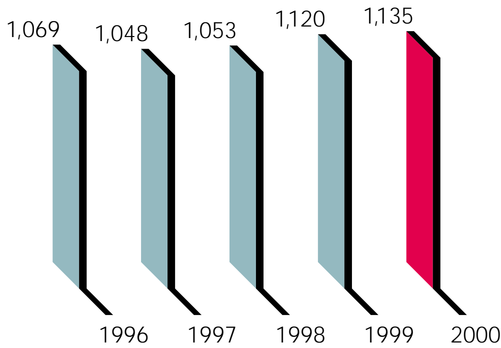
The facts behind the figures

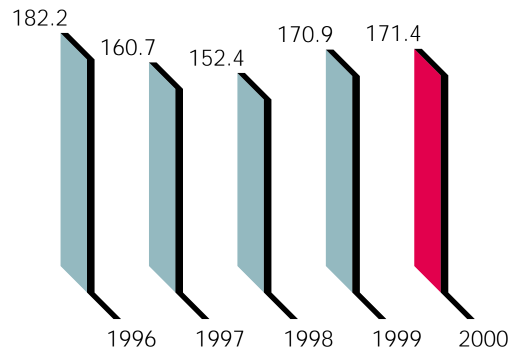
Strong financial performance

Underlying sales growth in our ongoing business areas was 9% and margins rose from 16% to 17%. Adjusted earnings per share were up by 8% after 7% restructuring dilution. Key factors in this achievement were the increasing innovation and strength of the product range and the planned expansion of our sales teams worldwide. Margins benefited from continuing manufacturing efficiencies and rationalisation.

Turnover
£ million



Profit before tax and exceptional items
£ million



Chairman's statement

Two years ago, we announced a plan to transform Smith & Nephew. Over three years the business would change from a healthcare conglomerate into a group focused on long term growth markets in medical devices. The measure of our success would be a substantial improvement in financial performance – with margins up by three percentage points to 17% and high single-digit earnings growth each year.

I am pleased to report that the transformation is progressing ahead of schedule. We are meeting our financial targets and have delivered a substantial increase in value for shareholders.

During 2000 we largely completed the repositioning of the business. In June we sold our consumer products business for a net consideration of £210m. In October we announced a joint venture with Beiersdorf to include both companies' traditional woundcare, casting, bandaging and compression hosiery (phlebology) businesses. We also agreed the purchase of Beiersdorf's advanced woundcare business for £30m and announced our intention to divest our ENT business.

Financial performance

Sales and profits in our ongoing business areas continued to grow well. The underlying sales growth was 9% and margins continued to strengthen despite the divestment of our profitable consumer business. Adjusted earnings per share (EPS) rose 8% to 11.61p.

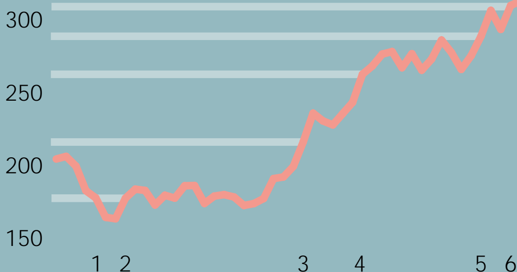
Importantly, investors are recognising the transformation in Smith & Nephew's growth prospects. Their confidence in our future has been reflected in a shareholder return of 43% in the year.

Capital structure and dividend

During the year we created a more efficient and cash generative capital structure and returned cash to shareholders, delivering the promised benefits from our active management of the business portfolio.

In August we paid shareholders a special dividend totalling £416m – 37.14p per share – and in a related share consolidation issued nine new shares for each 11 previously held. We also announced a change in dividend policy as part of our strategic emphasis on making Smith & Nephew a recognised growth business. Our intention is that shareholders' future returns will come increasingly from real growth in the value of their shares and so will depend less on the dividend. We have therefore raised our dividend cover to around 2.5 times, and accordingly propose a final dividend of 2.8p per ordinary share. This gives a total for the year of 4.5p, compared with 6.5p in 1999. The reduction in dividend will leave more cash in the business for future investment in acquisitions and organic growth, to support further improvement in shareholder value.

Share price (pence)



Share price progression in 2000

1 31.01.00 Acquisition of Collagenase
2 21.02.00 1999 Preliminary Results
3 28.06.00 Sale of Consumer/Intended JV/Capital Restructure
4 07.08.00 2000 Interim Results
5 02.11.00 JV signed/announced increased EPS target
6 20.11.00 Acquisition of Orthopaedic Biosystems

Board

Two directors left the board in October. Deputy Chief Executive Alan Fryer took early retirement following the restructuring of the Group; Dr Nancy Lane, a non-executive director, retired after three terms. Alan has had a distinguished career with the company over 31 years, 13 of them as a board member, and Nancy has been a director for nine years. We are grateful for all that they have both contributed and wish them well.

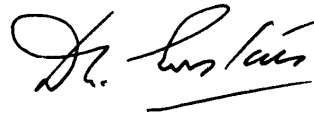
We have taken the opportunity to widen the board's international experience by bringing in two new non-executive directors from the USA. Warren Knowlton, who joined in November, is Chief Executive Officer of the US operations of Pilkington and worldwide President of its automotive and aerospace activities. Richard De Schutter, who joined in January 2001, is Chairman and Chief Executive Officer of The Dupont Pharmaceuticals Company. He was previously Chairman and Chief Executive Officer of G.D. Searle, the pharmaceutical subsidiary of the Monsanto Company, and was until recently Senior Vice President of Pharmacia Corporation.

Outlook

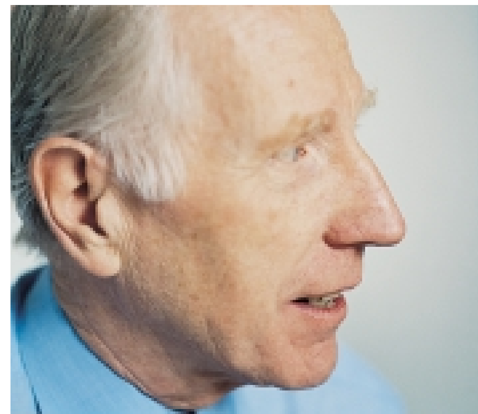
Two-thirds of the way through the transformation programme, Smith & Nephew is in better shape than ever to seize the opportunities for growth in its chosen markets.

Our targets for growth in margins and EPS were ambitious, but we have demonstrated our ability to meet them. Indeed, our progress has been so encouraging that in October we decided to raise the bar: in the three years from 2002 our targeted EPS growth rate is to be in the mid-teens.

This performance will not come from restructuring alone. As the Chief Executive's review on the following pages makes clear, our transformation has been underpinned by the strength and excellence of our product and service offering. It has also been sustained by the people who work for Smith & Nephew. Through their energy and dedication the group is driving towards its aim of being first choice in medical devices.



Dudley Eustace
Chairman



Chief Executive's statement

Transformation

The vision we adopted in 1998 was to become first choice in our chosen medical device areas of orthopaedics, endoscopy and wound management. These are technologically advanced areas of considerable growth potential where we can realistically aim for world market leadership. In 2000 we took the world No1 position in wound management for the first time and strengthened our leadership in the arthroscopic segment of endoscopy. In orthopaedics, where we are one of the market leaders, we continued to build market share.

Our exit from the consumer marketplace in June 2000 has given us a clear focus on medical devices and enables us to seek further acquisitions in this area. We sold our feminine hygiene and toiletries business – including Lil-lets and Simple – to a management buyout team for £140m, and the Elastoplast first aid dressings business to Beiersdorf for £80m. The disposal had a negative impact on earnings in 2000 but will allow stronger growth from 2002 onwards.

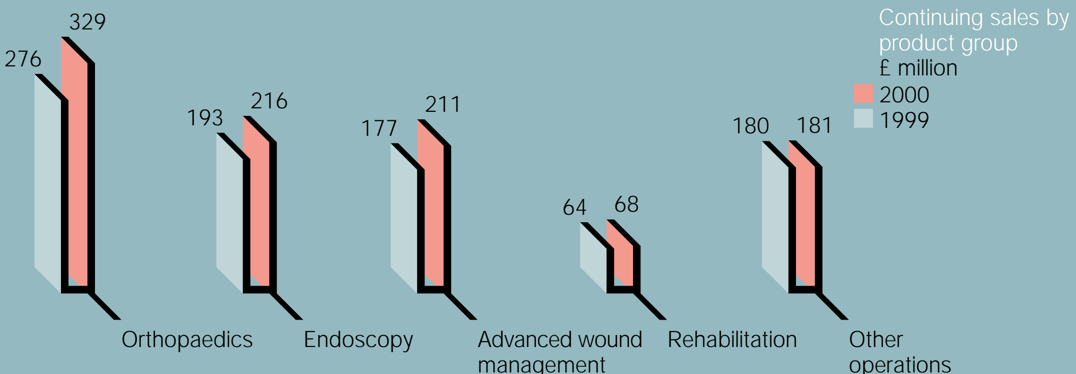
In November we announced a global joint venture with Beiersdorf that combines the two companies' traditional woundcare, casting, bandaging and phlebology businesses. The businesses we will transfer into the venture had annual sales of £150m and generated operating profits of £17m in 2000. The joint venture, 50% owned by each company and headquartered in Germany, will have annual sales of over £300m and some 3,000 employees. It begins operations in April 2001. There is flexibility for both partners to review their involvement after five years.

In a related transaction we agreed to acquire Beiersdorf's advanced woundcare business for £30m in cash. This will give us critical mass in several key national markets, particularly Germany; and brands such as the Cutinova moist wound healing products and Leukostrip/Leokoclip for wound closure strengthen our product portfolio and R&D capability. The business generated operating profit of £3m from sales of £35m in 2000.

To complete the restructuring of the group we intend to dispose of our ear, nose and throat (ENT) business this year. ENT provides implants to replace diseased bones in the middle ear and products for head, neck and sinus surgery. In 2000 it generated operating profit of £5m from sales of £31m.

We intend to develop our rehabilitation business as a fourth global business providing medical devices for the post-surgical orthopaedic and active rehabilitation markets. In our segments of the market we are already world leader. With 2000 sales of £68m and a growing market in orthopaedic recovery, we expect rehabilitation to make an increasing contribution to group sales and profit.

The joint venture with Beiersdorf, advanced woundcare acquisition and ENT disposal will modestly dilute earnings per share in 2001, be broadly neutral in 2002 and contribute to stronger growth thereafter.



While undertaking this major restructuring of the group we have also been working to maintain continued improvement throughout the business. In particular, we have been rationalising manufacturing, reducing costs to enhance margins, and increasing the impetus of our R&D and product development to deliver new products that meet clearly identified market needs.

Acquisitions

We have supplemented our product development programme by acquiring new products and businesses that strengthen our competitive position in our chosen markets.

In January 2000 we acquired the Collagenase advanced woundcare business from BASF Pharma for £74m. Collagenase (Santyl in North America and Iruxol and Novuxol in the rest of the world) is one of the world's three highest selling woundcare products. The acquisition gives our advanced wound management business an uplift in sales and has made us clear market leader in this strongly-growing field. It also gives us a substantially enlarged sales force in key markets worldwide – in the US, for example, our team has doubled to 190, the largest focused sales force in the sector.

Collagenase has strong market positions in the US, Germany, Spain, Italy and Brazil. We intend to accelerate its growth by registering it in further major markets including the UK, France, Japan and Australia.

In November we acquired Orthopaedic Biosystems, the Arizona-based arthroscopy business, for £17m. This rapidly expanding company sells effective and simple to use devices for reattaching muscle and ligaments to bone in the shoulder. This is one of the fastest-growing segments in arthroscopic surgery and the acquisition strengthens our leadership in arthroscopy and sports-related medicine.

Our sales in 2000 benefited from good performances by the businesses acquired in 1999. Exogen, our ultrasound bone healing product, received regulatory and reimbursement approvals in the USA and is well positioned for further growth in 2001. The hip and shoulder business acquired from 3M performed above expectations and was particularly successful in Japan.

Sales and market share

Our underlying sales growth was 9% in our ongoing operations. This good performance reflected the increasing strength of our product range, an uplift of just under 1% from price rises, and the growing effectiveness of our sales teams worldwide. We have substantially enlarged the sales force across the group, with particular growth in orthopaedics and wound management.

Our orthopaedics business had an excellent year. Underlying sales growth of 10% was driven by the success of the replacement hip and knee ranges, which increased sales by 17%. Global market share increased to 7%.

Endoscopy increased sales by 8%, benefiting from a series of important product introductions through the year. We can expect further benefit in 2001, when all these products will be making a full year's contribution. We remained market leader in arthroscopy with a global share of 31%.

Advanced Wound Management achieved sales growth of 10%. Global market

share increased to 21% and we gained market leadership. Once the Beiersdorf joint venture becomes operational in April this year, this business will be fully focused on high-technology, higher-margin products.

Our Rehabilitation business was in transition in 2000, as we reorganised and increased its focus on orthopaedics-related rehabilitation. Its market share in this area is 10%. Sales rose 4% in 2000.

ENT and casting and bandaging operations, which are not included in ongoing operations, grew by 2%.

Our values

We are commited to continuing to develop our values of performance, innovation and trust:

– We have a performance culture geared to sustained long term growth;

– We encourage innovation in products and services for our customers, and in our business processes;

– We are intent on deserving the trust of clinicians, patients, healthcare administrators, investors, employees and the communities we serve.

Product innovation

Innovation is the lifeblood of a medical device company like Smith & Nephew. We maintain a strong focus on introducing new products that will benefit patients and healthcare providers and enable us to grow sustainably at above-market rates.

The transformation of the business has included major changes in the way we conduct our R&D. Research is now more commercially focused, and each of our business units has its own project teams at the Group Research Centre.

This more commercially-oriented strategy is now delivering outstanding new products. In the past year we have seen an excellent sales performance from recently-launched products such as Synergy and Echelon hips, Endobutton ligament fixation and Profore leg ulcer treatment. We have also seen an enthusiastic market response to our latest products, including third generation TriGen nails for fracture fixation and the revolutionary TriVex system for minimally invasive removal of varicose veins.

E-business

We are now major users of internet technology. As well as offering websites that make ordering and inventory management easier for customers, we also use the net to provide information and support for our 2,000-strong sales force worldwide and to provide a number of information and education services for healthcare professionals and patients.

Costs and margins

Our commitment to improve underlying margins by 1 percentage point a year implies an energetic commitment to continuing cost reduction. This has involved substantial manufacturing rationalisation as well as the development of a more performance-oriented culture.

The programme to concentrate production on fewer centres is well under way. In 2000 we closed our factories in Australia and Canada, and opened a new manufacturing facility in Mexico. The balance of the rationalisation programme, which is continuing on schedule, will take place largely on behalf of the joint venture with Beiersdorf.

Other significant cost reduction activity includes a group purchasing initiative and the closure of regional offices in Birmingham and Milan. We have taken care to ensure that closures have not affected the service that we provide to customers. Where these initiatives have involved more job reductions than we could achieve through natural wastage we have sought to provide support to employees by giving as much notice as possible, and by easing the transition through counselling, advice and appropriate redundancy payments.

Social responsibility

Smith & Nephew seeks to balance the requirements of its shareholders with its responsibility to its employees, the community and environment.

Our employment policies emphasise equality of opportunity, continuous training and development, open communications and rewards appropriate to local markets. We welcome disabled people and make every effort to retain any employee who becomes disabled.

In 2000 the group's direct donations to charitable and community activities were £925,000, of which £400,000 went to the Smith & Nephew Foundation to fund awards to the medical and nursing professions. Smith & Nephew again made no political contribution in 2000.

Smith & Nephew's commitment to reducing its impact on the environment included continuing savings by reducing and recycling waste, and active energy management. We also substantially cut our atmospheric emissions. During the year, Orthopaedics achieved ISO 14001 accreditation for its environmental management systems and our other businesses continue to work towards this standard.

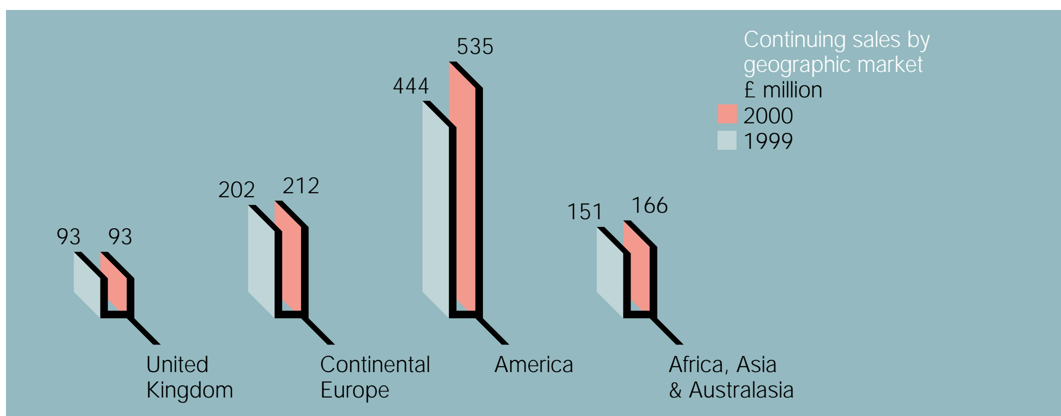
Our first report detailing our progress towards incorporating the principles of sustainable development in all our operations is now available on our website at www.smith-nephew.com.

Health and safety

During the year we consolidated our various health and safety policies across the group, recognising that good health and safety standards and practice go hand-in-hand with good business results. Each of our businesses is responsible for reporting health and safety progress and performance annually as part of our internal control measures.

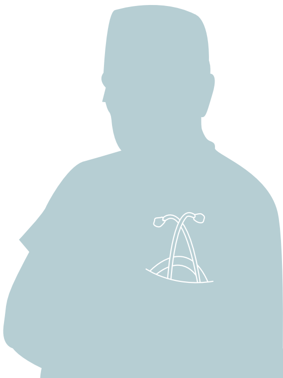
Our people

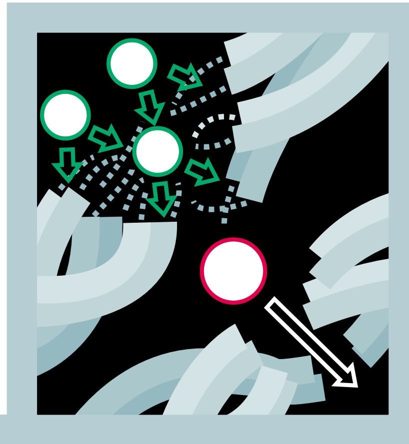
Before turning to the performance of individual business units, I would like to pay personal tribute to the drive and enthusiasm of the management team, and the real involvement of people throughout the business. Their efforts are enhancing relationships with our customers and enabling us to achieve the goals we have set ourselves for performance, innovation and trust.



