

Directors' report

Principal activities

The principal activities of the Company and its subsidiaries are the development, manufacture and sale of avionics for commercial aircraft and military requirements; marine and fighting vehicle systems; single-use disposable medical products for critical care applications; medical infusion pumps; operating tables and related equipment; ducting and ventilation systems; and a varied range of products for consumer, industrial and engineering applications. The main manufacturing operations are in the UK and USA. A review of the development of the Company and its subsidiary undertakings during the 1998/99 financial year is contained in pages 10 to 21.

Results and dividends

The results for the 52 weeks ended 31 July 1999 are set out in the Consolidated Profit and Loss Account on page 40. Sales for the year amounted to £1,323.9m, against £1,198.5m last year. The profit for the year after taxation and minority interests amounted to £163.2m (1998 £148.2m).

An interim dividend of 7.4p per ordinary share of 25p was paid on 4 June 1999 (a scrip dividend share alternative was offered at a cash equivalent price of 881p per share). The directors recommend for payment on 15 December 1999 a final dividend on each ordinary share of 14.25p, making a total dividend of 21.65p for the year. A scrip dividend share alternative will be offered.

The retained profit of £95.3m was transferred to Reserves.

Research and development

£127.0m was spent on research and development during the year, of which £53.9m 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 businesses in the manufacturing sector is centrally co-ordinated.

Changes in Company interests during the year

On 28 August 1998 Smiths Industries Aerospace & Defense Systems, Inc. acquired the business and assets of the Signal Processing Systems division of Global Associates, Ltd. for £4.6m in cash.

On 2 November 1998 the Company acquired all the issued share capital of Stewart Hughes Limited for £10.1m in cash.

On 30 November 1998 Smiths Industries, Inc. acquired all the issued share capital of Transtector Systems, Inc. for £21.7m including acquired debt.

On 30 November 1998 Icore International, Inc. acquired all the issued share capital of Engineering Transitions Company, Inc. for £3.3m in cash.

The Company concluded its negotiations to acquire Biochem International and, on 11 January 1999, Smiths Industries, Inc. acquired all of the issued share capital of Biochem International, Inc. for a net £42.3m in cash.

On 1 February 1999 Smiths Industries Medical Systems Nordic AB acquired all the issued share capital of Hemex Medical AB for £0.6m in cash.

On 30 April 1999 Smiths Industries Aerospace & Defense Systems, Inc. acquired all the issued share capital of Strategic Technology Systems, Inc. for £10.5m in cash.

Post balance sheet events

On 3 August 1999 Smiths Industries, Inc. acquired all the issued share capital of Environmental Technologies Group, Inc. for £9m in cash.

On 17 September 1999 the Company moved from being a part of the FTSE 100 Actuarial Index to become a member of the FTSE 250 Index.

Future developments

The Company will pursue its existing

international activities and continue to seek business opportunities in both the UK and overseas.

Interests in land

Land and buildings were professionally valued as at 31 July 1999. The value of land and buildings is estimated to exceed the book value by around £21.2m. This valuation has not been reflected in these accounts.

Charitable and political donations

During the year the Company made donations of £754,000 for charitable purposes including payments of £345,000 for the Portex Chair of Paediatric Anaesthesia and £20,000 to the Kent Institute of Medicine and Health Science. No political donations were made.

Directors

The names of those who were directors at the end of the financial year are listed on page 29. Sir Roger Hurn and Sir Peter Thompson retired as directors at the conclusion of the Annual General Meeting held on 24 November 1998. Mr K. Orrell-Jones was appointed as Chairman with effect from 24 November 1998. Mr P.T. Hollins was appointed as a non-executive director on 9 February 1999.

Re-appointment of directors

Messrs N.V. Barber, G.M. Kennedy and E. Lindh will retire by rotation, in accordance with Articles 73 and 74, and will seek re-appointment at the Annual General Meeting. Mr P.T. Hollins will also retire at the AGM, following his appointment during the year, and seek re-appointment.

Directors' service contracts

Mr N.V. Barber's service contract may be terminated by six months notice given by either party and Mr G.M. Kennedy's contract terminates on 3 August 2000. Mr K.O. Butler-Wheelhouse, Mr E. Lindh and

Mr A.M. Thomson have service contracts with the Company which are subject to termination by two years' notice, given to expire at any time.

With the exceptions referred to above, no director had a beneficial interest in any contract to which the Company or its subsidiaries was a party during the year.

Interests in shares

As at 28 September 1999 the Company had been notified, pursuant to the Companies Act 1985, of the following material interests in its issued share capital:

| | No. of shares | Per-centage of issued share capital† |
|---|---------------|--------------------------------------|
| Putnam Investments | 12,825,378 | 4.08 |
| Scottish Widows Fund and Life Assurance Society | 9,429,653 | 3.00 |
| Norwich Union plc | 9,442,007 | 3.01 |

† percentage of share capital in issue on 28 September 1999

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 and details of their share options are shown on pages 37 and 38.

Corporate Governance

The Company complies with the Combined Code developed by the Committee on Corporate Governance and defined in the Listing Rules of the London Stock Exchange (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 to deal with urgent developments.

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.

No director has been appointed as the director of a listed company for the first time during the accounting period under report. Arrangements have been made for all directors to be given appropriate training whether on their appointment, or periodically as necessary.

Mr K. Orrell-Jones, who is the senior non-executive director, has been appointed Chairman in succession to Sir Roger Hurn. Mr R. F. Leverton is the chairman of the Audit Committee. No other non-executive director has been appointed as "a recognised senior 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 Mr Leverton who have clear areas of responsibility. Mr K. O. Butler-Wheelhouse is the Chief Executive. There are five independent non-executive directors and five executive directors on the Board.

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, which is chaired by Mr Orrell-Jones and is composed of the non-executive directors, makes recommendations to the Board on appointments. Appointments approved by the Board are subject to confirmation by the shareholders.

All directors are subject to retirement by rotation 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. Mr K. O. Butler-Wheelhouse attends meetings of the Committee by invitation but does not participate in discussions of his 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 directors' remuneration is set out on pages 35 to 38.

The Company maintains a dialogue with institutional shareholders through regular meetings and presentations. At the AGM 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 principle C.2.

The Board believes that the present Report 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 39.

The Audit Committee's terms of reference accord with the Code. The Committee consists of all the non-executive directors and meets at least three times a year with the chief executive, financial director, director of internal audit and the auditors normally attending meetings. Its chairman is Mr R. F. Leverton.

Internal Control. The Board accepts its responsibility for maintaining an effective system of internal control which supports the Company's effective and efficient operation and enables it to respond to significant business, operational, financial, compliance and other risks. Any system of internal control can provide only reasonable, not absolute, assurance against material loss to the Company or material misstatements in the financial accounts.

In the highly regulated environment of the aerospace and medical industries, procedures are codified in detailed operating procedures manuals and are reinforced by regular educational programmes. This is designed to ensure not only compliance with the regulatory requirements but also with the general principles of business integrity. Compliance with these principles throughout the Company is monitored by the Internal Audit Department referred to below.

A key element in any system is communication and a number of committees exist which 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.

The Company has an Internal Audit Department. The Director of Internal Audit, who is responsible to the Chairman of the Audit Committee, has

reported to the Audit Committee upon the Company's internal control processes.

The internal financial control system includes the following key features, which have been designed and established over a number of years to provide internal financial control appropriate to the Company's businesses:

- the approval of comprehensive budgets by the Board and the monthly monitoring of performance against budget;
- a detailed investment approval process requires Board approval of all major capital projects;
- the Audit Committee's consideration of any significant control matters;
- appointment of experienced and professional staff by recruitment and promotion.

The Audit Committee has reviewed the effectiveness of the Company's system of internal financial control. In addition to consideration of reports from the Director of Internal Audit and from the Company's external auditors, the Committee has reviewed the results of an internal self-assessment exercise which required the heads of all the business units of each operating group to report through their operating groups to the Chief Executive.

The Board is establishing procedures for reviewing the effectiveness of its internal controls as recommended by the Turnbull Report. These procedures will be in place in the course of the current financial year and will be reported on in more detail in the next Annual Report.

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 have reviewed the Company's statements

as to compliance with the Combined Code to the extent required by the Listing Rules of the London Stock Exchange. The results of their review are set out on page 39.

Year 2000

The Company's businesses around the world have been working on their Year 2000 programmes since mid-1997. These programmes are intended to ensure that all products and critical operating systems will continue to operate through the Year 2000 transition without interruption. Products that have in-service safety implications are subject to review by the Company's safety organisation. Suppliers of goods and services are being approached to confirm their ability to trade without interruption into the next millennium. Each business has a team of senior executives that is accountable for the implementation of the Year 2000 programmes and regular progress reports are submitted to the Board. It is anticipated that the total cost of compliance with Year 2000 will be in the order of £10m with £9m already spent.

Economic and Monetary Union (EMU)

The introduction of the euro will affect the Company whether or not the UK participates in EMU. Our businesses operate in eight of the first wave countries and we expect the growing use of the euro within the UK for transactions with organisations in other European countries. The Company is taking steps to ensure that the anticipated changes will not jeopardise the continuing operation of our European businesses.

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 36 days for the parent company and 46 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 ensure that its operations and products cause the minimum reasonably achievable detriment to the environment. Care is taken to limit discharges of environmentally harmful substances and to dispose of waste in a safe manner. The Company is a founder member of VALPAK. Contingency arrangements and plans exist to reduce the risk of and limit the effect of any accidental spillage. Where sites occupied by the Company have been found to be contaminated by past industrial practices, programmed clearance has been undertaken in co-operation with the appropriate regulatory authorities. A senior corporate staff director has responsibility for safety, health and environmental matters: two full-time managers report to that director and co-ordinate and monitor the safety, health and environmental activities of the Company.

Personnel 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 participate financially in the affairs of the Company.

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

and other similar consultative bodies which allow the views and opinions 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 likewise covered by means of structured committees, including representation from recognised trade unions.

Authority to issue shares

At the Annual General Meeting shareholders will be asked to revise the authority, given to the directors at the Annual General Meeting in November 1998, to allot shares 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 ordinary resolution is set out in the Notice of AGM.

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 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 £3,919,256 (approximately 5% of the issued share capital).

During the period ended 31 July 1999, a total of 1,388,087 ordinary shares were issued pursuant to the terms of

shareholder-approved share schemes and 3,447,556 shares were issued under the Scrip Dividend Share Alternative scheme.

Authority to purchase shares

At the Annual General Meeting the Company will seek to renew the authority, granted in general meeting on 24 November 1998, to make market purchases of its shares, as defined in section 163 of the Companies Act 1985. The authority will be limited to not more than 5% of the issued share capital 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 ten business days prior to any purchase.

The directors will only exercise the authority 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.

