**(71.1)**	287.6
Other comprehensive income which will be, or has been, reclassified			
Exchange gains/(losses)		**(257.2)**	99.8
Fair value gains/(losses)			
– on available for sale financial assets		**2.8**	0.1
– deferred in the period on cash-flow and net investment hedges		**118.7**	(44.7)
– reclassified to income statement		**(2.4)**	(4.3)
Taxation recognised on fair value gains and losses		**0.1**	(1.0)
Total other comprehensive income		**(209.1)**	337.5
Total comprehensive income		**25.6**	654.1
Attributable to			
Smiths Group shareholders		**24.9**	654.2
Non-controlling interests		**0.7**	(0.1)
		25.6	654.1

Consolidated balance sheet

	Notes	31 July 2014 £m	31 July 2013 £m
Non-current assets			
Intangible assets	11	**1,543.6**	1,746.0
Property, plant and equipment	13	**258.4**	280.0
Financial assets – other investments	17	**116.9**	86.1
Retirement benefit assets	9	**122.6**	121.7
Deferred tax assets	7	**185.0**	185.4
Trade and other receivables	15	**35.0**	34.1
Financial derivatives	20	**9.2**	6.4
		2,270.7	2,459.7
Current assets			
Inventories	14	**427.3**	475.6
Current tax receivable		**33.8**	33.4
Trade and other receivables	15	**634.8**	695.5
Cash and cash equivalents	18	**190.2**	393.8
Financial derivatives	20	**7.7**	8.1
		1,293.8	1,606.4
Total assets		**3,564.5**	4,066.1
Non-current liabilities			
Financial liabilities			
– borrowings	18	**(981.9)**	(951.1)
– financial derivatives	20	**(4.3)**	(11.0)
Provisions for liabilities and charges	23	**(245.3)**	(258.1)
Retirement benefit obligations	9	**(364.3)**	(375.3)
Deferred tax liabilities	7	**(57.9)**	(73.1)
Trade and other payables	16	**(27.6)**	(31.0)
		(1,681.3)	(1,699.6)
Current liabilities			
Financial liabilities			
– borrowings	18	**(12.5)**	(187.1)
– financial derivatives	20	**(4.6)**	(5.8)
Provisions for liabilities and charges	23	**(81.9)**	(78.1)
Trade and other payables	16	**(464.1)**	(521.8)
Current tax payable		**(74.7)**	(80.1)
		(637.8)	(872.9)
Total liabilities		**(2,319.1)**	(2,572.5)
Net assets		**1,245.4**	1,493.6
Shareholders' equity			
Share capital	24	**147.9**	147.7
Share premium account		**346.4**	340.8
Capital redemption reserve		**5.8**	5.8
Revaluation reserve		**1.7**	1.7
Merger reserve		**234.8**	234.8
Retained earnings	26	**558.5**	929.2
Hedge reserve	26	**(57.7)**	(174.0)
Total shareholders' equity		**1,237.4**	1,486.0
Non-controlling interest equity		**8.0**	7.6
Total equity		**1,245.4**	1,493.6

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 2013		488.5	242.3	929.2	(174.0)	1,486.0	7.6	1,493.6
Profit for the year				232.8		232.8	1.9	234.7
Other comprehensive income								
Actuarial gains on retirement benefits and related tax				(71.1)		(71.1)		(71.1)
Exchange gains/(losses)				(256.0)		(256.0)	(1.2)	(257.2)
Fair value gains/(losses) and related tax				2.9	116.3	119.2		119.2
Total comprehensive income for the year				(91.4)	116.3	24.9	0.7	25.6
Transactions relating to ownership interests								
Exercises of share options	24	5.8				5.8		5.8
Taxation recognised on share options	7			(0.7)		(0.7)		(0.7)
Purchase of own shares	26			(12.8)		(12.8)		(12.8)
Dividends								
– equity shareholders	25			(275.0)		(275.0)		(275.0)
– non-controlling interest							(0.3)	(0.3)
Share-based payment	10			9.2		9.2		9.2
At 31 July 2014		**494.3**	**242.3**	**558.5**	**(57.7)**	**1,237.4**	**8.0**	**1,245.4**

	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 2012		479.2	242.3	376.1	(124.8)	972.8	8.0	980.8
Profit for the year (restated)				315.0		315.0	1.6	316.6
Other comprehensive income								
Actuarial losses on retirement benefits and related tax (restated)				287.6		287.6		287.6
Exchange (losses)/gains				101.7	(0.2)	101.5	(1.7)	99.8
Fair value gains/(losses) and related tax				(0.9)	(49.0)	(49.9)		(49.9)
Total comprehensive income for the year				703.4	(49.2)	654.2	(0.1)	654.1
Transactions relating to ownership interests								
Exercises of share options	24	9.3				9.3		9.3
Taxation recognised on share options	7			1.0		1.0		1.0
Purchase of own shares	26			(11.0)		(11.0)		(11.0)
Dividends								
– equity shareholders	25			(152.4)		(152.4)		(152.4)
– non-controlling interest							(0.3)	(0.3)
Share-based payment	10			12.1		12.1		12.1
At 31 July 2013		**488.5**	**242.3**	**929.2**	**(174.0)**	**1,486.0**	**7.6**	**1,493.6**

Consolidated cash-flow statement

	Notes	Year ended 31 July 2014 £m	Year ended 31 July 2013 £m
Net cash inflow from operating activities	27	**256.2**	353.4
Cash-flows from investing activities			
Expenditure on capitalised development		**(22.6)**	(28.4)
Expenditure on other intangible assets		**(17.5)**	(11.1)
Purchases of property, plant and equipment	13	**(53.9)**	(56.5)
Disposals of property, plant and equipment		**4.7**	3.9
Investment in financial assets		**(27.3)**	(24.3)
Acquisition of businesses		**(1.3)**	(0.5)
Disposals of businesses		**3.2**	0.3
Net cash-flow used in investing activities		**(114.7)**	(116.6)
Cash-flows from financing activities			
Proceeds from exercise of share options	24	**5.8**	9.3
Purchase of own shares		**(12.8)**	(11.0)
Dividends paid to equity shareholders	25	**(275.0)**	(152.4)
Dividends paid to non-controlling interests		**(0.3)**	(0.3)
Cash inflow/(outflow) from matured derivative financial instruments		**10.9**	(0.4)
Increase in new borrowings		**138.0**	247.2
Reduction and repayment of borrowings		**(179.6)**	(159.1)
Net cash-flow used in financing activities		**(313.0)**	(66.7)
Net (decrease)/increase in cash and cash equivalents		**(171.5)**	170.1
Cash and cash equivalents at beginning of year		**386.5**	203.7
Exchange differences		**(25.9)**	12.7
Cash and cash equivalents at end of year	18	**189.1**	386.5
Cash and cash equivalents at end of year comprise			
– cash at bank and in hand		**115.1**	164.2
– short-term deposits		**75.1**	229.6
– bank overdrafts		**(1.1)**	(7.3)
		189.1	386.5
Included in cash and cash equivalents per the balance sheet		**190.2**	393.8
Included in overdrafts per the balance sheet		**(1.1)**	(7.3)
		189.1	386.5

Reconciliation of net cash-flow to movement in net debt

	Notes	Year ended 31 July 2014 £m	Year ended 31 July 2013 £m
Net (decrease)/increase in cash and cash equivalents		**(171.5)**	170.1
Net decrease/(increase) in borrowings resulting from cash-flows		**41.6**	(88.1)
Movement in net debt resulting from cash-flows		**(129.9)**	82.0
Capitalisation, interest accruals and unwind of capitalisation fees		**2.6**	(3.8)
Movement from fair value hedging		**(2.8)**	9.7
Exchange differences		**70.3**	(40.9)
Movement in net debt in the year	18	**(59.8)**	47.0
Net debt at start of year		**(744.4)**	(791.4)
Net debt at end of year	18	**(804.2)**	(744.4)

Accounting policies

Basis of preparation

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

The accounting policies adopted are consistent with those of the previous financial year except for the adoption of:

- 'IAS 19 (Revised 2011): Employee benefits'. The consolidated income statement, consolidated statement of comprehensive income, consolidated statement of changes in equity and related notes have been restated to reflect the recognition requirements of this standard;
- 'IAS 28: Investments in Associates and Joint Ventures' which has not led to any changes in reported figures or disclosures;
- Amendments to IFRS 7 'Disclosures – Offsetting financial assets and financial liabilities' requiring additional disclosures on netting;
- 'IFRS 10: Consolidated financial statements' which has not led to any changes in reported figures or disclosures;
- 'IFRS 11: Joint Arrangements' which has not led to any changes in reported figures or disclosures;
- 'IFRS 12: Disclosure of Interests in Other Entities' which has not led to any changes in reported figures or disclosures; and
- 'IFRS 13: Fair value measurement' which has increased the disclosure on valuation methods.

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 £28.7m (2013: £53.0m) has been recognised in the period in respect of contracts in progress at the period end with a total expected value of £112.7m (2013: £149.7m). A 5% reduction in the proportion of the contract activity recognised in the current period would have reduced operating profit by an estimated £0.1m (2013: £0.5m) for Smiths Detection and £0.1m (2013: £0.3m) for Smiths Interconnect.

In addition to contracts accounted for on a percentage of completion basis, Smiths Detection also has long-term contractual arrangements for the sale of goods and services. Margins achieved on these contracts can reflect the impact of commercial decisions made in different economic circumstances. In addition, contract delivery is subject to commercial and technical risks which can affect the outcome of the contract.

Smiths Medical has rebate arrangements in place with some distributors in respect of sales to end customers where sales prices have been negotiated by Smiths Medical. Rebates are estimated based on the level of discount derived from sales data from distributors, the amount of inventory held by distributors and the time lag between the initial sale to the distributor and the rebate being claimed. The rebate accrual at 31 July 2014 was £19.1m (2013: £17.0m).

Taxation

The Group has recognised deferred tax assets of £21.3m (2013: £28.1m) relating to losses and £91.6m (2013: £85.6m) relating to the John Crane, Inc. and Titeflex Corporation litigation provisions. The recognition of assets pertaining to these items involves judgement by management as to the likelihood of realisation of these deferred tax assets and this is based on a number of factors, which seek to assess the expectation that the benefit of these assets will be realised, including appropriate taxable temporary timing differences, and it has been concluded that there are sufficient taxable profits in future periods to support recognition. Further detail on the Group's deferred taxation position is included in note 7.

Retirement benefits

The consolidated financial statements include costs in relation to, and provision for, retirement benefit obligations. The costs and the present value of any related pension assets and liabilities depend on such factors as life expectancy of the members, the returns that plan assets generate and the discount rate used to calculate the present value of the liabilities. The Group uses previous experience and impartial actuarial advice to select the values of critical estimates. The estimates, and the effect of variances in key estimates, are disclosed in note 9.

At 31 July 2014 there is a retirement benefit asset of £122.6m (2013: £121.7m) which arises from the rights of the employers to recover the surplus at the end of the life of the scheme. If the pension schemes were wound up while they still had members, the schemes would need to buy out the benefits of all members. The buyouts would cost significantly more than the present value of the scheme liabilities calculated in accordance with IAS 19: Employee benefits.

Working capital provisions

For inventory and receivables, if the carrying value is higher than the expected recoverable value, the Group makes provisions writing down the assets to their recoverable value. The recoverable value of inventory is estimated using historical selling prices, sales activity and customer contracts. The recoverable value of receivables is considered individually for each customer and incorporates past experience and progress with collecting receivables.

At 31 July 2014 the carrying value of inventory incorporates provisions of £76.4m (2013: £74.4m). The inventory turn rate of 3.8 (2013: 3.6) varies across the five divisions. Smiths Detection has the slowest inventory utilisation with a turn rate of 3.1 (2013: 2.4). See note 14 for additional information about inventory.

At 31 July 2014 the gross value of receivables partly provided for or more than three months overdue was £45.8m (2013: £53.4m) and there were provisions of £17.5m (2013: £17.8m) against these receivables which were carried at a net value of £28.3m (2013: £35.6m). See note 15 for disclosures on credit risk and ageing of trade receivables.

Impairment

Goodwill is tested at least annually for impairment and intangible assets acquired in business combinations are tested if there are any indications of impairment, in accordance with the accounting policy set out below. The recoverable amounts of cash generating units and intangible assets are determined based on value in use calculations. These calculations require the use of estimates including projected future cash-flows and other future events.

See note 12 for details of the critical assumptions made, including the sales and margin volatility in Smiths Detection and Smiths Interconnect and disclosures on the sensitivity of the impairment testing to these key assumptions, including details of the changes in assumptions which would be required to trigger an impairment in Smiths Detection or Smiths Interconnect Power.

Provisions for liabilities and charges

As previously reported, John Crane, Inc., a subsidiary of the Group, is currently one of many co-defendants in litigation relating to products previously manufactured which contained asbestos. Provision of £204.1m (2013: £210.0m) has been made for the future defence costs which the Group is expected to incur and the expected costs of future adverse judgments against John Crane, Inc. Whilst published incidence curves can be used to estimate the likely future pattern of asbestos related disease, John Crane, Inc.'s claims experience is significantly impacted by other factors which influence the US litigation environment. These can include: changing approaches on the part of the plaintiffs' bar; changing attitudes amongst the judiciary at both trial and appellate levels; and legislative and procedural changes in both the state and federal court systems. Therefore, because of the significant uncertainty associated with the future level of asbestos claims and of the costs arising out of the related litigation, there can be no guarantee that the assumptions used to estimate the provision will result in an accurate prediction of the actual costs that may be incurred. John Crane, Inc. takes account of the advice of an expert in asbestos liability estimation in quantifying the expected costs.

As previously reported, Titeflex Corporation, a subsidiary of the Group in the Flex-Tek division, has received a number of claims from insurance companies seeking recompense on a subrogated basis for the effects of damage allegedly caused by lightning strikes in relation to its flexible gas piping product. It has also received a number of product liability claims regarding this product, some in the form of purported class actions. Titeflex Corporation believes that its products are a safe and effective means of delivering gas when installed in accordance with the manufacturer's instructions and local and national codes, however some claims have been settled on an individual basis without admission of liability. Provision of £61.1m (2013: £65.6m) has been made for the costs which the Group is expected to incur in respect of these claims. However, because of the significant uncertainty associated with the future level of claims, there can be no guarantee that the assumptions used to estimate the provision will result in an accurate prediction of the actual costs that may be incurred.

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

All provisions may be subject to potentially material revisions from time to time if new information becomes available as a result of future events. See note 23 for details of the assumptions and disclosures on the sensitivity of the provision calculations.

Accounting policies

Basis of consolidation

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

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

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

Foreign currencies

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

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

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

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

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.

Revenue

Revenue is measured at the fair value of the consideration received, net of trade discounts (including distributor rebates) and sales taxes. Revenue is discounted only where the impact of discounting is material.