In two years Smith & Nephew has been transformed.

Today it is a focused, high-technology growth business with leading positions in its chosen medical device sectors.





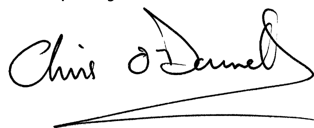
The picture above right shows the action of Collagenase in helping clean decaying matter from hard-to-heal wounds, thereby radically improving the healing process.

The new Genesis II zirconium knee in production. A major advance in knee implant technology.

The year 2000 has been a real turning point. Smith & Nephew has become a leaner, more purposeful business that we can grow more aggressively. The disposal of our consumer businesses and the joint venture with Beiersdorf mean that we are now fully focused on profitable, technology-based medical devices. These transactions, together with the capital restructuring, have been well received by the stock markets. The purchases of Exogen, Collagenase and Orthopaedic Biosystems, and the purchase in 2001 of Beiersdorf's advanced woundcare business, clearly demonstrate our aim of further strengthening the group's position by acquisitions as well as organic growth.

Our growth prospects are excellent. We have great products and great people. We continue to build our specialised global sales capabilities. Our refocused R&D activity is delivering a stream of innovative products providing clinical and economic benefits to health systems. We are broadening our product and service offerings through mutually advantageous alliances, and making them more accessible through e-commerce. We continue to earn the respect of healthcare professionals as a leading provider of medical education and training. Our relationships with surgeons, physicians and nurses have never been stronger.

The foundations are in place. We have begun to deliver the increased growth that we promised. Now we are confident enough to raise our targets still higher. The year's increase in shareholder return suggests that investors share our confidence in the company's future.



Christopher O'Donnell
Chief Executive

Our products are about improving outcomes for patients. The picture, above left, shows TransCyte, our bio-engineered temporary skin covering for treating burns, being applied at the Children's National Medical Centre, Washington DC.

Members of the knee and hip wear reduction team, above, at our orthopaedics business in Memphis – helping us maintain our reputation for innovation.

Performance

Our Orthopaedics business continued to grow strongly in 2000, gaining market share and increasing sales by an underlying 10%. Acquisitions in the previous year added another 5% to sales. An expanded sales force and industry-leading new products were major contributors to the gain.

To compete effectively in this growing global market, it is important to have a skilled sales force that can build strong relationships with surgeons, and to have a leading-edge product range. We expanded the sales force by 10%, attracting skilled orthopaedic sales people with deep understanding of their markets. We now have some 700 orthopaedics sales people in our key regions worldwide and continuing expansion in 2001 will include the creation of a specialist salesforce for key new products.

Hip and knee joint replacements performed outstandingly well during the year. Underlying sales growth of 17% was over twice the market rate. Our highly successful Genesis total knee replacement system proved particularly popular and has become Orthopaedics' first $100m per annum product.

Sales of our established trauma range grew by an underlying 6% and Exogen, the ultrasound system for healing fresh and delayed-healing bone fractures which we acquired in 1999, grew by 20%. In February it received FDA approval in the US for non-healing fractures and subsequently gained Medicare reimbursement approval in August.

The hip and shoulder products we acquired from 3M in 1999 added to our overall hip and shoulder portfolios.

Innovation

Smith & Nephew has a reputation for innovative products that offer clear clinical and cost benefits, backed-up with first-class service. We maintained this reputation in orthopaedics with a series of important new product and service launches in 2000.

TriGen, launched into targeted accounts in 2000 and now fully available, sets new standards in fixing long bone fractures. Made of titanium, it features a less invasive surgical technique than previous systems, and offers innovative instruments that provide new levels of surgical efficiency.

The development of web-based services and computer-assisted tools has provided new opportunities for us. In August we entered an alliance with Medtronic to develop and market orthopaedic applications for Image Guided Surgery (IGS). The use of IGS products will offer significant benefits for patients, surgeons and operating room staff, including less invasive procedures, increased surgical accuracy and reduced radiation exposure. An estimated 750,000

1. Launched in 1998, the Synergy and Echelon hip systems give us our first complete hip offering for both primary and revision needs. 2. Genesis II zirconium knee production, Memphis. Scheduled for launch in 2001, the oxidised zirconium coating on the implant significantly reduces the amount of wear thereby increasing the potential life of the implant.

Orthopaedics

1.

trauma and total joint operations could benefit from image-guided surgery every year. The overall market for computer-assisted surgery is estimated at $200m and annual growth is expected to average around 15% for the next five years.

Also in August, we launched Remote Image Services in conjunction with eTrauma.com. This interactive and secure web-based system allows surgeons to view images of a patient's x-ray anywhere in the world on a standard PC. It enables faster diagnosis and speedier treatment at low cost, and creates new possibilities in surgical planning, technical review and second opinions.

Supartz, a lubricant which is injected into knee joints to relieve the pain caused by osteoarthritis, received FDA approval in January 2001 and will be launched in the US in the second quarter. The market for this product is estimated at $200m in the US alone and is growing at 12% per annum.

Our strategy for future growth is founded on continuing leadership in new product development and we have active development pipelines to bring new products to all our markets. Innovations scheduled for launch in 2001 include Profix and Genesis II knee implants made from a new material for orthopaedic applications, oxidised zirconium with improved wear properties which are expected to be of significant benefit to younger, more active patients.

Future growth

The opportunity in orthopaedics is based on worldwide economic and demographic trends. Longer-living populations are resulting in growing demand for hip and knee replacements, and for revisions as they wear out. In turn, this is driving demand for longer-lasting bearing surfaces. The growing popularity of sports, especially among women, has brought an increase in injuries and joint operations. Patient empowerment and healthcare economics are driving demand for less invasive procedures such as Exogen and Supartz.

These trends play to our strengths. We will continue to penetrate the joint reconstruction market by leveraging our strong portfolio of products and services, and by introducing less invasive products and technologies. We are working to accelerate our growth in the trauma market by making effective use of radical new products such as our Image Guided Surgery applications. We are contributing to patient education and empowerment through our websites and intend to make further in roads into the fast-growing market for less invasive therapies.

2.

New products contribute 33% of sales

Endoscopy

Performance

Our Endoscopy business increased sales by an underlying 8%, boosted by a strong programme of 10 new product launches. We further strengthened and trained our sales force, and in addition to the world's largest arthroscopy sales team we now also have a dedicated endosurgery team driving our entry into non-arthroscopic procedures.

Relationships with surgeons are crucial. We are committed to working with them to develop new techniques that will reduce patient trauma and pain, cut costs to healthcare systems and improve outcomes for surgeons.

We continued to enhance our manufacturing performance. Initiatives to improve margins and reduce product costs included the introduction of a one-piece tubing machine in our blade line. This cut manufacturing time by 50%, saving $2m a year. We also completed our focused factory programme to concentrate similar products into single plants, saving almost $1m a year.

Innovation

We offer all four arthroscopic technologies – access, visualisation, resection and repair – and are building on our leadership position with a strong product development pipeline involving over 30 new techniques and products.

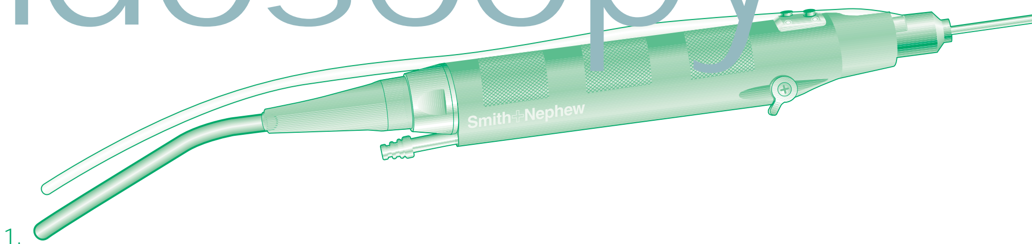
The majority of products launched in 2000 strengthened our portfolio in arthroscopy. In the larger endoscopy market we introduced TriVex, the first completely new varicose vein surgery technique in centuries.

The new Dyonics Power shaver system brings enhanced value to a $340m market. Its higher torque allows surgeons to operate at slower speeds with more control. The system's new BoneCutter blades are ideal for a variety of arthroscopic procedures. A single blade is able both to cut soft tissue and to act as a burr to remove bone, saving significant surgeon time.

We introduced our first absorbable product for rotator cuff ligament tears in the shoulder – the RotorloC suture anchor – and enhanced our leadership in knee ligament repair with the launch of the BioRCI screw. This attaches soft tissue grafts to bone and is then gradually absorbed by the body.

In December we acquired Orthopaedic Biosystems, an Arizona-based arthroscopy business. This brought us new tissue fixation technology and a complete shoulder repair product line, significantly increasing our share of the shoulder repair market.

TriVex, our revolutionary system for minimally invasive varicose vein removal, offers a major advance over traditional surgery. The technique allows precise,



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reliable and efficient vein extraction – cutting operating theatre time by up to 50%, requiring fewer incisions per operation and reducing post-operative pain. During 2000 we trained over 250 surgeons around the world to use the system, and numbers will continue to climb steadily this year.

We continue to develop e-business platforms that provide information, education and easier access to our products. The US launch of eFast, providing innovative, added-value service and financing support, has given healthcare purchasers better access to capital equipment such as visualisation products. Dyonics1.com provides a new outlet for pre-owned equipment. And new patient information sites – Knee1.com, Shoulder1.com and Veins1.com – helped thousands of patients to learn more about their conditions and available treatments, and to make contact with surgeons.

Future growth

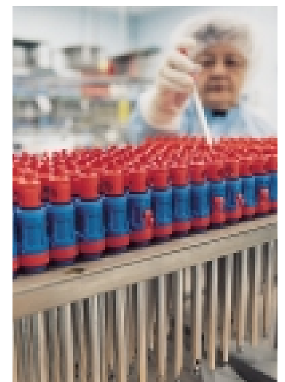
To sustain growth and maintain our strong market position we are increasing the value and number of customer relationship benefit programmes. An important element in this process is our OnSight training programme, which enables surgeons to visit Smith & Nephew and see for themselves the work we are doing to advance and simplify surgical techniques: 114 leading surgeons visited us in 2000.

We are also enhancing our reputation for surgeon-focused innovation with our InVentures BioSkills Lab at our Mansfield, Massachusetts facility. This is accelerating the progress of knee and shoulder surgery by enabling surgeons who have an idea for a new technique to visit us and develop the concept in our state-of-the-art facility. We can then commercialise both the technique and the necessary instrumentation. Last year, 115 surgeons from around the world participated in this programme and generated 240 prototypes.

The key to growth in the endoscopy market will continue to be innovation, with techniques that offer patient benefits and improved healthcare economics. We are earning increasing recognition as an innovator and our objective is that by 2004, 25% of all sales will be from products launched in the previous three years.

1. TriVex is the first completely new varicose vein surgery technique in centuries. Pictured is the TriVex powered resector. 2. Arthroscopy blade production at our facility in Andover, Massachussetts.

2.



10 new products launched during 2000

Performance

Our advanced wound management business increased underlying sales by 10%. BSN Medical, our joint venture with Beiersdorf, will acquire our traditional dressings products in 2001, allowing wound management to focus its attention on higher added value advanced woundcare products.

The acquisition of Collagenase in January 2000 made us clear world market leader in advanced wound management. It adds one of the world's top three wound management products to our portfolio and gives us a leading position in the pharmaceutically active segment of the market, which we expect to continue growing strongly. Collagenase is an enzyme that helps clean decaying matter from hard-to-heal wounds and radically improves the healing process. Linked to our existing products, it enables us to pioneer the concept of wound bed preparation as a new approach to the science of wound healing. We intend to accelerate Collagenase's growth by registering it in additional markets – notably the UK, France, Japan and Australia. We can now provide a complete service in wound management therapies, from wound bed preparation to full closure of the healing wound.

We have continued to build our sales and marketing infrastructure in the world's major markets – both through investment in our existing network and through the additional sales teams we gained with the acquisition of Collagenase. The integration of the two sales forces has increased our capacity throughout the world, particularly in our key markets in the US and Germany.

TransCyte, our bio-engineered temporary skin substitute for burns, which has been developed through our joint venture with Advanced Tissue Sciences (ATS), increased sales by 76%. It has clear advantages over competitive products as a covering and infection barrier, and is performing particularly well in the US. Profore, our four-layer bandage system for leg ulcers, increased sales by 28%. Allevyn, our hydrocellular foam dressing range, remained our most successful wound management product, growing sales by 19% and substantially increasing market share.

While building sales on the strength of our outstanding product range and leading-edge technology, we have also been raising the operational efficiency of our manufacturing and global supply chain to maximise return on capital. Without disruption to sales or customer service

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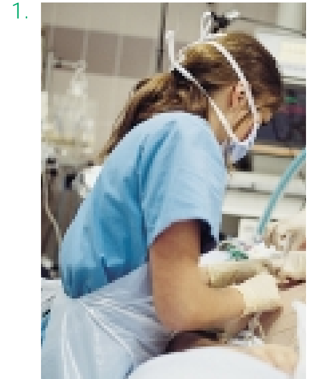


Wound mana

1. We are now focused entirely on higher added value advanced woundcare products – such as OpSite IV3000, being used here in the Chirurgische Klinik der Universitat, Munich. 2. Collagenase, branded Iruxol (Santyl in North America), which we acquired in January 2000, is one of the world's three highest selling wound care products.

in key markets, the manufacturing rationalisation programme has relocated low volume production from Australia and Canada to our new lower-cost facilities in Hull, where higher volumes have substantially improved production economics.

Innovation

Our market position is founded on a record of innovation that has given us a comprehensive range of state-of-the-art products. We intend to develop this position further and have radically re-engineered our R&D programme – raising expenditure from 4% of sales to 6%. We are also devoting increased resources to third party technology sourcing and partnerships.

Dermagraft, our bio-engineered foot ulcer treatment which has also been developed through our joint venture with ATS, continues to await approval from the Food and Drugs Administration in the US. Sales are becoming established in other countries, where we have obtained approval, including the UK and Canada.

E-business technology will support our education service for clinicians and patients and improve access and create enhanced solutions for customers. One example of this is our new interactive website, Wounds1.com, where patients and clinicians can learn more about wound management problems and opportunities.

We are confident that the transformation that has taken place in 2000 has created a strong platform for the wound management business to build further on its global market position.

Future growth

As a result of the formation of BSN Medical, our wound management business will be entirely focused on advanced products offering significant patient and economic benefits.

Our strategy for future products and sales growth focuses on three treatment areas: wound assessment, wound bed preparation and active healing. In these areas we intend to provide innovative solutions to customers' wound management problems, including the provision of substantial education and clinical support.

Number one global market position

gement

2.

Performance

After review, we decided in 2000 that our Rehabilitation business should be refocused to achieve a step-change in sales and profit growth in the expanding physical rehabilitation market. Although smaller than our other three major businesses, Rehabilitation is already the global leader in its served markets, with a 10% market share. The business has a strong foothold in the US, UK and Germany, and an established presence in the world's other major healthcare markets.

The transformation of this business has begun and is well underway. We are focusing on building a technology-based business that will provide therapists with products and services for complete rehabilitation procedures, and in particular those related to the needs of orthopaedic recovery patients.

We have also examined our manufacturing needs, aiming to reduce exposure to strong currencies and margin erosion. As a result, we reluctantly decided to close our Farnham site in the UK, where we manufacture the Homecraft range of aids to daily living and electro-mechanical products. These will be sourced from third-party suppliers worldwide when the site closes at the end of March 2001. We have also begun to rationalise manufacturing at our Germantown, Wisconsin site in the US, where our focus is now on proprietary products. The realignment of the business will provide considerable future benefits.

During 2000 global sales rose 4% underlying with a 7% increase in the US. The strong sales growth in the US benefited from strategies put in place after the 1999 reimbursement changes. Germany achieved double-digit sales growth. A 6% decline in UK sales growth was primarily due to a shift in customer purchasing practices. Local and health authorities are moving to direct care contracts, whereby loan equipment is managed on behalf of the authority.

We will gain further improvements in business performance from our recent reorganisation in the Canadian and French markets.

1.

Rehabilitation

Innovation

Our lead rehabilitation technology product line is the Kinetec range of continuous passive motion (CPM) machines. These apply mechanical force to help patients exercise joints after surgery in a controlled way and without effort. During 2000 sales of the Kinetic range increased by 18%.

In Germany, Europe's largest healthcare market, we were particularly successful in growing our Kinetec business. Germany uses an extensive network of distributors with close ties to orthopaedic surgeons and physiotherapists. We launched the new Kinetec Centura shoulder unit against strong competition from the market leader, collaborating with industry leaders in pain control to achieve good synergies in orthopaedic recovery.

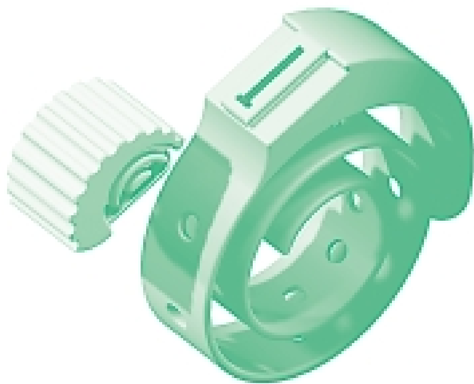
In the US, the Kinetec range showed significant year-on-year growth – as did clinic equipment products in general. We also forged a strong relationship with HealthSouth, the world's largest sports medicine and rehabilitation provider, which is resulting in opportunities for co-development of products.

We believe that the practice of rehabilitation therapy will benefit from the introduction of 'smart' devices using electronic capabilities to monitor and deliver enhanced therapy. We aim to lead the introduction of these 'smart' or active devices in the field of patient rehabilitation.

Future growth

Our R&D pipeline is expanding with rehabilitation technology products for the future. We are currently developing technology driven, clinically proven and cost effective rehabilitation protocol products both from our own resources and through strategic alliances.