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

Dividend – share alternative

A scrip dividend share alternative plan was approved at the 1997 Annual General Meeting which authorised the directors to offer a share alternative ("scrip dividend") to shareholders (i.e. the option to elect to receive new shares instead of all or part of the dividend in cash). The authority enables the directors to offer a share alternative in respect of any dividends that may be declared during a period of five years from the date of the meeting. The authority conforms to the provisions of Article 114 of the Company's Articles of Association.

The directors will only exercise the authority if it appears to them to

Directors' report continued

be in the best interests of the Company. The share alternative will not be offered to shareholders resident in territories or subject to jurisdictions where the share alternative would be illegal or where compliance with local laws or regulations would be unduly onerous.

If the final dividend for 1998/99 is approved at the AGM, a share alternative will be offered. Only shareholders eligible for the final dividend (i.e. those shareholders on the register on the dividend record date of 15 October 1999) will receive details of the share alternative and election procedures through the post. If a share alternative is offered in respect of any future dividend, shareholders at the time will be given the opportunity to elect to receive shares instead of cash. Elections to receive a share alternative may be made for a specific dividend only or for all future dividends for which a share alternative is offered, at the shareholder's discretion.

Auditor

Resolutions will be proposed at the Annual General Meeting to re-appoint PricewaterhouseCoopers as auditor and to authorise the directors to determine the auditor's remuneration.

Personal Equity Plans and Individual Savings Accounts

The Company's corporate and single company PEPs are managed by Hendersons Administrators (Helpline tel: 020 7452 1357). The Company's ISA is managed by Lloyds TSB Registrars (Helpline tel: 0870 24 24 244).

Dematerialisation of shares

On 17 March 1997 the Company's shares became tradable in uncertificated form through CREST. Shareholders who wish neither to become members of CREST nor to transfer their holdings into nominee companies may continue to hold their shares and deal in them in certificated

form. Further information on the opportunities presented by and the effects of dematerialising shares can be obtained from CRESTCo Limited, Trinity Tower, 9 Thomas Moore Street, London E1 9YN.

By Order of the Board

Alan Smith

Secretary

28 September 1999

London NW11 8DS

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;
- 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.

Directors' emoluments and interests

Report on Directors' remuneration

The Committee of the Board referred to on page 31 determines the remuneration of executive directors including their annual bonus targets and grants of share options. Its constitution and practice accord with Section B of the Combined Code as defined in the Listing Rules of the London Stock Exchange (the Code).

The Committee seeks to maintain a competitive programme which enables the company to attract and retain the highest calibre of executive. The Committee consults with the Chief Executive, and has access to external remuneration consultants, which enables wide-ranging comparisons to be made. In framing its remuneration policy the Committee has given full consideration to Section B of the Code.

Salaries are reviewed annually. The Committee takes into account individual performance and experience, the size and nature of the job, the

relative performance of the Company, pay policy within the Company and the salary available in comparable companies. Benefits include a company car, pension, health insurance and, where appropriate, relocation expenses, generally in line with benefits available for executives in similar positions in other international aerospace and engineering companies.

Bonuses are based on successful performance and are only paid on the achievement of carefully considered targets which have been approved by the Board. All bonuses are capped. Under a deferred share scheme, established in 1992, senior executives may use their after-tax bonus to buy the Company's shares at the prevailing market price; if they retain those shares for three years they may exercise options over a matching number of shares for a nominal sum. Income tax is payable on the market value of the matching shares when the option is exercised. In October 1998 executive

directors participated in the scheme in respect of their 1998 bonus and were granted options over shares to the values listed in a table on page 38.

The remuneration of directors is set out in tables on pages 36 to 38.

The annual bonus and any gains under share option schemes are not pensionable. Company car benefits which are subject to income tax and for which a cash alternative is available are pensionable.

Pensions. Subject to Revenue limits a final salary scheme provides a pension of up to two thirds of final salary (including pensionable benefits). Where Revenue limits apply the difference between the pension payable on the cap and that payable on two thirds of final salary is, after taking into account any pension transfers, made good by the Company through a funded unapproved retirement benefit scheme. Details of pension provisions are set out in a table on page 37.

Directors' emoluments and interests continued

Contract terms. Three directors have two-year rolling contracts. The Committee considered it would be inequitable to reduce this term without compensation and, in any event, considers it to be in the best interests of the Company to maintain a degree of stability on the Board at a time when two executive directors are due to retire within the next 12 months. The Company's policy is to phase out two-year rolling contracts and new executive directors will be appointed on contracts which have an initial fixed term followed by a one-year rolling period of notice. The Committee accepts and will apply the principle of mitigation of damages on termination of a contract.

Non-executive directors were paid a total of £121,000 in fees in the year to 31 July 1999: 20% of their fees (after deduction of tax) is applied in the purchase of Company shares: they have no service contracts and are not eligible for bonuses or participation in share schemes and no pension contributions are made on their behalf.

The remuneration of the non-executive directors is determined by the Board within the limits set out in the Articles of Association.

Directors' interests in the Company's shares

The interests of directors in the issued share capital of the Company are set out in a table on page 37.

The executive share option scheme approved at the Annual General Meeting in 1995 covers approximately 250 executives. Awards are approved by the Committee. In awarding share options the Committee has regard to guidelines published by investor protection committees, the individual performance of participants and any evidence that the scheme has encouraged option holders to become shareholders. Options granted under the 1995 Scheme may only be exercised after three years if a performance requirement has been met: that requirement is that the increase in the total shareholder return of the Company, over a period of three years from the date of grant, must exceed the increase in total return achieved by the companies comprising the General Industrials Sector of the FTSE Actuaries Index over the same period.

The Save-As-You-Earn scheme which is open to all UK employees with 12 months' service is subject to UK legislation as to the amount which 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.

In the 52 weeks to 31 July 1999, executive directors exercised share options and at 31 July 1999 held unexercised options as described in a table on page 38.

There were no changes in the options held by directors between 31 July 1999 and 28 September 1999. The Register of Directors' Interests (which is open to inspection) contains full details of directors' shareholdings and options to subscribe for shares in the Company.

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 directors' breadth of knowledge and experience. Directors are permitted to retain fees associated with such appointments.

Remuneration

The total remuneration of directors, excluding defined benefit pension arrangements, is as follows:

| | 1999 £000 | 1998 £000 |
|--|--------------|--------------|
| Fees, including Chairman's additional remuneration | 188 | 123 |
| Salaries and benefits | 1,545 | 1,783 |
| Performance related bonuses | 562 | 832 |
| Gain from exercise of share options | 392 | 1,925 |
| Money purchase pension contributions | 215 | 193 |
| | 2,902 | 4,856 |

The emoluments of the directors are set out below:

| | Fees | | Salary | | Bonus | | Benefits | | Deferred share scheme contributions | | Money purchase pension contributions | | Total | |
|--|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|-------------------------------------|--------------|--------------------------------------|--------------|--------------|--------------|
| | 1999 £000 | 1998 £000 | 1999 £000 | 1998 £000 | 1999 £000 | 1998 £000 | 1999 £000 | 1998 £000 | 1999 £000 | 1998 £000 | 1999 £000 | 1998 £000 | 1999 £000 | 1998 £000 |
| Chairman | | | | | | | | | | | | | | |
| Sir Roger Hurn (retired 24.11.98.) | | | 39 | 405 | | 203 | 13 | 26 | | | | | 52 | 634 |
| K Orrell-Jones (from 24.11.98.) | 84 | | | | | | | | | | | | 84 | |
| Chief Executive | | | | | | | | | | | | | | |
| K O Butler-Wheelhouse | | | 430 | 385 | 172 | 193 | 17 | 21 | 115 | 80 | 215 | 193 | 949 | 872 |
| Executive Directors | | | | | | | | | | | | | | |
| N V Barber | | | 260 | 235 | 104 | 118 | 22 | 21 | | 50 | | | 386 | 424 |
| G M Kennedy | | | 245 | 235 | 98 | 118 | 17 | 22 | 70 | 25 | | | 430 | 400 |
| E Lindh | | | 245 | 200 | 98 | 100 | 17 | 16 | 66 | 36 | | | 426 | 352 |
| A M Thomson | | | 225 | 200 | 90 | 100 | 15 | 17 | 60 | 41 | | | 390 | 358 |
| Non-Executive Directors | | | | | | | | | | | | | | |
| P Hollins (appointed 9.2.99.) | 13 | | | | | | | | | | | | 13 | |
| R F Leverton | 25 | 25 | | | | | | | | | | | 25 | 25 |
| R W O'Leary | 25 | 23 | | | | | | | | | | | 25 | 23 |
| K Orrell-Jones (to 24.11.98.) | 8 | 25 | | | | | | | | | | | 8 | 25 |
| A I H Pink | 25 | 25 | | | | | | | | | | | 25 | 25 |
| Sir Peter Thompson (retired 24.11.98.) | 8 | 25 | | | | | | | | | | | 8 | 25 |
| | 188 | 123 | 1,444 | 1,660 | 562 | 832 | 101 | 123 | 311 | 232 | 215 | 193 | 2,821 | 3,163 |

The deferred share scheme amounts relate to the previous year's bonus.

The payments to Mr K Orrell-Jones comprise £25,000 director's fees and £67,000 special remuneration as Chairman.

The pension benefits earned by the executive directors were:

| | Age at 31 July 1999 | Directors' contributions during the year £000 | Additional pension earned during the year (excluding any increase for inflation) £000 | Accrued entitlement at 31 July 1999 £000 |
|-------------|------------------------|--|---|--|
| | | | | |
| N V Barber | 60 | 13 | 20 | 166 |
| G M Kennedy | 58 | 12 | 9 | 167 |
| E Lindh | 54 | 12 | 22 | 108 |
| A M Thomson | 52 | 11 | 16 | 81 |

An executive director's normal retirement age is 60. An early retirement pension, based on actual service completed, may be paid after age 50, 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 rate of 5% per annum compound or the annual increase in the Retail Price Index, if less. 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' beneficial interests in the Company's shares:

| | Ordinary shares of 25p | | | Ordinary shares of 25p | |
|-----------------------|------------------------|---------------|----------------|------------------------|---------------|
| | 31 July 1999 | 1 August 1998 | | 31 July 1999 | 1 August 1998 |
| N V Barber | 116,497 | 120,877 | R W O'Leary | 2,882 | 2,370 |
| K O Butler-Wheelhouse | 23,888 | 9,502 | K Orrell-Jones | 2,782 | 2,311 |
| P Hollins | 162 | 0* | A I H Pink | 1,724 | 1,311 |
| G M Kennedy | 73,672 | 52,890 | A M Thomson | 21,957 | 12,340 |
| R F Leverton | 2,355 | 1,911 | | | |
| E Lindh | 15,946 | 15,678 | | | |

*Indicates share interest at appointment on 9 February 1999.

The Company has not been notified of any changes to the beneficial holdings of the directors, their families and any connected persons between 31 July 1999 and 28 September 1999.

