SMITH & NEPHEW PLC
Form 20-F
March 01, 2012
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 20-F

(Mark One)

¨ **REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934**

or

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2011

or

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

or

¨ **SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission file number 1-14978

Smith & Nephew plc

(Exact name of Registrant as specified in its charter)

England and Wales

(Jurisdiction of incorporation or organization)

15 Adam Street, London WC2N 6LA

(Address of principal executive offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of each class	Name on each exchange on which registered
American Depositary Shares	**New York Stock Exchange**
Ordinary Shares of 20¢ each	**New York Stock Exchange***

* **Not for trading, but only in connection with the registration of American Depositary Shares, pursuant to the requirements of the Securities and Exchange Commission.**

Securities registered or to be registered pursuant to Section 12(g) of the Act: None.

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: None.

Indicate the number of outstanding shares of each of the issuer s classes of capital or common stock as of the close of the period covered by the annual report: 951,021,116 Ordinary Shares of 20¢ each

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act Yes x No ¨

If this Report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 Yes ¨ No x

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days: Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ¨ No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer:

Large Accelerated Filer x	Accelerated Filer ¨	Non-accelerated filer ¨

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing.

U.S. GAAP ¨	International Financial Reporting Standards as issued by the International Accounting Standards Board	x	Other ¨

If Other has been checked to the previous question indicate by check mark which financial statement item the registrant has elected to follow: Item 17 ¨ Item 18 ¨

If this is an annual report, indicated by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

Table of Contents

Table of Contents

Every day each one of us at **smith&nephew**

helps improve the life of someone, somewhere

in the world. That s something to be proud of.

Front Cover:

Smith & Nephew is a world leader in sports medicine and joint replacement technology to relieve pain and heal the body.

Important information on Smith & Nephew, Presentation,

Special note regarding forward-looking statements, Segment data and Documents on

display are set out on page 156.

Table of Contents

Contents

For over 150 years, Smith & Nephew has developed advanced medical devices for healthcare professionals around the world. Our pioneering technologies enable nurses, surgeons and other medical practitioners to provide effective treatment more quickly and economically.

Table of Contents

Smith & Nephew at a glance

Smith & Nephew is a global medical technology business dedicated to helping improve people s lives. With leadership positions in Orthopaedic Reconstruction and Trauma, Advanced Wound Management and Endoscopy (sometimes referred to as Arthroscopy or sports medicine).

Our strategic priorities

Read more about our strategic priorities on page 10.

Established Markets
Emerging Markets
Innovate for value
Simplify and improve our operating model
Supplement the organic growth through acquisitions

Our performance

[1] Explanations of these non-GAAP financial measures are provided on pages 20 to 22.

[2] Underlying increase/decrease after adjusting for the effect of currency translation.

Table of Contents

In August 2011, the Group announced its new strategic priorities. Part of this framework was the implementation of an organisational change. Smith & Nephew has brought together the Orthopaedics and Endoscopy business segments, creating the Advanced Surgical Devices division, which will sit alongside the Advanced Wound Management division. These two divisions will serve the Established Markets and will support our newly created Emerging Markets (focusing on China, India, Brazil and Russia) and International Markets organisations. For reporting purposes, the two division structure will replace the three business segment structure during 2012.

Our business segments in 2011

Revenue by business **$4.3bn**

	$m
A Orthopaedics	2,312
B Endoscopy	939
C Advanced Wound Management	1,019

Orthopaedics

The Orthopaedics business segment comprises reconstruction (primarily implants including hip, knee and shoulder joints), trauma (internal and external fixation devices) and Clinical Therapies (bone growth stimulation and joint fluid therapies).

Global segment size[3]	Revenue
$17.8bn	$2.3bn
Global segment growth[2,3]	**Revenue growth[2]**
+2%	+2%
Trading profit	**Trading profit margin**
$492m	21.3%
Operating profit	**Operating profit margin**

Endoscopy

The Endoscopy business segment develops and commercialises arthroscopy (minimally invasive surgery) techniques, educational programmes and value-added services for surgeons to treat and repair soft tissue and articulating joints.

Global segment size[3]	Revenue
$3.8bn	$0.9bn
Global segment growth[2,3,4]	**Revenue growth[2]**
+8%	+6%
Trading profit	**Trading profit margin**
$222m	23.6%
Operating profit	**Operating profit margin**

Advanced Wound Management

The Advanced Wound Management business segment offers a range of products from initial wound bed preparation through to full wound closure and Negative Pressure Wound Therapy. These products are targeted at chronic wounds associated with the older population and for the treatment of wounds such as burns and from invasive surgery.

Global segment size[3]	Revenue
$5.5bn	$1.0bn
Global segment growth[2,3]	**Revenue growth[2]**
+3%	+7%
Trading profit	**Trading profit margin**
$247m	24.3%
Operating profit	**Operating profit margin**

$415m	17.9%
Segment share[3]	
11%	

VERILAST s use of OXINIUM, oxidized Zirconium, results in a knee which has been proven to last 30 years, twice the current industry standard of 15 years.

Read more about our Orthopaedics business on page 31.

$215m	22.9%
Segment share[3]	
21%	

The FAST-FIX 360 Meniscal Repair System offers exceptional fixation strength and enhanced control to optimise the chances of a successful meniscus repair.

Read more about our Endoscopy business on page 35.

$232m	22.8%
Segment share[3]	
18%	

PICO is a small portable pump, providing 7 days effective Negative Pressure Wound Therapy yet is small enough to fit discreetly into a pocket.

Read more about our Advanced Wound Management business on page 38.

[3] These are estimates generated by Smith & Nephew based upon public sources and internal analysis.

[4] Global segment data represents the Arthroscopy market which is a combination of repair and resection products. The Endoscopy business includes additional product categories.

Table of Contents

Where we operate

Smith & Nephew has nearly 11,000 employees and a presence in more than 90 countries.

Table of Contents

Chairman s statement

Sir John Buchanan

Chairman

We are striving to build a successful, sustainable business

6

Smith & Nephew Annual Report 2011

Table of Contents

Dear shareholder,

Smith & Nephew is in a transition phase. The external environment is a challenge for all businesses. With CEO succession we have taken the opportunity to review the fundamentals of what we do.

Led by our new CEO, Olivier Bohuon, the Group is embracing a new set of strategic priorities which build on established strengths, recent successes and emerging opportunities. To stimulate sales growth we are enhancing our innovation processes in both established and new markets.

The Group focuses both on what we do to create long-term sustainable value, and on how we do it. Matters of health, safety, environment, compliance, ethics and the treatment of employees, customers, suppliers and the communities in which we operate are all important to Smith & Nephew.

Financial & business review

We are building from a strong and stable financial base, a foundation that has strengthened despite the challenges of the last three years.

In 2011, we increased revenue by 4% on an underlying basis to $4,270m and delivered a trading profit of $961m. Free cash flow, a key indicator of the health of any business, was good and we increased our adjusted earnings per share. The Board is pleased to recommend a proposed final dividend for the year of 10.8 cents per share, up 10% on 2010.

All of our businesses contributed to the revenue uplift. In Orthopaedics we led the market in knee growth amongst our major competitors, Endoscopy generated double-digit growth in our sports medicine repair franchise and Advanced Wound Management grew at more than double the market rate and exceeded $1 billion in revenue for the first time.

We don t assume that the external environment will be easier in the year ahead. Nor do we expect competitive pressures to diminish. We are well positioned to deal with these challenges, building upon our performance in 2011, and we continue to seek ways to further enhance our competitive positions.

Board changes

We were very pleased to welcome our new CEO, Olivier Bohuon, in April 2011, following the retirement of David Illingworth.

David s numerous contributions, from putting the customer-relationship at the heart of the business to the earnings and margin achievements, leave a good platform for the next stage of our journey. I am sure you will join the Board in thanking David for his important contribution.

Olivier, with his healthcare background, leadership skills and notable record, is well placed to take the Group forward. The Board is confident that we will evolve as a fitter, more focused business, ready to tackle new opportunities and challenges.

We were also delighted to welcome Ajay Piramal to the Board in January 2012. He is one of India s most respected businessmen. Ajay s global healthcare experience and emerging markets expertise will further strengthen the Board.