We intend to retain our status as world leader in clinical rehabilitation products through innovation and to utilise technology to enhance our product line and continuously improve our global logistics and customer service.



2.

1. Our lead rehabilitation technology product line is the Kinetec range of continuous passive motion (CPM) machines. The picture shows a CPM machine being serviced at our plant in Wisconsin. 2. This smart wrist device is being developed to sense the patient's arm position and motion to monitor their exercise regime both at home and in the clinic.

Refocusing on 'smart' devices

Joint venture

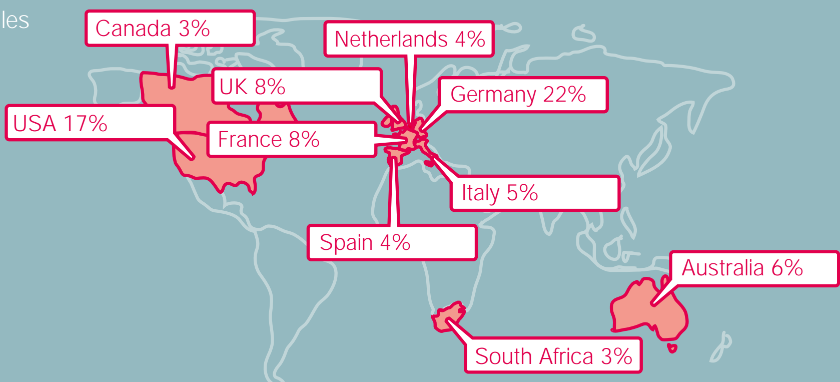
BSN Medical, our joint venture with Beiersdorf, starts operation in April 2001.

The joint venture was agreed in November 2000, subject to competition clearances in a number of countries – all of which have now been obtained.

The new venture brings together the interests of both partners in casting and bandaging, traditional woundcare and phlebology (compression hosiery). It will be 50% owned by each partner. We will transfer into the joint venture businesses with annual sales of £150m and operating profits of £17m. Future profits will be shared equally between the partners. BSN Medical will combine the strengths of both parent companies with a new and separate identity, independent management and dedicated sales and manufacturing teams all aimed at creating real market focus.

Smith & Nephew has had a relationship with Beiersdorf for over 50 years, most recently through the distribution agreement for Nivea. The joint venture – and the associated sale of Beiersdorf's advanced woundcare products to Smith & Nephew – is a logical extension of the relationship and perfectly fits the two companies' strategies: it will allow Smith & Nephew to concentrate on becoming an advanced medical device company, and Beiersdorf to focus its energies on consumer personal care.

Pro-forma joint venture sales in top 10 markets %



Portfolio of leading brands

BSN Medical will become a substantial global player with annual sales of about £300m worldwide. It will manage a portfolio of leading brands in its core product segments with a mandate to develop business strongly. Substantial synergies will be realised in all areas of the combined operation, enabling better resource allocation and creating significant cost reduction opportunities. This should enable BSN Medical to generate excellent profit growth over the medium term.

The new business will be headquartered in Hamburg, Germany. It will have some 3,000 employees and manufacturing facilities in the UK, the US, Germany, France, Ireland, South Africa, Mexico, India and Pakistan. It will gain continuing benefits from Smith & Nephew's manufacturing rationalisation programme, and from the integration of the Beiersdorf products and manufacturing facilities into the programme.

BSN Medical will be a market leader in many of the fields in which it operates. Casting and bandaging will contribute about 43% of the business, traditional woundcare 35% and phlebology 22%. Geographically, 59% of sales will be in Europe, 22% in North America and 19% in the rest of the world.

In the key markets of Germany, the UK, the US, France and the Netherlands, the company will have its own sales resources. In other countries, BSN Medical will share the selling resources of both parents. In most countries, Smith & Nephew will distribute BSN Medical's products into the hospital and other non-pharmacy channels; Beiersdorf will distribute products into the retail pharmacy sector. These relationships will enable the joint venture to benefit from a greater critical mass in all trade channels, to the mutual benefit of both partners.

New opportunities

Building on its strong market position is an overriding objective for BSN Medical in the coming years. With this in mind, the new business will actively seek to develop new opportunities through enhanced joint R&D investment and through acquisitions and licensing arrangements.

The new company will be managed by a combined team from Smith & Nephew and Beiersdorf led by Graham Siddle, who will become its Chief Executive. The business is being planned rigorously and carefully to become a leading independent global supplier of high quality healthcare products, and we expect its enhanced focus to generate real value for its parent companies. The partners know each other well and the deal will remain flexible: both companies have the option to review their positions after five years.

Financial review

Presentation

The group has announced four major restructuring steps during the year:

1) the disposal of the consumer business;

2) the payment of a special dividend of £416m and a consolidation of the number of ordinary shares in issue on a 9 new ordinary $12\frac{2}{9}$p shares for 11 old 10p shares basis, from 1,119m to 916m shares;

3) the transfer of the casting and bandaging and traditional woundcare businesses to a 50/50 joint venture with Beiersdorf AG and the disposal of the ear, nose and throat (ENT) business;

4) the acquisitions of the Collagenase and Beiersdorf advanced woundcare businesses and the Orthopaedic Biosystems Ltd. Inc. (OBL) arthroscopy business.

The disposal of the consumer business was completed in the second half of the year and the results of this business are classified as 'discontinued' in the profit and loss account. However, because the completion of the transfer to the joint venture of the casting and bandaging and traditional woundcare businesses will not occur until 2001 and the disposal of ENT is ongoing, the results of these businesses are classified as 'other operations'. This leaves a clear portrayal of the sales and profits of the ongoing businesses of orthopaedics, endoscopy, advanced wound management and rehabilitation. The Collagenase and OBL businesses have been acquired and are included in continuing operations. The acquisition of Beiersdorf's advanced woundcare business will become effective on 1 April 2001.

The group's 50% interest in the casting and bandaging and traditional woundcare joint venture will be accounted for using the gross equity method from its formation on 1 April 2001.

Trading results

Sales during the year amounted to £1,135m, an increase of 1% compared with last year. Adjusting for currency and putting acquisitions and disposals on a like for like basis, this was an underlying growth of 8%. Within that, the underlying sales growth of other operations was 2% and the sales growth of the ongoing businesses was 9%. Selling price increases accounted for approaching 1% of overall growth.

Profit before tax and exceptional items amounted to £171m, consistent with last year, despite the loss of profit following the disposal of the consumer business and the financing cost of the special dividend. Interest swung from £3m received in 1999 to £7m paid as a consequence of the net capital outflow of these two events. Unlike previous years when currency has been a cost, the overall currency effect was neutral, with a £4m translational gain offsetting a similar amount of transactional cost.

Operating profit before exceptional items of the ongoing businesses was £142m, a 24% increase, with margins increasing over 1% to 17.3%. The operating margin of the group as a whole was 15.7% compared with 15% a year ago: a 1% point improvement, before 0.3% point of transactional currency cost mentioned earlier, coming from the ongoing programme of cost and efficiency savings and from the manufacturing rationalisation programme implemented in 1999.

Exceptional Items

The principal exceptional item in the year was a £106m gain on the disposal of the consumer business, after deducting £32m of goodwill set off against reserves on a previous acquisition. £13m was spent on the manufacturing rationalisation programme, making £65m to date out of a total programme of £76m. Following the announcement of the joint venture with Beiersdorf and the related advanced woundcare acquisition, this programme has been extended to include the additional benefits arising from combining the businesses of the joint venture and integrating the acquisition and will involve a further £31m of programme expenditure. Acquisition integration costs of £3m were incurred during the year.

The net exceptional gain in the year was therefore £90m, increasing profit before tax to £261m, compared with £182m last year.

EPS and taxation

Earnings per share before exceptional items were 11.61p, an increase on 1999 of 8%. The underlying tax charge of £51.4m remains at 30%. The tax charge on the net exceptional items was £5m.

Adjusting for the effects of the disposal of the bracing business in 1999 and the consumer business this year, the interest cost on the special dividend offset by the associated reduction in the effective number of ordinary shares in issue, the increase in earnings per share before exceptional items rises to 15%.

Dividends and shareholders' funds

At the time of announcing the disposal of the consumer business, the special dividend and the consolidation of share capital, the Board intimated that it intended to adopt a dividend cover on a per share basis in the region of 2½ times for this year. Accordingly, having paid an interim dividend of 1.7 pence per ordinary share, it is recommended that the final dividend be 2.8 pence, making a total of 4.5 pence.

After a cost of ordinary dividends of £41m and £416m in respect of the special dividend, a £252m deficit has been charged to reserves. Against this, shareholders' funds have been augmented by £32m of goodwill on the consumer business on its disposal previously set off against reserves on acquisition, by £8m of new shares issued for share options less £10m of currency translation. The net movement in shareholders' funds was a decrease of £222m to £330m.

Employees

The average number of employees during the year declined 7% to 10,400, largely as a consequence of the disposal of the consumer business and also because of manufacturing rationalisation. A result of this was that sales per employee improved 9% to £109,000.

Investment

Capital expenditure of £64m on tangible and intangible fixed assets amounted to 5.6% of sales. The principal areas of investment were hospital based surgical instruments and equipment for orthopaedic implants and endoscopy, information technology and a new factory facility for casting and bandaging in Mexico. Technological investments were also made in eTrauma.com and image guided surgery.

In addition the Collagenase woundcare business was acquired for £74m of which £31m was in cash and the balance is phased over five years, and the OBL arthroscopy business was acquired for £17m.

The R&D investment of the continuing businesses was 5%, compared to 4% previously for the group, reflecting the higher innovation content of orthopaedics, endoscopy and advanced wound management. The Dermagraft programme involved further revenue investment of £6m. We also continue to invest in sales and marketing worldwide, with significant expansions occurring in the sales forces of our continuing businesses.

Cash flow and facilities

The conversion of operating profit to operating cash flow was 77%. This was after £23m of outgoings on manufacturing rationalisation, acquisition integration and divestment costs. Net proceeds of £210m were received from the disposal of the consumer business.

The special dividend was paid as a return of capital on 11 August following the disposal of the consumer business and the consolidation of the ordinary share capital by way of 9 new ordinary 12²⁄₉ shares for every 11 old ordinary 10p shares.

In order to finance the net cash flow requirement as a result of the special dividend, the company arranged committed bank facilities of £400m.

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

	£m
Operating cash flow	137
Interest, tax and dividends	(529)
Disposals net of acquisitions	159
Issues of share capital	8
Net cash flow	(225)
Exchange adjustments	(33)
Opening net cash	22
Closing net borrowings	(236)

Closing net debt of £236m compares to group capital and reserves of £330m. Interest of £7m was covered 25 times by operating profit.

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 risk 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 £450m of which £216m were committed facilities.

Shareholders' funds are protected by matching foreign currency assets, including acquisition goodwill, with foreign liabilities where practicable. These liabilities take the form of either borrowings or currency swaps. At the year end group borrowings were £261m, mainly in foreign currency. Cash and bank balances were £25m. Currency swaps amounted to £426m, of which 77% were to re-denominate internal borrowings into US dollars.

Group borrowings 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. The majority of interest costs and differentials have been protected through to December 2001 with some protection carrying over into 2003.

The group trades in over 90 countries and as a consequence manages £260m 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 and 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 £3.3m, the equivalent of 35 days credit.

Shareholder value

Year 2000 has been a year of major restructuring for the group, with very significant returns generated for shareholders from the re-rating that the ordinary shares have received from investors. At the end of 1999 the price earnings ratio was 19 on that year's results, whereas this year it was 27; through a combination of this and the special dividend, shareholders have received a total return of 43% in 2000.

Peter Hooley
Finance Director

The Board

Dudley Eustace 64, Chairman Appointed Deputy Chairman in 1999 and Chairman from January 2000. Chairman of the Nominations Committee. He is a non-executive director of KLM Royal Dutch Airlines NV, Aegon NV and Hagemeyer NV.
Pictured at 1 below.

Christopher O'Donnell 54, Chief Executive He joined the group in 1988 and was appointed a director in 1992. He was appointed Chief Executive in 1997.
Pictured at 5 below.

Peter Hooley 54, Finance Director He joined the group and was appointed a director in 1991.
Pictured at 7 below.

Sir Anthony Cleaver 62 A director since 1993. Chairman of the Audit Committee. Chairman of AEA Technology plc, the Medical Research Council, IX Europe Limited and S Three Limited. Also a non-executive director of Lockheed Martin UK Limited.
Pictured at 2 below.

Warren Knowlton 54 Appointed a director in November 2000. He is a director of Pilkington Plc and Chief Executive of Pilkington's Global Automotive and Aerospace businesses.
Pictured at 3 below.

Sir Timothy Lankester 58 A director since 1996. He is president of Corpus Christi College, Oxford. Also an independent director of the London Metal Exchange and Deputy Chairman of the British Council.
Pictured at 4 below.

Richard De Schutter 60 Appointed a director from January 2001. He is Chairman and Chief Executive Officer of The DuPont Pharmaceuticals Company and non-executive director of General Binding Corporation and ING Americas.
Pictured at 6 below.

Dr Rolf Stomberg 60 A director since 1998. Chairman of John Mowlem & Company PLC, Management Consulting Group PLC and Unipoly SA. A non-executive director of Scania AB, Stinnes AG, Reed Elsevier plc, Cordiant Communications plc, Aral AG and TPG Group.
Pictured at 8 below.

Sir Brian Pearse 67 A director since 1993. Senior independent director and Chairman of the Remuneration Committee. He is Deputy Chairman of Britannic plc and a member of the Board of Banking Supervision.
Pictured at 9 below.

- Non-executive directors
- Members of the Remuneration Committee
- Members of the Audit Committee
- Members of the Nominations Committee

Alan Fryer retired as a director on 26 October 2000.
Dr Nancy J Lane retired as a director on 26 October 2000.

Kenneth Kemp is Honorary Life President.

Group Executive Committee

Christopher O'Donnell Pictured at 5 below.

Peter Hooley Pictured at 7 below.

Larry Papasan 60, President – Orthopaedics
He joined the group in 1991 and was appointed to the Group Executive Committee in 1999.
Pictured at 10 below.

Margaret Stewart 49, Group Director Corporate Affairs
She joined the group in 2000 and was appointed to the Group Executive Committee in 2001.
Pictured at 11 below.

Jim Dick 48, President – Wound Management
He joined the group in 1977 and was appointed to the Group Executive Committee in 1999.
Pictured at 12 below.

Jim Taylor 44, Group Director Indirect Markets
He joined the group and was appointed to the Group Executive Committee in 2000.
Pictured at 13 below.

Paul Williams 54, Group Director Human Resources
He joined the group and was appointed to the Group Executive Committee in 1998.
Pictured at 14 below.

Peter Huntley 40, Group Director Strategy and Business Development He joined the group and was appointed to the Group Executive Committee in 1998.
Pictured at 15 below.

Dr Alan Suggett 57, Group Director of Technology
He joined the group in 1982 and was appointed to the Group Executive Committee in 1986.
Pictured at 16 below.

Ron Sparks 45, President – Endoscopy
He joined the group in 1983 and was appointed to the Group Executive Committee in 1999.
Pictured at 17 below.

Michael Parson 60, Company Secretary & Group Legal Adviser He joined the group and was appointed to the Group Executive Committee in 1991.
Pictured at 18 below.

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, two executive directors and six 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 Group 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 Group Executive Committee The Group Executive Committee assists the Chief Executive in the management of the group.

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

Directors
It is proposed to amend the Articles of Association at the AGM to provide that directors are required to submit themselves for re-election every three years. In accordance with the Articles of Association, Christopher O'Donnell, Sir Brian Pearse and Dr Rolf Stomberg retire by rotation and, being eligible, offer themselves for re-election at the forthcoming AGM. Warren Knowlton was appointed with effect from 1 November 2000 and Richard De Schutter from 1 January 2001 and both 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 2000.

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 quarterly business reviews and an annual risk assessment carried out by the head of each business unit and reviewed by the Chief Executive and Finance Director.

These procedures, which have been in place throughout the year, are designed to identify and manage those risks that could adversely impact the achievement of the group's objectives. Whilst they do not provide absolute assurance against material misstatement or loss, the directors, following a review of the systems described, are of the opinion that a proper system of internal control is in place within the group.

Share capital
The company has been informed of the following interests in its ordinary share capital as at 14 February 2001:

- Axa Investment Managers 6.19%
- Sanford C Bernstein 5.52%
- Hermes 4.00%
- Scudder Threadneedle Investments Ltd 3.18%

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.

Ernst & Young have stated that, subject to the approval of its partners, it is intending to transfer its business to a Limited Liability Partnership during the year. If this happens, it is the current intention of the directors to use their statutory powers to treat the appointment of Ernst & Young as extending to Ernst & Young LLP.

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 Group 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 Group 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 For executive directors the company operates an annual bonus scheme based on annual growth in adjusted basic earnings per share 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. 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% per annum in any period of three consecutive financial years from the date of grant. Executive options are not offered at a discount.

Proposals to bring the existing executive share option schemes into line with current market practice, particularly in the US, are to be put to shareholders at this year's AGM. Details are to be found in the shareholders' circular enclosed with this report.

Since 1997 the company has operated a long-term incentive plan (LTIP) for executive directors and members of the Group Executive Committee. Under this plan, shares are transferred to participants depending on the company's performance in relation to a comparator group of 45 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 granted. 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. UK participants in the LTIP will not be granted options under the executive share option schemes in the same year but they will continue to be eligible to participate in the savings related share option scheme.

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

year to 31 December	Maximum number of shares 2000	Maximum number of shares 1999	Maximum number of shares 1998
C.J. O'Donnell	155,065	183,040	161,263
P. Hooley	96,916	116,959	102,874
A.R. Fryer	–	134,502	108,435

For the plan year commencing in 1998 the company's TSR was ranked in the top quartile and the earnings per share performance criteria was met enabling the plan participants to be eligible for the vesting of 100% of the shares conditionally awarded for that year.

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.

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.

