Annual Report and Accounts 1999

Smith+Nephew
First Choice in Medical Devices

Performance Innovation Trust

Corporate governance

Combined Code
The Board considers that the company has complied throughout the year with the Combined Code of Best Practice on Corporate Governance.

The Board
The Board meets regularly during the year and is responsible for the strategic direction, policies and overall management of the group. There is a clear division of responsibilities between the Chairman and Chief Executive. The Board consists of an independent non-executive Chairman, three executive directors and five independent non-executive directors. All directors have full and timely access to all relevant information and independent professional advice.

The Board is assisted by the following committees:

The Audit Committee The Audit Committee monitors the operation and effectiveness of the internal financial controls and ensures that the accounts meet statutory and other requirements.

The Remuneration Committee The Remuneration Committee sets the pay and benefits of the executive directors and other members of the Executive Committee and approves their terms of employment.

The Nominations Committee The Nominations Committee oversees plans for management succession and recommends appointments to the Board.

The Charities and Community Committee The Charities and Community Committee co-ordinates environmental, charity and community programmes.

The Executive Committee The Executive Committee assists the Chief Executive in the day-to-day management of the group.

The Scientific Advisory Panel The Scientific Advisory Panel provides an independent perspective on the new product development process from research to manufacture and comprises leading authorities from the scientific community.

Membership of Board committees and of the Executive Committee is shown with the biographical details of directors on pages 24 and 25.

Directors
All directors are subject to re-election at least every three years, and in accordance with the Articles of Association, Alan Fryer, Peter Hooley and Sir Timothy Lankester retire by rotation and, being eligible, offer themselves for re-election at the forthcoming AGM. Dudley Eustace was appointed Deputy Chairman with effect from 10 November 1999 and Chairman from 1 January 2000 and will be proposed for re-election at the AGM.

No director had a material beneficial interest in any contract involving the company or its subsidiaries in 1999.

Shareholders
The group issues summary financial statements in place of full annual accounts unless shareholders request the latter. The summary financial statement is received by over 90% of shareholders. At the half year, an interim report is sent to all shareholders. There is a regular dialogue with individual institutional shareholders together with results presentations twice a year. There is an opportunity for individual shareholders to question directors at the AGM and the company regularly responds to letters from shareholders on a range of issues.

Internal control
The Board is responsible for the maintenance of the group's system of internal control and for reviewing its effectiveness. It has established an ongoing process of identifying, evaluating and managing key risks by a system of functional reports to the Board, the review of internal financial controls by the Audit Committee, augmented by risk reports to be completed by each business unit and reviewed by the Chief Executive and Finance Director.

These procedures will enable the Board to report on the effectiveness of its system of internal control for 2000.

Share capital
The company has been informed of the following interests in its ordinary share capital as at 22 February 2000:

- Sanford C Bernstein 6.82%
- Sun Life and Provincial Holdings 6.13%
- Hermes 4.04%
- Fidelity 3.97%
- T Rowe Price Associates 3.15%
- Legal & General 3.12%

At the AGM, the company will be seeking a renewal of its current permission from shareholders to purchase its own shares. No shares have been purchased or contracted for or are the subject of an option under the expiring authority.

Auditors
Ernst & Young have expressed their willingness to continue as auditors and a resolution proposing their reappointment will be put to the AGM.

Remuneration report

The Remuneration Committee

The Remuneration Committee comprises Sir Brian Pearse (Chairman), Sir Anthony Cleaver, Sir Timothy Lankester and Dr Rolf Stomberg.

Remuneration policy

The Remuneration Committee aims to ensure that remuneration packages are competitive enough to attract, retain and motivate executive directors and Executive Committee members of a calibre that meets the group's needs, and that they reflect the group's performance against financial objectives. In framing its policy the committee has given full consideration to the requirements set out in Schedule A of the Combined Code. It is advised by independent consultants and uses data from external research into companies of similar size, technologies and international complexity. Remuneration throughout the group is designed to be competitive locally.

The principal components of remuneration for executive directors and Executive Committee members are:

Basic salary and benefits Basic salary reflects the responsibility of the job and individual performance. The company also provides private healthcare cover and a company car or allowance.

Performance-related bonus The company operates an annual bonus scheme based on three criteria for executive directors: annual growth in adjusted basic earnings per share, annual growth in adjusted basic earnings per share measured at constant average exchange rates and return on operating capital employed. Over time, achievement of targets should produce a bonus of 30% of annual salary with a maximum of 100% for over achievement against targets that would demonstrably generate a step change in performance. Bonuses are not pensionable.

Share options and long-term incentives
Executive directors have been eligible for grants of share options under executive share option schemes, subject to a maximum value of four times salary in any ten-year period.

The company operates a long-term incentive plan (LTIP) for executive directors and members of the Executive Committee. Under this plan, shares are transferred to participants depending on the company's performance in relation to a comparator group of 58 other companies, using total shareholder return (TSR) over a three-year period as the prime measure. The maximum value of shares awarded will not exceed the participants' current annual rate of basic salary at the date the award is made. Shares will only be transferred to the participants if the company's TSR performance is at or above the median performance of the comparator companies and if there has been real growth in the company's adjusted earnings per share in the same three-year period. At the median level, 25% of the award shares will vest. If the company's performance is ranked in the top quartile, all the shares will vest. If the company's performance lies between the median and the top quartile, the proportion of shares vesting will vary on a straight-line basis.

The earnings per share performance target for the 1997 award has not been met. As a result the award has lapsed and no shares will be transferred to participants.

The following outstanding conditional awards have been granted under the LTIP:

year to 31 December	Maximum number of shares 1999	Maximum number of shares 1998
C.J. O'Donnell	183,040	161,263
A.R. Fryer	134,502	108,435
P. Hooley	116,959	102,874

Under the executive share option schemes, options granted since 1997 may not normally be exercised unless the company's average annual growth in adjusted basic earnings per share has exceeded that of the UK retail price index by 2% in any period of three consecutive financial years from the date of grant. Executive options are not offered at a discount.

Directors continue to be eligible to participate in the savings related share option scheme.

Service contracts Executive directors are appointed on contracts terminable by the company on not more than 12 months' notice and by the director on six months' notice.

Non-executive directors are appointed for terms of three years. Their remuneration is determined by the Board on the recommendation of the Nominations Committee.

Pensions Executive directors participate in the defined benefit Smith & Nephew UK Pension Fund and Smith & Nephew UK Executive Pension Scheme, under which normal retirement is at age 62 and pension has been accrued in the year at an annual rate of 1/30 of final pensionable salary, up to a limit of two thirds of final pensionable salary. Pensions in payment are guaranteed to increase by 5% per annum or inflation if lower. The company and the trustees of the pension plans have a policy of granting discretionary increases, particularly at times of high inflation. Death in service cover of four times salary and spouse's pension at the rate of two thirds of the member's pension are provided on death. Transfer values on leaving service would be calculated on the minimum funding requirement basis with allowance for pension increases in line with price inflation. A supplementary defined contribution plan partially compensates for the Inland Revenue earnings cap on final pensionable salary.

Remuneration report

Directors' emoluments and pensions

	Salaries & fees £'000	Benefits £'000	Annual bonus £'000	Pension entitlements £'000	Total 1999 £'000	Total 1998 £'000
Chairman (non-executive)						
J.H. Robinson (to 31 December 1999)	156	–	–	–	156	154
Deputy Chairman (non-executive)						
D.G. Eustace (from 10 November 1999)	21	–	–	–	21	–
Executive						
C.J. O'Donnell	313	7	266	17	603	337
A.R. Fryer	230	8	196	18	452	263
P. Hooley	202	15	172	43	432	240
J.R. Blair (to 31 December 1998)	–	–	–	–	–	450
Non-executive						
Sir Anthony Cleaver	24	–	–	–	24	23
Dr N.J. Lane	29	–	–	–	29	28
Sir Timothy Lankester	24	–	–	–	24	23
Sir Brian Pearse	24	–	–	–	24	23
Dr R.W.H. Stomberg	24	–	–	–	24	23
	1,047	30	634	78	1,789	1,564

John Robinson received an annual fee of £156,000 as Chairman, including a non-executive director's fee of £24,000.

Dudley Eustace was appointed Chairman from 1 January 2000 and receives an annual fee of £150,000 including a non-executive director's fee of £24,000.

The figure for pension entitlements consists of any increase in accrued pension benefit in the year (excluding inflation), together with a contribution of £41,000 to a supplementary plan for Peter Hooley. During 1999 executive directors paid contributions to the pension plans as follows: Christopher O'Donnell £15,000, Alan Fryer £11,000 and Peter Hooley £4,000.

The accumulated total amount of the accrued pension benefit for directors as of 31 December 1999 was as follows: Christopher O'Donnell £75,000 (1998 – £57,000), Alan Fryer £117,000 (1998 – £96,000) and Peter Hooley £20,000 (1998 – £17,000).

Jack Blair retired on 31 December 1998. The Remuneration Committee retains the discretion of allowing the vesting of his LTIP award of up to a maximum of 36,145 shares in respect of 1998 if the performance conditions are met.

The ages of the executive directors are set out on page 24.