Thank you

With so much change there can be unsettling effects. The Board has been constantly impressed by the passion to serve customers and the determination to compete which our management and employees continue to exhibit wherever they are in the world.

We recognise that change can also engender uncertainties for shareholders. We will continue to enhance our record of long-term value creation and thank you for your support over recent times. I have had the opportunity to meet many of our institutional and private shareholders and have appreciated greatly their ideas and input. We are your Group, and we strive to build a sustainable, successful business.

Sir John Buchanan

Chairman

Chief Executive Officer s statement

Olivier Bohuon

Chief Executive Officer

We are building a business that is stronger, growing faster, better balanced and is fit and effective for

the future

Dear shareholder,

Smith & Nephew delivered strong results in 2011, despite the prevailing difficult macro-economic climate. The market is not getting any easier, and we are not resting on the successes of the past. We have great ambitions for the future and are taking active measures to transform your Group.

I believe that many growth opportunities exist; that we can secure greater market-share in our Established Markets and be market leaders in the Emerging Markets. Our success will be built through innovation and efficiency, driving permanent improvements across the Group. These principles are at the heart of our new strategic priorities, announced in August 2011, which we are working tirelessly to embed across the Group.

New strategic priorities

First, in our **Established Markets**, we believe we can build upon existing strong positions and win market share. We will do this through greater innovation and being more efficient, liberating resources for investment in those areas that will maximise both revenue and margins.

Second, in **Emerging Markets**, we will build upon our initial success in China and expand to create sustainable businesses in India, Brazil and Russia. These Emerging Markets are enjoying good GDP growth and there is an increasing demand for high quality medical products from amongst the population and an expanding surgical infrastructure to deliver these safely, the key features required to make a new market attractive to Smith & Nephew.

Our performance in the Established and Emerging Markets will be driven by an unremitting focus to **Innovate for Value**, our third strategic priority. Our future success depends upon offering new technologies designed for each market where we operate. We are accelerating our rate of innovation by increasing the research & development budget and prioritising projects that will deliver maximum value.

Next, we will **Simplify and Improve our Operating Model**, streamlining the business and reducing our cost of goods through actions such as optimising our manufacturing footprint.

Finally, we will **Augment our Organic Growth through Acquisitions**. We will continue with our successful strategy of adding complementary technologies. We will also now seek to support our Emerging Markets ambitions by acquiring local manufacturing and/or distribution businesses and we remain alert to larger opportunities to support our ambitions in advanced woundcare, minimally invasive surgery and extremities.

Sustainability

Through our new strategic priorities we are seeking to maximise growth and revenue through building a sustainable business. We embrace the wider responsibilities this brings, and will work to protect the environment, our employees and the communities in which we work, as well as to meet our customers   high expectations and global compliance obligations, as we deliver on our action plans.

Progress in delivery

We have made considerable progress reshaping the business in line with these priorities.

Our management teams in our Advanced Surgical Devices and Advanced Wound Management divisions are now focused exclusively on meeting the needs of our customers in the Established Markets.

We have strong leadership to drive us into the Emerging and other International Markets. We are investing an additional $300m over the next five years into R&D to drive our innovation agenda. And our programmes to realise efficiencies, liberate resources and reduce the cost of goods are well underway.

We are building momentum every day and I am confident that the result will be a business that is stronger, growing faster, better balanced and is fit and effective for the future.

Olivier Bohuon

Chief Executive Officer

Table of Contents

Our strategic priorities and key performance indicators (KPIs)

Smith & Nephew use a range of measures to monitor progress against our five strategic priorities and against our overall financial goal. While their relative importance changes as market conditions evolve, progress against all five priorities continues to drive our growth.

Financial goal

To deliver a higher return to shareholders

than our peer group over the longer term.

Strategic priorities

Established Markets	In Established Markets (US, Europe, Australia, New Zealand, Canada and Japan), Smith & Nephew sees opportunities to build upon existing strong positions, to win market share through greater innovation and drive efficiencies to liberate resources. Through these actions the Group seeks to meet the challenges of subdued markets and maximise both revenue growth and profit margins.
Emerging Markets	Smith & Nephew believes it can secure market leadership in the Emerging Markets, building upon its initial success in China and expanding to create sustainable businesses in India, Brazil and Russia. In particular, the Group sees significant opportunities to build value through augmenting its existing portfolio with new products specifically designed for and manufactured in these markets.
Innovate for value	The Group s future success depends upon continuing to offer new technologies to customers around the world. Smith & Nephew is accelerating its rate of innovation by increasing the research & development budget and identifying and investing in the projects that will deliver maximum value.

Simplify and improve our operating model

Smith & Nephew will work to ensure the business structure and processes support our innovation agenda and the Group seeks to maximise efficiency in everything it does. There are opportunities to streamline the Group s operations and manufacturing processes and to remove duplication. Smith & Nephew is building strong global functions human capital, regulatory, quality, sustainability and legal affairs to support its management teams in their quest to better serve the Group s markets and customers.

Supplement organic growth through acquisitions

The Group aims to augment its organic growth through acquisitions. Smith & Nephew will continue with its successful strategy of acquiring complementary technologies, seek to support our Emerging Markets ambitions by acquiring local manufacturing and distribution businesses and remain alert to larger opportunities to support expansion in the advanced woundcare, extremities or minimally invasive surgery sectors.

Table of Contents

What we will measure (KPIs)	Why we will measure
Total Shareholder Return	Monitor the value created for shareholders over the longer term
Growth in statutory and adjusted earnings per share	Demonstrate the improvement in underlying earnings per share for our shareholders
Trading cash flow	Measure the long-term cash generation of the Group excluding the impact of specific transactions or events that management considers affect the Group s short-term performance
Growth in the Established Markets versus the market	Track the relative strength of our market positions
Emerging Markets % of Group revenue	Track underlying growth of Emerging Markets to global growth
Growth of individual Emerging Markets versus the market	Monitor progress in key market segments
% of Group revenue from products launched in the last 36 months	Monitor impact from innovation

R&D expense as % of Group revenue	Monitor underlying investment in R&D
Trading profit growth	Track our underlying trading profit growth
Trading profit margin	Monitor underlying trading profitability
Waste/Recycling normalised metric	Reduce amount of waste for the Group, our customers, and the environment
Energy use normalised metric	Total energy consumption (volumetrically)
Return on cash invested	Monitor value created for shareholders

Table of Contents

Risk management

Smith & Nephew is focused on managing the principal risks facing the Group.

As an integral part of planning and review, Group management and management of each of the business segments seek to identify the risks involved in the business, the probability of those risks materialising, the impact if they do materialise and the actions being taken, and to be taken, to manage and mitigate those risks. Internal audit reviews and reports on the effectiveness of the operation of the risk management process. The Group Risk Committee meets twice a year to review the major risks identified by the business segment and Group

management and any mitigating actions being taken. As appropriate, the Risk Committee may re-categorise risks or require further information or mitigating action to be undertaken. The Risk Committee reports to the Board on an annual basis detailing all principal risks categorised by potential financial impact on profit and share price. In addition, the risks considered to be most significant to the Group are reported to the Board on a regular basis. These reports include details of new, key or significantly increased risks, the senior