Directors' emoluments and interests continued

Directors' share options:

| | Scheme | Options held on | Options held on | Weighted average | Options exercised | | | Options granted | | | | |
|-----------------------|--------|-----------------|-----------------|------------------|-------------------|----------------|---------|-----------------|---------------|---------------|---------|----------------|
| | | 31 July 1999 | 1 August 1998 | | Exercise price | Date exercised | Number | Exercise price | Market price† | Date of grant | Number | Exercise price |
| K O Butler-Wheelhouse | B | 274,301 | 151,583 | 830.86p | | | | | 21/10/98 | 122,718 | 765.00p | 21/10/2008 |
| | C | 2,578 | 2,578 | 669.00p | | | | | | | | |
| | D | 23,443 | 9,429 | 0.10p | | | | | 17/11/98 | 14,014 | 0.10p | 17/10/2005 |
| N V Barber | B | 29,659 | 63,623 | 823.00p | 21/4/99 | 33,964 | 632.00p | 992.00p | | | | |
| | C | 2,729 | 2,729 | 632.00p | | | | | | | | |
| | D | 11,837 | 19,476 | 0.10p | 21/4/99 | 7,639 | 0.10p | 992.00p | | | | |
| G M Kennedy | B | 54,501 | 86,061 | 875.70p | 31/3/99 | 31,560 | 632.00p | 918.00p | | | | |
| | C | 3,312 | 6,941 | 430.20p | 14/7/99 | 3,629 | 248.00p | 847.00p | | | | |
| | D | 18,424 | 16,931 | 0.10p | 7/12/98 | 7,052 | 0.10p | 855.50p | 17/11/98 | 8,545 | 0.10p | 17/10/2005 |
| E Lindh | A | 16,851 | 16,851 | 451.00p | | | | | | | | |
| | B | 78,045 | 43,030 | 812.44p | | | | | 21/10/98 | 35,015 | 765.00p | 21/10/2008 |
| | C | 3,409 | 3,409 | 572.00p | | | | | | | | |
| | D | 23,140 | 15,140 | 0.10p | | | | | 17/11/98 | 8,000 | 0.10p | 17/10/2005 |
| A M Thomson | A | 62,500 | 62,500 | 480.00p | | | | | | | | |
| | B | 97,130 | 65,148 | 788.13p | | | | | 21/10/98 | 31,982 | 765.00p | 21/10/2008 |
| | C | 3,015 | 3,015 | 572.00p | | | | | | | | |
| | D | 17,581 | 12,245 | 0.10p | 7/12/98 | 1,936 | 0.10p | 855.50p | 17/11/98 | 7,272 | 0.10p | 17/10/2005 |

Key:

- A. The Smiths Industries (1984) Executive Share Option Scheme
- B. The Smiths Industries 1995 Executive Share Option Scheme
- C. The Smiths Industries 1982 SAYE Share Option Scheme
- D. The Smiths Industries Senior Executive Deferred Share Scheme

† Mid-market quotation from the London Stock Exchange Daily Official List or actual sale price if shares sold on date of acquisition.

Notes:

The high and low market prices of the ordinary shares during the period 2 August 1998 to 31 July 1999 were 1074p and 624p, respectively. The market price on 1 August 1998 was 711p and on 31 July 1999 was 869p.

All options held on 31 July 1999 were granted at exercise prices less than the market price on that date, except for options granted under the Smiths Industries 1995 Executive Share Option Scheme on 17 October 1997 (exercise price 934p per share).

No options lapsed during the period 2 August 1998 to 31 July 1999. No options have been granted or exercised or have lapsed between 31 July 1999 and 28 September 1999.

There are no performance criteria for The Smiths Industries (1984) Executive Share Option Scheme or The Smiths Industries Senior Executive Deferred Share Scheme apart from market price. The Smiths Industries 1995 Executive Share Option Scheme is subject to a performance criterion based on total shareholder return of the Company versus the total return of the General Industrials Sector of the FTSE Actuaries Index.

Deferred Share Scheme options were granted on 17 November 1998 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 1999, the deferred share scheme held 206,585 shares for the benefit of senior executives (including the directors as disclosed above). The market value of these shares at that date was £1.8m and dividends of approximately £43,728 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 2 August 1998 to 31 July 1999.

Full details of the directors' shareholdings and options are contained in the Register of Directors' Interests in Shares (which is open to inspection).

Auditors' report

To the members of Smiths Industries plc

We have audited the financial statements on pages 40 to 56 which have been prepared under the historical cost convention (as modified by the revaluation of certain fixed assets) and the accounting policies set out on page 56.

Respective responsibilities of directors and auditors

The directors are responsible for preparing the Annual Report, including as described on page 35 the financial statements. Our responsibilities, as independent auditors, are established by statute, the Auditing Practices Board, the Listing Rules of the London Stock Exchange and our profession's ethical guidance.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act. 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 or the Listing Rules regarding directors' remuneration and transactions is not disclosed.

We read the other information contained in the Annual Report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

We review whether the statement on page 31 reflects the Company's compliance with those provisions of the Combined Code specified for our review by the London Stock Exchange, and we report if it does not. We are not required to form an opinion on the effectiveness of the Company's or group's corporate governance procedures or its internal controls.

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. 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 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 1999 and of the profit and cash-flows of the group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers
Chartered Accountants and
Registered Auditors
London
28 September 1999

Consolidated profit and loss account

| | Note | Ordinary activities before goodwill amortisation £m | Goodwill amortisation £m | 52 weeks ended 31 July 1999 £m | 52 weeks ended 1 August 1998 £m |
|--|-------|--|-----------------------------|--------------------------------------|---------------------------------------|
| Turnover | | | | | |
| Continuing operations | | 1,290.4 | | 1,290.4 | 1,198.5 |
| Acquisitions | | 33.5 | | 33.5 | |
| | 1 & 2 | 1,323.9 | | 1,323.9 | 1,198.5 |
| Cost of sales | 3 | (762.8) | | (762.8) | (695.8) |
| Gross profit | | 561.1 | | 561.1 | 502.7 |
| Operating expenses | 4 | (313.6) | (3.0) | (316.6) | (278.5) |
| Operating profit | | | | | |
| Continuing operations | 5 | 243.7 | | 243.7 | 224.2 |
| Acquisitions | | 3.8 | (3.0) | 0.8 | |
| Profit on ordinary activities before interest | | 247.5 | (3.0) | 244.5 | 224.2 |
| Net interest | 6 | (7.0) | | (7.0) | (6.1) |
| Profit on ordinary activities before taxation | | 240.5 | (3.0) | 237.5 | 218.1 |
| Tax on profit | 8 | (74.0) | | (74.0) | (68.5) |
| Profit on ordinary activities after taxation | | 166.5 | (3.0) | 163.5 | 149.6 |
| Minority interests | | (0.3) | | (0.3) | (1.4) |
| Profit for the financial year | | 166.2 | (3.0) | 163.2 | 148.2 |
| Dividends | 9 | (67.9) | | (67.9) | (60.8) |
| Retained profit for the year | | 98.3 | (3.0) | 95.3 | 87.4 |
| Earnings per share | 10 | | | | |
| Basic | | 53.5p | (1.0p) | 52.5p | 48.2p |
| Fully-diluted | | 53.0p | (1.0p) | 52.0p | 47.8p |

Statement of total recognised gains and losses

| | 1999 £m | 1998 £m |
|--|--------------|------------|
| Profit for the financial year attributable to shareholders | 163.2 | 148.2 |
| Exchange adjustments | 4.4 | (1.5) |
| | 167.6 | 146.7 |

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 43 to 55 form part of these accounts.

Balance sheets

| | Note | Consolidated | | Company | |
|---|------|--------------------|---------------------|--------------------|---------------------|
| | | 31 July 1999 £m | 1 August 1998 £m | 31 July 1999 £m | 1 August 1998 £m |
| Fixed assets | | | | | |
| Intangible assets | 13 | 91.5 | | 48.3 | 46.2 |
| Tangible assets | 14 | 231.5 | 211.2 | 48.3 | 46.2 |
| Investments and advances | 16 | 0.2 | 4.2 | 582.3 | 481.8 |
| | | 323.2 | 215.4 | 630.6 | 528.0 |
| Current assets | | | | | |
| Stocks | 17 | 203.9 | 187.0 | 37.4 | 33.6 |
| Debtors | 18 | 351.3 | 310.8 | 104.0 | 102.4 |
| Cash at bank and on deposit | | 93.4 | 96.9 | 47.6 | 62.5 |
| | | 648.6 | 594.7 | 189.0 | 198.5 |
| Creditors: amounts falling due within one year | 20 | (446.1) | (408.9) | (216.8) | (171.7) |
| Net current assets/(liabilities) | | 202.5 | 185.8 | (27.8) | 26.8 |
| Total assets less current liabilities | | | | | |
| | | 525.7 | 401.2 | 602.8 | 554.8 |
| Creditors: amounts falling due after more than one year | 20 | (99.2) | (99.4) | (26.3) | (13.3) |
| Provisions for liabilities and charges | 24 | (68.0) | (75.4) | (16.5) | (20.1) |
| Net assets | | 358.5 | 226.4 | 560.0 | 521.4 |
| Capital and reserves | | | | | |
| Called up share capital | 26 | 78.4 | 77.2 | 78.4 | 77.2 |
| Share premium account | 27 | 91.1 | 57.2 | 91.1 | 57.2 |
| Revaluation reserve | 27 | 3.3 | 3.3 | 0.6 | 0.6 |
| Other reserves | 27 | | | 180.5 | 182.1 |
| Profit and loss account | 27 | 179.5 | 84.0 | 209.4 | 204.3 |
| Shareholders' equity | 28 | 352.3 | 221.7 | 560.0 | 521.4 |
| Minority equity interests | | 6.2 | 4.7 | | |
| Capital employed | | 358.5 | 226.4 | 560.0 | 521.4 |

The accounts on pages 40 to 56 were approved by the Board of directors on 28 September 1999 and were signed on its behalf by:



Keith Orrell-Jones



Alan M Thomson

Cash-flow statement

| | Note | 52 weeks ended 31 July 1999 £m | 52 weeks ended 1 August 1998 £m |
|--|------|--------------------------------------|---------------------------------------|
| Net cash inflow from operating activities (see below) | | 243.4 | 240.5 |
| Returns on investments and servicing of finance: | | | |
| Interest received | | 7.5 | 4.6 |
| Interest paid | | (15.6) | (10.7) |
| Net cash outflow from returns on investments and servicing of finance | | (8.1) | (6.1) |
| Tax paid | | (70.4) | (65.4) |
| Capital expenditure: | | | |
| Purchase of fixed assets | | (50.4) | (42.1) |
| Sale of fixed assets | | 2.0 | 5.2 |
| Net cash outflow for capital expenditure | | (48.4) | (36.9) |
| Acquisitions and disposals: | | | |
| Purchase of businesses | 25 | (98.1) | (152.3) |
| Bank overdrafts assumed | | | (1.9) |
| Disposal of businesses | 25 | (0.6) | 36.7 |
| Net cash outflow for acquisitions and disposals | | (98.7) | (117.5) |
| Equity dividends paid | | (37.0) | (52.5) |
| Net cash outflow before financing | | (19.2) | (37.9) |
| Management of liquid resources: | | | |
| Reduction in short-term deposits | | 6.2 | 40.6 |
| Financing: | | | |
| Increase in term borrowings | | 53.5 | 13.8 |
| Loan note redemptions | | (19.0) | (5.9) |
| Share issues | | 9.1 | 7.6 |
| Increase in cash | | 30.6 | 18.2 |
| Reconciliation to net debt | | | |
| Net cash inflow | | 30.6 | 18.2 |
| Reduction in short-term deposits | | (6.2) | (40.6) |
| Increase in term borrowings | | (53.5) | (13.8) |
| Loan notes redeemed, less issued | | 19.0 | 1.8 |
| Term debt of acquisitions assumed | 25 | (3.0) | (10.1) |
| Term deposits of acquisitions assumed | 25 | 8.0 | |
| Exchange variation | | (5.5) | 3.7 |
| Increase in net debt | | (10.6) | (40.8) |
| Net debt at 2 August 1998 | | (82.8) | (42.0) |
| Net debt at 31 July 1999 | 21 | (93.4) | (82.8) |
| Reconciliation of operating profit to net cash inflow from operating activities | | | |
| Operating profit | | 244.5 | 224.2 |
| Goodwill amortisation | | 3.0 | |
| Depreciation | | 35.6 | 32.2 |
| Increase in stocks | | (2.6) | (11.7) |
| Increase in debtors | | (28.1) | (13.4) |
| (Decrease)/increase in creditors | | (9.0) | 9.2 |
| | | 243.4 | 240.5 |

Notes on pages 43 to 55 form part of these accounts.

Notes to the accounts

| | Turnover | | Profit | | Assets | |
|--|-------------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| | 1999 £m | 1998 £m | 1999 £m | 1998 £m | 1999 £m | 1998 £m |
| 1 Analyses of turnover, profit and assets | | | | | | |
| Market | | | | | | |
| Aerospace | 528.5 | 463.0 | 98.5 | 77.0 | 103.1 | 63.5 |
| Medical Systems | 376.2 | 344.4 | 76.0 | 74.7 | 198.4 | 130.9 |
| Industrial | 419.2 | 391.1 | 73.0 | 72.5 | 144.2 | 110.1 |
| | 1,323.9 | 1,198.5 | 247.5 | 224.2 | 445.7 | 304.5 |
| Goodwill amortisation | | | | | | |
| Aerospace | | | (1.0) | | | |
| Medical Systems | | | (1.1) | | | |
| Industrial | | | (0.9) | | | |
| | | | 244.5 | 224.2 | 445.7 | 304.5 |
| Net interest/net borrowings | | | (7.0) | (6.1) | (93.4) | (82.8) |
| Profit before tax/net assets | | | 237.5 | 218.1 | 352.3 | 221.7 |
| Geographical origin | | | | | | |
| United Kingdom | 603.6 | 556.3 | 101.9 | 102.6 | 123.1 | 108.2 |
| USA | 612.2 | 535.5 | 124.3 | 100.8 | 248.7 | 140.1 |
| <i>US dollars</i> | \$1,004.0m | <i>\$883.5m</i> | \$203.9m | <i>\$166.3m</i> | \$402.9m | <i>\$229.8m</i> |
| Europe | 135.0 | 124.4 | 14.3 | 13.1 | 36.9 | 27.8 |
| Other overseas | 76.5 | 71.6 | 7.0 | 7.7 | 37.0 | 28.4 |
| Inter-company | (103.4) | (89.3) | | | | |
| | 1,323.9 | 1,198.5 | 247.5 | 224.2 | 445.7 | 304.5 |
| Goodwill amortisation | | | | | | |
| United Kingdom | | | (0.4) | | | |
| USA | | | (2.6) | | | |
| | | | 244.5 | 224.2 | 445.7 | 304.5 |
| The above segmental analyses include the following contributions from acquisitions made during the year: | | | | | | |
| Market | | | | | | |
| Aerospace | 11.7 | | (0.9) | | | |
| Medical Systems | 12.7 | | 2.9 | | | |
| Industrial | 9.1 | | 1.8 | | | |
| | 33.5 | | 3.8 | | | |
| Goodwill amortisation | | | | | | |
| Aerospace | | | (1.0) | | | |
| Medical Systems | | | (1.1) | | | |
| Industrial | | | (0.9) | | | |
| | | | 0.8 | | | |
| Geographical origin | | | | | | |
| United Kingdom | 2.5 | | (0.3) | | | |
| USA | 29.8 | | 4.0 | | | |
| Europe | 1.2 | | 0.1 | | | |
| | 33.5 | | 3.8 | | | |
| Goodwill amortisation | | | | | | |
| United Kingdom | | | (0.4) | | | |
| USA | | | (2.6) | | | |
| | | | 0.8 | | | |
| 2 Analysis of turnover by destination | | | | | | |
| | | | | | 1999 £m | 1998 £m |
| United Kingdom | | | | | 313.2 | 288.6 |
| USA | | | | | 598.7 | 533.7 |
| Europe | | | | | 237.6 | 210.9 |
| Japan | | | | | 66.9 | 63.8 |
| Other overseas | | | | | 107.5 | 101.5 |
| | | | | | 1,323.9 | 1,198.5 |

Notes to the accounts continued

3 Cost of sales

Cost of sales of £762.8m includes £17.7m in respect of acquisitions made during the year.

| 4 Operating expenses | 1999 £m | 1998 £m |
|--------------------------|--------------|------------|
| Continuing operations: | | |
| Distribution costs | 141.0 | 114.2 |
| Administrative expenses | 160.6 | 142.2 |
| | 301.6 | 256.4 |
| Acquisitions: | | |
| Distribution costs | 6.5 | 9.6 |
| Administrative expenses | 5.5 | 12.5 |
| Goodwill amortisation | 3.0 | |
| | 15.0 | 22.1 |
| Total operating expenses | 316.6 | 278.5 |

5 Operating profit is after charging

| | 1999 £m | 1998 £m |
|--|------------|------------|
| Goodwill amortisation | 3.0 | |
| Depreciation of fixed assets | 35.6 | 32.2 |
| Research and development expenditure | 53.9 | 48.8 |
| Operating leases – Land and buildings | 9.0 | 5.9 |
| – Others | 4.0 | 2.6 |
| Auditors – Audit fees: Parent company | 0.1 | 0.1 |
| Other | 1.2 | 1.1 |
| – Other fees: Acquisitions and disposals | 0.5 | 1.3 |
| Other | 0.2 | 0.2 |
| Restructuring and redundancy costs | 0.4 | 14.2 |
| Year 2000 related expenditure | 1.7 | 1.3 |

Other fees totalling £0.7m paid to the auditors include £0.5m charged to goodwill. Of the £0.7m, £0.1m (1998 £1.2m) was incurred in respect of the UK.

6 Net interest

| | 1999 £m | 1998 £m |
|--|--------------|------------|
| Receivable | 7.5 | 4.1 |
| Payable: | | |
| Bank loans and overdrafts repayable within 5 years | (8.5) | (3.6) |
| Other loans repayable within 5 years | (6.0) | (6.5) |
| Other loans repayable in more than 5 years | | (0.1) |
| | (7.0) | (6.1) |

7 Profit attributable to the parent company

Profits for the financial year of £74.7m (1998 £29.0m) were recorded in the accounts of Smiths Industries plc. The directors have taken advantage of the exemption afforded by s230 of the Companies Act 1985 not to present a separate profit and loss account for the parent company.

8 Taxation

| | 1999 £m | 1998 £m |
|---|-------------|------------|
| Taxation on the profit for the year: | | |
| UK corporation tax at 30.67% (1998 – 31%) | 37.1 | 35.0 |
| Double taxation relief | (3.2) | (0.4) |
| Deferred taxation | 2.8 | 0.5 |
| Overseas taxation | 37.3 | 33.4 |
| | 74.0 | 68.5 |

| 9 Dividends | 1999 | 1998 |
|---|-------------|------|
| | £m | £m |
| Ordinary interim paid 7.4p per share (1998 6.75p) | 23.1 | 20.8 |
| Ordinary final proposed 14.25p per share (1998 12.9p) | 44.8 | 40.0 |
| | 67.9 | 60.8 |

As stated in note 27, scrip dividends amounting to £26.0m were taken up from the 1997/8 final and 1998/9 interim dividends.

| 10 Earnings per share | 1999 | 1998 |
|--|--------------------|-------------|
| Separate figures are given for earnings per share related to the weighted average number of shares in issue: | | |
| Basic | 310,932,199 | 307,320,126 |
| Effect of dilutive share options | 2,558,478 | 2,826,778 |
| Fully-diluted | 313,490,677 | 310,146,904 |

11 Post-retirement benefits

Smiths Industries operates a number of pension schemes throughout the world. The major schemes are located in the UK and USA and are of the defined benefit type, with assets held in separate trustee-administered funds.

Contributions to these schemes are made on the advice of independent qualified actuaries, using in the UK the Projected Unit method and in the USA the Entry Age Normal method. The aim is for the benefits to be fully funded during the scheme members' working lives.

In both countries the regular pension cost is assessed using the Projected Unit method. The latest actuarial assessments were as at 31 March 1998 for the UK and 31 July 1998 for the USA for the major schemes.

At these dates the market value of the defined benefit schemes' assets was £729m for the UK and \$273m for the USA. The aggregate funding levels of the principal schemes were 125% for the UK and 119% for the USA. The funding levels were determined by comparing the market value of the funds' assets with the value of benefits accrued to date. Allowance is made for future annual salary increases at approximately 5% and, for the UK schemes, for pension increases of approximately 3%. The future investment return assumed in assessing the present value of future benefits was 6% p.a. for UK pensioner liabilities and 7% p.a. for UK active member liabilities and 7% p.a. for the USA. The investment return assumptions were derived from prevailing yields on government stocks.

The regular pension cost is assessed at each actuarial valuation and applied until the next valuation. The variation from regular pension cost, which recognises the excess of assets over liabilities of the pension schemes, is spread over the average remaining working life of relevant employees, generally between 10 and 15 years.

A prepayment of £35.7m is included in debtors, this being the excess of the amount funded over the accumulated pension cost.

