during the year and lower US Dollar and Euro interest rates on borrowings and swap liabilities offset in part by lower Sterling interest rates on cash balances and swap assets.

Taxation
The taxation charge increased by £16.2m to £82.0m in 2003. The taxation charge on profit before goodwill amortisation and exceptional items was £70.2m an increase of £8.6m on the 2002 charge due to higher profits. The effective rate of taxation on profit before goodwill amortisation and exceptional items was 29.0% compared with 29.3% in 2002.

The taxation charge was reduced in 2003 by £3.5m as a consequence of the exceptional costs, by £0.8m from the exceptional costs in BSN Medical and increased by £16.1m as a result of the gain on disposal of AbilityOne.

Business Segment Analysis
Group sales by business unit and geographic market and operating profit by business unit are set out below:

	2003	2002
	(£ million)	
Sales by business segment		
Orthopaedics	525.4	470.2
Endoscopy	300.0	291.8
Advanced wound management	353.5	321.7
Ongoing Operations	1,178.9	1,083.7
Operating profit by business segment		
Orthopaedics	118.7	98.2
Endoscopy	59.5	53.8
Advanced wound management	42.5	44.0
Ongoing Operations before goodwill amortisation and exceptional items	220.7	196.0
Sales by geographic market		
Europe (Continental Europe and United Kingdom)	369.9	318.7
United States and Other America	632.3	610.5
Africa, Asia and Australia	176.7	154.5
Ongoing Operations	1,178.9	1,083.7

Orthopaedics

Sales
Orthopaedics sales were £525.4m in 2003, an increase of £55.2m or 12% compared to £470.2m for 2002. Underlying growth in sales was 16%. This increase demonstrated Smith & Nephew’s market share gains in the global orthopaedics market (excluding spine), which is estimated to be growing at 13%. Sales pricing contributed approximately 3% to reported growth. Products introduced within the last three years represented 25% of sales in 2003.

During 2003 the business recruited 60 dedicated trauma sales representatives, with further plans for expansion in 2004 in the US.

Reconstructive implant sales grew by 15% (equivalent to an underlying growth rate of 19% after 4% of adverse currency translation) following an aggressive expansion of OXINIUM products into the market. The OXINIUM bearing material continues to be a great success and has helped surgeons successfully treat younger implant patients due to its wear reduction properties.

Knees sales grew by 20%, (an underlying rate of 24% after 4% of adverse currency) driven mainly by the promotion and rollout of OXINIUM technology; hips sales grew by 11% (an underlying rate of 16% after 5% of adverse currency effect) driven by the launch of the OXINIUM femoral head.

More than 30,000 knees made of OXINIUM have now been implanted into patients and by the end of 2003 it was accounting for 40% of knee units being sold by the business in the US. The joint fluid therapy product SUPARTZ contributed 3% to knee sales growth.

Growth in sales of hips resulted from the continued solid performance of the SYNERGY and ECHELON platform systems and the introduction in 2003 of femoral heads made of OXINIUM, which by the end of 2003 were accounting for 35% of hip heads sold by Smith & Nephew in the US.

Trauma sales increased by 6% (an underlying rate of 10% after 4% of adverse currency effect) benefiting from increased focus following the divisionalisation of the US business. Trauma sales increased in the US by 4% (equivalent to 13% underlying growth after 9% adverse currency). These results were helped by growth in worldwide sales of the EXOGEN ultrasound bone stimulation products of 14% (22% underlying growth after 8% adverse currency) and the introduction of the JET-X unilateral fixator in 2003.

Higher than normal revision rates in respect of the macrotextured femoral knee component prompted a voluntary withdrawal of the product from the market on 18 August 2003. The total number of components implanted was 2,971 and, to 8 March 2004, 190 revisions have been notified to the Group.

Operating Profit
Operating profit from the orthopaedics business before goodwill amortisation and exceptional items increased by £20.5m (21%) from £98.2m in 2002 to £118.7m in 2003. The operating profit margin increased from 20.9% to 22.6% as a result of cost and efficiency savings, additional sales volume and price increases.

Endoscopy

Sales
Endoscopy sales in 2003 were £300.0m, an increase of £8.2m or 3% compared to £291.8m for 2002. Underlying growth in sales was 4%. Sales in the US declined by 7% with an underlying fall of 2% after adjusting for 9% adverse currency and 4% for the benefit of ORATEC. Outside the US sales growth was 19% (14% underlying after 5% adverse currency translation).