Risk	Context	Specific risks we face
Disruptive technologies	The medical devices industry has a rapid rate of new product introduction. The Group must be adept at monitoring the landscape for technological advances, make good investment/acquisition choices, have an efficient and valuable product development pipeline and secure protection for its intellectual property.	Competitors may introduce a disruptive technology, or obtain patents or other intellectual property rights, that affect the Group s competitive position Lack of innovation due to low R&D investment, R&D skills gap or poor product development execution Failure to successfully commercialise a pipeline product, failure to receive regulatory approval, or changes in consumer demand
Government action, pricing and reimbursement	In most markets throughout the world, expenditure on medical devices is controlled to a large extent by governments, many of which are facing increasingly intense budgetary constraints. Funds may be made available or withdrawn from healthcare budgets depending	Reduced reimbursement levels and increasing pricing pressures

pressure	on government policy budgetary and other considerations. The Group is therefore largely dependent on governments providing increased funds commensurate with the increased demand arising from demographic trends. 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.	Reduced demand for elective surgery Increased focus on health economics Changes in medical device tax policy Competitors with higher market share and lower costs
Supply, system and site disruption	Unexpected events could disrupt the business by affecting either a key facility or system or a large number of employees. The business is also reliant on certain key suppliers of raw materials, components, finished products and packaging materials.	Catastrophe could render one of the Group s production facilities out of action A significant event could impact key leadership or a large number of employees Issues with a single source supplier of a key component and failure to secure critical supply A severe IT fault could disable critical systems
Product regulation, compliance and litigation	The medical device industry is highly regulated. 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. Such controls have become increasingly stringent and costly to comply with and the Group believe this trend will continue. They also review data supporting the safety and efficacy of such products and regulatory requirements may entail inspections for compliance with appropriate standards, including those relating to Quality Management Systems (QMS) or Good Manufacturing Practice (GMP) regulations.	Non-compliance with regulatory policies and standards could result in fines, penalties, and prosecutions. Product recalls, lost sales and inventory write-offs Third party liability claims Damage to reputation
Compliance with laws and regulations	Business practices in the healthcare industry are subject to increasing regulation and review by various government authorities. In general, the trend in many countries is towards higher expectations and increased enforcement activity by governmental authorities. The Group is also subject to increased regulation of personal information. Expansion into emerging	Violation of healthcare, data privacy or anti-corruption laws could result in fines, loss of reimbursement and impact reputation.

markets could also pose additional compliance risks.

Serious breaches could potentially prevent the Group from doing business.

Table of Contents

management who have primary responsibility for managing each of these risks along with selected actions they have put in place to mitigate such risks. In addition, the Board considers risk as part of the development of strategy.

There are known and unknown risks and uncertainties relating to Smith & Nephew s business. The table below provides an overview of what the Board considers to be the most significant risks that could cause the Group s business, financial position

and results of operations to differ materially and adversely from expected and historical levels, and how these risks relate to the Group s strategic priorities. A more detailed discussion of the Group s risks and uncertainties can be found in the Risk factors section on pages 16 to 18. In addition, other factors not listed here, that Smith & Nephew cannot presently identify or does not believe to be equally significant, could also materially adversely affect Smith & Nephew s business, financial position or results of operations.

	Possible impacts include	Mitigation	Link to strategic priority
	Loss of market share, profit and long-term growth	R&D Model: increasing productivity, prioritisation and allocation of funds Increasing R&D investment in order to enhance clinical capability, invest in biomaterials, stregthen intellectual property rights and support an Emerging Market portfolio Business development to augment the portfolio Speed to market of new products	**Innovate for value** **Simplify and improve our operating model** **Supplement the organic growth through acquisitions**

Loss of revenue, profit and cash flows	Enhanced expertise supporting reimbursement strategy and guidance Develop innovative economic product and service solutions for both Established and Emerging Markets Incorporate health economic component into design and development of new products Optimise cost to serve to protect margins and liberate funds for investment Streamline cost of goods sold and inventory	**Simplify and improve our operating model** **Established Markets**
Loss of revenue, profit and cash flows	Ensure crisis response/business continuity plans at all major facilities and for key products Audit programme for critical suppliers and second sources for critical components Regular review of supply contracts with supplier consolidation and vertical integration where beneficial IT disaster and data recovery plans are in place and support overall business continuity plans	**Simplify and improve our operating model** **Established Markets**
Loss of revenue, reduction	Enhanced leadership and resources	**Simplify and improve our operating model**

in share price and negative impact on brand/reputation	Standardise the Group s management review practice Maintain internal auditing programmes to assure compliance Group-wide robust validation practices to drive true production line performance and dependability Group-wide objectives for quality, operational and process yield improvements	**Innovate for value**
Loss of profit and reduction in share price	Board and Executive oversight committees supported by Compliance experts and infrastructure Code of Conduct/Global Policies and Procedures (GPPs) providing controls for significant compliance risks Training and e-resources to guide employees and third parties with compliance responsibilities Monitoring and auditing programmes to verify implementation and compliance Independent reporting channels for employees and third parties to report concerns with confidentiality	**Simplify and improve our operating model** **Emerging Markets** **Established Markets**

Table of Contents

Our business, marketplace and other factors that could affect us

We look at our business in relation to issues in the wider marketplace in which we operate.

Sales and marketing

Smith & Nephew s customers are the providers of medical and surgical services worldwide. In certain parts of the world, including the UK, much of Continental Europe, Canada and Japan, these are largely government organisations funded by tax revenues. In the US, the Group s major customers are public and private hospitals, which receive revenue from private health insurance and government reimbursement programmes. Medicare is the major source of reimbursement in the US, for knee and hip reconstruction procedures and for wound healing treatment regimes.

Competition exists among healthcare providers to gain patients on the basis of quality, service and price. Providers are under pressure to reduce the total cost of healthcare delivery. There has been some consolidation in the Group s customer base, as well as amongst the Group s competitors, and these trends are expected to continue in the long term. Smith & Nephew competes against both local and multinational corporations, including some with greater financial, marketing and other resources.

The Group s business reflects a wide range of distribution channels, purchasing agents and buying entities in over 90 countries worldwide. The largest single customers worldwide are purchasing groups in the US and the UK that represented 6% and 5% respectively of the Group s worldwide revenue in 2011.

In the US, the Group s products are marketed directly to healthcare providers, hospitals and other healthcare facilities with each business segment operating dedicated sales forces. The US sales forces consist of a mixture of independent contract workers and employees. Sales agents are contractually prohibited from selling products that compete with Smith & Nephew products. Orthopaedics and Endoscopy products are principally shipped and invoiced to healthcare providers, hospitals and other healthcare facilities. Certain Advanced Wound Management products are shipped and invoiced to wholesale distributors, others are consigned to distributors that lease the devices to healthcare providers, hospitals and other healthcare facilities and end-users. In most other Established Markets, each business segment typically manages employee sales forces directly, and also ships and invoices products both directly to healthcare providers, hospitals and other healthcare facilities and to wholesale distributors.

In Emerging Markets and International Markets the Group operates through direct selling and marketing operations, and through distributors. In these markets, Orthopaedics and Endoscopy frequently share sales resources. The Advanced Wound Management sales force may be separate where it calls on different customers.

Sales trends

Smith & Nephew s business segments participate in the global medical devices market and share a common focus on the repair of the human body. Smith & Nephew s principal geographic markets are in the established healthcare economies of the US, Europe, Japan, Canada, Australia and New Zealand.

These markets are characterised by increased longevity, more active lifestyles, obesity, increased affluence and an increase in the average age of the population caused by the immediate post-World War II baby boomer generation approaching retirement. Together these factors have created significant demand for more effective healthcare products which deliver improved outcomes through technology advances. Furthermore, pressure to resist increases in overall healthcare spending has led healthcare providers to demand products which minimise the length of hospital stays and use of surgeon and nursing resources.

Increasing patient awareness of available healthcare treatments through the internet and direct-to-customer advertising has led to some increased patient influence over product purchasing decisions.

For a description of the impact on each business segment refer to the Market and competition sections under Business segment reviews on pages 30 to 40.

Manufacturing, supply & distribution

The Group has a central Global Operations function which continues to implement Lean Manufacturing throughout the factories and the supply chain which is designed to improve and sustain higher levels of productivity, quality, service and efficiency.

Core competencies include: materials technology; high precision machining in Orthopaedics and Endoscopy; and high-volume, automated manufacturing in Advanced Wound Management.

Each business segment purchases raw materials, components, finished products and packaging materials from certain key suppliers. These principally include metal forgings and stampings for Orthopaedics, optical and electronic sub-components and finished goods for Endoscopy, active ingredients and finished goods for Advanced Wound Management and packaging materials across all businesses. Suppliers are selected, and contracts negotiated, by a centralised Group procurement team wherever possible, with a view to ensure value for money based on the total spending across the Group.

The Group outsources manufacturing where necessary to obtain specialised expertise or where it is possible to gain lower cost without undue risk to intellectual property. Suppliers of outsourced products and services are selected based on their ability to deliver products and services to specification, and establish and maintain a quality system. Suppliers are trained and are monitored through on-site assessments and performance audits that include quality, service and delivery. Finished goods purchased for resale include screen displays, optical and electrical devices in the Endoscopy business and skincare products in the Advance Wound Management business.