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

Remuneration report

Directors' emoluments and pensions

	Salaries & fees £'000	Benefits £'000	Bonus £'000	Pension entitlements £'000	Total 2000 £'000	Total 1999 £'000
Chairman (non-executive)						
D.G. Eustace	150	–	–	–	150	21
J.H. Robinson (to 31 December 1999)	–	–	–	–	–	156
Executive						
C.J. O'Donnell	354	15	315	19	703	603
P. Hooley	224	15	197	53	489	432
A.R. Fryer (to 31 December 2000)	281	9	324	27	641	452
Non-executive						
Sir Anthony Cleaver	24	–	–	–	24	24
Dr N.J. Lane (to 31 October 2000)	24	–	–	–	24	29
Sir Timothy Lankester	24	–	–	–	24	24
Sir Brian Pearse	24	–	–	–	24	24
Dr R.W.H. Stomberg	24	–	–	–	24	24
W.D. Knowlton (from 1 November 2000)	4	–	–	–	4	–
	1,133	39	836	99	2,107	1,789

Dudley Eustace 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 £50,000 to a supplementary plan for Peter Hooley. During 2000 executive directors paid contributions to the pension plans as follows: Christopher O'Donnell £17,000, Alan Fryer £12,000 and Peter Hooley £4,000.

The accumulated total amount of the accrued pension benefit for directors as of 31 December 2000 was as follows: Christopher O'Donnell £95,000 (1999 – £75,000), Alan Fryer £144,000 (1999 – £117,000) and Peter Hooley £22,000 (1999 – £20,000).

Alan Fryer retired from the Board on 26 October 2000, aged 59, but continued in executive office until 31 December 2000, whereupon he became due an annual pension of £142,000. His bonus includes an additional amount relating to the formation of the joint venture with Beiersdorf AG. The Remuneration Committee retains the discretion of allowing the vesting of his LTIP award of up to a maximum of 89,668 shares in respect of 1999 if the performance conditions are met.

The Remuneration Committee exercised its discretion in allowing the vesting of 36,145 shares to Jack Blair, a former director who retired on 31 December 1998, under his 1998 LTIP award.

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

Directors' share options

	Number of options 1 Jan 2000	Granted during the year	Exercised	Exercise price (p)	Market price at date of exercise (p)	Profit on exercise £	Number of options 31 Dec 2000	Average exercise price (p)	Range of exercisable dates of options held at 31 Dec 2000
C.J. O'Donnell	367,862	–	190,000	151.71	305.00	291,251	177,862	183.89	8/1997 – 8/2006
P. Hooley	405,362	–	–	–	–	–	405,362	155.00	9/1994 – 8/2006
A.R. Fryer	195,539	–	191,000	168.23	285.00	223,031	–	–	–
			4,539	152.00	296.50	6,559	–	–	–

The range in the market price of the company's shares during the year, excluding the anomalous closing share price of 386p on 31 July, was 156.75p to 329.75p and the market price at 31 December 2000 was 310p. All outstanding options at 31 December 2000 were below 310p. The total profit on exercise of options during the year was £520,841 as set out above (1999 – £18,137: Alan Fryer £18,137).

Directors' interests

	31 December 2000		1 January 2000	
Beneficial interests of directors in the company's ordinary shares	Shares	Options	Shares	Options
D.G. Eustace	40,909	–	–	–
C.J. O'Donnell	111,339	177,862	19,490	367,862
P. Hooley	4,090	405,362	5,000	405,362
Sir Anthony Cleaver	13,730	–	16,782	–
Sir Timothy Lankester	5,911	–	6,389	–
Sir Brian Pearse	20,000	–	20,000	–
Dr R.W.H. Stomberg	864	–	1,035	–

On 14 February 2001 Christopher O'Donnell became entitled to 161,263 shares and Peter Hooley 102,874 shares in respect of the 100% vesting of the 1998 long term incentive plan. There were no other changes in the interests of directors between 31 December 2000 and 14 February 2001.

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, 14 February 2001

Michael Parson
Secretary

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 maintenance of 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
The directors are responsible for preparing the annual report. As described on this page, this includes responsibility for preparing 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 Financial Services Authority 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 group is not disclosed.

We read the other information in the Annual Report and Accounts, including the corporate governance statement, 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 Listing Rules, 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 group's corporate governance procedures or its risk and control procedures.

Basis of audit opinion We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the 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 2000 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, 14 February 2001

Group profit and loss account

for the year ended 31 December 2000	Notes	**2000 £ million**	1999 £ million
Turnover	1,2		
Ongoing operations		824.8	709.9
Other operations		180.6	179.6
Continuing operations		1,005.4	889.5
Discontinued operations		129.3	230.4
		1,134.7	1,119.9
Operating profit	1,2		
Continuing operations:			
Before exceptional items – ongoing operations		142.5	114.6
Before exceptional items – other operations		22.0	20.1
Exceptional items*	3	(16.3)	(42.0)
		148.2	92.7
Discontinued operations:			
Before exceptional items		13.9	32.8
Exceptional items*	3	–	(9.7)
		162.1	115.8
Discontinued operations:			
Net profit on disposals*	3	106.3	62.9
Profit on ordinary activities before interest		268.4	178.7
Interest (payable)/receivable	4	(7.0)	3.4
Profit on ordinary activities before taxation		261.4	182.1
Taxation	7	56.2	77.3
Attributable profit for the year		205.2	104.8
Dividends:			
Ordinary	8	41.3	72.5
Special	8	415.6	–
Retained (deficit)/profit for the year	22	(251.7)	32.3
Basic earnings per ordinary share	10	19.85p	9.39p
Diluted earnings per ordinary share	10	19.73p	9.37p
Results before exceptional items (*)			
Profit before taxation	9	171.4	170.9
Adjusted basic earnings per ordinary share	10	11.61p	10.72p
Adjusted diluted earnings per ordinary share	10	11.54p	10.69p

Group balance sheet

at 31 December 2000	Notes	2000 £ million	1999 £ million
Fixed assets			
Intangible assets	11	163.0	74.0
Tangible assets	12	251.1	270.5
Investments	13	24.0	16.6
		438.1	361.1
Current assets			
Stocks	14	228.2	237.6
Debtors	15	277.8	281.1
Cash and bank	16	24.6	100.5
		530.6	619.2
Creditors: amounts falling due within one year			
Borrowings	16	82.0	58.0
Other creditors	17	322.0	312.4
		404.0	370.4
Net current assets		126.6	248.8
Total assets less current liabilities		564.7	609.9
Creditors: amounts falling due after more than one year			
Borrowings	16	178.9	20.2
Other creditors	17	8.3	–
Provisions for liabilities and charges	18	47.9	38.0
		235.1	58.2
		329.6	551.7
Capital and reserves			
Called up share capital:			
Equity share capital	20	112.4	111.8
Non-equity share capital	20	0.3	0.3
Share premium account	22	125.4	118.3
Profit and loss account	22	91.5	321.3
		329.6	551.7

Approved by the Board on 14 February 2001
Dudley Eustace Chairman **Peter Hooley** Finance Director

Group cash flow

for the year ended 31 December 2000	Notes	**2000 £ million**	1999 £ million
Net cash inflow from operating activities*	23	204.0	198.1
Interest received		4.4	10.3
Interest paid		(11.4)	(6.9)
Net cash (outflow)/inflow from returns on investments and servicing of finance		(7.0)	3.4
Tax paid		(46.5)	(60.1)
		150.5	141.4
Capital expenditure and financial investment			
Capital expenditure		(63.9)	(67.1)
Disposal of fixed assets		6.1	8.7
Trade investments		(6.0)	(6.7)
Own shares purchased		(2.9)	–
		(66.7)	(65.1)
Acquisitions and disposals			
Acquisitions	25	(51.1)	(50.9)
Disposals		209.8	121.8
		158.7	70.9
Equity dividends paid		(475.9)	(70.3)
Cash (outflow)/inflow before use of liquid resources and financing		(233.4)	76.9
Management of liquid resources	23	72.3	(72.3)
Financing			
Issues of ordinary share capital		7.7	4.4
Increase/(decrease) in borrowings	23	160.6	(16.8)
Decrease in currency swaps	23	(9.6)	(7.3)
Net cash inflow/(outflow)from financing		158.7	(19.7)
Decrease in cash	23	(2.4)	(15.1)

*After £23.1m (1999 – £18.5m) of outgoings on rationalisation, acquisition integration and divestment costs.

Statement of gains and losses
Movements in shareholders' funds

Group statement of total recognised gains and losses

for the year ended 31 December 2000	**2000 £ million**	1999 £ million
Profit for the financial year	205.2	104.8
Currency translation differences on foreign currency net investments	(9.9)	(4.0)
Total gains and losses related to the year	195.3	100.8

Group reconciliation of movements in shareholders' funds

for the year ended 31 December 2000	**2000 £ million**	1999 £ million
Profit for the financial year	205.2	104.8
Dividends	456.9	72.5
Retained (deficit)/profit for the year	(251.7)	32.3
Exchange adjustments	(9.9)	(4.0)
Issue of shares	7.7	4.4
Goodwill on disposals	31.8	33.5
Net (reduction)/addition to shareholders' funds	(222.1)	66.2
Opening shareholders' funds	551.7	485.5
Closing shareholders' funds	329.6	551.7

Parent company balance sheet

at 31 December 2000	Notes	**2000** **£ million**	1999 £ million
Fixed assets			
Tangible assets	12	7.9	8.1
Investments	13	413.9	413.9
		421.8	422.0
Current assets			
Debtors	15	382.2	476.8
Cash and bank	16	14.9	77.2
		397.1	554.0
Creditors: amounts falling due within one year			
Borrowings	16	66.2	28.9
Other creditors	17	212.7	299.8
		278.9	328.7
Net current assets		118.2	225.3
Total assets less current liabilities		540.0	647.3
Creditors: amounts falling due after more than one year			
Borrowings	16	163.5	4.5
Provisions for liabilities and charges	18	0.1	0.9
		163.6	5.4
		376.4	641.9
Capital and reserves			
Called up share capital:			
Equity share capital	20	112.4	111.8
Non-equity share capital	20	0.3	0.3
Share premium account	22	125.4	118.3
Profit and loss account	22	138.3	411.5
		376.4	641.9

Approved by the Board on 14 February 2001
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 Standard 18 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 2000 for the periods during which they were members of the group.

Joint arrangements are included in the consolidated accounts in proportion to the group's interest in the results, assets and liabilities of these joint arrangements.

Turnover

Turnover comprises sales of products and services to third parties at amounts invoiced net of trade discounts and rebates, excluding turnover taxes.

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.

Research and development

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

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.

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.

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 maintenance of 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
The directors are responsible for preparing the annual report. As described on this page, this includes responsibility for preparing 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 Financial Services Authority 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 group is not disclosed.

We read the other information in the Annual Report and Accounts, including the corporate governance statement, 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 Listing Rules, 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 group's corporate governance procedures or its risk and control procedures.

Basis of audit opinion We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the 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 2000 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, 14 February 2001

Group profit and loss account

for the year ended 31 December 2000	Notes	**2000 £ million**	1999 £ million
Turnover	1,2		
Ongoing operations		824.8	709.9
Other operations		180.6	179.6
Continuing operations		1,005.4	889.5
Discontinued operations		129.3	230.4
		1,134.7	1,119.9
Operating profit	1,2		
Continuing operations:			
Before exceptional items – ongoing operations		142.5	114.6
Before exceptional items – other operations		22.0	20.1
Exceptional items*	3	(16.3)	(42.0)
		148.2	92.7
Discontinued operations:			
Before exceptional items		13.9	32.8
Exceptional items*	3	–	(9.7)
		162.1	115.8
Discontinued operations:			
Net profit on disposals*	3	106.3	62.9
Profit on ordinary activities before interest		268.4	178.7
Interest (payable)/receivable	4	(7.0)	3.4
Profit on ordinary activities before taxation		261.4	182.1
Taxation	7	56.2	77.3
Attributable profit for the year		205.2	104.8
Dividends:			
Ordinary	8	41.3	72.5
Special	8	415.6	–
Retained (deficit)/profit for the year	22	(251.7)	32.3
Basic earnings per ordinary share	10	19.85p	9.39p
Diluted earnings per ordinary share	10	19.73p	9.37p
Results before exceptional items (*)			
Profit before taxation	9	171.4	170.9
Adjusted basic earnings per ordinary share	10	11.61p	10.72p
Adjusted diluted earnings per ordinary share	10	11.54p	10.69p

Group balance sheet

at 31 December 2000	Notes	2000 £ million	1999 £ million
Fixed assets			
Intangible assets	11	163.0	74.0
Tangible assets	12	251.1	270.5
Investments	13	24.0	16.6
		438.1	361.1
Current assets			
Stocks	14	228.2	237.6
Debtors	15	277.8	281.1
Cash and bank	16	24.6	100.5
		530.6	619.2
Creditors: amounts falling due within one year			
Borrowings	16	82.0	58.0
Other creditors	17	322.0	312.4
		404.0	370.4
Net current assets		126.6	248.8
Total assets less current liabilities		564.7	609.9
Creditors: amounts falling due after more than one year			
Borrowings	16	178.9	20.2
Other creditors	17	8.3	–
Provisions for liabilities and charges	18	47.9	38.0
		235.1	58.2
		329.6	551.7
Capital and reserves			
Called up share capital:			
Equity share capital	20	112.4	111.8
Non-equity share capital	20	0.3	0.3
Share premium account	22	125.4	118.3
Profit and loss account	22	91.5	321.3
		329.6	551.7

Approved by the Board on 14 February 2001
Dudley Eustace Chairman **Peter Hooley** Finance Director

Group cash flow

for the year ended 31 December 2000	Notes	**2000 £ million**	1999 £ million
Net cash inflow from operating activities*	23	204.0	198.1
Interest received		4.4	10.3
Interest paid		(11.4)	(6.9)
Net cash (outflow)/inflow from returns on investments and servicing of finance		(7.0)	3.4
Tax paid		(46.5)	(60.1)
		150.5	141.4
Capital expenditure and financial investment			
Capital expenditure		(63.9)	(67.1)
Disposal of fixed assets		6.1	8.7
Trade investments		(6.0)	(6.7)
Own shares purchased		(2.9)	–
		(66.7)	(65.1)
Acquisitions and disposals			
Acquisitions	25	(51.1)	(50.9)
Disposals		209.8	121.8
		158.7	70.9
Equity dividends paid		(475.9)	(70.3)
Cash (outflow)/inflow before use of liquid resources and financing		(233.4)	76.9
Management of liquid resources	23	72.3	(72.3)
Financing			
Issues of ordinary share capital		7.7	4.4
Increase/(decrease) in borrowings	23	160.6	(16.8)
Decrease in currency swaps	23	(9.6)	(7.3)
Net cash inflow/(outflow)from financing		158.7	(19.7)
Decrease in cash	23	(2.4)	(15.1)

*After £23.1m (1999 – £18.5m) of outgoings on rationalisation, acquisition integration and divestment costs.

Statement of gains and losses
Movements in shareholders' funds

Group statement of total recognised gains and losses

for the year ended 31 December 2000	**2000** **£ million**	1999 £ million
Profit for the financial year	205.2	104.8
Currency translation differences on foreign currency net investments	(9.9)	(4.0)
Total gains and losses related to the year	195.3	100.8

Group reconciliation of movements in shareholders' funds

for the year ended 31 December 2000	**2000** **£ million**	1999 £ million
Profit for the financial year	205.2	104.8
Dividends	456.9	72.5
Retained (deficit)/profit for the year	(251.7)	32.3
Exchange adjustments	(9.9)	(4.0)
Issue of shares	7.7	4.4
Goodwill on disposals	31.8	33.5
Net (reduction)/addition to shareholders' funds	(222.1)	66.2
Opening shareholders' funds	551.7	485.5
Closing shareholders' funds	329.6	551.7

Parent company balance sheet

at 31 December 2000	Notes	**2000 £ million**	1999 £ million
Fixed assets			
Tangible assets	12	7.9	8.1
Investments	13	413.9	413.9
		421.8	422.0
Current assets			
Debtors	15	382.2	476.8
Cash and bank	16	14.9	77.2
		397.1	554.0
Creditors: amounts falling due within one year			
Borrowings	16	66.2	28.9
Other creditors	17	212.7	299.8
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Net current assets		118.2	225.3
Total assets less current liabilities		540.0	647.3
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Profit and loss account	22	138.3	411.5
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Approved by the Board on 14 February 2001
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 Standard 18 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 2000 for the periods during which they were members of the group.

Joint arrangements are included in the consolidated accounts in proportion to the group's interest in the results, assets and liabilities of these joint arrangements.

Turnover

Turnover comprises sales of products and services to third parties at amounts invoiced net of trade discounts and rebates, excluding turnover taxes.

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.

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

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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.

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 2000 £ million	Operating profit 2000 £ million	Operating assets 2000 £ million	Turnover 1999 £ million	Operating profit 1999 £ million	Operating assets 1999 £ million
Ongoing operations	824.8	134.8	565.8	709.9	82.7	500.6
Other operations	180.6	13.4	90.2	179.6	10.0	81.2
Continuing operations	1,005.4	148.2	656.0	889.5	92.7	581.8
Discontinued operations	129.3	13.9	9.9	230.4	23.1	59.7
	1,134.7	162.1	665.9	1,119.9	115.8	641.5

Exceptional costs of £16.3m (1999 – £51.7m) have been charged as follows: ongoing operations £7.7m (1999 – £31.9m), other operations £8.6m (1999 – £10.1m) and discontinued operations nil (1999 – £9.7m).

Other operations comprise the casting and bandaging and traditional woundcare businesses which will be contributed to the Joint venture with Beiersdorf AG on 1 April 2001 and the ear, nose and throat business, the intended disposal of which was announced on 2 November 2000.

Discontinued operations comprise the results of the Consumer business and the first half year results of the Bracing business in 1999.

Analysis by geographic origin	Turnover 2000 £ million	Operating profit 2000 £ million	Operating assets 2000 £ million	Turnover 1999 £ million	Operating profit 1999 £ million	Operating assets 1999 £ million
United Kingdom	187.0	18.8	110.4	173.8	19.4	115.0
Continental Europe	230.5	16.5	90.5	232.6	11.0	84.3
America	641.0	92.7	401.1	545.9	51.1	321.9
Africa, Asia and Australasia	155.8	20.2	54.0	144.2	11.2	60.6
Continuing operations	1,214.3	148.2	656.0	1,096.5	92.7	581.8
Discontinued operations	129.3	13.9	9.9	230.4	23.1	59.7
	1,343.6	162.1	665.9	1,326.9	115.8	641.5
Less intragroup sales	(208.9)	–	–	(207.0)	–	–
	1,134.7	162.1	665.9	1,119.9	115.8	641.5

Exceptional costs of £7.2m have been charged to the UK (1999 – £4.0m), £1.3m to Continental Europe (1999 – £3.0m), £6.3m to America (1999 – £28.7m) and £1.5m to Africa, Asia and Australasia (1999 – £6.3m). Nil was charged to discontinued operations (1999 – £9.7m).