Sale of goods

Revenue from the sale of goods is recognised when the risks and rewards of ownership have been transferred to the customer, the amount of revenue can be measured reliably and recovery of the consideration is probable. For established products with simple installation requirements, revenue is recognised when the product is delivered to the customer in accordance with the agreed delivery terms. For products which are technically innovative, highly customised or require complex installation, revenue is recognised when the customer has completed its acceptance procedures.

Services

Revenue from services is recognised in accounting periods in which the services are rendered, by reference to completion of the specific transaction, assessed on the basis of the actual service provided as a proportion of the total services to be provided. Depending on the nature of the contract, revenue will be recognised on the basis of the proportion of the contract term completed, the proportion of the contract costs incurred or the specific services provided to date.

Construction contracts

Contracts for the construction of substantial assets are accounted for as construction contracts if the customer specifies major structural elements of the design, including the ability to amend the design during the construction process. These projects normally involve installing customised systems with site-specific integration requirements.

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

Employee benefits

Share-based compensation

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

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

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

Pension obligations and post-retirement benefits

The Group has defined benefit plans, defined contribution plans and post-retirement healthcare schemes.

For defined benefit plans and post-retirement healthcare schemes the liability for each scheme recognised in the balance sheet is the present value of the obligation at the balance sheet date less the fair value of any plan assets. The obligation is calculated annually by independent actuaries using the projected unit credit method. The present value is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related liability. Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are recognised in full in the period in which they occur, outside of the income statement, and are presented in the statement of comprehensive income. Past service costs are recognised immediately in the income statement.

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

Leases

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

Exceptional items

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

- profits/(losses) on disposal of businesses and costs of acquisitions and disposals;
- spend on the integration of significant acquisitions and other major restructuring programmes;
- significant goodwill or other asset impairments;
- income and expenditure relating to material litigation in respect of products no longer in production; and
- other particularly significant or unusual items.

Exceptional items are excluded from the headline profit measures used by the Group. See note 3 for the basis of calculation of these measures.

Taxation

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

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

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

Deferred tax liabilities and assets are not discounted.

Discontinued operations

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

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

Intangible assets

Goodwill

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

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

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

Research and development

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

- amounts recoverable from third parties; and
- expenditure incurred in respect of the development of major new products where the outcome of those projects is assessed as being reasonably certain as regards viability and technical feasibility. Such expenditure is capitalised and amortised straight line over the estimated period of sale for each product, commencing in the year that sales of the product are first made.

The cost of development projects which are expected to take a substantial period of time to complete, and commenced after 1 August 2009, includes attributable borrowing costs.

Intangible assets acquired in business combinations

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

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

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

Software, patents and intellectual property

The estimated useful lives are as follows:

Software	up to 7 years
Patents and intellectual property	shorter of the economic life and the period the right is legally enforceable

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

Property, plant and equipment

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

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

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

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

Inventories

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

Trade and other receivables

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

Provisions

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

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

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

Assets and businesses held for sale

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

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

Cash and cash equivalents

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

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

Financial assets

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

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

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

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

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

Financial liabilities

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

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

Derivative financial instruments and hedging activities

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

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

Fair value hedge

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

Net investment hedge

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

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

Cash-flow hedge

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

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

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

Fair value of financial assets and liabilities

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

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

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

See note 21 for information on the methods the Group uses to estimate the fair values of its financial instruments.

Dividends

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

Recent accounting developments

The following standards and interpretations have been issued by the IASB and will affect future annual reports and accounts.

- 'IFRS 9: Financial instruments'
- 'IFRS 15: Revenue from contracts with customers'
- Amendment to 'IAS 36: Impairment of assets' on recoverable amount disclosures.

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.

Notes to the accounts

1 Segment information

Analysis by operating segment

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

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

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

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

							Year ended 31 July 2014
	John Crane £m	**Smiths Medical £m**	**Smiths Detection £m**	**Smiths Interconnect £m**	**Flex-Tek £m**	**Corporate costs £m**	**Total £m**
Revenue	**941.0**	**803.7**	**512.3**	**445.2**	**249.4**		**2,951.6**
Divisional headline operating profit	**234.1**	**159.5**	**24.7**	**71.2**	**47.1**		**536.6**
Corporate headline operating costs						**(32.2)**	**(32.2)**
Headline operating profit/(loss)	**234.1**	**159.5**	**24.7**	**71.2**	**47.1**	**(32.2)**	**504.4**
Exceptional operating items (note 4)	**(55.5)**	**(8.5)**	**(1.3)**	**(5.0)**	**(10.1)**	**(1.2)**	**(81.6)**
Legacy retirement benefits	**(0.1)**	**(0.1)**	**(0.1)**		**(0.1)**	**(6.1)**	**(6.5)**
Amortisation and impairment of acquired intangible assets	**(12.2)**	**(8.9)**	**(0.3)**	**(17.1)**	**(0.2)**		**(38.7)**
Operating profit/(loss)	**166.3**	**142.0**	**23.0**	**49.1**	**36.7**	**(39.5)**	**377.6**
Exceptional finance costs – adjustment to discounted provision (note 4)	**(4.7)**				**(1.3)**		**(6.0)**
Net finance costs – other							**(69.6)**
Profit before taxation							**302.0**

							Year ended 31 July 2013
	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Corporate costs £m	Total £m
Revenue	985.7	850.4	559.0	460.6	252.9		3,108.6
Divisional headline operating profit	230.5	189.1	58.0	68.8	43.2		589.6
Corporate headline operating costs						(29.9)	(29.9)
Headline operating profit/(loss)	230.5	189.1	58.0	68.8	43.2	(29.9)	559.7
Exceptional operating items (note 4)	(10.8)	1.2	(4.9)	(0.2)	(7.0)	1.8	(19.9)
Legacy retirement benefits (restated)						(6.7)	(6.7)
Amortisation and impairment of acquired intangible assets	(14.2)	(11.4)	(1.1)	(19.7)	(0.2)		(46.6)
Operating profit/(loss) (restated)	205.5	178.9	52.0	48.9	36.0	(34.8)	486.5
Exceptional finance costs – adjustment to discounted provision (note 4)	(3.3)				(0.9)		(4.2)
Net finance costs – other (restated)							(86.6)
Profit before taxation (restated)							395.7

1 Segment information continued

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

	Year ended 31 July 2014						
	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Reconciling items £m	Total £m
Depreciation	**13.7**	**15.6**	**5.1**	**7.3**	**3.1**	**1.3**	**46.1**
Amortisation of capitalised development		**12.1**	**9.1**	**0.1**			**21.3**
Amortisation of software, patents and intellectual property	**2.6**	**2.1**	**3.6**	**0.7**	**0.1**	**3.9**	**13.0**
Amortisation of acquired intangibles						**38.7**	**38.7**
Share-based payment	**2.3**	**1.1**	**0.4**	**0.6**	**1.2**	**4.3**	**9.9**

	Year ended 31 July 2013						
	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Reconciling items £m	Total £m
Depreciation	14.4	19.1	6.6	7.5	3.3	1.4	52.3
Amortisation of capitalised development		12.6	8.7				21.3
Amortisation of software, patents and intellectual property	2.6	3.2	3.4	0.8		3.2	13.2
Amortisation of acquired intangibles						46.6	46.6
Share-based payment	1.7	1.7	0.7	0.6	2.0	6.1	12.8

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

The capital expenditure for each division is:

	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Reconciling items £m	Total £m
Capital expenditure year ended 31 July 2014	**18.0**	**43.7**	**13.9**	**11.0**	**3.4**	**5.1**	**95.1**
Capital expenditure year ended 31 July 2013	17.3	39.8	22.4	9.7	2.6	5.7	97.5

The reconciling items comprise corporate capital expenditure through Smiths Business Information Services on IT equipment and software.

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

	31 July 2014					
	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Total £m
Property, plant, equipment, development projects and other intangibles	**91.3**	**159.6**	**96.8**	**39.0**	**18.8**	**405.5**
Working capital assets	**349.7**	**227.6**	**274.6**	**161.4**	**73.6**	**1,086.9**
Operating assets	**441.0**	**387.2**	**371.4**	**200.4**	**92.4**	**1,492.4**
Derivatives, tax and retirement benefit assets						**358.3**
Goodwill and acquired intangibles						**1,381.2**
Corporate assets						**142.4**
Cash						**190.2**
Total assets						**3,564.5**
Working capital liabilities	**(143.6)**	**(96.8)**	**(165.8)**	**(70.2)**	**(25.7)**	**(502.1)**
Corporate and non-headline liabilities						**(316.7)**
Derivatives, tax and retirement benefit liabilities						**(505.9)**
Borrowings						**(994.4)**
Total liabilities						**(2,319.1)**
Average divisional capital employed	**875.7**	**1,100.1**	**631.9**	**518.5**	**138.5**	**3,264.7**
Average corporate capital employed						**(47.3)**
Average total capital employed						**3,217.4**

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

Capital employed is a non-statutory measure of invested resources. It comprises statutory net assets adjusted to add goodwill recognised directly in reserves in respect of subsidiaries acquired before 1 August 1998 of £815.2m (2013: £815.2m) and eliminate post-retirement benefit related assets and liabilities and litigation provisions relating to exceptional items, both net of related tax, and net debt.

1 Segment information continued

						31 July 2013
	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Total £m
Property, plant, equipment, development projects and other intangibles	100.8	163.8	108.7	36.7	20.4	430.4
Working capital assets	363.0	245.2	343.1	159.5	78.1	1,188.9
Operating assets	463.8	409.0	451.8	196.2	98.5	1,619.3
Derivatives, tax and retirement benefit assets						355.0
Goodwill and acquired intangibles						1,576.9
Corporate assets						121.1
Cash						393.8
Total assets						4,066.1
Working capital liabilities	(166.8)	(96.8)	(202.0)	(69.5)	(28.5)	(563.6)
Corporate and non-headline liabilities						(325.4)
Derivatives, tax and retirement benefit liabilities						(545.3)
Borrowings						(1,138.2)
Total liabilities						(2,572.5)
Average divisional capital employed	897.9	1,141.4	657.4	554.4	140.2	3,391.3
Average corporate capital employed						(29.6)
Average total capital employed						3,361.7

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

Analysis of revenue

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

	Original equipment manufacture			Aftermarket		Total
John Crane	£m	Oil, gas and petrochemical £m	Chemical and pharmaceutical £m	Distributors £m	General industry £m	£m
Revenue year ended 31 July 2014	**360.1**	**350.4**	**80.6**	**67.8**	**82.1**	**941.0**
Revenue year ended 31 July 2013	363.5	379.8	84.3	71.2	86.9	985.7

Smiths Medical	Medication delivery £m	Vital care £m	Safety devices £m	Total £m
Revenue year ended 31 July 2014	**241.4**	**327.5**	**234.8**	**803.7**
Revenue year ended 31 July 2013	237.7	354.5	258.2	850.4

Smiths Detection	Transportation £m	Ports and borders £m	Military £m	Emergency responders £m	Critical infrastructure £m	Non-security £m	Total £m
Revenue year ended 31 July 2014	**263.5**	**78.1**	**60.1**	**14.1**	**95.6**	**0.9**	**512.3**
Revenue year ended 31 July 2013	286.2	95.7	69.3	13.7	91.3	2.8	559.0

Smiths Interconnect	Connectors £m	Microwave £m	Power £m	Total £m
Revenue year ended 31 July 2014	**152.9**	**198.5**	**93.8**	**445.2**
Revenue year ended 31 July 2013	161.2	200.8	98.6	460.6

Flex-Tek	Fluid Management £m	Flexible Solutions £m	Heat Solutions £m	Construction Products £m	Total £m
Revenue year ended 31 July 2014	**82.7**	**34.2**	**57.2**	**75.3**	**249.4**
Revenue year ended 31 July 2013	87.8	35.7	56.1	73.3	252.9

1 Segment information continued

Analysis of revenue continued

The Group's statutory revenue is analysed as follows:

	Year ended 31 July 2014 £m	Year ended 31 July 2013 £m
Sale of goods	**2,682.4**	2,855.5
Services	**239.4**	213.5
Contracts	**29.8**	39.6
	2,951.6	3,108.6

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 2014 £m	Year ended 31 July 2013 £m	31 July 2014 £m	31 July 2013 £m
United Kingdom	**119.0**	128.8	**132.5**	140.9
Germany	**148.1**	155.7	**303.6**	334.6
France	**87.9**	93.5	**18.7**	20.2
Other European	**340.1**	356.8	**66.7**	78.0
United States of America	**1,318.7**	1,398.1	**1,131.9**	1,278.3
Canada	**120.9**	122.3	**14.3**	12.6
Mexico	**31.9**	33.1	**9.0**	10.4
Japan	**105.9**	114.3	**15.6**	18.4
China	**112.8**	99.1	**53.3**	60.3
Rest of the World	**566.3**	606.9	**56.4**	72.3
	2,951.6	3,108.6	**1,802.0**	2,026.0

2 Operating profit is stated after charging

	Year ended 31 July 2014 £m	Year ended 31 July 2013 (restated) £m
Research and development expense	**84.8**	77.9
Operating leases		
– land and buildings	**28.6**	30.4
– other	**9.8**	10.8

Research and development expense has been restated to eliminate John Crane's engineering costs of £4.7m for customer-specific product modifications, following a review that determined that this work was not providing a significant contribution to new product development.

	Year ended 31 July 2014 £m	Year ended 31 July 2013 (restated) £m
Audit services		
Fees payable to the Company's auditors for the audit the company's annual financial statements	**2.3**	2.0
Fees payable to the Company's auditors and its associates for other services		
– the audit of the Company's subsidiaries	**2.4**	2.4
	4.7	4.4
Tax services		
– advisory services	**0.2**	0.1
– compliance services	**0.1**	0.1
Other assurance services relating to corporate transactions		0.6
All other services	**0.5**	0.1

Other services relate to one-off IT and consulting projects.

The split of fees payable in respect of audit services has been restated to separately reflect the nature of fees payable for subsidiary statutory audits.

3 Headline profit measures

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

The following items have been excluded from the headline measure:

- exceptional items, including income and expenditure relating to material litigation in respect of products no longer in production;
- amortisation and impairment of intangible assets acquired in a business combination – the charge is a non-cash item, and the directors believe that it should be added back to give a clearer picture of underlying performance;
- other financing gains and losses, which represent the potentially volatile gains and losses on derivatives and other financial instruments which do not fall to be hedge accounted under IAS 39; and
- scheme administration costs, financing credits and charges relating to retirement benefits.