The Group operates a number of central distribution facilities in the key geographical areas in which it operates. Orthopaedics and Endoscopy operate a facility in Baar, Switzerland which acts as the main holding and consolidation point for markets in Europe. Hubs serving the US are located in Memphis for Orthopaedics and Oklahoma City for Endoscopy. Products are shipped to Group companies who hold small amounts of inventory locally for immediate or urgent customer requirements. Advanced Wound Management distribution hubs include: Neunkirchen, Germany; Nottingham, UK; and Atlanta, US.

Research and development

Smith & Nephew manage a portfolio of short and long-term product development projects designed to meet the future needs of customers and continue to provide growth opportunities for the business. The Group s research and development is directed towards each business segment. Expenditure on research and development amounted to $167m in 2011 (2010 $151m, 2009 $155m), representing approximately 3.9% of Group revenue (2010 3.8%, 2009 4.1%).

The Group continues to invest in future technology opportunities for clinical needs identified from across the Smith & Nephew businesses.

Research and development is primarily carried out at the Group s principal locations, notably in Memphis, US (Orthopaedics), Mansfield, US (Endoscopy) and Hull, UK (Advanced Wound Management). There are a number of other smaller research and developments units situated at other locations around the Group. In-house research is supplemented by work performed by academic institutions and other external research organisations in Europe, America and Asia.

Intellectual property

Smith & Nephew has a policy of protecting the results of research and development carried out by the Group. Patents have been obtained in a wide range of fields, including orthopaedic reconstruction and trauma, endoscopy and advanced wound management. Patent protection for Group products is sought routinely in the Group s principal markets. Currently, the Group s patent portfolio stands at approximately 4,000 patents in force and patent applications pending.

Smith & Nephew also has a policy of protecting the Group s products by registering trademarks under local laws of markets in which such products are sold. The Group vigorously protects its trademarks against infringement.

In addition to protecting its market position by filing and enforcing patents and trademarks, Smith & Nephew may oppose third party patents and trademark filings where appropriate in those areas that might conflict with the Group s business interests.

In the ordinary course of its business, the Group enters into a number of licensing arrangements with respect to its products. None of these arrangements individually is considered material to the current operations and the financial results of the Group.

Exchange and interest rate

risk and financial instruments

The Board of Directors of the Company has established a set of policies to manage funding, currency and interest rate risks. Derivative financial instruments are used only to manage the financial risks associated with underlying business activities and their financing. See Note 16 of the Notes to the Group accounts for further details of these risks.

The Group s financial instruments are subject to changes in fair values as a result of changes in market rates of exchange and forward interest rates. Financial instruments entered to hedge sales and purchase transactions in foreign currency and interest rate exposures are accounted for as hedges. Changes in fair values of effective financial instruments would not affect the Group s income statement immediately. The movements in the fair value of financial instruments that are not accounted for as hedges offset movements in the values of assets and liabilities and are recognised through the income statement.

Table of Contents

Business Review

Our business, marketplace and other factors that could affect us continued

Risk factors

There are known and unknown risks and uncertainties relating to Smith & Nephew s business. The factors listed below could cause the Group s business, financial position and results of operations to differ materially and adversely from expected and historical levels. In addition, other factors not listed here that Smith & Nephew cannot presently identify or does not believe to be equally significant could also materially adversely affect Smith & Nephew s business, financial position or results of operations.

Highly competitive markets

The Group s business segments compete across a diverse range of geographic and product markets. Each market in which the business segments operate 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 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 sales 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. Increased competition and unanticipated actions by competitors or customers could lead to downward pressure on prices and/or a decline in market share in any of the Group s 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, each of the Group s business segments 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. 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 s business segments operate. 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 established 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 established 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 on-going 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 changes in reimbursement policy, tax policy and pricing which may have an adverse impact on sales and operating profit. In particular, changes to the healthcare legislation in the US are due to impose significant taxes on medical device manufacturers from 2013. There may be an increased risk of adverse changes to government funding policies arising from the deterioration in macro-economic conditions in some of 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.

Table of Contents

During 2011, economic conditions worldwide continued to create several challenges for the Group, including deferrals of joint replacement procedures, heightened pricing pressure, significant declines in capital equipment expenditures at hospitals and increased uncertainty over the collectability of European government debt, particularly those in certain parts of southern Europe. These factors tempered the overall growth of the Group s global markets and could have an increased impact on growth in the future.

Political uncertainties

The Group operates on a worldwide basis and has distribution channels, purchasing agents and buying entities in over 90 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 import quotas, taxation or other matters could adversely affect the Group s turnover and operating profit. War, terrorist activities or other conflict could also adversely impact the Group.

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 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. If the US Dollar, Sterling or Swiss Franc should strengthen against the Euro, Australian Dollar and the Japanese Yen, the Group s trading margin could be adversely affected.

The Group manages the impact of exchange rate movements on sales and cost of goods sold by a policy of transacting forward foreign currency commitments when firm purchase orders are placed. In addition, the Group s policy is for forecast transactions to be covered between 50% and 90% for up to one year.

The Group uses the US Dollar as its reporting currency and the US Dollar is the functional currency of Smith & Nephew plc. The Group s revenues, profits and earnings are also affected by exchange rate movements on the translation of results of operations in foreign subsidiaries for financial reporting purposes. See Financial position, liquidity and capital resources on page 25.

Manufacturing and supply

The Group s manufacturing production is concentrated at 11 main facilities in Memphis, Mansfield and Oklahoma City in the US, Hull, Warwick and Gilberdyke in the UK, Aarau in Switzerland, Tüttlingen in Germany, Alberta in Canada and Suzhou and Beijing 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. There is a risk that failures in operational execution could lead to excess inventory or individual product shortages.

Each of the business segments is reliant on certain key suppliers of raw materials, components, finished products and packaging materials. These suppliers must provide the materials and perform the activities to the Group s standard of quality requirements. If any of these suppliers is unable to meet the Group s needs, compromises on standards of quality or substantially increases its prices, Smith & Nephew would need to seek alternative suppliers. There can be no assurance that alternative suppliers would provide the necessary raw materials on favourable or cost-effective terms at the desired quality. Consequently, the Group may be forced to pay higher prices to obtain raw materials, which it may not be able to pass on to its customers in the form of increased prices for its finished products. In addition, some of the raw materials used may become unavailable, and there can be no assurance that the Group will be able to obtain suitable and cost-effective substitutes. Any interruption of supply caused by these or other factors could negatively impact Smith & Nephew s revenue and operating profit.

The Group uses a variety of information systems to conduct its manufacturing, supply and selling operations. An unrecoverable fault in one of these systems could disrupt trading in certain markets and locations.

The Group is in the process of outsourcing to third parties or relocating to lower cost countries certain of its manufacturing and other processes. As a result of these transfers, there is a risk of disruption to supply.

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 sales 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

Our business, marketplace and other factors that could affect us continued

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.

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.

Regulatory 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. In the UK, a new Bribery Act was passed in 2010 and became effective in 2011, increasing the risk for companies that allow improper conduct on their behalf. 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. See Legal proceedings on page 28. 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.

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 and the State Food and Drug Administration in China. At any time, the Group is awaiting a number of regulatory approvals which, if not received, could adversely affect results of operations.

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. In the US, many of the Group s products are brought to market following pre-market notification to the FDA under Section 510(k) of the Food, Drug and Cosmetic Act, with a request that FDA clear the product as being substantially equivalent in terms of safety and effectiveness to a previously approved device. The FDA is considering changes in the 510(k) clearance process that might lengthen or modify the path to clearance in some circumstances.

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 and Group medical device regulation and 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.

Other risk factors

Smith & Nephew is subject to a number of other risks, which are common to most global medical technology groups and are reviewed as part of the Group s risk management process.

Table of Contents

Financial review

Adrian Hennah

Chief Financial Officer

Table of Contents

Financial review continued

Chief Financial Officer highlights

Group revenue was $4,270m for the year ended 31 December 2011, representing an 8% growth compared to 2010. This comprised of underlying revenue growth of 4% and favourable currency translation of 4%.

Profit before taxation was $848m in 2011, compared with $895m in 2010. Attributable profit in 2011 was $582m compared to $615m in 2010. Adjusted attributable profit (calculated as set out in Selected financial data on pages 145 to 146) rose 2% to $664m in 2011, from $654m in 2010.

