

FROM THE AEROSPACE INDUSTRY TO
HOSPITALS, FROM PETROCHEMICAL
COMPANIES TO NATIONAL GOVERNMENTS,
**SMITHS ADVANCES ITS CUSTOMERS'
CAPABILITIES THROUGH THE INTELLIGENT
APPLICATION OF TECHNOLOGY.**

smiths

SMITHS FOCUSES ON DEVELOPING AND ACQUIRING TECHNOLOGIES THAT MAKE A DIFFERENCE, WHILE CONTINUOUSLY DRIVING FOR GREATER EFFICIENCY IN ALL ITS BUSINESSES.

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PRINCIPAL ACTIVITIES

The principal activities of the company and its subsidiaries are the development, manufacture, sale and support of:

- integrated aerospace systems, including electronic and actuation systems and precision components, for civil and military aircraft;
- advanced security equipment, using the power of trace detection and x-ray imaging, to detect and identify explosives, chemical and biological agents, weapons and contraband;
- medical devices and critical care equipment aligned to specific therapies, principally airway, pain and temperature management and infusion. Also needle protection, critical care monitoring, women's healthcare and vascular access; and
- mechanical seals used in industries ranging from petrochemical processing to aerospace; interconnect products to connect and protect safety-critical electrical and electronic equipment; navigational radar, marine electronics and charts; and rigid tubular and flexible hose assemblies.

The main manufacturing operations are in the United Kingdom, the Americas and Continental Europe. A review of the development of the company and its subsidiary undertakings during the 2002-2003 financial year is on pages 5 to 19 of the Annual Review 2003 that accompanies this Directors' Report and Financial Statements.

RESULTS AND DIVIDENDS

The results for the year to 31 July 2003 are set out in the Consolidated Profit and Loss Account on page 13. Sales for the year amounted to £3,056m, against £3,223m last year. The profit for the year after taxation, minority interests and goodwill amortisation amounted to £112m (2002 £185m).

An interim dividend of 8.75p per ordinary share of 25p was paid on 17 April 2003. The directors recommend for payment on 14 November 2003 a final cash dividend on each ordinary share of 17.25p, making a total dividend of 26p for the year.

The retained loss of £34m was transferred from Reserves.

RESEARCH AND DEVELOPMENT

£251m was spent on research and development during the year, of which £130m was funded by the company and the balance by customers. Each business carries out research and development programmes to suit its own particular market and product needs. Interchange of technology and technical information between Smiths' manufacturing businesses is centrally coordinated.

CHANGES IN THE COMPANY AND ITS INTERESTS DURING THE YEAR

On 18 October 2002 the business and assets of Precision Handling Systems were sold to Parkburn Engineering Limited for £2.3m in cash.

On 4 November 2002 the business and assets of Lodge Ignition were sold to Meggitt PLC for £33m in cash.

On 29 November 2002 the company acquired all the issued share capital of Heimann Systems GmbH (Germany) for a cash consideration of £236m.

On 3 December 2002 the business and assets of the Air Movement and Cable Management businesses were sold to HSBC Private Equity for £125m in cash.

On 29 January 2003 the company completed the private placement of US\$250m in senior notes with 11 leading North American institutional investors. The notes have a 10-year term and a coupon of 5.45%, priced at 140 basis points over the 10-year US Treasury Bill.

On 1 April 2003 the issued share capital of C & F Millier Limited was sold to a management buy-out for a cash consideration of £0.3m.

On 8 May 2003 John Crane Chile S.A. acquired the business and assets of General Seals S.A. (Chile) for a cash consideration of £1.7m.

POST BALANCE SHEET EVENTS

On 1 August 2003 a new division was created to include Smiths Detection and Smiths Heimann. The move reflected the recent acquisition of Heimann and the potential for growth of these two market-leading businesses, both previously part

of Aerospace. At the same time, the Sealings Solutions and Industrial divisions were merged to form the new Specialty Engineering division.

On 29 August 2003, the sale of Matzen & Timm to Masterflex AG was completed for €1.35m in cash.

On 22 September 2003, the sale of the Polymer Sealing Solutions business to Trelleborg AB for £495m in cash became unconditional, with completion expected by the end of September.

FUTURE DEVELOPMENTS

The company will pursue its existing international activities and continue to seek business opportunities in both the United Kingdom and overseas.

CHARITABLE AND POLITICAL DONATIONS

During the year the company made donations of £708,000 for charitable purposes including payments totalling £300,000 for the Portex Chair of Paediatric Anaesthesia. No political donations were made.

DIRECTORS

The directors at the end of the financial year are shown on page 22 of the accompanying Annual Review 2003. Mr J M Hignett retired at the Annual General Meeting in November 2002. The Rt Hon. Lord Robertson of Port Ellen has been appointed as a non-executive director with effect from 15 February 2004.

REAPPOINTMENT OF DIRECTORS

Mr K O Butler-Wheelhouse, Dr J Ferrie and Mr J M Horn-Smith will retire in accordance with Article 57 and, being eligible, will seek reappointment at the Annual General Meeting.

DIRECTORS' REMUNERATION REPORT

The directors' remuneration report is on pages 5 to 11. An ordinary resolution to approve the report will be put to shareholders at the Annual General Meeting.

DIRECTORS' INTERESTS IN CONTRACTS

Details of the executive directors' service contracts are as disclosed in the service contracts section of the directors' remuneration report on page 9. Details of the interests of the executive directors in the company's share option schemes are shown in the remuneration report on pages 10 and 11.

Apart from the exceptions referred to above, no director had an interest in any contract to which the company or its subsidiaries was a party during the year.

INTERESTS IN SHARES

As at 23 September 2003 the company had been notified, pursuant to the Companies Act 1985, of the following material or notifiable interests in its issued share capital:

	No. of shares	Percentage of issued share capital†
The Capital Group Companies, Inc*	68.6m	12.3%
Franklin Resources, Inc.	50.5m	9.0%
Legal & General Group plc	19.3m	3.4%

*includes the interests of Capital Guardian Trust Company in 9.9% of the issued share capital
 † percentage of share capital in issue on 23 September 2003

The company has not acquired or disposed of any interests in its own shares.

The interests of the directors, their families and any connected persons in the issued share capital of the company are shown on page 8.

CORPORATE GOVERNANCE

The company complies with the Combined Code, as appended to the April 2002 edition of the Listing Rules of the UK Listing Authority (the Code), except that no senior independent director is recognised as required by A.2.1 of the Code. Subject to that exception, the company has complied with the Code throughout the accounting period covered by this report. Reasons for non-compliance with A.2.1 are given below.

The Board of Directors normally meets formally eight times a year to make and review major business decisions and monitor current trading against budgets which it has approved. It additionally exercises control by determining matters specifically reserved to it in a formal schedule which only the Board may change: these matters include the acquisition of companies and major capital expenditure. Once a year the Board meets in conference to consider long-term strategy and industrial developments affecting the company. Additional meetings are arranged as necessary to deal with urgent items.

There is an agreed procedure for all directors to take independent professional advice at the company's expense in connection with their duties. They also have access to the advice and assistance of the Company Secretary whose appointment is in accordance with the Code. Arrangements are in place for all directors to receive appropriate training, whether on their appointment or periodically, as necessary.

Mr Orrell-Jones is the Chairman and also chairs the Nominations and Remuneration Committee. Sir Colin Chandler is the Deputy Chairman and chairman of the Audit Committee. No non-executive director has been appointed as 'a recognised senior independent member' for the purposes of A.2.1 of the Code because matters of concern can readily be brought to the attention of either Mr Orrell-Jones or Sir Colin. Sir Colin has accepted the company's nomination as Chairman of TI Automotive Limited. There are three other independent non-executive directors of the company. Lord Robertson's appointment as an additional independent non-executive director will take effect on 15 February 2004. Mr Butler-Wheelhouse is the Chief Executive and there are six other executive directors. (See page 22 of the accompanying Annual Review 2003.)

The Board is provided with detailed information on matters to be considered at its meetings and non-executive directors have ready access to the executive directors. Regular site visits are arranged and non-executive directors are encouraged to visit sites independently. During site visits, briefings are arranged and the Board is free to discuss aspects of the business with employees at all levels.

There is a formal procedure for appointment of all new directors. The Nominations and Remuneration Committee, of which all the non-executive directors are members and which is chaired by Mr Orrell-Jones, makes recommendations to the Board on appointments. Appointments made by the Board are subject to approval by the shareholders at the next Annual General Meeting.

All directors are subject to retirement under Article 57 and submit themselves for re-election at intervals of no more than three years: any director who attains the age of 70 is subject to annual re-election. The initial appointment of non-executive directors is for three years; they do not participate in company bonus, share option or pension schemes.

The Nominations and Remuneration Committee meets at least three times a year. The Chief Executive and the General Counsel attend meetings of the Committee by invitation but do not participate in discussions of their own interests. The Committee monitors the performance of the Chief Executive and other executive directors and has access to all information required for that purpose. The report of the Board on remuneration is set out on pages 5 to 11.

The company maintains a dialogue with institutional shareholders through regular meetings and presentations. At the Annual General Meeting shareholders are encouraged to ask questions and after the meeting have access to directors and other senior executives. The company has complied with the Code provisions related to principles C.1 and C.2.

The Board believes that the full Reports and Accounts present a balanced and understandable assessment of the company's position and prospects: the Board has complied with the Code provisions D.1.1 to D.1.3. A statement by the auditors appears on page 12.

The Audit Committee's terms of reference accord with the Code. The Committee comprises the Chairman and all the non-executive directors and meets at least three times a year with the Chief Executive, Financial Director, General Counsel, Director of Internal Audit and the Auditors normally attending meetings.

Apart from work in relation to acquisitions and disposals, all material work not related to the audit for which the company might consider engaging the Auditors, is put out to tender. The Board is kept fully informed of all non-audit work awarded to the Auditors.

Internal control. Internal control is based on assessment of risk and a framework of control procedures to manage risks and to monitor compliance with procedures. The procedures of accountability and control, which accord with the guidance on internal control issued by the Turnbull Committee, are outlined below.

The Board accepts its responsibility for maintaining and reviewing the effectiveness of the company's internal control systems. These are designed to meet the company's particular needs and the risks to which it is exposed and, by their nature, can provide only reasonable, not absolute, assurance against material loss to the company or material misstatement in the financial accounts.

The group has an embedded process for the identification, evaluation and management of significant business risks. The process is reviewed through the Audit Committee and monitored by the Group Internal Audit Department. The four operating divisions and Corporate HQ have, during the year, identified and evaluated the key risks under three categories – strategic; operational; and information – and have ensured that effective controls and procedures are in place to manage these risks.

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

A key element in any system is communication and a number of committees enable the executive directors and senior corporate staff to address financial, human resource, risk management and other control issues. Experience is shared by subsidiaries through company-wide seminars.

Throughout the year the Board has reviewed the effectiveness of internal control and the management of risks at its regular Board

meetings. In addition to financial and business reports, the Board has reviewed medium and longer-term strategic plans; capital expenditure and development programmes; management and product development programmes; reports on key operational issues; tax; treasury; risk management; insurance; legal matters; and Audit Committee reports, including internal and external auditor reports.

Going concern. The Board's review of the accounts, budgets and forward plans, together with the internal control system, lead the directors to believe that the company has ample resources to continue in operation for the foreseeable future. The accounts are therefore prepared on a going concern basis.

Auditors. PricewaterhouseCoopers LLP have reviewed the company's statements as to compliance with the Code to the extent required by the Listing Rules of the UK Listing Authority.

New Combined Code. On 23 July 2003 the Financial Reporting Council issued a new Combined Code which will come into effect for listed companies for reporting years beginning on or after 1 November 2003. It is anticipated that the new Code will replace the existing version of the Code and that some changes to the Listing Rules will follow therefrom. The company is currently reviewing the new Code and will address what steps need to be taken to comply with its provisions.

POLICY ON PAYMENT OF CREDITORS

The company's policy and practice is to pay creditors promptly in accordance with agreed terms of business. The average time taken to pay an invoice was 37 days (2002: 37 days) for the parent company and 50 days (2002: 51 days) for the group as a whole (calculated in compliance with the Companies Act 1985 (Directors' Report) (Statement of Payment Practice) Regulations 1997).

ENVIRONMENT

The company seeks to minimise, as far as is reasonably practicable, any detrimental effects to the environment of its operations and products. A senior corporate staff

director has responsibility for safety, health and environmental matters. The corporate and social responsibility review appears on pages 20 and 21 of the accompanying Annual Review 2003.

EMPLOYMENT POLICIES

It is the company's policy to provide equal opportunities for employment and to give the fullest consideration to employment prospects for the disabled. The company continues to be actively involved in all aspects of the training and development of young persons, including government sponsored schemes and unit initiatives designed to ease the transition from school to work.

Share option schemes enable employees to acquire an interest in the company's shares and to align their interests more closely with those of the shareholders.

Employees are regularly provided with a wide range of information concerning the performance and prospects of the business in which they are involved by means of Employee Councils, Works Councils and other consultative bodies that allow the views of personnel to be taken into account.

All matters concerning the environment, health and safety continue to be regulated by preventative, investigatory and consultative systems; issues relevant to the company pension scheme are covered by means of structured committees, including representation from recognised trade unions. A more detailed statement appears on pages 20 and 21 of the accompanying Annual Review 2003.

AUTHORITY TO ISSUE SHARES

At the Annual General Meeting shareholders will be asked to renew the authority, given to the directors at the last Annual General Meeting, to allot relevant securities for the purposes of section 80 of the Companies Act 1985, so as to reflect the increase in the company's issued share capital since the last Annual General Meeting. The authority proposed will expire on the fifth anniversary of the Meeting unless otherwise renewed. The amount of relevant securities to which this authority relates (£46,629,434 nominal of share

capital) represents one third of the share capital in issue on 23 September 2003. The directors have no present intention of exercising this authority except for allotments of shares pursuant to the company's share option schemes. The ordinary resolution is set out in the Notice of Annual General Meeting.

Also in the Notice is the special resolution to renew the power granted to directors under section 95 of the Companies Act 1985. The new authority sought will be on substantially similar terms to those attaching to the existing authority and will expire on the fifth anniversary of the Meeting, unless otherwise renewed. It will permit the directors to allot equity securities for cash:

- in connection with a rights issue *pro rata* to the rights of the existing shareholders;
- pursuant to the terms of any share scheme approved by the shareholders in General Meeting; and
- for any other purpose provided that the aggregate nominal value of such allotments does not exceed £6,994,415 (approximately 5% of the issued share capital on 23 September 2003).

The directors intend seeking renewal of these authorities annually.

During the year ended 31 July 2003 the following ordinary shares in Smiths Group plc were issued:

- 753,369 shares pursuant to the terms of the company's shareholder-approved share option schemes; and
- 186,794 shares pursuant to the terms of TI Group share option schemes.

AUTHORITY TO PURCHASE SHARES

At the Annual General Meeting the company will seek to renew the authority, granted at the last Annual General Meeting to the directors, to purchase the company's shares in the market. The authority will be limited to 10% of the share capital in issue on 23 September 2003 and will be renewed annually. The maximum price that may be paid under the authority will be limited to 105% of the average of the middle market quotations of the company's shares, as derived from the London Stock Exchange Daily Official List, for the five business days

prior to any purchase. On 23 September 2003 options over approximately 26m shares were outstanding under the company's share option schemes, representing approximately 4.6% of the then issued share capital. If the authority to purchase shares being sought at the Annual General Meeting were to be used in full, then the outstanding options would represent approximately 5.2% of the reduced issued share capital.