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

	Notes	Year ended 31 July 2014 £m	Year ended 31 July 2013 £m
Operating profit (2013 restated)		**377.6**	486.5
Exclude			
– exceptional operating items	4	**81.6**	19.9
– legacy retirement benefits (restated)	9	**6.5**	6.7
– amortisation and impairment of acquired intangible assets	11	**38.7**	46.6
Non-headline items in operating profit		**126.8**	73.2
Headline operating profit		**504.4**	559.7
Finance costs (2013 restated)		**(75.6)**	(90.8)
Exclude			
– exceptional finance costs	4	**6.0**	4.2
– other financing gains and losses		**1.4**	1.9
– other financing costs retirement benefits (restated)	5,9	**8.4**	23.0
Non-headline items in finance costs		**15.8**	29.1
Headline finance costs		**(59.8)**	(61.7)
Profit before taxation (2013 restated)		**302.0**	395.7
Non-headline items in operating profit		**126.8**	73.2
Non-headline items in finance costs		**15.8**	29.1
Headline profit before taxation		**444.6**	498.0
Profit after taxation – continuing operations (2013 restated)		**234.6**	316.6
Exclude			
– non-headline items in profit before taxation		**142.6**	102.3
– tax on excluded items	7	**(52.6)**	(52.9)
		90.0	49.4
Headline profit after taxation – continuing operations		**324.6**	366.0

Headline earnings before interest, tax, depreciation and amortisation

Headline EBITDA, calculated as follows, is used to calculate one of Smiths cash-flow targets, see note 26 for details.

	Year ended 31 July 2014 £m	Year ended 31 July 2013 £m
Headline operating profit	**504.4**	559.7
Exclude:		
Depreciation	**46.1**	52.3
Amortisation of development costs	**21.3**	21.3
Amortisation of software, patents and intellectual property	**13.0**	13.2
Headline EBITDA	**584.8**	646.5

4 Exceptional items

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

	Year ended 31 July 2014 £m	Year ended 31 July 2013 £m
Operating items		
Restructuring programmes	**(28.8)**	(7.8)
Sale of intellectual property relating to diabetes	**1.1**	1.2
Resolution of legacy litigation	**0.6**	
Gains on changes to post-retirement benefits (note 9)		3.5
Profit on disposal of businesses and property	**3.0**	5.9
Adjustment to contingent consideration provided on acquisitions	**2.6**	1.4
Costs of acquisitions, disposals and aborted transactions	**(1.3)**	(3.0)
Litigation		
– provision for Titeflex Corporation claims (note 23)	**(10.0)**	(6.8)
– provision for John Crane, Inc. asbestos litigation (note 23)	**(48.8)**	(14.3)
	(81.6)	(19.9)
Financing items		
Exceptional finance costs – adjustment to discounted provisions		
– provision for Titeflex Corporation claims (note 23)	**(1.3)**	(0.9)
– provision for John Crane, Inc. asbestos litigation (note 23)	**(4.7)**	(3.3)
	(87.6)	(24.1)

Year ended 31 July 2014

Restructuring costs include the final charge of £2.6m in respect of the Smiths Detection improvement programme and £25.9m in respect of Fuel for Growth. These programmes, which involve redundancy, relocation and consolidation of manufacturing, are considered exceptional by virtue of their size.

Profit on disposal of businesses includes the expiry of certain warranties on the disposal of Cross Match Technologies, Inc., which has generated an additional profit of £2.5m. Profits on disposal of business and property have been combined this year, because there are no individually material disposals.

A charge of £10.0m has been made by Titeflex Corporation. This reflects costs (which are not expected to recur) associated with one anomalous case which was settled during the year together with the estimated cost of future claims including those from insurance companies seeking recompense for damage allegedly caused by lightning strike, net of gains of £0.1m relating to changes in discounting.

The operating charge in respect of John Crane, Inc. litigation comprises £49.6m in respect of increased provision for adverse judgments and legal defence costs, £1.4m in respect of legal fees in connection with litigation against insurers, less £2.2m arising from changes in US risk free rates. The increase in the provision reflects two large historical judgments which were settled in the year.

The sale of intellectual property and resolution of legacy litigation have been reported as exceptional items because the earlier transactions relating to the same items were reported as exceptional items. The litigation provisions for Titeflex Corporation and John Crane, Inc., and the commutation of insurance policies received by John Crane, Inc., were reported as exceptional in the year of recognition. Consequently, the ongoing adjustments to these provisions are reported as exceptional items.

Year ended 31 July 2013

Restructuring costs included £6.9m in respect of the improvement programme in Smiths Detection announced in September 2011. This programme, which involves redundancy, relocation, and consolidation of manufacturing, was considered exceptional by virtue of its size.

Gains on changes to post-retirement benefits comprised a settlement gain of £2.2m on the closure of a defined benefit pension scheme which was net of professional costs of £0.8m, and a past service gain of £2.1m on a scheme which has been closed to future accruals.

The agreement of the Cross Match Technologies, Inc. closing balance sheet and tax position generated a £0.6m additional profit on disposal of businesses. The profit on disposal of property arose from the sale of two sites which were formerly occupied by businesses which are no longer owned by Smiths.

Professional fees of £3m were incurred in relation to potential acquisitions and disposals.

A charge of £6.8m was made by Titeflex Corporation in respect of changes to the estimated cost of future claims including those from insurance companies seeking recompense for damage allegedly caused by lightning strike, net of gains of £2.6m relating to changes in discounting.

The operating charge in respect of John Crane, Inc. litigation comprised £22.6m in respect of increased provision for adverse judgments and legal defence costs, £0.5m in respect of legal fees in connection with litigation against insurers, less £8.8m arising from the increase in US risk free rates.

5 Net finance costs

	Year ended 31 July 2014 £m	Year ended 31 July 2013 (restated) £m
Interest receivable	**2.6**	2.6
Interest payable		
– bank loans and overdrafts, including associated fees	**(7.4)**	(7.4)
– other loans	**(55.0)**	(56.9)
Interest payable	**(62.4)**	(64.3)
Other financing gains/(losses)		
– fair value gains/(losses) on hedged debt	**(2.8)**	9.7
– fair value (losses)/gains on fair value hedge	**2.8**	(9.7)
– net foreign exchange (losses)/gains	**(1.4)**	(1.9)
– exceptional finance costs – adjustment to discounted provisions	**(6.0)**	(4.2)
Other financing losses	**(7.4)**	(6.1)
Net interest expense on retirement benefit obligations	**(8.4)**	(23.0)
Net finance costs	**(75.6)**	(90.8)

6 Earnings per share

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

	Year ended 31 July 2014 £m	Year ended 31 July 2013 (restated) £m
Profit attributable to equity shareholders for the year		
– continuing	**232.7**	315.0
– total	**232.8**	315.0
Average number of shares in issue during the year	**394,296,986**	393,323,206

Diluted earnings per share are calculated by dividing the profit attributable to ordinary shareholders by 398,399,449 (2013: 397,467,678) 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 2014 no options (2013: no options) were excluded from this calculation because their effect was anti-dilutive for continuing operations.

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

	Year ended 31 July 2014		Year ended 31 July 2013 (restated)	
	£m	EPS (p)	£m	EPS (p)
Profit attributable to equity shareholders of the Parent Company	**232.7**	**59.0**	315.0	80.1
Exclude				
Non-headline items and related tax (note 3)	**90.0**	**22.8**	49.4	12.6
Headline	**322.7**	**81.8**	364.4	92.7
Statutory earnings per share – diluted (p)		**58.4**		79.3
Headline earnings per share – diluted (p)		**81.0**		91.7

7 Taxation

The Group's approach to taxation is set out in the Financial review. This note only provides information about corporate income taxes under IFRS. Smiths companies operate in over 50 countries across the world. They pay and collect many different taxes in addition to corporate income taxes including: payroll taxes; value added and sales taxes; property taxes; product-specific taxes and environmental taxes. The costs associated with these other taxes are included in profit before tax.

	Year ended 31 July 2014 £m	Year ended 31 July 2013 (restated) £m
The taxation charge in the consolidated income statement for the year comprises		
– current income tax charge	**93.0**	86.7
– current tax adjustments in respect of prior periods	**(3.7)**	8.1
Current taxation	**89.3**	94.8
– deferred taxation	**(21.9)**	(15.7)
Total taxation expense in the consolidated income statement	**67.4**	79.1

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 22.3% (2013: 23.7%). The difference is reconciled as follows:

	Year ended 31 July 2014 £m	Year ended 31 July 2013 (restated) £m
Profit before taxation – continuing operations	**302.0**	395.7
Notional taxation expense at UK rate of 22.3% (2013: 23.7%)	**67.4**	93.7
Different tax rates on non-UK profits and losses	**6.8**	2.3
Non-deductible expenses, tax credits and non-taxable income	**(6.1)**	(2.8)
Adjustments to unrecognised deferred tax	**5.3**	(15.5)
Non-taxable profit on disposal of businesses	**0.4**	(0.6)
Prior year true-up	**(6.4)**	2.0
	67.4	79.1
Comprising		
– taxation on headline profit	**120.0**	132.0
– tax on non-headline loss	**(52.6)**	(52.9)
Taxation expense in the consolidated income statement	**67.4**	79.1

The head office of Smiths Group is domiciled in the UK, so the tax charge has been reconciled to UK tax rates. In recent years, Smiths has made substantial payments to its UK defined benefit pension plans which generated significant UK tax losses.

	Year ended 31 July 2014 £m	Year ended 31 July 2013 (restated) £m
Tax on items charged/(credited) to equity		
Deferred tax charge/(credit)		
– retirement benefit schemes	**(5.8)**	39.0
– cash-flow hedges	**(0.1)**	1.0
– share options	**0.7**	(1.0)
	(5.2)	39.0

The net retirement benefit credit to equity includes £1.1m (2013: £4.2m) relating to UK schemes. The UK schemes are closed and this amount represents tax relief that was set off against amounts previously charged to equity.

7 Taxation continued

Deferred taxation

	Excess tax depreciation on fixed assets and goodwill £m	Share-based payment £m	Retirement benefit obligations £m	Capitalised development expenditure £m	Other £m	Total £m
At 31 July 2012	(75.4)	4.2	92.8	(33.7)	145.9	133.8
Credit/(charge) to income statement (restated)	(6.3)	1.5	(3.3)	(2.2)	26.0	15.7
Credit/(charge) to equity (restated)		1.0	(39.0)		(1.0)	(39.0)
Exchange adjustments	(2.6)		1.8	(1.3)	3.9	1.8
At 31 July 2013	(84.3)	6.7	52.3	(37.2)	174.8	112.3
Deferred tax assets	(20.2)	6.6	49.6	(10.0)	159.4	185.4
Deferred tax liabilities	(64.1)	0.1	2.7	(27.2)	15.4	(73.1)
At 31 July 2013	(84.3)	6.7	52.3	(37.2)	174.8	112.3
Credit/(charge) to income statement	3.6	(1.2)	(8.9)	(0.2)	28.6	21.9
Credit/(charge) to equity		(0.7)	5.8		0.1	5.2
Exchange adjustments	8.5	(0.1)	(5.3)	4.1	(19.5)	(12.3)
At 31 July 2014	**(72.2)**	**4.7**	**43.9**	**(33.3)**	**184.0**	**127.1**
Deferred tax assets	(18.9)	4.7	43.8	(8.9)	164.3	185.0
Deferred tax liabilities	(53.3)		0.1	(24.4)	19.7	(57.9)
At 31 July 2014	**(72.2)**	**4.7**	**43.9**	**(33.3)**	**184.0**	**127.1**

Included in other deferred tax balances above are:

- a deferred tax asset of £21.3m (2013: £28.1m) relating to losses carried forward. The decrease mainly relates to additional non-recognition provisions. The Group has recognised deferred tax on the basis that operations show a consistent pattern of improving results and the Group has implemented plans to support continuing improvements or the losses relate to specific, identified non-recurring events;
- a deferred tax asset of £117.3m (2013: £99.0m) relating to provisions where current tax relief is only available as payments are made. Of this asset, £68.4m (2013: £60.7m) relates to the John Crane, Inc. litigation provision, and £23.2m (2013: £24.9m) relates to Titeflex Corporation. See note 23 for additional information on provisions; and
- a deferred tax asset of £17.6m (2013: £22.2m) relating to inventory where current tax relief is only available when the inventory is sold.

The Group has not recognised deferred tax assets relating to tax losses of £470.2m (2013: £392.9m) and pensions and other long-term liabilities of £244.7m (2013: £284.5m) due to uncertainty as to their recoverability. This includes £83.3m (2013: £71.5m) relating to the UK pension deficit.

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

	2014 £m	**Expiry of losses**	2013 £m	Expiry of losses
Territory				
– Americas	**31.5**	**2016-2034**	15.6	2016-2033
– Asia	**5.6**	**2016-2021**	3.9	2016-2020
Total restricted losses	**37.1**		19.5	
Unrestricted losses				
– operating losses	**433.1**	**No expiry**	373.4	No expiry
Total	**470.2**		392.9	

8 Employees

	Year ended 31 July 2014 £m	Year ended 31 July 2013 £m
Staff costs during the period		
Wages and salaries	**717.5**	756.3
Social security	**85.8**	89.2
Share-based payment (note 10)	**9.9**	12.8
Pension costs (including defined contribution schemes) (note 9)	**32.3**	33.8
	845.5	892.1

The average number of persons employed was:

	Year ended 31 July 2014	Year ended 31 July 2013
John Crane	**6,850**	7,000
Smiths Medical	**7,850**	7,900
Smiths Detection	**2,250**	2,250
Smiths Interconnect	**4,000**	3,850
Flex-Tek	**2,000**	2,000
Smiths Business Information Services	**200**	200
Corporate	**50**	50
	23,200	23,250

Smiths Business Information Services directly employs people working in its operations. All the costs of IT infrastructure and support, including these employment costs, are reflected in reported divisional operating profit.

Key management

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

	Year ended 31 July 2014 £m	Year ended 31 July 2013 £m
Key management compensation		
Salaries and short-term employee benefits	**9.0**	8.5
Cost of post-retirement benefits	**0.1**	
Cost of share-based incentive plans	**3.4**	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 2014		Year ended 31 July 2013	
	Number of instruments '000	Weighted average price	Number of instruments '000	Weighted average price
CIP	**706**		834	
ESOS	**31**	**£10.12**	126	£8.71
VSP			78	
LTIP	**1,629**		1,251	
SAYE	**10**	**£8.57**	5	£7.28

Related party transactions

There are no related party transactions in the year ended 31 July 2014.

In 2013 the Group had a service contract with a company connected to a member of the Executive Committee. Costs of £0.2m were incurred in respect of this arrangement.

9 Post-retirement benefits

Smiths provides post-retirement benefits to employees in a number of countries. This includes defined benefit and defined contribution plans and, mainly in the United Kingdom (UK) and United States of America (US), post-retirement healthcare.

Defined contribution plans

The Group operates a number of defined contribution plans across many countries. In the UK a defined contribution plan has been offered since the closure of the UK defined benefit pension plans. In the US a 401k defined contribution plan operates. The total expense recognised in the consolidated income statement in respect of all these plans was £30.0m (2013: £29.9m).