Basic earnings per Ordinary Share were 65.3¢, compared to 69.3¢ for 2010. EPSA (as set out in Selected financial data) was 74.5¢ in 2011 compared to 73.6¢ for 2010, representing a 1% increase.

Financial highlights (i) (iii)	**2011 $ million**	2010 $ million	2009 $ million
Revenue	**4,270**	3,962	3,772
Underlying growth in revenue (%)	***4%***	*4%*	*2%*
Trading profit	***961***	*969*	*857*
Underlying growth in trading profit (%)	***(4)%***	*11%*	*15%*
Trading profit margin (%)	***22.5%***	*24.5%*	*22.7%*
Operating profit	**862**	920	723
Attributable profit for the year	**582**	615	472
Adjusted attributable profit	***664***	*654*	*580*
Basic earnings per Ordinary Share	**65.3¢**	69.3¢	53.4¢
EPSA	**74.5¢**	73.6¢	65.6¢
Growth in EPSA (%)	***1%***	*12%*	*18%*
Dividends per Ordinary Share (ii)	**17.40¢**	15.82¢	14.39¢
Cash generated from operations	**1,135**	1,111	1,030
Trading cash flow	***838***	*825*	*771*
Trading profit to cash conversion (%)	***87%***	*85%*	*90%*

(i) Items shown in italics are non-GAAP measures. Reconciliations to reported figures are on pages 21 to 22.

(ii) The Board has proposed a final dividend of 10.80 US cents per share which together with the first interim dividend of 6.60 US cents makes a total for 2011 of 17.40 US cents. The final dividend is expected to be paid, subject to shareholder approval, on 9 May 2012 to shareholders on the Register of Members at the close of business on 20 April 2012.

(iii) All items are $ million unless otherwise indicated.

Measuring performance

Revenue

Underlying growth in revenue is used to compare the revenue in a given year to the previous year on a like-for-like basis. This is achieved by adjusting for the impact of sales of products acquired in material business combinations and for movements in exchange rates. Underlying growth in revenue is not presented in the accounts prepared in accordance with International Financial Reporting Standards (IFRS) and is therefore a measure not in accordance with Generally Accepted Accounting Principles (a non-GAAP measure).

The Group believes that the tabular presentation and reconciliation of reported revenue growth to underlying revenue growth assists investors in their assessment of the Group s performance in each business segment and for the Group as a whole.

Underlying growth in revenue is considered by the Group to be an important measure of performance in terms of local functional currency since it excludes those items considered to be outside the influence of local management. The Group s management uses this non-GAAP measure in its internal financial reporting, budgeting and planning to assess performance on both a business segment and a consolidated Group basis. Revenue growth at constant currency is important in measuring business performance compared to competitors and compared to the growth of the market itself.

The Group considers that revenue from sales of products acquired in material business combinations results in a step-up in growth in revenue in the year of acquisition that cannot be wholly attributed to local management s efforts with respect to the business in the year of acquisition. Depending on the timing of the acquisition, there will usually be a further step change in the following year. A measure of growth excluding the effects of business combinations also allows senior management to evaluate the performance and relative impact of growth from the existing business and growth from acquisitions. The process of making business acquisitions is directed. approved and funded from the Group corporate centre in line with strategic objectives.

The material limitation of the underlying growth in revenue measure is that it excludes certain factors, described above, which ultimately have a significant impact on total revenues. The Group compensates for this limitation by taking into account relative movements in exchange rates in its investment. strategic planning and resource allocation. in addition, as the evaluation and assessment of business acquisitions is not within the control of local management. performance of acquisitions is monitored centrally until the business is integrated.

The Group s management considers that the non-GAAP measure of underlying growth in revenue and the GAAP measure of growth in revenue are complementary measures, neither of which management uses exclusively.

Underlying growth in revenue reconciles to growth in revenue reported, the most directly comparable financial measure calculated in accordance with IFRS by making two adjustments, the constant currency exchange effect and the acquisitions effect , described below.

The constant currency exchange effect is a measure of the increase/decrease in revenue resulting from currency movements on non-US Dollar sales. This is measured as the difference between the increase in revenue translated into US Dollars on a GAAP basis (i.e. current year revenue translated at the current year average rate, prior year revenue translated at the prior year average rate) and the increase measured by translating current and prior year revenue into US Dollars using the prior year closing rate.

The acquisitions effect is the measure of the impact on revenue from newly acquired business combinations. This is calculated by excluding the revenue from sales of products acquired as a result of a business combination consummated in the current year, with non-US Dollar sales translated at the prior year average rate. Additionally, prior year revenue is adjusted to include a full year of revenue from the sales of products acquired in those business combinations consummated in the previous year, calculated by adding back revenue from sales of products in the period prior to the Group s ownership. These sales are separately tracked in the Group s internal reporting systems and are readily identifiable.

Reported revenue growth, the most directly comparable financial measure calculated in accordance with IFRS, reconciles to underlying growth in revenue as follows:

	2011	2010	2009
	%	%	%
Reported revenue growth	8	5	(1)
Constant currency exchange effect	(4)	(1)	3
Underlying revenue growth	4	4	2

A reconciliation of reported revenue growth to underlying revenue growth, by business segment, can be found on pages 30 to 40.

Trading profit

Trading profit is a trend measure which presents the long-term profitability of the Group excluding the impact of specific transactions that management considers affects the Group s short-term profitability. The Group presents this measure to assist investors in their understanding of trends. The Group has identified the following items, where material, as those to be excluded from operating profit when arriving at trading profit: acquisition and disposal related items including amortisation of acquisition intangible assets and impairments; significant restructuring events; and gains and losses resulting from legal disputes and uninsured losses.

Growth in trading profit and trading profit margin (trading profit expressed as a percentage of revenue) are measures which present the growth trend in the long-term profitability of the Group excluding the impact of specific transactions or events that management considers affect the Group s short-term profitability. The Group presents these measures to assist investors in their understanding of the trends. The Group s international financial reporting (budgets, monthly reporting, forecasts, long-term planning and incentive plans) focusses primarily on profit and earnings before these items. Trading profit and trading profit margin are not recognised measures under IFRS and are therefore non-GAAP financial measures.

The material limitation of these measures is that they exclude significant income and costs that have a direct impact on current and prior years profit attributable to shareholders. They do not, therefore, measure the overall performance of the Group presented by the GAAP financial measure of operating profit. The Group considers that no single measure enables it to assess overall performance and therefore it compensates for the limitation of the trading profit measure by considering it in conjunction with its GAAP equivalent. The gains or losses which are identified separately arise from irregular events or transactions. Such events or transactions are authorised centrally and require a strategic assessment which includes consideration of financial returns and generation of shareholder value. Amortisation of acquisition intangibles will occur each year, whilst other excluded items arise irregularly depending on the events that give rise to such items.

Operating profit, the most directly comparable financial measure calculated in accordance with IFRS, reconciles to trading profit as follows:

	2011	2010	2009
	$ million	$ million	$ million
Operating profit	**862**	920	723
Acquisition related costs			26
Restructuring and rationalisation costs	**40**	15	42

Amortisation of acquisition intangibles and impairments	**36**	34	66
Legal provision (see page 29)	**23**		
Trading profit	**961**	**969**	**857**

A reconciliation of operating profit to trading profit, by business segment, can be found on pages 30 to 40.

Adjusted earnings per Ordinary Share

Growth in adjusted earnings per Ordinary Share (EPSA) is another measure which presents the trend in the long-term profitability of the Group. EPSA is not a recognised measure under IFRS and is therefore a non-GAAP financial measure. The most directly comparable financial measure calculated in accordance with IFRS is earnings per Ordinary Share.

EPSA excludes the same impact of specific transactions or events that management considers affect the Group s short-term profitability, is used by the Group for similar purposes, and is subject to the same material limitations, as set out and discussed in the above section on trading profit.