The directors will exercise the authority only if they are satisfied that any purchase will increase the earnings per share of the ordinary share capital in issue and will be in the interests of the shareholders. The directors will also give careful consideration to the gearing levels of the company and its general financial position.

No shares have ever been purchased or contracted for or the subject of any option under the expiring or any prior authority.

The Companies (Acquisition of Own Shares) (Treasury Shares) Regulations 2003 (the 'Regulations'), will come into force on 1 December 2003. They will enable certain listed companies to hold shares in treasury, as an alternative to cancelling them, following a purchase of own shares by the company in accordance with the Companies Act 1985. Shares held in treasury in this manner will be available for resale by the company rather than, as is currently the case, being immediately cancelled.

Accordingly, if the authority is renewed at the Annual General Meeting and the directors were to exercise it after the Regulations have come into force, the company would have the option of holding those shares in treasury, rather than cancelling them.

The Board will have regard to any guidelines issued by investor groups which may be published at the time of any such purchase, holding or resale of treasury shares.

The Financial Services Authority is currently consulting on the changes required to the Listing Rules to reflect the amendments to the Companies Act 1985 to be made by the Regulations.

AUDITORS

PricewaterhouseCoopers resigned as auditors during the year, following a restructuring as a limited liability partnership. The Board appointed PricewaterhouseCoopers LLP as auditors to fill the vacancy. Special notice having been received by the company, resolutions will be proposed at the Annual General Meeting to reappoint PricewaterhouseCoopers LLP as auditors and to authorise the directors to determine the auditors' remuneration.

SUMMARY FINANCIAL STATEMENT

The company has produced the Annual Review 2003 (a Summary Financial Statement) which, together with this Directors' Report and Financial Statements 2003, forms the statutory Reports and Accounts for 2003. Shareholders will be automatically sent Annual Reviews alone each year unless they elect in writing to receive the statutory Reports and Accounts. Shareholders who wish to receive the statutory Reports and Accounts (free of charge) in future years should write to Lloyds TSB Registrars, The Causeway, Worthing, West Sussex BN99 6DA, quoting Reference 0282. The publication of Annual Reviews results in significant savings in the cost of producing the accounts each year.

WWW.SMITHS-GROUP.COM

Electronic copies of the Annual Review 2003, the Directors' Report and Financial Statements 2003 and the Notice of Annual General Meeting will be posted on the company's website, www.smiths-group.com. The company's announcements to the Stock Exchange and press releases are available on-line through the website. Shareholding details and practical help on share transfers and changes of address can be found at www.shareview.co.uk.

By Order of the Board

DAVID P LILLYCROP DIRECTOR AND SECRETARY

765 Finchley Road
London NW11 8DS

24 September 2003

INTRODUCTION

The directors' remuneration report is presented to shareholders by the Board. The report complies with the Directors' Remuneration Report Regulations 2002 (the Regulations), which apply to the company for the first time this year. A resolution will be put to shareholders at the Annual General Meeting on 11 November 2003 inviting them to approve this report.

The Nominations and Remuneration Committee (the Committee) of the Board currently comprises Mr K Orrell-Jones (Chairman of the Committee) and the following independent non-executive directors: Sir Nigel Broomfield, Sir Colin Chandler, Mr J M Horn-Smith and Mr R W O'Leary. The Chairman is absent when his own remuneration is under consideration. The Chief Executive attends meetings of the Committee by invitation, save that he is absent when his own remuneration is under consideration. The Committee operates within agreed terms of reference and has responsibility for making recommendations to the Board on the group's general policy relating to executive remuneration. It also determines, on behalf of the Board, specific remuneration packages for the executive directors including their annual bonus targets and grants of share options.

The Committee's constitution and practice accord with the relevant provisions of the Combined Code, which is appended to the April 2002 edition of the Listing Rules of the UK Listing Authority (the Code). In reviewing its remuneration policy the Committee has given full consideration to the Code and has complied with the Code's provisions relating to directors' remuneration throughout 2002-2003. A revised version of the Code was published in July 2003 and will apply to the company for the financial year commencing 1 August 2004. The Committee will, during the current financial year, address what steps need to be taken to comply with the provisions of the revised Code relating to directors' remuneration.

The Committee seeks to maintain a competitive remuneration programme that enables the company to attract and retain the highest calibre of executive.

The Committee meets regularly and takes advice from both inside and outside the group on a range of matters, including the scale and composition of the total remuneration package payable to people with similar responsibilities, skills and experience in comparable industrial companies which are UK-based but which, like Smiths, have extensive operations outside the United Kingdom.

During the year the Committee received material assistance and advice from the Chief Executive and from the General Counsel (who is also Secretary to the Committee). In addition the Committee received material assistance and advice from:

- Towers Perrin, remuneration consultants;
- Aon Consulting, actuaries; and
- Freshfields Bruckhaus Deringer, solicitors.

Towers Perrin, which also provided remuneration and pensions advice to the company during the year, was appointed by the Committee. Freshfields Bruckhaus Deringer was appointed by the company but advised only in relation to remuneration matters. Aon Consulting was also appointed by the trustee of a group pension scheme to which it also provided actuarial advice.

The remuneration of directors is set out in tables on pages 7 and 8.

REMUNERATION POLICY

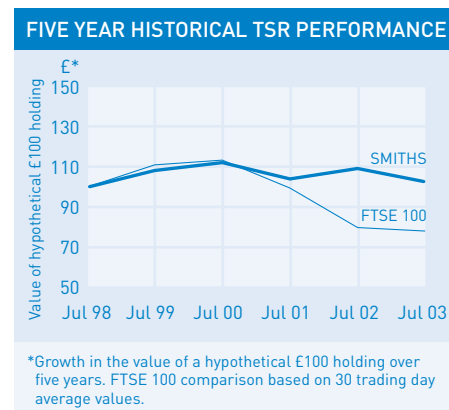
The Committee believes that the individual contributions made by the executive directors are fundamental to the successful performance of the company.

The Committee has adopted a remuneration policy (which will continue to apply during 2003-2004) with the following objectives:

- (a) performance-related remuneration should seek to align the interests of executive directors with those of shareholders;
- (b) a significant proportion of remuneration should be based on operational and financial performance both in the short and long term together with the individual contributions made by the executive directors; and
- (c) the remuneration packages for executive directors should be competitive in terms of market practice.

Although the Committee has no current plans to change this policy, changes are possible because the company's remuneration policy needs to be sufficiently flexible to take account of changes in the company's business environment and in remuneration practice.

The following graph shows the company's 'total shareholder return' (TSR) performance over the past five years. As required by the Regulations, the company's TSR is compared to a broad equity market index. The index chosen here is the FTSE 100 Index which provides an effective indication of the TSR performance of other leading UK-listed companies.



ELEMENTS OF REMUNERATION

Executive directors' remuneration comprises: basic salary, benefits in kind, annual bonus and pension benefits. In addition, executive directors and senior executives participate in certain share based incentive schemes, comprising the Smiths Industries 1982 SAYE Share Option Scheme, the Smiths Industries 1995 Executive Share Option Scheme and the Smiths Industries Senior Executive Deferred Share Scheme. The annual bonus element, participation in the deferred share scheme, which provides for a share match (see below), and participation in the executive share option scheme are linked to performance, and the Committee regards them as key elements in the executive directors' remuneration packages. The value of the matching share element is derived from annual bonus, and other corporate financial, criteria and, while vesting of matching shares is not dependent on satisfaction of a further performance condition, there is a strong

and direct relationship to performance at the time the award is determined. Entitlement to the matching shares is also dependent upon the executive remaining in service for a further period.

SALARY AND BENEFITS IN KIND

Salaries are reviewed annually for each director. The Committee takes into account individual performance and experience, the size and nature of the role, the relative performance of the company, pay policy within the company and the salaries in comparable industrial companies. Benefits include a fully expensed company car (or an allowance in lieu), health insurance and, where appropriate, relocation and education expenses.

BONUSES

Executive directors are eligible to participate in an annual bonus scheme which is based upon a combination of corporate financial goals and individual objectives which are geared to the achievement of the group's strategic goals. The majority of the annual bonus opportunity, which is capped, is based upon the corporate financial element.

Under the deferred share scheme (referred to above), executive directors may elect to use their after-tax bonus to acquire the company's shares at the prevailing market price. Provided that a director retains them for three years he may exercise an option to acquire a number of matching shares for a nominal sum at the end of the three year period.

The number of matching shares that may be awarded is determined by the Committee at the end of the year in which the bonus is earned by reference to annual bonus, and other corporate financial, criteria. The number of matching shares awarded may be up to, but no more than, 100% of the number of shares the executive director acquires with his after-tax bonus. In respect of bonus earned in the year to 31 July 2003 the full amount of the shares so acquired is available for matching.

PENSIONS

The company operates a number of different pension arrangements for executive directors, generally reflecting the individual's pension arrangements at the time he was appointed to the Board. In some cases, the company pays monthly salary supplements to enable the director to make his own pension provision. For other directors, final salary schemes provide a pension of up to two-thirds of final pensionable salary. Where Inland Revenue limits apply, the difference between the pension payable on the cap and the target pension is, after taking into account any retained benefits from previous employment, provided by the company. Details of the salary supplement payments and other pension provisions are set out in the tables on pages 7 and 8.

Directors' annual bonus payments and any gains under share option schemes are not pensionable.

SHARE OPTIONS

The company operates a number of share option schemes for executive directors and other employees.

The Smiths Industries 1995 Executive Share Option Scheme (the 1995 Scheme), approved at the Annual General Meeting in 1995 and amended in 2001, covers approximately 350 executives. Awards are approved by the Committee. In awarding share options the Committee has regard to guidelines published by or on behalf of institutional shareholders, the individual performance of participants and executive directors' compliance with the company's policy on share ownership (referred to below). It is the Committee's policy that the value of shares over which options are granted to executive directors in any year should not normally exceed twice base salary. Options granted under the 1995 Scheme may only be exercised after three years if a performance requirement, determined by the Committee, has been met. For the last grant of options, on 2 October 2002, and for anticipated future

grants the performance requirement is that the growth in the company's normalised earnings per share over the three financial years beginning immediately prior to the option grant must exceed the increase in the UK Retail Prices Index over the same period by 3% p.a. (for options up to one times base salary) and by 4% p.a. (for the excess up to two times base salary). The Committee selected this performance condition for the 1995 Scheme because it serves to align directors' interests with those of shareholders by linking the reward available to participants with the achievement of significant earnings growth by the company.

If a performance requirement is not satisfied at the end of the third year, the performance period may be extended for up to two further years so that performance is tested over a four year period at the end of the fourth year and a five year period at the end of the fifth year.

The Save-As-You-Earn Share Option Scheme, which is open to all UK employees with 12 months' service, is subject to UK legislation as to the amount that can be saved. Participants save a fixed sum per month for three or five years and may use the sum generated by their savings contracts to exercise the options which are usually granted at a 20% discount to the market price. These options are not subject to a corporate performance condition.

In the year to 31 July 2003, executive directors exercised share options and at 31 July 2003 held unexercised options as described in the table on pages 10 and 11.

There were no changes in the options held by directors between 31 July 2003 and 23 September 2003. The Register of Directors' Interests (which is open to inspection) contains full details of directors' shareholdings and options to acquire shares in the company.

REMUNERATION

The total remuneration of directors, excluding the value of shares to which certain directors may become entitled under the deferred share scheme (shown alongside the emoluments table) and also defined benefit pension arrangements, was as follows:

	2003 £000	2002 £000
Fees, salaries and benefits	3,639	3,360
Performance-related bonuses	1,545	943
Gain from exercise of share options	7	74
Incremental gain/(loss) from deferred share scheme exercises	(63)	(40)
Payments in lieu of pension contribution	591	556
	5,719	4,893

The emoluments of the directors are set out below:

	Fees/salary		Benefits	Bonus	Payments in lieu of pension contribution	Total emoluments		Deferred share scheme contributions	Total
	2003 £000	2002 £000	2003 £000	2003 £000	2003 £000	2003 £000	2002 £000	2003 £000	2002 £000
Chairman									
K Orrell-Jones	210	180	27			237	199	237	199
Chief executive									
K O Butler-Wheelhouse	735	700	51	528	368	1,682	1,444	214	1,896
Executive directors									
J Ferrie	355	320	65	222	142	784	642	76	860
L H N Kinet	325	310	208	91	81	705	584	16	721
J Langston	325	310	32	211		568	447	66	634
D P Lillycrop	310	300	54	166		530	453	64	594
E Lindh	325	300	24	144		493	392	36	529
A M Thomson	395	360	33	183		611	513	77	688
Non-executive directors									
Sir Nigel Broomfield	30	30				30	30		30
Sir Colin Chandler	65	65				65	65		65
J M Hignett (retired 12/11/02)	10	30				10	30		30
J M Horn-Smith	30	30				30	30		30
R W O'Leary	30	30				30	30		30
	3,145	2,965	494	1,545	591	5,775	4,859	549	6,324

1. The deferred share scheme amounts represent shares to which certain directors may become entitled and relate to the previous year's bonus. These have been shown separately from 'Total emoluments' in order to comply with the Regulations.

2. Benefits for Dr Ferrie and Mr Kinet include payments related to their relocation to the United Kingdom from the United States.

DIRECTORS' REMUNERATION REPORT CONTINUED

PENSIONS

	Age at 31 July 2003	Accrued entitlement at 31 July 2002 €000	Directors' contributions during the year €000	Additional pension earned during the year [excluding any increase for inflation] €000	Transfer value of accrued benefits at 31 July 2003 (A) €000	Transfer value of accrued benefits at 31 July 2002 (B) €000	The amount of [A – B] less contributions made by the director in 2003 €000	Accrued entitlement at 31 July 2003 €000
J Langston	53	108	5	15	1,802	1,248	549	125
D P Lillycrop	47	95	5	9	1,155	784	366	105
E Lindh	58	201	16	13	3,853	3,104	733	218
A M Thomson	56	118	20	32	2,542	1,669	853	152

An executive director's normal retirement age is 60. An early retirement pension, based on actual service completed, may be paid after age 50 and may be subject to a reduction on account of early payment. On death a spouse's pension of two-thirds of the director's pension (or for death-in-service his prospective pension at age 60) is payable. All pensions in excess of the Guaranteed Minimum Pension (GMP) are guaranteed to increase at the lesser of (i) in the case of Messrs Lindh and Thomson, 5% p.a. compound and, in the case of Messrs Langston and Lillycrop, 7% p.a. compound and (ii) the annual increase in the Retail Prices Index. There has, however, been a long-standing practice of granting additional discretionary increases on pensions in excess of the GMP to bring them into line with price inflation.

DIRECTORS' INTERESTS IN THE COMPANY'S SHARES

	Ordinary shares of 25p	
	31 July 2003	31 July 2002
Sir Nigel Broomfield	103	103
K O Butler-Wheelhouse	156,715	117,537
Sir Colin Chandler	8,778	8,778
J Ferrie	32,911	22,438
J M Horn-Smith	6,682	6,682
L H N Kinet	2,152	0
J Langston	63,270	60,270
D P Lillycrop	67,144	65,144
E Lindh	68,887	38,189
R W O'Leary	2,642	2,642
K Orrell-Jones	3,226	3,226
A M Thomson	62,178	51,526

These interests include beneficial interests of the directors and their families in the company's shares held in PEPs and ISAs and holdings through nominee companies. Except as reported below, none of the directors has disclosed any non-beneficial interests in the company's shares.

Mr J Langston and Mr D P Lillycrop also both have a technical interest in 438,569 ordinary shares in the company as discretionary beneficiaries under the TI Group Jersey Employee Share Trust and the TI Group Employee Share Trust. These shares may be transferred to employees who exercise options granted under the TI Group share option schemes. In addition, Mr Langston has a contingent interest in 125,000 ordinary shares and Mr Lillycrop has a contingent interest in 100,000 ordinary shares, arising from contractual arrangements entered into following the merger of TI Group plc with the company.