Analysis of turnover by geographic market	2000 £ million	1999 £ million
United Kingdom	92.7	93.2
Continental Europe	211.8	201.7
America	535.2	444.0
Africa, Asia and Australasia	165.7	150.6
Continuing operations	1,005.4	889.5
Discontinued operations	129.3	230.4
	1,134.7	1,119.9

Note 1 Segmental analysis continued

Analysis of turnover by product	2000 £ million	1999 £ million
Orthopaedics	329.3	276.4
Endoscopy	216.4	192.8
Advanced wound management	210.9	176.9
Rehabilitation	68.2	63.8
Ongoing operations	824.8	709.9
Other operations	180.6	179.6
Continuing operations	1,005.4	889.5
Discontinued operations	129.3	230.4
	1,134.7	1,119.9

Note 2 Operating profit

	Continuing operations 2000 £ million	Discontinued operations 2000 £ million	Total 2000 £ million	Continuing operations 1999 £ million	Discontinued operations 1999 £ million	Total 1999 £ million
Turnover	1,005.4	129.3	1,134.7	889.5	230.4	1,119.9
Cost of sales	370.4	86.4	456.8	342.8	136.8	479.6
Gross profit	635.0	42.9	677.9	546.7	93.6	640.3
Marketing, selling and distribution	(333.2)	(24.8)	(358.0)	(286.5)	(54.7)	(341.2)
Administration	(109.3)	(4.6)	(113.9)	(111.4)	(14.2)	(125.6)
Research and development	(46.4)	–	(46.4)	(43.6)	(1.6)	(45.2)
Other	2.1	0.4	2.5	(12.5)	–	(12.5)
Operating profit	148.2	13.9	162.1	92.7	23.1	115.8

Results of continuing operations have been stated after charging exceptional costs of £16.3m (1999 – £42.0m), which have been allocated in total as follows: cost of sales £13.2m (1999 – £8.2m), marketing, selling and distribution £1.2m (1999 – £4.6m), administration £1.9m (1999 – £16.7m) and other nil (1999 – £12.5m).

Results of discontinued operations have been stated after charging exceptional costs of nil (1999 – £9.7m). 1999 exceptional costs of £9.7m were allocated as follows: cost of sales £3.8m, marketing, selling and distribution £1.8m and administration £4.1m.

Operating profit is stated after charging:	2000 £ million	1999 £ million
Depreciation	53.0	50.3
Loss on sale of fixed assets	3.2	1.9
Amortisation of goodwill	7.5	1.8
Amortisation of other intangibles	2.4	4.0
Exceptional asset provisions	–	28.6
Operating lease rentals for land and buildings	8.8	8.2
Auditors' remuneration	1.0	1.1

Payments made to the group's auditors for non-audit services amounted to £1.2m (1999 – £0.5m) in the UK and £0.9m (1999 – £0.8m) outside the UK. Of these payments £1.6m (1999 – £0.8m) relate to taxation services and £0.5m (1999 – £0.5m) to statutory and other certifications and accountancy services. Of the total payments for non-audit services, £0.9m (1999 – £0.4m) relates to capital transactions.

Unrecognised gains and losses relating to forward foreign exchange contracts in respect of anticipated purchases over the next 12 months amounted to £2.0m (1999 – £3.9m) and £1.3m (1999 – £2.2m) respectively. The unrecognised gains and losses on forward foreign exchange contracts at 31 December 1999 were recognised in 2000. 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

In 2000, operating exceptional items comprise the cost of the manufacturing rationalisation programme begun in 1999 of £12.9m (1999 – £24.3m) and acquisition integration costs of £3.4m (1999 – £5.2m). In 1999 £6.5m was written off intangible assets relating to the Dermagraft joint arrangement and a £6.0m provision was taken against the group's equity investment in Advanced Tissue Sciences. Discontinued exceptional items of £9.7m in 1999 represent that element of manufacturing rationalisation costs which related to the Consumer business.

The net profit on disposal related to the sale of the Consumer healthcare business in June 2000 for a net cash consideration of £209.8m. The net profit comprised a gain of £138.1m less £31.8m of acquisition goodwill previously written off to reserves. The net profit on disposal in 1999 related to the sale of the Bracing business.

Note 4 Interest

	2000 £ million	1999 £ million
Interest receivable	4.4	10.3
Interest payable:		
On bank borrowings	8.7	6.1
Other	2.7	0.8
	11.4	6.9
Net interest (payable)/receivable	(7.0)	3.4

Interest payable on currency swaps of £23.5m (1999 – £25.8m) has been set off against interest receivable.

At 31 December 2000 the group held sterling interest bearing assets of £401m on which interest has been fixed on £107m at 6.4% for one year and £37m on which interest has been fixed for a further two years at 5.6%, a weighted average of 6.1% for a weighted average period of 1.7 years. The remainder was cash balances held on short term deposit at floating rates. The group also held £23m 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 2000 included £481m of US dollars and £107m of euros on which interest has been fixed for one year on £100m of US dollars and £107m of euros at weighted average rates of 6.3% and 4.6% respectively. Interest has also been fixed on £35m of euros for a further two years at 3.6%. The remaining interest bearing liabilities totalled £72m of various currencies. 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 the group held sterling interest bearing assets of £560m on which interest had been fixed on £390m at 5.7% for one year and £37m on which interest had 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 had 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 had 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 had been fixed at 6.0% for one year. Where interest had not been fixed the rates were typically based on the three month interest rate relevant to the currency concerned.

At 31 December 2000 unrecognised gains and losses on the value of interest rate swaps were £1.6m and £0.5m respectively (1999 – gains £3.2m, losses £3.3m). Unrecognised gains of £0.8m will be realised in 2001 and £0.8m between 2002 and 2003. Unrecognised losses of £0.4m will be realised in 2001 and £0.1m between 2002 and 2003. Unrecognised net losses of £0.9m on interest rate swaps at 31 December 1999 were recognised in 2000. The group's interest rate risk management policy is set out on page 31. The fair values of interest rate swaps are calculated as the net present value of the future cash flows at 31 December, discounted at market rates of interest on that date.

After the balance sheet date, the group transacted additional interest rate swaps thereby fixing 2001 interest rates on a further £260m of sterling assets and £335m of US dollar liabilities to give weighted average rates on these principals of 5.5% and 5.3% respectively.

Note 5 Employees

The average number of employees during the year was:	2000	1999
United Kingdom	2,589	2,973
Continental Europe	1,549	1,602
America	3,387	3,370
Africa, Asia and Australasia	2,910	3,268
	10,435	11,213

Staff costs during the year amounted to:	£ million	£ million
Wages and salaries	249.1	232.1
Social security costs	25.4	25.1
Other pension costs (Note 28)	10.6	9.1
	285.1	266.3

Note 6 Directors' emoluments

Aggregate emoluments of the directors, including pension entitlements of £98,000 (1999 – £78,000), were £2,107,000 (1999 – £1,789,000). The emoluments of the highest paid director excluding pension entitlement were £684,000 (1999 – £586,000). The accrued pension benefit of the highest paid director at the end of the year was £95,000 (1999 – £75,000).

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

Note 7 Taxation

	2000 £ million	1999 £ million
United Kingdom:		
Corporation tax at 30% (1999 – 30.25%)	28.8	29.7
Adjustments in respect of prior years	(1.7)	–
Deferred taxation	0.8	(3.8)
	27.9	25.9
Overseas:		
Tax on ordinary activities	28.1	47.6
Adjustments in respect of prior years	(1.7)	–
Deferred taxation	1.9	3.8
	28.3	51.4
	56.2	77.3

The tax charge has been reduced by £3.2m (1999 – £9.5m) as a consequence of the exceptional costs of the rationalisation programme and acquisition integration costs and increased by £8.0m (1999 – £35.5m) as a result of the exceptional profit on disposal, leaving the tax charge on ordinary activities at £51.4m (1999 – £51.3m).

If full provision had been made for deferred tax, the tax charge would have reduced by £1.0m (1999 – increased by £5.7m) as follows:

	2000 £ million	1999 £ million
Fixed asset timing differences	(1.9)	2.0
Other timing differences	0.9	3.7
	(1.0)	5.7

Note 8 Dividends

	2000 £ million	1999 £ million
Ordinary interim of 1.7p (1999 – 2.5p) paid 6 December 2000	15.6	27.8
Proposed ordinary final of 2.8p (1999 – 4.0p) payable 18 May 2001	25.7	44.7
	41.3	72.5

A special dividend of £415.6m (37.14p per share) was paid on 11 August 2000. Non-equity preference dividends amounting to £15,000 were paid (1999 – £13,000).

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.

	2000 £ million	1999 £ million
Profit on ordinary activities before taxation	261.4	182.1
Adjustments:		
Continuing operations: exceptional items	16.3	42.0
Discontinued operations: exceptional items	–	9.7
Discontinued operations: net gain on disposal	(106.3)	(62.9)
Profit before taxation and exceptional items	171.4	170.9
Taxation on profit before exceptional items	51.4	51.3

Note 10 Earnings per ordinary share

Basic earnings per ordinary share of 19.85p (1999 – 9.39p) are based on profit on ordinary activities after taxation and preference dividends of £205.2m (1999 – £104.8m) and on 1,034m ordinary shares being the basic weighted average number of shares in issue during the year (1999 – 1,116m). No adjustment has been made to comparative data in respect of the share consolidation as together with the special dividend payment the overall effect was that of a share repurchase at fair value. The calculation of diluted earnings per ordinary share is based on basic earnings and on 1,040m ordinary shares (1999 – 1,119m) calculated as follows:

	Shares 2000 million	Shares 1999 million
Basic weighted average number of shares	1,034	1,116
Weighted average number of shares under option	22	16
Number of shares that would have been issued at fair value	(16)	(13)
Diluted weighted average number of shares	1,040	1,119
Diluted earnings per ordinary share	19.73p	9.37p

The calculation of adjusted basic earnings per ordinary share is as follows:

	2000 £ million	1999 £ million
Basic earnings	205.2	104.8
Continuing operations: exceptional items	16.3	42.0
Discontinued operations: exceptional items	–	9.7
Discontinued operations: net gain on disposal	(106.3)	(62.9)
Exceptional taxation	4.8	26.0
Adjusted basic earnings	120.0	119.6
Adjusted basic earnings per ordinary share	11.61p	10.72p
Adjusted diluted basic earnings per ordinary share	11.54p	10.69p

Note 11 Intangible fixed assets

Group	Goodwill £ million	Other £ million	Total £ million
Cost:			
At 1 January 2000	49.1	40.9	90.0
Exchange adjustment	5.4	2.9	8.3
Acquisitions	89.9	–	89.9
Additions	–	4.0	4.0
Transfers	2.1	(2.1)	–
Discontinued operations	–	(2.4)	(2.4)
At 31 December 2000	146.5	43.3	189.8
Amortisation:			
At 1 January 2000	2.1	13.9	16.0
Exchange adjustment	0.2	0.9	1.1
Charge for the year	7.5	2.4	9.9
Transfers	0.2	(0.2)	–
Discontinued operations	–	(0.2)	(0.2)
At 31 December 2000	10.0	16.8	26.8
Net book amounts:			
At 31 December 2000	136.5	26.5	163.0
At 31 December 1999	47.0	27.0	74.0

Note 12 Tangible fixed assets

Group	Land and buildings freehold £ million	Land and buildings leasehold £ million	Plant and equipment £ million	In course of construction £ million	Total £ million
Cost:					
At 1 January 2000	83.7	11.2	481.7	17.3	593.9
Exchange adjustment	3.0	0.3	12.8	0.5	16.6
Additions	0.6	0.4	35.5	23.4	59.9
Disposals	(5.5)	–	(46.0)	(1.3)	(52.8)
Transfers	0.6	–	19.9	(20.5)	–
Discontinued operations	(6.8)	–	(40.6)	(0.7)	(48.1)
At 31 December 2000	75.6	11.9	463.3	18.7	569.5
Depreciation:					
At 1 January 2000	18.2	3.2	302.0	–	323.4
Exchange adjustment	0.6	0.1	7.8	–	8.5
Charge for the year	2.7	0.8	49.5	–	53.0
Disposals	(3.4)	–	(43.1)	–	(46.5)
Discontinued operations	(1.2)	–	(18.8)	–	(20.0)
At 31 December 2000	16.9	4.1	297.4	–	318.4
Net book amounts:					
At 31 December 2000	58.7	7.8	165.9	18.7	251.1
At 31 December 1999	65.5	8.0	179.7	17.3	270.5

Fixed assets include land with a cost of £5.0m (1999 – £5.8m) that is not subject to depreciation. Leases with less than 50 years to run amounted to £5.1m (1999 – £5.1m). Included in the amounts above are assets held under finance leases with a net book amount of £2.8m (1999 – £3.0m).

Note 12 Tangible fixed assets continued

Parent company
The opening net book amount of £8.1m represented plant and equipment, with a cost of £17.1m and accumulated depreciation of £9.0m. Movements in the year comprised £3.6m of additions, depreciation charged in the year of £1.4m (1999 – £1.4m) and assets of £2.4m written off in connection with the Consumer disposal. The closing net book value of £7.9m represented plant and equipment with a cost of £20.7m and accumulated depreciation of £12.8m.

Note 13 Investments

	Group own shares £ million	Group associated undertakings £ million	Group trade investments £ million	Group total £ million	Parent subsidiary undertakings £ million
At 1 January 2000	–	0.7	15.9	16.6	413.9
Exchange adjustment	–	0.1	1.3	1.4	–
Additions	2.9	–	6.0	8.9	–
Disposals	–	–	(2.9)	(2.9)	–
At 31 December 2000	2.9	0.8	20.3	24.0	413.9

Principal subsidiary and associated undertakings are listed on pages 54 and 55. Trade investments are all US dollar denominated and include an 8% equity investment in Advanced Tissue Sciences Inc, quoted on the Nasdaq exchange in the US. The quoted market price of the company at 31 December 2000 and 14 February 2001 was $3.03 and $5.00 respectively.

Own shares represent the purchase in the year of the Company's own shares in respect of the Smith & Nephew Employees' Share Trust (see note 29).

Note 14 Stocks

	Group 2000 £ million	Group 1999 £ million
Raw materials and consumables	54.3	52.1
Work in progress	16.6	16.1
Finished goods and goods for resale	157.3	169.4
	228.2	237.6

Note 15 Debtors

	Group 2000 £ million	Group 1999 £ million	**Parent 2000 £ million**	Parent 1999 £ million
Amounts falling due within one year:				
Trade and other debtors	246.2	241.8	6.9	2.4
Amounts owed by subsidiary undertakings	–	–	361.8	466.7
Prepayments and accrued income	24.4	23.6	13.4	7.4
	270.6	265.4	382.1	476.5
Amounts falling due after more than one year:				
Pension prepayments (Note 28)	5.3	5.7	–	–
Other debtors	1.4	2.7	–	–
Deferred taxation (Note 19)	0.5	7.3	0.1	0.3
	277.8	281.1	382.2	476.8

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 2000 £ million**	Group 1999 £ million	**Parent 2000 £ million**	Parent 1999 £ million
Gross borrowings:				
Due within one year	82.0	58.0	66.2	28.9
Due after one year	178.9	20.2	163.5	4.5
	260.9	78.2	229.7	33.4
Cash and bank	(24.6)	(100.5)	(14.9)	(77.2)
	236.3	(22.3)	214.8	(43.8)

Gross borrowings				
Bank loans and overdrafts	259.1	75.9	229.5	33.0
Other loans wholly repayable within five years:				
5½% US dollar convertible bonds 2000	–	0.2	–	0.2
Other	1.8	1.8	0.2	0.2
	1.8	2.0	0.2	0.4
Other loans wholly repayable after five years	–	0.3	–	–
	260.9	78.2	229.7	33.4

Bank loans and overdrafts represent drawings under committed and uncommitted facilities of £418m and £264m respectively. Of the undrawn committed facilities of £216m, £106m expire within one year and £110m after more than two years. Borrowings secured on fixed and current assets were £1.4m (1999 – £1.7m). 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 2001 to 2005. For the group, gross sterling equivalents of £399.9m (1999 – £477.6m) receivable and £425.9m (1999 – £484.3m) payable have been netted. The balance of £26.0m (1999 – £6.7m) is included as £1.0m in cash and bank and as £27.0m in borrowings (1999 – £4.4m in cash and bank and £11.1m in borrowings). For the parent company, gross sterling equivalents of £374.0m (1999 – £446.5m) receivable and £398.5m (1999 – £453.9m) payable have been netted, the balance of £24.5m (1999 – £7.4m) is included as £1.0m in cash and bank and as £25.5m in borrowings (1999 – £3.7m in cash and bank and £11.1m in borrowings). Currency swaps comprise floating interest rate contracts and forward foreign exchange contracts and are used for hedging foreign investments.

Note 16 Borrowings continued

Gross borrowings are repayable as follows:	**Group 2000 £ million**	Group 1999 £ million	**Parent 2000 £ million**	Parent 1999 £ million
Within one year:				
Bank loans and overdrafts	81.7	57.5	66.2	28.7
Other loans	0.3	0.5	–	0.2
Total within one year	82.0	58.0	66.2	28.9
Bank loans and overdrafts:				
After one year and within two years	20.2	3.5	12.7	2.5
After two years and within five years	157.2	14.9	150.6	1.8
	177.4	18.4	163.3	4.3
Other loans:				
After one year and within two years	0.6	0.3	0.2	–
After two years and within five years	0.9	1.2	–	0.2
After five years	–	0.3	–	–
	1.5	1.8	0.2	0.2
Total after one year	178.9	20.2	163.5	4.5
	260.9	78.2	229.7	33.4

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

Amounts falling due within one year:	**Group 2000 £ million**	Group 1999 £ million	**Parent 2000 £ million**	Parent 1999 £ million
Trade creditors	114.6	128.5	3.3	2.4
Amounts owed to subsidiary undertakings	–	–	150.3	221.2
Social security costs and other taxes	13.0	14.8	0.4	0.3
Accruals and deferred income	59.5	49.7	15.6	11.0
Acquisition consideration	32.3	–	–	–
Current taxation	76.9	74.7	17.4	20.2
Ordinary share dividends	25.7	44.7	25.7	44.7
	322.0	312.4	212.7	299.8

Amounts falling due after more than one year: acquisition consideration of £8.3m (1999 – nil) is payable by the Group.