Adjusted attributable profit represents the numerator used in the EPSA calculation. Adjusted attributable profit is reconciled to attributable profit, the most directly comparable financial measure in accordance with IFRS, as follows:

	2011 $ million	2010 $ million	2009 $ million
Attributable profit for the year	**582**	615	472
Acquisition related costs			26
Restructuring and rationalisation expenses	**40**	15	42
Amortisation of acquisition intangibles and impairments	**36**	34	66
Legal provision (see page 29)	**23**		
Taxation on excluded items	**(17)**	(10)	(26)
Adjusted attributable profit	**664**	654	580
Earnings per Ordinary share			
Basic	**65.3¢**	69.3¢	53.4¢
Diluted	**65.0¢**	69.2¢	53.3¢
Adjusted: Basic	**74.5¢**	73.6¢	65.6¢
Adjusted: Diluted	**74.2¢**	73.6¢	65.5¢

Financial review continued

Trading cash flow and trading profit to cash conversion ratio

Growth in trading cash flow and improvement in the trading profit to cash conversion ratio are measures which present the trend growth in the long-term cash generation of the Group excluding the impact of specific transactions or events that management considers affect the Group s short-term performance.

Trading cash flow is defined as cash generated from operations less net capital expenditure but before acquisition related cash flows, restructuring and rationalisation cash flows and cash flows arising from legal disputes and uninsured losses. Trading profit to cash conversion ratio is trading cash flow expressed as a percentage of trading profit. The nature and material limitations of these adjusted items are discussed above.

The Group presents those measures to assist investors in their understanding of trends. The Group s internal financial reporting (budgets, monthly reporting, forecasts, long-term planning and incentive plans) focuses on cash generation before these items. Trading cash flow and trading profit to cash conversion ratio are not recognised measures under IFRS and are therefore considered non-GAAP financial measures.

The material limitation of this measure is that it could exclude significant cash flows that have had a direct impact on the current and prior years financial performance of the Group. It does not, therefore, measure the financial performance of the Group presented by the GAAP measure of cash generated from operations. The Group considers that no single measure enables it to assess financial performance and therefore it compensates for the limitation of the trading cash flow measure by considering it in conjunction with the GAAP equivalents. Cash flows excluded relate to irregular events or transactions including acquisition related costs, restructuring and rationalisation costs and cash flows arising from legal disputes and uninsured losses.

Trading cash flow reconciles to cash generated from operations, the most directly comparable financial measure calculated in accordance with IFRS, as follows:

	2011 $ million	2010 $ million	2009 $ million
Cash generated from operations	**1,135**	1,111	1,030
Less: Capital expenditure	**(321)**	(315)	(318)
Add: Cash received on disposal of fixed assets		8	
Add: Acquisition related expenditure	**1**		22
Add: Restructuring and rationalisation related expenditure	**20**	16	32
Add: Macrotexture expenditure	**3**	5	5
Trading cash flow	**838**	825	771
Trading Profit	**961**	969	857
Trading profit to cash conversion ratio	**87%**	85%	90%

Recent developments

On 4 January 2012, the Group announced it had entered into an agreement with Essex Woodlands for the disposal of the Group s Clinical Therapies business. After disposal, the Group will retain a 49% investment in the newly formed company, Bioventus LLC, which will be reported as an associate. At 31 December 2011, the assets and liabilities of the Clinical Therapies business, $125m and $19m respectively, are disclosed as held for sale. In 2011, the Clinical Therapies business contributed $237m to revenue and $48m to trading profit. The Group expects to recognise a profit before tax in excess of $250m on the transaction on completion.

2011 Financial highlights

The following table sets out certain income statement data for the periods indicated:

	2011	2010
	$ million	$ million
Revenue (i)	**4,270**	3,962
Cost of goods sold (ii)	**(1,140)**	(1,031)
Gross profit	**3,130**	2.931
Marketing, selling and distribution expenses (iii)	**(1,526)**	(1,414)
Administrative expenses (iv, v, vi)	**(575)**	(446)
Research and development expenses	**(167)**	(151)
Operating profit (i)	**862**	920
Net interest payable	**(8)**	(15)
Other finance costs	**(6)**	(10)
Profit before taxation	**848**	895
Taxation	**(266)**	(280)
Attributable profit for the year	**582**	615

(i) Group revenue and operating profit are derived wholly from continuing operations and discussed on a segment basis on pages 30 to 40.

(ii) In 2011, $7m of restructuring and rationalisation expenses were charged to cost of goods sold (2010 $nil).

(iii) In 2011, no restructuring and rationalisation expenses were charged to marketing, selling and distribution expenses (2010 $3m).

(iv) 2011 includes $42m of amortisation of other intangible assets (2010 $34m).

(v) 2011 includes $23m relating to legal provision (2010 $nil).

(vi) 2011 includes $33m of restructuring and rationalisation expenses and $36m relating to amortisation of acquisition intangibles (2010 $12m of restructuring and rationalisation expenses and $34m relating to amortisation of acquisition intangibles).

Revenue

Group revenue increased by $308m (8%) from $3,962m in 2010 to $4,270m in 2011. Underlying revenue growth was 4% and 4% growth was attributable to favourable currency translation.

Orthopaedics revenues increased by $117m (5%), of which 2% was attributable to underlying growth, and 3% due to favourable currency translation. Endoscopy revenues increased by $84m (10%), of which 6% was attributable to underlying growth, and 4% due to favourable currency translation. Advanced Wound Management revenues increased by $107m (12%), of which 7% was attributable to underlying growth and 5% due to favourable currency translation.

A more detailed analysis is included within the Revenue sections of the individual business segments that follow on pages 30 and 40.

Cost of goods sold

Cost of goods sold increased by $109m to $1,140m from $1,031m in 2010 which represents an 11% increase. Of this movement, 4% is due to adverse translation movements leaving an underlying movement of 7% compared to an increase in underlying revenue of 4%. The residual movement is largely attributable to continued pricing pressure across all of the Group s markets which Smith & Nephew was not able to pass on to suppliers and an adverse movement in the mix of products sold, towards lower gross margin product.

Further margin analysis is included within the Trading profit sections of the individual business segments that follow on pages 30 to 40.

Marketing, selling and distribution expenses

Marketing, selling and distribution expenses increased by $112m (8%) to $1,526m from $1,414m in 2010. After adjusting for an unfavourable currency movement of 3% the underlying movement of 5% is broadly in line with increased Group revenues.

Administrative expenses

Administrative expenses increased by $129m (29%) to $575m from $446m in 2010. Unfavourable currency movements contributed towards 5% of this increase. The factors contributing to the underlying movement of 24% were; the non-recurrence of the one-off benefit of $25m arising from the BlueSky settlement in 2010, a charge of $23m relating to legal provision, an increase of $21m in restructuring and rationalisation expenses, an increase of $12m in the bad debt expense and an $8m increase in the amortisation charge on intangible assets. Other factors contributing to this increase included the additional investment in China and Emerging Markets during the year.

Research and development expenses

Expenditure as a percentage of revenue increased by 0.1% to 3.9% in 2011 (2010 3.8%). Actual expenditure was $167m in 2011 compared to $151m in 2010. The Group continues to invest in innovative technologies and products to differentiate it from competitors.

Operating profit

Operating profit decreased by $58m to $862m from $920m in 2010 comprising a decrease of $88m in Orthopaedics, offset by increases of $18m in Endoscopy and $12m in Advanced Wound Management.

Net interest payable

Net interest payable reduced by $7m from $15m in 2010 to $8m in 2011. This is a consequence of the overall reduction of borrowings within the Group and a reduction in the applicable interest rates.

Other finance cost

Other finance costs in 2011 were $6m compared to $10m in 2010. This decrease is attributable to an increase in the expected return on pension plan assets.

Taxation

The taxation charge decreased by $14m to $266m from $280m in 2010. The effective rate of tax was 31.4%, compared with 31.3% in 2010.

The tax charge was reduced by $17m in 2011 (2010 $10m) as a consequence of restructuring and rationalisation expenses, amortisation of acquisition intangibles and legal provision. The effective tax rate was 29.9% (2010 30.8%) after adjusting for these items and the tax thereon.