Directors' share options

	Number of options 1 Jan 1999	Granted during the year	Exercised	Exercise price	Market price at date of exercise (p)	Profit on exercise £	Number of options 31 Dec 1999	Average exercise price (p)	Range of exercisable dates of options held at 31 Dec 1999
C.J. O'Donnell	367,862	–	–	–	–	–	367,862	1.67	9/1994-8/2006
A.R. Fryer	228,339	–	30,000	137.00	190.50	16,050	–	–	–
		–	2,800	123.20	197.75	2,087	195,539	1.68	9/1994-8/2006
P. Hooley	405,362	–	–	–	–	–	405,362	1.55	9/1994-8/2006

The range in the market price of the company's shares during the year was 150p to 217.5p and the market price at 31 December 1999 was 208p. All outstanding options at 31 December 1999 were below 208p. The total profit on exercise of options during the year was £18,137 as set out above (1998 – £89,004: Alan Fryer £65,468, John Robinson £23,536).

Directors' interests

	31 December 1999		1 January 1999	
Beneficial interests of the directors in the company's ordinary shares	Shares	Options	Shares	Options
C.J. O'Donnell	19,490	367,862	17,885	367,862
A.R. Fryer	69,993	195,539	66,873	228,339
P. Hooley	5,000	405,362	5,000	405,362
Sir Anthony Cleaver	16,782	–	16,782	–
Dr N.J. Lane	2,934	–	2,838	–
Sir Timothy Lankester	6,389	–	1,803	–
Sir Brian Pearse	20,000	–	10,000	–
Dr R.W.H. Stomberg	1,035	–	1,014	–

There was no change in the interests of directors between 31 December 1999 and 23 February 2000.

The register of directors' interests, which is open to inspection at the company's registered office, contains full details of directors' shareholdings and share options.

By order of the Board, 23 February 2000

Michael Parson
Secretary

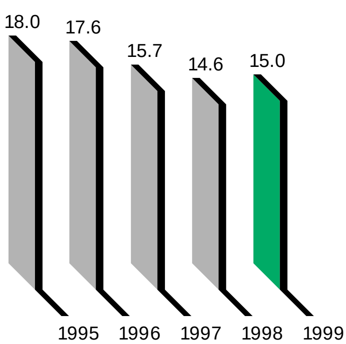
Financial review

Trading results
Sales during the year amounted to £1,120m, a 6% increase. Adjusting for currency and putting acquisitions and disposals on a like-for-like basis, this was an underlying growth of 8%, an improvement on the 5% of recent years – led by the strong performance in our orthopaedics business.

Pre-tax profit before exceptional items amounted to £171m, an increase of 12% coming from improved sales growth and programmes to improve operating margins. Margins were stronger, nearly 1% ahead before 0.3% of transactional currency costs, in an operating environment where sales prices overall improved slightly.

Margin improvement reflects our established programme of cost and efficiency savings and the management and workforce restructuring started at the end of 1998, which together delivered cost savings of £27m and more than offset the impact of cost inflation.

Margins %
Operating profit before exceptional items to sales



After a number of years in which the relative strength of sterling and the US dollar have adversely affected the group, the negative impact on profit abated in the year to a more modest £2m – £4m from adverse transactional currency offset by a £2m translational gain. Nevertheless over the last three years currency has taken £38m off our profit base.

The effect of acquisitions in the second half of the year was broadly neutral, whereas the bracing disposal diluted pre-tax profit by 2%.

Exceptional items
During the year we launched our programme to rationalise manufacturing facilities worldwide to concentrate production on fewer centres. Our wound management, casting and bandaging and consumer healthcare businesses are in the process of closing their Australian and Canadian factories and we are constructing a new casting manufacturing facility in Mexico. We have also exited manufacturing of orthopaedics products in France.

We expect the manufacturing rationalisation programme to produce cost and efficiency savings of £25m a year by 2002 with benefits starting to feed through in 2000. This together with the management and workforce restructuring largely completed in 1999 will yield the cost savings needed to meet our goal of a three percentage point increase in underlying operating margins by 2001.

Last year we charged £18m by way of an exceptional item for the cost of the restructuring and rationalisation programmes. This year we have provided £34m and over the next two years we expect to charge a further £24m as we complete the programme. The total expenditure of £76m is anticipated to provide annual benefits of £40m by 2002.

The sale of the bracing business in the middle of the year realised an exceptional gain of £63m after charging £34m of goodwill previously set off against reserves on the original acquisition of the business.

We have also provided £5m to integrate Exogen, acquired in September, with our orthopaedics business.

Because of delays in obtaining regulatory approval for Dermagraft, we have provided £7m against the cost of the joint arrangement with Advanced Tissue Sciences (ATS) in respect of the product. We have also provided £6m against our equity investment in ATS.

The result is a net exceptional gain of £11m, increasing profit before tax to £182m, compared with £135m last year.

EPS and taxation
Earnings per share before exceptional items were 10.72p, a 12% increase on 1998. The underlying tax charge of £51m remains at 30%. Tax on exceptional items amounted to a net charge of £26m. This is higher than the net exceptional gain due to the write back of goodwill previously set off against reserves on the original acquisition of the bracing business, and the write down of asset values involved in the manufacturing rationalisation programme and in respect of our involvements with ATS not being deductible for tax purposes.

Dividends and shareholders' funds
The recommended final dividend of 4.0p per ordinary share, together with the interim dividend of 2.5p, makes a total for the year of 6.5p, an increase of 0.3p on 1998. The cost of dividends will be £73m, representing 61% of earnings before exceptional items.

Retained profit of £32m has been taken to reserves, and shareholders' funds have also been augmented by £4m of new shares issued for share options and £34m of goodwill on the bracing business on its disposal previously set off against reserves on acquisition. Currency translation of £4m was charged to reserves. The net movement in shareholders' funds was an increase of £66m.

Employees
The average number of employees during the year declined 9% to 11,213 largely as a result of the management and work force restructuring programme and the disposal of the bracing business. As a consequence sales per employee improved 17% to £100,000, compared with a total staff cost per employee increase of 9%.

Investment
Capital expenditure of £65m on tangible and intangible fixed assets amounted to 6% of sales, lower than recent years. The principal projects were the continued renovation and expansion of facilities at

Hull, further investment in hospital based surgical instruments for orthopaedic implants and the completion of year 2000 information technology projects.

We continue to invest 4% of sales in R&D as well as investing in sales and marketing worldwide and in enhancing our cost-competitiveness. The Dermagraft programme involved revenue investment of £8m in 1999.

Year 2000 and the euro

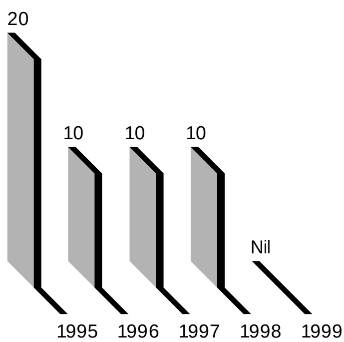
The conversion of our systems to cope with the changeover to the year 2000 went satisfactorily. Our transactional systems converted on time and the work with suppliers and customers has proven worthwhile. The revenue cost of conversion was £5m spread over 1998 and 1999 and £15m of capital expenditure on systems renewal was brought forward into these years to ensure year 2000 compliance.

The group trades in all 11 European countries which have adopted the euro. The cost of modifications to administration and systems as a result of the new currency is not expected to be significant.

Cash flow and facilities

Conversion of operating profit to operating cash flow was 79%, an improvement on last year's 65%. This was after £18m of outgoings on the management and workforce restructuring and manufacturing rationalisation programmes and on acquisition integration costs. Of the net proceeds of £122m from the disposal of the bracing business, £42m was applied in acquisitions, the principal of which was Exogen acquired in September and £9m was paid for further Dermagraft rights.

Gearing %



Net cash flow and movement in net borrowings during the year were:

	£m
Operating cash flow	133
Interest, tax and dividends	(127)
Disposals net of acquisitions	71
Issues of share capital	4
Net cash flow	81
Exchange adjustments	(9)
Opening net borrowings	(50)
Closing net cash	22

The group's year end position of net cash balances and thus no gearing provides considerable financing flexibility.

Capital structure and treasury policy

The directors have established a set of policies to manage funding, currency and interest rate risks. The group only uses financial instruments to manage the financial risks associated with underlying business activities and their financing.

Our policy is to ensure that there is sufficient funding and facilities in place to meet foreseeable borrowing requirements. Unused bank facilities amounted to £425m of which £140m were committed.

Our policy is to protect shareholders' funds by matching foreign currency assets, including acquisition goodwill, with foreign currency liabilities where practicable. These liabilities take the form of either borrowings or currency swaps. At the year end group borrowings were £78m, mainly in foreign currency. Cash and bank balances were £100m. Currency swaps amounted to £484m, of which 80% were to re-denominate internal borrowings into US dollars.

Most group borrowings are due within one year and take advantage of short-term interest rates. We use interest rate swaps to protect borrowing costs and the differentials between borrowing and deposit rates, fixing interest rates on major exposures by the beginning of the financial year. At the year end the majority of interest costs and differentials have been protected through to December 2000 with some protection carrying over into 2003.

The group trades in over 90 countries and as a consequence manages £250m of foreign currency transactions using forward foreign exchange contracts. Our policy is for firm commitments to be fully covered and forecasts to be covered between 50% and 90% for up to one year. There are therefore no currency exposures on monetary assets and liabilities that could give rise to material gains or losses in the profit and loss account. It is group policy for operating units not to hold unhedged monetary assets or liabilities other than in their functional operating currencies.