Note 18 Provisions for liabilities and charges

Group	Rationalisation and integration £ million	Retirement healthcare £ million	Other £ million	Total £ million
At 1 January 2000	18.2	8.8	11.0	38.0
Exchange adjustments	(0.1)	0.4	0.3	0.6
Profit and loss account	37.7	0.7	5.4	43.8
Utilisation	(29.8)	(0.6)	(4.1)	(34.5)
At 31 December 2000	26.0	9.3	12.6	47.9

At 31 December 2000 rationalisation and integration provisions included acquisition integration of £2.2m (1999 – £3.6m). 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 two 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 £0.9m to £0.1m represented expenditure of £0.8m.

Note 19 Deferred taxation

	Group £ million	Parent £ million
At 1 January 2000	7.3	0.3
Profit and loss – current year	(2.7)	(0.2)
Profit and loss – prior year adjustments	(4.2)	–
Exchange adjustment	0.1	–
At 31 December 2000	0.5	0.1

Deferred tax asset/(liability) is analysed as follows:

Group	**Amount provided 2000 £ million**	Amount provided 1999 £ million	**Full potential liability 2000 £ million**	Full potential liability 1999 £ million
Fixed asset timing differences	(4.1)	(3.3)	(24.0)	(30.2)
Other timing differences	4.6	10.6	6.9	16.2
	0.5	7.3	(17.1)	(14.0)

Parent company
The deferred tax asset recognised in the parent company of £0.1m (1999 – £0.3m) is represented by other timing differences. The full potential deferred tax liability of £1.4m (1999 – £1.5m) is represented by fixed asset timing differences.

Note 20 Called up share capital

Authorised	**Shares 2000 '000**	**2000 £ million**	Shares 1999 '000	1999 £ million
Ordinary shares 12²⁄₉p (1999 – 10p)	1,223,591	149.5	1,495,500	149.5
5½% cumulative preference shares £1	450	0.5	450	0.5
		150.0		150.0

On 7 August 2000, the ordinary share capital was consolidated by the issue of 9 new ordinary shares of 12²⁄₉p for every 11 ordinary shares of 10p held.

Allotted, issued and fully paid Equity capital: ordinary shares 10p	Shares '000	£ million
At 1 January 2000	1,117,545	111.8
Share options and convertible bonds	1,408	0.1
At 6 August 2000	1,118,953	111.9
Effect of share consolidation: ordinary shares 12²⁄₉p	(203,446)	–
At 7 August 2000	915,507	111.9
Share options and convertible bonds	3,682	0.5
	919,189	112.4
Non-equity capital: 5½% cumulative preference shares £1		
At 1 January 2000 and 31 December 2000	269	0.3
Total called up share capital at 31 December 2000		112.7

The 5½% cumulative preference shares are denominated in sterling and the fair value is not materially different. They are non-voting and carry preferential rights to dividend and distribution on winding up.

Note 21 Share option schemes

At 31 December 2000 21,862,000 (1999 – 25,464,000) of the authorised but unissued ordinary shares of $12\frac{2}{9}$p 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	2001-2006	124.0p-221.2p	5,299
Executive share option schemes	2001-2010	133.0p-270.0p	16,563
			21,862

As the employee scheme is an Inland Revenue approved Save As You Earn scheme the company is exempt from accounting for the cost between the share option price and the market value at the grant date.

Note 22 Reserves

Group	Share premium £ million	Profit and loss account £ million
At 1 January 2000	118.3	321.3
Exchange adjustment	–	(9.9)
Retained deficit for the year	–	(251.7)
Share options and convertible bonds	7.1	–
Goodwill on disposals	–	31.8
At 31 December 2000	125.4	91.5

Net exchange losses of £32.9m (1999 – loss of £9.5m) arising on foreign currency net borrowings are included within the £9.9m (1999 – £4.0m) exchange adjustment.

The cumulative amount of goodwill (before merger relief of £116.0m) charged to reserves is £344.4m (1999 – £368.8m). The decrease is due to the goodwill written back to reserves on the disposal of the consumer business of £31.8m offset by exchange differences on acquisitions made prior to 31 December 1997 of £7.4m.

Parent company	Share premium £ million	Profit and loss account £ million
At 1 January 2000	118.3	411.5
Retained deficit for the year	–	(273.2)
Share options and convertible bonds	7.1	–
At 31 December 2000	125.4	138.3

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 £183.7m (1999 – £31.7m).

Note 23 Cash flow statement

Reconciliation of operating profit to net cash flow from operating activities	2000 £ million	1999 £ million
Operating profit	162.1	115.8
Depreciation and amortisation	62.9	56.1
Exceptional asset write downs	–	28.6
Loss on sale of tangible fixed assets	3.2	1.9
Rationalisation and integration costs	(23.1)	(18.5)
(Increase)/decrease in stocks	(7.1)	0.6
Decrease/(increase) in debtors	4.5	(14.2)
Increase in creditors and provisions	1.5	27.8
Net cash inflow from operating activities	204.0	198.1

Analysis of net borrowings	Opening net borrowings £ million	Cash flow £ million	Exchange adjustments £ million	Closing net borrowings £ million
Cash	23.8	–	(0.2)	23.6
Overdrafts	(5.1)	(2.4)	0.3	(7.2)
	18.7	(2.4)	0.1	16.4
Borrowings due within one year	(46.0)	(14.5)	(1.1)	(61.6)
Borrowings due after one year	(16.0)	(146.1)	(3.0)	(165.1)
	(43.3)	(163.0)	(4.0)	(210.3)
Net currency swaps	(6.7)	9.6	(28.9)	(26.0)
Liquid resources: cash deposits	72.3	(72.3)	–	–
	22.3	(225.7)	(32.9)	(236.3)

Cash and bank at 31 December 2000 totals £24.6m (1999 – £100.5m) and comprises cash £23.6m (1999 – £23.8m), liquid resources £nil (1999 – £72.3m) and currency swaps of £1.0m (1999 – £4.4m) as detailed in Note 16.

Reconciliation of net cash flow to movement in net borrowings

for the year ended 31 December 2000	2000 £ million	1999 £ million
Change in cash in the year	(2.4)	(15.1)
Change in liquid resources	(72.3)	72.3
Change in net currency swaps	9.6	7.3
Change in borrowings	(160.6)	16.8
Change in net borrowings/cash from cash flows	(225.7)	81.3
Exchange adjustments	(32.9)	(9.5)
Change in net borrowings/cash in the year	(258.6)	71.8
Opening net cash/(borrowings)	22.3	(49.5)
Closing net (borrowings)/cash	(236.3)	22.3

Disposals

The net assets of the Consumer business disposed of in 2000 comprised fixed assets £28.1m, stocks £23.9m, debtors £1.6m and creditors and provisions £13.0m. During 2000 the business contributed £20.6m of the group's net operating cash flow and incurred capital expenditure amounting to £0.6m.

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 2000	Average rate 1999	**Year end rate 2000**	Year end rate 1999
US dollar	1.51	1.62	1.49	1.61
Euro	1.64	1.53	1.59	1.61
Australian dollar	2.62	2.49	2.69	2.46
South African rand	10.55	9.87	11.31	9.92

Note 25 Acquisitions

The principal acquisitions during the year were the Collagenase business acquired in January 2000 and the Orthopaedics Biosystems business acquired in November 2000. Under the acquisition method of accounting the impact on the consolidated balance sheet of acquisitions in the year was:

	Net book value £ million
Tangible fixed assets	0.1
Current assets	1.9
Current liabilities	(1.1)
	0.9
Goodwill	89.9
Total consideration	90.8

Of the total consideration £39.7m is deferred consideration (payable in cash) and £51.1m was cash consideration. There was no material difference between the fair value and book value of net assets acquired.

Note 26 Financial commitments

Group capital expenditure contracted but not provided for in these accounts amounted to £2.8m (1999 – £2.1m).

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 £6.7m (1999 – £6.2m) 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 2000 £ million**	Land and buildings 1999 £ million	**Other assets 2000 £ million**	Other assets 1999 £ million
Within one year	1.7	1.7	2.1	2.2
After one year and within five years	2.8	3.4	5.8	5.6
After five years	5.6	2.3	0.2	–
	10.1	7.4	8.1	7.8

Note 27 Contingent liabilities

	Group 2000 £ million	Group 1999 £ million	**Parent 2000 £ million**	Parent 1999 £ million
Guarantees in respect of subsidiary undertakings' borrowings	–	–	28.6	17.3
Other	3.0	3.5	3.0	3.5
	3.0	3.5	31.6	20.8

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 has 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	5.3	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	12.4 years

At the date of the most recent actuarial valuations (which took place between July 1997 and December 2000) the aggregate market value of the assets of the group's major defined benefit plans was £267m (1999 – £256m). The actuarial value of plan assets represented 102% 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 £5.3m (1999 – £5.7m) relating to the excess funding of certain group pension plans. Included in creditors is an accrual of £9.8m (1999 – £12.0m) 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 £8.5m (1999 – £12.7m).

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 2000 was £0.4m (1999 – £0.5m). The amount receivable at 31 December 2000 was £0.2m (1999 – £0.1m).

Note 28 Post-retirement benefits continued

The costs of providing healthcare benefits after retirement of £0.7m (1999 – £0.7m) are determined by independent qualified actuaries. The unfunded liability of £9.3m (1999 – £8.8m) 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	6.0	9.0
Medical cost inflation	7.0	9.0

Note 29 Smith & Nephew Employees' Share Trust

	2000 £ million	1999 £ million
Shares acquired	2.9	–

The Smith & Nephew Employees' Share Trust (the "Trust") was established to encourage and facilitate the acquisition and holding of shares in the company by and for the benefit of employees, including directors, and former employees and their dependants, as the trustees may determine.

The trust is administered by an independent professional trust company resident in Jersey and is funded by a direct loan from the parent company. The costs of the Trust are charged to the profit and loss account as they accrue. There is a dividend waiver in place in respect of the shares held by the Trust.

At 31 December 2000 the Trust held 0.9 million ordinary shares of the company at an aggregate cost of £2.9 million, which is included within fixed asset investments on the group balance sheet. The market value of the shares at 31 December 2000 was £2.9 million.

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%
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	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	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	Australia	100%
Smith & Nephew Limited	Medical devices	Hong Kong	100%
Smith & Nephew Healthcare Limited	Medical devices	India	100%
PT Smith & Nephew Healthcare	Medical devices	Indonesia	100%
Smith & Nephew KK	Medical devices	Japan	100%
Smith & Nephew Limited	Medical devices	Korea	100%
Smith & Nephew Healthcare Sdn Berhad	Medical devices	Malaysia	100%
Smith & Nephew Limited	Medical devices	New Zealand	100%
Smith & Nephew Pakistan (Pvt) Limited	Medical devices	Pakistan	97%
Smith & Nephew Pte Limited	Medical devices	Singapore	100%
Smith & Nephew Limited	Medical devices	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 (1999 – £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.

Summary remuneration report and auditors' statement

Directors' emoluments and share interests

		Total emoluments*		Share interests			
				31 December 2000		1 January 2000	
		2000 £'000	1999 £'000	Shares	Options	Shares	Options
Chairman:	D.G. Eustace	150	21	40,909	–	–	–
	J.H. Robinson (to 31 Dec 1999)	–	156	–	–	–	–
Executive:	C.J. O'Donnell	703	603	111,339	177,862	19,490	367,862
	P. Hooley	489	432	4,090	405,362	5,000	405,362
	A.R. Fryer (to 31 Dec 2000)	641	452	–	–	–	–
Non-executive:	Sir Anthony Cleaver	24	24	13,730	–	16,782	–
	Dr N.J. Lane (to 26 Oct 2000)	24	29	–	–	–	–
	Sir Timothy Lankester	24	24	5,911	–	6,389	–
	Sir Brian Pearse	24	24	20,000	–	20,000	–
	Dr R.W.H. Stomberg	24	24	864	–	1,035	–
	W.D. Knowlton (from 1 Nov 2000)	4	–	–	–	–	–
		2,107	1,789				

*Inclusive of salaries and fees, benefits, annual bonus and pension entitlements. Profits on exercise of share options were: Christopher O'Donnell £291,000 and Alan Fryer £230,000 (1999 – £18,000).

Directors' incentive plans

Executive directors participate in an annual bonus scheme based on achieving performance criteria and in a long-term incentive plan based on the company's total shareholder return in relation to other companies and growth in earnings per share over a three-year period. Total outstanding conditional awards of shares are: Christopher O'Donnell 499,368 (1999 – 344,303) and Peter Hooley 316,749 (1999 – 219,833). For the plan year 1998, the company's total shareholder return was ranked in the top quartile of the comparator group and the earnings per share performance criteria was met, thus enabling the plan participants to be eligible for the vesting of 100% of the shares conditionally awarded for 1998. As a result, on 14 February 2001, Christopher O'Donnell became entitled to 161,263 shares and Peter Hooley entitled to 102,874 shares which are both included in the outstanding conditional awards of shares above.

Auditors' statement to the members of Smith & Nephew plc on the summary financial statement

We have examined the summary remuneration report above and the summary financial statement set out on pages 28 and 29, the preparation of which is the responsibility of the directors. Our responsibility is to report to you our opinion on the consistency of the statement with the annual accounts and directors' report, and its compliance with the relevant requirements of section 251 of the Companies Act 1985 and regulations made thereunder. We also read the other information contained in the Report to Shareholders and Summary Financial Statement and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the summary financial statement. We conducted our work in accordance with Bulletin 1999/6 'The auditors' statement on the summary financial statement' issued by the Auditing Practices Board.

In our opinion, the summary financial statement is consistent with the annual accounts and directors' report of Smith & Nephew plc for the year ended 31 December 2000 and complies with the applicable requirements of section 251 of the Companies Act 1985, and regulations made thereunder.

Ernst & Young
Registered auditor
London, 14 February 2001

This summary financial statement is a summary of information in the group's full annual accounts and was approved by the Board on 14 February 2001 and signed on its behalf by Dudley Eustace and Peter Hooley. It does not contain sufficient information to allow a full understanding of the results of the group and state of affairs of the company or of the group. A review of the business is included in the directors' report. The report of the auditors on the full accounts for the year ended 31 December 2000 was unqualified and did not contain a statement made under either section 237(2) of the Companies Act 1985 (accounting records or returns inadequate or accounts not agreeing with records or returns) or section 237(3) (failure to obtain necessary information and explanations).

For further information the full annual accounts and the auditors' report on those accounts should be consulted. Shareholders have the right to demand, free of charge, a copy of the group's full annual report and accounts, which may be obtained from the company's registrars.

Summary financial statement

Group profit and loss account

for the year ended 31 December 2000	2000 £ million	1999 £ million
Turnover		
Ongoing operations	824.8	709.9
Other operations	180.6	179.6
Continuing operations	1,005.4	889.5
Discontinued operations	129.3	230.4
	1,134.7	1,119.9
Operating profit		
Continuing operations:		
Before exceptional items – ongoing operations	142.5	114.6
Before exceptional items – other operations	22.0	20.1
Exceptional items*	(16.3)	(42.0)
	148.2	92.7
Discontinued operations:		
Before exceptional items	13.9	32.8
Exceptional items*	–	(9.7)
	162.1	115.8
Discontinued operations:		
Net profit on disposals*	106.3	62.9
Profit on ordinary activities before interest	268.4	178.7
Interest (payable)/receivable	(7.0)	3.4
Profit on ordinary activities before taxation	261.4	182.1
Taxation	56.2	77.3
Attributable profit for the year	205.2	104.8
Dividends:		
Ordinary	41.3	72.5
Special	415.6	–
Retained (deficit)/profit for the year	(251.7)	32.3
Basic earnings per ordinary share	19.85p	9.39p
Diluted earnings per ordinary share	19.73p	9.37p
Results before exceptional items (*)		
Profit before taxation	171.4	170.9
Adjusted basic earnings per ordinary share	11.61p	10.72p
Adjusted diluted earnings per ordinary share	11.54p	10.69p

Group balance sheet

at 31 December 2000	2000 £ million	1999 £ million
Fixed assets		
Intangible fixed assets	163.0	74.0
Tangible fixed assets	251.1	270.5
Investments	24.0	16.6
	438.1	361.1
Working capital		
Stocks	228.2	237.6
Debtors	277.8	281.1
Creditors	(330.3)	(312.4)
	175.7	206.3
Provisions	(47.9)	(38.0)
	565.9	529.4
Share capital and reserves	329.6	551.7
Net borrowings/(cash)	236.3	(22.3)
	565.9	529.4

Group cash flow

for the year ended 31 December 2000	2000 £ million	1999 £ million
Operating profit	162.1	115.8
Depreciation and amortisation	62.9	56.1
Exceptional asset write downs	–	28.6
Working capital and provisions	(21.0)	(2.4)
Net cash inflow from operating activities*	204.0	198.1
Capital expenditure and financial investment	(66.7)	(65.1)
Operating cash flow	137.3	133.0
Interest	(7.0)	3.4
Tax paid	(46.5)	(60.1)
Dividends paid	(475.9)	(70.3)
Acquisitions	(51.1)	(50.9)
Disposals	209.8	121.8
Issues of ordinary share capital	7.7	4.4
Net cash flow	(225.7)	81.3
Exchange adjustments	(32.9)	(9.5)
Opening net cash/(borrowings)	22.3	(49.5)
Closing net (borrowings)/cash	(236.3)	22.3

*After £23.1m (1999 – £18.5m) of outgoings on rationalisation, acquisition integration and divestment costs.