The pension costs of other countries' schemes were assessed in accordance with local practice. The Company operates a defined contribution (401K) plan for its USA employees, and provides post-retirement healthcare benefit plans, principally at Grand Rapids in the USA. The cost of the post-retirement healthcare benefits is assessed by independent qualified actuaries and is fully accrued (see note 24). The major assumptions used are interest rate 7.25% p.a. and medical cost inflation 7% p.a., ultimately reducing to 5% p.a.

| 12 Employees | 1999 | 1998 |
|---|---------------|--------|
| | £m | £m |
| Staff costs during the year: | | |
| Wages and salaries | 334.8 | 306.6 |
| Social Security | 32.3 | 29.8 |
| Company pension costs | 4.9 | 3.7 |
| | 372.0 | 340.1 |
| The average number of persons employed was: | 1999 | 1998 |
| Aerospace | 5,248 | 5,055 |
| Medical Systems | 4,332 | 4,095 |
| Industrial | 4,888 | 4,723 |
| | 14,468 | 13,873 |

Details of directors' remuneration are given on pages 36 to 38.

Notes to the accounts continued

| 13 Intangible fixed assets | 1999 £m |
|--|--------------------|
| Goodwill: | |
| Acquired during the year | 94.5 |
| Amortisation charged to operating profit | (3.0) |
| Net book value at 31 July 1999 | 91.5 |

| 14 Tangible fixed assets | Land and buildings | Plant and machinery | Fixtures, fittings, tools and equipment | Total |
|---------------------------------|-------------------------------|--------------------------------|--|--------------|
| | £m | £m | £m | £m |
| Consolidated | | | | |
| Cost or valuation | | | | |
| At 2 August 1998 | 128.5 | 166.5 | 203.0 | 498.0 |
| Exchange adjustments | 1.9 | 1.0 | 1.2 | 4.1 |
| Additions | 7.3 | 15.0 | 28.1 | 50.4 |
| Acquisitions | 2.9 | 3.7 | 2.7 | 9.3 |
| Disposals | (0.5) | (7.0) | (11.0) | (18.5) |
| At 31 July 1999 | 140.1 | 179.2 | 224.0 | 543.3 |
| Depreciation | | | | |
| At 2 August 1998 | 28.6 | 115.3 | 142.9 | 286.8 |
| Exchange adjustments | 0.4 | 0.7 | 0.8 | 1.9 |
| Charge for the year | 3.6 | 11.6 | 20.4 | 35.6 |
| Acquisitions | 0.5 | 2.5 | 2.0 | 5.0 |
| Eliminated on disposals | (0.3) | (6.6) | (10.6) | (17.5) |
| At 31 July 1999 | 32.8 | 123.5 | 155.5 | 311.8 |
| Net book value | | | | |
| At 31 July 1999 | 107.3 | 55.7 | 68.5 | 231.5 |
| At 2 August 1998 | 99.9 | 51.2 | 60.1 | 211.2 |
| Company | | | | |
| Cost or valuation | | | | |
| At 2 August 1998 | 29.3 | 7.7 | 64.0 | 101.0 |
| Additions | 1.0 | 1.0 | 6.8 | 8.8 |
| Transfers | | 6.4 | 0.4 | 6.8 |
| Disposals | (0.1) | (0.4) | (2.7) | (3.2) |
| At 31 July 1999 | 30.2 | 14.7 | 68.5 | 113.4 |
| Depreciation | | | | |
| At 2 August 1998 | 2.3 | 5.5 | 47.0 | 54.8 |
| Transfers | | 5.2 | 0.3 | 5.5 |
| Charge for the year | 0.4 | 0.7 | 6.2 | 7.3 |
| Eliminated on disposals | | (0.3) | (2.2) | (2.5) |
| At 31 July 1999 | 2.7 | 11.1 | 51.3 | 65.1 |
| Net book value | | | | |
| At 31 July 1999 | 27.5 | 3.6 | 17.2 | 48.3 |
| At 2 August 1998 | 27.0 | 2.2 | 17.0 | 46.2 |

| | Consolidated | | Company | |
|---|--------------|------------|-------------|------------|
| | 1999 £m | 1998 £m | 1999 £m | 1998 £m |
| 14 Tangible fixed assets continued | | | | |
| Land and buildings | | | | |
| Cost | 132.8 | 121.2 | 29.6 | 28.7 |
| Valuation 1974 | 7.3 | 7.3 | 0.6 | 0.6 |
| | 140.1 | 128.5 | 30.2 | 29.3 |
| Freehold | 126.9 | 119.1 | 30.0 | 29.3 |
| Long leasehold (in excess of 50 years unexpired) | 4.4 | 4.2 | 0.2 | |
| Short leasehold | 8.8 | 5.2 | | |
| | 140.1 | 128.5 | 30.2 | 29.3 |
| If land and buildings had not been revalued they would have been included at the following amounts: | | | | |
| Cost | 136.1 | 124.5 | 29.6 | 28.7 |
| Aggregate depreciation | 32.0 | 27.9 | 2.7 | 2.3 |

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, and the directors do not intend to adopt a policy of annual revaluations in the future. A quinquennial external revaluation of the Company's properties as at 31 July 1999 has produced a surplus of £21.2m over book value, as noted in the Directors' Report on page 30.

| | 1999 £m | 1998 £m |
|---|------------|------------|
| 15 Capital commitments | | |
| Estimated commitments not included in the accounts: | | |
| Company | 2.1 | 3.5 |
| Subsidiaries | 4.3 | 4.3 |
| | 6.4 | 7.8 |

| | Consolidated | | Company | |
|------------------------------------|--------------|------------|----------------|------------|
| | 1999 £m | 1998 £m | 1999 £m | 1998 £m |
| 16 Investments and advances | | | | |
| At cost less amounts written off: | | | | |
| Subsidiary companies | | | 582.3 | 481.8 |
| Assets held for resale | | 4.0 | | |
| Unlisted investments | 0.2 | 0.2 | | |
| | 0.2 | 4.2 | 582.3 | 481.8 |
| Investments in subsidiaries: | | | | |
| Shares at cost | | | 553.1 | 589.0 |
| Due from subsidiaries | | | 200.4 | 73.3 |
| | | | 753.5 | 662.3 |
| Due to subsidiaries | | | (171.2) | (180.5) |
| | | | 582.3 | 481.8 |

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

England

Smiths Industries Aerospace & Defence Systems Limited*
Graseby Dynamics Limited
SIMS Portex Limited*
SIMS Graseby Limited
Eschmann Bros & Walsh Limited*
Smiths Industries Industrial Group Limited*
Air Movement (Holdings) Limited*

Europe

SIMS Deltec Graseby Vertriebs GmbH (Germany)
FRB Connectron SA (France)
Interconnectron GmbH (Germany)
Flexiplas SA (Spain)

USA

Smiths Industries, Inc.*
Smiths Industries Aerospace & Defense Systems, Inc.
SIMS Portex, Inc.
SIMS Deltec, Inc.
SIMS BCI, Inc.
SIMS Level 1, Inc.
Flexible Technologies, Inc.
Tutco, Inc.
Hypertronics Corporation
Icore International, Inc.
PolyPhaser Corporation
Transtector Systems, Inc.

Japan

Japan Medico Co. Limited (62%)

All subsidiaries marked * are 100% owned by the Company direct. The others are 100% owned through intermediate holding companies, with the exception of Japan Medico, which is 62% owned by the Company. Shareholdings are of ordinary shares, ordinary stock units or common stock. All subsidiaries operate in their country of incorporation.

Notes to the accounts continued

| | Consolidated | | Company | |
|-------------------------------|--------------|------------|------------|------------|
| | 1999 £m | 1998 £m | 1999 £m | 1998 £m |
| 17 Stocks | | | | |
| Stocks comprise: | | | | |
| Raw materials and consumables | 66.2 | 61.4 | 3.2 | 1.9 |
| Work in progress | 67.5 | 61.0 | 31.4 | 25.2 |
| Finished goods | 83.5 | 71.5 | 12.8 | 9.9 |
| | 217.2 | 193.9 | 47.4 | 37.0 |
| Less: Payments on account | (13.3) | (6.9) | (10.0) | (3.4) |
| | 203.9 | 187.0 | 37.4 | 33.6 |

| | Consolidated | | Company | |
|--|--------------|------------|------------|------------|
| | 1999 £m | 1998 £m | 1999 £m | 1998 £m |
| 18 Debtors | | | | |
| Amounts falling due within one year: | | | | |
| Trade debtors | 247.2 | 223.7 | 51.1 | 51.0 |
| Amounts recoverable on contracts | 29.6 | 13.5 | 6.9 | 4.0 |
| Amounts owed by subsidiaries | | | 2.8 | 5.3 |
| Other debtors | 5.4 | 6.2 | 1.6 | 1.4 |
| Prepayments and accrued income | 14.6 | 12.7 | 5.9 | 5.6 |
| | 296.8 | 256.1 | 68.3 | 67.3 |
| Amounts falling due after more than one year: | | | | |
| Other debtors | 5.4 | 4.9 | | |
| Deferred taxation (note 19) | 13.4 | 13.1 | | 3.6 |
| Pensions prepayment | 35.7 | 36.7 | 35.7 | 31.5 |
| | 351.3 | 310.8 | 104.0 | 102.4 |

The comparative figures for 1998 have been restated to include deferred taxation transferred from Provisions for Liabilities and Charges.

| | Consolidated | | | | Company | |
|---|----------------------|------------|------------|------------|------------|------------|
| | Full provision basis | | Provided | | 1999 £m | 1998 £m |
| | 1999 £m | 1998 £m | 1999 £m | 1998 £m | | |
| 19 Deferred taxation | | | | | | |
| Deferred taxation: | | | | | | |
| Accelerated capital allowances | (10.1) | (9.9) | (10.1) | (9.9) | (5.4) | (5.4) |
| Advance corporation tax | | 10.0 | | 10.0 | | 10.0 |
| Post-retirement benefits | 9.3 | 9.6 | 9.3 | 9.6 | | |
| Short-term and other timing differences | 25.3 | 12.3 | 14.2 | 3.4 | 1.1 | (1.0) |
| Deferred tax asset/(liability) | 24.5 | 22.0 | 13.4 | 13.1 | (4.3) | 3.6 |
| | | | £m | £m | £m | £m |
| Movements during the year: | | | | | | |
| At 2 August 1998 | | | 13.1 | 14.7 | 3.6 | 4.3 |
| Exchange adjustments | | | (1.0) | 0.1 | | |
| Acquisitions | | | 3.7 | 0.7 | | |
| Charge for the year | | | (2.8) | (0.5) | (1.2) | 1.1 |
| Other | | | 0.4 | (1.9) | (6.7) | (1.8) |
| At 31 July 1999 | | | 13.4 | 13.1 | (4.3) | 3.6 |

No provision has been made for potential taxation which could arise on the remittance to the United Kingdom of retained overseas earnings, as no remittances are envisaged in the foreseeable future which could give rise to a material liability. There are no material unprovided deferred tax liabilities of the Company.