It is company policy to ensure that suppliers are paid within agreed terms. At the year end the company's trade creditors amounted to £2m the equivalent of 21 days credit.

Peter Hooley
Finance Director

Directors' responsibilities for the accounts and auditors' report

Directors' responsibilities for the accounts

The directors are required by company law to prepare accounts for each financial year that give a true and fair view of the state of affairs of the company and of the group as at the end of the financial year and of the results of the group for the year. In preparing the accounts, suitable accounting policies have been used and applied consistently, and reasonable and prudent judgements and estimates have been made. Applicable accounting standards have been followed. The directors have satisfied themselves from internal forecasts and available bank facilities that the group continues as a going concern.

The directors are also responsible for the group's system of internal financial controls. These are designed to give reasonable assurance that proper procedures exist for the maintenance of adequate accounting records, safeguarding the assets of the group and for preventing and detecting fraud and other irregularities. To this end the company has identified and documented minimum internal financial control standards. Annual budgets are prepared and approved by the directors, and the directors have reserved capital expenditure and treasury authority levels to the Board and its delegated committees. The group operates a system of regular monthly reporting including revised profit and cash forecasts. Business risks are identified and monitored on a regular basis. The group operates an internal audit function which monitors the adequacy of internal financial controls and systems and compliance with group standards. The internal auditor gives a report to the Audit Committee and the Audit Committee reviews the operation and effectiveness of internal financial controls and reporting of the group.

Report of the auditors to the members of Smith & Nephew plc

We have audited the accounts on pages 33 to 55 which have been prepared under the historical cost convention and on the basis of the accounting policies set out on page 38.

Respective responsibilities of directors and auditors As described on this page, the company's directors are responsible for the preparation of the accounts in accordance with applicable United Kingdom law and accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board, the Listing Rules of the London Stock Exchange and by our profession's ethical guidance.

We report to you our opinion as to whether the accounts 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 accounts, 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 the information specified by law or the Listing Rules regarding directors' remuneration and transactions with the company is not disclosed.

We read the other information in the Annual Report and Accounts and consider whether it is consistent with the audited accounts. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the accounts.

We review whether the corporate governance statement on page 26 reflects the company's compliance with the seven provisions of the Combined Code specified for our review by the Stock Exchange, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of either the company's corporate governance procedures or its risk and control procedures.

Basis of audit opinion We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the accounts. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the accounts, and of whether the accounting policies are appropriate to the group'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 accounts 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 accounts.

Opinion In our opinion the accounts give a true and fair view of the state of affairs of the company and of the group as at 31 December 1999 and of the profit of the group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

Ernst & Young
Registered auditor
London, 23 February 2000

Group profit and loss account

for the year ended 31 December 1999	Notes	1999 £ million	1998 £ million
Turnover	1,2		
Continuing operations		1,075.7	977.8
Discontinued operations		44.2	75.6
		1,119.9	1,053.4
Operating profit	1,2		
Continuing operations:			
Before exceptional items		162.0	144.4
Exceptional items*	3	(51.7)	(17.9)
		110.3	126.5
Discontinued operations		5.5	9.7
		115.8	136.2
Discontinued operations:			
Net profit on disposals*	3	62.9	–
Profit on ordinary activities before interest		178.7	136.2
Interest receivable/(payable)	4	3.4	(1.7)
Profit on ordinary activities before taxation		182.1	134.5
Taxation	7	77.3	40.8
Attributable profit for the year		104.8	93.7
Dividends	8	72.5	69.2
Retained profit for the year	22	32.3	24.5
Basic earnings per ordinary share	10	9.39p	8.42p
Diluted earnings per ordinary share	10	9.37p	8.40p
Results before exceptional items (*)			
Profit before taxation	9	170.9	152.4
Adjusted basic earnings per ordinary share	10	10.72p	9.58p

Group balance sheet

at 31 December 1999	Notes	1999 £ million	1998 £ million
Fixed assets			
Intangible assets	11	74.0	28.3
Tangible assets	12	270.5	291.7
Investments	13	16.6	14.4
		361.1	334.4
Current assets			
Stocks	14	237.6	242.4
Debtors	15	281.1	278.6
Cash and bank	16	100.5	49.9
		619.2	570.9
Creditors: amounts falling due within one year			
Borrowings	16	58.0	86.6
Other creditors	17	312.4	289.0
		370.4	375.6
Net current assets		248.8	195.3
Total assets less current liabilities		609.9	529.7
Creditors: amounts falling due after more than one year			
Borrowings	16	20.2	12.8
Provisions for liabilities and charges	18	38.0	31.4
		58.2	44.2
		551.7	485.5
Capital and reserves			
Called up share capital:			
Equity share capital	20	111.8	111.4
Non-equity share capital	20	0.3	0.3
Share premium account	22	118.3	114.3
Profit and loss account	22	321.3	259.5
		551.7	485.5

Approved by the Board on 23 February 2000

Dudley Eustace Chairman **Peter Hooley** Finance Director

Group cash flow

for the year ended 31 December 1999	Notes	1999 £ million	1998 £ million
Net cash inflow from operating activities*	23	198.1	161.9
Interest received		10.3	8.1
Interest paid		(6.9)	(9.8)
Net cash inflow/(outflow) from returns on investments and servicing of finance		3.4	(1.7)
Tax paid		(60.1)	(20.6)
		141.4	139.6
Capital expenditure and financial investment			
Capital expenditure		(67.1)	(69.3)
Disposal of fixed assets		8.7	7.4
Trade investment		(6.7)	–
		(65.1)	(61.9)
Acquisitions and disposals			
Acquisitions	25	(50.9)	(21.2)
Disposals		121.8	4.8
		70.9	(16.4)
Equity dividends paid		(70.3)	(69.0)
Cash inflow/(outflow) before use of liquid resources and financing		76.9	(7.7)
Management of liquid resources	23	(72.3)	1.5
Financing			
Issues of ordinary share capital		4.4	3.0
Net decrease in borrowings and currency swaps	23	(24.1)	(2.4)
Net cash (outflow)/inflow from financing		(19.7)	0.6
Decrease in cash	23	(15.1)	(5.6)

*After £18.5m (1998 – £9.5m) of outgoings on rationalisation programme and acquisition integration costs.

Statement of gains and losses
Movements in shareholders' funds

Group statement of total recognised gains and losses

for the year ended 31 December 1999	1999 £ million	1998 £ million
Profit for the financial year	104.8	93.7
Currency translation differences on foreign currency net investments	(4.0)	(3.3)
Total gains and losses related to the year	100.8	90.4

Group reconciliation of movements in shareholders' funds

for the year ended 31 December 1999	1999 £ million	1998 £ million
Profit for the financial year	104.8	93.7
Dividends	72.5	69.2
Retained profit for the year	32.3	24.5
Exchange adjustments	(4.0)	(3.3)
Issue of shares	4.4	3.0
Goodwill on disposals	33.5	–
Net addition to shareholders' funds	66.2	24.2
Opening shareholders' funds	485.5	461.3
Closing shareholders' funds	551.7	485.5

Parent company balance sheet

at 31 December 1999	Notes	1999 £ million	1998 £ million
Fixed assets			
Tangible assets	12	8.1	9.8
Investments	13	413.9	413.9
		422.0	423.7
Current assets			
Debtors	15	476.8	662.0
Cash and bank	16	77.2	24.0
		554.0	686.0
Creditors: amounts falling due within one year			
Borrowings	16	28.9	55.0
Other creditors	17	299.8	369.3
		328.7	424.3
Net current assets		225.3	261.7
Total assets less current liabilities		647.3	685.4
Creditors: amounts falling due after more than one year			
Borrowings	16	4.5	5.8
Provisions for liabilities and charges	18	0.9	1.3
		5.4	7.1
		641.9	678.3
Capital and reserves			
Called up share capital:			
Equity share capital	20	111.8	111.4
Non-equity share capital	20	0.3	0.3
Share premium account	22	118.3	114.3
Profit and loss account	22	411.5	452.3
		641.9	678.3

Approved by the Board on 23 February 2000

Dudley Eustace Chairman **Peter Hooley** Finance Director

Accounting policies

The accounts have been prepared under the historical cost convention and in accordance with Financial Reporting Standards 15 and 16 and other applicable accounting standards.

Consolidation The consolidated accounts include the accounts of the company and the accounts of all the subsidiary and associated undertakings during the year ended 31 December 1999 for the periods during which they were members of the group.

Foreign currencies Balance sheet items of overseas companies and foreign currency borrowings are translated into sterling at the year end rates of exchange. Profit and loss items and the cash flows of overseas subsidiary and associated undertakings are translated at the average rates for the year.

Forward currency contracts entered into in respect of contracted and anticipated amounts payable on purchase transactions are accounted for as hedges. Changes in the fair value of these forward contracts are recognised in the profit and loss account on the ultimate sale of the item purchased.

Exchange differences on the translation at closing rates of exchange of the opening net assets, including acquisition goodwill, of overseas subsidiary and associated undertakings are recorded as adjustments to reserves. Where foreign currency borrowings or swaps are used to finance or hedge group equity investments, the difference on translation of these borrowings or swaps is offset as an adjustment to reserves. The differences arising between the translation of profits at average and closing rates of exchange are also recorded as adjustments to reserves. All other exchange differences are dealt with in arriving at profit before taxation.

