Company Registration No. 00093994 (England and Wales)

T.J.SMITH AND NEPHEW,LIMITED

ANNUAL REPORT AND FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2019

T.J.SMITH AND NEPHEW,LIMITED

COMPANY INFORMATION

Directors	S.M. Swabey I.C. Melling S.C.C. Tarry J.R. Mackinnon
Company number	00093994
Registered office	PO Box 81 101 Hessle Road Hull HU3 2BN
Auditor	KPMG LLP 1 Sovereign Square Sovereign Street Leeds United Kingdom LS1 4DA

T.J.SMITH AND NEPHEW,LIMITED

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T.J.SMITH AND NEPHEW,LIMITED

STRATEGIC REPORT

FOR THE YEAR ENDED 31 DECEMBER 2019

The Directors present the strategic report and financial statements, for T.J.Smith and Nephew,Limited, (the "Company"), for the year ended 31 December 2019.

Principal activities and review of the business
The profit after taxation for the year amounted to £40,305,000 (2018 - £42,417,000).

The principal activity of the Company is the design, development, manufacture and sale of advanced medical devices.

This includes global strategic management, product manufacturing, development and marketing of wound management products; and manufacturing and distribution of knee, hip and other implants, trauma and other clinical therapy devices and distribution of endoscopic and sports medicine (minimally invasive surgery) devices and value-added services for surgeons, mostly within the UK. The Company's primary manufacturing facility of advanced wound management products is based in Hull.

Sales in 2019 were £26,321,000 higher than in 2018, an increase of 5.0% as a result of a continuing increase in demand from emerging and international markets.

Operating profit in 2019 was £30,103,000 excluding the decrease in the provision of estimated costs to resolve UK and Ireland metal-on-metal hip claims, and this represents an increase of £3,210,000 compared with 2018. Net non-trading items amounted to a net expense of £3,765,000 in 2019 compared with a net expense in 2018 of £4,073,000.

During 2018 the Company recognised a net income statement gain of £14,036,000 relating to metal-on-metal hip claims principally related to a portfolio of modular metal-on-metal hip products which are no longer on the market. On re-measurement of the potential liabilities arising from such claims in 2019, a net income statement gain of £6,906,000 has been recognised. This charge represents the difference between the present value of the estimated costs to resolve these known and anticipated metal-on-metal hip claims by UK and Republic of Ireland customers and the provision held in respect of those claims as at 31 December 2019. The legal claims are against Smith & Nephew Orthopaedics Limited, which has been financially indemnified in this regard by the Company.

Principal risks and uncertainties
The Company is reliant on fellow undertakings in the Smith & Nephew Group (the "Group" or "Smith & Nephew") for the majority of its sales and for its purchases of inventory. The risks and uncertainties affecting the wider Group are therefore relevant to the Company. The principal risks and uncertainties considered as affecting the Company and to the extent relevant, the Group, are discussed below.

COVID-19 and Going Concern
Since the balance sheet date, the COVID-19 pandemic has spread across the world. This has adversely impacted the elective surgeries market in which the Smith+Nephew Group's subsidiaries operates worldwide. Uncertainty as to the length of the pandemic and the related measures to combat it mean that the 2020 full year impact cannot yet be known. The Company has received a letter of support from its parent company, Smith & Nephew plc, indicating that it will receive the financial and other support necessary for the Company to trade and meet its liabilities as and when they become due for a period of at least twelve months from the date of signing of these financial statements.

After making due enquiries and considering the impact of COVID-19 and the support available from the parent company described above, the directors have a reasonable expectation that the Company has adequate resources to continue in operation for at least 12 months from the date of signing of these financial statements. These considerations included the impact of COVID-19 on the wider Smith & Nephew group, the Smith & Nephew Group's directors' assessment of going concern (as set out in its interim results announcement dated 28 July 2020 and available at www.smith-nephew.com). Accordingly, the financial statements have been prepared on the going concern basis.

Development and performance

Highly competitive markets

The Group competes across a diverse range of geographic and product markets. Each market in which the Group operates contains a number of different competitors, including specialised and international corporations. Significant product innovations, technical advances or the intensification of price competition by competitors could adversely affect the Group's operating results.

Some of these competitors may have greater financial, marketing and other resources than Smith & Nephew. These competitors may be able to initiate technological advances in the field, deliver products on more attractive terms, more aggressively market their products or invest larger amounts of capital and research and development (R&D) into their businesses.

There is a possibility of further consolidation of competitors, which could adversely affect the Group's ability to compete with larger companies due to insufficient financial resources.

If any of the Group's businesses were to lose market share or achieve lower than expected revenue growth, there could be a disproportionate adverse impact on the Group's share price and its strategic options. Competition exists among healthcare providers to gain patients on the basis of quality, service and price. There has been some consolidation in the Group's customer base and this trend is expected to continue. Some customers have joined group purchasing organisations or introduced other cost containment measures that could lead to downward pressure on prices or limit the number of suppliers in certain business areas, which could adversely affect Smith+Nephew's results of operations and hinder its growth potential.

Continual development and introduction of new products

The medical devices industry has a rapid rate of new product introduction. In order to remain competitive, the Group must continue to develop innovative products that satisfy customer needs and preferences or provide cost or other advantages. Developing new products is a costly, lengthy and uncertain process. The Group may fail to innovate due to low R&D investment, a R&D skills gap or poor product development. A potential product may not be brought to market or not succeed in the market for any number of reasons, including failure to work optimally, failure to receive regulatory approval, failure to be cost-competitive, infringement of patents or other intellectual property rights and changes in consumer demand. The Group's products and technologies are also subject to marketing attack by competitors. Furthermore, new products that are developed and marketed by the Group's competitors may affect price levels in the various markets in which the Group operates. If the Group's new products do not remain competitive with those of competitors, the Group's revenue could decline.

The Group maintains reserves for excess and obsolete inventory resulting from the potential inability to sell its products at prices in excess of current carrying costs. Marketplace changes resulting from the introduction of new products or surgical procedures may cause some of the Group's products to become obsolete. The Group makes estimates regarding the future recoverability of the costs of these products and records a provision for excess and obsolete inventories based on historical experience, expiration of sterilisation dates and expected future trends. If actual product life cycles, product demand or acceptance of new product introductions are less favourable than projected by management, additional inventory write-downs may be required.

Dependence on government and other funding
In most markets throughout the world, expenditure on medical devices is ultimately controlled to a large extent by governments. Funds may be made available or withdrawn from healthcare budgets depending on government policy. The Group is therefore largely dependent on future governments providing increased funds commensurate with the increased demand arising from demographic trends.

Pricing of the Group's products is largely governed in most markets by governmental reimbursement authorities. Initiatives sponsored by government agencies, legislative bodies and the private sector to limit the growth of healthcare costs, including price regulation, excise taxes and competitive pricing, are ongoing in markets where the Group has operations. This control may be exercised by determining prices for an individual product or for an entire procedure. The Group is exposed to government policies favouring locally sourced products. The Group is also exposed to changes in reimbursement policy, tax policy and pricing which may have an adverse impact on revenue and operating profit. Provisions in US healthcare legislation which previously imposed significant taxes on medical device manufacturers were permanently repealed effective 1 January 2020. There may be an increased risk of adverse changes to government funding policies arising from deterioration in macro economic conditions from time to time in the Group's markets.
The Group must adhere to the rules laid down by government agencies that fund or regulate healthcare, including extensive and complex rules in the US. Failure to do so could result in fines or loss of future funding.

World economic conditions
Demand for the Group's products is driven by demographic trends, including the ageing population and the incidence of osteoporosis and obesity. Supply of, use of and payment for the Group's products are also influenced by world economic conditions, which could place increased pressure on demand and pricing, adversely impacting the Group's ability to deliver revenue and margin growth. The conditions could favour larger, better capitalised groups, with higher market shares and margins. As a consequence, the Group's prosperity is linked to general economic conditions and there is a risk of deterioration of the Group's performance and finances during adverse macro-economic conditions.

Economic conditions worldwide continue to create several challenges for the Group, including the US Administration's approach to trade policy, heightened pricing pressure, significant declines in capital equipment expenditures at hospitals and increased uncertainty over the collectability of government debt, particularly those in the Emerging Markets. These factors could have an increased impact on growth in the future.

Widespread outbreaks of infectious diseases, such as the COVID-19 outbreak create uncertainty and challenges for the Group. The challenges created by the COVID-19 virus outbreak include, but are not limited to, declines in elective procedures at hospitals, disruptions at manufacturing facilities in China, and disruptions in supply and other commercial activities due to travel restrictions. The length and severity of the outbreak and pace of recovery are not clear and there could be an increased impact on the Group depending on these factors.

Political uncertainties
The Group operates on a worldwide basis and has distribution channels, purchasing agents and buying entities in over 100 countries. Political upheaval in some of those countries or in surrounding regions may impact the Group's results of operations. Political changes in a country could prevent the Group from receiving remittances of profit from a member of the Group located in that country or from selling its products or investments in that country. Furthermore, changes in government policy regarding preference for local suppliers, import quotas, taxation or other matters could adversely affect the Group's revenue and operating profit. War, economic sanctions, terrorist activities or other conflict could also adversely impact the Group. These risks may be greater in Emerging Markets, which account for an increasing portion of the Group's business.

There remain heightened levels of political and regulatory uncertainty in the UK following the result of the referendum in June 2016 to leave the European Union. As of the date of this report, there remains uncertainty as to the UK's future trade and regulatory relationship with the EU. This may adversely impact trading performance across the sector. Regulatory uncertainty forms the most significant risk presently; the ability for us to continue to manufacture and register our products in a compliant manner for global distribution is key. Smith+Nephew has taken steps to prepare for the various Brexit scenarios, including moving certain of its product certifications from UK-based notified bodies to notified bodies based in the EU. The UK accounts for approximately 5% of global Group revenue and the majority of our manufacturing takes place outside the UK and EU. There is also uncertainty around US-China trade relations, which has resulted in tariffs on some medical devices being exported between the two countries.

Currency fluctuations
Smith+Nephew's results of operations are affected by transactional exchange rate movements in that they are subject to exposures arising from revenue in a currency different from the related costs and expenses. The Group's manufacturing cost base is situated principally in the US, the UK, China, Costa Rica and Switzerland, from which finished products are exported to the Group's selling operations worldwide. Thus, the Group is exposed to fluctuations in exchange rates between the US Dollar, Sterling and Swiss Franc and the currency of the Group's selling operations, particularly the Euro, Australian Dollar and Japanese Yen.

The Group manages the impact of exchange rate movements on revenue and cost of goods sold by a policy of transacting forward foreign currency commitments when firm purchase orders are placed.

Manufacturing and supply
The Company's manufacturing production is concentrated at two main facilities in Hull and Warwick in the UK and Suzhou in China. If major physical disruption took place at any of these sites, it could adversely affect the results of operations.