The company has not been notified of any changes to the holdings of the directors, their families and any connected persons between 31 July 2003 and 23 September 2003.

SHARE OWNERSHIP

It is the company's policy that executive directors should over time acquire a shareholding with a value equal to at least one and a half years' gross salary.

SERVICE CONTRACTS

The company's policy is that executive directors are employed on terms which include a one year rolling period of notice and provision for the payment of predetermined damages in the event of termination of employment in certain circumstances.

Mr Butler-Wheelhouse is employed under a service contract with the company dated 26 September 2001. Mr Butler-Wheelhouse's contract is for an indefinite term ending automatically on his anticipated normal retirement date (age 60), but may be terminated by 12 months' notice given by the company or 6 months' notice given by Mr Butler-Wheelhouse. The company may at its discretion elect to terminate the contract by making a payment in lieu of notice equal to:

- (a) the salary Mr Butler-Wheelhouse would have received during the notice period;
- (b) an amount equal to 50% of the maximum bonus potential that Mr Butler-Wheelhouse was entitled to receive under the executive bonus scheme for the then current bonus year;
- (c) the annual cost to the company of providing all other benefits to which Mr Butler-Wheelhouse is entitled under his contract, which has been pre-agreed as 10% of basic salary; and
- (d) one year's payment in lieu of pension contribution.

Mr Langston, Mr Lillycrop, Mr Lindh and Mr Thomson are all employed under service contracts with the company dated 26 September 2001. Each service contract is for an indefinite term ending automatically on the anticipated normal retirement date (age 60), but may be

terminated by 12 months' notice given by the company or six months' notice given by the director concerned. The company may at its discretion elect to terminate the contract by making a payment in lieu of notice on the same terms as those applicable to Mr Butler-Wheelhouse, save that the payment at item (d) is replaced by an amount to secure one year's pensionable service in the appropriate pension scheme(s). In addition, for Mr Langston and Mr Lillycrop, the company has given its irrevocable consent to early payment of their pension from age 50 and without actuarial reduction from age 55.

Mr Kinet is employed under a service contract with the company dated 24 January 2000. Mr Kinet's contract is for an indefinite term ending automatically on his anticipated normal retirement date (age 60), but may be terminated by 12 months' notice given by either the company or Mr Kinet.

Dr Ferrie is employed under a service contract with the company dated 31 January 2000. Dr Ferrie's contract is for an indefinite term ending automatically on his anticipated normal retirement date (age 60), but may be terminated by 12 months' notice given by the company or six months' notice given by Dr Ferrie.

There are no specific termination provisions in Mr Kinet's or Dr Ferrie's service contracts. In case of early termination, the company may be liable to pay an amount in damages, having regard to salary and other benefits the executive would have received had he served out his notice period and taking into account the executive's duty to mitigate his loss.

EXTERNAL APPOINTMENTS

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

NON-EXECUTIVE DIRECTORS

Non-executive directors were paid a total of £402,000 (including £375,000 in fees) in the year to 31 July 2003. Their remuneration is determined by the Board in accordance with the Articles of Association. They are not eligible for bonuses or participation in share schemes and no pension contributions are made on their behalf. The non-executive directors, including Mr Horn-Smith who is to be proposed for re-election at the Annual General Meeting, serve the company under letters of appointment and do not have contracts of service or contracts for service.

AUDITABLE PART

The directors' remuneration tables and accompanying notes on page 7, the directors' pensions table and accompanying notes on page 8, and the directors' share options table on pages 10 and 11 have been audited.

DIRECTORS' REMUNERATION REPORT CONTINUED

DIRECTORS' SHARE OPTIONS

Director	Scheme	Options held	Options held	Performance test	Exercise price	Grant date	Vesting date*	Expiry date	Options exercised 2002-2003					
		on 31 July 2003	on 31 July 2002						Exercise date	Exercise price	Market price at date of grant**	Market price at date of exercise*		
K O Butler-Wheelhouse	95 ESOS	68,043	68,043	A	823.00p	25/10/96	25/10/99	25/10/06						
		83,540	83,540	A	934.00p	17/10/97	17/10/00	17/10/07						
		122,718	122,718	A	765.00p	21/10/98	21/10/01	21/10/08						
		16,806	16,806	A	858.50p	01/10/99	01/10/02	01/10/09						
		53,230	53,230	A	807.00p	01/12/00	01/12/03	01/12/10						
		47,800	47,800	A	790.00p	19/04/01	19/04/04	19/04/11						
		86,849	86,849	B	806.00p	09/04/02	09/04/05	09/04/12						
		86,848	86,848	C	806.00p	09/04/02	09/04/05	09/04/12						
		112,500	0	B	654.00p	02/10/02	02/10/05	02/10/12						
		112,500	0	C	654.00p	02/10/02	02/10/05	02/10/12						
		SAYE	0	2,578		669.00p	14/05/98	01/07/03		09/07/03	669.00p	See note**	734.00p	
			2,964	0		554.00p	08/05/03	01/08/08	01/02/09					
		DSS	0	11,841		0.10p	03/11/99	03/11/02		04/12/02	0.10p	865.00p	716.00p	
			17,964	17,964		0.10p	04/12/00	04/12/03	04/11/07					
	38,758	38,758		0.10p	22/11/01	22/11/04	22/10/08							
	29,507	0		0.10p	24/10/02	24/10/05	24/09/09							
J Ferrie	95 ESOS	55,424	55,424	A	765.00p	11/04/00	11/04/03	11/04/10						
		31,895	31,895	A	807.00p	01/12/00	01/12/03	01/12/10						
		42,700	42,700	A	790.00p	19/04/01	19/04/04	19/04/11						
		39,702	39,702	B	806.00p	09/04/02	09/04/05	09/04/12						
		39,702	39,702	C	806.00p	09/04/02	09/04/05	09/04/12						
		54,250	0	B	654.00p	02/10/02	02/10/05	02/10/12						
		54,250	0	C	654.00p	02/10/02	02/10/05	02/10/12						
		SAYE	2,775	2,775		608.00p	10/05/01	01/08/06	01/02/07					
		DSS	22,438	22,438		0.10p	22/11/01	22/11/04	22/10/08					
			10,473	0		0.10p	24/10/02	24/10/05	24/09/09					
L H N Kinet	95 ESOS	59,733	59,733	A	750.00p	31/03/00	31/03/03	31/03/10						
		33,308	33,308	A	807.00p	01/12/00	01/12/03	01/12/10						
		42,700	42,700	A	790.00p	19/04/01	19/04/04	19/04/11						
		38,462	38,462	B	806.00p	09/04/02	09/04/05	09/04/12						
		38,461	38,461	C	806.00p	09/04/02	09/04/05	09/04/12						
		49,750	0	B	654.00p	02/10/02	02/10/05	02/10/12						
		49,750	0	C	654.00p	02/10/02	02/10/05	02/10/12						
		SAYE	1,593	1,593		608.00p	11/05/01	01/08/04	01/02/05					
		DSS	2,152	0		0.10p	24/10/02	24/10/05	24/09/09					
J Langston	95 ESOS	42,700	42,700	A	790.00p	19/04/01	19/04/04	19/04/11						
		38,462	38,462	B	806.00p	09/04/02	09/04/05	09/04/12						
		38,461	38,461	C	806.00p	09/04/02	09/04/05	09/04/12						
		49,750	0	B	654.00p	02/10/02	02/10/05	02/10/12						
		49,750	0	C	654.00p	02/10/02	02/10/05	02/10/12						
		SAYE	1,593	1,593		608.00p	11/05/01	01/08/04	01/02/05					
		DSS	9,147	0		0.10p	24/10/02	24/10/05	24/09/09					
		TI 90 ESOS	14,264	14,264		1,097.82p	02/04/97	02/04/00	02/04/07					
			18,691	18,691		1,219.80p	08/09/97	08/09/00	08/09/07					
			14,756	14,756		1,026.67p	13/03/98	13/03/01	13/03/08					
			4,918	4,918		849.79p	06/08/98	06/08/01	06/08/08					
			51,401	51,401		943.31p	11/03/99	11/03/02	11/03/09					
		TI 99 ESOS	61,485	61,485		907.23p	24/05/99	24/05/02	24/05/09					
			98,376	98,376		661.23p	06/03/00	06/03/03	06/03/10					
	98,376	98,376		626.16p	31/03/00	31/03/03	31/03/10							
D P Lillycrop	95 ESOS	42,700	42,700	A	790.00p	19/04/01	19/04/04	19/04/11						
		37,221	37,221	B	806.00p	09/04/02	09/04/05	09/04/12						
		37,220	37,220	C	806.00p	09/04/02	09/04/05	09/04/12						
		47,500	0	B	654.00p	02/10/02	02/10/05	02/10/12						
		47,500	0	C	654.00p	02/10/02	02/10/05	02/10/12						
		SAYE	1,539	1,539		645.00p	09/05/02	01/08/07	01/02/08					
			1,185	0		554.00p	08/05/03	01/08/08	01/02/09					
		DSS	20,697	20,697		0.10p	22/11/01	22/11/04	22/10/08					
			8,876	0		0.10p	24/10/02	24/10/05	24/09/09					
		TI 90 ESOS	2,459	2,459		846.74p	19/04/94	19/04/97	19/04/04					
			2,459	2,459		1,058.18p	15/04/96	15/04/99	15/04/06					
			11,067	11,067		1,121.20p	09/09/96	09/09/99	09/09/06					
			15,248	15,248		1,097.82p	02/04/97	02/04/00	02/04/07					
			19,675	19,675		1,219.80p	08/09/97	08/09/00	08/09/07					
			23,364	23,364		1,026.67p	13/03/98	13/03/01	13/03/08					
			17,953	17,953		849.79p	06/08/98	06/08/01	06/08/08					
			36,153	36,153		943.31p	11/03/99	11/03/02	11/03/09					
		TI 99 ESOS	61,731	61,731		907.23p	24/05/99	24/05/02	24/05/09					
			106,246	106,246		661.23p	06/03/00	06/03/03	06/03/10					
			106,246	106,246		626.16p	31/03/00	31/03/03	31/03/10					
		TI SAYE	0	778		886.39p	28/08/97	01/10/02	01/04/03					

Director	Scheme	Options held	Options held	Performance test	Exercise price	Grant date	Vesting date*	Expiry date	Options exercised 2002-2003					
		on 31 July 2003	on 31 July 2002						Number	Number	Exercise date	Exercise price	Market price at date of grant**	Market price at date of exercise#
E Lindh	84 ESOS	8,851	8,851		451.00p	21/10/94	21/10/97	21/10/04						
	95 ESOS	4,905	4,905	A	632.00p	20/12/95	20/12/98	20/12/05						
		18,814	18,814	A	823.00p	25/10/96	25/10/99	25/10/06						
		19,311	19,311	A	934.00p	17/10/97	17/10/00	17/10/07						
		35,015	35,015	A	765.00p	21/10/98	21/10/01	21/10/08						
		32,001	32,001	A	858.50p	01/10/99	01/10/02	01/10/09						
		36,631	36,631	A	750.00p	31/03/00	31/03/03	31/03/10						
		40,903	40,903	A	807.00p	01/12/00	01/12/03	01/12/10						
		29,400	29,400	A	790.00p	19/04/01	19/04/04	19/04/11						
		37,221	37,221	B	806.00p	09/04/02	09/04/05	09/04/12						
		37,220	37,220	C	806.00p	09/04/02	09/04/05	09/04/12						
		49,750	0	B	654.00p	02/10/02	02/10/05	02/10/12						
		49,750	0	C	654.00p	02/10/02	02/10/05	02/10/12						
		SAYE	0	3,409		572.00p	17/05/96	01/07/03			03/07/03	572.00p	See note**	720.50p
			1,593	1,593		608.00p	10/05/01	01/08/04	01/02/05					
		DSS	0	3,319		0.10p	29/10/96	29/10/99			27/01/03	0.10p	818.00p	642.50p
		0	4,310		0.10p	28/10/97	28/10/00			27/01/03	0.10p	840.00p	642.50p	
		0	8,000		0.10p	17/11/98	17/11/01			27/01/03	0.10p	818.00p	642.50p	
		0	6,740		0.10p	03/11/99	03/11/02			27/01/03	0.10p	865.00p	642.50p	
	10,128	10,128		0.10p	04/12/00	04/12/03	04/11/07							
	11,610	11,610		0.10p	22/11/01	22/11/04	22/10/08							
	4,920	0		0.10p	24/10/02	24/10/05	24/09/09							
A M Thomson	84 ESOS	62,500	62,500		480.00p	18/04/95	18/04/98	18/04/05						
	95 ESOS	20,569	20,569	A	632.00p	20/12/95	20/12/98	20/12/05						
		22,989	22,989	A	823.00p	25/10/96	25/10/99	25/10/06						
		21,590	21,590	A	934.00p	17/10/97	17/10/00	17/10/07						
		31,982	31,982	A	765.00p	21/10/98	21/10/01	21/10/08						
		24,790	24,790	A	858.50p	01/10/99	01/10/02	01/10/09						
		31,598	31,598	A	807.00p	01/12/00	01/12/03	01/12/10						
		26,250	26,250	A	790.00p	19/04/01	19/04/04	19/04/11						
		44,665	44,665	B	806.00p	09/04/02	09/04/05	09/04/12						
		44,665	44,665	C	806.00p	09/04/02	09/04/05	09/04/12						
		60,500	0	B	654.00p	02/10/02	02/10/05	02/10/12						
		60,500	0	C	654.00p	02/10/02	02/10/05	02/10/12						
		SAYE	2,775	2,775		608.00p	10/05/01	01/08/06	01/02/07					
		DSS	4,849	4,849		0.10p	20/10/97	20/10/00	20/09/04					
			7,272	7,272		0.10p	17/11/98	17/11/01	17/10/05					
			6,190	6,190		0.10p	03/11/99	03/11/02	03/10/06					
		9,555	9,555		0.10p	04/12/00	04/12/03	04/11/07						
		16,584	16,584		0.10p	22/11/01	22/11/04	22/10/08						
		10,652	0		0.10p	24/10/02	24/10/05	24/09/09						

Key													
84 ESOS	The Smiths Industries (1984) Executive Share Option Scheme				TI 90 ESOS	The TI Group (1990) Executive Share Option Scheme							
95 ESOS	The Smiths Industries 1995 Executive Share Option Scheme				TI 99 ESOS	The TI Group 1999 Executive Share Option Scheme							
SAYE	The Smiths Industries 1982 SAYE Share Option Scheme				TI SAYE	The TI Group 1994 Savings-Related Share Option Scheme							
DSS	The Smiths Industries Senior Executive Deferred Share Scheme												

Performance tests

- A Total Shareholder Return of the company versus the Total Return of FTSE General Industrials Index
B EPS growth versus UK RPI + 3% p.a.
C EPS growth versus UK RPI + 4% p.a.

* The vesting dates shown above in respect of options granted under the Smiths Industries 1995 Executive Share Option Scheme are subject to the relevant performance test being passed.

** Market price of a Smiths share at date of grant (if different from exercise price). The exercise price of options under the Smiths Industries 1982 SAYE Share Option Scheme is set at 20% less than the mid-market closing price of a Smiths share on the business day preceding the date of grant.

Mid-market closing quotation from the London Stock Exchange Daily Official List.

NOTES

The high and low market closing prices of the ordinary shares during the period 1 August 2002 to 31 July 2003 were 553p and 765p respectively.