Intangible fixed assets Goodwill, representing the excess of purchase consideration over fair value of net assets acquired prior to 31 December 1997, was written off direct to reserves in the year of acquisition. Goodwill acquired since 1 January 1998 is capitalised and written off over a period not exceeding 20 years. Goodwill previously written off to reserves is included in the calculation of profits and losses on disposals.

Purchased patents, know-how, trade marks, licences and distribution rights are capitalised and amortised over a period not exceeding 20 years.

Tangible fixed assets Tangible fixed assets are stated at cost and, except for freehold and long leasehold land (leases 50 years or over), are depreciated as wasting assets. Freehold and long leasehold buildings are depreciated on a straight-line basis at between 1% and 5% per annum. Short leasehold land and buildings (leases of under 50 years) are depreciated by equal annual instalments over the term of the lease. Plant and equipment are depreciated over lives ranging between three and 20 years by equal annual instalments to write down the assets to their estimated disposal value at the end of their working lives.

Assets held under finance leases are capitalised as tangible fixed assets and depreciated accordingly. The capital element of future lease payments is included in borrowings and interest is charged to profit before taxation on a reducing balance basis over the term of the lease.

Investments Associated undertakings are those companies in which the group has a beneficial interest of 50% or less in the equity capital and where the group exercises significant influence over commercial and financial policy decisions. The consolidated balance sheet includes the group's share of the underlying net assets of associated undertakings. Trade investments are stated at the lower of cost and the recoverable amount.

Stocks Finished goods and work in progress are valued at factory cost, including appropriate overheads, on a first-in first-out basis. Raw materials are valued at purchase price and all stocks are reduced to net realisable value where lower.

Deferred taxation Deferred taxation is provided under the liability method on timing differences between tax and accounting treatments where these are likely to crystallise in the foreseeable future. Deferred taxation is not provided on undistributed profits retained overseas.

Financial instruments Currency swaps entered into to match foreign currency assets with foreign currency liabilities are translated into sterling at the year end rate of exchange. Changes in the principal values of currency swaps are matched in reserves against changes in the values of the related assets. Interest rate swaps used to protect interest costs and income are accounted for as hedges. Changes in the values of interest rate swaps are offset against the interest in the period relating to the hedge. The group has taken advantage of the dispensation of not disclosing short term debtors and creditors as financial instruments.

Research and development Revenue expenditure on research and development is written off as incurred.

Post-retirement benefits The group's major pension plans are of the defined benefit type. For these plans, costs are charged to operating profit so as to spread the expense of providing future pensions to employees over their working lives with the group. Where defined contribution plans operate the contributions to these plans are charged to operating profit as they become payable. Where the group provides healthcare benefits after retirement the expected cost of these is charged to operating profit over the employees' working lives with the group.

Note 1 Segmental analysis

Analysis by activity	Turnover 1999 £ million	Operating profit 1999 £ million	Operating assets 1999 £ million	Turnover 1998 £ million	Operating profit 1998 £ million	Operating assets 1998 £ million
Medical devices	889.5	92.7	581.8	809.9	102.9	573.5
Consumer healthcare	186.2	17.6	66.2	167.9	23.6	59.0
	1,075.7	110.3	648.0	977.8	126.5	632.5
Discontinued operations	44.2	5.5	(6.5)	75.6	9.7	(5.2)
	1,119.9	115.8	641.5	1,053.4	136.2	627.3

Exceptional costs of £51.7m (1998 – £17.9m) have been charged as follows: medical devices £42.0m (1998 – £16.3m) and consumer healthcare £9.7m (1998 – £1.6m).

Analysis by geographic origin	Turnover 1999 £ million	Operating profit 1999 £ million	Operating assets 1999 £ million	Turnover 1998 £ million	Operating profit 1998 £ million	Operating assets 1998 £ million
United Kingdom	286.4	37.6	160.3	274.8	39.6	177.1
Continental Europe	243.3	11.8	88.3	242.3	9.4	79.6
America	561.2	48.7	324.3	484.2	65.8	292.9
Africa, Asia and Australasia	191.8	12.2	75.1	163.9	11.7	82.9
	1,282.7	110.3	648.0	1,165.2	126.5	632.5
Discontinued operations	44.2	5.5	(6.5)	75.6	9.7	(5.2)
	1,326.9	115.8	641.5	1,240.8	136.2	627.3
Less intragroup sales	(207.0)	–	–	(187.4)	–	–
	1,119.9	115.8	641.5	1,053.4	136.2	627.3

Exceptional costs of £8.6m have been charged to the UK (1998 – £5.3m), £3.0m to Continental Europe (1998 – £4.7m), £31.4m to America (1998 – £5.2m) and £8.7m to Africa, Asia and Australasia (1998 – £2.7m).

Analysis of turnover by geographic market	1999 £ million	1998 £ million
United Kingdom	205.8	190.6
Continental Europe	212.4	204.7
America	459.3	414.5
Africa, Asia and Australasia	198.2	168.0
	1,075.7	977.8
Discontinued operations	44.2	75.6
	1,119.9	1,053.4

Analysis of turnover by product	1999 £ million	1998 £ million
Orthopaedics	276.4	237.7
Endoscopy	192.8	173.9
Wound management	230.8	212.1
Casting, support and ENT	189.5	186.2
Medical devices	889.5	809.9
Consumer healthcare	186.2	167.9
	1,075.7	977.8
Discontinued operations	44.2	75.6
	1,119.9	1,053.4

Notes to the accounts

Note 2 Operating profit

	Continuing operations 1999 £ million	Discontinued operations 1999 £ million	Total 1999 £ million	Continuing operations 1998 £ million	Discontinued operations 1998 £ million	Total 1998 £ million
Turnover	1,075.7	44.2	1,119.9	977.8	75.6	1,053.4
Cost of sales	459.2	20.4	479.6	418.1	35.2	453.3
Gross profit	616.5	23.8	640.3	559.7	40.4	600.1
Marketing, selling and distribution	(330.7)	(10.5)	(341.2)	(298.6)	(18.7)	(317.3)
Administration	(118.8)	(6.8)	(125.6)	(95.1)	(10.5)	(105.6)
Research and development	(44.2)	(1.0)	(45.2)	(41.6)	(1.5)	(43.1)
Other	(12.5)	–	(12.5)	2.1	–	2.1
Operating profit	110.3	5.5	115.8	126.5	9.7	136.2

Operating profit includes loss on sales of fixed assets of £1.9m (1998 – gain of £1.9m).

Results of continuing operations have been stated after charging exceptional costs of £51.7m (1998 – £17.9m), which have been allocated in total as follows: cost of sales £12.0m (1998 – £5.7m), marketing, selling and distribution £6.4m (1998 – £2.7m), administration £20.8m (1998 – £9.5m) and other £12.5m (1998 – nil).

Operating profit is stated after charging:	1999 £ million	1998 £ million
Depreciation	50.3	48.6
Amortisation of goodwill	1.8	0.3
Amortisation of other intangibles	4.0	0.8
Exceptional asset provisions	28.6	–
Operating lease rentals for land and buildings	8.2	9.2
Auditors' remuneration	1.1	1.1

Payments made to the group's auditors for non-audit services amounted to £0.5m (1998 – £0.4m) in the UK and £0.8m (1998 – £0.8m) outside the UK. Of these payments £0.8m (1998 – £0.7m) relate to taxation services and £0.5m (1998 – £0.5m) to statutory and other certifications and accountancy services.

Unrecognised gains and losses relating to forward foreign exchange contracts in respect of anticipated purchases over the next 12 months amounted to £3.9m and £2.2m respectively. The group's policy on currency risk management is set out on page 31. The group's operating units hold no material unhedged monetary assets or liabilities other than in their functional operating currency.

Note 3 Exceptional items

Operating exceptional items comprise the cost of the manufacturing rationalisation begun in April 1999 of £34.0m, a £6.5m provision against the cost of intangible fixed assets as set out in Note 11, a £6.0m provision against the group's equity investment in Advanced Tissue Sciences Inc as set out in Note 13 and acquisition integration costs of £5.2m, principally in connection with the Exogen business acquired in September 1999. In 1998 exceptional costs of £17.9m were incurred on a management and work force restructuring programme.

The net profit on disposal relates to the sale of the bracing business in July 1999 for cash consideration of £121.8m. The net profit comprises a gain of £96.4m on net assets realised less £33.5m of acquisition goodwill previously written off to reserves.

Note 4 Interest

	1999 £ million	1998 £ million
Interest receivable	10.3	8.1
Interest payable:		
On bank borrowings	6.1	9.2
On other borrowings	0.8	0.6
	6.9	9.8
	3.4	(1.7)

Interest payable on currency swaps amounting to £25.8m (1998 – £24.8m) has been set off against interest receivable.

At 31 December 1999 the group held sterling interest bearing assets of £560m on which interest has been fixed on £390m at 5.7% for one year and £37m on which interest has been fixed for a further three years at 5.6%, a weighted average of 5.7% for a weighted average period of 1.2 years. The remainder was cash balances held on short term deposit at floating rates. The group also held £14m of foreign currency interest bearing assets as cash or on short term deposit at floating rates.