| | Consolidated | | Company | |
|--|--------------|------------|------------|------------|
| | 1999 £m | 1998 £m | 1999 £m | 1998 £m |
| 20 Creditors | | | | |
| Amounts falling due within one year: | | | | |
| Bank loans and overdrafts | 112.1 | 82.6 | 61.9 | 0.9 |
| Floating rate loan notes | 4.6 | 23.2 | 4.6 | 23.2 |
| Other loan notes | 3.6 | 3.3 | | |
| | 120.3 | 109.1 | 66.5 | 24.1 |
| Trade creditors | 86.2 | 77.5 | 20.0 | 16.3 |
| Bills of exchange payable | 1.3 | 1.7 | | |
| Amounts owed to subsidiaries | | | 4.6 | 1.9 |
| Other creditors | 16.2 | 19.8 | 3.5 | 10.5 |
| Proposed dividend | 44.8 | 40.0 | 44.8 | 40.0 |
| Corporate taxation | 36.1 | 32.6 | 20.1 | 20.3 |
| Other taxation and social security costs | 9.2 | 9.7 | 0.7 | 2.7 |
| Accruals and deferred income | 132.0 | 118.5 | 56.6 | 55.9 |
| | 446.1 | 408.9 | 216.8 | 171.7 |
| Amounts falling due after more than one year: | | | | |
| 8.34% Senior Notes 2002 | 61.7 | 61.0 | | |
| Floating rate loan notes | 4.6 | 4.8 | 4.6 | 4.8 |
| Other loan notes | 0.2 | 0.7 | | |
| Bank loans | | 4.1 | | |
| Deferred taxation (note 19) | | | 4.3 | |
| | 66.5 | 70.6 | 8.9 | 4.8 |
| Other creditors | 32.7 | 28.8 | 17.4 | 8.5 |
| | 99.2 | 99.4 | 26.3 | 13.3 |

21 Borrowings and net debt

Short-term debtors and creditors have been excluded from all the following disclosures, other than the currency risk disclosures.

| | Fixed borrowings | | | Floating borrowings £m | Total 1999 £m | Total 1998 £m |
|--------------------------|------------------|-------------|--------------|---------------------------|------------------|------------------|
| | Weighted average | | Amount £m | | | |
| | Interest rate | Years fixed | | | | |
| Currencies: | | | | | | |
| Sterling | 9.20% | 1 | 3.8 | 9.2 | 13.0 | 32.9 |
| US Dollar | 8.34% | 3 | 15.4 | 117.2 | 132.6 | 93.0 |
| EMU participants | | | | 7.5 | 7.5 | 9.9 |
| Japanese Yen | | | | 33.3 | 33.3 | 42.3 |
| Other | | | | 0.4 | 0.4 | 1.6 |
| | | | 19.2 | 167.6 | 186.8 | 179.7 |
| Cash and deposits | | | | | 93.4 | 96.9 |
| Net debt | | | | | 93.4 | 82.8 |
| Maturity: | | | | | | |
| On demand/under one year | | | 3.6 | 116.7 | 120.3 | 109.1 |
| One to two years | | | 0.2 | 2.1 | 2.3 | 5.3 |
| Two to five years | | | 15.4 | 48.8 | 64.2 | 64.6 |
| Over five years | | | | | | 0.7 |
| | | | 19.2 | 167.6 | 186.8 | 179.7 |

21 Borrowings and net debt continued

The floating-rate borrowings are related to LIBOR in the UK, to LIBOR and bank funding rates in the USA, and to LIBOR and bank base rates in Japan. Borrowings in continental Europe are based on the banks' overdraft rates.

The borrowings of all non-UK operations are in local currencies.

The medium-term borrowings are principally an issue of US\$100m Senior Notes maturing in 2002. Interest rate swaps cause the effective interest rate to be 6.2% variable on US\$75m, and 8.34% fixed on the remainder.

Cash and deposits comprise sterling and foreign currency deposits placed principally on the London money markets at call, 7-day and monthly rates on fixed interest bases. The Sterling deposits of £63m were yielding a weighted average interest rate of 5.1% and the foreign currency deposits (including US dollars totalling £3m) 3.5% as at 31 July 1999.

| | Borrowings | | | Net debt £m |
|---|----------------------------|-------------------------|------------------------|----------------|
| | Cash and deposits £m | Under one year £m | Over one year £m | |
| Reconciliation of movement in net debt | | | | |
| As at 2 August 1998 | 96.9 | (109.1) | (70.6) | (82.8) |
| Net cash (outflow)/inflow | (5.4) | 36.0 | | 30.6 |
| Deposits/(debt) acquired with subsidiaries | 8.0 | (3.0) | | 5.0 |
| Other movements in cash/borrowings | (6.2) | (39.3) | 4.8 | (40.7) |
| Exchange variation | 0.1 | (4.9) | (0.7) | (5.5) |
| As at 31 July 1999 | 93.4 | (120.3) | (66.5) | (93.4) |

Borrowing facilities

The Company has no committed borrowing facilities at 31 July 1999, although as noted in the Financial Review, the Company has a number of uncommitted facilities and overdraft lines.

22 Financial instruments

Fair values of financial assets and liabilities

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 price 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.

| | 1999 | 1999 | 1998 | 1998 |
|---|------------------|------------------|------------------|------------------|
| | Book value £m | Fair value £m | Book value £m | Fair value £m |
| Cash | 93.4 | 93.4 | 96.9 | 96.9 |
| Borrowings: hedge against Yen income | (15.4) | (17.7) | (23.2) | (21.7) |
| other short-term | (104.9) | (104.9) | (85.9) | (85.9) |
| long-term element | (66.5) | (69.5) | (70.6) | (74.7) |
| Net debt – book value/fair value | (93.4) | (98.7) | (82.8) | (85.4) |
| Derivative financial instruments: | | | | |
| Interest rate swaps | | 2.0 | | 2.9 |
| Currency swaps | (3.6) | (4.5) | | |
| Forward currency contracts | | (0.5) | | |
| Net financial liabilities – book value/fair value | (97.0) | (101.7) | (82.8) | (82.5) |

As described in the Financial Review, the Company's policy is to hedge all material contractually committed future sales using forward exchange contracts and currency options.

Sales under a supply contract to our subsidiary Japan Medico continue to be covered by borrowing against the contract in Yen. The proceeds are converted to Sterling such that the income from supplies to Japan Medico for the year to 31 July 2000 is fully hedged.

A currency swap was entered into by the Company during the year to hedge the foreign currency exposure arising on intercompany finance.

The premium received on the contract is being treated as deferred income and released evenly over the life of the contract.

The transactions to which the forward currency contracts relate are mainly expected to occur in 2000 and 2001.

22 Financial instruments continued

Currency exposures

The extent to which the Company has monetary assets and liabilities in currencies other than in their local currency has been examined. Taking into account the effect of forward contracts and other derivative instruments, the Company had no material financial exposure to foreign exchange gains or losses on monetary assets and monetary liabilities denominated in foreign currencies at 31 July 1999.

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.

Hedges

As explained in the operating and financial review, the Company's policy is to hedge against exposure to movements in interest rates and exchange rates.

The table below shows the extent to which the Company has unrecognised gains and losses in respect of hedges at the beginning and end of the year.

| | £m |
|---|--------------|
| Net gains/(losses) on hedges at 2 August 1998 | 0.3 |
| Net gains/(losses) arising in previous years included in 1999 income | |
| Net gains/(losses) not included in 1999 income arising before 1 August 1999 | 0.3 |
| Losses arising in 1999 | (5.0) |
| Losses on hedges at 31 July 1999 | (4.7) |
| Of which: | |
| Losses expected to be included in 2000 income | (0.5) |
| Losses expected to be included in 2001 income or later | (4.2) |

All the gains and losses on the hedging 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.

23 Operating lease commitments

At 31 July 1999 the Company had annual commitments under non-cancellable operating leases as follows:

| | Land & Buildings £m | Others £m |
|-------------------------------------|------------------------|--------------|
| Expiring in less than one year | 1.2 | 0.4 |
| Expiring between one and five years | 5.8 | 1.0 |
| Expiring after five years | 5.0 | |
| | 12.0 | 1.4 |

Notes to the accounts continued

| 24 Provisions for liabilities and charges | At 2.8.98 £m | Exchange adjustments £m | Profit and loss account | | Acquisitions £m | Utilisation £m | At 31.7.99 £m |
|---|-----------------|-------------------------------|-------------------------|----------------|--------------------|-------------------|------------------|
| | | | Provisions £m | Releases £m | | | |
| Consolidated | | | | | | | |
| Post-retirement healthcare | 27.2 | 0.3 | 1.1 | | | (2.1) | 26.5 |
| Service guarantees & product liability | 14.9 | 0.1 | 7.2 | (1.2) | 0.5 | (7.5) | 14.0 |
| Reorganisation | 17.5 | | 4.5 | (4.1) | | (8.6) | 9.3 |
| Property | 12.4 | 0.1 | 1.1 | (1.0) | 2.3 | (2.2) | 12.7 |
| Litigation | 3.4 | 0.1 | 1.6 | | 0.9 | (0.5) | 5.5 |
| | 75.4 | 0.6 | 15.5 | (6.3) | 3.7 | (20.9) | 68.0 |
| Company | | | | | | | |
| Post-retirement healthcare | 2.8 | | | | | | 2.8 |
| Service guarantees & product liability | 5.8 | | 2.9 | (0.4) | 0.1 | (3.9) | 4.5 |
| Reorganisation | 6.5 | | 0.2 | | | (2.8) | 3.9 |
| Property | 3.8 | | 0.3 | (0.3) | | (0.1) | 3.7 |
| Litigation | 1.2 | | 0.8 | | | (0.4) | 1.6 |
| | 20.1 | | 4.2 | (0.7) | 0.1 | (7.2) | 16.5 |

Post-retirement healthcare

The Company has contractual commitments to provide private healthcare after retirement to a significant number of employees, mostly in the USA. The annual charge against profits and the amount of the provision carried forward are based on actuarial assessments of the Company's discounted future obligations.

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 Industrial, have been undergoing a phased restructuring programme over the past three years. Full provision is made for schemes approved and committed by the end of each financial year. This year's balance relates mainly to the Aerospace sites at Cheltenham and in the USA, together with a number of Industrial businesses in the UK and Europe.

Property

As stated in the Accounting Policies on page 56, where a property is vacant, or sub-let under terms such that the rental income is insufficient to meet all outgoings, the Company provides for the anticipated 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.

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 anticipated fees and associated costs, based on professional advice as to the likely duration of each case.

Company provisions

The Parent Company's opening balances have been restated to recognise certain provisions previously included in creditors, but which more properly fall within the definition of provisions under FRS12.