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 2014. Scheme assets are stated at their market values. Contributions to the schemes are made on the advice of the actuaries.

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

	Year ended 31 July 2014 £m	Year ended 31 July 2013 (restated) £m
At beginning of period	**(253.6)**	(620.2)
Exchange adjustment	**18.3**	(8.1)
Current service cost	**(2.6)**	(4.1)
Scheme administration costs	**(6.5)**	(6.7)
Past service cost, curtailments, settlements	**0.1**	4.3
Finance charges – retirement benefits	**(8.4)**	(23.0)
Contributions by employer	**87.9**	77.5
Actuarial (loss)/gain	**(76.9)**	326.6
Movement in surplus restriction		0.1
Net retirement benefit liability	**(241.7)**	(253.6)

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 was performed using the Projected Unit Method as at 31 March 2012, and the next funding valuation is required no later than 31 March 2015. Under the current funding plan for SIPS Smiths pays cash contributions of £3m a month until October 2019. In addition, Smiths invests £2m a month in index-linked gilts held in an escrow account. The escrow account remains an asset of the Group until 2020, see note 17. At that time, the assets in escrow will be allocated subject to the funding position of SIPS. In addition, the escrow account may revert to the Group, should there be a surplus at an intervening funding valuation.

SIPS are reviewing member records to prepare for the implementation of Guaranteed Minimum Pensions equalisation in respect of members contracted out of the State Earnings Related Pensions Scheme prior to 6 April 1997 and implement any outstanding Barber equalisation. It is not yet possible to reliably quantify the impact of either of these adjustments.

The duration of the SIPS liabilities is around 23 years (2013: 22 years) for active deferred members, 23 years (2013: 24 years) for deferred members and 11 years (2013: 12 years) for pensioners and dependants.

TI Group Pension Scheme (“TIGPS”)

This scheme was closed to future accrual effective 1 November 2009. TIGPS provides index-linked pension benefits based on final earnings at the date of closure. TIGPS is governed by a corporate trustee (TI Pension Trustee Limited, an independent company). The board of trustee directors comprises five company-nominated trustees and four member-nominated trustees, with an independent trustee director selected by the Trustee. The Trustee is responsible for the management, administration, funding and investment strategy of the scheme.

The most recent actuarial valuation of this scheme was performed using the Projected Unit Method as at 5 April 2012, and the next funding valuation is required no later than 5 April 2015. Under the current funding plan for TIGPS Smiths pays cash contributions of £16m a year until April 2016.

Under the governing documentation of the TIGPS, any future surplus would be returnable to Smiths Group plc by refund, assuming gradual settlement of the liabilities over the lifetime of the scheme. If TIGPS was wound up while it had members, the scheme would need to buy out the benefits of all members. The buyouts would cost significantly more than the present value of the scheme liabilities calculated in accordance with IAS 19 (revised).

9 Post-retirement benefits continued

Defined benefit and post-retirement healthcare plans continued

UK pension schemes continued

TI Group Pension Scheme ("TIGPS") continued

TIGPS is compliant with all identified requirements of Barber equalisation. TIGPS will implement Guaranteed Minimum Pensions equalisation in respect of members contracted out of the State Earnings Related Pensions Scheme prior to 6 April 1997, once the government has completed its consultations and confirmed an approach. It is not yet possible to reliably quantify the impact of this adjustment.

The duration of the TIGPS liabilities is around 23 years (2013: 23 years) for active deferred members, 20 years (2013: 21 years) for deferred members and 10 years (2013:10 years) for pensioners and dependants.

US pension plans

The most recent valuations of the six principal US pension and post-retirement healthcare plans were performed at 1 January 2014.

The pension plans were closed with effect from 30 April 2009 and benefits were calculated as at that date and are not revalued. Governance of the US pension plans is managed by a Settlor Committee appointed by Smiths Group Services Corp. The US pension plans are offering deferred members a one-off option to elect to cash out their retirement entitlements rather than receive a pension at retirement. Lump sum payments of $145m were made in August 2014, with further payments of approximately $5m expected in September 2014 for applications where data review or corrections were required. This programme will generate a settlement gain that will be reported in the 31 January 2015 Interim report. The final settlement gain will not be confirmed until the September payment has been finalised, but it is expected to be approximately $20m.

The duration of the liabilities for the largest US plan is around 18 years (2013: 17 years) for active deferred members, 19 years (2013: 19 years) for deferred members and 9 years (2013: 9 years) for pensioners and dependants.

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 indexed-linked pensions are higher than expected; and
- increased contributions may be required to meet regulatory funding targets if lower interest rates increase the current value of liabilities.

These risks are managed separately for each pension scheme. However Smiths has adopted a common approach of closing defined benefit schemes to cap members' entitlements and supporting trustees in adopting investment strategies which match assets to future obligations, after allowing for the funding position of the scheme.

TIGPS with a mature member profile, and a strong funding position, has been able to progress its matching strategy to the point where 53% of liabilities are covered by matching annuities, eliminating investment return, longevity, inflation and funding risks. In September 2013, the Trustees of the TIGPS invested a further £160m in annuities matched with specific liabilities of the Scheme.

From August 2014, SIPS have adjusted the scheme investment strategy. The scheme has invested in diversified growth funds and introduced a synthetic equity mandate with BlackRock, using exchange-traded futures, which are derivative contracts entered into for a fixed term, to invest in global equity markets. If equity markets rise, the value of the synthetic equity mandate will increase, whilst if equity markets fall, the value of the synthetic equity mandate will fall. At future year-ends the value of the mandate could be positive or negative depending upon movement in the global equity markets. The risk and return characteristics of synthetic equities are similar to physical equities.

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

	2014 UK	**2014 US**	**2014 Other**	2013 UK	2013 US	2013 Other
Rate of increase in salaries	**n/a**	**n/a**	**2.6%**	n/a	n/a	2.7%
Rate of increase for active deferred members	**4.2%**	**n/a**	**n/a**	4.3%	n/a	n/a
Rate of increase in pensions in payment	**3.3%**	**n/a**	**0.9%**	3.4%	n/a	0.9%
Rate of increase in deferred pensions	**3.3%**	**n/a**	**0.1%**	3.4%	n/a	1.0%
Discount rate	**4.0%**	**4.4%**	**3.8%**	4.4%	4.8%	4.0%
Inflation rate	**3.3%**	**n/a**	**1.6%**	3.4%	n/a	1.7%
Healthcare cost increases	**4.3%**	**n/a**	**2.3%**	5.0%	n/a	2.6%

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 to better reflect the shape of the yield curve considering the Aon Hewitt GBP Select AA curve. For the USA, the discount rate referenced Moody's Aa annualised yield, the Citigroup High Grade Index, the Merrill Lynch 15+ years High Quality Index and the Towers Watson cash-flow matching models.

9 Post-retirement benefits continued

Defined benefit and post-retirement healthcare plans continued

Risk management continued

Mortality assumptions

The mortality assumptions used in the principal UK schemes are based on the recent actual mortality experience of members within each scheme. The assumptions are based on the new SAPS All Birth year tables with relevant scaling factors based on the experience of the schemes. The assumption also allows for future improvements in life expectancy in line with the 2013 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 2000 table projected to 2025. The table selected allows for future mortality improvements and applies an adjustment for job classification (blue collar versus white collar). The assumptions give the following:

Expected further years of life				UK schemes				US schemes
	Male 31 July 2014	**Female 31 July 2014**	Male 31 July 2013	Female 31 July 2013	**Male 31 July 2014**	**Female 31 July 2014**	Male 31 July 2013	Female 31 July 2013
Member who retires next year at age 65	**23**	**25**	23	25	**20**	**21**	20	21
Member, currently 45, when they retire in 20 years' time	**25**	**27**	25	27	**20**	**21**	20	21

Sensitivity

Sensitivities in respect of the key assumptions used to measure the principal pension schemes as at 31 July 2014 are set out below. These sensitivities show the hypothetical impact of a change in each of the listed assumptions in isolation, with the exception of the sensitivity to inflation which incorporates the impact of certain correlating assumptions. While each of these sensitivities holds all other assumptions constant, in practice such assumptions rarely change in isolation and the impacts may offset to some extent.

	Profit before tax for year ended 31 July 2014 £m	**Increase/ (decrease) in scheme assets £m**	**(Increase)/ decrease in scheme liabilities £m**	Profit before tax for year ended 31 July 2013 £m	Increase/ (decrease) in scheme assets £m	(Increase)/ decrease in scheme liabilities £m
Rate of mortality – 1 year increase in life expectancy	**(3.4)**	**44.5**	**(130.8)**	(4.1)	32.8	(123.3)
Rate of mortality – 1 year decrease in life expectancy	**3.6**	**(45.2)**	**132.7**	4.0	(32.8)	124.0
Rate of inflation – 0.25% increase	**(2.9)**	**12.5**	**(86.9)**	(3.3)	11.0	(85.6)
Discount rate – 0.25% increase	**4.9**	**(19.6)**	**141.2**	(5.6)	(16.2)	139.8
Market value of scheme assets – 2.5% increase	**2.9**	**73.2**		3.3	74.6	

The effect on profit before tax reflects the impact of current service cost and net interest cost.

The value of the scheme assets is affected by changes in mortality rates, inflation and discounting because they affect the carrying value of the insurance assets.

Retirement benefit plan assets

				31 July 2014 £m				31 July 2013 £m
	UK schemes	**US schemes**	**Other countries**	**Total**	UK schemes	US schemes	Other countries	Total
Cash and cash equivalents								
– Cash	**592.9**		**0.4**	**593.3**	34.2			34.2
– Liquidity funds	**42.7**	**60.5**		**103.2**	183.5			183.5
Equities								
– UK funds	**178.4**		**3.5**	**181.9**	768.0		3.6	771.6
– North American funds	**156.7**	**136.6**	**1.6**	**294.9**	319.6	240.9	1.9	562.4
– Other regions and global funds	**269.0**	**56.7**	**13.9**	**339.6**	530.7	70.3	13.9	614.9
Government bonds								
– index-linked bonds	**657.5**			**657.5**	145.2			145.2
– fixed-interest bonds	**92.1**	**64.9**	**10.9**	**167.9**	42.0	29.1	11.2	82.3
Corporate bonds	**266.9**	**181.2**	**2.3**	**450.4**	274.2	158.9	2.3	435.4
Insured liabilities	**811.4**		**0.4**	**811.8**	672.1		0.5	672.6
Property								
– UK property	**181.2**			**181.2**	176.4			176.4
– other property			**0.3**	**0.3**			0.5	0.5
Other	**0.7**		**17.2**	**17.9**		2.0	15.2	17.2
Total market value	**3,249.5**	**499.9**	**50.5**	**3,799.9**	3,145.9	501.2	49.1	3,696.2

SIPS was in the process of implementing a change to its investment strategy at 31 July 2014, so the UK schemes cash includes £326m which was reinvested in diversified growth funds shortly after the year end. The balance of the cash held by SIPS will be retained within the scheme to meet calls on the equity strategy.

Liquidity funds, equities and bonds are valued using quoted market prices in active markets. Insured liabilities comprise annuity policies matching the scheme obligation to identified groups of pensioners. These assets are valued at the actuarial valuation of the corresponding liability, reflecting this matching relationship. Property is valued by specialists applying recognised property valuation methods incorporating current market data on rental yields and transaction prices.

The scheme assets do not include any property occupied by, or other assets used by, the Group. The only financial instruments of the Group included in scheme assets are ordinary equity shares in Smiths Group plc held in broad-based equity investment funds.

9 Post-retirement benefits continued

Defined benefit and post-retirement healthcare plans continued

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

	31 July 2014 £m			31 July 2013 £m		
	SIPS	**TIGPS**	**US schemes**	SIPS	TIGPS	US schemes
Present value of funded scheme liabilities						
– Active deferred members	**(71.4)**	**(73.6)**	**(96.3)**	(85.7)	(71.5)	(108.6)
– Deferred members	**(713.8)**	**(589.2)**	**(221.5)**	(702.9)	(557.3)	(221.2)
– Pensioners	**(999.3)**	**(810.1)**	**(277.3)**	(925.8)	(800.2)	(290.7)
Present value of funded scheme liabilities	**(1,784.5)**	**(1,472.9)**	**(595.1)**	(1,714.4)	(1,429.0)	(620.5)
Market value of scheme assets	**1,639.1**	**1,594.3**	**499.9**	1,580.9	1,549.4	501.2
Surplus/(deficit)	**(145.4)**	**121.4**	**(95.2)**	(133.5)	120.4	(119.3)

Net retirement benefit obligations

	31 July 2014 £m				31 July 2013 £m			
	UK schemes	**US schemes**	**Other countries**	**Total**	UK schemes	US schemes	Other countries	Total
Market value of scheme assets	**3,249.5**	**499.9**	**50.5**	**3,799.9**	3,145.9	501.2	49.1	3,696.2
Present value of funded scheme liabilities	**(3,275.3)**	**(595.1)**	**(64.1)**	**(3,934.5)**	(3,160.6)	(620.5)	(61.5)	(3,842.6)
Surplus/(deficit)	**(25.8)**	**(95.2)**	**(13.6)**	**(134.6)**	(14.7)	(119.3)	(12.4)	(146.4)
Unfunded pension plans	**(49.9)**	**(6.0)**	**(32.9)**	**(88.8)**	(48.3)	(6.5)	(31.3)	(86.1)
Post-retirement healthcare	**(7.6)**	**(9.7)**	**(1.0)**	**(18.3)**	(8.5)	(11.6)	(1.0)	(21.1)
Present value of unfunded obligations	**(57.5)**	**(15.7)**	**(33.9)**	**(107.1)**	(56.8)	(18.1)	(32.3)	(107.2)
Net pension liability	**(83.3)**	**(110.9)**	**(47.5)**	**(241.7)**	(71.5)	(137.4)	(44.7)	(253.6)
Post-retirement assets	**121.4**		**1.2**	**122.6**	120.6		1.1	121.7
Post-retirement liabilities	**(204.7)**	**(110.9)**	**(48.7)**	**(364.3)**	(192.1)	(137.4)	(45.8)	(375.3)
Net pension liability	**(83.3)**	**(110.9)**	**(47.5)**	**(241.7)**	(71.5)	(137.4)	(44.7)	(253.6)

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 (2013 restated)

	Year ended 31 July 2014 £m	Year ended 31 July 2013 £m
Amounts (credited)/charged to operating profit		
Current service cost	**2.6**	4.1
Past service (gain)/cost	**(0.1)**	(2.1)
Settlement (gain)/loss		(2.2)
Scheme administration costs	**6.5**	6.7
	9.0	6.5
The operating cost is charged/(credited) as follows:		
Cost of sales	**0.5**	1.0
Sales and distribution costs	**0.9**	1.2
Administrative expenses	**7.6**	8.6
Exceptional operating items		(4.3)
	9.0	6.5
Amounts charged to finance costs		
Net interest cost	**8.4**	23.0