Group five year summary

Profit and loss account	**2000 £ million**	1999 £ million	1998 £ million	1997 £ million	1996 £ million
Turnover					
Continuing operations	1,005.4	889.5	801.3	785.8	806.4
Discontinued operations	129.3	230.4	252.1	262.3	262.8
	1,134.7	1,119.9	1,053.4	1,048.1	1,069.2
Operating profit					
Continuing operations:					
Before exceptional items	164.5	134.7	119.5	131.4	155.6
Exceptional items*	(16.3)	(42.0)	(16.3)	(1.8)	(4.4)
Discontinued operations					
Before exceptional items	13.9	32.8	34.6	33.2	32.3
Exceptional items*	–	(9.7)	(1.6)	–	–
	162.1	115.8	136.2	162.8	183.5
Profit/(loss) on disposals*	106.3	62.9	–	(6.5)	0.9
Profit before interest	268.4	178.7	136.2	156.3	184.4
Interest (payable)/receivable	(7.0)	3.4	(1.7)	(3.9)	(5.7)
Profit before taxation	261.4	182.1	134.5	152.4	178.7
Taxation	56.2	77.3	40.8	38.7	58.0
Profit after taxation	205.2	104.8	93.7	113.7	120.7
Ordinary dividends	41.3	72.5	69.2	69.0	66.5
Special dividend	415.6	–	–	–	–
Retained (deficit)/profit	(251.7)	32.3	24.5	44.7	54.2
Basic earnings per ordinary share	19.85p	9.39p	8.42p	10.24p	10.92p
Diluted earnings per ordinary share	19.73p	9.37p	8.40p	10.22p	10.86p
Dividends per ordinary share	4.50p	6.50p	6.20p	6.20p	6.00p
Results before exceptional items (*):					
Profit before taxation	171.4	170.9	152.4	160.7	182.2
Adjusted earnings per ordinary share	11.61p	10.72p	9.58p	11.00p	11.21p
Adjusted diluted earnings per ordinary share	11.54p	10.69p	9.57p	10.97p	11.16p
Operating profit (before exceptional items) to sales	15.7%	15.0%	14.6%	15.7%	17.6%
Research and development costs to sales	4.0%	4.0%	4.1%	4.0%	3.9%
Capital investment (including intangibles) to sales	5.6%	5.8%	6.6%	7.1%	6.7%

Balance sheet	2000 £ million	1999 £ million	1998 £ million	1997 £ million	1996 £ million
Fixed assets	438.1	361.1	334.4	302.0	277.3
Working capital	175.7	206.3	232.0	235.8	233.4
Provisions	(47.9)	(38.0)	(31.4)	(29.9)	(32.3)
Capital employed	565.9	529.4	535.0	507.9	478.4
Called up share capital	112.7	112.1	111.7	111.5	111.0
Reserves	216.9	439.6	373.8	349.8	324.4
Capital and reserves	329.6	551.7	485.5	461.3	435.4
Net borrowings/(cash)	236.3	(22.3)	49.5	46.6	43.0
	565.9	529.4	535.0	507.9	478.4
Operating profit (before exceptional items) to average capital employed	33%	31%	30%	33%	39%
Gearing	72%	nil	10%	10%	10%

Cash flow	2000 £ million	1999 £ million	1998 £ million	1997 £ million	1996 £ million
Cash inflow from operating activities	204.0	198.1	161.9	181.7	189.3
Capital expenditure and financial investment	(66.7)	(65.1)	(61.9)	(66.8)	(63.4)
	137.3	133.0	100.0	114.9	125.9
Interest, tax and dividends	(529.4)	(127.0)	(91.3)	(113.0)	(106.3)
Acquisitions and disposals	158.7	70.9	(16.4)	(8.0)	(42.6)
Issues of share capital	7.7	4.4	3.0	4.3	5.2
Net cash flow	(225.7)	81.3	(4.7)	(1.8)	(17.8)
Exchange adjustments	(32.9)	(9.5)	1.8	(1.8)	56.8
Opening net cash/(borrowings)	22.3	(49.5)	(46.6)	(43.0)	(82.0)
Closing net (borrowings)/cash	(236.3)	22.3	(49.5)	(46.6)	(43.0)

Note 1 Segmental analysis

Analysis by activity	Turnover 2000 £ million	Operating profit 2000 £ million	Operating assets 2000 £ million	Turnover 1999 £ million	Operating profit 1999 £ million	Operating assets 1999 £ million
Ongoing operations	824.8	134.8	565.8	709.9	82.7	500.6
Other operations	180.6	13.4	90.2	179.6	10.0	81.2
Continuing operations	1,005.4	148.2	656.0	889.5	92.7	581.8
Discontinued operations	129.3	13.9	9.9	230.4	23.1	59.7
	1,134.7	162.1	665.9	1,119.9	115.8	641.5

Exceptional costs of £16.3m (1999 – £51.7m) have been charged as follows: ongoing operations £7.7m (1999 – £31.9m), other operations £8.6m (1999 – £10.1m) and discontinued operations nil (1999 – £9.7m).

Other operations comprise the casting and bandaging and traditional woundcare businesses which will be contributed to the Joint venture with Beiersdorf AG on 1 April 2001 and the ear, nose and throat business, the intended disposal of which was announced on 2 November 2000.

Discontinued operations comprise the results of the Consumer business and the first half year results of the Bracing business in 1999.

Analysis by geographic origin	Turnover 2000 £ million	Operating profit 2000 £ million	Operating assets 2000 £ million	Turnover 1999 £ million	Operating profit 1999 £ million	Operating assets 1999 £ million
United Kingdom	187.0	18.8	110.4	173.8	19.4	115.0
Continental Europe	230.5	16.5	90.5	232.6	11.0	84.3
America	641.0	92.7	401.1	545.9	51.1	321.9
Africa, Asia and Australasia	155.8	20.2	54.0	144.2	11.2	60.6
Continuing operations	1,214.3	148.2	656.0	1,096.5	92.7	581.8
Discontinued operations	129.3	13.9	9.9	230.4	23.1	59.7
	1,343.6	162.1	665.9	1,326.9	115.8	641.5
Less intragroup sales	(208.9)	–	–	(207.0)	–	–
	1,134.7	162.1	665.9	1,119.9	115.8	641.5

Exceptional costs of £7.2m have been charged to the UK (1999 – £4.0m), £1.3m to Continental Europe (1999 – £3.0m), £6.3m to America (1999 – £28.7m) and £1.5m to Africa, Asia and Australasia (1999 – £6.3m). Nil was charged to discontinued operations (1999 – £9.7m).

Analysis of turnover by geographic market	2000 £ million	1999 £ million
United Kingdom	92.7	93.2
Continental Europe	211.8	201.7
America	535.2	444.0
Africa, Asia and Australasia	165.7	150.6
Continuing operations	1,005.4	889.5
Discontinued operations	129.3	230.4
	1,134.7	1,119.9

Note 1 Segmental analysis continued

Analysis of turnover by product	2000 £ million	1999 £ million
Orthopaedics	329.3	276.4
Endoscopy	216.4	192.8
Advanced wound management	210.9	176.9
Rehabilitation	68.2	63.8
Ongoing operations	824.8	709.9
Other operations	180.6	179.6
Continuing operations	1,005.4	889.5
Discontinued operations	129.3	230.4
	1,134.7	1,119.9

Note 2 Operating profit

	Continuing operations 2000 £ million	Discontinued operations 2000 £ million	Total 2000 £ million	Continuing operations 1999 £ million	Discontinued operations 1999 £ million	Total 1999 £ million
Turnover	1,005.4	129.3	1,134.7	889.5	230.4	1,119.9
Cost of sales	370.4	86.4	456.8	342.8	136.8	479.6
Gross profit	635.0	42.9	677.9	546.7	93.6	640.3
Marketing, selling and distribution	(333.2)	(24.8)	(358.0)	(286.5)	(54.7)	(341.2)
Administration	(109.3)	(4.6)	(113.9)	(111.4)	(14.2)	(125.6)
Research and development	(46.4)	–	(46.4)	(43.6)	(1.6)	(45.2)
Other	2.1	0.4	2.5	(12.5)	–	(12.5)
Operating profit	148.2	13.9	162.1	92.7	23.1	115.8

Results of continuing operations have been stated after charging exceptional costs of £16.3m (1999 – £42.0m), which have been allocated in total as follows: cost of sales £13.2m (1999 – £8.2m), marketing, selling and distribution £1.2m (1999 – £4.6m), administration £1.9m (1999 – £16.7m) and other nil (1999 – £12.5m).

Results of discontinued operations have been stated after charging exceptional costs of nil (1999 – £9.7m). 1999 exceptional costs of £9.7m were allocated as follows: cost of sales £3.8m, marketing, selling and distribution £1.8m and administration £4.1m.

Operating profit is stated after charging:	2000 £ million	1999 £ million
Depreciation	53.0	50.3
Loss on sale of fixed assets	3.2	1.9
Amortisation of goodwill	7.5	1.8
Amortisation of other intangibles	2.4	4.0
Exceptional asset provisions	–	28.6
Operating lease rentals for land and buildings	8.8	8.2
Auditors' remuneration	1.0	1.1

Payments made to the group's auditors for non-audit services amounted to £1.2m (1999 – £0.5m) in the UK and £0.9m (1999 – £0.8m) outside the UK. Of these payments £1.6m (1999 – £0.8m) relate to taxation services and £0.5m (1999 – £0.5m) to statutory and other certifications and accountancy services. Of the total payments for non-audit services, £0.9m (1999 – £0.4m) relates to capital transactions.

Unrecognised gains and losses relating to forward foreign exchange contracts in respect of anticipated purchases over the next 12 months amounted to £2.0m (1999 – £3.9m) and £1.3m (1999 – £2.2m) respectively. The unrecognised gains and losses on forward foreign exchange contracts at 31 December 1999 were recognised in 2000. 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

In 2000, operating exceptional items comprise the cost of the manufacturing rationalisation programme begun in 1999 of £12.9m (1999 – £24.3m) and acquisition integration costs of £3.4m (1999 – £5.2m). In 1999 £6.5m was written off intangible assets relating to the Dermagraft joint arrangement and a £6.0m provision was taken against the group's equity investment in Advanced Tissue Sciences. Discontinued exceptional items of £9.7m in 1999 represent that element of manufacturing rationalisation costs which related to the Consumer business.

The net profit on disposal related to the sale of the Consumer healthcare business in June 2000 for a net cash consideration of £209.8m. The net profit comprised a gain of £138.1m less £31.8m of acquisition goodwill previously written off to reserves. The net profit on disposal in 1999 related to the sale of the Bracing business.

Note 4 Interest

	2000 £ million	1999 £ million
Interest receivable	4.4	10.3
Interest payable:		
On bank borrowings	8.7	6.1
Other	2.7	0.8
	11.4	6.9
Net interest (payable)/receivable	(7.0)	3.4

Interest payable on currency swaps of £23.5m (1999 – £25.8m) has been set off against interest receivable.

At 31 December 2000 the group held sterling interest bearing assets of £401m on which interest has been fixed on £107m at 6.4% for one year and £37m on which interest has been fixed for a further two years at 5.6%, a weighted average of 6.1% for a weighted average period of 1.7 years. The remainder was cash balances held on short term deposit at floating rates. The group also held £23m 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 2000 included £481m of US dollars and £107m of euros on which interest has been fixed for one year on £100m of US dollars and £107m of euros at weighted average rates of 6.3% and 4.6% respectively. Interest has also been fixed on £35m of euros for a further two years at 3.6%. The remaining interest bearing liabilities totalled £72m of various currencies. 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 the group held sterling interest bearing assets of £560m on which interest had been fixed on £390m at 5.7% for one year and £37m on which interest had 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 had 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 had 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 had been fixed at 6.0% for one year. Where interest had not been fixed the rates were typically based on the three month interest rate relevant to the currency concerned.

At 31 December 2000 unrecognised gains and losses on the value of interest rate swaps were £1.6m and £0.5m respectively (1999 – gains £3.2m, losses £3.3m). Unrecognised gains of £0.8m will be realised in 2001 and £0.8m between 2002 and 2003. Unrecognised losses of £0.4m will be realised in 2001 and £0.1m between 2002 and 2003. Unrecognised net losses of £0.9m on interest rate swaps at 31 December 1999 were recognised in 2000. The group's interest rate risk management policy is set out on page 31. The fair values of interest rate swaps are calculated as the net present value of the future cash flows at 31 December, discounted at market rates of interest on that date.

After the balance sheet date, the group transacted additional interest rate swaps thereby fixing 2001 interest rates on a further £260m of sterling assets and £335m of US dollar liabilities to give weighted average rates on these principals of 5.5% and 5.3% respectively.

Note 5 Employees

The average number of employees during the year was:	2000	1999
United Kingdom	2,589	2,973
Continental Europe	1,549	1,602
America	3,387	3,370
Africa, Asia and Australasia	2,910	3,268
	10,435	11,213

Staff costs during the year amounted to:	£ million	£ million
Wages and salaries	249.1	232.1
Social security costs	25.4	25.1
Other pension costs (Note 28)	10.6	9.1
	285.1	266.3

Note 6 Directors' emoluments

Aggregate emoluments of the directors, including pension entitlements of £98,000 (1999 – £78,000), were £2,107,000 (1999 – £1,789,000). The emoluments of the highest paid director excluding pension entitlement were £684,000 (1999 – £586,000). The accrued pension benefit of the highest paid director at the end of the year was £95,000 (1999 – £75,000).

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

Note 7 Taxation

	2000 £ million	1999 £ million
United Kingdom:		
Corporation tax at 30% (1999 – 30.25%)	28.8	29.7
Adjustments in respect of prior years	(1.7)	–
Deferred taxation	0.8	(3.8)
	27.9	25.9
Overseas:		
Tax on ordinary activities	28.1	47.6
Adjustments in respect of prior years	(1.7)	–
Deferred taxation	1.9	3.8
	28.3	51.4
	56.2	77.3

The tax charge has been reduced by £3.2m (1999 – £9.5m) as a consequence of the exceptional costs of the rationalisation programme and acquisition integration costs and increased by £8.0m (1999 – £35.5m) as a result of the exceptional profit on disposal, leaving the tax charge on ordinary activities at £51.4m (1999 – £51.3m).

If full provision had been made for deferred tax, the tax charge would have reduced by £1.0m (1999 – increased by £5.7m) as follows:

	2000 £ million	1999 £ million
Fixed asset timing differences	(1.9)	2.0
Other timing differences	0.9	3.7
	(1.0)	5.7

Note 8 Dividends

	2000 £ million	1999 £ million
Ordinary interim of 1.7p (1999 – 2.5p) paid 6 December 2000	15.6	27.8
Proposed ordinary final of 2.8p (1999 – 4.0p) payable 18 May 2001	25.7	44.7
	41.3	72.5

A special dividend of £415.6m (37.14p per share) was paid on 11 August 2000. Non-equity preference dividends amounting to £15,000 were paid (1999 – £13,000).

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.

	2000 £ million	1999 £ million
Profit on ordinary activities before taxation	261.4	182.1
Adjustments:		
Continuing operations: exceptional items	16.3	42.0
Discontinued operations: exceptional items	–	9.7
Discontinued operations: net gain on disposal	(106.3)	(62.9)
Profit before taxation and exceptional items	171.4	170.9
Taxation on profit before exceptional items	51.4	51.3

Note 10 Earnings per ordinary share

Basic earnings per ordinary share of 19.85p (1999 – 9.39p) are based on profit on ordinary activities after taxation and preference dividends of £205.2m (1999 – £104.8m) and on 1,034m ordinary shares being the basic weighted average number of shares in issue during the year (1999 – 1,116m). No adjustment has been made to comparative data in respect of the share consolidation as together with the special dividend payment the overall effect was that of a share repurchase at fair value. The calculation of diluted earnings per ordinary share is based on basic earnings and on 1,040m ordinary shares (1999 – 1,119m) calculated as follows:

	Shares 2000 million	Shares 1999 million
Basic weighted average number of shares	1,034	1,116
Weighted average number of shares under option	22	16
Number of shares that would have been issued at fair value	(16)	(13)
Diluted weighted average number of shares	1,040	1,119
Diluted earnings per ordinary share	19.73p	9.37p

The calculation of adjusted basic earnings per ordinary share is as follows:

	2000 £ million	1999 £ million
Basic earnings	205.2	104.8
Continuing operations: exceptional items	16.3	42.0
Discontinued operations: exceptional items	–	9.7
Discontinued operations: net gain on disposal	(106.3)	(62.9)
Exceptional taxation	4.8	26.0
Adjusted basic earnings	120.0	119.6
Adjusted basic earnings per ordinary share	11.61p	10.72p
Adjusted diluted basic earnings per ordinary share	11.54p	10.69p

Note 11 Intangible fixed assets

Group	Goodwill £ million	Other £ million	Total £ million
Cost:			
At 1 January 2000	49.1	40.9	90.0
Exchange adjustment	5.4	2.9	8.3
Acquisitions	89.9	–	89.9
Additions	–	4.0	4.0
Transfers	2.1	(2.1)	–
Discontinued operations	–	(2.4)	(2.4)
At 31 December 2000	146.5	43.3	189.8
Amortisation:			
At 1 January 2000	2.1	13.9	16.0
Exchange adjustment	0.2	0.9	1.1
Charge for the year	7.5	2.4	9.9
Transfers	0.2	(0.2)	–
Discontinued operations	–	(0.2)	(0.2)
At 31 December 2000	10.0	16.8	26.8
Net book amounts:			
At 31 December 2000	136.5	26.5	163.0
At 31 December 1999	47.0	27.0	74.0

Note 12 Tangible fixed assets

Group	Land and buildings freehold £ million	Land and buildings leasehold £ million	Plant and equipment £ million	In course of construction £ million	Total £ million
Cost:					
At 1 January 2000	83.7	11.2	481.7	17.3	593.9
Exchange adjustment	3.0	0.3	12.8	0.5	16.6
Additions	0.6	0.4	35.5	23.4	59.9
Disposals	(5.5)	–	(46.0)	(1.3)	(52.8)
Transfers	0.6	–	19.9	(20.5)	–
Discontinued operations	(6.8)	–	(40.6)	(0.7)	(48.1)
At 31 December 2000	75.6	11.9	463.3	18.7	569.5
Depreciation:					
At 1 January 2000	18.2	3.2	302.0	–	323.4
Exchange adjustment	0.6	0.1	7.8	–	8.5
Charge for the year	2.7	0.8	49.5	–	53.0
Disposals	(3.4)	–	(43.1)	–	(46.5)
Discontinued operations	(1.2)	–	(18.8)	–	(20.0)
At 31 December 2000	16.9	4.1	297.4	–	318.4
Net book amounts:					
At 31 December 2000	58.7	7.8	165.9	18.7	251.1
At 31 December 1999	65.5	8.0	179.7	17.3	270.5

Fixed assets include land with a cost of £5.0m (1999 – £5.8m) that is not subject to depreciation. Leases with less than 50 years to run amounted to £5.1m (1999 – £5.1m). Included in the amounts above are assets held under finance leases with a net book amount of £2.8m (1999 – £3.0m).