Group balance sheet

The following table sets out certain balance sheet data as at 31 December of the years indicated:

	2011 **$ million**	2010 $ million
Non-current assets	**2,542**	2,579
Current assets	**2,080**	2,154
Assets held for sale	**125**	
Total assets	**4,747**	4,733
Non-current liabilities	**422**	1,046
Current liabilities	**1,119**	914
Liabilities directly associated with assets held for sale	**19**	
Total liabilities	**1,560**	1,960
Total equity	**3,187**	2,773
Total equity and liabilities	**4,747**	4,733

Non-current assets

Non-current assets decreased by $37m to $2,542m in 2011 from $2,579m in 2010. This is attributable to the following:

Goodwill decreased by $5m from $1,101m in 2010 to $1,096m in 2011. Goodwill totalling $37m was transferred to assets held for sale. Following the acquisition of Tenet Medical Engineering during 2011, an amount of $44m was capitalised as goodwill. The balance relates to unfavourable currency movements totalling $12m.

Intangible assets decreased by $3m from $426m in 2010 to $423m in 2011. Intangible assets totalling $14m were transferred to assets held for sale. Amortisation of $78m was charged during the year and assets with a net book value of $2m were written-off. A total of $92m relates to the addition of intellectual property and software. The balance relates to unfavourable currency movements totalling $1m.

Property, plant and equipment decreased by $4m from $787m in 2010 to $783m in 2011. Property, plant and equipment totalling $3m were transferred to assets held for sale. Depreciation of $217m was charged during 2011 and assets with a net book value of $7m were written-off. These movements were largely offset by $229m of additions relating primarily to instruments and other plant & machinery. The balance relates to unfavourable currency movements totalling $6m.

Trade and other receivables decreased by $22m to $nil in 2011 from $22m in 2010 due to non-current receivables switching to current receivables during the year.

Deferred tax assets and other non-current assets decreased by $3m in the year.

Table of Contents

Financial review continued

Current assets

Current assets decreased by $74m to $2,080m from $2,154m in 2010. The movement relates to the following:

- Inventories fell by $64m to $859m in 2011 from $923m in 2010. Inventories totalling $15m were transferred to assets held for sale. Of the remaining movement, $10m related to unfavourable currency movements.

- The level of trade and other receivables increased by $13m to $1,037m in 2011 from $1,024m in 2010. Trade and other receivables totalling $49m were transferred to assets held for sale. Of the movement in the year, $18m related to unfavourable currency movements.

- Cash and bank has fallen by $23m to $184m from $207m in 2010. Of the movement, $2m related to unfavourable currency movements.

Assets held for sale

Assets held for sale totalling $125m relate to the underlying assets of Clinical Therapies business, the proposed sale of which was announced on 4 January 2012.

Non-current liabilities

Non-current liabilities decreased by $624m from $1,046m in 2010 to $422m in 2011. This movement relates to the following items:

- Long-term borrowings have fallen from $642m in 2010 to $16m in 2011. This decrease of $626m is mainly attributable to the long-term loan repayable in May 2012 switching to a current liability.

- The net retirement benefit obligation increased by $25m to $287m in 2011 from $262m in 2010. This was largely due to actuarial losses of $70m which were only partly offset by pension contributions.

- Deferred acquisition consideration was $8m at the end of 2011, an increase of $8m from $nil at the end of 2010 as a result of the acquisition of Tenet Medical Engineering during the year.

- Provisions decreased from $73m in 2010 to $45m in 2011 which is largely due to a number of settlements during the year.

Deferred tax liabilities decreased by $3m in the year.

Current liabilities

Current liabilities increased by $205m from $914m in 2010 to $1,119m in 2011. This movement is attributable to:

Bank overdrafts and current borrowings have increased by $249m from $57m in 2010 to $306m in 2011 mainly as a result of the long-term loan repayable in May 2012 switching to a current liability.

Trade and other payables have decreased by $53m to $564m in 2011 from $617m in 2010. Trade and other payables totalling $19m were transferred to liabilities directly associated with assets held for sale. An amount of $8m is attributable to favourable currency movements.

Provisions have increased by $41m from $37m in 2010 to $78m in 2011. The most significant item contributing to this increase is the $23m legal provision (see Note 3).

Current tax payable is $171m at the end of 2011 compared to $203m in 2010. Of the $32m reduction, $1m is attributable to favourable currency movements.

Liabilities directly associated with assets held for sale

Liabilities held for sale totalling $19m relate to the underlying liabilities of the Clinical Therapies business, the proposed sale of which was announced on 4 January 2012.

Total equity

Total equity increased by $414m from $2,773m in 2010 to $3,187m in 2011. The principal movements were:

	Total equity $ million
1 January 2011	2,773
Attributable profit	582
Currency translation losses	(36)
Hedging reserves	14
Actuarial loss on retirement benefit obligations	(70)
Dividends paid during the year	(146)
Taxation benefits on Other Comprehensive Income and equity items	22
Net share based transactions	48
31 December 2011	3,187

Transactional and translational exchange

The Group s principal markets outside the US are, in order of significance, Continental Europe, UK, Australia and Japan. Revenues in these markets fluctuate when translated into US Dollars on consolidation. During the year, the average rates of exchange against the US Dollar used to translate revenues and profits arising in these markets changed compared to the previous year as follows: the Euro strengthened from $1.32 to $1.39 (5%), Sterling strengthened from $1.54 to $1.60 (4%), the Swiss Franc strengthened from $0.96 to $1.13 (18%), the Australian Dollar strengthened from $0.92 to $1.03 (12%) and the Japanese Yen strengthened from ¥88 to ¥80 (9%).

The Group s principal manufacturing locations are in the US (Orthopaedics and Endoscopy), Switzerland (Orthopaedics), UK (Advanced Wound Management and Orthopaedics) and China (Orthopaedics and Advanced Wound Management). The majority of the Group s selling and distribution subsidiaries around the world purchase finished products from these locations. As a result of currency movements compared with the previous year, sales from the US became relatively less profitable to all of these countries. The Group s policy of purchasing forward a proportion of its currency requirements and the existence of an inventory pipeline reduce the short-term impact of currency movements.

Financial position, liquidity and capital resources

Cash flow and net debt

The main elements of Group cash flow and movements in net debt can be summarised as follows:

	2011 $ million	2010 $ million	2009 $ million
Cash generated from operations	**1,135**	1,111	1,030
Net interest paid	**(8)**	(17)	(41)
Income taxes paid	**(285)**	(235)	(270)
Net cash inflow from operating activities	**842**	859	719
Capital expenditure (net of disposal of property, plant and equipment)	**(321)**	(307)	(318)
Acquisitions (net of cash acquired)	**(33)**		(25)
Plus Orthopedics settlement			137
Equity dividends paid	**(146)**	(132)	(120)
Proceeds from own shares	**7**	8	10
Issue of ordinary share capital	**17**	15	7
Treasury shares purchased	**(6)**	(5)	
Change in net debt from net cash flow (see Note 21 of the Notes to the Group accounts)	**360**	438	410
Exchange adjustment	**(6)**	13	(21)
Opening net debt	**(492)**	(943)	(1,332)
Closing net debt	**(138)**	(492)	(943)

The Group s net debt decreased from $1,332m at the beginning of 2009 to $138m at the end of 2011, representing an overall decrease of $1,194m. Translation of foreign currency net debt into US Dollars had the effect of increasing net debt by $14m in the three-year period ended 31 December 2011.

Net cash inflow from operating activities

Cash generated from operations in 2011 of $1,135m (2010 $1,111m, 2009 $1,030m) is after paying out $3m (2010 $5m, 2009 $5m) of macrotextured claim settlements unreimbursed by insurers, $1m (2010 $nil, 2009 $22m) of acquisition related costs and $20m (2010 $16m, 2009 $32m) of restructuring and rationalisation expenses.

Capital expenditure

The Group s on-going capital expenditure and working capital requirements were financed through cash flow generated by business operations and, where necessary, through short-term committed and uncommitted bank facilities. In recent years, capital expenditure on tangible and intangible fixed assets represented approximately 8% of continuing Group revenue.

In 2011, gross capital expenditure amounted to $321m (2010 $315m, 2009 $318m). The principal areas of investment were the placement of orthopaedic instruments with customers, patents and licences, plant and equipment and information technology.

At 31 December 2011, $9m (2010 $15m, 2009 $7m) of capital expenditure had been contracted but not provided for which will be funded from cash inflows.