Physical loss and consequential loss insurance is carried to cover such risks but is subject to limits and deductibles and may not be sufficient to cover catastrophic loss. Management of orthopaedic inventory is complex, particularly forecasting and production planning. here is a risk that failures in operational execution could lead to excess inventory or individual product shortages.

The Group is reliant on certain key suppliers of raw materials, components, finished products and packaging materials or in some cases on a single supplier. These suppliers must provide the materials in compliance with legal requirements and perform the activities to the Group's standard of quality requirements.

Requirements of global regulatory agencies have become more stringent in recent years and we expect them to continue to do so. The Group's Quality and Regulatory Affairs team is leading a major Group-wide programme to prepare for implementation of the EU Medical Devices Regulation (MDR), which came into force in May 2017, with a three-year transition period until May 2020. The regulation includes new requirements for the manufacture, supply and sale of all CE marked products sold in Europe and requires the reregistration of all medical devices, regardless of where they are manufactured.

Attracting and retaining key personnel
The Group's continued development depends on its ability to hire and retain highly-skilled personnel with particular expertise. This is critical, particularly in general management, research, new product development and in the sales forces. If Smith+Nephew is unable to retain key personnel in general management, research and new product development or if its largest sales forces suffer disruption or upheaval, its revenue and operating profit would be adversely affected. Additionally, if the Group is unable to recruit, hire, develop and retain a talented, competitive workforce, it may not be able to meet its strategic business objectives.

Proprietary rights and patents
Due to the technological nature of medical devices and the Group's emphasis on serving its customers with innovative products, the Group has been subject to patent infringement claims and is subject to the potential for additional claims. Claims asserted by third parties regarding infringement of their intellectual property rights, if successful, could require the Group to expend time and significant resources to pay damages, develop non-infringing products or obtain licences to the products which are the subject of such litigation, thereby affecting the Group's growth and profitability. Smith+Nephew attempts to protect its intellectual property and regularly opposes third party patents and trademarks where appropriate in those areas that might conflict with the Group's business interests. If Smith+Nephew fails to protect and enforce its intellectual property rights successfully, its competitive position could suffer, which could harm its results of operations. In addition, intellectual property rights may not be protectable to the same extent in all countries in which the Group operates.

Product liability claims and loss of reputation
The development, manufacture and sale of medical devices entail risk of product liability claims or recalls. Design and manufacturing defects with respect to products sold by the Group or by companies it has acquired could damage, or impair the repair of, body functions. The Group may become subject to liability, which could be substantial, because of actual or alleged defects in its products. In addition, product defects could lead to the need to recall from the market existing products, which may be costly and harmful to the Group's reputation.

There can be no assurance that customers, particularly in the US, the Group's largest geographical market, will not bring product liability or related claims that would have a material adverse effect on the Group's financial position or results of operations in the future, or that the Group will be able to resolve such claims within insurance limits. As at 31 December 2019, a provision of £1,824,000 is recognised relating to the present value of the estimated costs to resolve all unsettled known and unknown anticipated metal-on-metal hip implant claims for the UK and Republic of Ireland.

Regulatory standards and compliance in the healthcare industry
Business practices in the healthcare industry are subject to regulation and review by various government authorities. In general, the trend in many countries in which the Group does business is towards higher expectations and increased enforcement activity by governmental authorities. While the Group is committed to doing business with integrity and welcomes the trend to higher standards in the healthcare industry, the Group and other companies in the industry have been subject to investigations and other enforcement activity that have incurred and may continue to incur significant expense. Under certain circumstances, if the Group were found to have violated the law, its ability to sell its products to certain customers could be restricted.

International regulation
The Group operates across the world and is subject to extensive legislation, including anti-bribery and corruption and data protection, in each country in which the Group operates. Our international operations are governed by the UK Bribery Act and the US Foreign Corrupt Practices Act which prohibit us or our representatives from making or offering improper payments to government officials and other persons or accepting payments for the purpose of obtaining or maintaining business. Our international operations in the Emerging Markets which operate through distributors increase our Group exposure to these risks.

The Group is also required to comply with the requirements of the EU General Data Protection Regulation (GDPR), which imposes additional obligations on companies regarding the handling of personal data and provides certain individual privacy rights to persons whose data is stored and became effective on 25 May 2018. As privacy and data protection have become more sensitive issues for regulators and consumers, new privacy and data protection laws, such as the GDPR, continue to develop in ways we cannot predict. Ensuring compliance with evolving privacy and data protection laws and regulations on a global basis may require us to change or develop our current business models and practices and may increase our cost of doing business. Despite those efforts, there is a risk that we may be subject to fines and penalties, litigation, and reputational harm in connection with our European activities as enforcement of such legislation has increased in recent years on companies and individuals where breaches are found to have occurred. Failure to comply with the requirements of privacy and data protection laws, including GDPR, could adversely affect our business, financial condition or results of operations.

Regulatory Approval

The international medical device industry is highly regulated. Regulatory requirements are a major factor in determining whether substances and materials can be developed into marketable products and the amount of time and expense that should be allotted to such development.

National regulatory authorities administer and enforce a complex series of laws and regulations that govern the design, development, approval, manufacture, labelling, marketing and sale of healthcare products. They also review data supporting the safety and efficacy of such products. Of particular importance is the requirement in many countries that products be authorised or registered prior to manufacture, marketing or sale and that such authorisation or registration be subsequently maintained. The major regulatory agencies for Smith+Nephew's products include the Food and Drug Administration (FDA) in the US, the Medicines and Healthcare products Regulatory Agency in the UK, the Ministry of Health, Labour and Welfare in Japan, the State Food and Drug Administration in China and the Australian Therapeutic Goods Administration. At any time, the Group is awaiting a number of regulatory approvals which, if not received, could adversely affect results of operations. In 2017, the EU reached agreement on a new set of Medical Device Regulations which entered into force on 25 May 2017. These had a three-year transition period and therefore were due to apply in EU Member States from 26 May 2020, which has been extended further given the current COVID-19 pandemic to 26 May 2021.

The trend is towards more stringent regulation and higher standards of technical appraisal. Such controls have become increasingly demanding to comply with and management believes that this trend will continue. Privacy laws (including HIPAA in the US and GDPR in the UK) and environmental regulations have also become more stringent. Regulatory requirements may also entail inspections for compliance with appropriate standards, including those relating to Quality Management Systems or Good Manufacturing Practices regulations. All manufacturing and other significant facilities within the Group are subject to regular internal and external audit for compliance with national medical device regulation and Group policies. Payment for medical devices may be governed by reimbursement tariff agencies in a number of countries. Reimbursement rates may be set in response to perceived economic value of the devices, based on clinical and other data relating to cost, patient outcomes and comparative effectiveness. They may also be affected by overall government budgetary considerations. The Group believes that its emphasis on innovative products and services should contribute to success in this environment. Failure to comply with these regulatory requirements could have a number of adverse consequences, including withdrawal of approval to sell a product in a country, temporary closure of a manufacturing facility, fines and potential damage to Company reputation.

Relationships with healthcare professionals

The Group seeks to maintain effective and ethical working relationships with physicians and medical personnel who assist in the research and development of new products or improvements to our existing product range or in product training and medical education. If we are unable to maintain these relationships our ability to meet the demands of our customers could be diminished and our revenue and profit could be materially adversely affected.

Reliance on sophisticated information technology

The Group uses a wide variety of information systems, programmes and technology to manage our business. The Group also develops and sells certain products that are or will be digitally enabled including connection to networks and/or the internet. Our systems and the systems of the entities we acquire are vulnerable to a cyber attack, theft of intellectual property, malicious intrusion, loss of data privacy or other significant disruption. Our systems have been and will continue to be the target of such threats. Cybersecurity is a multifaceted discipline covering people, process and technology. It is also an area where more can always be done; it is a continually evolving practice. We have a layered security approach in place to prevent, detect and respond, in order to minimise the risk and disruption of these intrusions and to monitor our systems on an ongoing basis for current or potential threats. There can be no assurance that these measures will prove effective in protecting Smith +Nephew from future interruptions and as a result the performance of the Group could be materially adversely affected.

S.172 Companies Act 2006 Statement

At Group level, Smith+Nephew's key stakeholders have been identified and their interests taken into consideration, in accordance with the Directors' section 172 duties of the Companies Act 2006 and the UK Corporate Governance Code 2018. This is noted in detail on pages 84 and 85 within Smith & Nephew plc's Annual Report and Accounts for the year ended 31 December 2019. As the Company forms part of the Group, the framework adopted by the ultimate parent has been disseminated and applied by the subsidiary Company. Beyond this, Smith+Nephew's Subsidiary Corporate Governance Code, adopted by the Company, provides an additional codified framework for the Directors to work within to promote the success of the Company whilst having regard to its stakeholders. The relevant issues, factors and stakeholders, with whom the Directors have had regard to during the year, are reported in detail on pages 8 to 11.

On behalf of the Board

Sam M. Swabey
S.M. Swabey
Director

Date: 18 December 2020

DIRECTORS' REPORT

FOR THE YEAR ENDED 31 DECEMBER 2019

The Directors present their annual report and financial statements for the year ended 31 December 2019.

Principal activities
The principal activity of the Company is the design, development, manufacture and sale of advanced medical devices.

Results and dividends
The results for the year are set out on page 17. During the year, the Directors declared and paid an interim dividend of £120,000,000 for the year ended 31 December 2019 (2018 - £140,000,000).

Directors
The Directors who held office during the year and up to the date of signature of the financial statements were as follows:

S.M. Swabey
I.C. Melling
S.C.C. Tarry
J.R. Mackinnon

Indemnity
The Company's ultimate parent Company, Smith & Nephew plc, has made qualifying third party indemnity provision for the benefit of the Company's Directors which were in place throughout the year and which remain in place at the date of approval of this report.

Political donations
No political contributions were made during the year (2018 - £nil).

Stakeholders and Employee Engagement
The Board is aware of the overlap between the Group's key stakeholders and the Company's key stakeholders. Given the Company forms part of the Group, the Board acknowledges their duties to the Company and the Group as a whole. It is felt that the actions driven from Smith & Nephew plc for the Group and its approach to certain stakeholders in particular are relevant and therefore should and have been adopted by the Company. The principal stakeholders identified by the Group and Directors and the decisions made with regard for them are discussed in turn below.

Customers and suppliers

The Company's customers and suppliers are seen as principal stakeholders and integral to the success of the Company and achieving its purpose, aligned with that of the Group, which was defined during 2019 as 'Life Unlimited'. Customers and Suppliers of the Company are not limited to but include other companies within the Smith+Nephew Group.

The Company's current policy concerning the payment of trade creditors is to follow the Prompt Payment Code (PPC).