The mid-market price on 31 July 2002 was 775p and on 31 July 2003 was 732p.

Of the 3.485m shares under options granted to directors under the executive and savings-related share option schemes operated by the company, 2.115m shares were granted at exercise prices above the market price of a Smiths share on 23 September 2003 (703p) and 1.370m shares were at exercise prices below the market price on that date.

None of the options listed above was subject to any payment on grant.

An option granted to Mr D P Lillycrop under the TI Group Savings-Related Share Option Scheme lapsed on 1 April 2003; no other options held by any director lapsed during the period 1 August 2002 to 31 July 2003.

No options have been granted or exercised or have lapsed during the period 31 July to 23 September 2003.

Options granted under the Smiths Industries 1995 Executive Share Option Scheme up to 2001 are subject to performance testing based on total shareholder return of the company versus the total return of the General Industrials Sector of the FTSE All Shares Index. Options granted from 2002 are subject to a performance test based on growth in the company's earnings per share exceeding the UK RPI plus a fixed percentage. There are no further performance criteria for the Smiths Industries (1984) Executive Share Option Scheme, The Smiths Industries Senior Executive Deferred Share Scheme or the TI Group Executive Share Option Schemes.

Deferred Share Scheme options were granted on 24 October 2002 at an Exercise Price of 0.1p per share and match shares purchased in the market by the grantee on that day. At 31 July 2003 the trustee of the Deferred Share Scheme held 531,061 shares for the benefit of senior executives (including the directors as disclosed above). The market value of these shares at that date was £3.887m and dividends of approximately £123,626 were waived in the year in respect of the shares.

Special provisions permit early exercise of options in the event of retirement; redundancy; death etc.

No other director held any options over the company's shares during the period 1 August 2002 to 31 July 2003.

STATEMENT OF DIRECTORS' RESPONSIBILITIES

Company law requires the directors to prepare accounts for each financial year which give a true and fair view of the state of affairs of the company and the group at the end of the year, and of the profit or loss of the group for that period. In preparing those accounts, the directors are required to:

- select suitable accounting policies and then apply them consistently;

- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the accounts; and
- prepare the accounts on the going concern basis unless it is inappropriate to assume that the company will continue in business.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the accounts comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention of fraud and other irregularities.

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF SMITHS GROUP PLC

We have audited the financial statements which comprise the consolidated profit and loss account, the balance sheet, the cash-flow statement, the statement of total recognised gains and losses and the related notes, which have been prepared under the historical cost convention and the accounting policies set out in the statement of accounting policies. We have also audited the disclosures required by Part 3 of Schedule 7A to the Companies Act 1985 contained in the directors' remuneration report ('the auditable part').

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

The directors' responsibilities for preparing the Statutory Reports and Accounts, comprising the Annual Review 2003 and the Directors' Report and Financial Statements 2003, in accordance with applicable United Kingdom law and accounting standards, are set out in the statement of directors' responsibilities. The directors are also responsible for preparing the directors' remuneration report.

Our responsibility is to audit the financial statements and the auditable part of the directors' remuneration report in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards issued by the Auditing Practices Board. This report, including the opinion, has been prepared for and only for the company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the auditable part of the directors' remuneration report have been

properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the directors' report is not consistent with the financial statements, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions is not disclosed.

We read the other information contained in the Statutory Reports and Accounts and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. The other information comprises only the Annual Review 2003, the directors' report, the unaudited part of the directors' remuneration report, the statement of directors' responsibilities and the five year review.

We review whether the corporate governance statement in the directors' report reflects the company's compliance with the seven provisions of the Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or to form an opinion on the effectiveness of the company's or group's corporate governance procedures or its risk and control procedures.

BASIS OF AUDIT OPINION

We conducted our audit in accordance with auditing standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the auditable part of the directors' remuneration report. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to

the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements and the auditable part of the directors' remuneration report are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

OPINION

In our opinion:

- the financial statements give a true and fair view of the state of affairs of the company and the group at 31 July 2003 and of the result and cash-flows of the group for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- those parts of the directors' remuneration report required by Part 3 of Schedule 7A to the Companies Act 1985 have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers LLP
Chartered Accountants and Registered
Auditors
London

24 September 2003

NOTES

(a) The maintenance and integrity of the Smiths Group plc website is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

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

CONSOLIDATED PROFIT AND LOSS ACCOUNT

	Year ended 31 July 2003						Year ended 31 July 2002 (restated)				
	Note	Ordinary activities Em	Discontinued businesses Em	Goodwill amortisation Em	Exceptional items Em	Total Em	Ordinary activities Em	Discontinued businesses Em	Goodwill amortisation and impairment Em	Exceptional items Em	Total Em
Continuing operations		2,505.6				2,505.6	2,588.4				2,588.4
Acquisitions		123.6				123.6					
Discontinued businesses			426.9			426.9		635.1			635.1
Turnover	1 & 2	2,629.2	426.9			3,056.1	2,588.4	635.1			3,223.5
Continuing operations		346.4		(24.6)		321.8	364.1		(38.8)	(43.7)	281.6
Acquisitions		25.5		(7.8)		17.7					
Discontinued businesses			51.9	(11.7)		40.2		64.0	(11.9)		52.1
Operating profit	4	371.9	51.9	(44.1)		379.7	364.1	64.0	(50.7)	(43.7)	333.7
Exceptional items											
– profit/(loss) on disposal of businesses	5				14.5	14.5				(24.3)	(24.3)
– write-down of goodwill on anticipated future disposal	5				(137.0)	(137.0)					
Profit before interest and tax		371.9	51.9	(44.1)	(122.5)	257.2	364.1	64.0	(50.7)	(68.0)	309.4
Net interest payable	6	(20.3)	(17.3)			(37.6)	(25.7)	(31.8)			(57.5)
Other finance (costs)/income – retirement benefits	6	(2.2)				(2.2)	25.5				25.5
Profit/(loss) before taxation		349.4	34.6	(44.1)	(122.5)	217.4	363.9	32.2	(50.7)	(68.0)	277.4
Taxation	8	(94.3)	(9.4)	3.9	(5.3)	(105.1)	(101.9)	(9.0)	3.8	16.1	(91.0)
Profit/(loss) after taxation		255.1	25.2	(40.2)	(127.8)	112.3	262.0	23.2	(46.9)	(51.9)	186.4
Minority interests		(0.5)	(0.3)			(0.8)	(1.1)	(0.2)			(1.3)
Profit/(loss) for the period		254.6	24.9	(40.2)	(127.8)	111.5	260.9	23.0	(46.9)	(51.9)	185.1
Dividends	9	(145.4)				(145.4)	(142.2)				(142.2)
Retained profit/(loss)		109.2	24.9	(40.2)	(127.8)	(33.9)	118.7	23.0	(46.9)	(51.9)	42.9
Earnings/(loss) per share	10										
Basic		45.6p	4.5p	(7.2p)	(22.9p)	20.0p	46.9p	4.1p	(8.4p)	(9.3p)	33.3p
Diluted		45.5p	4.5p	(7.2p)	(22.9p)	19.9p	46.8p	4.1p	(8.4p)	(9.3p)	33.2p

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

	2003 Em	2002 Em
Profit for the financial year attributable to shareholders	111.5	185.1
Exchange adjustments	14.7	(56.4)
Taxation recognised on exchange gains/losses:		
Current – United Kingdom	5.3	(1.2)
Deferred – United States	3.7	4.5
FRS17 – Retirement Benefits:		
Actuarial gains and losses on retirement benefit schemes – gross	(258.6)	(427.0)
Deferred tax credit related thereto	73.4	131.7
	(50.0)	(163.3)
Prior year adjustment re FRS17 – Retirement Benefits – cumulative to 31 July 2002	(157.6)	
	(207.6)	

Comparative figures for 2002 have been restated following the adoption of FRS17 – Retirement Benefits.

There is no material difference between the profit on ordinary activities or retained profit for the year stated above, and their historical cost equivalents.

Notes on pages 16 to 39 form part of these accounts.

BALANCE SHEETS

	Note	Consolidated		Company	
		31 July 2003 £m	31 July 2002 (restated) £m	31 July 2003 £m	31 July 2002 (restated) £m
Fixed assets					
Intangible assets	13	830.2	638.3		
Tangible assets	14	557.6	563.9	64.0	42.2
Investments and advances – TI Automotive Limited preference shares	16	325.0	325.0		325.0
– other	16	8.2	11.6	2,104.1	1,150.5
		1,721.0	1,538.8	2,168.1	1,517.7
Current assets					
Stocks	17	489.5	474.5	62.3	42.7
Debtors – amounts falling due within one year	18	662.6	597.7	113.1	81.4
– amounts falling due after more than one year	18	10.8	15.4	2.5	
Cash at bank and on deposit	21	82.0	109.5	89.9	125.2
		1,244.9	1,197.1	267.8	249.3
Creditors: amounts falling due within one year	20	(912.7)	(912.0)	(580.1)	(636.0)
Net current assets/(liabilities)		332.2	285.1	(312.3)	(386.7)
Total assets less current liabilities					
		2,053.2	1,823.9	1,855.8	1,131.0
Creditors: amounts falling due after more than one year	20	(754.4)	(728.9)	(558.4)	(520.7)
Provisions for liabilities and charges	24	(116.0)	(113.8)	(20.8)	(21.1)
Net assets excluding pension assets/liabilities		1,182.8	981.2	1,276.6	589.2
Pension assets	11	25.3	84.7		
Retirement benefit liabilities	11	(333.7)	(213.4)	(38.7)	(28.9)
Net assets including pension assets/liabilities		874.4	852.5	1,237.9	560.3
Capital and reserves					
Called up share capital	27	139.8	139.6	139.8	139.6
Share premium account	28	170.0	163.7	170.0	163.7
Revaluation reserve	28	2.6	2.6	0.5	0.5
Merger reserve	28	234.8	234.8	180.5	180.5
Profit and loss account	28	315.4	299.9	747.1	76.0
Shareholders' equity	29	862.6	840.6	1,237.9	560.3
Minority equity interests		11.8	11.9		
Capital employed		874.4	852.5	1,237.9	560.3

Comparative figures for 2002 have been restated on the adoption of FRS17 – Retirement Benefits.

The accounts on pages 13 to 39 were approved by the Board of Directors on 24 September 2003 and were signed on its behalf by:



KEITH ORRELL-JONES
CHAIRMAN



ALAN M THOMSON
FINANCIAL DIRECTOR

CASH-FLOW STATEMENT

	Year ended 31 July 2003	Year ended 31 July 2002 (restated)
Note	£m	£m
Reconciliation of operating profit to net cash inflow from operating activities		
Operating profit	379.7	333.7
Exceptional items		43.7
Operating profit before exceptional items	379.7	377.4
Goodwill amortisation and impairment	44.1	50.7
Depreciation	88.9	91.5
Retirement benefits	(4.6)	29.0
Decrease/(increase) in stocks	(1.6)	18.7
Decrease/(increase) in debtors	(55.8)	48.5
(Decrease)/increase in creditors	15.8	(32.8)
Net cash inflow from normal operating activities	466.5	583.0
Exceptional restructuring expenditure	(22.8)	(59.2)
Net cash inflow from operating activities	443.7	523.8

Cash-flow statement

Net cash inflow from operating activities		443.7	523.8
Returns on investments and servicing of finance	22c	(26.1)	(56.5)
Tax paid		(60.8)	(52.8)
Capital expenditure	14	(86.3)	(100.0)
		270.5	314.5
Acquisitions and disposals	25 & 26	(92.0)	180.9
Equity dividends paid		(142.5)	(139.1)
Management of liquid resources	21	2.3	0.1
Financing	21	(68.7)	(124.3)
(Decrease)/increase in cash		(30.4)	232.1
Reconciliation to net debt			
Net debt at 1 August		(725.2)	(1,119.8)
(Decrease)/increase in cash		(30.4)	232.1
Reduction in short-term deposits	21	(2.3)	(0.1)
Decrease in other borrowings	21	73.4	139.8
Loan note repayments	21	1.2	2.0
Term debt acquired with acquisitions		(13.1)	
Exchange variation		(18.7)	20.8
Net debt at 31 July	21	(715.1)	(725.2)

The cash-flow statement for 2002 has been restated following the adoption of FRS17 – Retirement Benefits.

Notes on pages 16 to 39 form part of these accounts.

ACCOUNTING POLICIES

ACCOUNTING CONVENTION

The accounts have been prepared in accordance with the Companies Act 1985, as amended and with all applicable financial reporting and accounting standards under the historical cost convention modified to include the revaluation of certain properties. FRS17 – Retirement Benefits has been adopted during the year to 31 July 2003.

BASIS OF CONSOLIDATION

The consolidated financial statements include those of the parent company and its subsidiary undertakings.

The results of subsidiaries acquired during the year are consolidated from the date of acquisition.

Up to 1 August 1998, goodwill arising on consolidation was set against reserves in the year of acquisition. Goodwill impairment on prospective disposals is recognised through the profit and loss account.

Goodwill arising from acquisitions after 1 August 1998 is capitalised at cost, and amortised on a straight-line basis over an estimated useful economic life of up to 20 years.

TURNOVER

Turnover represents the invoiced amount of goods sold and services provided during the year, after the deduction of trade discounts and sales related taxes, and the value of work undertaken during the year on long-term contracts.

RESEARCH AND DEVELOPMENT

Expenditure, other than that recoverable from third parties, is written off in the year in which it is incurred.

FIXED ASSETS

Depreciation is provided at rates estimated to write off the relevant assets by equal annual amounts over their expected useful lives. In general, the rates used are: Freehold and long leasehold buildings – 2%, Short leasehold property – over the period of the lease, Plant, machinery, etc. – 10% to 20%, Motor vehicles – 25%, Tools and other equipment – 10% to 33%.

Fixed assets held under finance leases are capitalised and depreciated in accordance with the company's depreciation policy. The capital element of future lease payments is included in creditors.

Payments made under operating leases are charged to the profit and loss account as incurred over the term of the lease.

FREEHOLD PROPERTIES

These financial statements include certain properties at 1974 valuation, less depreciation on the enhanced values calculated in accordance with the policy set out above. The directors have decided to invoke the transitional provisions of FRS15 – Tangible Fixed Assets, and do not intend to revalue these properties every year.

LEASED PROPERTIES

Where a leasehold property is vacant, or sub-let under terms such that the rental income is insufficient to meet all outgoings, provision is made for the anticipated future shortfall up to termination of the lease.

STOCKS

Stocks and work in progress are valued at cost, including related production overheads, reduced to estimated net realisable value where appropriate. Profit is taken on long-term contracts by reference to the work completed. Provision for losses is made as soon as they are recognised.

FINANCIAL INSTRUMENTS

Financial assets are recognised in the balance sheet at the lower of cost and net realisable value. Discounts, premia and related costs of issue are charged or credited to the profit and loss account over the life of the asset or liability to which they relate.

The company uses derivative financial instruments to hedge its exposure to fluctuations in interest rates and foreign exchange rates.

Receipts and payments on interest rate instruments are recognised on an accruals basis over the life of the instrument.

Foreign currency assets and liabilities covered by forward contracts are translated at the contract rates of exchange. Other assets and liabilities in foreign currencies are translated at closing rates.

FOREIGN CURRENCIES

The profit and loss accounts of overseas subsidiaries are translated into sterling at average rates of exchange for the year.

Exchange adjustments arising from the retranslation of opening net assets in

overseas subsidiaries and their results for the year at closing rates, and the translation of foreign currency borrowings to match overseas investments, are taken to the statement of total recognised gains and losses. All other exchange gains and losses are taken to the profit and loss account.