25 Acquisitions

During the year the Company acquired the business of Signal Processing Systems (SPS) and the issued share capitals of Stewart Hughes Ltd. and Strategic Technology Systems, Inc. (STSI) for Aerospace, Biochem International, Inc. (BCI) and Hemex Medical AB for Medical Systems, and Transtector Systems, Inc. and Engineered Transitions Company, Inc. (Entraco) for Industrial. Details of the consideration paid, book values of retained assets at the dates of acquisition, and adjustments to reflect the Company's assessments of fair values are set out below. These fair values are provisional pending completion of detailed reviews, and will be finalised in subsequent financial statements.

| | Dates of acquisition | Consideration £m | Bank deposits and borrowings assumed £m | Goodwill £m | Net assets £m |
|-------------------------|----------------------|---------------------|--|----------------|------------------|
| SPS | 28.8.98 | 4.6 | | 11.0 | (6.4) |
| Stewart Hughes | 2.11.98 | 10.1 | | 9.6 | 0.5 |
| STSI | 30.4.99 | 10.5 | | 8.9 | 1.6 |
| BCI | 11.1.99 | 50.3 | 8.0 | 37.8 | 4.5 |
| Hemex | 1.2.99 | 0.6 | | 0.4 | 0.2 |
| Transtector | 30.11.98 | 18.7 | (3.0) | 21.7 | |
| Entraco | 30.11.98 | 3.3 | | 5.1 | (1.8) |
| | | 98.1 | 5.0 | 94.5 | (1.4) |
| Prior year adjustments: | Specac Disposals | 0.6 | | 0.7 | |
| | | 0.6 | | 0.6 | |
| | | 0.6 | | 1.3 | |

| | Book value £m | Revaluation £m | Consistency of accounting policy £m | Fair value £m |
|------------------------|------------------|-------------------|--|------------------|
| Fixed assets | 8.9 | (1.8) | (2.5) | 4.6 |
| Stock | 11.0 | (3.2) | (0.2) | 7.6 |
| Debtors | 12.0 | (0.9) | | 11.1 |
| Creditors | (11.9) | (11.9) | | (23.8) |
| Provisions | (0.1) | (0.6) | (3.0) | (3.7) |
| Taxation | 1.7 | 1.1 | | 2.8 |
| Borrowings assumed | (3.0) | | | (3.0) |
| Term deposits acquired | 8.0 | | | 8.0 |
| Net assets acquired | 26.6 | (17.3) | (5.7) | 3.6 |
| Goodwill | | | | 94.5 |
| Consideration | | | | 98.1 |
| Satisfied by cash | | | | 98.1 |

Ongoing reviews of the businesses acquired during the year have identified the following principal revaluation and accounting policy adjustments:

Fixed assets – the write-down of obsolete plant and machinery and the write-off of intangible assets in line with Company policy.

Stock and work in progress – reduction of book value to net realisable value where lower than cost.

Creditors – the write-off of development costs inappropriately capitalised; the full recognition of losses on loss-making contracts and adjustments for employee bonus/holiday pay and other costs under-accrued.

Provisions – reinstatement of service guarantee reserves, void property costs and ongoing litigation fees in line with Company policy.

Taxation – recognition of a US deferred tax asset.

Specac, which was acquired as part of Graseby PLC in 1997/8, and held for resale at the end of that year, has now been absorbed into Industrial. Goodwill written off against reserves at the time has been increased by £0.7m as a result, together with a further £0.6m arising from an adjustment to the consideration received from Thermo Environmental Instruments Inc. and Thermo Sentron Inc. for the sale of the Graseby product monitoring and environmental businesses.

In accordance with the provisions of FRS10 – Goodwill and Intangible Assets, the Company amortises goodwill arising on acquisitions after 1 August 1998 on a straight-line basis over a period of up to 20 years. The charge for the year was £3.0m. Goodwill relating to acquisitions up to 1 August 1998 was charged to reserves.

Notes to the accounts continued

| | Shares | Issued capital £m |
|-----------------------------------|-------------|----------------------|
| 26 Called up share capital | | |
| At 2 August 1998 | 308,704,905 | 77.2 |
| Exercise of share options | 1,388,087 | 0.3 |
| Issues of scrip dividend shares | 3,447,556 | 0.9 |
| At 31 July 1999 | 313,540,548 | 78.4 |

The authorised capital at 31 July 1999 consisted of 400,000,000 shares of 25p each.

At 31 July 1999 the following options had been granted and were still outstanding:

| | Date issued | Number of shares | Subscription prices | Dates normally exercisable |
|------------------|-------------|---------------------|------------------------|-------------------------------|
| SAYE | 1992 | 119,387 | 248p | 1997/1999 |
| | 1993 | 199,249 | 278p | 1998/2000 |
| | 1994 | 641,890 | 392p | 1999/2001 |
| | 1995 | 960,388 | 384p | 2000/2002 |
| | 1996 | 918,443 | 572p | 2001/2003 |
| | 1997 | 1,410,625 | 632p | 2000/2004 |
| | 1998 | 1,096,401 | 669p | 2001/2005 |
| | 1999 | 945,512 | 721p | 2002/2006 |
| Executive | 1991 | 8,736 | 250p | 1994/2001 |
| | 1993 | 42,229 | 347p | 1996/2003 |
| | 1993 | 79,394 | 395p | 1996/2003 |
| | 1994 | 268,034 | 451p | 1997/2004 |
| | 1995 | 62,500 | 480p | 1998/2005 |
| | 1995 | 329,929 | 632p | 1998/2005 |
| | 1996 | 609,312 | 823p | 1999/2006 |
| | 1997 | 698,604 | 934p | 2000/2007 |
| | 1998 | 1,207,566 | 765p | 2001/2008 |

| | Share premium account £m | Revaluation reserve £m | Other reserves £m | Profit and loss account £m | Goodwill reserve £m |
|--|--------------------------------|------------------------------|-------------------------|----------------------------------|---------------------------|
| 27 Share premium account and reserves | | | | | |
| Consolidated: | | | | | |
| At 2 August 1998 | 57.2 | 3.3 | 199.8 | 694.5 | (810.3) |
| Adjustment to 1998 goodwill | | | | | (1.3) |
| Goodwill set off against other reserves | | | (199.8) | (611.8) | 811.6 |
| Premium on allotments | 33.9 | | | (2.9) | |
| Retained profit | | | | 95.3 | |
| Exchange rate changes | | | | 4.4 | |
| At 31 July 1999 | 91.1 | 3.3 | | 179.5 | |
| Company: | | | | | |
| At 2 August 1998 | 57.2 | 0.6 | 182.1 | 204.3 | |
| Premium on allotments | 33.9 | | | (2.2) | |
| Elimination of dormant subsidiaries | | | (1.6) | | |
| Retained profit | | | | 6.8 | |
| Exchange rate changes | | | | 0.5 | |
| At 31 July 1999 | 91.1 | 0.6 | 180.5 | 209.4 | |

The retained profit of the Company represents a profit for the year of £74.7m, less dividends payable of £67.9m.

During the year the Company received £9.1m on the issue of shares in respect of the exercise of options awarded under various share option schemes. Employees paid £6.2m for the issue of these shares and the balance of £2.9m 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.

3,447,556 shares at market values totalling £26.0m were taken up by shareholders as a scrip alternative to cash dividends.

| | 1999 £m | 1998 £m |
|---|---------------|------------|
| 28 Movements in shareholders' equity | | |
| Profit for the year | 163.2 | 148.2 |
| Dividends | (67.9) | (60.8) |
| | 95.3 | 87.4 |
| Exchange variations | 4.4 | (1.5) |
| Share issues | 32.2 | 11.8 |
| Goodwill on acquisitions | (1.3) | (116.4) |
| Net increase – 1998 decrease – in shareholders' funds | 130.6 | (18.7) |
| Shareholders' funds: | | |
| At 2 August 1998 | 221.7 | 240.4 |
| At 31 July 1999 | 352.3 | 221.7 |

| | 1999 £m | 1998 £m |
|---|-------------|------------|
| 29 Contingent liabilities | | |
| The Company has guaranteed the 8.34% Senior Notes 2002 privately placed by a subsidiary | 61.7 | 61.0 |

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, and now encompassing:-

FRS10 – Goodwill and Intangible Assets

FRS11 – Impairment of Fixed Assets and Goodwill

FRS12 – Provisions, Contingent Liabilities and Contingent Assets

FRS13 – Derivatives and Other Financial Instruments: Disclosure

FRS14 – Earnings per Share

FRS15 – Tangible Fixed Assets

Company profit and loss account

In accordance with the concession granted under section 230(3) of the Companies Act 1985 the profit and loss account of Smiths Industries plc has not been separately presented in these accounts.

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, representing the difference between the cost of acquisition of a subsidiary undertaking and the fair value of its net assets at the date of acquisition, was charged to reserves in the year of acquisition.

Following the implementation of FRS10 – Goodwill and Intangible Assets, 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 and premium 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 re-translation 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

Tax deferred or accelerated by the effect of timing differences is accounted for to the extent that it is considered probable that a liability or asset will crystallise in the foreseeable future. The only exception to this is in respect of deferred tax assets relating to provisions for post-retirement benefits which are recognised in full.

Post-retirement benefits

The cost of providing pensions and post-retirement healthcare for employees is charged in the profit and loss account over the working life of the employees taking into account the recommendation of qualified actuaries. Any funding surpluses or deficits that arise are amortised over the average working life of employees.