During 2019, the Board formally considered the Company's Payment Practices on a number of occasions and within the year, upon review of the data, identified that the Company had fallen below the threshold of 90% of invoices being paid within 60 days. As such the Company was suspended from the Prompt Payment Code with effect from 1 October 2019. The Company engaged with the Chartered Institute of Credit Management, the body responsible for overseeing adherence to the Prompt Payment Code on behalf of the Government. In addition, an internal review was conducted and an action plan put in place, approved by the Board, which sought to address the issues, deemed to cause payments to exceed the 60 day payment timeline. Following implementation of these actions, the Company saw a significant improvement, resulting in compliance and reinstatement to the Prompt Payment Code before the end of the year.

The Board continues to keep this under review.

Government and Regulators

The Company operates in a heavily regulated industry and it is imperative to the Company that it continues to act within the scope of all applicable laws and regulations which govern its business and operations.

The Directors and employees of the Company are subject to a comprehensive suite of mandatory trainings throughout the year including the Group's Code of Conduct and Business Principles, which sets out the legal and ethical principles for the Company in conducting business. The Company also has various tools available to employees and others to raise concerns including a whistle blowing policy and confidential hotline, which enables both employees and third parties to anonymously report any concerns.

During the year, the Board addressed a number of Governance matters. Company specific training was also provided to the Directors, where applicable, to keep them informed and their knowledge up to date on regulatory matters and requirements, for example in respect of Guidelines on Good Distribution Practice as referred to earlier.

Employees

The workforce is defined as ‘Employees’ of the Company. This group is regarded as key and integral stakeholders. We are proud of our employees and in turn want them to be proud of working for the Company. This can only be achieved by having regard to their voice.

Live global Group employee webcasts led by the Group’s Chief Executive Officer and members of the Executive Committee are held on a quarterly basis. These are open to the Group as whole including the Company’s employees and take the form of a presentation, providing an update on financial performance, company strategy and non-financial matters, projects or developments of note for the Group, followed by a Q&A session. This supports and enhances employees awareness of the financial and economic factors affecting the Group and the Company’s performance.

Town Halls are also held on a quarterly basis at the Company’s office. These focus more on Company specific matters such as Site updates or information on latest initiatives undertaken by the sites committee’s such as the Inclusion and Diversity or Social Committees.

These forums provide employees with a greater understanding not only of the Group’s performance and strategy and the role they play but also serve as an opportunity to interact in an open and informal setting with senior leadership, enabling them to voice their questions and concerns.

Further to this, on a Group level, Feedback is gathered more formally on an annual basis through a third party independent employee engagement survey (Gallup). As the Directors of the Company are all people managers within the Group, they are able to gain further understanding of their teams and the Company’s employees through the survey.

Both employees and Directors have benefited from the insights shared during the webcasts, Town Halls and annual surveys. In particular, on a quarterly basis, the webcasts and Town Halls are discussed and noted by the Directors at a Board meeting. These initiatives enable the Directors to consider and note the key issues and interests of employees to be able to have regard to them when making principle decisions on behalf of the Company.

During the year, other employee related items such as the Modern Slavery Statement were considered and adopted by the Board, whilst the Directors had regard to employees interests. In accordance with S.54 of The Modern Slavery Act, the Company's statement on Modern Slavery for the year ended 31 December 2019 is available on the Group's website at www.smith-nephew.com.

The Company’s Gender Pay reporting was also considered by the Company and published externally. The Board acknowledges that the ratio is higher than it would want and requires improvement. It was noted that the increase was because of a higher level of female attrition with more males having been promoted or recruited during the year into senior level positions. In addition, one senior level female executive moved from the UK to the US early in the year. In light of this, a number of initiatives are underway by the Group, including the Company to improve this ratio.

At Group Level, we operate two all-employee share plan arrangements depending on the most appropriate arrangement for different geographies. Participation in the ShareSave Plan and Employee Stock Purchase Plan is encouraged to involve employees in the Group’s performance.

The Company operates in a heavily regulated industry and it is imperative to the Company that it continues to act within the scope of all applicable laws and regulations which govern its business and operations.

The Directors and employees of the Company are subject to a comprehensive suite of mandatory trainings throughout the year including the Group’s Code of Conduct and Business Principles, which sets out the legal and ethical principles for the Company in conducting business. The Company also has various tools available to employees and others to raise concerns including a whistle blowing policy and confidential hotline, which enables both employees and third parties to anonymously report any concerns.

During the year, the Board addressed a number of Governance matters. Company specific training was also provided to the Directors, where applicable, to keep them informed and their knowledge up to date on regulatory matters and requirements, for example in respect of Guidelines on Good Distribution Practice as referred to earlier.

Diversity

We are committed to employment practices based on equality of opportunity, regardless of colour, creed, race, national origin, sex, age, marital status, sexual orientation or mental or physical disability unrelated to to the ability of the person to perform the essential functions of the job.

We recruit, employ and promote employees on the sole basis of the qualifications and abilities needed for the work to be performed. We do not tolerate discrimination on any grounds and provide equal opportunity based on merit. We do not use any form of force, compulsory or child labour. We support the Universal Declaration of Human Rights of the United Nationals. This means we respect human rights, dignity and privacy of the individual and the right of employees to freedom of association and freedom of expression and the right to be heard.

Post balance sheet events

Since the balance sheet date, the COVID-19 pandemic has spread across the world. This has adversely impacted the elective surgeries market in which the Smith+Nephew Group's subsidiaries operate worldwide. This is considered a non-adjusting post-balance sheet event and the impact of COVID-19 will be reported in the 2020 financial statements.

Uncertainty as to the length of the pandemic and the related measures to combat it mean that the 2020 full year impact, including any impact on the carrying value of the Company's investment in subsidiaries cannot yet be known.

Future developments

We believe that our strategy of market led innovation and high customer service levels will position us to achieve above market growth in the future.

Notwithstanding the challenging economic environment particularly concerning the uncertainty over 'Brexit', our success in continuing to develop innovative products and deliver our Earnings Improvement Programme in conjunction with maintaining tight cost discipline gives us confidence in our ability to deliver a good outcome for 2019.

Going Concern

Notwithstanding net current liabilities of £361,054,000 as at 31 December 2019 and the current economic uncertainties arising from the COVID-19 outbreak, the financial statements have been prepared on a going concern basis which the directors consider to be appropriate for the following reasons:

The Company's going concern is dependent on the Company's fellow Group Company, Smith & Nephew plc, not seeking repayment of the amounts currently due from the Company, which at 31 December 2019 amounted to £122,198,311. Smith & Nephew plc have indicated that they do not intend to seek repayment of these amounts for the period 12 months from the date of approval of the financial statements.

Smith & Nephew plc has also indicated its intention to continue to make available funds as needed by the Company for a period of twelve months from the date of approval of the financial statements. Consequently, the directors are confident that the Company will have sufficient funds to continue to meet its liabilities as they fall due for at least twelve months from the date of approval of the financial statements and therefore have prepared the financial statements on a going concern basis.

As with any company placing reliance on other group entities for financial support, the directors acknowledge that there can be no certainty that this support will continue although, at the date of approval of these financial statements, they have no reason to believe that it will not do so.

Consequently, the Directors are confident that the Company will have sufficient funds to continue to meet its liabilities as they fall due for at least 12 months from the date of approval of the financial statements and therefore have prepared the financial statements on a going concern basis.

Auditor

KPMG LLP has agreed to remain in office in accordance with section 487(2) of the Companies Act 2006.

Statement of disclosure to Auditor

In accordance with Section 418 of the Companies Act 2006, the Directors serving at the time of approving the Directors' report confirm that, to the best of their knowledge and belief, there is no relevant audit information of which the Auditor, KPMG LLP, is unaware and the Directors also confirm that they have taken reasonable steps to be aware of any relevant audit information and, accordingly, to establish that the Auditor is aware of such information.

On behalf of the Board

Susan M. Swabey
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S.M. Swabey

Director

PO Box 81

101 Hessle Road

Hull

HU3 2BN

Date: 18 December 2020

STATEMENT OF DIRECTORS' RESPONSIBILITIES

FOR THE YEAR ENDED 31 DECEMBER 2019

The Directors are responsible for preparing the Strategic Report, the Directors' Report and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law they have elected to prepare the financial statements in accordance with UK accounting standards and applicable law (UK Generally Accepted Accounting Practice), including FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*.

Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable UK accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- assess the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and
- use the going concern basis of accounting unless they either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

INDEPENDENT AUDITOR'S REPORT

TO THE MEMBERS OF T.J.SMITH AND NEPHEW,LIMITED

We have audited the financial statements of T.J.Smith and Nephew,Limited (“the Company”) for the year ended 31 December 2019 which comprise the Profit and Loss account, Statement of Comprehensive Income, Balance Sheet, Statement of Changes in Equity and related notes, including the accounting policies in note 1.

In our opinion the financial statements:

- give a true and fair view of the state of the Company’s affairs as at 31 December 2019 and of its profit for the year then ended;
- have been properly prepared in accordance with UK accounting standards, including FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Basis for opinion
We conducted our audit in accordance with International Standards on Auditing (UK) (“ISAs (UK)”) and applicable law. Our responsibilities are described below. We have fulfilled our ethical responsibilities under, and are independent of the company in accordance with, UK ethical requirements including the FRC Ethical Standard. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion.

Going concern
The Directors have prepared the financial statements on the going concern basis as they do not intend to liquidate the Company or to cease its operations, and as they have concluded that the Company’s financial position means that this is realistic. They have also concluded that there are no material uncertainties that could have cast significant doubt over its ability to continue as a going concern for at least a year from the date of approval of the financial statements (“the going concern period”).

We are required to report to you if we have concluded that the use of the going concern basis of accounting is inappropriate or there is an undisclosed material uncertainty that may cast significant doubt over the use of that basis for a period of at least a year from the date of approval of the financial statements. In our evaluation of the Directors’ conclusions, we considered the inherent risks to the company’s business model and analysed how those risks might affect the Company’s financial resources or ability to continue operations over the going concern period. We have nothing to report in these respects.

However, as we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgements that were reasonable at the time they were made, the absence of reference to a material uncertainty in this Auditor's report is not a guarantee that the Company will continue in operation.

Strategic report and Directors’ report
The Directors are responsible for the other information, which comprises the Strategic report and the Directors’ report. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except as explicitly stated below, any form of assurance conclusion thereon.

Our responsibility is to read the other information and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work:

- we have not identified material misstatements in the other information;
- in our opinion the information given in the Strategic report and the Directors’ report for the financial year is consistent with the financial statements; and
- in our opinion those reports have been prepared in accordance with the Companies Act 2006.

Matters on which we are required to report by exception
Under the Companies Act 2006 we are required to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

We have nothing to report in these respects.