9 Post-retirement benefits continued

Defined benefit and post-retirement healthcare plans continued

Amounts recognised directly in the consolidated statement of comprehensive income (2013 restated)

	Year ended 31 July 2014 £m	Year ended 31 July 2013 £m
Actuarial gains/(losses)		
Difference between interest credit and return on assets	**97.1**	321.5
Experience gains and losses on scheme liabilities	**5.8**	(3.1)
Actuarial gains/(losses) arising from changes in demographic assumptions	**30.6**	(16.1)
Actuarial gains/(losses) arising from changes in financial assumptions	**(210.4)**	24.2
Movements in surplus restriction		0.1
	(76.9)	326.6

Changes in present value of funded scheme assets (2013 restated)

				31 July 2014 £m				31 July 2013 £m
	UK schemes	US schemes	Other countries	Total	UK schemes	US schemes	Other countries	Total
At beginning of period	**3,145.9**	**501.2**	**49.1**	**3,696.2**	2,844.9	458.1	44.6	3,347.6
Interest on assets	**136.6**	**22.4**	**2.1**	**161.1**	115.2	17.0	1.8	134.0
Actuarial gain on scheme assets	**58.5**	**32.4**	**6.2**	**97.1**	278.7	32.5	10.4	321.6
Employer contributions	**53.4**	**25.3**	**2.9**	**81.6**	53.5	7.7	9.8	71.0
Employee contributions			**0.2**	**0.2**			0.2	0.2
Assets distributed on settlement							(16.8)	(16.8)
Scheme administration costs	**(4.2)**	**(2.1)**	**(0.2)**	**(6.5)**	(4.5)	(2.2)		(6.7)
Exchange adjustments		**(52.1)**	**(7.1)**	**(59.2)**		15.7	1.4	17.1
Benefits paid	**(140.7)**	**(27.2)**	**(2.7)**	**(170.6)**	(141.9)	(27.6)	(2.3)	(171.8)
At end of period	**3,249.5**	**499.9**	**50.5**	**3,799.9**	3,145.9	501.2	49.1	3,696.2

Changes in present value of funded defined benefit obligations

				31 July 2014 £m				31 July 2013 £m
	UK schemes	US schemes	Other countries	Total	UK schemes	US schemes	Other countries	Total
At beginning of period	**(3,160.6)**	**(620.5)**	**(61.5)**	**(3,842.6)**	(3,116.7)	(680.6)	(66.3)	(3,863.6)
Current service cost	**(0.3)**		**(1.0)**	**(1.3)**	(0.3)		(2.1)	(2.4)
Interest on obligations	**(136.1)**	**(26.9)**	**(2.5)**	**(165.5)**	(125.0)	(25.4)	(2.7)	(153.1)
Employee contributions			**(0.2)**	**(0.2)**			(0.2)	(0.2)
Past service gain/(cost)			**0.1**	**0.1**			2.1	2.1
Actuarial (loss)/gain on liabilities	**(119.0)**	**(38.8)**	**(10.2)**	**(168.0)**	(60.5)	77.5	(11.3)	5.7
Liabilities extinguished on settlement							19.0	19.0
Curtailment gain/(cost)								
Exchange adjustments		**63.9**	**8.5**	**72.4**		(19.6)	(2.3)	(21.9)
Benefits paid	**140.7**	**27.2**	**2.7**	**170.6**	141.9	27.6	2.3	171.8
At end of period	**(3,275.3)**	**(595.1)**	**(64.1)**	**(3,934.5)**	(3,160.6)	(620.5)	(61.5)	(3,842.6)

Changes in present value of unfunded defined benefit pensions and post-retirement healthcare plans

		Assets		Obligations
	Year ended 31 July 2014 £m	Year ended 31 July 2013 £m	Year ended 31 July 2014 £m	Year ended 31 July 2013 £m
At beginning of period			**(107.2)**	(104.1)
Current service cost			**(1.3)**	(1.7)
Interest on obligations			**(4.0)**	(3.9)
Actuarial (loss)/gain			**(6.0)**	(0.7)
Employer contributions	**6.3**	6.5		
Exchange adjustments			**5.1**	(3.3)
Benefits paid	**(6.3)**	(6.5)	**6.3**	6.5
At end of period			**(107.1)**	(107.2)

9 Post-retirement benefits continued

Defined benefit and post-retirement healthcare plans continued

Cash contributions

Company contributions to the funded defined benefit pension plans for 2014 totalled £81.6m (2013: £71.0m).

In 2015 the following cash contributions to the Group's principal defined benefit schemes are expected: £36.4m to SIPS; £16.6m to TIGPS; and approximately £31.5m to other plans, including the US defined benefit scheme. Expected cash payments for 2015 total £84.5m. In addition, £24m will be invested in UK government bonds held in escrow, in accordance with the funding plan for SIPS.

Adopting IAS 19 (Revised 2011) has had the following impact on reported results

	Year ended 31 July 2014 £m	Year ended 31 July 2013 £m
Additional charge to operating profit	**(6.5)**	(6.7)
Increased finance charges	**(48.7)**	(39.4)
Impact on profit before tax	**(55.2)**	(46.1)
Change to actuarial gains and losses recognised	**55.2**	46.1

10 Employee share schemes

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

Long-Term Incentive Plan (LTIP)

The LTIP is a share plan under which an award over a capped number of shares will vest after the end of the three-year performance period if performance conditions are met. Group LTIP awards are made to selected senior corporate executives, including the executive directors. These awards have three performance conditions: 50% of the award is conditional on 3-year growth of headline EPS adjusted to exclude tax; 30% of the award is conditional on 3-year TSR relative to the FTSE 100 (excluding financial services companies); and 20% of the award is conditional on 3-year average annual headline operating cash conversion.

Divisional LTIP awards are made to selected divisional senior executives. These awards also have three performance conditions, and the relative significance of the conditions reflects the strategic priorities for each division: 20% to 40% of the awards are conditional on 3-year revenue growth; 30% to 40% of the awards are conditional on 3-year average annual headline operating margins; and 30% to 40% of the awards are conditional on 3-year average annual headline operating cash conversion.

Each performance condition has a threshold below which no shares vest and a maximum performance target at or above which the award vests in full. For performance between 'threshold' and 'maximum', awards vest on a straight-line sliding scale. The performance conditions are assessed separately, so performance on one condition does not affect the vesting of the other elements of the award. To the extent that the performance targets are not met over the three-year performance period, awards will lapse. There is no re-testing of the performance conditions.

2010 Value Sharing Plan (2010 VSP)

The 2010 VSP is a long-term incentive plan approved by the shareholders at the Annual General Meeting on 16 November 2010, rewarding executives for value creation at Group and divisional levels. Corporate participants were rewarded under the VSP for value creation at a Group level, whereas the executives with divisional responsibilities were rewarded for value creation within the division for which they are responsible. For the Group scheme, one-third of the award depended on the growth in Smiths' TSR over and above the median for the companies comprising the FTSE 100 (excluding financial services companies) and the remaining two-thirds of each award was determined by the growth in internal value in excess of fixed rate. The growth in internal value was calculated as follows: adjusted profit before tax ('PBT') times the ratio of PBT to market capitalisation determined at the date of grant plus net equity cash-flows to shareholders. The divisional awards depended on meeting an internal value growth target set for the division in which the participant worked. The performance conditions are measured over a three-year period commencing with the financial year 2010/11, and the Group scheme hurdle rate is 8.5% a year.

Smiths Group Co-Investment Plan (CIP)

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

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

10 Employee share schemes continued

	CIP	Long-term incentive plans	Other share schemes	Total	Weighted average price for option plans £
Ordinary shares under option ('000)					
1 August 2012	1,708	2,299	3,475	7,482	£4.10
Granted	707	1,020	149	1,876	£0.80
Update of estimates		(64)		(64)	£0.00
Exercised	(306)	(721)	(1,224)	(2,251)	£4.60
Lapsed	(235)	(167)	(314)	(716)	£4.15
31 July 2013	1,874	2,367	2,086	6,327	£2.98
Granted	412	927	398	1,737	£2.27
Update of estimates		6		6	£0.00
Exercised	(546)	(349)	(657)	(1,552)	£3.87
Lapsed	(172)	(256)	(83)	(511)	£1.49
31 July 2014	**1,568**	**2,695**	**1,744**	**6,007**	**£2.67**

Options were exercised on an irregular basis during the period. The average closing share price over the financial year was 1,353.95p (2013: 1,195.79p). There has been no change to the effective option price of any of the outstanding options during the period.

Range of exercise prices	Total shares under option ('000)	Weighted average remaining contractual life (months)	**Options exercisable at 31 July 2014 ('000)**	Options exercisable at 31 July 2013 ('000)	**Exercisable weighted average exercise price for options exercisable at 31 July 2014**
£0.00 – £2.00	4,263	9			**£0.00**
£2.01 – £6.00	164	9	**23**		**£5.69**
£6.01 – £10.00	1,093	30	**463**	1,071	**£8.85**
£10.01 – £14.00	487	34	**289**	532	**£10.96**

For the purposes of valuing options to arrive at the share-based payment charge, the Binomial option pricing model has been used for most schemes and the Monte Carlo method is used for schemes with total shareholder return performance targets. The key assumptions used in the models for 2014 and 2013 are volatility of 25% (2013: 25% to 27%) and dividend yield of 3.75% (2013: 3.75%). Assumptions on expected volatility and expected option term have been made on the basis of historical data, for the period corresponding with the vesting period of the option. These generated a weighted average fair value for CIP of £14.04 (2013: £10.84), Group long-term incentive plans of £12.26 (2013: £9.18) and divisional long-term incentive plans of £14.12 (2013: £10.84). The fair value disclosed for the CIP award treats the two matching shares as separate options.

Included within staff costs is an expense arising from share-based payment transactions of £9.9m (2013: £12.8m), of which £9.2m (2013: £12.1m) relates to equity-settled share-based payment.

At 31 July 2014 the payable relating to cash-settled schemes is £0.2m (2013: £0.5m).

11 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 2012	1,488.1	181.3	413.6	143.4	2,226.4
Exchange adjustments	69.2	7.7	16.6	2.6	96.1
Additions		29.9		11.1	41.0
Disposals	(4.0)	(1.5)		(1.4)	(6.9)
At 31 July 2013	1,553.3	217.4	430.2	155.7	2,356.6
Exchange adjustments	(156.3)	(21.7)	(43.2)	(8.2)	(229.4)
Business combinations	1.0		0.3		1.3
Additions		24.6		17.5	42.1
Disposals	(2.7)	(4.4)	(1.7)	(1.1)	(9.9)
At 31 July 2014	**1,395.3**	**215.9**	**385.6**	**163.9**	**2,160.7**
Amortisation					
At 1 August 2012	93.7	70.6	249.1	95.9	509.3
Exchange adjustments	4.9	3.1	12.3	2.4	22.7
Charge for the year		21.3	46.6	13.2	81.1
Disposals		(1.5)		(1.0)	(2.5)
At 31 July 2013	98.6	93.5	308.0	110.5	610.6
Exchange adjustments	(9.2)	(9.8)	(32.0)	(6.9)	(57.9)
Charge for the year		21.3	38.7	13.0	73.0
Disposals	(2.7)	(3.3)	(1.7)	(0.9)	(8.6)
At 31 July 2014	**86.7**	**101.7**	**313.0**	**115.7**	**617.1**
Net book value at 31 July 2014	**1,308.6**	**114.2**	**72.6**	**48.2**	**1,543.6**
Net book value at 31 July 2013	1,454.7	123.9	122.2	45.2	1,746.0
Net book value at 1 August 2012	1,394.4	110.7	164.5	47.5	1,717.1

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 2012	73.4	139.0	201.2	413.6
Exchange adjustments	1.8	4.8	10.0	16.6
At 1 August 2013	75.2	143.8	211.2	430.2
Exchange adjustments	(7.5)	(14.5)	(21.2)	(43.2)
Business combinations	0.2		0.1	0.3
Disposals		(1.7)		(1.7)
At 31 July 2014	**67.9**	**127.6**	**190.1**	**385.6**
Amortisation				
At 1 August 2012	33.2	77.9	138.0	249.1
Exchange adjustments	1.0	3.2	8.1	12.3
Charge for the year	5.8	16.5	24.3	46.6
At 31 July 2013	40.0	97.6	170.4	308.0
Exchange adjustments	(4.1)	(10.2)	(17.7)	(32.0)
Charge for the year	5.3	15.1	18.3	38.7
Disposals		(1.7)		(1.7)
At 31 July 2014	**41.2**	**100.8**	**171.0**	**313.0**
Net book value at 31 July 2014	**26.7**	**26.8**	**19.1**	**72.6**
Net book value at 31 July 2013	35.2	46.2	40.8	122.2
Net book value at 1 August 2012	40.2	61.1	63.2	164.5

12 Impairment testing

Goodwill

Goodwill is not amortised but is tested for impairment at least annually. Value in use calculations are used to determine the recoverable amount of goodwill held allocated to each group of cash generating units (CGU). Value in use is calculated as the net present value of the projected risk-adjusted cash-flows of the CGU. These forecast cash-flows are based on the 2015 budget and the four-year divisional strategic plan, which have both been approved by the Board.

Goodwill is allocated by division as follows:

	2014 £m	2014 Number of CGUs	2013 £m	2013 Number of CGUs
John Crane	**121.3**	**4**	142.7	4
Smiths Medical	**480.6**	**1**	529.5	1
Smiths Detection	**368.6**	**1**	407.8	1
Smiths Interconnect	**316.7**	**3**	351.6	3
Flex-Tek	**21.4**	**2**	23.1	2
	1,308.6	**11**	1,454.7	11

As required by IAS 36, the allocation of goodwill to CGUs for John Crane has been revised following a reorganisation of the division into a new structure. If goodwill had been tested using the previous allocation, it would not have triggered any impairments.