Endoscopy was adversely affected in the US by two market issues — increased re-use of arthroscopic resection blades and decreased business from one of its largest customers, HealthSouth. With respect to blade re-use, the business has launched an educational campaign that features research highlighting the risks of this practice to hospitals and clinicians in the US. Whilst the issue of blade re-use is expected to continue in 2004, the adverse impact to the growth of the business is expected to moderate somewhat.

Endoscopy sales growth was also affected by its decision to defer two product launches into 2004 — the digital scanning camera and the next generation varicose vein removal system. Clinical evaluations identified the opportunity to make improvements prior to both products’ broader launch. Both of these products were launched in early 2004 and Smith & Nephew expects them to improve overall sales growth.

Sales of knee and shoulder repair products grew by 14% (an underlying rate of 18% after 4% of adverse currency translation) while ORATEC products produced sales growth of 41% (of which 17% arose from underlying growth, 32% was the acquisition effect less 8% adverse currency translation) helping Smith & Nephew to maintain its market leadership position in arthroscopy with a market share of 29%.

Smith & Nephew has been sued by ArthroCare Inc., for infringement of three US patents related to certain bipolar radio frequency products. In March 2004 a Delaware Court granted a motion for issuance of an injunction against Smith & Nephew following an earlier jury finding of infringement, but the terms and effective date of a possible injunction are still in dispute. The sales of the affected products in the 2003 financial year were less than £6m. Smith & Nephew believes it has meritorious defences based upon pending trial court motions, re-examinations taking place in the US Patent and Trademark Office and an appeal to the Court of Appeals for the Federal Circuit and intends to contest the case.

Operating Profit
Operating profit from the endoscopy business before goodwill amortisation and exceptional items increased by £5.7m (11%) from £53.8m in 2002 to £59.5m in 2003. The operating profit margin increased from 18.4% to 19.8% as a result of effective expense control and by accelerating the integration of the ORATEC acquisition. During 2003 the manufacturing and development activities of ORATEC at Palo Alto, California were relocated and integrated with endoscopy operations at Andover, Massachusetts.

Advanced Wound Management

Sales

Advanced wound management sales were £353.5m for 2003, an increase of 10% compared to £321.7m for 2002. Underlying sales growth was 9%. The advanced wound management business maintained its leadership position with approximately 20% of the market for advanced treatments of hard-to-heal wounds. It further developed the concept of wound bed preparation as a new clinical and scientific platform. DERMAGRAFT and TRANSCYTE bioengineered human tissue products, acquired in November 2002, were integrated successfully into the US business.

DERMAGRAFT achieved its target sales of £7m. Sales of the ALLEVYN family of products continued to grow strongly at 24% (20% underlying growth plus 4% favourable currency translation) and ACTICOAT silver-based antimicrobial dressing achieved sales growth of 51% (55% underlying less 4% adverse currency).

The business launched a new enzymatic wound bed preparation product, GLADASE, following the termination of a supply arrangement for the previous equivalent US product, SANTYL. This issue adversely impacted sales in the second half of 2003 and will continue to do so in 2004 during the switch to the new product.

Operating Profit

Operating profit from the advanced wound management business before goodwill amortisation and exceptional items decreased by £1.5m (3%) from £44.0m in 2002 to £42.5m in 2003. The operating profit margin decreased from 13.7% to 12.0% principally as a result of acquiring, at the end of 2002, the remaining 50% of the DERMAGRAFT joint venture not already owned and due to increased pension costs in the UK and the US.

2002 YEAR

Financial Highlights of 2002

Group turnover was £1,109.9m for the year ended 31 December 2002, representing 3% growth compared to 2001. Underlying growth in sales of Ongoing Operations was 14%.

Profit on ordinary activities before taxation was £177.9m, compared with £193.6m in 2001. Profit before taxation goodwill amortisation and exceptional items (calculated as set out in the “Five Year Record”), improved 16% to £209.9m.

Basic earnings per Ordinary Share were 12.11p, a 14% decrease compared to 14.07p for 2001. Adjusted basic earnings per share Ordinary Share before goodwill amortisation and exceptional items were (calculated as set out in the “Five Year Record”) were 16.02p compared to 13.96p for 2001 representing a 15% increase.