Note 12 Tangible fixed assets continued

Parent company

The opening net book amount of £8.1m represented plant and equipment, with a cost of £17.1m and accumulated depreciation of £9.0m. Movements in the year comprised £3.6m of additions, depreciation charged in the year of £1.4m (1999 – £1.4m) and assets of £2.4m written off in connection with the Consumer disposal. The closing net book value of £7.9m represented plant and equipment with a cost of £20.7m and accumulated depreciation of £12.8m.

Note 13 Investments

	Group own shares £ million	Group associated undertakings £ million	Group trade investments £ million	Group total £ million	Parent subsidiary undertakings £ million
At 1 January 2000	–	0.7	15.9	16.6	413.9
Exchange adjustment	–	0.1	1.3	1.4	–
Additions	2.9	–	6.0	8.9	–
Disposals	–	–	(2.9)	(2.9)	–
At 31 December 2000	2.9	0.8	20.3	24.0	413.9

Principal subsidiary and associated undertakings are listed on pages 54 and 55. Trade investments are all US dollar denominated and include an 8% equity investment in Advanced Tissue Sciences Inc, quoted on the Nasdaq exchange in the US. The quoted market price of the company at 31 December 2000 and 14 February 2001 was $3.03 and $5.00 respectively.

Own shares represent the purchase in the year of the Company's own shares in respect of the Smith & Nephew Employees' Share Trust (see note 29).

Note 14 Stocks

	Group 2000 £ million	Group 1999 £ million
Raw materials and consumables	54.3	52.1
Work in progress	16.6	16.1
Finished goods and goods for resale	157.3	169.4
	228.2	237.6

Note 15 Debtors

	Group 2000 £ million	Group 1999 £ million	**Parent 2000 £ million**	Parent 1999 £ million
Amounts falling due within one year:				
Trade and other debtors	246.2	241.8	6.9	2.4
Amounts owed by subsidiary undertakings	–	–	361.8	466.7
Prepayments and accrued income	24.4	23.6	13.4	7.4
	270.6	265.4	382.1	476.5
Amounts falling due after more than one year:				
Pension prepayments (Note 28)	5.3	5.7	–	–
Other debtors	1.4	2.7	–	–
Deferred taxation (Note 19)	0.5	7.3	0.1	0.3
	277.8	281.1	382.2	476.8

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 2000 £ million**	Group 1999 £ million	**Parent 2000 £ million**	Parent 1999 £ million
Gross borrowings:				
Due within one year	82.0	58.0	66.2	28.9
Due after one year	178.9	20.2	163.5	4.5
	260.9	78.2	229.7	33.4
Cash and bank	(24.6)	(100.5)	(14.9)	(77.2)
	236.3	(22.3)	214.8	(43.8)

Gross borrowings				
Bank loans and overdrafts	259.1	75.9	229.5	33.0
Other loans wholly repayable within five years:				
5½% US dollar convertible bonds 2000	–	0.2	–	0.2
Other	1.8	1.8	0.2	0.2
	1.8	2.0	0.2	0.4
Other loans wholly repayable after five years	–	0.3	–	–
	260.9	78.2	229.7	33.4

Bank loans and overdrafts represent drawings under committed and uncommitted facilities of £418m and £264m respectively. Of the undrawn committed facilities of £216m, £106m expire within one year and £110m after more than two years. Borrowings secured on fixed and current assets were £1.4m (1999 – £1.7m). 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 2001 to 2005. For the group, gross sterling equivalents of £399.9m (1999 – £477.6m) receivable and £425.9m (1999 – £484.3m) payable have been netted. The balance of £26.0m (1999 – £6.7m) is included as £1.0m in cash and bank and as £27.0m in borrowings (1999 – £4.4m in cash and bank and £11.1m in borrowings). For the parent company, gross sterling equivalents of £374.0m (1999 – £446.5m) receivable and £398.5m (1999 – £453.9m) payable have been netted, the balance of £24.5m (1999 – £7.4m) is included as £1.0m in cash and bank and as £25.5m in borrowings (1999 – £3.7m in cash and bank and £11.1m in borrowings). Currency swaps comprise floating interest rate contracts and forward foreign exchange contracts and are used for hedging foreign investments.

Note 16 Borrowings continued

Gross borrowings are repayable as follows:	**Group 2000 £ million**	Group 1999 £ million	**Parent 2000 £ million**	Parent 1999 £ million
Within one year:				
Bank loans and overdrafts	81.7	57.5	66.2	28.7
Other loans	0.3	0.5	–	0.2
Total within one year	82.0	58.0	66.2	28.9
Bank loans and overdrafts:				
After one year and within two years	20.2	3.5	12.7	2.5
After two years and within five years	157.2	14.9	150.6	1.8
	177.4	18.4	163.3	4.3
Other loans:				
After one year and within two years	0.6	0.3	0.2	–
After two years and within five years	0.9	1.2	–	0.2
After five years	–	0.3	–	–
	1.5	1.8	0.2	0.2
Total after one year	178.9	20.2	163.5	4.5
	260.9	78.2	229.7	33.4

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

Amounts falling due within one year:	**Group 2000 £ million**	Group 1999 £ million	**Parent 2000 £ million**	Parent 1999 £ million
Trade creditors	114.6	128.5	3.3	2.4
Amounts owed to subsidiary undertakings	–	–	150.3	221.2
Social security costs and other taxes	13.0	14.8	0.4	0.3
Accruals and deferred income	59.5	49.7	15.6	11.0
Acquisition consideration	32.3	–	–	–
Current taxation	76.9	74.7	17.4	20.2
Ordinary share dividends	25.7	44.7	25.7	44.7
	322.0	312.4	212.7	299.8

Amounts falling due after more than one year: acquisition consideration of £8.3m (1999 – nil) is payable by the Group.

Note 18 Provisions for liabilities and charges

Group	Rationalisation and integration £ million	Retirement healthcare £ million	Other £ million	Total £ million
At 1 January 2000	18.2	8.8	11.0	38.0
Exchange adjustments	(0.1)	0.4	0.3	0.6
Profit and loss account	37.7	0.7	5.4	43.8
Utilisation	(29.8)	(0.6)	(4.1)	(34.5)
At 31 December 2000	26.0	9.3	12.6	47.9

At 31 December 2000 rationalisation and integration provisions included acquisition integration of £2.2m (1999 – £3.6m). 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 two 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 £0.9m to £0.1m represented expenditure of £0.8m.

Note 19 Deferred taxation

	Group £ million	Parent £ million
At 1 January 2000	7.3	0.3
Profit and loss – current year	(2.7)	(0.2)
Profit and loss – prior year adjustments	(4.2)	–
Exchange adjustment	0.1	–
At 31 December 2000	0.5	0.1

Deferred tax asset/(liability) is analysed as follows:

Group	**Amount provided 2000 £ million**	Amount provided 1999 £ million	**Full potential liability 2000 £ million**	Full potential liability 1999 £ million
Fixed asset timing differences	(4.1)	(3.3)	(24.0)	(30.2)
Other timing differences	4.6	10.6	6.9	16.2
	0.5	7.3	(17.1)	(14.0)

Parent company

The deferred tax asset recognised in the parent company of £0.1m (1999 – £0.3m) is represented by other timing differences. The full potential deferred tax liability of £1.4m (1999 – £1.5m) is represented by fixed asset timing differences.

Note 20 Called up share capital

Authorised	**Shares 2000 '000**	**2000 £ million**	Shares 1999 '000	1999 £ million
Ordinary shares 12⅔p (1999 – 10p)	1,223,591	149.5	1,495,500	149.5
5½% cumulative preference shares £1	450	0.5	450	0.5
		150.0		150.0

On 7 August 2000, the ordinary share capital was consolidated by the issue of 9 new ordinary shares of 12⅔p for every 11 ordinary shares of 10p held.

Allotted, issued and fully paid Equity capital: ordinary shares 10p	Shares '000	£ million
At 1 January 2000	1,117,545	111.8
Share options and convertible bonds	1,408	0.1
At 6 August 2000	1,118,953	111.9
Effect of share consolidation: ordinary shares 12⅔p	(203,446)	–
At 7 August 2000	915,507	111.9
Share options and convertible bonds	3,682	0.5
	919,189	112.4
Non-equity capital: 5½% cumulative preference shares £1		
At 1 January 2000 and 31 December 2000	269	0.3
Total called up share capital at 31 December 2000		112.7

The 5½% cumulative preference shares are denominated in sterling and the fair value is not materially different. They are non-voting and carry preferential rights to dividend and distribution on winding up.

Note 21 Share option schemes

At 31 December 2000 21,862,000 (1999 – 25,464,000) of the authorised but unissued ordinary shares of 12⅖p 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	2001-2006	124.0p-221.2p	5,299
Executive share option schemes	2001-2010	133.0p-270.0p	16,563
			21,862

As the employee scheme is an Inland Revenue approved Save As You Earn scheme the company is exempt from accounting for the cost between the share option price and the market value at the grant date.

Note 22 Reserves

Group	Share premium £ million	Profit and loss account £ million
At 1 January 2000	118.3	321.3
Exchange adjustment	–	(9.9)
Retained deficit for the year	–	(251.7)
Share options and convertible bonds	7.1	–
Goodwill on disposals	–	31.8
At 31 December 2000	125.4	91.5

Net exchange losses of £32.9m (1999 – loss of £9.5m) arising on foreign currency net borrowings are included within the £9.9m (1999 – £4.0m) exchange adjustment.

The cumulative amount of goodwill (before merger relief of £116.0m) charged to reserves is £344.4m (1999 – £368.8m). The decrease is due to the goodwill written back to reserves on the disposal of the consumer business of £31.8m offset by exchange differences on acquisitions made prior to 31 December 1997 of £7.4m.

Parent company	Share premium £ million	Profit and loss account £ million
At 1 January 2000	118.3	411.5
Retained deficit for the year	–	(273.2)
Share options and convertible bonds	7.1	–
At 31 December 2000	125.4	138.3

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 £183.7m (1999 – £31.7m).

Note 23 Cash flow statement

Reconciliation of operating profit to net cash flow from operating activities	2000 £ million	1999 £ million
Operating profit	162.1	115.8
Depreciation and amortisation	62.9	56.1
Exceptional asset write downs	–	28.6
Loss on sale of tangible fixed assets	3.2	1.9
Rationalisation and integration costs	(23.1)	(18.5)
(Increase)/decrease in stocks	(7.1)	0.6
Decrease/(increase) in debtors	4.5	(14.2)
Increase in creditors and provisions	1.5	27.8
Net cash inflow from operating activities	204.0	198.1

Analysis of net borrowings	Opening net borrowings £ million	Cash flow £ million	Exchange adjustments £ million	Closing net borrowings £ million
Cash	23.8	–	(0.2)	23.6
Overdrafts	(5.1)	(2.4)	0.3	(7.2)
	18.7	(2.4)	0.1	16.4
Borrowings due within one year	(46.0)	(14.5)	(1.1)	(61.6)
Borrowings due after one year	(16.0)	(146.1)	(3.0)	(165.1)
	(43.3)	(163.0)	(4.0)	(210.3)
Net currency swaps	(6.7)	9.6	(28.9)	(26.0)
Liquid resources: cash deposits	72.3	(72.3)	–	–
	22.3	(225.7)	(32.9)	(236.3)

Cash and bank at 31 December 2000 totals £24.6m (1999 – £100.5m) and comprises cash £23.6m (1999 – £23.8m), liquid resources £nil (1999 – £72.3m) and currency swaps of £1.0m (1999 – £4.4m) as detailed in Note 16.

Reconciliation of net cash flow to movement in net borrowings

for the year ended 31 December 2000	2000 £ million	1999 £ million
Change in cash in the year	(2.4)	(15.1)
Change in liquid resources	(72.3)	72.3
Change in net currency swaps	9.6	7.3
Change in borrowings	(160.6)	16.8
Change in net borrowings/cash from cash flows	(225.7)	81.3
Exchange adjustments	(32.9)	(9.5)
Change in net borrowings/cash in the year	(258.6)	71.8
Opening net cash/(borrowings)	22.3	(49.5)
Closing net (borrowings)/cash	(236.3)	22.3

Disposals

The net assets of the Consumer business disposed of in 2000 comprised fixed assets £28.1m, stocks £23.9m, debtors £1.6m and creditors and provisions £13.0m. During 2000 the business contributed £20.6m of the group's net operating cash flow and incurred capital expenditure amounting to £0.6m.

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 2000	Average rate 1999	**Year end rate 2000**	Year end rate 1999
US dollar	1.51	1.62	1.49	1.61
Euro	1.64	1.53	1.59	1.61
Australian dollar	2.62	2.49	2.69	2.46
South African rand	10.55	9.87	11.31	9.92

Note 25 Acquisitions

The principal acquisitions during the year were the Collagenase business acquired in January 2000 and the Orthopaedics Biosystems business acquired in November 2000. Under the acquisition method of accounting the impact on the consolidated balance sheet of acquisitions in the year was:

	Net book value £ million
Tangible fixed assets	0.1
Current assets	1.9
Current liabilities	(1.1)
	0.9
Goodwill	89.9
Total consideration	90.8

Of the total consideration £39.7m is deferred consideration (payable in cash) and £51.1m was cash consideration. There was no material difference between the fair value and book value of net assets acquired.

Note 26 Financial commitments

Group capital expenditure contracted but not provided for in these accounts amounted to £2.8m (1999 – £2.1m).

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 £6.7m (1999 – £6.2m) 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 2000 £ million**	Land and buildings 1999 £ million	**Other assets 2000 £ million**	Other assets 1999 £ million
Within one year	1.7	1.7	2.1	2.2
After one year and within five years	2.8	3.4	5.8	5.6
After five years	5.6	2.3	0.2	–
	10.1	7.4	8.1	7.8

Note 27 Contingent liabilities

	Group 2000 £ million	Group 1999 £ million	**Parent 2000 £ million**	Parent 1999 £ million
Guarantees in respect of subsidiary undertakings' borrowings	–	–	28.6	17.3
Other	3.0	3.5	3.0	3.5
	3.0	3.5	31.6	20.8

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 has 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	5.3	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	12.4 years

At the date of the most recent actuarial valuations (which took place between July 1997 and December 2000) the aggregate market value of the assets of the group's major defined benefit plans was £267m (1999 – £256m). The actuarial value of plan assets represented 102% 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 £5.3m (1999 – £5.7m) relating to the excess funding of certain group pension plans. Included in creditors is an accrual of £9.8m (1999 – £12.0m) 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 £8.5m (1999 – £12.7m).

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 2000 was £0.4m (1999 – £0.5m). The amount receivable at 31 December 2000 was £0.2m (1999 – £0.1m).

Note 28 Post-retirement benefits continued

The costs of providing healthcare benefits after retirement of £0.7m (1999 – £0.7m) are determined by independent qualified actuaries. The unfunded liability of £9.3m (1999 – £8.8m) 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	6.0	9.0
Medical cost inflation	7.0	9.0

Note 29 Smith & Nephew Employees' Share Trust

	2000 £ million	1999 £ million
Shares acquired	2.9	–

The Smith & Nephew Employees' Share Trust (the "Trust") was established to encourage and facilitate the acquisition and holding of shares in the company by and for the benefit of employees, including directors, and former employees and their dependants, as the trustees may determine.

The trust is administered by an independent professional trust company resident in Jersey and is funded by a direct loan from the parent company. The costs of the Trust are charged to the profit and loss account as they accrue. There is a dividend waiver in place in respect of the shares held by the Trust.

At 31 December 2000 the Trust held 0.9 million ordinary shares of the company at an aggregate cost of £2.9 million, which is included within fixed asset investments on the group balance sheet. The market value of the shares at 31 December 2000 was £2.9 million.

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%
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	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	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	Australia	100%
Smith & Nephew Limited	Medical devices	Hong Kong	100%
Smith & Nephew Healthcare Limited	Medical devices	India	100%
PT Smith & Nephew Healthcare	Medical devices	Indonesia	100%
Smith & Nephew KK	Medical devices	Japan	100%
Smith & Nephew Limited	Medical devices	Korea	100%
Smith & Nephew Healthcare Sdn Berhad	Medical devices	Malaysia	100%
Smith & Nephew Limited	Medical devices	New Zealand	100%
Smith & Nephew Pakistan (Pvt) Limited	Medical devices	Pakistan	97%
Smith & Nephew Pte Limited	Medical devices	Singapore	100%
Smith & Nephew Limited	Medical devices	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 (1999 – £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.

Information for shareholders

Analysis of shareholdings

The number of shareholders as at 31 December 2000 was 27,769.

Shareholders range:	Shareholders %	Shares %
1,000 and under	37.7	0.6
1,001 to 5,000	44.7	3.3
5,001 to 10,000	9.3	2.0
10,001 to 100,000	6.4	4.9
Over 100,000	1.9	89.2
Held by:		
Individuals	82.8	7.0
Institutions and companies	17.2	93.0

Financial calendar

Annual General Meeting	4 April 2001
Payment of 2000 final dividend	18 May 2001
Interim results announced	2 August 2001
Payment of 2001 interim dividend	5 December 2001
Full year results announced	mid February 2002
Annual report posted	early March 2002
Annual General Meeting	3 April 2002

Final dividend

The ordinary shares will trade ex-dividend on both the London and New York Stock Exchanges from 18 April 2001 and the record date will be 20 April 2001 in respect of this year's proposed final dividend to be paid on 18 May 2001.

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 2000 final dividend are available from Lloyds TSB Registrars who administer the plan on behalf of the company. Applications for re-investment should be returned to the company's registrars by 1 May 2001.

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

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 and telephone facility that provides a simple low-cost method of buying and selling Smith & Nephew shares is available through Hoare Govett Limited.

American depositary receipts (ADRs)

In the US, the company's ordinary shares are traded in the form of American Depositary shares, evidenced by ADRs, and trade under the symbol SNN. Each American Depositary Share represents ten ordinary shares. Bank of New York is the authorised depositary bank for the company's ADR programme. A global BuyDIRECT plan is available for US residents enabling investment directly in ADRs with reduced brokerage commissions and service costs.

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.

Annual General Meeting

The company's 64th Annual General Meeting is to be held on 4 April 2001 at 9.30 am at The Royal Society of Medicine, 1 Wimpole Street, London W1G 0AE. 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
	Pinsent Curtis Biddle
Auditors:	Ernst & Young
Stockbrokers:	Cazenove & Co
	Dresdner Kleinwort Benson