Directors' responsibilities
As explained more fully in their statement set out on page 13, the Directors are responsible for: the preparation of the financial statements and for being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities
Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue our opinion in an Auditor's report. Reasonable assurance is a high level of assurance, but does not guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

A fuller description of our responsibilities is provided on the FRC's website at www.frc.org.uk/auditorsresponsibilities.

INDEPENDENT AUDITOR'S REPORT (CONTINUED)

TO THE MEMBERS OF T.J.SMITH AND NEPHEW,LIMITED

The purpose of our audit work and to whom we owe our responsibilities

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an Auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the Company's members, as a body, for our audit work, for this report, or for the opinions we have formed.

Claire Gallimore

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Claire Gallimore (Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
1 Sovereign Square
Sovereign Street
Leeds
United Kingdom
LS1 4DA

Date: 18 December 2020

T.J.SMITH AND NEPHEW,LIMITED

PROFIT AND LOSS ACCOUNT

FOR THE YEAR ENDED 31 DECEMBER 2019

	Notes	2019 £000	2018 £000
Turnover	**3**	552,599	526,278
Cost of sales		(343,923)	(310,944)
Gross profit		208,676	215,334
Research and development costs		(28,578)	(27,004)
Marketing, selling and distribution costs		(72,344)	(78,433)
Administrative expenses		(40,690)	(35,052)
Other operating expenses		(26,290)	(29,843)
Other non-trading costs and charges	**4**	(10,671)	(18,109)
Other non-trading income	**4**	6,906	14,036
Operating profit	**5**	37,009	40,929
Interest receivable and similar income	**8**	24,460	19,717
Interest payable and similar expenses	**9**	(18,321)	(16,678)
Profit before taxation		43,148	43,968
Tax on profit	**10**	(2,843)	(1,551)
Profit for the financial year		40,305	42,417

The results presented above are generated from continuing operations.

The notes on pages 21 to 48 form an integral part of these financial statements.

T.J.SMITH AND NEPHEW,LIMITED

STATEMENT OF COMPREHENSIVE INCOME

FOR THE YEAR ENDED 31 DECEMBER 2019

	Notes	2019 £000	2018 £000
Profit for the year		40,305	42,417
Other comprehensive income / (loss)			
Actuarial (loss)/gain on defined benefit pension schemes	22	(8,427)	3,050
Changes in fair value of cash flow hedges		6,104	1,415
Cash flow hedges loss reclassified to profit or loss		(736)	(1,469)
Tax relating to other comprehensive income	10	721	(135)
Other comprehensive (loss)/income for the year		(2,338)	2,861
Total comprehensive income for the year		37,967	45,278

The notes on pages 21 to 48 form an integral part of these financial statements.

T.J.SMITH AND NEPHEW,LIMITED

BALANCE SHEET

AS AT 31 DECEMBER 2019

	Notes	2019 £000	2019 £000	2018 £000	2018 £000
Fixed assets					
Goodwill	12		11,484		18,796
Other intangible assets	12		24,039		17,506
Total intangible assets			35,523		36,302
Tangible assets	13		101,977		101,334
Fixed asset investments	14		339,688		350,872
Retirement benefit surplus	22		53,806		56,838
Debtors falling due after one year	16		-		3,071
			530,994		548,417
Current assets					
Stocks	15	84,177		96,547	
Debtors	16	126,289		132,715	
Cash at bank and in hand		-		342	
		210,466		229,604	
Creditors: amounts falling due within one year	17	(571,520)		(518,678)	
Net current liabilities			(361,054)		(289,074)
Total assets less current liabilities			169,940		259,343
Provisions for liabilities	20		(2,372)		(11,136)
Deferred tax liability	21		(10,009)		(8,615)
Net assets			157,559		239,592
Capital and reserves					
Called up share capital	24		123		123
Share premium account			66,731		66,731
Hedging reserve			3,285		(1,277)
Profit and loss reserves			87,420		174,015
Total equity			157,559		239,592

The notes on pages 21 to 48 form an integral part of these financial statements.

The financial statements were approved by the Board of Directors and authorised for issue on 18 December 2020 and are signed on its behalf by:

Susan M. Swabey

S.M. Swabey
Director
Company Registration No. 00093994

T.J.SMITH AND NEPHEW,LIMITED

STATEMENT OF CHANGES IN EQUITY

FOR THE YEAR ENDED 31 DECEMBER 2019

		Share capital	Share premium account	Hedging reserve	Profit and loss reserves	Total
		£000	£000	£000	£000	£000
Balance at 1 January 2018		123	66,731	(1,231)	268,691	334,314
Year ended 31 December 2018:						
Profit for the year		-	-	-	42,417	42,417
Other comprehensive income:						
Actuarial gain on defined benefit plans		-	-	-	3,050	3,050
Net movement in fair value of cash flow hedges		-	-	(54)	-	(54)
Tax relating to other comprehensive income		-	-	8	(143)	(135)
Total comprehensive income for the year		-	-	(46)	45,324	45,278
Dividends	**11**	-	-	-	(140,000)	(140,000)
Balance at 31 December 2018		123	66,731	(1,277)	174,015	239,592
Year ended 31 December 2019:						
Profit for the year		-	-	-	40,305	40,305
Other comprehensive income:						
Actuarial loss on defined benefit plans		-	-	-	(8,427)	(8,427)
Net movement in fair value of cash flow hedges		-	-	5,368	-	5,368
Tax relating to other comprehensive income		-	-	(806)	1,527	721
Total comprehensive income for the year		-	-	4,562	33,405	37,967
Dividends	**11**	-	-	-	(120,000)	(120,000)
Balance at 31 December 2019		123	66,731	3,285	87,420	157,559

The total distributable reserves of the Company are £90,705,000 (2018: £172,738,000).

The notes on pages 21 to 48 form an integral part of these financial statements.

1 Accounting policies

Company information

T.J.Smith and Nephew,Limited is a Company limited by shares incorporated in England and Wales. The registered office is PO Box 81, 101 Hessle Road, Hull, HU3 2BN.

1.1 Accounting convention

The Company is exempt by virtue of s400 of the Companies Act 2006 from the requirement to prepare Group financial statements. These financial statements present information about the Company as an individual undertaking and not about its Group.

These financial statements were prepared in accordance with Financial Reporting Standard 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland ("FRS 102") as issued in August 2014. The amendments to FRS 102 issued in July 2015 and effective immediately have been applied. The financial statements are prepared on the historical cost basis except that derivative financial instruments are stated at their fair value.

The Company's ultimate parent undertaking, Smith & Nephew plc, includes the Company in its consolidated financial statements. The consolidated financial statements of Smith & Nephew plc are prepared in accordance with International Financial Reporting Standards as adopted by the EU and are available to the public at www.smith-nephew.com.

In these financial statements, the Company is considered to be a qualifying entity (for the purposes of this FRS) and has applied the exemptions available under FRS 102 in respect of the following disclosures:
- Cash Flow Statement and related notes
- Financial instrument disclosures conferred by FRS 102.11.39-48A and FRS 102.12.26-29.

The financial statements are prepared in sterling, which is the functional currency of the Company. Monetary amounts in these financial statements are rounded to the nearest £1,000.

The financial statements have been prepared on the historical cost convention, modified to include certain financial instruments at fair value. The principal accounting policies adopted are set out below.

This company is a qualifying entity for the purposes of FRS 102, being a member of a group where the parent of that group prepares publicly available consolidated financial statements, including this company, which are intended to give a true and fair view of the assets, liabilities, financial position and profit or loss of the group. The company has therefore taken advantage of exemptions from the following disclosure requirements:

- Section 7 'Statement of Cash Flows': Presentation of a statement of cash flow and related notes and disclosures;
- Section 11 'Basic Financial Instruments' and Section 12 'Other Financial Instrument Issues': Interest income/expense and net gains/losses for each category of financial instrument; basis of determining fair values; details of collateral, loan defaults or breaches, details of hedges, hedging fair value changes recognised in profit or loss and in other comprehensive income;
- Section 26 'Share based Payment': Share-based payment expense charged to profit or loss, reconciliation of opening and closing number and weighted average exercise price of share options, how the fair value of options granted was measured, measurement and carrying amount of liabilities for cash-settled share-based payments, explanation of modifications to arrangements;
- Section 33 'Related Party Disclosures': Compensation for key management personnel.

The financial statements of the company are consolidated in the financial statements of Smith & Nephew plc. The consolidated financial statements of the Group are available to the public and may be obtained from Building 5, Croxley Park, Hatters Lane, Watford, Hertfordshire, WD18 8YE or online via www.smith-nephew.com.

1 Accounting policies **(Continued)**

1.2 COVID-19 and going concern

Notwithstanding net current liabilities of £361,054,000 as at 31 December 2019 and the current economic uncertainties arising from the COVID-19 outbreak, the financial statements have been prepared on a going concern basis which the directors consider to be appropriate for the following reasons:

The Company's going concern is dependent on the Company's fellow Group Company, Smith & Nephew plc, not seeking repayment of the amounts currently due from the Company, which at 31 December 2019 amounted to £122,198,311. Smith & Nephew plc have indicated that they do not intend to seek repayment of these amounts for the period 12 months from the date of approval of the financial statements.

Smith & Nephew plc has also indicated its intention to continue to make available funds as needed by the Company for a period of twelve months from the date of approval of the financial statements. Consequently, the directors are confident that the Company will have sufficient funds to continue to meet its liabilities as they fall due for at least twelve months from the date of approval of the financial statements and therefore have prepared the financial statements on a going concern basis.
As with any company placing reliance on other group entities for financial support, the directors acknowledge that there can be no certainty that this support will continue although, at the date of approval of these financial statements, they have no reason to believe that it will not do so.

Consequently, the Directors are confident that the Company will have sufficient funds to continue to meet its liabilities as they fall due for at least 12 months from the date of approval of the financial statements and therefore have prepared the financial statements on a going concern basis.

1.3 Turnover

Turnover comprises sales of products and services supplied by the Company at amounts invoiced net of trade discounts and rebates, excluding turnover taxes.

Revenue from the sale of goods is recognised when the significant risks and rewards of ownership of the goods have passed to the buyer (usually on dispatch of the goods), the amount of revenue can be measured reliably, it is probable that the economic benefits associated with the transaction will flow to the entity and the costs incurred or to be incurred in respect of the transaction can be measured reliably.

Revenue from contracts for the provision of professional services is recognised by reference to the stage of completion when the stage of completion, costs incurred and costs to complete can be estimated reliably. The stage of completion is calculated by comparing costs incurred, mainly in relation to contractual hourly staff rates and materials, as a proportion of total costs. Where the outcome cannot be estimated reliably, revenue is recognised only to the extent of the expenses recognised that it is probable will be recovered.

1.4 Intangible fixed assets - goodwill

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 amortised on a straight-line basis over the economic life of the business acquired not exceeding 20 years. Some goodwill is amortised over a period greater than 10 years as this reflects management's realistic expectation that the useful life of the benefits from the goodwill acquired will surpass 10 years. Goodwill previously written off to reserves is included in the calculation of profits and losses on disposals.