John Crane and Smiths Medical have strong aftermarket and consumables businesses, with consistent sales trends. Smiths Detection and Smiths Interconnect have greater sales and margin volatility due to lower levels of recurring revenue and involvement in government-funded programmes, particularly defence, and customer-led technology innovation. The key assumptions used in value in use calculations are:

- Sales: projected sales are built up with reference to markets and product categories. They incorporate past performance, historical growth rates and projections of developments in key markets.
- Margins: projected margins reflect historical performance and the impact of all completed projects to improve operational efficiency and leverage scale. The projections do not include the impact of future restructuring projects to which the Group is not yet committed.
- Discount rate: the discount rates have been calculated based on the Group's weighted average cost of capital and risks specific to the CGU being tested. The discount rates disclosed incorporate risk adjustments where the projected sales and margins are affected by significant delivery risks. Pre-tax rates of 10.7% to 13.6% (2013: 10.9% to 14.9%) 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 2.03% (2013: 2.13%). 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 2014				
	Smiths Medical	**Smiths Detection**	**Smiths Interconnect**		
			Microwave	**Connectors**	**Power**
Net book value of goodwill (£m)	**480.6**	**368.6**	**124.1**	**78.6**	**114.0**
Discount rate	**10.7%**	**12.5%**	**13.6%**	**13.2%**	**11.4%**
Period covered by management projections	**5 years**	**5 years**	**5 years**	**5 years**	**5 years**
Long-term growth rates	**2.0%**	**2.3%**	**1.0%**	**1.5%**	**2.5%**

	Year ended 31 July 2013				
	Smiths Medical	Smiths Detection	Smiths Interconnect		
			Microwave	Connectors	Power
Net book value of goodwill (£m)	529.5	407.8	137.3	87.4	126.9
Discount rate	10.9%	14.9%	13.2%	13.8%	13.3%
Period covered by management projections	5 years	5 years	5 years	5 years	5 years
Long-term growth rates	2.1%	1.6%	2.8%	2.5%	2.4%

The discount rates used for testing Smiths Interconnect Connectors and Smiths Interconnect Power for the year ended 31 July 2014 are lower than previous years because higher risk adjustments have been made to the cash-flow projections, requiring a corresponding reduction in the risk adjustment incorporated in the discount rate.

The remaining balance of the goodwill represents smaller individual amounts which have been allocated to smaller CGUs.

12 Impairment testing continued

Goodwill continued

Sensitivity analysis

Smiths Detection

Smiths Detection's value in use exceeds its carrying value by £165m. Sensitivity analysis performed around the base case assumptions has indicated that for Smiths Detection, the following changes in assumptions (in isolation), would cause the value in use to fall below the carrying value:

	Year ended 31 July 2014 Change required to trigger impairment
Forecast operating cash-flow	**30% reduction**
Discount rate	**300 basis points higher**
Long-term growth rates	**690 basis points lower**

Sales assumptions for Smiths Detection are based on:

- the current order book and tenders in progress, including airport, cargo scanning and military opportunities;
- expected market growth rates. Market growth drivers considered include
  - passenger numbers for air transportation;
  - global trade for cargo screening;
  - increased regulatory standards to detect a wider range of substances at lower threat mass; and
  - expected rate of replacement for units initially installed following 11 September 2001.
  - expected rate of adoption of new products and technologies, including HI-SCAN 10080 XCT for baggage handling systems, HI-SCAN 6040-2is for critical infrastructure and Ace-ID for trace; and
- forecast servicing of the installed product base.

Margin projections for Smiths Detection are based on historical margins, projected margins on tenders in progress and the current fixed cost base.

Smiths Detection is currently implementing a significant performance improvement programme, see note 4. As required by IAS 36, the benefit of future restructuring has been eliminated from the projections used for impairment testing. However, this required material changes to the projections approved by the Board. As a result, the directors also reviewed the fair value less costs to sell for the division when considering the results of the impairment testing. This additional work also indicated that the Smiths Detection goodwill was not impaired.

Smiths Interconnect Power

Smiths Interconnect Power's value in use exceeds its carrying value by £7.8m (2013: £7.8m). Sensitivity analysis performed around the base case assumptions has indicated that for Smiths Interconnect Power, the following changes in assumptions (in isolation), would cause the value in use to fall below the carrying value:

	Year ended 31 July 2014 Change required to trigger impairment	Year ended 31 July 2013 Change required to trigger impairment
Forecast operating cash-flow	**6% reduction**	4% reduction
Discount rate	**40 basis points higher**	50 basis points higher
Long-term growth rates	**70 basis points lower**	90 basis points lower

Sales assumptions for Smiths Interconnect Power are based on:

- the current order book;
- proportion of recent tenders which have been successful; and
- independent projections of the expected growth of the data centre market in North America.

Margin projections for Smiths Interconnect Power are based on current variable costs and production capacity, and the expected costs of increasing capacity to support higher levels of sales.

The directors also reviewed the fair value less costs to sell for the division when considering the results of the impairment testing, which also supported the conclusion that the Smiths Interconnect Power goodwill was not impaired.

Other CGUs

For the other CGUs, sensitivity analysis performed around the base case assumptions has indicated that no reasonable changes in key assumptions would cause the carrying amount of any of the CGUs to exceed their respective recoverable amounts.

Other intangible assets

The Group has no indefinite life intangible assets other than goodwill. During the year impairment tests were carried out for development projects which have not yet started to be amortised and acquired intangibles where there were indications of impairment. Value in use calculations were used to determine the recoverable values of these assets.

No impairment charges have been incurred (2013: £nil).

13 Property, plant and equipment

	Land and buildings £m	Plant and machinery £m	Fixtures, fittings, tools and equipment £m	Total £m
Cost or valuation				
At 1 August 2012	192.7	516.0	213.7	922.4
Exchange adjustments	7.4	20.0	8.0	35.4
Additions	7.8	33.0	15.7	56.5
Disposals	(8.3)	(15.1)	(7.8)	(31.2)
At 31 July 2013	199.6	553.9	229.6	983.1
Exchange adjustments	(20.0)	(58.0)	(23.0)	(101.0)
Additions	5.8	33.6	14.5	53.9
Disposals	(1.1)	(10.0)	(8.7)	(19.8)
At 31 July 2014	**184.3**	**519.5**	**212.4**	**916.2**
Depreciation				
At 1 August 2012	92.7	389.6	169.6	651.9
Exchange adjustments	3.4	15.1	6.7	25.2
Charge for the year	7.5	29.3	15.5	52.3
Disposals	(5.3)	(14.3)	(6.7)	(26.3)
At 31 July 2013	98.3	419.7	185.1	703.1
Exchange adjustments	(10.0)	(44.6)	(18.8)	(73.4)
Charge for the year	7.2	26.8	12.1	46.1
Disposals	(0.9)	(8.9)	(8.2)	(18.0)
At 31 July 2014	**94.6**	**393.0**	**170.2**	**657.8**
Net book value at 31 July 2014	**89.7**	**126.5**	**42.2**	**258.4**
Net book value at 31 July 2013	101.3	134.2	44.5	280.0
Net book value at 1 August 2012	100.0	126.4	44.1	270.5

14 Inventories

	31 July 2014 £m	31 July 2013 £m
Inventories comprise		
Raw materials and consumables	**142.9**	155.5
Work in progress	**93.9**	110.2
Finished goods	**194.3**	227.3
	431.1	493.0
Less: payments on account	**(3.8)**	(17.4)
	427.3	475.6

The Group consumed £1,325.9m (2013: £1,408.7m) of inventories during the period. £21.4m (2013: £12.3m) was recognised as an expense resulting from the write-down of inventory and £4.1m (2013: £4.8m) was released to the consolidated income statement from inventory provisions charged in earlier years but no longer required.

15 Trade and other receivables

	31 July 2014 £m	31 July 2013 £m
Non-current		
Trade receivables	**25.8**	23.6
Accrued income	**3.6**	4.9
Prepayments	**0.7**	0.7
Other receivables	**4.9**	4.9
	35.0	34.1
Current		
Trade receivables	**577.8**	628.2
Accrued income	**17.6**	37.8
Prepayments	**12.8**	12.6
Other receivables	**26.6**	16.9
	634.8	695.5

Accrued income and prepayments have been separately disclosed following a review of the nature and liquidity of the balances.

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 £624.4m (2013: £677.2m).

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 4% (2013: 4%) of Group revenue.

Ageing of trade receivables

	31 July 2014 £m	31 July 2013 £m
Trade receivables which are not impaired and not yet due	**482.8**	516.7
Trade receivables which are not impaired and less than three months overdue	**92.5**	99.5
Trade receivables which are not impaired and more than three months overdue	**25.5**	30.9
Gross value of partially and fully provided receivables	**20.3**	22.5
	621.1	669.6
Provision for bad and doubtful debts	**(17.5)**	(17.8)
Trade receivables	**603.6**	651.8

16 Trade and other payables

	31 July 2014 £m	31 July 2013 £m
Non-current		
Other payables	**27.6**	31.0
Current		
Trade payables	**198.0**	213.5
Bills of exchange payable	**0.4**	2.7
Other payables	**8.2**	10.7
Other taxation and social security costs	**21.9**	23.0
Accruals	**192.4**	219.2
Deferred income	**43.2**	52.7
	464.1	521.8

Accruals and deferred income have been separately disclosed following a review of the nature and liquidity of the balances.

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

17 Financial assets

Available for sale financial assets include £111.1m (2013: £83.0m) UK government bonds. This investment forms part of the deficit-funding plan agreed with the trustee of one of the principal UK pension schemes. See note 9 for additional details.

The Group also invests in early stage businesses that are developing or commercialising related technology. In the current year £0.2m (2013: £0.3m) was invested in detection technologies and £3.1m (2013: £nil) in interconnect technologies.

18 Borrowings and net debt

This note sets out the calculation of net debt, an important measure in explaining our financing position. The net debt figure includes accrued interest and the fair value adjustments relating to hedge accounting.

	31 July 2014 £m	31 July 2013 £m
Cash and cash equivalents		
Net cash and deposits	**190.2**	393.8
Short-term borrowings		
Bank overdrafts	**(1.1)**	(7.3)
$250m 6.05% US$ Guaranteed notes 2014		(164.5)
Bank and other loans	**(0.9)**	(1.2)
Interest accrual	**(10.5)**	(14.1)
	(12.5)	(187.1)
Long-term borrowings		
£150m 7.25% Sterling Eurobond 2016	**(149.7)**	(149.6)
€300m 4.125% Eurobond 2017	**(242.6)**	(267.5)
$175m 7.37% US$ Private placement 2018	**(103.6)**	(115.3)
Revolving Credit Facility 2019	**(106.6)**	
$250m 7.20% US$ Guaranteed notes 2019	**(147.4)**	(163.8)
$400m 3.625% US$ Guaranteed notes 2022	**(230.7)**	(253.4)
Bank and other loans	**(1.3)**	(1.5)
	(981.9)	(951.1)
Borrowings	**(994.4)**	(1,138.2)
Net debt	**(804.2)**	(744.4)

On 14 May 2014 Smiths Group plc repaid the maturing 6.05% US$ Guaranteed notes 2014.

Borrowings are accounted for at amortised cost and are categorised as other financial liabilities. See note 19 for a maturity analysis of borrowings. The borrowings repayable after five years are repayable in 2022.

Interest of £48.2m (2013: £49.7m) was charged to the consolidated income statement in this period in respect of public bonds.

Net cash and cash equivalents

	31 July 2014 £m	31 July 2013 £m
Cash at bank and in hand	**115.1**	164.2
Short-term deposits	**75.1**	229.6
Cash and cash equivalents	**190.2**	393.8
Bank overdrafts	**(1.1)**	(7.3)
Net cash and cash equivalents	**189.1**	386.5

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

Netting

Cash and overdraft balances in interest compensation cash pooling systems are reported gross on the balance sheet. The cash pooling agreements incorporate a legally enforceable right of net settlement. However there is no intention to settle the balances net, so these arrangements do not qualify for net presentation.

	Assets 31 July 2014 £m	Liabilities 31 July 2014 £m	Assets 31 July 2013 £m	Liabilities 31 July 2013 £m
Gross amount recognised	**59.3**		71.8	(6.4)
Related assets and liabilities subject to master netting agreements			(6.4)	6.4
Net exposure	**59.3**		65.4	

The balances held in zero balancing cash pooling arrangements are not included in this disclosure, since these arrangements have daily settlement of balances.

18 Borrowings and net debt continued
Movements in net debt

	Net cash and cash equivalents £m	Other short-term borrowing £m	Long-term borrowings £m	Net debt £m
At 31 July 2013	386.5	(179.8)	(951.1)	(744.4)
Foreign exchange gains and losses	(25.9)	15.8	80.4	70.3
Net cash outflow	(171.5)			(171.5)
Repayment of borrowings		150.1	29.5	179.6
Drawdown of borrowings			(138.0)	(138.0)
Capitalisation, interest accruals and unwind of capitalised fees		3.3	(0.7)	2.6
Fair value movement from interest rate hedging		0.1	(2.9)	(2.8)
Change in maturity analysis		(0.9)	0.9	
At 31 July 2014	**189.1**	**(11.4)**	**(981.9)**	**(804.2)**

Secured loans

Loans amounting to £2.3m (2013: £2.7m) were secured on plant and equipment with a book value of £2.3m (2013: £2.5m).

19 Financial risk management

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

Treasury and risk management policies are set by the Board. The policy sets out specific guidelines to manage foreign exchange risk, interest rate risk, credit risk and the use of financial instruments to manage risk. The instruments and techniques used to manage exposures include foreign currency derivatives, debt and other interest rate derivatives. The central treasury function monitors financial risks and compliance with risk management policies. The management of operational credit risk is discussed in note 15.

(a) Foreign exchange risk

Transactional currency exposure

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

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

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

					At 31 July 2014
	Sterling £m	US$ £m	Euro £m	Other £m	Total £m
Financial assets and liabilities					
Financial instruments included in trade and other receivables	**33.7**	**322.4**	**115.3**	**153.0**	**624.4**
Financial instruments included in trade and other payables	**(36.4)**	**(171.0)**	**(68.7)**	**(60.7)**	**(336.8)**
Cash and cash equivalents	**23.8**	**76.9**	**27.0**	**62.5**	**190.2**
Borrowings not designated as net investment hedges	**(149.6)**	**(10.4)**	**(3.5)**		**(163.5)**
	(128.5)	**217.9**	**70.1**	**154.8**	**314.3**
Exclude balances held in operations with the same functional currency	**127.9**	**(167.3)**	**(71.3)**	**(141.2)**	**(251.9)**
Exposure arising from intra-group loans		**(37.2)**		**(2.9)**	**(40.1)**
Forward foreign exchange contracts	**(87.1)**	**29.4**	**30.8**	**26.9**	
	(87.7)	**42.8**	**29.6**	**37.6**	**22.3**

19 Financial risk management continued

	At 31 July 2013				
	Sterling £m	US$ £m	Euro £m	Other £m	Total £m
Financial assets and liabilities					
Financial instruments included in trade and other receivables	34.8	349.0	145.2	148.2	677.2
Financial instruments included in trade and other payables	(34.0)	(191.0)	(82.6)	(70.9)	(378.5)
Cash and cash equivalents	129.5	142.7	34.5	87.1	393.8
Borrowings not designated as net investment hedges	(149.9)	(13.8)	(9.6)	(0.4)	(173.7)
	(19.6)	286.9	87.5	164.0	518.8
Exclude balances held in operations with the same functional currency	19.1	(168.3)	(87.8)	(163.5)	(400.5)
Exposure arising from intra-group loans		(61.6)		4.3	(57.3)
Forward foreign exchange contracts	(1.0)	(75.6)	76.6		
	(1.5)	(18.6)	76.3	4.8	61.0

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

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

	Impact on profit for the year 31 July 2014 £m	**Gain/(loss) recognised in reserves 31 July 2014 £m**	Impact on profit for the year 31 July 2013 £m	Gain/(loss) recognised in reserves 31 July 2013 £m
US dollar	**3.8**	**(0.6)**	2.9	(1.7)
Euro	**(1.3)**	**0.1**	5.3	2.0
Sterling	**3.9**	**1.1**	(0.6)	0.9

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 2014 contracts with a nominal value of £200.9m (2013: £234.0m) were designated as hedging instruments. In addition, the Group had outstanding foreign currency contracts with a nominal value of £237.1m (2013: £87.5m) which were being used to manage transactional foreign exchange exposures, but were not accounted for as cash-flow hedges. The fair value of the contracts is disclosed in note 20.