The group's interest bearing liabilities at 31 December 1999 included £409m of US dollars and £80m of euros on which interest has been fixed for one year on £288m of US dollars and £62m of euros at weighted average rates of 5.7% and 3.0% respectively. Interest has also been fixed on £34m of euros for a further three years at 3.6%. The remaining interest bearing liabilities totalled £62m of various currencies of which the largest was £16m of Australian dollars on which interest has been fixed at 6.0% for one year. Where interest has not been fixed the rates are typically based on the three month interest rate relevant to the currency concerned. Details of financial instruments as defined by Financial Reporting Standard 13 are set out in Notes 13, 15, 16 and 20.

At 31 December 1999 unrecognised gains and losses on the value of interest rate swaps were £3.2m and £3.3m respectively (1998 – gains £7.8m, losses £3.6m). Unrecognised gains of £2.4m will be realised in 2000 and £0.8m between 2001 and 2003. Unrecognised losses on interest rate swaps will be realised in 2000. The unrecognised net losses on interest rate swaps at 31 December 1998 were realised in 1999. The group's interest rate risk management policy is set out on page 31.

Note 5 Employees

The average number of employees during the year was:	1999	1998
United Kingdom	2,973	3,209
Continental Europe	1,602	1,618
America	3,370	4,123
Africa, Asia and Australasia	3,268	3,406
	11,213	12,356

Staff costs during the year amounted to:	£ million	£ million
Wages and salaries	232.1	234.7
Social security costs	25.1	25.5
Other pension costs (Note 28)	9.1	7.8
	266.3	268.0

Note 6 Directors' emoluments

Aggregate emoluments of the directors, including pension entitlements of £78,000 (1998 – £151,000), were £1,789,000 (1998 – £1,564,000).

The emoluments of the highest paid director excluding pension entitlement were £586,000 (1998 – £350,000). The accrued pension benefit of the highest paid director at the end of the year was £75,000 (1998 – £29,000).

Information concerning individual directors' emoluments, pension entitlements, shareholdings and share options is shown on pages 27 to 29.

Note 7 Taxation

	1999 £ million	1998 £ million
United Kingdom:		
Corporation tax at 30.25% (1998 – 31%)	29.7	39.4
Double taxation relief	–	(7.0)
Deferred taxation	(3.8)	(3.2)
	25.9	29.2
Overseas:		
Current taxation	12.1	15.8
Tax on gain on disposal	35.5	–
Deferred taxation	3.8	(2.7)
Adjustments in respect of prior years	–	(1.5)
	51.4	11.6
	77.3	40.8

The tax charge has been reduced by £9.5m (1998 – £4.9m) as a consequence of the exceptional costs of the rationalisation programme and acquisition integration costs and increased by £35.5m (1998 – nil) as a result of the exceptional profit on disposal, leaving the tax charge on ordinary activities at £51.3m (1998 – £45.7m).

If full provision had been made for deferred tax, the tax charge would have increased by £5.7m (1998 – £5.8m) as follows:

	1999 £ million	1998 £ million
Fixed asset timing differences	2.0	3.1
Other timing differences	3.7	2.7
	5.7	5.8

Note 8 Dividends

	1999 £ million	1998 £ million
Ordinary interim of 2.5p (1998 – 2.4p) paid 8 December 1999	27.8	26.7
Proposed ordinary final of 4.0p (1998 – 3.8p) payable 2 June 2000	44.7	42.5
	72.5	69.2

Non-equity preference dividends amounting to £13,000 were paid (1998 – £10,000).

Note 9 Results before exceptional items

In order to provide a trend measure of underlying performance, profit before taxation is adjusted below to exclude exceptional items, and basic earnings per share has been recalculated as set out in Note 10.

	1999 £ million	1998 £ million
Profit on ordinary activities before taxation	182.1	134.5
Adjustments:		
Discontinued operations: net gain on disposal	(62.9)	–
Continuing operations: exceptional items	51.7	17.9
	(11.2)	17.9
Profit before taxation and exceptional items	170.9	152.4
Taxation on profit before exceptional items	51.3	45.7

Note 10 Earnings per ordinary share

Basic earnings per ordinary share of 9.39p (1998 – 8.42p) are based on profit on ordinary activities after taxation and preference dividends of £104.8m (1998 – £93.7m) and on 1,116m ordinary shares being the basic weighted average number of shares in issue during the year (1998 – 1,113m).

The calculation of diluted earnings per ordinary share is based on basic earnings as defined above and on 1,119m ordinary shares (1998 – 1,115m) calculated as follows:

	Shares 1999 million	Shares 1998 million
Basic weighted average number of shares	1,116	1,113
Weighted average number of shares under option	16	15
Number of shares that would have been issued at fair value	(13)	(13)
Diluted weighted average number of shares	1,119	1,115
Diluted earnings per ordinary share	9.37p	8.40p

The calculation of adjusted basic earnings per ordinary share is based on the basic weighted average number of shares, together with basic earnings as defined above, adjusted to exclude exceptional items as follows:

	1999 £ million	1998 £ million
Basic earnings	104.8	93.7
Discontinued operations: net gain on disposal	(62.9)	–
Continuing operations: exceptional items	51.7	17.9
Exceptional taxation	26.0	(4.9)
Adjusted basic earnings	119.6	106.7
Adjusted basic earnings per ordinary share	10.72p	9.58p

Note 11 Intangible fixed assets

Group	Goodwill £ million	Other £ million	Total £ million
Cost:			
At 1 January 1999	7.6	24.9	32.5
Exchange adjustment	0.4	0.6	1.0
Acquisitions	41.1	9.3	50.4
Additions	–	7.3	7.3
Discontinued operations	–	(1.2)	(1.2)
At 31 December 1999	49.1	40.9	90.0
Amortisation:			
At 1 January 1999	0.3	3.9	4.2
Exchange adjustment	–	0.1	0.1
Charge for the year	1.8	4.0	5.8
Exceptional provision	–	6.5	6.5
Discontinued operations	–	(0.6)	(0.6)
At 31 December 1999	2.1	13.9	16.0
Net book amounts:			
At 31 December 1999	47.0	27.0	74.0
At 31 December 1998	7.3	21.0	28.3

The cost of intangible fixed assets includes £15.5m in respect of milestone payments to Advanced Tissue Sciences Inc for a 50% interest in the intellectual property rights for Dermagraft. A £6.5m provision has been taken against this investment. This has been based on current projections of product sales over the expected life cycle of the technology, which include annual sales increasing significantly above the long term average applicable GDP growth rates in the first ten years and declining thereafter. Resultant net cash flows have been discounted at an appropriate rate.

Note 12 Tangible fixed assets

Group	Land and buildings freehold £ million	leasehold £ million	Plant and equipment £ million	In course of construction £ million	Total £ million
Cost:					
At 1 January 1999	85.6	15.1	443.5	32.6	576.8
Exchange adjustment	0.7	0.1	2.8	0.3	3.9
Additions	0.8	0.5	32.4	23.9	57.6
Disposals	(3.3)	(1.6)	(26.9)	(0.6)	(32.4)
Discontinued operations	(0.2)	(3.2)	(8.6)	–	(12.0)
Transfers	0.1	0.3	38.5	(38.9)	–
At 31 December 1999	83.7	11.2	481.7	17.3	593.9
Depreciation:					
At 1 January 1999	14.8	4.0	266.3	–	285.1
Exchange adjustments	–	0.1	1.6	–	1.7
Charge for the year	1.2	0.6	48.5	–	50.3
Exceptional provision	3.6	–	12.5	–	16.1
Disposals	(1.4)	(0.4)	(20.0)	–	(21.8)
Discontinued operations	–	(1.1)	(6.9)	–	(8.0)
At 31 December 1999	18.2	3.2	302.0	–	323.4
Net book amounts:					
At 31 December 1999	65.5	8.0	179.7	17.3	270.5
At 31 December 1998	70.8	11.1	177.2	32.6	291.7

Fixed assets include land with a cost of £5.8m (1998 – £7.2m) that is not subject to depreciation. Leases with less than 50 years to run amounted to £5.1m (1998 – £7.6m). Included in the amounts above are assets held under finance leases with a net book amount of £3.0m (1998 – £3.4m).

Note 12 Tangible fixed assets continued

Parent company

The opening net book amount of £9.8m represented £1.9m land and buildings and £7.9m plant and equipment, with a cost of £2.5m and £17.1m respectively. Movements in the year comprised £2.0m of additions and £2.3m of disposals. The depreciation charged in the year was £1.4m (1998 – £1.4m). The closing net book value of £8.1m represented plant and equipment with a cost of £17.1m.

Note 13 Investments

	Group associated undertakings £ million	Group trade investments £ million	Group total £ million	Parent subsidiary undertakings £ million
At 1 January 1999	0.6	13.8	14.4	413.9
Exchange adjustment	0.1	0.4	0.5	–
Acquisitions	–	6.7	6.7	–
Transfers	–	1.0	1.0	–
Exceptional provision	–	(6.0)	(6.0)	–
At 31 December 1999	0.7	15.9	16.6	413.9

Principal subsidiary and associated undertakings are listed on pages 54 and 55. Trade investments are US dollar denominated and include an 8% equity investment in Advanced Tissue Sciences Inc, quoted on the Nasdaq exchange in the US. An exceptional provision of £6.0m has been taken to state the carrying cost of this investment at £13.1m, equivalent to $4.90 per share. The quoted market price of the company at 31 December 1999 and 22 February 2000 was $2.50 and $8.50 respectively.