Investments in subsidiaries are stated at cost. The true and fair override has been invoked in the recognition of goodwill via the hive up of trade and assets relating to ArthroCare UK Limited, prior to it's dissolution on 27 December 2016.

1 Accounting policies **(Continued)**

1.5 Intangible fixed assets other than goodwill

Intangible assets acquired separately from a business are recognised at cost and are subsequently measured at cost less accumulated amortisation and accumulated impairment losses. Intangible assets acquired on business combinations are recognised separately from goodwill at the acquisition date if the fair value can be measured reliably.

Purchased patents, know-how, trademarks, licences (including computer software) and distribution rights are capitalised at their cost to the Company and amortised over the economic life of the asset concerned, not exceeding 20 years.

The carrying values of intangibles are reviewed for impairment at the end of the first full financial year following an acquisition and in other periods if significant events or changes in circumstances indicate the carrying value may be impaired.

Research expenditure is written off against profits in the year in which it is incurred. Identifiable development expenditure is capitalised to the extent that the technical, commercial and financial feasibility can be demonstrated.

Amortisation is recognised so as to write off the cost or valuation of assets less their residual values over their useful lives on the following bases:

Trademarks and licences	<20 years
Software	3-7 years

Assets in the course of contruction are not amortised.

1.6 Tangible fixed assets

Tangible fixed assets are initially measured at cost and subsequently measured at cost or valuation, net of depreciation and any impairment losses.

Tangible fixed assets are stated at cost and, except for freehold land, are depreciated over their useful economic lives. Freehold and long-leasehold buildings are depreciated on a straight-line basis over lives ranging between 20 and 50 years. Short-leasehold land and buildings (leases of under 50 years) are depreciated by equal annual instalments over the term of the lease. Plant, equipment and vehicles are depreciated over lives ranging between 3 and 20 years by equal annual instalments to write down the assets to their estimated disposal value at the end of their working lives.

The useful lives and residual values of all property, plant and equipment are reviewed each financial year end, and where adjustments are required these are made prospectively.

Depreciation methods, useful lives and residual values are reviewed if there is an indication of a significant change since last annual reporting date in the pattern by which the company expects to consume an asset's future economic benefits.

The useful economic lives of tangible fixed assets discussed above are summarised below:

Land and buildings	20-50 years
Plant, equipment & vehicles	3-20 years

Assets in the course of construction and freehold land are not depreciated.

The gain or loss arising on the disposal of an asset is determined as the difference between the sale proceeds and the carrying value of the asset, and is credited or charged to profit or loss.

1 Accounting policies **(Continued)**

1.7 Impairment of fixed assets

At each reporting end date, the Company reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the Company estimates the recoverable amount of the cash-generating unit to which the asset belongs.

Intangible assets with indefinite useful lives and intangible assets not yet available for use are tested for impairment annually, and whenever there is an indication that the asset may be impaired.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised immediately in profit or loss, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease.

1.8 Stocks

Stocks are stated at the lower of cost and estimated selling price less costs to complete and sell. Cost is based on the first-in first-out principle and includes expenditure incurred in acquiring the stocks, production or conversion costs and other costs in bringing them to their existing location and condition.

Stocks held for distribution at no or nominal consideration are measured at cost, adjusted where applicable for any loss of service potential.

At each reporting date, an assessment is made for impairment. Any excess of the carrying amount of stocks over its estimated selling price less costs to complete and sell is recognised as an impairment loss in profit or loss. Reversals of impairment losses are also recognised in profit or loss.

1.9 Cash and cash equivalents

Cash and cash equivalents are basic financial assets and include cash in hand, deposits held at call with banks, other short-term liquid investments with original maturities of three months or less, and bank overdrafts. Bank overdrafts are shown within borrowings in current liabilities.

1 Accounting policies (Continued)

1.10 Financial instruments

The Company has elected to apply the recognition and measurement provisions of IAS 39 Financial Instruments: Recognition and Measurement (*International Financial Reporting Standards*, *as adopted in the EU*), the disclosure requirements of Sections 11 and 12 (FRS *102 The Financial Reporting Standard applicable in the UK and Republic of Ireland*) and the presentation requirements of paragraphs 11.38A and 12.25B of FRS 102.

Classification of financial instruments issued by the Company

In accordance with FRS 102.22, financial instruments issued by the Company are treated as equity only to the extent that they meet the following two conditions:

(a) they include no contractual obligations upon the Company to deliver cash or other financial assets or to exchange financial assets or financial liabilities with another party under conditions that are potentially unfavourable to the Company; and

(b) where the instrument will or may be settled in the Company's own equity instruments, it is either a non-derivative that includes no obligation to deliver a variable number of the Company's own equity instruments or is a derivative that will be settled by the Company's exchanging a fixed amount of cash or other financial assets for a fixed number of its own equity instruments.

To the extent that this definition is not met, the proceeds of issue are classified as a financial liability. Where the instrument so classified takes the legal form of the Company's own shares, the amounts presented in these financial statements for called up share capital and share premium account exclude amounts in relation to those shares.

Where a financial instrument that contains both equity and financial liability components exists these components are separated and accounted for individually under the above policy. Transaction costs are allocated between the debt component and the equity component on the basis of their relative fair values.

Basic financial instruments

Trade and other debtors / creditors
Trade and other debtors are recognised initially at transaction price less attributable transaction costs. Trade and other creditors are recognised initially at transaction price plus attributable transaction costs. Subsequent to initial recognition they are measured at amortised cost using the effective interest method, less any impairment losses in the case of trade debtors. If the arrangement constitutes a financing transaction, for example if payment is deferred beyond normal business terms, then it is measured at the present value of future payments discounted at a market rate of instrument for a similar debt instrument.

Interest-bearing borrowings classified as basic financial instruments
Interest-bearing borrowings are recognised initially at the present value of future payments discounted at a market rate of interest. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost using the effective interest method, less any impairment losses.

Investments in preference and ordinary shares
Investments in equity instruments are measured initially at fair value, which is normally the transaction price. Transaction costs are excluded if the investments are subsequently measured at fair value through profit and loss. Subsequent to initial recognition investments that can be measured reliably are measured at fair value with changes recognised in profit or loss. Other investments are measured at cost less impairment in profit or loss.

1 Accounting policies **(Continued)**

1.10 Financial instruments **(Continued)**

Investments in subsidiaries
These are separate financial statements of the Company. Investments in subsidiaries are carried at cost less impairment.

Cash and cash equivalents
Cash and cash equivalents comprise cash balances and call deposits.

1.11 Taxation
The tax expense for the period comprises current and deferred tax.

Current tax
The current income tax expense is based on taxable profits of the period, after any adjustments for prior periods. It is calculated using taxation rates enacted or substantively enacted by the Balance Sheet date and is measured at the amount expected to be recovered or paid.

Deferred tax
Deferred tax is recognised in respect of all temporary differences between the tax bases of assets and liabilities and their carrying amounts in the financial statements, except where the deferred tax asset or liability arises from the initial recognition of an asset or a liability which affects neither the accounting profit nor taxable profit or loss.

Deferred tax assets are recognised only to the extent that it is regarded as probable that future taxable profits will be available against which the temporary differences can be utilised.

Deferred tax is measured on an undiscounted basis at the tax rates that are expected to apply in the period in which temporary differences reverse, based on tax rates and laws enacted or substantively enacted at the balance sheet date.

1.12 Provisions
Provisions are recognised when the Company has a legal or constructive present obligation as a result of a past event, it is probable that the Company will be required to settle that obligation and a reliable estimate can be made of the amount of the obligation.

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at the reporting end date, taking into account the risks and uncertainties surrounding the obligation.

Where the effect of the time value of money is material, the amount expected to be required to settle the obligation is recognised at present value. When a provision in measured at present value the unwinding of the discount is recognised as a finance cost in profit or loss in the period it arises.

1.13 Employee benefits
The costs of short-term employee benefits are recognised as a liability and an expense, unless those costs are required to be recognised as part of the cost of stock or fixed assets.

The cost of any unused holiday entitlement is recognised in the period in which the employee's services are received.

Termination benefits are recognised immediately as an expense when the Company is demonstrably committed to terminate the employment of an employee or to provide termination benefits.

1 Accounting policies (Continued)

1.14 Retirement benefits

Contributions to defined contribution schemes are recognised in the profit and loss account in the period in which they become payable.

The Company is a participating employer of the Smith & Nephew UK Pension Fund (the UK Plan). Our accounting policy is to recognise this plan in full within the Company's accounts on the basis that the Company employs or employed the majority of members of this plan.

The UK Plan is a defined benefit pension scheme which is funded by the payment of contributions to, and the assets held by, separate trust funds or insurance companies. For many years, the Company’s major pension plans in the UK were of the defined benefit type. These were closed to new employees in 2003 and future accrual with effect from December 2016 and replaced by defined contribution plans. The Company also operates an unfunded post-retirement healthcare plan for certain former employees.

When a settlement or a curtailment occurs, the change in the present value of the scheme liabilities and the fair value of the plan assets reflects the gain or loss which is recognised in the profit and loss account. Losses are measured at the date that the employer becomes demonstrably committed to the transaction and gains when all parties whose consent is required are irrevocably committed to the transaction.

Changes in the net defined benefit liability arising from employee services rendered during the period, net interest on net defined benefit liability, benefit changes, curtailments and settlements during the period are recognised in profit or loss. Remeasurement of the net defined benefit liability/asset is recognised in other comprehensive income in the period in which it occurs.

The defined benefit pension asset or liability in the balance sheet comprises the present value of the defined benefit obligation (using a discount rate based on high-quality corporate bonds that have been rated at AA or equivalent status), less any past service cost not yet recognised and less the fair value of plan assets out of which the obligations are to be settled directly. Fair value is based on market price information and in the case of quoted securities is the published current bid price. The value of a net pension benefit asset is limited to the amount that may be recovered either through reduced contributions or refunds from the scheme.

1.15 Share-based payments

The Company operates a number of equity settled executive and employee share schemes. For all grants of share options and awards, the fair value as at the date of grant is calculated using option pricing models and the corresponding expense is recognised over the vesting period.

1.16 Leases

Rentals payable under operating leases, including any lease incentives received, are charged to profit or loss on a straight line basis over the term of the relevant lease except where another more systematic basis is more representative of the time pattern in which economic benefits from the leases asset are consumed.

1.17 Foreign exchange

Transactions in foreign currencies are recorded at the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities dominated in foreign currencies are retranslated at the rate of exchange ruling at the balance sheet date.