The majority of hedged transactions will be recognised in the consolidated income statement in the same period that the cash-flows are expected to occur, with the only differences arising as a result of normal commercial credit terms on sales and purchases. Of the foreign exchange contracts designated as hedging instruments 100% are for periods of 12 months or less (2013: 99.9%).

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

	Year ended 31 July 2014 £m	Year ended 31 July 2013 £m
Brought forward cash-flow hedge reserve at start of year	**1.8**	(4.7)
Exchange adjustments		(0.2)
Gains/(losses) on effective cash-flow hedges recognised in equity	**0.8**	11.0
Amounts removed from the hedge reserve and recognised in the following lines on the income statement		
– revenue	**(4.2)**	(3.8)
– cost of sales	**1.8**	(0.5)
Carried forward cash-flow hedge reserve at end of year	**0.2**	1.8

19 Financial risk management continued

Translational currency exposure

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

Net investment hedges

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

					At 31 July 2014
	Sterling £m	**US$ £m**	**Euro £m**	**Other £m**	**Total £m**
Loans designated as net investment hedges		**(588.3)**	**(242.6)**		**(830.9)**
Currency swap contracts	**184.4**	**(44.6)**	**(49.7)**	**(90.1)**	
	184.4	**(632.9)**	**(292.3)**	**(90.1)**	**(830.9)**

					At 31 July 2013
	Sterling £m	US$ £m	Euro £m	Other £m	Total £m
Loans designated as net investment hedges		(697.0)	(267.5)		(964.5)
Currency swap contracts	197.1	(56.2)	(52.4)	(88.5)	
	197.1	(753.2)	(319.9)	(88.5)	(964.5)

At 31 July 2014 swap contracts in other currencies hedged the Group's exposure to Canadian dollars, Japanese yen and Chinese renminbi (31 July 2013: Canadian dollars, Japanese yen and Chinese renminbi).

Of the contracts designated as net investment hedges, 58% (2013: 55%) are current and the balance matures over the next two years (2013: three years).

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

	Year ended 31 July 2014 £m	Year ended 31 July 2013 £m
Brought forward net investment hedge reserve at start of year	**(175.8)**	(120.1)
Amounts deferred in the period on effective net investment hedges	**117.9**	(55.7)
Carried forward net investment hedge reserve at end of year	**(57.9)**	(175.8)

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 2014 £m	Loss recognised in hedge reserve 31 July 2013 £m
US dollar	**63.7**	76.2
Euro	**28.7**	29.2

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

(b) Interest rate risk

The Group operates an interest rate policy designed to optimise interest cost and reduce volatility in reported earnings. The Group's current policy is to require interest rates to be fixed for greater than 70% of the level of gross debt. This is achieved primarily through fixed rate borrowings, and also through the use of interest rate swaps. At 31 July 2014 63% (2013: 76%) 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. In May 2014 the $250m 6.05% fixed rate Notes were partly refinanced using floating rate bank debt and the fixed rate metric is being managed in the short term under the medium term target of 70%. 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 2014, after interest rate swaps, is 4.5% (2013: 5.2%).

19 Financial risk management continued

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

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

	Available for sale investments 31 July 2014 £m	**Cash and cash equivalents 31 July 2014 £m**	**Borrowings 31 July 2014 £m**	**Fair value of borrowings 31 July 2014 £m**	Available for sale investments 31 July 2013 £m	Cash and cash equivalents 31 July 2013 £m	Borrowings 31 July 2013 £m	Fair value of borrowings 31 July 2013 £m
Fixed interest								
Less than one year			**(0.9)**	**(0.9)**			(165.7)	(170.9)
Between one and five years			**(544.2)**	**(619.2)**			(423.3)	(483.7)
Greater than five years	**111.1**		**(146.4)**	**(142.4)**	83.0		(327.3)	(349.0)
Total fixed interest financial assets/(liabilities)	**111.1**		**(691.5)**	**(762.5)**	83.0		(916.3)	(1,003.6)
Floating rate interest financial assets/(liabilities)		**168.9**	**(302.9)**	**(302.9)**		339.8	(221.9)	(221.9)
Total interest-bearing financial assets/(liabilities)	**111.1**	**168.9**	**(994.4)**	**(1,065.4)**	83.0	339.8	(1,138.2)	(1,225.5)
Non-interest-bearing assets/(liabilities) in the same category	**5.8**	**21.3**			3.1	54.0		
Total	**116.9**	**190.2**	**(994.4)**	**(1,065.4)**	86.1	393.8	(1,138.2)	(1,225.5)

Interest rate hedging

At 31 July 2014 the Group has designated US$150.0m interest rate swaps which mature on 12 October 2022 and €120.0m interest rate swaps which mature on 5 May 2017 as fair value hedges on the US$ 2022 Guaranteed notes and the € 2017 Eurobond respectively which mature on the same dates. At 31 July 2013 the same hedging arrangements were in place. These positions hedge the risk of variability in the fair value of borrowings arising from fluctuations in base rates.

The fair values of the hedging instruments are disclosed in note 20. The effect of the swaps is to convert £184.0m (2013: £203.8m) debt from fixed rate to floating rate.

Sensitivity of interest charges to interest rate movements

The Group has exposure to sterling, US dollar and euro interest rates. However the Group does not have a significant exposure to interest rate movements for any individual currency. Based on the composition of net debt and foreign exchange rates at 31 July 2014, and taking into consideration all fixed rate borrowings and interest rate swaps in place, a one percentage point (100 basis points) change in average floating interest rates for all three currencies would have a £0.7m (2013: £0.4m) impact on the Group's profit before tax.

Based on the investments held at 31 July 2014 a one percentage point (100 basis points) increase in sterling interest rates would reduce the carrying value of investments by £15.0m (2013: £11.8m), generating a corresponding charge to reserves.

(c) Financial credit risk

The Group is exposed to credit-related losses in the event of non-performance by counterparties to financial instruments, but does not currently expect any counterparties to fail to meet their obligations. Credit risk is mitigated by the Board-approved policy of only placing cash deposits with highly rated relationship bank counterparties within counterparty limits established by reference to their Standard & Poor's long-term debt rating. In the normal course of business, the Group operates cash pooling systems, where a legal right of set-off applies.

The maximum credit risk exposure in the event of other parties failing to perform their obligations under financial assets, excluding trade and other receivables and derivatives, totals £307.1m at 31 July 2014 (2013: £479.9m).

	31 July 2014 £m	31 July 2013 £m
UK government bonds with at least a AA credit rating (note 17)	**111.1**	83.0
Cash at banks with at least a AA- credit rating	**111.0**	230.2
Cash at banks with a A+ credit rating	**43.2**	89.6
Cash at other banks	**36.0**	74.0
Other investments	**5.8**	3.1
	307.1	479.9

At 31 July 2014 the maximum exposure with a single bank for deposits and cash is £59.7m (2013: £121.8m), whilst the maximum mark to market exposure for derivatives is £2.6m (2013: £3.1m). These banks have AA- and A credit rating, respectively (2013: AA- and A).

19 Financial risk management continued

(d) Liquidity risk

Borrowing facilities

The Board policy specifies the maintenance of unused committed credit facilities of at least £200m at all times to ensure it has sufficient available funds for operations and planned development, which is provided by a multi-currency revolving credit facility.

On 19 February 2014 Smiths completed the refinancing of its existing $800m Revolving Credit Facility which was due to mature in December 2015. The new $800m Revolving Credit Facility matures in February 2019 with two uncommitted extension options. At the balance sheet date the Group had the following undrawn credit facilities:

	31 July 2014 £m	31 July 2013 £m
Expiring within one year		
Expiring between one and two years		
Expiring after two years	**367.2**	527.1
	367.2	527.1

Cash deposits

As at 31 July 2014, £75.1m (2013: £229.6m) of cash and cash equivalents was on deposit with various banks of which £4.0m (2013: £167.1m) was on deposit in the UK.

Gross contractual cash-flows for borrowings

	Borrowings (Note 18) 31 July 2014 £m	**Fair value adjustments 31 July 2014 £m**	**Contractual interest payments 31 July 2014 £m**	**Total contractual cash-flows 31 July 2014 £m**	Borrowings (Note 18) 31 July 2013 £m	Fair value adjustments 31 July 2013 £m	Contractual interest payments 31 July 2013 £m	Total contractual cash-flows 31 July 2013 £m
Less than one year	**(12.5)**		**(36.2)**	**(48.7)**	(187.1)	(0.2)	(51.2)	(238.5)
Between one and two years	**(150.4)**	**(0.3)**	**(47.6)**	**(198.3)**	(0.9)		(51.7)	(52.6)
Between two and three years	**(243.2)**	**4.8**	**(36.7)**	**(275.1)**	(150.1)	(0.4)	(51.6)	(202.1)
Between three and four years	**(103.6)**		**(26.9)**	**(130.5)**	(267.5)	5.1	(40.7)	(303.1)
Between four and five years	**(254.0)**	**(0.7)**	**(19.2)**	**(273.9)**	(115.3)	(0.1)	(29.9)	(145.3)
Greater than five years	**(230.7)**	**(6.2)**	**(30.1)**	**(267.0)**	(417.3)	(11.0)	(54.9)	(483.2)
Total	**(994.4)**	**(2.4)**	**(196.7)**	**(1,193.5)**	(1,138.2)	(6.6)	(280.0)	(1,424.8)

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 2014 £m	**Payments 31 July 2014 £m**	**Net cash-flow 31 July 2014 £m**	Receipts 31 July 2013 £m	Payments 31 July 2013 £m	Net cash-flow 31 July 2013 £m
Assets						
Less than one year	**256.5**	**(247.2)**	**9.3**	214.2	(204.2)	10.0
Greater than one year	**81.4**	**(73.2)**	**8.2**	12.0	(5.3)	6.7
Liabilities						
Less than one year	**222.2**	**(225.4)**	**(3.2)**	171.9	(176.6)	(4.7)
Greater than one year	**25.3**	**(15.5)**	**9.8**	102.3	(93.8)	8.5
Total	**585.4**	**(561.3)**	**24.1**	500.4	(479.9)	20.5

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 20.

Gross contractual cash-flows for other financial liabilities

The contractual cash-flows for financial liabilities included in trade and other payables are: £323.4m (2013: £360.8m) due in less than one year, £8.7m (2013: £12.6m) due between one and five years and £4.7m (2013: £5.1m) due after more than five years.

20 Derivative financial instruments

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

	Contract or underlying nominal amount £m	Fair value (At 31 July 2014) Assets £m	Liabilities £m	Net £m
Foreign exchange contracts (cash-flow hedges)	**200.9**	**2.3**	**(2.7)**	**(0.4)**
Foreign exchange contracts (not hedge accounted)	**237.1**	**1.4**	**(1.4)**	
Total foreign exchange contracts	**438.0**	**3.7**	**(4.1)**	**(0.4)**
Currency swaps (net investment hedges)	**213.8**	**7.5**	**(0.6)**	**6.9**
Interest rate swaps (fair value hedges)	**184.0**	**5.7**	**(4.2)**	**1.5**
Total financial derivatives	**835.8**	**16.9**	**(8.9)**	**8.0**
Balance sheet entries				
Non-current		**9.2**	**(4.3)**	**4.9**
Current		**7.7**	**(4.6)**	**3.1**
Total financial derivatives		**16.9**	**(8.9)**	**8.0**

	Contract or underlying nominal amount £m	Fair value (At 31 July 2013) Assets £m	Liabilities £m	Net £m
Foreign exchange contracts (cash-flow hedges)	234.0	5.0	(2.3)	2.7
Foreign exchange contracts (not hedge accounted)	87.5	1.1	(1.4)	(0.3)
Total foreign exchange contracts	321.5	6.1	(3.7)	2.4
Currency swaps (net investment hedges)	197.1	2.0	(5.4)	(3.4)
Interest rate swaps (fair value hedges)	203.8	6.4	(7.7)	(1.3)
Total financial derivatives	722.4	14.5	(16.8)	(2.3)
Balance sheet entries				
Non-current		6.4	(11.0)	(4.6)
Current		8.1	(5.8)	2.3
Total financial derivatives		14.5	(16.8)	(2.3)

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 2014 £m	Liabilities 31 July 2014 £m	Assets 31 July 2013 £m	Liabilities 31 July 2013 £m
Gross value of assets and liabilities	**16.9**	**(8.9)**	14.5	(16.8)
Related assets and liabilities subject to master netting agreements	**(3.8)**	**3.8**	(5.7)	5.7
Net exposure	**13.1**	**(5.1)**	8.8	(11.1)

21 Fair value of financial instruments

	Notes	Carrying value 31 July 2014 £m	Fair value 31 July 2014 £m	Carrying value 31 July 2013 £m	Fair value 31 July 2013 £m
Level 1 valuations					
Financial assets – other investments	17	**111.1**	**111.1**	83.0	83.0
Level 2 valuations					
Financial derivatives – assets	20	**16.9**	**16.9**	14.5	14.5
Borrowings	18	**(994.4)**	**(1,065.4)**	(1,138.2)	(1,225.5)
Financial derivatives – liabilities	20	**(8.9)**	**(8.9)**	(16.8)	(16.8)
Level 3 valuations					
Financial assets – other investments		**5.8**	**5.8**	3.1	3.1

Investments with level 1 valuations comprise quoted government bonds.

Derivatives, including forward exchange contracts, currency swaps, interest rate instruments, and embedded derivatives, are valued at the net present value of the future cash-flows calculated using market data at the balance sheet date (principally exchange rates and yield curves).

Borrowings are valued at the net present value of the future cash-flows using credit spreads and yield curves derived from market data. Borrowings are carried on the balance sheet at amortised cost adjusted for fair value interest rate hedging. The fair value of fixed rate borrowings is only used for supplementary disclosures.

Cash, trade receivables and trade payables are excluded from this table because carrying value is a reasonable approximation to fair value for all these assets and liabilities.