TAXATION

Deferred tax is recognised in respect of timing differences that have originated but not reversed as at the balance sheet date. Timing differences are differences between the group's taxable profits and its results as disclosed in the financial statements, arising from the inclusion of gains and losses in tax assessments in periods different from those in which they are recognised in the financial statements.

Deferred tax is recognised in respect of the retained earnings of overseas subsidiaries and associates only to the extent that, at the balance sheet date, dividends have been declared or an obligation is present to distribute past earnings. Deferred tax is not recognised on any fixed assets that have been revalued unless there is a binding agreement to sell the asset.

POST-RETIREMENT BENEFITS

For defined benefit schemes, the cost of benefits accruing during the year in respect of current and past service is charged against operating profit. The expected return on the schemes' assets and the increase in the present value of the schemes' liabilities arising from the passage of time are included in other finance income. Actuarial gains and losses are recognised in the statement of total recognised gains and losses. The balance sheet includes the surplus/deficit in schemes taking assets at their year-end market values and liabilities at their actuarially calculated values discounted at year-end AA corporate bond interest rates.

Amounts charged in respect of defined contribution schemes are the contributions payable in the year.

NOTES TO THE ACCOUNTS

1 ANALYSES OF TURNOVER, PROFIT AND ASSETS (ORDINARY ACTIVITIES)

	Turnover		Profit		Assets	
	2003 £m	2002 £m	2003 £m	(restated) 2002 £m	2003 £m	(restated) 2002 £m
Market						
Aerospace	998.2	1,078.8	105.5	139.3	589.5	564.7
Detection	273.3	119.4	70.6	28.8	311.7	44.6
Medical	486.1	479.9	87.9	93.2	386.4	361.3
Specialty Engineering:	871.6	910.3	107.9	102.8	453.5	536.6
John Crane	445.1	451.5	58.1	53.2	171.0	255.0
Industrial	298.8	321.3	44.5	48.4	233.7	235.1
Marine/Tubular Systems	127.7	137.5	5.3	1.2	48.8	46.5
	2,629.2	2,588.4	371.9	364.1	1,741.1	1,507.2
Discontinued businesses	426.9	635.1	51.9	64.0	145.0	187.3
	3,056.1	3,223.5	423.8	428.1	1,886.1	1,694.5
Goodwill amortisation			(44.1)	(50.7)		
Exceptional items			(122.5)	(68.0)		
Net interest/net borrowings			(37.6)	(57.5)	(715.1)	(725.2)
Retirement benefits – net finance (costs)/income – net liabilities			(2.2)	25.5	(308.4)	(128.7)
Profit before tax/net assets			217.4	277.4	862.6	840.6
Geographical origin						
United Kingdom	762.3	760.7	52.6	66.5	527.9	500.6
North America	1,513.3	1,623.6	241.4	252.1	847.8	902.6
Europe	399.6	278.0	58.0	25.3	322.9	60.8
Other overseas	165.1	137.2	19.9	20.2	42.5	43.2
Inter-company	(211.1)	(211.1)				
	2,629.2	2,588.4	371.9	364.1	1,741.1	1,507.2

The segmental analysis has been redefined to show the market breakdown in accordance with the company's new divisional structure. Exceptionally for this year only, the components of the Specialty Engineering Division have been separately identified to facilitate comparison with the divisional structure previously adopted. The segmental analysis has also been redefined to show North America as a separate segment due to acquisition and restructuring activities resulting in the company having more closely-linked operations in the United States, Canada and Mexico.

The analyses of 2002 profits and assets employed have been restated following the adoption of FRS17 – Retirement Benefits.

Operating profit from continuing activities after exceptional items amounted to £339.5m (2002 £281.6m) after charging goodwill amortisation of £32.4m (2002 £38.8m) and exceptional items of £nil (2002 £43.7m).

The contribution from discontinued businesses (predominantly Polymer Sealing Solutions) comprised turnover of £426.9m (2002 £635.1m) and operating profit of £40.2m (2002 £52.1m) after charging goodwill amortisation of £11.7m (2002 £11.9m).

1 ANALYSES OF TURNOVER, PROFIT AND ASSETS (ORDINARY ACTIVITIES) CONTINUED

The above segmental analyses include the following contributions from acquisitions made during the year:

	Turnover £m	Profit £m
Market		
Detection	123.2	25.5
Specialty Engineering	0.4	
	123.6	25.5
Geographical origin		
United Kingdom	2.2	
North America	25.9	1.6
Europe	77.2	22.6
Other overseas	18.3	1.3
	123.6	25.5

Goodwill amortisation of £44.1m comprised:

	Continuing activities £m	Acquisitions £m	Discontinued businesses £m	2003 Total £m	2002 Total £m
Aerospace	13.2			13.2	13.0
Detection	1.6	7.8		9.4	2.0
Medical	3.9			3.9	3.8
Specialty Engineering	5.9		11.7	17.6	31.9
	24.6	7.8	11.7	44.1	50.7

The Specialty Engineering 2002 goodwill amortisation charge of £31.9m included £12m relating to an impairment write-down in respect of Radio Waves, Inc., acquired in December 2000.

2 ANALYSIS OF TURNOVER BY DESTINATION (ORDINARY ACTIVITIES)

	2003 £m	2002 £m
United Kingdom	319.5	377.1
North America	1,497.0	1,505.4
Europe	477.3	405.4
Japan	95.0	91.4
Other overseas	240.4	209.1
	2,629.2	2,588.4
Discontinued businesses	426.9	635.1
	3,056.1	3,223.5

3 ANALYSIS OF COSTS

	Ordinary activities	Discontinued businesses	Goodwill amortisation	2003 Total	2002 Total (restated)
	£m	£m	£m	£m	£m
Cost of sales					
Continuing operations	1,497.9			1,497.9	1,583.3
Acquisitions	70.5			70.5	
	1,568.4			1,568.4	1,583.3
Discontinued businesses		247.1		247.1	388.9
	1,568.4	247.1		1,815.5	1,972.2
Sales and distribution costs					
Continuing operations	275.6			275.6	291.8
Acquisitions	10.5			10.5	
	286.1			286.1	291.8
Discontinued businesses		51.1		51.1	66.3
	286.1	51.1		337.2	358.1
Administrative expenses					
Continuing operations	385.7		24.6	410.3	388.0
Acquisitions	17.1		7.8	24.9	
	402.8		32.4	435.2	388.0
Discontinued businesses		76.8	11.7	88.5	127.8
	402.8	76.8	44.1	523.7	515.8

Cost of sales and other costs for 2002 have been restated to reflect additional pensions charges arising from the adoption of FRS17 – Retirement Benefits.

4 OPERATING PROFIT IS AFTER CHARGING

	2003 £m	2002 £m
Goodwill amortisation and impairment	44.1	50.7
Depreciation of fixed assets	88.9	91.5
Research and development expenditure	129.7	116.5
Operating leases – land and buildings	21.6	30.1
– other	8.6	14.5
Amounts paid to PricewaterhouseCoopers:		
Audit fees – parent	0.1	0.1
– other	3.8	3.7
Other assurance services – due diligence		0.3
– vendor assistance	0.7	
– other	0.1	0.2
Taxation – compliance services	0.2	0.1
– advisory services	0.2	0.4
Other fees		0.3

In addition to the above fees, £0.4m (2002 £0.1m) was capitalised within goodwill.

5 EXCEPTIONAL ITEMS

a) Operating

In 2002 the company incurred £43.7m of exceptional costs charged against operating profit arising from the ongoing restructuring of its operations – mainly in relation to Aerospace. No such charges were incurred in 2003.

b) Profit/(loss) on disposal of businesses

	Air Movement £m	Other disposals £m	2003 Total disposals £m	2002 £m
Surplus of consideration over net assets, fees and expenses	74.0	15.0	89.0	124.9
Goodwill set against reserves	(66.8)	(7.7)	(74.5)	(149.2)
	7.2	7.3	14.5	(24.3)

Details of the disposals are set out in note 26.

c) Write-down of goodwill on anticipated future disposals

In connection with the anticipated disposal of the Polymer business, the company has written off £137m of goodwill previously set against reserves.

6 NET INTEREST PAYABLE

	2003 £m	2002 £m
Interest receivable	3.3	5.8
Other financing gains	7.5	4.0
Interest payable:		
Bank loans and overdrafts repayable within five years	(14.1)	(31.8)
Other loans repayable within five years	(12.7)	(17.2)
Other loans repayable in more than five years	(21.5)	(18.2)
Finance leases	(0.1)	(0.1)
	(37.6)	(57.5)
Other finance (costs)/income: retirement benefits		
Expected return on pension scheme assets	152.7	176.2
Interest on retirement benefit liabilities	(154.9)	(150.7)
	(2.2)	25.5

Interest is allocated to discontinued businesses on the basis of net proceeds receivable.

7 PROFIT ATTRIBUTABLE TO THE PARENT COMPANY

Profits for the financial year of £854.2m (2002 £155.7m) were recorded in the accounts of Smiths Group plc. The directors have taken advantage of the exemption afforded by Section 230 of the Companies Act 1985 not to present a separate profit and loss account for the parent company.

8 TAXATION

	2003 £m	2002 (restated) £m
Taxation on the profit for the year		
UK corporation tax at 30% (2002 30%)	27.8	62.8
Double taxation relief	(13.8)	(7.7)
	14.0	55.1
Overseas taxation	76.4	61.0
	90.4	116.1
Tax relief on exceptional items – restructuring charges (note 5)		(16.1)
Current taxation	90.4	100.0
Deferred taxation		
On ordinary and discontinued activities	9.4	(9.0)
On exceptional items	5.3	
	14.7	(9.0)
Tax charge for the year	105.1	91.0

The deferred tax charge for the year arises from the origination and reversal of timing differences.

Tax reconciliation

Profit before taxation	217.4	277.4
Effective taxation at 30%	65.2	83.2
Effect of higher overseas rates of tax	9.9	9.8
Effect of reversal of timing differences	(14.7)	9.0
Global tax incentives	(11.8)	(5.8)
Tax relief on employee share schemes	(0.3)	(0.6)
Tax effect of exceptional charges	42.1	4.4
Current tax charge for the year	90.4	100.0

9 DIVIDENDS

	2003 £m	2002 £m
Ordinary interim paid 8.75p per share (2002 8.75p)	48.9	48.6
Ordinary final proposed 17.25p per share (2002 16.75p)	96.5	93.6
	145.4	142.2

10 EARNINGS PER SHARE

	2003	2002
Separate figures are given for earnings per share related to the weighted average number of shares in issue:		
Basic	558,610,819	556,496,716
Effect of dilutive share options	838,286	1,267,591
Diluted	559,449,105	557,764,307

11 POST-RETIREMENT BENEFITS

Smiths operates a number of pension schemes throughout the world. The principal schemes are in the United Kingdom and in the United States and are of the defined benefit type, with assets held in separate trustee-administered funds. Pension costs are assessed in accordance with the advice of independent, professionally qualified actuaries. The group accounts for its pension and other post-retirement benefit costs, principally post-retirement healthcare, in accordance with FRS17 – Retirement Benefits.

The most recent actuarial valuations of the two principal UK schemes were performed using the Projected Unit Method as at 31 March 2003 and 5 April 2003. The most recent valuations of the principal US pension and post-retirement healthcare plans were performed at 1 August 2002. These valuations have been updated by independent qualified actuaries for the purposes of FRS17 in order to assess the liabilities of the schemes as at 31 July 2003. Scheme assets are stated at their market values at 31 July 2003.

Contributions to these schemes are made on the advice of the actuaries with the objective that the benefits be fully funded during the scheme members' working lives.

The pension costs of other schemes operated by the group were assessed in accordance with local practice. The group provides a defined contributions (401K) plan for its US employees.

The disclosures relate to all defined benefit retirement plans in the United Kingdom and the United States. Defined benefit plans in other territories, most of which are unfunded, have net pension liabilities of £27.4m (2002 £18.3m). No additional disclosure is given in respect of these plans on grounds of their immateriality. The principal assumptions used in updating the valuations are set out below.

	2003		2002		2001	
	UK	US	UK	US	UK	US
Rate of increase in salaries	4.2%	4.0%	3.9%	4.2%	4.0%	4.5%
Rate of increase in pensions	2.8%	n/a	2.5%	n/a	2.5%	n/a
Discount rate	5.5%	6.5%	6.0%	7.0%	6.0%	7.25%
Inflation rate	2.7%	3.0%	2.4%	3.3%	2.5%	3.5%
Healthcare cost increases	5.0%	*	5.0%	**	4.5%	***

*10% p.a. reducing 1% p.a. to 5% p.a. in 2009.

**10% p.a. reducing 1% p.a. to 5% p.a. in 2008.

***10% p.a. reducing 1% p.a. to 5% p.a. in 2007.

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

	2003				2002				2001			
	UK schemes		US schemes		UK schemes		US schemes		UK schemes		US schemes	
	Long-term rate of return	Value £m	Long-term rate of return	Value £m	Long-term rate of return	Value £m	Long-term rate of return	Value £m	Long-term rate of return	Value £m	Long-term rate of return	Value £m
Equities	8.25%	1,026.0	9.0%	183.9	8.25%	827.9	9.0%	158.1	8.0%	1,012.0	9.0%	160.0
Government bonds	4.8%	622.2	5.5%	46.7	4.9%	810.2	5.5%	38.7	5.2%	738.0	5.5%	150.0
Corporate bonds	5.5%	340.6	6.5%	55.5	6.0%	251.1	7.0%	54.6	6.0%	371.0	7.3%	23.0
Property	7.25%	115.9	n/a	n/a	7.25%	115.8	n/a	n/a	7.0%	118.0	n/a	n/a
Other	3.5%	69.1	3.0%	8.1	4.9%	78.2	3.5%	10.1	5.0%	81.0	3.5%	6.0
Total market value		2,173.8		294.2		2,083.2		261.5		2,320.0		339.0
Present value of funded pension scheme liabilities		(2,392.7)		(383.5)		(2,075.4)		(354.9)		(1,990.0)		(350.0)
Surplus/(deficit)		(218.9)		(89.3)		7.8		(93.4)		330.0		(11.0)
Unfunded pension plans		(26.8)		(4.7)		(19.7)		(4.5)		(17.0)		(5.0)
Post-retirement healthcare		(20.4)		(93.1)		(15.5)		(78.7)		(15.0)		(70.0)
		(266.1)		(187.1)		(27.4)		(176.6)		298.0		(86.0)
Related deferred tax asset/(liability)		73.7		71.1		8.2		67.1		(89.0)		33.0
Net pension asset/(liability)		(192.4)		(116.0)		(19.2)		(109.5)		209.0		(53.0)

At 31 July 2003, the net UK pension liability of £192.4m represented, net of related deferred tax, individual plan surpluses of £25.3m (2002 £84.7m) and deficits of £178.5m (2002 £79.3m) in funded pension plans and unfunded pension/post-retirement healthcare balances of £39.2m (2002 £24.6m). All US plans were in deficit at 31 July 2002 and 31 July 2003.