Note 14 Stocks

	Group 1999 £ million	Group 1998 £ million
Raw materials and consumables	52.1	56.9
Work in progress	16.1	17.9
Finished goods and goods for resale	169.4	167.6
	237.6	242.4

Note 15 Debtors

	Group 1999 £ million	Group 1998 £ million	Parent 1999 £ million	Parent 1998 £ million
Amounts falling due within one year:				
Trade and other debtors	241.8	233.1	2.4	1.4
Amounts owed by subsidiary undertakings	–	–	466.7	653.4
Prepayments and accrued income	23.6	19.9	7.4	7.2
Advance corporation tax	–	3.3	–	–
	265.4	256.3	476.5	662.0
Amounts falling due after more than one year:				
Pension prepayments (Note 28)	5.7	5.8	–	–
Other debtors	2.7	9.4	–	–
Deferred taxation (Note 19)	7.3	7.1	0.3	–
	281.1	278.6	476.8	662.0

Other debtors falling due after more than one year are non interest bearing, denominated in various currencies and are stated at fair value.

Note 16 Borrowings

Net borrowings	Group 1999 £ million	Group 1998 £ million	Parent 1999 £ million	Parent 1998 £ million
Gross borrowings:				
Due within one year	58.0	86.6	28.9	55.0
Due after one year	20.2	12.8	4.5	5.8
	78.2	99.4	33.4	60.8
Cash and bank	(100.5)	(49.9)	(77.2)	(24.0)
	(22.3)	49.5	(43.8)	36.8

Gross borrowings				
Bank loans and overdrafts	75.9	95.4	33.0	59.3
Other loans wholly repayable within five years:				
5½% US dollar convertible bonds 2000	0.2	1.1	0.2	1.1
Other	1.8	2.2	0.2	0.4
	2.0	3.3	0.4	1.5
Other loans wholly repayable after five years	0.3	0.7	–	–
	78.2	99.4	33.4	60.8

Bank loans and overdrafts represent drawings under committed and uncommitted facilities of £170m and £320m respectively. £150m of the committed facilities expire within one year. Borrowings secured on fixed and current assets were £1.7m (1998 – £2.2m). Borrowings are shown at fair value. The group's liquidity risk management policy is set out on page 31.

The group and parent company have currency swaps which are revalued at year end exchange rates and have maturities ranging from 1999 to 2005. For the group, gross sterling equivalents of £477.6m (1998 – £442.3m) receivable and £484.3m (1998 – £450.1m) payable have been netted. The balance of £6.7m is included as £4.4m in cash and bank and as £11.1m in borrowings (1998 – £2.7m in cash and bank and £10.5m in borrowings). For the parent company, gross sterling equivalents of £446.5m (1998 – £406.1m) receivable and £453.9m (1998 – £415.7m) payable have been netted, the balance of £7.4m (1998 – £9.6m) is included as £3.7m in cash and bank and as £11.1m in borrowings (1998 – £0.9m in cash and bank and £10.5m in borrowings). Currency swaps comprise floating interest rate contracts and forward foreign exchange contracts and are used for hedging foreign investments.

The 5½% US dollar convertible bonds are convertible into ordinary shares at 109p per share at a fixed exchange rate of US dollar 1.4202 to £1. If not converted the bonds are repayable by 18 December 2000.

Note 16 Borrowings continued

Gross borrowings are repayable as follows:	Group 1999 £ million	Group 1998 £ million	Parent 1999 £ million	Parent 1998 £ million
Within one year:				
Bank loans and overdrafts	57.5	86.2	28.7	55.0
Other loans	0.5	0.4	0.2	–
Total within one year	58.0	86.6	28.9	55.0
Bank loans and overdrafts:				
After one year and within two years	3.5	4.3	2.5	4.3
After two years and within five years	14.9	4.9	1.8	–
	18.4	9.2	4.3	4.3
Other loans:				
After one year and within two years	0.3	0.3	–	–
After two years and within five years	1.2	2.6	0.2	1.5
After five years	0.3	0.7	–	–
	1.8	3.6	0.2	1.5
Total after one year	20.2	12.8	4.5	5.8
	78.2	99.4	33.4	60.8

In addition to the above gross borrowings, other financial liabilities are £0.3m being 5½% undated cumulative preference shares as set out in Note 20.

Note 17 Other creditors

	Group 1999 £ million	Group 1998 £ million	Parent 1999 £ million	Parent 1998 £ million
Trade creditors	128.5	128.4	2.4	2.0
Amounts owed to subsidiary undertakings	–	–	221.2	295.8
Social security costs and other taxes	14.8	16.3	0.3	0.2
Accruals and deferred income	49.7	41.6	11.0	9.0
Current taxation	74.7	60.2	20.2	19.8
Ordinary share dividends	44.7	42.5	44.7	42.5
	312.4	289.0	299.8	369.3

Note 18 Provisions for liabilities and charges

Group	Rationalisation and integration £ million	Retirement healthcare £ million	Other £ million	Total £ million
At 1 January 1999	14.3	8.5	8.6	31.4
Exchange adjustments	0.2	0.2	0.1	0.5
Profit and loss account	17.0	0.7	10.9	28.6
Utilisation	(13.3)	(0.6)	(8.6)	(22.5)
At 31 December 1999	18.2	8.8	11.0	38.0

At 31 December 1999 rationalisation and integration provisions included acquisition integration of £3.6m (1998 – £0.6m). The retirement healthcare provision is long term in nature, as is the timing of its utilisation. All other provisions are expected to be utilised within three years. There are no provisions for contractual amounts and hence none is treated as a financial instrument.

Parent company

The movement in provisions for liabilities and charges in the year from £1.3m to £0.9m represented expenditure of £0.4m.

Note 19 Deferred taxation

Group	£ million
At 1 January 1999	7.1
Exchange adjustment	0.2
At 31 December 1999	7.3

Deferred tax asset/(liability) is analysed as follows: Group	Amount provided 1999 £ million	Amount provided 1998 £ million	Full potential liability 1999 £ million	Full potential liability 1998 £ million
Fixed asset timing differences	(3.3)	(0.3)	(30.2)	(28.3)
Other timing differences	10.6	7.4	16.2	20.4
	7.3	7.1	(14.0)	(7.9)

Parent company

The parent company has a full potential deferred tax liability of £1.5m represented by fixed asset timing differences. The full potential deferred tax liability in 1998 of £2.8m was represented by fixed asset timing differences.

Note 20 Called up share capital

Authorised	Shares 1999 '000	1999 £ million	Shares 1998 '000	1998 £ million
Ordinary shares 10p	1,495,500	149.5	1,495,500	149.5
5½% cumulative preference shares £1	450	0.5	450	0.5
		150.0		150.0

Allotted, issued and fully paid Equity capital: ordinary shares 10p	Shares '000	£ million
At 1 January 1999	1,114,270	111.4
Share options and convertible bonds	3,275	0.4
At 31 December 1999	1,117,545	111.8
Non-equity capital: 5½% cumulative preference shares £1		
At 1 January 1999 and 31 December 1999	269	0.3
Total called up share capital at 31 December 1999		112.1

The 5½% cumulative preference shares are denominated in sterling and are shown at fair value. They are non-voting and carry preferential rights to dividends and distribution on winding up.

Note 21 Share option schemes

At 31 December 1999 25,464,000 (1998 – 24,369,000) of the authorised but unissued ordinary shares of 10p were reserved in respect of the following options:

	Exercisable in stages between	Exercise prices per share range between	Shares the subject of options '000
Employee share option schemes	2000-2005	123.2p -156.0p	7,421
Executive share option schemes	2000-2009	93.5p -195.5p	18,043
			25,464

Note 22 Reserves

Group	Share premium £ million	Profit and loss account £ million
At 1 January 1999	114.3	259.5
Exchange adjustment	–	(4.0)
Retained profit for the year	–	32.3
Share options and convertible bonds	4.0	–
Goodwill on disposals	–	33.5
At 31 December 1999	118.3	321.3

Net exchange losses of £9.5m (1998 – gains of £1.8m) arising on foreign currency net borrowings have been taken directly to reserves.

The cumulative amount of goodwill (before merger relief of £116.0m) charged to reserves is £368.8m (1998 – £398.4m). The decrease is due to the goodwill written back to reserves on the disposal of the bracing business of £33.5m and exchange on acquisitions made prior to 31 December 1998 of £3.9m.

Parent company	Share premium £ million	Profit and loss account £ million
At 1 January 1999	114.3	452.3
Retained loss for the year	–	(40.8)
Share options and convertible bonds	4.0	–
At 31 December 1999	118.3	411.5

In accordance with the exemption permitted by Section 230(3) of the Companies Act 1985, the parent company has not presented its own profit and loss account. The attributable profit for the year dealt with in the accounts of the parent company is £31.7m (1998 – £70.5m).