1 Accounting policies **(Continued)**

1.18 Interest receivable and interest payable

Interest payable and similar charges include interest payable, finance charges on shares classified as liabilities, unwinding of the discount on provisions, and net foreign exchange losses that are recognised in the profit and loss account. Other interest receivable and similar income include interest receivable on funds invested and net foreign exchange gains.

Interest income and interest payable are recognised in profit or loss as they accrue, using the effective interest method. Dividend income is recognised in the profit and loss account on the date the Company's right to receive payments is established. Foreign currency gains and losses are reported on a net basis.

1.19 Non-trading items

The Company classifies significant restructuring events, gains and losses arising from legal disputes, uninsured losses, acquisition and disposal related items, significant one-off items and waivers of group debtors or creditors as exceptional where these are considered to be material to the financial statements.

2 Judgements and key sources of estimation uncertainty

In the application of the Company's accounting policies, the Directors are required to make judgements, estimates and assumptions about the carrying amount of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised where the revision affects only that period.

Key sources of estimation uncertainty - Valuation of inventories

Adjustments to the carrying value of inventory are required to be made every period. These adjustments are calculated in accordance with a formula based on levels of inventory compared with historical usage. This formula is applied on an individual product line basis and is first applied when a product group has been on the market for two years. This method of calculation is considered appropriate based on experience, but it does require management estimate in respect of customer demand, effectiveness of inventory deployment, length of product lives and phase out of old products.

3 Turnover

Turnover is attributable to one continuing activity, the manufacture and sale of advanced medical devices.

Geographical market

	2019 £000	2018 £000
United Kingdom	169,106	173,363
Continental Europe	166,365	134,558
America	102,842	110,725
Africa, Asia, Latin America and Australasia	114,286	107,632
	552,599	526,278

4 Non-trading items

	2019 £000	2018 £000
Non-trading costs and charges	10,671	18,109
Non-trading (income)	(6,906)	(14,036)
	3,765	4,073

Non-trading costs in 2019 include £4,134,000 of restructuring and rationalisation costs associated with the Group's Accelerating Performance and Execution (APEX) programme, announced in February 2018, legal expenses of £2,515,000 related to ongoing metal-on-metal hip claims and £5,089,000 of costs incurred in relation to the update of technical documentation and processes to meet the requirements of the new European Union Medical Devices Regulations (EU MDR), of which £1,077,000 is recorded in Cost of Sales. The remaining non-trading costs related to other non-recurring costs.

Non-trading costs in 2018 include £10,971,000 of restructuring and rationalisation costs associated with the Group's Accelerating Performance and Execution (APEX) programme, announced in February 2018, legal expenses of £4,101,000 related to ongoing metal-on-metal hip claims, £359,000 of inventory write off costs related to the recall of Renasys negative pressure wound therapy devices and £2,667,000 of costs incurred in relation to the update of technical documentation and processes to meet the requirements of the new European Union Medical Devices Regulations (EU MDR). The remaining non-trading costs related to other non-recurring costs.

Non-trading income in 2019 and 2018 relates to a decrease in the provision that reflects the present value of the estimated costs to resolve all known and anticipated metal-on-metal hip claims in the UK and Ireland.

5 Operating profit

Operating profit for the year is stated after charging/(crediting):	2019 £000	2018 £000
Exchange losses / (gains)	1,885	(339)
Research and development costs	28,578	27,004
Depreciation of owned tangible fixed assets	14,121	15,264
Amortisation of intangible assets	13,193	14,324
Operating lease rentals	4,418	2,351
Fees payable to the Company's auditor for the audit of the Company's annual accounts	325	140

6 Employees

The average monthly number of persons (including directors) employed by the company during the year was:

	2019	2018
Production	560	545
Marketing, selling and distribution	453	465
Administration	104	187
Research and development	301	255
	1,418	1,452

Their aggregate remuneration comprised:

	2019 £000	2018 £000
Wages and salaries	72,490	77,513
Social security costs	9,072	8,410
Pension costs	7,318	7,429
Share based payments	3,037	3,037
	91,917	96,389

Pension costs in 2019 are comprised of £7,318,000 in relation to defined contribution schemes. Net income associated with defined benefit schemes total £595,000 and comprised net interest costs and adminstration costs, which have been excluded above. See note 22 for further details.

7 Directors' remuneration

	2019 £000	2018 £000
Aggregate remuneration in respect of qualifying services	609	458
Aggregate remuneration in respect of the highest paid director	609	458

The remaining Directors are remunerated via fellow group undertakings.

8 Interest receivable and similar income

	2019 £000	2018 £000
Interest income		
Interest on bank deposits	60	-
Other interest income	600	-
Dividends receivable on preference shares classified as foreign equity investments	23,800	19,717
Total income	24,460	19,717

9 Interest payable and similar expenses

	2019 £000	2018 £000
Interest payable to group undertakings	18,321	16,629
Other finance costs	-	49
	18,321	16,678

10 Income tax expense

	2019 £000	2018 £000
Current tax		
Current year taxation	2,093	4,438
Adjustments in respect of prior periods	(472)	352
Total current tax charge	1,621	4,790
Deferred tax		
Current year taxation	1,757	(4,177)
Impact of tax rate adjustment	(171)	442
Adjustments in respect of prior periods	(364)	496
Total deferred tax charge / (credit)	1,222	(3,239)
Tax charge in income statement	2,843	1,551

10 Income tax expense (Continued)

The actual charge for the year can be reconciled to the expected charge for the year based on the profit or loss and the standard rate of tax as follows:

	2019 £000	2018 £000
Profit before taxation	43,148	43,968
Expected tax charge based on a corporation tax rate of 19% (2018: 19%)	8,198	8,354
Non-deductible/non-taxable items	(3,385)	(662)
Adjustments in respect of prior years	(836)	848
Impact of changes in tax rate	(171)	442
Effect of group relief/other reliefs	(782)	(7,304)
Deemed income for tax purposes	(181)	(127)
Total tax charge	2,843	1,551

For the year ended 31 December 2019, the corporation tax rate was 19% (2018: 19%).

In addition to the amount charged to the profit and loss account, the following amounts relating to tax have been recognised directly in other comprehensive income:

	2019 £000	2018 £000
Deferred tax in respect of hedging and derivative contacts	806	(8)
Tax on defined benefit plans	(1,527)	143
Total tax recognised in other comprehensive income	(721)	135

11 Dividends

	2019 £000	2018 £000
Interim Dividend Paid	120,000	140,000
	120,000	140,000

On 29 October 2019 an interim dividend of £120,000,000 was paid to Smith & Nephew Trading Group Limited, for the year ended 31 December 2019.

12 Intangible fixed assets

	Goodwill	Trademarks and licences	Software	Assets under construction	Total
	£000	**£000**	**£000**	**£000**	**£000**
Cost					
At 1 January 2019	141,034	19,692	22,833	3,376	186,935
Additions	-	279	227	12,006	12,512
Disposals	-	-	-	(98)	(98)
Transfers	-	-	510	(510)	-
At 31 December 2019	141,034	19,971	23,570	14,774	199,349
Amortisation and impairment					
At 1 January 2019	122,238	13,889	14,506	-	150,633
Amortisation charged for the year	7,312	2,347	3,534	-	13,193
At 31 December 2019	129,550	16,236	18,040	-	163,826
Carrying amount					
At 31 December 2019	11,484	3,735	5,530	14,774	35,523
At 31 December 2018	18,796	5,803	8,327	3,376	36,302

13 Tangible fixed assets

	Land and buildings	Plant, equipment & vehicles	Assets under construction	Total
	£000	**£000**	**£000**	**£000**
Cost				
At 1 January 2019	44,149	192,487	14,349	250,985
Additions	5	8,666	8,814	17,485
Disposals	-	(19,101)	-	(19,101)
Transfer from assets under construction	-	2,847	(2,847)	-
At 31 December 2019	44,154	184,899	20,316	249,369
Depreciation and impairment				
At 1 January 2019	14,100	135,551	-	149,651
Depreciation charged in the year	2,095	12,026	-	14,121
Eliminated in respect of disposals	-	(16,380)	-	(16,380)
At 31 December 2019	16,195	131,197	-	147,392
Carrying amount				
At 31 December 2019	27,959	53,702	20,316	101,977
At 31 December 2018	30,049	56,936	14,349	101,334

14 Fixed asset investments

	Foreign equity investments	Trade Investments	Total
	£000	£000	£000
Cost or valuation			
At 1 January 2019	350,872	1,510	352,382
Valuation changes	(11,184)	-	(11,184)
At 31 December 2019	339,688	1,510	341,198
Impairment			
At 1 January 2019 and 31 December 2019	-	1,510	1,510
Carrying amount			
At 31 December 2019	339,688	-	339,688
At 31 December 2018	350,872	-	350,872

Foreign equity investments include 448,915,000 preference shares of US$1 each in Smith & Nephew USD Limited that the Company acquired on 22 September 2014. The preference shares entitle the Company to be paid a fixed cumulative preferential dividend. The preference shares do not confer a further right to participate in the profits of Smith & Nephew USD Limited or to vote at a general meeting. The movement on this asset during the period is due to foreign exchange fluctuations.

On 23 June 2020, Smith & Nephew USD Limited called and cancelled all of its 448,915,000 redeemable $1 preference shares.

Refer to Note 30 for details of subsidiaries and other undertakings.

15 Stocks

	2019 £000	2018 £000
Raw materials and consumables	7,660	7,636
Work in progress	7,704	6,941
Finished goods and goods for resale	68,813	81,970
	84,177	96,547

Reserves for excess and obsolete inventories were £15,586,000 (2018 - 16,726,000).

The cost of stocks recognised as an expense and included in cost of sales amounted to £334,488,000 (2018 - £303,020,000). In addition write downs of inventories recognised as an expense in cost of sales amounted to £4,168,000 (2018 - £5,205,000).

No inventory is carried at fair value less cost to sell in either 2019 or 2018.

16 Debtors

	2019 £000	2018 £000
Amounts falling due within one year:		
Trade debtors	30,098	34,445
Corporation tax recoverable	725	695
Amounts due from fellow group undertakings	67,911	78,755
Derivative financial instruments	8,959	5,300
Other debtors	15,429	10,539
Prepayments and accrued income	3,167	2,981
	126,289	132,715
Amounts falling due after one year:		
Other non-current receivables	-	3,071
	-	3,071
Total debtors	126,289	135,786

Trade debtors disclosed above are measured at amortised cost.

Amounts due from fellow group undertakings are repayable on demand and bear no interest.

17 Creditors: amounts falling due within one year

	Notes	2019 £000	2018 £000
Loans and overdrafts	**19**	98	3,066
Trade creditors		4,951	6,311
Amounts due to fellow group undertakings		524,758	456,701
Derivative financial instruments		4,231	6,781
Other creditors		12,725	12,668
Accruals and deferred income		24,757	33,151
		571,520	518,678

Amounts due to fellow group undertakings are repayable on demand, of which £184,943,000 bears no interest.