Five year review

| | 1999 £m | 1998 £m | 1997 £m | 1996 £m | 1995 £m |
|--|----------------|------------|------------|------------|------------|
| Turnover | 1,323.9 | 1,198.5 | 1,076.2 | 1,008.4 | 899.3 |
| Operating profit (before goodwill amortisation) | 247.5 | 224.2 | 194.6 | 168.1 | 140.9 |
| Goodwill amortisation | (3.0) | | | | |
| Operating profit (after goodwill amortisation) | 244.5 | 224.2 | 194.6 | 168.1 | 140.9 |
| Net interest | (7.0) | (6.1) | (2.5) | (2.7) | (2.4) |
| Profit before exceptional items | 237.5 | 218.1 | 192.1 | 165.4 | 138.5 |
| Exceptional items | | | (0.5) | 5.0 | (0.5) |
| Profit before taxation | 237.5 | 218.1 | 191.6 | 170.4 | 138.0 |
| Profit after taxation | 163.5 | 149.6 | 132.6 | 117.8 | 93.9 |
| Minority interests | (0.3) | (1.4) | (0.9) | | |
| Shareholders' equity | 352.3 | 221.7 | 240.4 | 211.8 | 225.5 |
| Represented by: | | | | | |
| Intangible fixed assets | 91.5 | | | | |
| Tangible fixed assets | 231.7 | 215.4 | 198.8 | 190.6 | 171.3 |
| Net current assets | 122.5 | 89.1 | 83.6 | 49.5 | 53.4 |
| Net debt | (93.4) | (82.8) | (42.0) | (28.3) | 0.8 |
| Funds employed | 352.3 | 221.7 | 240.4 | 211.8 | 225.5 |
| Goodwill charged against reserves | 814.6 | 810.3 | 693.9 | 648.2 | 559.3 |
| Shareholder investment | 1,166.9 | 1,032.0 | 934.3 | 860.0 | 784.8 |
| Ratios | | | | | |
| Operating profit before goodwill amortisation: turnover (%) | 18.7 | 18.7 | 18.1 | 16.7 | 15.7 |
| Taxation before goodwill amortisation and exceptional items (%) | 30.8 | 31.4 | 32.0 | 33.0 | 33.5 |
| After-tax return on average shareholder investment (%) | 15.1 | 15.1 | 14.6 | 13.5 | 12.2 |
| Cash-flow | | | | | |
| Cash-flow from operating activities | 243.4 | 240.5 | 203.9 | 183.2 | 168.8 |
| Less capital expenditure (net) | (48.4) | (36.9) | (42.9) | (32.0) | (24.5) |
| Operating cash after capital expenditure | 195.0 | 203.6 | 161.0 | 151.2 | 144.3 |
| Free cash-flow (before acquisitions and dividends, after capital expenditure) | 116.5 | 132.1 | 98.1 | 98.7 | 103.4 |
| Free cash-flow per share (p) | 37.5 | 43.0 | 32.2 | 32.6 | 34.5 |
| Earnings per share before exceptional items (p) | 52.5 | 48.2 | 42.5 | 36.6 | 30.7 |
| Dividends | | | | | |
| Pence per share | 21.65 | 19.65 | 17.85 | 16.20 | 14.40 |
| Times covered | 2.4 | 2.4 | 2.4 | 2.2 | 2.1 |
| Number of employees (000's) | | | | | |
| UK | 7.0 | 6.9 | 6.4 | 6.5 | 6.1 |
| Overseas | 7.9 | 7.2 | 6.9 | 6.3 | 6.2 |
| | 14.9 | 14.1 | 13.3 | 12.8 | 12.3 |

Analysis of ordinary shareholders

16 September 1999

| Class of Shareholder | No. of Holders | No. of Shares | % of total Listed Shares |
|--|----------------|--------------------|--------------------------|
| Insurance Companies | 25 | 11,082,409 | 3.53 |
| Pension Funds | 13 | 2,095,580 | 0.67 |
| Banks | 31 | 55,938 | 0.02 |
| Nominees | 10,456 | 278,451,127 | 88.67 |
| Limited Companies and other Corporate Bodies | 2,539 | 6,717,773 | 2.14 |
| Individuals | 9,678 | 15,601,877 | 4.97 |
| Total | 22,742 | 314,004,704 | 100.00 |

Financial calendar

1999

October

- 11 Ordinary shares final dividend ex-div date
- 15 Ordinary shares final dividend record date

November

- 16 Annual General Meeting
- 24 Scrip dividend share alternative election closing date†

December

- 15 Ordinary shares final dividend payment date
- Scrip dividend share alternative allotment date‡

2000

March

- 15 1999/2000 interim results announced
- 27 Ordinary shares interim dividend ex-div date
- 31 Ordinary shares interim dividend record date

April

- 26 Scrip dividend share alternative election closing date‡
provisional

May

- 17 Ordinary shares interim dividend payment date
provisional
- Scrip dividend share alternative allotment date‡

July

- 31 Smiths Industries financial year end

†subject to the approval of the final dividend at the AGM on 16 November 1999 and other conditions.

‡subject to the directors' decision to declare an interim dividend and offer a share alternative.

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The senior management of Smiths Industries

Chairman

Keith Orrell-Jones

Chief Executive

Keith Butler-Wheelhouse

Executive Directors

Norman Barber

Chairman, Aerospace

George Kennedy CBE

Chairman, Medical Systems

Einar Lindh

Chairman, Industrial

Alan Thomson

Financial Director

Corporate Staff

David Flowerday

Director, Strategy

David Jeffcoat

Financial Contoller

Peter Mason

Director, Corporate Finance

Anne Minto

Director, Human Resources

Russell Plumley

Director, Public Affairs

Alan Smith

(Associate Director)

Secretary & Solicitor

Robin Taunt

Director, Business
Development

Michael Walls

Director, Internal Audit

Aerospace

Norman Barber

Chairman

Ron Albrecht

Director & Group
Controller

Doug Clark

President, Sensors &
Components

Phil Collins

Director, Technology

George Donovan

VP Government Liaison,
USA

Ian Donovan

Aerospace Group Director

Robert Ehr

President, Information
Management Systems

Michael Jones

Group Director,
Operational Support

John Legg

Managing Director,
Product Support

David Sheppard

Managing Director,
Naval & Marine

Graham Thornton

Director, Marketing &
Business Development

Nick Wilton

Managing Director,
Display & Control Systems

Medical Systems

George Kennedy

Chairman

Donald Broad

Director & Group
Controller

David Buyher

President, SIMS NA

Malcolm Carlisle

Director, Regulatory Affairs
& Legal Adviser

Tom Curry

Director, Manufacturing
& Supply

Martin Jamieson

Managing Director,
SIMS Portex Ltd

Carol Kennedy Filer

Director, Product Innovation
& Publicity

Greg Markham

Director, Strategic Marketing

Hitoshi Mikami

President,
Japan Medico Co Ltd

Industrial

Einar Lindh

Chairman

Brian Knight

Director & Group
Controller

Roger Ellis

Director, Business
Development

Martin Jones

Director, Technology &
Innovation

Peter Norris

Managing Director,
Vent-Axia

Stephen Phipson

Managing Director,
Hypertac Interconnect

Tedd Smith

President, Flex-Tek US

David Spencer

Managing Director,
Icore International

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Notice of Annual General Meeting

Notice is hereby given that the eighty-fifth Annual General Meeting of Smiths Industries Public Limited Company will be held at 765 Finchley Road, London NW11 8DS on Tuesday 16 November 1999 at 12.00 noon for the following purposes:

Ordinary Business

1. To adopt the reports of the directors and the auditors and the audited accounts for the 52 weeks ended 31 July 1999.
2. To declare a final dividend on the ordinary shares (except that such dividend shall not be declared and will not be paid in cash on any ordinary shares in respect of which a valid election shall be made for any share alternative offered to the final dividend to the extent that such election is satisfied by the allotment of further shares).

To re-appoint the following directors:

3. Mr N V Barber
4. Mr G M Kennedy
5. Mr E Lindh
6. Mr P T Hollins

Notes:

Messrs Barber, Kennedy and Lindh will retire by rotation in accordance with Articles 73 and 74.

Mr Hollins will retire following his appointment during the year.

Mr Hollins is a member of the Audit and Remuneration and Nominations Committees.

7. To re-appoint PricewaterhouseCoopers as auditor to the Company.
8. To authorise the directors to determine the remuneration of the auditor.

Special business

9. To consider and, if thought fit, pass the following ordinary resolution:

That, subject to and in accordance with Article 6 of the Articles of Association of the Company, the directors be and are hereby authorised to allot relevant equity securities having a nominal value not exceeding £26,128,379 in aggregate and that all previous authorities under section 80 of the Companies Act 1985 are hereby

revoked and shall henceforth cease to have effect.

10. To consider and, if thought fit, pass the following special resolution:

That, subject to and in accordance with Article 7 of the Articles of Association of the Company, the directors be and are hereby authorised to allot equity securities for cash, provided that this power shall be limited for the purposes described in paragraphs (a) and (b) of Article 7 and, for the purposes of limitation of said power referred to in paragraph (b) of Article 7, the nominal amount therein mentioned shall be £3,919,256.

11. To consider and, if thought fit, pass the following special resolution:

That the Company is hereby generally and unconditionally authorised to make market purchases (within the meaning of section 163 of the Companies Act 1985) of ordinary shares of 25p each in the capital of the Company ("ordinary shares") provided that:

- (a) the maximum number of ordinary shares hereby authorised to be purchased is 15,677,027;
- (b) the minimum price which may be paid for ordinary shares is 25p per ordinary share;
- (c) the maximum price which may be paid for an ordinary share is an amount equal to 105 per cent of the average middle market quotations for an ordinary share, as derived from the London Stock Exchange Daily Official List, for the ten business days immediately preceding the day on which the ordinary share is purchased;
- (d) the authority hereby conferred shall expire at the conclusion of the next general meeting of the Company, unless such authority is renewed at such time; and
- (e) the Company may make a contract to purchase ordinary shares under the authority hereby conferred prior to the expiry of such authority which will or may be executed wholly or partly after the expiry of such authority and may make a purchase in pursuance of any such contract.

By Order of the Board

Alan Smith

Secretary

28 September 1999

London NW11 8DS

Notes

1. A member entitled to attend and vote may appoint a proxy or proxies to attend and, on a poll, vote on his behalf. A proxy need not be a member. Proxy Forms must be deposited not later than 48 hours before the Meeting to be effective. In the case of a corporation, the appointment of a proxy must be made either under its common seal or by a duly authorised officer or attorney. In the case of joint holders, the vote of the first named on the register will be accepted to the exclusion of other joint holders.

2. Pursuant to Regulation 34 of the Uncertificated Securities Regulations 1995, the Company hereby specifies that only those shareholders registered in the register of members of the Company at 6 p.m. on 14 November 1999 shall be entitled to attend or vote at the aforesaid general meeting in respect of the numbers of shares registered in their names at that time. Changes to entries on the relevant register of securities after 6 p.m. on 14 November 1999 shall be disregarded in determining the rights of any person to attend or vote at the meeting.

3. A copy of the contract of service of each director of the Company with the Company or any of its subsidiaries will be available for inspection at the registered office of the Company during normal business hours on any weekday (Saturdays and Bank Holidays excepted) from the date of this Notice until the conclusion of the Annual General Meeting on 16 November 1999.

4. Subject to the final dividend being approved at the Annual General Meeting, dividend warrants will be payable on 15 December 1999 to the ordinary shareholders on the register at the close of business on 15 October 1999 except that no dividend will be paid in cash on any ordinary shares for which a valid election is made to receive any share alternative offered to the final dividend to the extent that such election is satisfied by the allotment of further shares. Subject to the admission to the London Stock Exchange Official List of any new shares issued under a share alternative, where an election for a share alternative has been validly made, share certificates will be posted on 14 December 1999 and CREST member accounts will be credited on 15 December 1999 for dealing from 15 December 1999.

5. The market value of an ordinary share on 31 March 1982 for the purposes of capital gains tax was:

Ordinary shares 91.25p
(taking into account the sub-division of 50p shares into 25p shares on 14 January 1985).

6. Although copies of the Annual Report are distributed to share- and option-holders, only ordinary shareholders, or their proxies, are entitled to attend and vote at the Meeting.

7. The Company is not a close company.