22 Commitments

Operating lease commitments – minimum lease payments

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

	31 July 2014		31 July 2013	
	Land and buildings £m	Other £m	Land and buildings £m	Other £m
Payments due				
– not later than one year	**28.5**	**7.2**	32.3	8.2
– later than one year and not later than five years	**55.9**	**8.0**	69.0	8.8
– later than five years	**8.4**		12.6	
	92.8	**15.2**	113.9	17.0

Other commitments

At 31 July 2014, commitments, comprising bonds and guarantees arising in the normal course of business, amounted to £152.8m (2013: £166.0m), including pension commitments of £50.8m (2013: £52.1m).

23 Provisions and contingent liabilities

	Trading	Exceptional and legacy			Total
	£m	John Crane, Inc. litigation £m	Titeflex Corporation litigation £m	Other £m	£m
At 31 July 2013	40.7	210.0	65.6	19.9	336.2
Exchange adjustments	(4.2)	(21.7)	(6.7)	(1.3)	(33.9)
Provision charged	34.5	47.4	14.1	6.5	102.5
Provision released	(5.9)		(4.1)	(0.7)	(10.7)
Unwind of provision discount		4.7	1.3		6.0
Utilisation	(21.9)	(36.3)	(9.1)	(5.6)	(72.9)
At 31 July 2014	**43.2**	**204.1**	**61.1**	**18.8**	**327.2**
Current liabilities	31.7	25.5	13.5	11.2	81.9
Non-current liabilities	11.5	178.6	47.6	7.6	245.3
At 31 July 2014	**43.2**	**204.1**	**61.1**	**18.8**	**327.2**

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

Trading

Warranty provision and product liability

At 31 July 2014 there are warranty and product liability provisions of £35.3m (2013: £40.0m). Warranties over the Group's products typically cover periods of between one and three years. Provision is made for the likely cost of after-sales support based on the recent past experience of individual businesses.

Commercial disputes and litigation in respect of ongoing business activities

The Group has on occasion been required to take legal action to protect its intellectual property and other rights against infringement. It has also had to defend itself against proceedings brought by other parties, including product liability and insurance subrogation claims. Provision is made for any expected costs and liabilities in relation to these proceedings where appropriate, though there can be no guarantee that such provisions (which may be subject to potentially material revision from time to time) will accurately predict the actual costs and liabilities that may be incurred. Trading provisions include £7.0m in connection with ongoing price audits of overhead cost recovery charges associated with certain historical supply arrangements.

Contingent liabilities

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

The Group operates in some markets where the risk of unethical or corrupt behaviour is material and has procedures, including an employee 'Ethics Alertline', to help it identify potential issues. Such procedures will, from time to time, give rise to internal investigations, sometimes conducted with external support, to ensure that Smiths Group properly understands risks and concerns and can take steps both to manage immediate issues and to improve its practices and procedures for the future. From time to time the Group also co-operates with relevant authorities in investigating business conduct issues. The Group is not aware of any issues which are expected to generate material financial exposures.

Exceptional and legacy

John Crane, Inc.

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

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

23 Provisions and contingent liabilities continued

Exceptional and legacy continued

John Crane, Inc. continued

John Crane, Inc. litigation provision

JCI continues to actively monitor the conduct and effect of its current and expected asbestos litigation, including the most efficacious presentation of its 'safe product' defence, and intends to continue to resist these asbestos claims based upon this defence. Approximately 235,000 claims (2013: 230,000 claims) against JCI have been dismissed before trial over the last 35 years. JCI is currently a defendant in cases involving approximately 80,000 claims (2013: 81,000 claims). Despite the large number of claims brought against JCI, since the inception of the litigation it has had final judgments against it, after appeals, in 131 cases (2013: 121 cases) over the period, and has had to pay awards amounting to approximately US$149m (2013: US$120m). JCI has also incurred significant additional defence costs. The litigation involves claims for a number of allegedly asbestos related diseases, with awards, when made, for mesothelioma tending to be larger than those for the other diseases JCI's ability to defend mesothelioma cases successfully is, therefore, likely to have a significant impact on its annual aggregate adverse judgment and defence costs.The provision is based on past history and published tables of asbestos incidence projections and is determined using asbestos valuation experts, Bates White LLC. Whilst published incidence curves can be used to estimate the likely future pattern of asbestos related disease, John Crane, Inc.'s claims experience is significantly impacted by other factors which influence the US litigation environment. These can include: changing approaches on the part of the plaintiffs' bar; changing attitudes amongst the judiciary at both trial and appellate levels; and legislative and procedural changes in both the state and federal court systems. The projections use a 10 year time horizon on the basis that Bates White LLC consider that there is substantial uncertainty in the asbestos litigation environment so probable expenditures are not reasonably estimable beyond this time horizon.

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

- The period over which the expenditure can be reliably estimated.
- The future trend of legal costs.
- The rate of future claims filed.
- The rate of successful resolution of claims.
- The average amount of judgments awarded.

The provision in respect of JCI is a discounted pre-tax provision using discount rates, being the risk free rate on US debt instruments for the appropriate period. The deferred tax asset related to this provision is shown within the deferred tax balance (note 7). Set out below is the gross, discounted and post-tax information relating to this provision:

	31 July 2014 £m	31 July 2013 £m
Gross provision	**226.8**	232.8
Discount	**(22.7)**	(22.8)
Discounted pre-tax provision	**204.1**	210.0
Deferred tax	**(68.4)**	(60.7)
Discounted post-tax provision	**135.7**	149.3

John Crane, Inc. litigation provision sensitivities

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

Statistical analysis of the provision indicates that there is a 50% probability that the total future spend will fall between £212m and £239m (2013: between £221m and £240m), compared to the gross provision value of £226.8m (2013: 232.8m).

John Crane, Inc. contingent liabilities

Provision has been made for future defence costs and the cost of adverse judgments expected to occur. JCI's claims experience is significantly impacted by other factors which influence the US litigation environment. These can include: changing approaches on the part of the plaintiffs' bar; changing attitudes amongst the judiciary at both trial and appellate levels; and legislative and procedural changes in both the state and federal court systems. As a result, whilst the Group anticipates that asbestos litigation will continue beyond the period covered by the provision, the uncertainty surrounding the US litigation environment beyond this point is such that the costs cannot be reliably estimated.

Titeflex Corporation

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

23 Provisions and contingent liabilities continued

Exceptional and legacy continued

Titeflex Corporation continued

Titeflex Corporation litigation provision

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

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

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

The projections use a rolling 10 year time horizon on the basis that there is substantial uncertainty in the US litigation environment so probable expenditures are not reasonably estimable beyond this time horizon.

The provision of £61.1m (2013: £65.6m) is a discounted pre-tax provision using discount rates, being the risk free rate on US debt instruments for the appropriate period. The deferred tax asset related to this provision is shown within the deferred tax balance (note 7).

	31 July 2014 £m	31 July 2013 £m
Gross provision	**67.5**	72.3
Discount	**(6.4)**	(6.7)
Discounted pre-tax provision	**61.1**	65.6
Deferred tax	**(23.2)**	(24.9)
Discounted post-tax provision	**37.9**	40.7

Titeflex Corporation litigation provision sensitivities

However, because of the significant uncertainty associated with the future level of claims and of the costs arising out of related litigation, there can be no guarantee that the assumptions used to estimate the provision will result in an accurate prediction of the actual costs that may be incurred and, as a result, the provision may be subject to potentially material revision from time to time if new information becomes available as a result of future events.

Titeflex Corporation contingent liabilities

The Group anticipates that litigation might continue beyond the period covered by the provision. However, the uncertainty surrounding the US litigation environment beyond this point (which reflects factors such as changing approaches on the part of the plaintiffs' bar; changing attitudes amongst the judiciary at both trial and appellate levels; and legislative and procedural changes in both the state and federal court systems) is such that the costs cannot be reliably estimated.

Other exceptional and legacy

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

These provisions cover exceptional reorganisation, vacant properties, disposal indemnities and litigation in respect of old products and discontinued business activities.

Reorganisation and property

At 31 July 2014 provisions of £5.7m relate to Fuel for Growth, £6.5m relate to onerous leases and dilapidations provisions, and £1.4m relate to actual and potential environmental issues for sites which are no longer occupied by Smiths operations.

The fuel for growth provisions are expected to be spent in 2015.

At 31 July 2013, there was a provision of £10.7m relating to the performance improvement programme in Smiths Detection.

Disposal

Other provisions include disposal provisions of £3.4m (2013: £3.6m) 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.

24 Share capital

	Number of shares	Issued capital £m	Consideration £m
Ordinary shares of 37.5p each			
At 31 July 2012	392,725,943	147.3	
Exercise of share options	1,092,567	0.4	9.3
At 31 July 2013	393,818,510	147.7	
Exercise of share options	637,625	0.2	5.8
Total share capital at 31 July 2014	**394,456,135**	**147.9**	

At 31 July 2014 all of the issued share capital was in free issue. All issued shares are fully paid.

25 Dividends

The following dividends were declared and paid in the period:

	Year ended 31 July 2014 £m	Year ended 31 July 2013 £m
Ordinary final dividend of 27.00p for 2013 (2012: 26.25p) paid 22 November 2013	**106.4**	103.2
Special dividend of 30.00p for 2013 paid 22 November 2013	**118.3**	
Ordinary interim dividend of 12.75p for 2014 (2013: 12.50p) paid 25 April 2014	**50.3**	49.2
	275.0	152.4

The final dividend for the year ended 31 July 2014 of 27.5p per share was recommended by the Board on 16 September 2014 and will be paid to shareholders on 21 November 2014, 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 24 October 2014.

26 Reserves

Retained earnings include the value of Smiths Group plc shares held by the Smiths Industries Employee Benefit Trust. In the year the Company issued nil (2013: nil) shares to the Trust, and the Trust purchased 895,489 shares (2013: 1,027,540 shares) in the market. At 31 July 2014 the Trust held 855 (2013: 855) ordinary shares.

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

Capital management

Capital employed comprises total equity adjusted for goodwill recognised directly in reserves, net post-retirement benefit related assets and liabilities, net litigation provisions relating to exceptional items and net debt. The efficiency of the allocation of the capital to the divisions is monitored through the return on capital employed (ROCE). This ratio is calculated over a rolling 12-month period and is the percentage that headline operating profit comprises of monthly average capital employed. The ROCE was 15.7% (2013: 16.6%).

The capital structure is based on the directors' judgement of the balance required to maintain flexibility while achieving an efficient cost of capital. The Group has a target gearing, calculated on a market value basis, of approximately 20%. At the balance sheet date the Group had gearing of 15% (2013: 13%).

In November 2013 the Group returned £118.3m to shareholders in the form of a special dividend of 30.0p per share. This has brought the ratio of net debt to headline EBITDA of 1.4 (2013: 1.2) close to the medium term target of 1.5 to 2.0. The Group's robust balance sheet and record of strong cash generation is more than able to fund the immediate investment needs and other legacy obligations.

As part of its capital management the Group strategy is to maintain a solid investment grade credit rating to ensure access to the widest possible sources of financing and to minimise the resulting cost of capital. At 31 July 2014 the Group had a credit rating of BBB+/Baa2 (2013: BBB+/Baa2) with Standard & Poor's and Moody's respectively. The credit rating is managed through the following cash-flow targets: headline operating cash conversion of greater than 80% and a ratio of net debt to headline EBITDA of less than two. For the year ended 31 July 2014 these measures were 97% (2013: 98%) and 1.4 (2013: 1.2).

The Board aims for dividend cover of around 2.5 times, to ensure that the Group retains sufficient cash to finance investment in growth and to meet its legacy liabilities.

Hedge reserve

	31 July 2014 £m	31 July 2013 £m
The hedge reserve on the balance sheet comprises		
– cash-flow hedge reserve	**0.2**	1.8
– net investment hedge reserve	**(57.9)**	(175.8)
	(57.7)	(174.0)

See transactional currency exposure risk management disclosures in note 19 for additional details of cash-flow hedges, and translational currency exposure risk management disclosure also in note 19 for additional details of net investment hedges.

27 Cash-flow

Cash-flow from operating activities

	Year ended 31 July 2014 £m	Year ended 31 July 2013 (restated) £m
Operating profit – continuing	**377.6**	486.5
Amortisation of intangible assets	**73.0**	81.1
Loss/(profit) on disposal of property, plant and equipment	**2.6**	(4.3)
Profit on disposal of business	**(2.8)**	(0.9)
Depreciation of property, plant and equipment	**46.1**	52.3
Share-based payment expense	**9.2**	12.1
Retirement benefits	**(78.9)**	(71.0)
Decrease/(increase) in inventories	**3.8**	(20.3)
Increase in trade and other receivables	**(13.1)**	(30.3)
Increase/(decrease) in trade and other payables	**(8.6)**	31.8
Increase/(decrease) in provisions	**18.9**	(9.9)
Cash generated from operations	**427.8**	527.1
Interest	**(76.2)**	(59.6)
Tax paid	**(95.4)**	(114.1)
Net cash inflow from operating activities	**256.2**	353.4

Smiths Group cash-flow measures

The Group uses two non-statutory cash-flow measures to monitor performance: headline operating cash-flow and free cash-flow. Headline operating cash-flow is net cash inflow from headline operating activities less capital expenditure. See note 3 for a description of headline profit measures. Free cash-flow is cash-flow after interest and tax but before acquisitions, financing activities and dividends. The tables below reconcile these two measures to statutory cash-flow measures.

Headline operating cash-flow

	Year ended 31 July 2014 £m	Year ended 31 July 2013 £m
Net cash inflow from operating activities	**256.2**	353.4
Exclude:		
Interest	**76.2**	59.6
Tax paid	**95.4**	114.1
Cash outflow in respect of exceptional operating items	**73.0**	43.9
Pension deficit payments	**82.2**	71.4
Include:		
Expenditure on capitalised development, other intangible assets and property, plant and equipment	**(94.0)**	(96.0)
Disposals of property, plant and equipment in the ordinary course of business	**0.6**	1.5
Headline operating cash-flow	**489.6**	547.9

Free cash-flow

	Year ended 31 July 2014 £m	Year ended 31 July 2013 £m
Net cash inflow from operating activities	**256.2**	353.4
Expenditure on capitalised development, other intangible assets and property, plant and equipment	**(94.0)**	(96.0)
Disposals of property, plant and equipment	**4.7**	3.9
Investment in financial assets relating to pensions financing	**(24.0)**	(24.0)
Free cash-flow	**142.9**	237.3
Investment in other financial assets	**(3.3)**	(0.3)
Acquisition of businesses	**(1.3)**	(0.5)
Disposal of businesses	**3.2**	0.3
Net cash-flow used in financing activities	**(313.0)**	(66.7)
Net (decrease)/increase in cash and cash equivalents	**(171.5)**	170.1