11 POST-RETIREMENT BENEFITS CONTINUED

The effect of retirement benefits calculated in accordance with FRS17 is included in the financial statements as follows:

Profit and Loss Account

	2003			2002		
	Funded defined benefit pension schemes		Unfunded pension/post-retirement healthcare plans	Funded defined benefit pension schemes		Unfunded pension/post-retirement healthcare plans
	UK £m	US £m	UK & US £m	UK £m	US £m	UK & US £m
Amounts charged to operating profit						
Current service cost	31.3	12.7	2.1	34.2	12.4	2.1
Past service cost	1.3		0.2		0.8	0.1
Total operating charge	32.6	12.7	2.3	34.2	13.2	2.2
Exceptional items						
Curtailment gains	(1.5)					
Amounts charged/(credited) to other finance costs/(income)						
Expected return on pension scheme assets	(132.7)	(20.0)		(152.3)	(23.9)	
Interest on pension scheme liabilities	122.6	24.5	7.8	118.0	25.2	7.5
Net return	(10.1)	4.5	7.8	(34.3)	1.3	7.5
Total charged to profit and loss account	21.0	17.2	10.1	(0.1)	14.5	9.7

Amounts recognised in Statement of Total Recognised Gains and Losses (STRGL)

Actual return less expected return on pension scheme assets – £m	3.6	8.4		(307.1)	(61.6)	
<i>As % of scheme assets</i>	0%	3%		(15)%	(22)%	
Experience gains/(losses) arising on the scheme liabilities – £m	29.6	3.9	(6.8)	54.6	1.6	(9.1)
<i>As % of present value of scheme liabilities</i>	1%	1%	(5)%	3%	0%	(8)%
Changes in assumptions underlying the present value of the scheme liabilities	(256.0)	(22.8)	(18.5)	(82.3)	(16.3)	(6.8)
Actuarial gains/(losses) recognised in the STRGL – £m	(222.8)	(10.5)	(25.3)	(334.8)	(76.3)	(15.9)
<i>As % of present value of scheme liabilities</i>	(9)%	(3)%	(17)%	(16)%	(22)%	(13)%

Movement in surplus/(deficit) during the year

	2003			2002		
	Funded defined benefit pension schemes		Unfunded pension/post-retirement healthcare plans	Funded defined benefit pension schemes		Unfunded pension/post-retirement healthcare plans
	UK £m	US £m	UK & US £m	UK £m	US £m	UK & US £m
Surplus/(deficit) at beginning of year	7.8	(93.4)	(118.4)	329.3	(10.7)	(106.1)
Current service cost	(31.3)	(12.7)	(2.1)	(34.2)	(12.4)	(2.1)
Employer contributions	17.1	29.0	6.1	13.2	0.9	6.0
Past service costs	(1.3)		(0.2)		(0.8)	(0.1)
Curtailments	1.5					
Other finance (costs)/income	10.1	(4.5)	(7.8)	34.3	(1.3)	(7.5)
Actuarial gain/(loss) recognised in STRGL	(222.8)	(10.5)	(25.3)	(334.8)	(76.3)	(15.9)
Exchange		2.8	2.7		7.2	7.3
Surplus/(deficit) at end of year	(218.9)	(89.3)	(145.0)	7.8	(93.4)	(118.4)

NOTES TO THE ACCOUNTS CONTINUED

11 POST-RETIREMENT BENEFITS CONTINUED

Cash contributions

The company contributions to the funded defined benefit pension plans for 2003 totalled £46.1m (2002 £14.1m). For 2004 the company has presently agreed to contribute the current service cost plus £12m to its UK plans. In the United States no contributions for 2004 have presently been determined. The actual contributions will depend upon investment conditions and are likely to be in the range £20-30m.

Comparative information

Comparative figures for 2002 have been restated on the adoption of FRS17 with the following effects:

	£m
Decrease in operating profit	(34.2)
Other finance income – retirement benefits	25.5
Decrease in taxation	2.5
Decrease in profit after taxation	(6.2)
Decrease in net assets	(157.6)

For 2003, if the company had continued to apply SSAP24, based on the last full actuarial valuations of the principal schemes referred to above, the charge to operating profit and profit before tax would have been £28.8m (£18.8m and £21.0m lower than the equivalent charge under FRS17).

12 EMPLOYEES

	2003 £m	2002 £m
Staff costs during the year		
Wages and salaries	828.7	860.8
Social Security	93.1	94.0
Company pension costs (including defined contribution schemes)	53.3	57.7
	975.1	1,012.5

The average number of persons employed was:

	2003	2002
Aerospace	8,951	9,607
Detection	1,312	612
Medical	4,914	4,709
Specialty Engineering	16,233	17,579
	31,410	32,507

Details of directors' remuneration are given on pages 5 to 11.

13 INTANGIBLE FIXED ASSETS

Goodwill

Cost

At 1 August 2002	743.1
Acquired during the year	228.4
Adjustments to prior year acquisitions	0.6
Exchange adjustments	7.1
At 31 July 2003	979.2

Amortisation

At 1 August 2002	104.8
Charge for the year	44.1
Exchange adjustments	0.1
At 31 July 2003	149.0

Net book value at 31 July 2003 **830.2**

Net book value at 1 August 2002 638.3

14 TANGIBLE FIXED ASSETS

	Land and buildings £m	Plant and machinery £m	Fixtures, fittings, tools and equipment £m	Total £m
Consolidated				
Cost or valuation				
At 1 August 2002	295.8	661.6	431.0	1,388.4
Exchange adjustments	1.2	3.9	1.2	6.3
Additions	6.2	46.1	41.9	94.2
Acquisitions	15.7	1.4	14.5	31.6
Disposals	(8.7)	(21.7)	(24.1)	(54.5)
Business disposals	(10.9)	(27.4)	(25.7)	(64.0)
At 31 July 2003	299.3	663.9	438.8	1,402.0
Depreciation				
At 1 August 2002	87.7	427.1	309.7	824.5
Exchange adjustments	0.5	3.1	0.9	4.5
Charge for the year	8.4	42.0	38.5	88.9
Acquisitions	1.2	0.6	10.5	12.3
Disposals	(2.3)	(22.1)	(22.6)	(47.0)
Business disposals	(1.1)	(19.4)	(18.3)	(38.8)
At 31 July 2003	94.4	431.3	318.7	844.4
Net book value at 31 July 2003	204.9	232.6	120.1	557.6
Net book value at 1 August 2002	208.1	234.5	121.3	563.9
Company				
Cost or valuation				
At 1 August 2002	26.9	16.5	76.4	119.8
Additions	0.3	6.1	10.1	16.5
Transfers		46.6	18.0	64.6
Disposals	(3.5)	(3.2)	(3.5)	(10.2)
At 31 July 2003	23.7	66.0	101.0	190.7
Depreciation				
At 1 August 2002	3.4	12.3	61.9	77.6
Transfers		28.9	15.4	44.3
Charge for the year	0.4	3.4	6.5	10.3
Disposals	(0.3)	(2.2)	(3.0)	(5.5)
At 31 July 2003	3.5	42.4	80.8	126.7
Net book value at 31 July 2003	20.2	23.6	20.2	64.0
Net book value at 1 August 2002	23.5	4.2	14.5	42.2
The book values of assets under finance leases included in plant and machinery were:				
		Cost £m	Depreciation £m	Net book value £m
2003		5.1	(4.5)	0.6
2002		9.0	(7.8)	1.2

14 TANGIBLE FIXED ASSETS CONTINUED

	Consolidated		Company	
	2003 £m	2002 £m	2003 £m	2002 £m
Land and buildings				
Cost	292.9	289.4	23.2	26.4
Valuation 1974	6.4	6.4	0.5	0.5
	299.3	295.8	23.7	26.9
Freehold	274.1	269.9	23.2	26.7
Long leasehold	3.2	6.8	0.5	0.2
Short leasehold	22.0	19.1		
	299.3	295.8	23.7	26.9

If land and buildings had not been revalued they would have been included at the following amounts:

	Consolidated		Company	
	2003 £m	2002 £m	2003 £m	2002 £m
Cost	295.9	292.4	23.2	26.4
Aggregate depreciation	93.6	86.9	0.5	3.4

The company's properties were revalued on the basis of open market valuation in 1974, and that valuation was incorporated into the financial statements. These values have been retained under the transitional provisions of FRS15, but the directors do not intend to adopt a policy of annual revaluations in the future. A quinquennial external revaluation of the company's properties was carried out as at 31 July 1999 which disclosed a surplus of £17.5m over 31 July 2003 book values.

Capital expenditure – cash-flow

Purchase of tangible fixed assets	94.2	110.2
Less: proceeds of disposals	(7.9)	(10.2)
	86.3	100.0

15 CAPITAL COMMITMENTS

	2003 £m	2002 £m
Estimated commitments not included in the accounts		
Company	3.7	1.6
Subsidiaries	8.8	11.8
	12.5	13.4

16 INVESTMENTS AND ADVANCES

	Consolidated		Company	
	2003 £m	2002 £m	2003 £m	2002 £m
At cost less amounts written off				
Subsidiary companies			2,104.1	1,150.5
Unlisted investments				
TI Automotive Limited preference shares	325.0	325.0		325.0
Other trade investments	2.8	3.6		
Own shares	5.4	8.0		
	333.2	336.6	2,104.1	1,475.5
Investments in subsidiaries				
Shares at cost			2,320.0	825.3
Due from subsidiaries			1,039.2	1,194.6
			3,359.2	2,019.9
Due to subsidiaries			(1,255.1)	(869.4)
			2,104.1	1,150.5

TI Automotive Limited preference shares arose from the demerger of the former Automotive Systems division from the group, and are held at cost. They carry a fixed cumulative preference dividend at the rate of 15% p.a. One third of the dividend is payable on 25 July each year, subject to certain financial conditions having been met. To date, these conditions have not been met, and no dividends have been paid. The preference shares are redeemable, together with unpaid dividends, following full repayment of the outstanding liabilities of TI Automotive Limited under its bank facilities. During the year, TI Automotive successfully renegotiated the terms of its bank syndicate facility. No dividend accrual has been recognised as at 31 July 2003.

The company also holds 19.99% of the issued ordinary share capital of TI Automotive Limited. The shares confer 19.99% of the voting rights attaching to ordinary shares, and additionally confer the right to appoint the Chairman and to benefit from compulsory transfer provisions which oblige the other shareholders to sell their shares to a purchaser making an offer accepted by Smiths subject to certain conditions. The ordinary shares are recorded at nil value in these accounts.

The company's principal subsidiaries and their countries of incorporation are:

England

Smiths Aerospace Limited*
Aerostructures Hamble Limited
Graseby Medical Limited
Portex Limited*
John Crane UK Limited
Smiths Detection – Watford Ltd

Europe

Smiths Medical Deutschland GmbH (Germany)
Hypertac SA (France)
Hypertac GmbH (Germany)
Heimann Systems GmbH (Germany)

Japan

Smiths Medical Japan Limited (62%)

United States

Smiths Group North America, Inc.
Smiths Aerospace, Inc.
Smiths Detection – Warren, Inc.
Tri Industries, Inc.
John Crane, Inc.
Portex, Inc.
Deltec, Inc.
BCI, Inc.
Level 1, Inc.
Flexible Technologies, Inc.
Tutco, Inc.
Hypertronics Corporation
PolyPhaser Corporation
Sabritec, Inc.
Transtector Systems, Inc.

Those subsidiary companies marked * are 100% owned by the company direct, together with the 62% shareholding in Smiths Medical Japan Limited. The others are 100% owned through intermediate holding companies. Shareholdings are of ordinary shares or common stock. All subsidiaries operate in their country of incorporation.

17 STOCKS

	Consolidated		Company	
	2003 £m	2002 £m	2003 £m	2002 £m
Stocks comprise				
Raw materials and consumables	142.3	133.4	5.7	2.5
Work in progress	142.9	149.2	45.8	32.2
Finished goods	244.9	216.9	20.4	16.8
	530.1	499.5	71.9	51.5
Less: payments on account	(40.6)	(25.0)	(9.6)	(8.8)
	489.5	474.5	62.3	42.7

18 DEBTORS

	Consolidated		Company	
	2003 £m	2002 £m	2003 £m	2002 £m
Amounts falling due within one year				
Trade debtors	533.7	486.5	72.7	46.4
Amounts recoverable on contracts	61.6	52.9	13.0	8.7
Amounts owed by subsidiaries			6.0	5.7
Other debtors	23.2	28.3	9.3	13.4
Prepayments and accrued income	44.1	30.0	12.1	7.2
	662.6	597.7	113.1	81.4
Amounts falling due after more than one year				
Deferred taxation			2.5	
Other debtors	10.8	15.4		
	673.4	613.1	115.6	81.4

19 DEFERRED TAXATION

	Consolidated		Company	
	2003 £m	2002 £m	2003 £m	2002 £m
Deferred taxation				
Accelerated tax depreciation on fixed assets and goodwill	(60.8)	(63.7)	(11.5)	(12.9)
Post-retirement benefits			5.4	3.5
Short-term and other timing differences	47.2	60.0	8.6	8.5
Net deferred tax (liability)/asset	(13.6)	(3.7)	2.5	(0.9)
Movements during the year				
At 1 August	(6.2)	(27.7)	(15.9)	1.2
FRS17 adjustment	2.5	6.8	15.0	11.8
	(3.7)	(20.9)	(0.9)	13.0
Exchange adjustments	(0.8)	(6.9)		
Acquisitions	0.7	3.5		
Disposals				
Charge for the year	(13.0)	4.0	3.4	(16.9)
Recognised on exchange gains and losses	3.7	4.5		
Other	(0.5)	12.1		3.0
At 31 July	(13.6)	(3.7)	2.5	(0.9)

20 CREDITORS

	Consolidated		Company	
	2003 £m	2002 £m	2003 £m	2002 £m
Amounts falling due within one year				
Bank loans and overdrafts	98.4	45.2	284.4	350.9
Finance leases	0.2	1.5		
Short-term loans	19.7	117.0		
Total short-term indebtedness (note 21)	118.3	163.7	284.4	350.9
Trade creditors	191.5	196.0	31.5	17.8
Bills of exchange payable	2.7	3.3		
Amounts owed to subsidiaries			7.6	4.2
Other creditors	25.1	39.4	3.5	3.0
Proposed dividend	96.5	93.6	96.5	93.6
Corporate taxation	145.8	119.0	64.4	77.3
Other taxation and social security costs	37.4	31.6	10.9	11.1
Accruals and deferred income	295.4	265.4	81.3	78.1
	912.7	912.0	580.1	636.0
Amounts falling due after more than one year				
Term loans	678.5	670.8	511.5	497.8
Finance leases	0.3	0.2		
Total long-term indebtedness (note 21)	678.8	671.0	511.5	497.8
Other creditors	75.6	57.9	46.9	22.9
	754.4	728.9	558.4	520.7

21 BORROWINGS AND NET DEBT

The company funding requirements are largely driven by acquisition activity and met by centrally arranged debt finance. This is lent through to the relevant subsidiary on inter-company loans at commercial arm's length terms. Smiths' strong cash generation in the businesses is tax-efficiently remitted to the United Kingdom to repay central borrowings. Local working capital needs and capital expenditure requirements are typically funded by local bank facilities, which are not guaranteed by the parent company.