Note 23 Cash flow statement

Reconciliation of operating profit to net cash flow from operating activities	1999 £ million	1998 £ million
Operating profit	115.8	136.2
Depreciation and amortisation	56.1	49.7
Exceptional asset write downs	28.6	–
Loss/(profit) on sale of tangible fixed assets	1.9	(1.9)
Rationalisation and integration costs	(18.5)	(9.5)
Decrease/(increase) in stocks	0.6	(20.5)
Increase in debtors	(14.2)	(8.3)
Increase in creditors and provisions	27.8	16.2
Net cash inflow from operating activities	198.1	161.9

Analysis of net borrowings	Opening net borrowings £ million	Cash flow £ million	Exchange adjustments £ million	Closing net borrowings £ million
Cash	47.2	(21.7)	(1.7)	23.8
Overdrafts	(11.7)	6.6	–	(5.1)
	35.5	(15.1)	(1.7)	18.7
Borrowings due within one year	(64.4)	19.1	(0.7)	(46.0)
Borrowings due after one year	(12.8)	(2.3)	(0.9)	(16.0)
	(41.7)	1.7	(3.3)	(43.3)
Net currency swaps	(7.8)	7.3	(6.2)	(6.7)
Liquid resources: cash deposits	–	72.3	–	72.3
	(49.5)	81.3	(9.5)	22.3

Cash and bank at 31 December 1999 totals £100.5m (1998 – £49.9m) and comprises cash £23.8m (1998 – £47.2m), liquid resources £72.3m (1998 – nil) and currency swaps of £4.4m (1998 – £2.7m) as detailed in Note 16.

Reconciliation of net cash flow to movement in net borrowings

for the year ended 31 December 1999	1999 £ million	1998 £ million
Change in cash in the year	(15.1)	(5.6)
Change in liquid resources	72.3	(1.5)
Change in net currency swaps	7.3	(7.3)
Change in borrowings	16.8	9.7
Change in net cash/borrowings from cash flows	81.3	(4.7)
Exchange adjustments	(9.5)	1.8
Change in net cash/borrowings in the year	71.8	(2.9)
Opening net borrowings	(49.5)	(46.6)
Closing net cash/(borrowings)	22.3	(49.5)

Disposals

The net assets of the bracing business disposed of in the year comprised fixed assets £4.6m, stocks £8.5m, debtors £10.2m and creditors and provisions £6.1m. During the year the business contributed £2.6m of the group's net operating cash flows and incurred capital expenditure amounting to £0.9m.

Note 24 Currency translation

The exchange rates used for the translation of currencies that have the most significant impact on the group results were:

	Average rate 1999	Average rate 1998	Year end rate 1999	Year end rate 1998
US dollar	1.62	1.66	1.61	1.66
French franc	10.04	9.78	10.55	9.29
German mark	2.99	2.92	3.14	2.77
Australian dollar	2.49	2.65	2.46	2.71
South African rand	9.87	9.21	9.92	9.79

Note 25 Acquisitions

The principal acquisitions during the year were the Exogen orthopaedic business acquired in September 1999 and an intangible fixed asset addition of £9.3m in Advanced Tissue Sciences in January 1999. Under the acquisition method of accounting the impact on the consolidated balance sheet of acquisitions in the year was:

	Net book value £ million
Intangible fixed assets	9.3
Tangible fixed assets	0.5
Current assets	4.5
Current liabilities	(4.5)
	9.8
Goodwill	41.1
Cash consideration	50.9

There were no fair value adjustments with respect to the acquisitions.

Note 26 Financial commitments

Group capital expenditure contracted but not provided for in these accounts amounted to £2.1m (1998 – £4.9m).

Under the group's joint arrangement with Advanced Tissue Sciences for the treatment of diabetic foot ulcers and other wound indications, amounts of up to £6m could become payable in the future, subject to achievement of certain milestones related to regulatory and reimbursement approvals, with further amounts payable on future regulatory, reimbursement and sales milestones, providing profits exceed certain minimum levels.

The annual commitments of the group under operating leases were:

Operating leases which expire:	Land and buildings 1999 £ million	Land and buildings 1998 £ million	Other assets 1999 £ million	Other assets 1998 £ million
Within one year	1.7	1.0	2.2	1.6
After one year and within five years	3.4	4.6	5.6	6.1
After five years	2.3	3.1	–	–
	7.4	8.7	7.8	7.7

Notes to the accounts

Note 27 Contingent liabilities

	Group 1999 £ million	Group 1998 £ million	Parent 1999 £ million	Parent 1998 £ million
Guarantees in respect of subsidiary undertakings' borrowings	–	–	17.3	15.1
Other	3.5	8.5	3.5	8.5
	3.5	8.5	20.8	23.6

The group is party to legal proceedings in the normal course of business which it is considered will not result in any material adverse effect.

Note 28 Post-retirement benefits

The group sponsors pension plans for its employees in most of the countries in which it has major operating companies. In those countries where there is no company-sponsored pension plan, the state benefits are considered adequate. Employees' retirement benefits are the subject of regular management review.

The group's major pension plans are of the defined benefit type. The group also operates defined contribution type plans appropriate to local circumstances. Pension plans are established under the laws of the relevant territory with their assets held in separate trust funds or by insurance companies.

The pension cost for the group's defined benefit plans have been determined by independent qualified actuaries, using the projected unit method to give a substantially level percentage cost on the current and expected future pensionable payroll. The excess of plan assets over plan liabilities is amortised, using the percentage of payroll method, over the weighted average of expected pensionable payroll and remaining service lives of current employees in the plan. The actuarial assumptions used vary according to local circumstances, the most significant being those in the UK and the US:

	UK % per annum	US % per annum
Return on investments	8.5	9.0
Increase in pensionable earnings	5.0	6.0
Increase in pensions	3.5	nil
Increase in dividend income	5.1	n/a
Inflation	3.5	3.0
Average remaining service lives	10.0 years	13.2 years

Note 28 **Post-retirement benefits** continued

At the date of the most recent actuarial valuations (which took place between October 1997 and January 1999) the aggregate market value of the assets of the group's major defined benefit plans was £256m (1998 – £234m). The actuarial value of plan assets represented 103% of plan liabilities for accrued benefits, including allowance for projected future increases in salaries.

Included in debtors due after more than one year is a prepayment of £5.7m (1998 – £5.8m) relating to the excess funding of certain group pension plans. Included in creditors is an accrual of £12.0m (1998 – £9.3m) relating to the deferred funding of certain group pension plans.

At the balance sheet date the unamortised balance of the actuarial value of plan assets over liabilities not recognised in the group accounts was £12.7m (1998 – £19.1m).

The group recharges the group's UK pension schemes with the costs of administration and independent advisers borne by the group. The total amount recharged in the year to 31 December 1999 was £0.5m (1998 – £0.4m). The amount receivable at 31 December 1999 was £0.1m (1998 – £0.1m).

The costs of providing healthcare benefits after retirement of £0.7m (1998 – £0.7m) are determined by independent qualified actuaries. The unfunded liability of £8.8m (1998 – £8.5m) in respect of the accrued healthcare benefits is included in provisions. The principal actuarial assumptions that are most significant in determining the cost of providing healthcare benefits are those in the UK and the US:

	UK % per annum	US % per annum
Interest rate	5.5	9.0
Medical cost inflation	6.5	7.5

Subsidiary and associated undertakings

Principal subsidiary undertakings

The information provided below is given for principal subsidiary undertakings in accordance with Section 231(5)(a) of the Companies Act 1985. A full list will be appended to the company's next annual return.

	Activity	Country of operation and incorporation	% owned
United Kingdom			
Smith & Nephew Healthcare Limited	Medical devices	United Kingdom	100%
Smith & Nephew Homecraft Limited	Medical devices	United Kingdom	100%
Smith & Nephew Medical Limited	Medical devices	United Kingdom	100%
Smith & Nephew Medical Fabrics Limited*	Medical devices	United Kingdom	100%
TJ Smith & Nephew Limited	Medical devices	United Kingdom	100%
Smith & Nephew Consumer Products Limited	Consumer healthcare	United Kingdom	100%
Continental Europe			
Smith & Nephew GmbH	Medical devices	Austria	100%
Smith & Nephew SA-NV	Medical devices	Belgium	100%
Smith & Nephew A/S	Medical devices	Denmark	100%
Smith & Nephew OY	Medical devices	Finland	100%
Smith & Nephew SA	Medical devices	France	100%
Smith & Nephew GmbH	Medical devices	Germany	100%
Smith & Nephew Orthopaedics GmbH	Medical devices	Germany	100%
Smith & Nephew Limited	Medical devices & consumer healthcare	Ireland	100%
Smith & Nephew Srl	Medical devices	Italy	100%
Smith & Nephew BV	Medical devices	Netherlands	100%
Smith & Nephew A/S	Medical devices	Norway	100%
Smith & Nephew Lda	Medical devices	Portugal	100%
Smith & Nephew SA	Medical devices	Spain	100%
Smith & Nephew AB	Medical devices	Sweden	100%
Smith & Nephew AG	Medical devices	Switzerland	100%
America			
Smith & Nephew Inc	Medical devices & consumer healthcare	Canada	100%
Smith & Nephew SA de CV	Medical devices	Mexico	100%
Smith & Nephew Inc	Medical devices	Puerto Rico	100%
Smith & Nephew Inc	Medical devices	United States	100%

*Owned directly by the parent company

Principal subsidiary undertakings continued

	Activity	Country of operation and incorporation	% owned
Africa, Asia and Australasia			
Smith & Nephew Pty Limited	Medical devices & consumer healthcare	Australia	100%
Smith & Nephew Limited	Medical devices & consumer healthcare	Hong Kong	100%
Smith & Nephew Healthcare Limited	Medical devices	India	100%
PT Smith & Nephew Healthcare	Medical devices & consumer healthcare	Indonesia	100%
Smith & Nephew KK	Medical devices	Japan	100%
Smith & Nephew Limited	Medical devices	Korea	100%
Smith & Nephew Healthcare Sdn Berhad	Medical devices & consumer healthcare	Malaysia	100%
Smith & Nephew Limited	Medical devices & consumer healthcare	New Zealand	100%
Smith & Nephew Pakistan (Pvt) Limited	Medical devices & consumer healthcare	Pakistan	97%
Smith & Nephew Pte Limited	Medical devices & consumer healthcare	Singapore	100%
Smith & Nephew Limited	Medical devices & consumer healthcare	South Africa	100%
Smith & Nephew Limited	Medical devices	Thailand	100%
Smith & Nephew FZE	Medical devices	United Arab Emirates	100%

Principal associated undertakings and other arrangements

The group owns 49% of Eurociencia CA, a Venezuelan healthcare company, which has a share capital of £0.2m (1998 – £0.2m). There are no debt securities attributable to the group's interest.