18 Creditors: amounts falling due after more than one year

	2019 £000	2018 £000
Deferred tax liability	10,009	8,615

19 Loans and overdrafts

	2019 £000	2018 £000
Bank overdrafts - payable within one year	98	3,066

20 Provisions for liabilities

	£000 Metal-on-metal	£000 Restructuring	£000 Total
At 1 January 2019	8,730	2,406	11,136
Utilisation of provisions	-	(5,992)	(5,992)
Net (credit) / charge to income statement	(6,906)	4,134	(2,772)
At 31 December 2019	1,824	548	2,372

During the year ended 31 December 2019 £5,992,000 of provisions were utilised related to restructuring payments incurred in relation to the Group's Accelerating Performance and Execution programme (APEX). The estimated value of the metal-on-metal provision has been updated and determined using an actuarial model. This resulted in a decrease to the residual provision of £6,906,000. The provision of £1,824,000 at 31 December 2019 represents the estimated costs to resolve all known and anticipated metal-on-metal hip claims in the UK and Republic of Ireland. Given the inherent uncertainty in assumptions relating to factors such as the number of claims and outcome the actual costs may differ from this estimate.

The legal obligation in relation to metal-on-metal is that of Smith & Nephew Orthopaedics Limited, who has been indemnified of financial responsibility in this regard by the Company.

21 Deferred taxation

The following are the major deferred tax liabilities and assets recognised by the company in the current and prior reporting period:

Balances:	Liabilities 2019 £000	Liabilities 2018 £000	Assets 2019 £000	Assets 2018 £000
Accelerated capital allowances	1,326	1,272	-	-
Other timing differences	-	-	127	1,073
Pensions	9,004	9,502	-	-
Share based payments	-	-	834	921
Hedging reserve	640	-	-	165
	10,970	10,774	961	2,159

Deferred tax assets and liabilities are offset where the company has a legally enforceable right to do so.
Difference

The UK government announced that the planned UK corporation tax main rate reduction from 19% to 17% from 1 April 2020 will not take place as envisaged. Deferred tax balances have been calculated at 17%, being the rate substantively enacted at the balance sheet date. The impact of re-calculating at a 19% rate would be to increase the deferred tax liability by £1,278k.

22 Retirement benefit schemes

Defined contribution schemes

The Company operates a defined contribution pension scheme for all qualifying employees. The assets of the scheme are held separately from those of the Company in an independently administered fund.

The charge to profit and loss in respect of defined contribution plans was £7,318,000 (2018 - £7,429,000).

Defined benefit schemes

Funded plans are funded by the payment of contributions to, and the assets held by, separate trust funds or insurance companies. Employees' retirement benefits are the subject of regular management review. For many years, the Company's major pension plans in the UK were of the defined benefit type. These were closed to new employees in 2003 and replaced by defined contribution plans. In December 2016 the UK defined benefit scheme was closed to future accrual.

Post-closure to further accrual, the level of entitlement is dependent on the years of service of the employee at the time of closure.

The Company is a participating employer in the Smith & Nephew Executive Pension Scheme, responsibility for the funding of this plan was transferred from Smith & Nephew plc to Smith & Nephew UK Limited in January 2006.

The UK Plan operates under trust law and responsibility for its governance lies with a Board of Trustees. This Board is composed of representatives of the Group, plan participants and an independent trustee, who act on behalf of members in accordance with the terms of the Trust Deed and Rules and relevant legislation. The UK Plan's assets are held by the Trust. Annual increases on benefits in payment are dependent on inflation. There is no legislative minimum funding requirement in the UK, however the it has agreed with the Board of Trustees to pay a schedule of supplementary payments. The Trust Deed of the UK Plan states that any surplus is ultimately accessible by the company as a refund. Furthermore, in the ordinary course of business, the UK trustees have no rights to unilaterally wind up, or otherwise augment the benefits due to members of the plans. Based on these rights, any net surplus in the UK Plan is recognised in full.

Valuation

A full valuation is performed by actuaries for the Trustees to determine the level of funding required. Employer contributions rates, based on these full valuations, are agreed between the Trustees of each plan and the Company. The assumptions used in the funding actuarial valuations may differ from those assumptions disclosed below.

The most recent full actuarial valuation of the UK Plan was undertaken at 30 September 2018. Contributions to the UK Plan in 2019 were £5m (2018 - £19m). In 2019 and 2018 these contributions were entirely supplementary contributions.

22 Retirement benefit schemes **(Continued)**

Key assumptions

	2019 %	2018 %
Discount rate	1.9	2.7
Expected rate of increase of pensions in payment	3.0	3.2
Expected rate of salary increases	N/A	N/A
Expected rate of price inflation	3.0	3.2

The average duration of the scheme liabilities is 18.5 years (2018: 18.9 years).

A 50bps increase/decrease in the discount rate would decrease/increase the scheme liabilities by £52m/£60m. A 50bps increase/decrease in the pension increase rate would bear no impact on the scheme liabilities. A 50bps increase/decrease in the rate of salary increases would bear no impact on the scheme liabilities. A 50bps increase/decrease in the rate inflation would increase/decrease the schemes liabilities by £56m/£50m.

Mortality assumptions

The assumed life expectations on retirement at age 60 are:

	2019 Years	2018 Years
Retiring today		
- Males	28.9	28.9
- Females	30.4	30.4
Retiring in 20 years		
- Males	31.1	31.1
- Females	31.9	31.9

A 1 year increase/decrease in assumed life expectations, on retirement at age 60, would increase/decrease the scheme liabilities by £26m/£26m.

Amounts recognised in the profit and loss account

	2019 £000	2018 £000
Net interest on defined benefit liability/(asset)	(1,700)	(1,200)
Administration costs and taxes	1,000	1,100
Total costs	(700)	(100)

Costs of £100,000 have been recognised in the income statement in relation to the retirement healthcare plan.

Amounts taken to other comprehensive income

22 Retirement benefit schemes **(Continued)**

	2019 £000	2018 £000
Actual return on scheme assets	58,400	(19,700)
Less: calculated interest element	(16,500)	(15,700)
Return on scheme assets excluding interest income	41,900	(35,400)
Actuarial changes related to obligations	(50,492)	37,691
Actuarial (losses) / gains	(8,592)	2,291

The retirement healthcare plan recognised a net actuarial gain of £165,000 in 2019, of which a £205,000 gain was relating to experience, £300,000 relating demographic and £340,000 loss was relating to a change in financial assumptions (2018: £639,000 gain, £nil gain or loss, £120,000 gain).

The amounts included in the balance sheet arising from the Company's obligations in respect of defined benefit plans are as follows:

	2019 £000	2018 £000
Present value of defined benefit obligations	600,474	561,482
Fair value of plan assets	(657,600)	(621,800)
Surplus in scheme	(57,126)	(60,318)
Retirement healthcare plan liability	3,320	3,480
Total asset recognised	(53,806)	(56,838)

Movements in the present value of defined benefit obligations

	2019 £000	2018 £000
Liabilities at 1 January 2019	561,482	631,173
Administration costs and taxes	1,000	1,100
Benefits paid	(27,300)	(47,600)
Actuarial (gains) due to experience assumption changes	(2,582)	(4,673)
Actuarial (gains) due to demographic assumption changes	(24,600)	-
Actuarial losses / (gains) due to financial assumption changes	77,674	(33,018)
Interest cost	14,800	14,500
At 31 December 2019	600,474	561,482

22 Retirement benefit schemes (Continued)

The defined benefit obligations arise from plans funded as follows:

	2019 £000	2018 £000
Wholly unfunded obligations	3,320	3,480
Wholly or partly funded obligations	600,474	561,482
	603,794	564,962

Movements in the fair value of plan assets

	2019 £000	2018 £000
Fair value of assets at 1 January 2019	621,800	670,300
Interest income	16,500	15,700
Return on plan assets (excluding amounts included in net interest)	41,900	(35,400)
Benefits paid	(27,300)	(47,600)
Contributions by the employer	4,700	18,800
At 31 December 2019	657,600	621,800

Fair value of plan assets at the reporting period end

	2019 £000	2018 £000
Equity instruments	83,530	99,200
Debt instruments	32,900	224,300
Insurance contract	176,614	188,700
Other quoted securities	82,544	108,000
Other	282,012	1,600
	657,600	621,800

The plan assets do not include any of the entity's own financial instruments or any property, or other assets, which are used by the entity.

The plan assets include liability matching assets and annuity policies purchased by the trustees, which aim to match the benefits to be paid to certain members from the plan and therefore remove the investment, inflation and demographic risks in relation to those liabilities. The terms of the policy define that the contract value exactly matches the amount and timing of the pensioner obligations covered by the contract. In accordance with IAS19R *Employee Benefits*, the fair value of the insurance contract is deemed to be the present value of the related obligations which is discounted at the AA corporate bond rate.

23 Share-based payment transactions

Employee plans

The Smith & Nephew Sharesave Plan (2002) (adopted by shareholders on 3 April 2002) (the Save As You Earn (SAYE) plan) and the Smith & Nephew Sharesave Plan (2012) (the Save As You Earn ("SAYE 2012") plan) (adopted by shareholders on 12 April 2012) are available to all employees in the UK employed by participating group companies, subject to three months service. The schemes enable employees to save up to £250 per month on plans up to 2014 and £500 per month from 2015 onwards and give them an option to acquire shares based on the committed amount to be saved. The option price is not less than 80% of the average of middle market quotations of the ordinary shares on the three dealing days preceding the date of invitation.

Executive plans

The Smith & Nephew 2001 UK Approved Share Option Plan, the Smith & Nephew 2001 UK Unapproved Share Option Plan, the Smith & Nephew 2001 US Share Plan (adopted by shareholders on 4 April 2001), the Smith & Nephew 2004 Executive Share Option Plan (adopted by shareholders on 6 May 2004) and the Smith & Nephew Global Share Plan 2010 (adopted by shareholders on 6 May 2010) are together termed the ‘Executive Plans’.

Under the terms of the Executive Plans, the Remuneration Committee, consisting of non-executive directors, may at their discretion approve the grant of options to employees of the group to acquire ordinary shares in the parent company. Options granted under the Smith & Nephew 2001 US Share Plan (the ‘US Plan’) and the Smith & Nephew 2004 Executive Share Option Plan are to acquire ordinary shares.

For Executive Plans adopted in 2001 and 2004, the market value is the average quoted price of an ordinary share for the three business days preceding the date of grant or the average quoted price of an ordinary share, for the three business days preceding the date of grant or the quoted price on the date of grant if higher. For the Global Share Plan adopted in 2010 the market value is the closing price of an ordinary share on the last trading day prior to the grant date. With the exception of options granted under the 2001 US Plan and the Global Share Plan 2010, the vesting of options granted from 2001 are subject to achievement of a performance condition. Options granted under the 2001 US Plan and the Global Share Plan 2010 are not subject to any performance conditions. Prior to 2008, the 2001 US Plan options became cumulatively exercisable as to 10% after one year, 30% after two years, 60% after three years and the remaining balance after four years. With effect from 2008, options granted under the 2001 US Plan became cumulatively exercisable as to 33.3% after one year, 66.7% after two years and the remaining balance after the third year.