The company seeks to manage its borrowings and business risks to maintain its current credit ratings. Borrowings for periods more than 364 days require Board approval. The company seeks to maintain a spread of maturity profiles on its debt and no more than 30% of the company's net debt will be held on borrowings due within one year, without firm plans for refinancing or repayment. The analysis of net debt, after taking into account interest rate swaps, is as follows:

As at 31 July 2003	Weighted average		Fixed borrowings		Total 2003 £m
	Interest rate	Years fixed	Amount £m	Floating borrowings £m	
Currencies					
Sterling	7.15%	12	157.8	170.2	328.0
US Dollar	5.98%	8	75.0	129.3	204.3
Euro	4.03%	2	164.7	85.4	250.1
Japanese Yen	2.30%	1	7.7	0.3	8.0
Other			0.1	6.6	6.7
			405.3	391.8	797.1
Cash and deposits					(82.0)
Net debt					715.1
Maturity					
On demand/under one year			27.8	90.5	118.3
One to two years			154.1	58.7	212.8
Two to five years			1.6		1.6
Over five years			221.8	242.6	464.4
			405.3	391.8	797.1

21 BORROWINGS AND NET DEBT CONTINUED

As at 31 July 2002	Weighted average		Fixed borrowings		Total 2002 £m
	Interest rate	Years fixed	Amount £m	Floating borrowings £m	
Currencies					
Sterling	7.19%	13	161.9	167.0	328.9
US Dollar	8.27%	1	43.6	196.8	240.4
Euro	4.45%	2	136.8	77.0	213.8
Japanese Yen	2.30%	1	8.0	32.4	40.4
Other	10.07%	1	0.7	10.5	11.2
			351.0	483.7	834.7
Cash and deposits					(109.5)
Net debt					725.2
Maturity					
On demand/under one year			46.7	117.0	163.7
One to two years			17.3	165.7	183.0
Two to five years			139.0	52.5	191.5
Over five years			148.0	148.5	296.5
			351.0	483.7	834.7

Borrowing facilities

The current net debt level of £715.1m represents 2.6 times free cash-flow, and EBITDA interest cover is more than 13 times – comfortably within the current credit rating parameter. The borrowings of all non-UK operations are in local currencies to provide a structural hedge against foreign currency movements on the overseas assets.

The medium-term borrowings principally comprise an unsecured nominal €300m 6.375% bond maturing in 2005 which is largely swapped to floating interest rates.

The long-term borrowings (greater than five years) of £464m (2002 £297m) relate to Smiths Group plc unsecured nominal £150m 7.875% bonds maturing in 2010 which are swapped to floating interest rates and to unsecured nominal £150m 7.25% bonds maturing in 2016 which remain fixed rate. In January 2003 the group raised US\$250m in the US private placement market. The coupon on the 10 year Senior Notes was set at 5.45%, two-thirds of which was swapped to floating rate for the life of the instrument. Notes are guaranteed by Smiths Group plc.

To ensure better than adequate liquidity committed unused credit facilities of at least £100m are maintained at all times. At the year-end the company had the following unused committed borrowing facilities:

	2003 £m	2002 £m
Expiring within one year	540.0	65.0
Expiring between one and two years		337.0
	540.0	402.0

The company also has a number of uncommitted facilities and overdraft lines provided by its core relationship banking group.

21 BORROWINGS AND NET DEBT CONTINUED

	Borrowings			Net debt £m
	Cash and deposits £m	Under one year £m	Over one year £m	
Analysis of changes in net debt				
As at 1 August 2002	109.5	(163.7)	(671.0)	(725.2)
Net cash inflow/(outflow)	(32.3)	52.1	22.1	41.9
Other movements in cash/borrowings		(0.3)	(12.8)	(13.1)
Exchange variation	4.8	(6.4)	(17.1)	(18.7)
As at 31 July 2003	82.0	(118.3)	(678.8)	(715.1)

	2003 £m	2002 £m
Financing		
Reduction in term borrowings		(141.8)
Share issues		17.5
Total financing	(68.7)	(124.3)

Management of liquid resources defined as short-term deposits shown in the cash-flow statement comprises a reduction of £2.3m in deposits.

22 FINANCIAL INSTRUMENTS

a) Fair values of financial assets and liabilities

The company uses financial instruments to raise finance for its operations and manage the related financial risks. Acceptable derivative instruments for hedging are forward currency contracts, currency and interest rate swaps and options, spot and forward rate agreements, collars, caps, floors, cylinders and similar bank products. Counterparties for hedging are limited to our relationship banks with credit ratings of A- or better to avoid unnecessary credit risk. Short-term debtors and creditors have been excluded from all the following disclosures, other than the currency risk disclosures. The company's policy forbids trading or speculation in financial instruments. Where the underlying transaction being hedged disappears or is cancelled or does not arise, the related financial instrument must also be cancelled or otherwise negated as soon as possible.

Set out below is a year-end comparison of the book value and current fair value of the company's financial instruments by category. Fair values of interest rate swaps, currency swap and forward currency contracts are based on the market prices of comparable instruments at the balance sheet date. Where market prices are not available, the fair value has been calculated by discounting cash-flows at prevailing interest and exchange rates.

	2003 Book value £m	2003 Fair value £m	2002 Book value £m	2002 Fair value £m
Cash	82.0	82.0	109.5	109.5
Borrowings – short-term	(118.3)	(118.6)	(163.7)	(163.7)
– long-term	(678.8)	(735.9)	(671.0)	(715.3)
Net debt – book value/fair value	(715.1)	(772.5)	(725.2)	(769.5)
Derivative financial instruments – interest rate swaps	(0.8)	11.9	0.4	12.7
– currency rate swaps	5.4	7.0	8.8	8.7
– forward currency contracts		6.4		5.5
Preference shares (note 16)	325.0	325.0	325.0	325.0
Net financial liabilities – book value/fair value	(385.5)	(422.2)	(391.0)	(417.6)

The company's policy is to hedge all material contractually committed future sales using forward exchange contracts and currency options. The transactions to which the forward currency contracts relate are mainly expected to occur in 2004 and 2005. Currency rate swaps protect the group from transaction exposure in line with its policy as set out in note 22(e) and interest rate swaps are used to ensure that the group's debt is broadly evenly split between fixed and floating rate funds.

22 FINANCIAL INSTRUMENTS CONTINUED

b) Hedges

	Unrecognised gains £m	Unrecognised (losses) £m	Deferred total net gains £m	Total 2003 £m
Net gains/(losses) on hedges at 1 August 2002	26.9	(9.2)	6.2	23.9
Net gains/losses arising in previous years included in 2003 income	(9.1)	5.9	(2.4)	(5.6)
Net gains/(losses) not included in 2003 income arising before 1 August 2002	17.8	(3.3)	3.8	18.3
Change in market value of hedges not recognised in year	9.8	(0.9)		8.9
Gains and losses arising in 2003 that were not recognised in that year	4.8	(7.5)		(2.7)
At 31 July 2003	32.4	(11.7)	3.8	24.5
Of which:				
Expected to be included in 2004 income	17.7	(7.2)	0.3	10.8
Expected to be included in 2005 income or later	14.7	(4.5)	3.5	13.7

	Unrecognised gains £m	Unrecognised (losses) £m	Deferred total net gains £m	Total 2002 £m
Net gains/(losses) on hedges at 1 August 2001	21.7	(29.3)	9.1	1.5
Net gains/losses arising in previous years included in 2002 income	(6.0)	15.4	(2.9)	6.5
Net gains/(losses) not included in 2002 income arising before 1 August 2001	15.7	(13.9)	6.2	8.0
Change in market value of hedges not recognised in year	1.2	9.5		10.7
Gains and losses arising in 2002 that were not recognised in that year	10.0	(4.8)		5.2
At 31 July 2002	26.9	(9.2)	6.2	23.9
Of which:				
Expected to be included in 2003 income	9.1	(5.8)	1.4	4.7
Expected to be included in 2004 income or later	17.8	(3.4)	4.8	19.2

There were no deferred losses in either year. The unrecognised gains on hedges at 31 July 2003 largely relate to interest rate swap contracts that swap fixed rate debt obligations to floating rates. However, all the gains and losses on the hedging of foreign currency transactions are expected to be matched by losses and gains on the hedged transactions or positions. There are no material gains or losses on hedging instruments within the consolidated balance sheet.

c) Interest management

The net interest cash-flow is analysed below:

	2003 £m	2002 £m
Interest received	3.2	5.8
Financing gains	20.4	1.0
Interest paid	(49.7)	(63.3)
Net interest	(26.1)	(56.5)

Financing gains include £16.4m of exchange gains recognised in the Statement of Total Recognised Gains and Losses.

22 FINANCIAL INSTRUMENTS CONTINUED

d) Financial assets

	Preference shares (note 16)		Bank balances and cash		Short-term deposits	
	2003 £m	2002 £m	2003 £m	2002 £m	2003 £m	2002 £m
Sterling	325.0	325.0	3.0	12.9	17.9	20.7
US Dollar			9.0	8.1		2.0
Canadian Dollar			5.1	28.9	3.0	0.2
Euro			9.6	10.7	0.6	1.2
Yen			10.7	7.3	0.5	
Other			19.7	14.4	2.9	3.1
	325.0	325.0	57.1	82.3	24.9	27.2
Weighted average interest rate on interest bearing balances			2.10%	2.18%	3.10%	4.15%

The company strives to minimise the level of surplus cash balances but where these arise, tight controls apply to ensure that they are securely placed with highly rated counterparties and are available for redeployment around the group at short notice.

The bank balances and cash comprise £28.4m in respect of short-term balances earning interest, £21.8m in respect of balances which are non-interest earning and £6.9m held as compensating credits against Yen term loans. Short-term deposits are invested for periods with maturity under one year.

e) Currency exposures

Transactions

All material cross-border trading contracts or forecast commitments are hedged at inception by appropriate derivative financial instruments, with the company's core banks as counterparties. The company takes competitive quotes on all major foreign exchange contracts through its central foreign exchange programme. For smaller deals, the company has centralised the entire group's foreign exchange dealings through an e-based foreign exchange trading system operated by a major bank.

The analysis below shows the net monetary assets and liabilities of the group companies that are not denominated in their functional currency and therefore give rise to exchange gains and losses in the profit and loss account. The amounts shown in the table take into account the effect of hedging instruments used to manage these exposures.

Functional currency of group companies	2003 Net foreign currency monetary assets/(liabilities)			
	Sterling £m	US Dollar £m	Euro £m	Other £m
Sterling		(4.1)	1.0	0.7
US Dollar	0.4		0.3	1.3
Euro	0.4	0.5		(0.5)
Other	0.4	6.6	1.6	3.3
As at 31 July 2003	1.2	3.0	2.9	4.8

Functional currency of group companies	2002 Net foreign currency monetary assets/(liabilities)			
	Sterling £m	US Dollar £m	Euro £m	Other £m
Sterling		11.2	3.0	1.3
US Dollar	(0.1)		1.4	0.8
Euro	0.2	1.1		(0.4)
Other	0.7	8.6	(0.3)	1.4
As at 31 July 2002	0.8	20.9	4.1	3.1

Translation

The company protects its reserves from foreign currency fluctuations by ensuring that at least 75% of the total net overseas operational assets are offset, either by borrowings in the respective currency or by currency swaps. The company does not hedge the translation of its overseas profits, although does mitigate currency effects through foreign interest costs and by applying average exchange rates for the year.

Gains and losses arising on net investments overseas and the financial instruments used to hedge the currency exposures are recognised in the statement of total recognised gains and losses.

NOTES TO THE ACCOUNTS CONTINUED

23 OPERATING LEASE COMMITMENTS

At 31 July 2003 the company had annual commitments under non-cancellable operating leases as follows:

	Land and buildings £m	Others £m
Expiring in less than one year	3.0	3.0
Expiring between one and five years	11.0	7.4
Expiring after five years	11.1	0.1
	25.1	10.5

24 PROVISIONS FOR LIABILITIES AND CHARGES

	At 1/8/02 (restated) £m	Exchange adjustments £m	Profit and loss account				Disposals £m	At 31/7/03 £m
			Provisions £m	Releases £m	Acquisitions £m	Utilisation £m		
Consolidated								
Service guarantees and product liability	34.7	0.5	28.2	(5.0)	11.9	(19.2)	(2.0)	49.1
Reorganisation	37.1	0.1		(1.9)		(20.9)	(0.4)	14.0
Property	20.0		5.8	(5.5)		(2.9)	(0.3)	17.1
Litigation	18.3	0.2	6.9	(2.6)	2.1	(2.7)		22.2
	110.1	0.8	40.9	(15.0)	14.0	(45.7)	(2.7)	102.4
Deferred taxation (note 19)	3.7							13.6
Total provisions for liabilities and charges	113.8							116.0
Company								
Service guarantees and product liability	7.0		4.0	(0.2)	5.5	(4.1)	(1.5)	10.7
Reorganisation	6.8				5.1	(9.8)		2.1
Property	6.1		5.2	(1.2)		(2.4)		7.7
Litigation	0.3		0.3	(0.3)				0.3
	20.2		9.5	(1.7)	10.6	(16.3)	(1.5)	20.8
Deferred taxation (note 19)	0.9							
	21.1							20.8

Service guarantees and product liability

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

Reorganisation

Significant parts of the company's operations, especially in Aerospace and Sealing Solutions, have been undergoing a phased restructuring programme. Full provision is made for reorganisation approved and committed by the end of each financial year. This year's residual balance relates mainly to Aerospace.

Property

As stated in the accounting policies on page 16, where a property is vacant, or sub-let under terms such that rental income is insufficient to meet all outgoings, the company provides for the expected future shortfall up to termination of the lease. Provision is also made for the cost of reinstatement work on leased properties where there is an obligation under the lease, and the costs can be reasonably estimated. Where evidence of contamination is found on property in the company's occupation, provision is made for estimated remedial costs pending action on the affected site. Provisions totalling £5.5m were released following a reassessment of certain future obligations.

Litigation

The company has on occasion been required to take legal action to protect its patents and other business intellectual property rights against infringement, and to similarly defend itself against proceedings brought by other parties. Provision is made for the expected fees and associated costs, based on professional advice as to the likely duration of each case. Provisions totalling £2.6m were released relating to litigation settled at less than the expected cost.

25 ACQUISITIONS

During the year under review the company acquired the businesses set out below. The fair values are provisional, and will be finalised in the 2004 accounts.

	Dates of acquisition	Consideration (including associated costs) £m	Goodwill £m	Net assets £m
Businesses acquired				
Heimann Systems GmbH	29/11/02	236.1	221.4	14.7
Other	various	7.2	7.0	0.2
		243.3	228.4	14.9
		Book value £m	Consistency of accounting policy £m	Fair value £m
Assets acquired				
Fixed assets		19.3		19.3
Stocks		28.1		28.1
Debtors		39.4		39.4
Creditors		(42.4)	(0.6)	(43.0)
Loans		(13.1)		(13.1)
Provisions		(12.3)	(1.7)	(14.0)
Taxation		(1.8)		(1.8)
Net assets acquired		17.2	(2.3)	14.9
Goodwill				228.4
Consideration – total				243.3
– deferred				(3.7)
– satisfied by cash				239.6

Fair values on acquisitions made in 2002 have now been finalised.

Goodwill arising on acquisitions made in 2003 is being amortised over its estimated useful economic life of 20 years.

In the 12 months to 31 December 2001, Heimann Systems earned post-tax profits of €15.2m, and in the 11 months prior to acquisition earned post-tax profits of €30.1m.

26 DISPOSALS

The principal disposal during the year was the Air Movement and Cable Management businesses, which were sold on 3 December 2002. The table below shows the details of the transaction.

	£m
Proceeds received	125.0
Net assets at date of sale	
Tangible fixed assets	22.7
Stocks	14.4
Debtors	21.4
Creditors	(15.4)
Tangible net assets	43.1
Costs and retained liabilities	
Transaction costs	5.1
Provision for retained liabilities	4.1
Pension curtailment benefit	(1.3)
	7.9
Surplus of proceeds over net assets, costs and expenses	74.0
Goodwill previously set against reserves	(66.8)
Profit on sale	7.2

	Air Movement and Cable Management £m	Other £m	Total £m
Air Movement and other disposals – profit on disposal			
Proceeds less costs and retained liabilities	117.1	20.2	137.3
Net assets	(43.1)	(5.2)	(48.3)
Surplus over net assets/retained liabilities	74.0	15.0	89.0
Goodwill previously set against reserves	(66.8)	(7.7)	(74.5)
Profit on sale	7.2	7.3	14.5

£147.6m of the disposal proceeds was received in cash during the year.