The group has interests in two joint arrangements with Advanced Tissue Sciences Inc, one relating to products for the treatment of diabetic foot ulcers and other wound indications, and the other to cartilage replacement.

Group five year summary

Profit and loss account	1999 £ million	1998 £ million	1997 £ million	1996 £ million	1995 £ million
Turnover					
Continuing and acquired operations	1,075.7	977.8	961.2	980.2	902.8
Discontinued operations	44.2	75.6	86.9	89.0	123.5
	1,119.9	1,053.4	1,048.1	1,069.2	1,026.3
Operating profit					
Continuing and acquired operations:					
Before exceptional items	162.0	144.4	154.4	177.1	169.9
Exceptional items*	(51.7)	(17.9)	(1.8)	(4.4)	(14.6)
Discontinued operations	5.5	9.7	10.2	10.8	15.1
	115.8	136.2	162.8	183.5	170.4
Profit/(loss) on disposals*	62.9	–	(6.5)	0.9	11.0
Profit before interest	178.7	136.2	156.3	184.4	181.4
Interest receivable/(payable)	3.4	(1.7)	(3.9)	(5.7)	(4.6)
Profit before taxation	182.1	134.5	152.4	178.7	176.8
Taxation	77.3	40.8	38.7	58.0	64.0
Profit after taxation	104.8	93.7	113.7	120.7	112.8
Ordinary dividends	72.5	69.2	69.0	66.5	62.3
Retained profit	32.3	24.5	44.7	54.2	50.5
Basic earnings per ordinary share	9.39p	8.42p	10.24p	10.92p	10.29p
Diluted earnings per ordinary share	9.37p	8.40p	10.22p	10.86p	10.24p
Dividends per ordinary share	6.50p	6.20p	6.20p	6.00p	5.65p
Results before exceptional items (*):					
Profit before taxation	170.9	152.4	160.7	182.2	180.4
Adjusted earnings per ordinary share	10.72p	9.58p	11.00p	11.21p	11.04p
Operating profit (before exceptional items) to sales	15.0%	14.6%	15.7%	17.6%	18.0%
Research and development costs to sales	4.0%	4.1%	4.0%	3.9%	3.6%
Capital investment (including intangibles) to sales	5.8%	6.6%	7.1%	6.7%	6.8%

Balance sheet	1999 £ million	1998 £ million	1997 £ million	1996 £ million	1995 £ million
Fixed assets	361.1	334.4	302.0	277.3	278.7
Working capital	206.3	232.0	235.8	233.4	259.3
Provisions	(38.0)	(31.4)	(29.9)	(32.3)	(51.3)
Capital employed	529.4	535.0	507.9	478.4	486.7
Called up share capital	112.1	111.7	111.5	111.0	110.5
Reserves	439.6	373.8	349.8	324.4	294.2
Capital and reserves	551.7	485.5	461.3	435.4	404.7
Net (cash)/borrowings	(22.3)	49.5	46.6	43.0	82.0
	529.4	535.0	507.9	478.4	486.7
Operating profit (before exceptional items) to average capital employed	31%	30%	33%	39%	40%
Gearing	nil	10%	10%	10%	20%

Cash flow					
Cash inflow from operating activities	198.1	161.9	181.7	189.3	180.3
Capital expenditure and financial investment	(65.1)	(61.9)	(66.8)	(63.4)	(61.8)
	133.0	100.0	114.9	125.9	118.5
Interest, tax and dividends	(127.0)	(91.3)	(113.0)	(106.3)	(133.4)
Acquisitions and disposals	70.9	(16.4)	(8.0)	(42.6)	(73.8)
Issues of share capital	4.4	3.0	4.3	5.2	11.3
Net cash flow	81.3	(4.7)	(1.8)	(17.8)	(77.4)
Exchange adjustments	(9.5)	1.8	(1.8)	56.8	(9.6)
Opening net borrowings	(49.5)	(46.6)	(43.0)	(82.0)	5.0
Closing net cash/(borrowings)	22.3	(49.5)	(46.6)	(43.0)	(82.0)

Information for shareholders

Analysis of shareholdings

The number of shareholders as at 31 December 1999 was 28,285.

Shareholders range:	Shareholders %	Shares %
1,000 and under	31.9	0.4
1,001 to 5,000	46.3	2.9
5,001 to 10,000	11.8	2.1
10,001 to 100,000	7.7	4.6
Over 100,000	2.3	90.0
Held by:		
Individuals	83.8	7.3
Institutions and companies	16.2	92.7

Financial calendar

Annual General Meeting	11 April 2000
Payment of 1999 final dividend	2 June 2000
Interim results announced	8 August 2000
Payment of 2000 interim dividend	6 December 2000
Full year results announced	mid February 2001
Annual report posted	early March 2001
Annual General Meeting	3 April 2001

Final dividend

The ordinary shares will trade ex-dividend on both the London and New York Stock Exchanges from 2 May 2000 and the record date will be 8 May 2000 in respect of this year's proposed final dividend to be paid on 2 June 2000.

Ordinary shares

Payment of cash dividends

Shareholders who wish their dividends to be paid directly to a bank or building society and who have not already completed a BACS mandate should contact the company's registrars.

Dividend re-investment plan

The company has a dividend re-investment plan that offers shareholders the opportunity to invest their cash dividends in Smith & Nephew shares, which are purchased in the market at competitive dealing costs. Application forms for re-investing the 1999 final dividend are available from Lloyds TSB Registrars, telephone 01903 854287, who administer the plan on behalf of the company. Applications for re-investment should be returned to the company's registrars by 15 May 2000.

UK capital gains tax

For the purposes of capital gains tax the price of ordinary shares on 31 March 1982 was 28.67p.

Registrars

Lloyds TSB Registrars are the company's registrars and maintain the share register. Any enquiries about shareholdings in Smith & Nephew should be directed to:

Lloyds TSB Registrars
The Causeway
Worthing
West Sussex BN99 6DA
Telephone: 0870 600 3996

Correspondence should refer to Smith & Nephew marked for the attention of Team 54 Reference 530 and state clearly the registered name and address of the shareholder.

Smith & Nephew share price

The company's share price is quoted daily in national newspapers, as well as on Ceefax and Teletext and at www.londonstockexchange.com where it is updated at intervals throughout the day. The Financial Times Cityline Service, telephone 0891 434043, provides an up to the minute share price. A fee is charged for this service.

Low-cost dealing service

A postal facility that provides a simple low-cost method of buying and selling Smith & Nephew shares is available through:

Hoare Govett Limited
250 Bishopsgate
London EC2M 4AA
Telephone: 020 7678 8300

American depositary receipts (ADRs)

Smith & Nephew's ordinary shares are traded on the New York Stock Exchange (symbol: SNN) in the form of American Depositary Shares, evidenced by ADRs. ADRs are issued by the Bank of New York which acts as depositary. Each American Depositary Share represents ten ordinary shares. Voting rights as a shareholder are exercised through the depositary.

All enquiries regarding ADR holder accounts and payment of dividends should be addressed to:

Bank of New York
Church Street Station
PO Box 11258
New York
New York 10286-1258

Smith & Nephew ADR price

The company's ADR price is quoted daily in the Wall Street Journal and can be obtained from the official New York Stock Exchange website (www.nyse.com).

Global BuyDIRECT

A Global BuyDIRECT plan for Smith & Nephew's ADR programme will be available in March from the Bank of New York. Global BuyDIRECT is a direct ADR purchase/sale and dividend re-investment plan for ADR investors who are resident in the US. This plan enables existing and first-time investors to invest directly in ADRs with reduced brokerage commissions and service costs. For further information, contact the Bank of New York on 1-888-BNY-ADRS (toll-free) or visit www.adrbny.com.

Annual General Meeting

The company's 63rd Annual General Meeting is to be held on 11 April 2000 at 11.00 am at the London Marriott Hotel, Grosvenor Square, London W1A 4AW. Notice of the meeting is enclosed with an accompanying letter from the Chairman.

Registered office

Smith & Nephew plc
Heron House
15 Adam Street
London WC2N 6LA

Registered in England No. 324357

Advisers

Solicitors:	Ashurst Morris Crisp
Auditors:	Ernst & Young
Stockbrokers:	Cazenove & Co Dresdner Kleinwort Benson

World Wide Web

The company's address on the web is www.smith-nephew.com. Recent press releases are on the website together with the latest annual and interim reports.

Trademarks

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