The 2001 UK Unapproved Share Option Plan was open to certain employees outside the US and the US Plan is open to certain employees in the US, Canada, Mexico and Puerto Rico. The Global Share Plan 2010 is open to employees globally. The 2004 Plan was open to executive directors only.

The maximum term of options granted, under all plans, is 10 years from the date of grant. All share option plans are settled in shares.

From 2012 onwards Senior Executives were granted share awards instead of share options and from 2013 executives were granted conditional share awards instead of share options. The awards vest 33.3% after one year, 66.7% after two years and the remaining balance after the third year subject to continued employment. There are no performance conditions for executives. Vesting for senior executives is subject to personal performance levels. The market value used to calculate the number of awards is the closing price of an ordinary share on the last day prior to the grant date.

The expense charged to the profit and loss account in respect of share-based payments is £3,037,000 (2018 - £3,037,000). Share based payments are paid by the ultimate parent company, Smith & Nephew plc, and then recharged to the Company.

23 Share-based payment transactions (Continued)

At 31 December 2019, 1,408,000 (2018 - 1,460,000) options were outstanding under share option plans as follows:

	Number of options (Thousand)	Range of exercise price (Pence)	Weighted average exercise price (Pence)
Employee schemes:			
Outstanding at 1 January 2018	1,194	535.0 - 1092.0	986.4
Granted	322	1097.0	1097.0
Forfeited	(115)	535.0 - 1097.0	1025.4
Exercised	(363)	535.0 - 1092.0	901.1
Outstanding at 31 December 2018	1,038	625.0 - 1097.0	1046.2
Granted	311	1541.0	1326.1
Forfeited	(74)	949.0 - 1541.0	1067.5
Exercised	(261)	625.0 - 1097.0	983.1
Outstanding at 31 December 2019	1,014	625.0 - 1097.0	1191.8
Options exerciseable:			
31 December 2019	27	831.0 - 1026.0	1015.0
31 December 2018	24	625.0 - 949.0	914.7
Executive schemes:			
Outstanding at 1 January 2018	95	538.0 - 650.0	620.7
Exercised	(37)	599.0 - 650.0	609.2
Expired	(12)	538.0 - 650.0	629,4
Outstanding at 31 December 2018	46	538.0 - 650.0	626.7
Exercised	(7)	538.0 - 650.0	602.0
Expired	(5)	599.0	599.0
Outstanding at 31 December 2019	34	538.0 - 650.0	635.9
Options exerciseable:			
31 December 2019	34	538.0 - 650.0	635.9
31 December 2018	46	538.0 - 650.0	626.7

23 Share-based payment transactions **(Continued)**

	Employee 2019	Employee 2018	Executive 2019	Executive 2018
Weighted average remaining contractual life of options outstanding	2.5	2.6	1.8	2.9
Weighted average remaining contractual life of options exerciseable	0.3	0.3	1.8	2.9

Options granted during the year were as follows:

	Options granted (Thousand)	Weighted average fair value per option at grant date (Pence)	Weighted average share price at grant (Pence)	Weighted average exercise price (Pence)	Weighte d average options life (Years)
Employee schemes	267	522.17	1908.5	1541.0	3.94

Weighted average fair value of options granted under employee plans during 2019 was 522.17p.

Options granted under employee plans are valued using the Black-Scholes option model as management considered that options granted under these plans are exercised within a short period of time after the vesting date.

For all plans the inputs to the option pricing models are reassessed for each grant. The following assumptions were used in calculating the fair value of options granted:

	Employee schemes 2019	Employee schemes 2018	Employee schemes 2017	Executive schemes 2019	Executive schemes 2018	Executive schemes 2017
	(%, except expected life in years)					
Dividend yield	1.5	2.0	2.0	n/a	n/a	n/a
Expected volatility (i)	25.0	25.0	25.0	n/a	n/a	n/a
Risk-free interest rate (ii)	2.3	3.3	2.5	n/a	n/a	n/a
Expected life in years	3.9	3.9	4.0	n/a	n/a	n/a

(i) Volatility is assessed on a historic basis primarily based on past share price movements over the expected life of the options.
(ii) The risk-free interest rate reflects the yields available on zero coupon government bonds over the option term and currency.

23 Share-based payment transactions (Continued)

Share based-payments - long-term incentive plans

In 2004, a share-based incentive plan was introduced for Executive Directors, Executive Officers and the next level of Senior Executives. The plan included a Performance Share Plan (PSP) and a Bonus Co-Investment Plan (CIP).

Vesting of the PSP awards are dependent upon performance relative to the FTSE 100 and an index based on major international companies in the medical devices industry.

Under the CIP, participants could elect to use up to a maximum of one-half of their annual bonus to purchase shares. If the shares are held for three years and the group’s EPSA growth targets are achieved participants receive an award of matching shares for each share purchased.

From 2009, the CIP was replaced by a Deferred Bonus Plan (DBP). This plan was designed to encourage Executives to build up and maintain a significant shareholding in the Group. Under the plan, up to one-third of any bonus earned at target level or above by an eligible employee was compulsorily deferred into shares which vested, subject to continued employment, in equal annual tranches over three years (i.e. one-third each year). No further performance conditions applied to the deferred shares.

From 2010, Performance Share awards were granted under the Global Share Plan 2010 (GSP 2010) for all Executives over than Executive Directors. Awards granted under both plans are combined to provide the figures below.

From 2012, Deferred Bonus Plan and GSP 2010 options for Executive Directors, Executive Officers and the next level of Senior Executives were replaced by the Equity Incentive Awards ("EIA"). EIA are designed to encourage Executives to build up and maintain a significant shareholding in the Group. EIA will vest, in equal annual tranches over three years (i.e. one third each year), subject to continued employment and personal performance. No further performance conditions apply to the EIA.

The fair values of awards granted under long-term incentive plans are calculated using a binomial model. Performance Share awards under both the PSP and Global Share Plan 2010 contain vesting conditions based on TSR versus a comparator group which represent market-based performance conditions for valuation purposes and an assessment of vesting probability is therefore factored into the award date calculations. The assumptions include the volatilities for the comparator groups. A correlation of 35% (2014 - 40%, 2013 - 40%) has been assumed for the companies in the medical devices sector as they are impacted by similar factors. The Performance Target for the Global Share Plan 2010 is a combination of free cash flow growth, revenue in emerging and international markets and the Group's TSR performance over the three-year performance period.

23 Share-based payment transactions **(Continued)**

At 31 December 2019 the maximum number of shares that could be awarded under the Group's long-term incentive plans were:

(Numbers of shares in thousands)	Other awards	DBP	PSP	EIA	Total
Outstanding at 1 January 2018	150	-	220	62	432
Awarded	77	-	49	27	153
Vested	(58)	-	(79)	(44)	(181)
Lapsed	(19)	-	(8)	-	(27)
Outstanding at 31 December 2018	150	-	182	45	377
Awarded	50	-	74	30	154
Vested	(70)	-	(58)	(22)	(150)
Lapse	(5)	-	(17)	-	(22)
Outstanding at 31 December 2019	125	-	181	53	359

The weighted average remaining contractual life of awards outstanding at 31 December 2019 was 1.2 years (2018 – 1.1years) for the PSP, 0 years for the DBP (2018 – 0), 0.9 years for the EIA (2018 – 0.9) and 1.25 years for the other awards (2018 – 0.96).

24 Share capital

	2019 £000	2018 £000
Ordinary share capital		
Issued and fully paid		
122,539 ordinary shares of £1 each (2018 - 122,539 shares of £1 each)	123	123

25 Financial commitments, guarantees and contingent liabilities

The Company, together with Smith & Nephew plc and certain fellow subsidiary undertakings, has entered into guarantees with the National Westminister Bank plc and HSBC Bank plc. The arrangement with National Westminister Bank is in respect of the net overdrafts of the other parties to the guarantee. The maximum exposure under this guarantee amounts to £10,000,000 (2018 - £10,000,000). The arrangement with HSBC Bank plc is in respect of gross overdrafts in the guarantee. The maximum exposure under this guarantee is £37,835,000 ($50,000,000) (2018: £nil).

26 Operating lease commitments

Non-cancellable operating lease rentals are payable as follows:

	Land and Buildings		Other	
	2019	2018	2019	2018
	£000	£000	£000	£000
Within one year	343	330	1,706	1,861
Between two and five years inclusive	903	203	1,812	2,033
In over five years	275	-	-	-
	1,521	533	3,518	3,894

During the year £4,418,000 was recognised as an expense in the profit and loss account in respect of operating leases (2018: £2,351,000).

27 Events after the reporting date

Since the balance sheet date, the COVID-19 pandemic has spread across the world. This has adversely impacted the elective surgeries market in which the Company's subsidiaries operate worldwide. This is considered a non-adjusting post-balance sheet event and the impact of COVID-19 will be reported in the 2020 financial statements. The COVID-19 pandemic has, at the time of approving these financial statements, had no adverse impact on the Company.

Uncertainty as to the length of the pandemic and the related measures to combat it mean that the 2020 full year impact, including any impact on the carrying value of the Company's investment in subsidiaries, cannot yet be known.

28 Related party transactions

The companies has taken advantage of the exemption conferred by FRS102 paragraph 33.1A in not disclosing details of transactions with fellow Group undertakings. Amounts due from and to fellow Group undertakings are disclosed in notes 16 and 17 respectively.

29 Ultimate parent company & parent company of larger group

The Company is a subsidiary undertaking of Smith & Nephew Trading Group Limited (122,538 shares, equivalent to 99.999%) and Smith & Nephew Nominee Services Limited (1 share, equivalent to 0.001%), which are the immediate parent companies incorporated in England and Wales. The ultimate parent undertaking of the Company is Smith & Nephew Plc. The smallest and largest group in which the results of the Company are consolidated is that headed by Smith & Nephew plc. The consolidated financial statements of the Group are available to the public and may be obtained from Building 5, Croxley Park, Hatters Lane, Watford, Hertfordshire, WD18 8YE or online via www.smith-nephew.com.

30 Subsidiaries and other undertakings

Details of the company's subsidiaries and other undertakings at 31 December 2019 are as follows:

Name of undertaking	Country of incorporation	Registered Office	Class of Shareholding	% of ownership
Michelson Diagnostics Ltd	United Kingdom	Ground Floor, Eclipse House Eclipse Park, Sittingbourne Road, Maidstone, Kent, ME14 3EN	ordinary shares	7.50