27 CALLED UP SHARE CAPITAL

	Shares	Issued capital £m	Consideration £m
At 1 August 2002	558,332,069	139.6	
Exercise of share options	940,163	0.2	5.9
At 31 July 2003	559,272,232	139.8	5.9

The authorised capital at 31 July 2002 and 2003 consisted of 800,000,000 shares of 25p each.

At 31 July 2003 the following options had been granted and were still outstanding:

	Date issued	Number of shares	Subscription prices	Dates normally exercisable
SAYE	1996	27,930	572.0p	2003
	1997	143,239	632.0p	2000-2004
	1998	272,357	669.0p	2001-2005
	1999	235,217	721.0p	2002-2006
	2000	763,297	612.0p	2003-2007
	2001	1,277,557	608.0p	2004-2008
	2002	899,123	645.0p	2005-2009
	2003	1,734,297	554.0p	2006-2010
Executive	1993	506	395.0p	1996-2003
	1994	56,760	451.0p	1997-2004
	1995	62,500	480.0p	1998-2005
	1995	141,532	632.0p	1998-2005
	1996	311,447	823.0p	1999-2006
	1997	418,326	934.0p	2000-2007
	1998	795,652	765.0p	2001-2008
	1999	789,354	858.5p	2002-2009
	2000	1,034,772	750.0p	2003-2010
	2000	55,424	765.0p	2003-2010
	2000	190,934	807.0p	2003-2010
	2001	1,599,995	790.0p	2004-2011
	2002	2,769,931	806.0p	2005-2012
2002	3,920,500	645.0p	2005-2012	
SAYE (rolled over from TI Scheme)	1996	23,930	853.86p	2003
	1997	22,582	886.39p	2002-2004
	1998	281,707	719.68p	2001-2005
	1999	127,236	805.07p	2002-2006
	2000	613,268	587.54p	2003-2007
Executive (rolled over from TI Schemes)	1993	4,426	716.63p	2001-2003
	1994	86,073	846.74p	2001-2004
	1994	241,015	759.33p	2001-2004
	1995	66,893	765.42p	2001-2005
	1995	70,827	875.21p	2001-2005
	1996	185,921	1,058.18p	2001-2006
	1996	131,078	1,121.20p	2001-2006
	1997	454,977	1,097.82p	2001-2007
	1997	794,612	1,219.80p	2001-2007
	1998	762,142	1,026.66p	2001-2008
	1998	448,071	849.79p	2001-2008
	1999	643,620	943.31p	2002-2009
	1999	1,515,955	907.23p	2002-2009
	1999	543,984	1,103.92p	2002-2009
	2000	1,274,063	661.23p	2003-2010
	2000	951,140	626.16p	2003-2010
	2000	73,044	672.92p	2003-2010

28 SHARE PREMIUM ACCOUNT AND RESERVES

	Share premium account £m	Revaluation reserve £m	Merger reserve £m	Profit and loss account £m
Consolidated				
At 1 August 2002	163.7	2.6	234.8	457.5
Prior period adjustment – FRS17 – Retirement Benefits				(157.6)
At 1 August 2002 (as restated)	163.7	2.6	234.8	299.9
Premium on allotments	6.3			(0.6)
Retained loss				(33.9)
Write-back of goodwill on disposals				211.5
Actuarial loss on retirement benefits				(258.6)
Deferred tax credit related thereto				73.4
Exchange rate changes (including tax on recognised gains)				23.7
At 31 July 2003	170.0	2.6	234.8	315.4

	2003 £m	2002 (restated) £m
Profit and loss account excluding pension and other retirement benefit liabilities (net)	623.8	428.6
Pension and other retirement benefit liabilities (net)	(308.4)	(128.7)
	315.4	299.9

	Share premium account £m	Revaluation reserve £m	Merger reserve £m	Profit and loss account £m
Company				
At 1 August 2002	163.7	0.5	180.5	115.1
Prior period adjustment – FRS17 – Retirement Benefits				(39.1)
Premium on allotments	163.7	0.5	180.5	76.0
Exchange rate changes	6.3			(0.6)
Actuarial loss on retirement benefits				(27.9)
Deferred tax credit related thereto				(10.8)
Retained profit				1.6
				708.8
At 31 July 2003	170.0	0.5	180.5	747.1

	2003 £m	2002 (restated) £m
Profit and loss account excluding pension and other retirement benefit liabilities (net)	785.8	104.9
Pension and other retirement benefit liabilities (net)	(38.7)	(28.9)
	747.1	76.0

The retained profit of the company represents a profit for the year of £854.2m less dividends payable of £145.4m.

The company's profit and loss reserve of £747.1m includes £615.4m not available for distribution as dividend.

During the year the company received £6.5m on the issue of shares in respect of the exercise of options awarded under various share option schemes. Employees paid £5.9m for the issue of these shares and the balance of £0.6m comprised contributions to the qualifying employee share ownership trust (QUEST) from undertakings within the company. The trust has been included within the company and consolidated financial statements.

Goodwill relating to acquisitions made before 1 August 1998 and set against reserves amounted to £1,392.6m (2002 £1,604.1m). Upon subsequent disposal, such goodwill is charged as part of the profit or loss arising thereon.

29 MOVEMENTS IN SHAREHOLDERS' EQUITY

	2003 £m	2002 £m
Profit for the year	111.5	185.1
Dividends	(145.4)	(142.2)
	(33.9)	42.9
Exchange variations	14.7	(56.4)
Taxation recognised on exchange gains/losses:		
Current – United Kingdom	5.3	(1.2)
Deferred – United States	3.7	4.5
Share issues	5.9	17.5
Write-back of goodwill on disposals	211.5	149.2
FRS17 – Retirement Benefits:		
Actuarial gains and losses on retirement benefit schemes – gross	(258.6)	(427.0)
Deferred tax charge/credit related thereto	73.4	131.7
Net increase in shareholders' equity	22.0	(138.8)
Shareholders' equity:		
At 1 August (as previously stated)	998.2	839.7
Prior year adjustment re FRS17 – Retirement Benefits – cumulative to 31 July 2002	(157.6)	139.7
Shareholders' equity at 1 August (as restated)	840.6	979.4
At 31 July	862.6	840.6

30 CONTINGENT LIABILITIES

	2003 £m	2002 £m
The parent company has guaranteed the 5.45% Senior Notes 2013 and the 8.853% Senior Notes 2003 privately placed by a subsidiary. The remaining US\$20m of 8.853% Senior Notes 2003 are repayable in October 2003.	167.7	89.7

FIVE YEAR REVIEW

	2003 £m	2002 (restated) £m	2001*	2000*	1999*
Turnover – continuing operations	2,629.2	2,588.4	2,586.8	2,227.9	2,087.8
– discontinued operations	426.9	635.1	2,371.4	2,425.0	1,683.5
	3,056.1	3,223.5	4,958.2	4,652.9	3,771.3
Operating profit – continuing operations	371.9	364.1	430.4	355.9	336.7
– discontinued operations	51.9	64.0	220.9	266.9	194.5
	423.8	428.1	651.3	622.8	531.2
Goodwill amortisation	(44.1)	(50.7)	(48.7)	(35.5)	(5.9)
Operating profit (after goodwill amortisation)	379.7	377.4	602.6	587.3	525.3
Net interest	(39.8)	(32.0)	(116.2)	(80.7)	(46.7)
Profit before exceptional items	339.9	345.4	486.4	506.6	478.6
Exceptional items	(122.5)	(68.0)	(598.7)	(22.6)	(15.0)
Profit before taxation	217.4	277.4	(112.3)	484.0	463.6
Profit after taxation	112.3	186.4	(204.4)	325.7	316.8
Minority interests	(0.8)	(1.3)	(1.6)	(1.7)	(1.1)
Shareholders' equity	862.6	840.6	839.7	787.4	605.7
Represented by:					
Intangible fixed assets	830.2	638.3	678.3	851.4	380.5
Tangible fixed assets and investments	890.8	900.5	957.2	1,018.8	907.8
Net current assets/provisions/retirement benefit liabilities	(143.3)	27.0	324.0	382.9	290.8
Net debt	(715.1)	(725.2)	(1,119.8)	(1,465.7)	(973.4)
Funds employed	862.6	840.6	839.7	787.4	605.7
Goodwill charged directly to reserves	1,392.6	1,604.1	1,753.3	2,223.6	2,223.6
Shareholder investment	2,255.2	2,444.7	2,593.0	3,011.0	2,829.3
Ratios					
Operating profit before goodwill amortisation: turnover (%)	13.9	13.3	13.1	13.4	14.1
Effective tax rate before goodwill amortisation and exceptional items (%)	27.0	28.0	29.2	30.6	30.9
After tax return on average shareholder investment (%)	11.9	11.0	12.5	12.9	12.6
Cash-flow					
Cash-flow from normal operating activities	466.5	583.0	701.0	666.6	551.3
Less capital expenditure (net)	(86.3)	(100.0)	(188.0)	(168.2)	(135.1)
Operating cash after capital expenditure	380.2	483.0	513.0	498.4	416.2
Free cash-flow (before acquisitions and dividends, after capital expenditure)	270.5	314.5	205.3	336.5	223.7
Free cash-flow per share (p)	48.4	56.5	37.1	61.7	41.8
Earnings per share before goodwill amortisation and exceptional items (p)	50.1	51.0	68.3	68.6	62.7
Dividends					
Pence per share	26.0	25.5	25.0	23.8	21.65
Times covered before goodwill amortisation	1.9	2.0	2.7	2.5	2.4
Number of employees (000s)					
United Kingdom	8.5	10.7	13.5	15.1	15.4
Overseas	23.8	22.3	24.2	45.7	37.4
	32.3	33.0	37.7	60.8	52.8

*Information for 2001 and earlier years has not been restated following the adoption of FRS17.

FINANCIAL CALENDAR

2003

Preliminary announcement of results for 2002-2003	SEPTEMBER 24
Ordinary shares final dividend ex-dividend date	OCTOBER 15
Ordinary shares final dividend record date	17
Annual General Meeting	NOVEMBER 11
Ordinary shares final dividend payment date	14

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2004

2003-2004 interim results announced	MARCH 10 provisional
Ordinary shares interim dividend ex-dividend date	17 provisional
Ordinary shares interim dividend record date	19 provisional
Ordinary shares interim dividend payment date	APRIL 16 provisional
Smiths Group plc financial year-end	JULY 31
Preliminary announcement of results for 2003-2004	SEPTEMBER 22 provisional
Ordinary shares final dividend ex-dividend date	OCTOBER 13 provisional
Ordinary shares final dividend record date	15 provisional
Annual General Meeting	NOVEMBER 9 provisional
Ordinary shares final dividend payment date	12 provisional

REGISTRAR

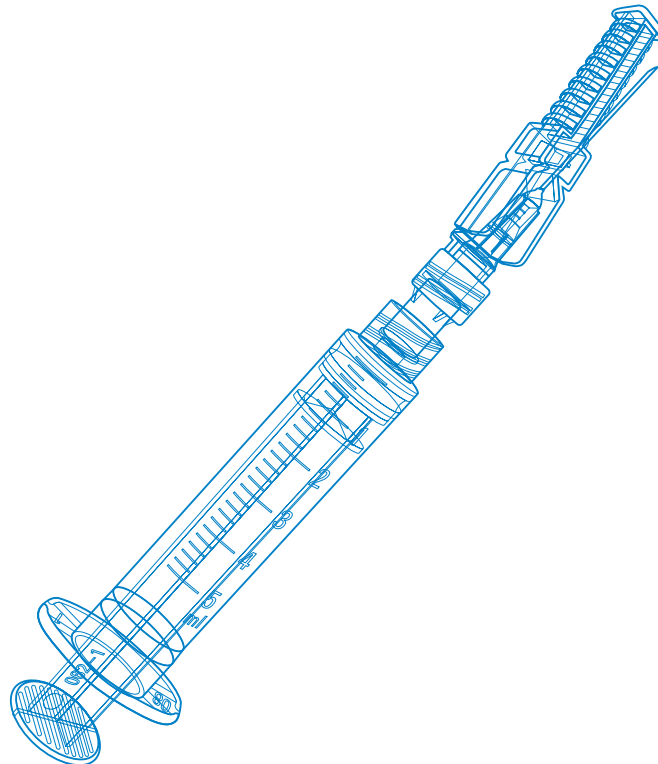
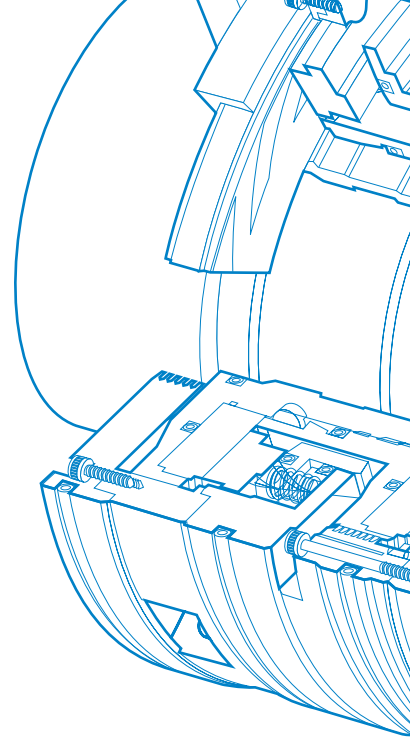
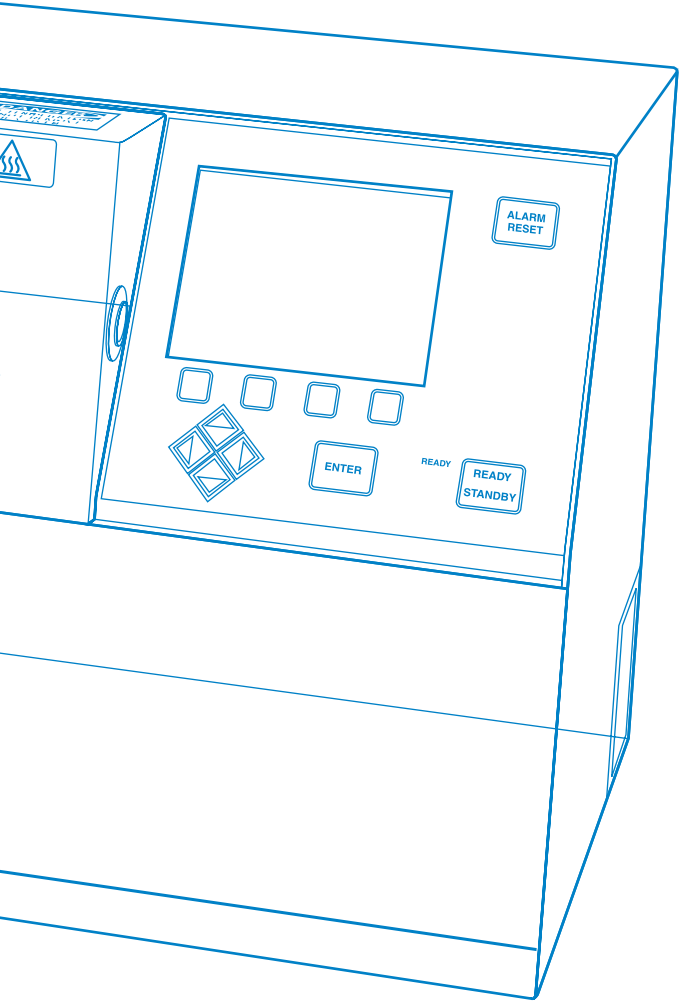
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The market value of an ordinary share of the company on 31 March 1982 for the purposes of capital gains tax was 91.25p (taking into account the sub-division of 50p shares into 25p shares on 14 January 1985).



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