Acquisitions and disposals

In the three-year period ended 31 December 2011, $58m was spent on acquisitions, funded from net debt and cash inflows. This comprised, $33m for Tenet Medical Engineering during 2011 and $25m for Nucryst in 2009. During 2009, the Group reached an agreement with the vendors of Plus Orthopedics Holdings AG to reduce the total original purchase price to CHF927m. This resulted in a cash inflow of $137m.

Liquidity

The Group s policy is to ensure that it has sufficient funding and facilities in place to meet foreseeable borrowing requirements. In December 2010, the Group reviewed and replaced its principal banking facilities ahead of the maturity in May 2012. The Group reduced its $1,000m 5 year term loan to $500m with effect from 20 December 2010. As at 31 December 2011 the balance outstanding was $245m. Smith & Nephew also cancelled its $1,500m multi-currency revolving loan facility and replaced it with a new 5 year $1,000m multi-currency revolving loan facility.

At 31 December 2011, the Group held $184m (2010 $207m, 2009 $192m) in cash and balances at bank. The Group has committed and uncommitted facilities of $1.3bn and $0.3bn respectively. The undrawn committed facilities totalling $1.0bn expires after two but within five years. Smith & Nephew intends to repay the amounts due within one year by using available cash and drawing down on the longer-term facilities. In addition, Smith & Nephew has finance lease commitments of $18m (of which $8m extends beyond five years).

The principal variations in the Group s borrowing requirements result from the timing of dividend payments, acquisitions and disposals of businesses, timing of capital expenditure and working capital fluctuations.

Smith & Nephew believes that its capital expenditure needs and its working capital funding for 2012, as well as its other known or expected commitments or liabilities, can be met from its existing resources and facilities.

The Group s planned future contributions are considered adequate to cover the current underfunded position in the Group s defined benefit plans.

Further disclosure regarding borrowings, related covenants and the liquidity risk exposures is set out in Note 15 of the Notes to the Group accounts. The Group believes that its borrowing facilities do not contain restrictions that would have significant impact on its funding or investment policy for the foreseeable future.

Table of Contents

Financial review continued

2010 Financial highlights

The following table sets out certain income statement data for the periods indicated:

	2010 $ million	2009 $ million
Revenue (i)	**3,962**	3,772
Cost of goods sold (ii)	**(1,031)**	(1,030)
Gross profit	**2.931**	2,742
Marketing, selling and distribution expenses (iii)	**(1,414)**	(1,351)
Administrative expenses (iv)	**(446)**	(513)
Research and development expenses	**(151)**	(155)
Operating profit (i)	**920**	723
Net interest payable	**(15)**	(40)
Other finance costs	**(10)**	(15)
Share of results of associates		2
Profit before taxation	**895**	670
Taxation	**(280)**	(198)
Attributable profit for the year	**615**	472

(i) Group revenue and operating profit are derived wholly from continuing operations and discussed on a segment basis on pages 30 to 40.

(ii) In 2010 no restructuring and rationalisation expenses and no acquisition related costs were charged to cost of goods sold (2009 $15m of restructuring and rationalisation expenses and $12m of acquisition related costs).

(iii) 2010 includes $3m of restructuring and rationalisation expenses. No acquisition related costs were charged to marketing, selling and distribution expenses in 2010. (2009 $7m of acquisition related costs and $10m of restructuring and rationalisation expenses).

(iv) 2010 includes $12m of restructuring and rationalisation expenses and $34m relating to amortisation of acquisition intangibles and impairments (2009 $7m of acquisition related costs, $17m of restructuring and rationalisation expenses and $66m relating to amortisation of acquisition intangibles and impairments).

Revenue

Group revenue increased by $190m (5%) from $3,772m in 2009 to $3,962m in 2010. Underlying revenue growth was 4%, and a further 1% growth was attributable to favourable currency translation.

Orthopaedics revenues increased by $60m (3%), of which 2% was attributable to underlying growth, and 1% due to favourable currency translation. Endoscopy revenues increased by $64m (8%), of which 7% was attributable to underlying growth, and 1% due to favourable currency translation. Advanced Wound Management revenues increased by $66m (8%), of which 7% was attributable to underlying growth and 1% due to favourable currency translation.

A more detailed analysis is included within the Revenue sections of the individual business segments that follow on pages 30 and 40.

Cost of goods sold

Cost of goods sold increased by $1m to $1,031m from $1,030m in 2009. This represents 26% of revenue compared to 27% in 2009. During 2010, the Group has continued to deliver on its efficiency commitments, including the new Advanced Wound Management manufacturing facility in China and improved inventory management in Orthopaedics. Other factors contributing to the movement were the decrease of $15m in restructuring and rationalisation expenses and decrease of $12m in other acquisition related costs. Currency had little impact on the year on year movement.

Further margin analysis is included within the Trading profit sections of the individual business segments that follow on pages 30 to 40.

Marketing, selling and distribution expenses

These expenses increased by $63m (5%) to $1,414m from $1,351m in 2009. In line with increased revenue there has been a 4% underlying increase in advertising, marketing and selling costs. Unfavourable currency movements have contributed to the remaining 1% movement.

Administrative expenses

Administrative expenses decreased by $67m (-13%) to $446m from $513m in 2009. The principal factors contributing to the underlying movement of -14% were a $32m reduction in the amortisation and impairment charge of intangible assets, a $7m reduction in acquisition related costs and a decrease of $5m in restructuring and rationalisation expenses. This was partially offset by a 1% unfavourable movement in currency.

Research and development expenses

Expenditure as a percentage of revenue decreased by 0.3% to 3.8% in 2010 (2009 4.1%). The Group continues to invest in innovative technologies and products to differentiate itself from competitors.

Operating profit

Operating profit increased by $197m to $920m from $723m in 2009 comprising increases of $93m in Orthopaedics, $28m in Endoscopy and $76m in Advanced Wound Management.

Net interest payable

Net interest payable reduced by $25m from $40m in 2009 to $15m in 2010. This is a consequence of the overall reduction of borrowings within the Group and a reduction in the applicable interest rates.

Other finance cost

Other finance costs in 2010 were $10m compared to $15m in 2009. This decrease is attributable to an increase in the expected return on pension plan assets.

Taxation

The taxation charge increased by $82m to $280m from $198m in 2009. The effective rate of tax was 31.3%, compared with 29.6% in 2009.

The tax charge was reduced by $10m in 2010 (2009 $26m) as a consequence of restructuring and rationalisation expenses, acquisition related costs, amortisation of acquisition intangibles and impairments. The effective tax rate was 30.8% (2009 27.9%) after adjusting for these items and the tax thereon.

Group balance sheet

The following table sets out certain balance sheet data as at 31 December of the years indicated:

	2010	2009
	$ million	$ million
Non-current assets	**2,579**	2,480
Current assets	**2,154**	2,071
Assets held for sale		14
Total assets	**4,733**	4,565
Non-current liabilities	**1,046**	1,523
Current liabilities	**914**	863
Total liabilities	**1,960**	2,386
Total equity	**2,773**	2,179
Total equity and liabilities	**4,733**	4,565

Non-current assets

Non-current assets increased by $99m to $2,579m from $2,480 in 2009. Intangible assets and goodwill increased by $22m of which $65m related to additions of intangibles, $28m related to favourable currency translation and $2m of transfers. These were partially offset by $68m of amortisation and a $4m adjustment to contingent consideration. Property, plant and equipment increased by $34m comprising $250m of additions and $3m of favourable currency translation, partially offset by $203m of depreciation charge, $14m of disposals and $2m of transfers. Deferred tax assets and other non-current assets increased by $43m in the year.

Current assets

Current assets increased by $83m to $2,154m from $2,071m in 2009. This was due to an increase in trade and other receivables of $78m and an increase in cash at bank of $15m. These increases were partially offset by a reduction in inventories of $10m.

Non-current liabilities

Non-current liabilities decreased by $477m from $1,523m in 2009 to $1,046m in 2010. $448m of this decrease was due to the reduction of long-term borrowings. The net retirement benefit obligation decreased by $60m. This was largely due to the excess of pension contributions totalling $65m over the charge to the income statement in the year of $35m which gave rise to a net $30m reduction in the liability. In addition, there were actuarial gains totalling $26m. Other movements in non-current liabilities related to a reduction in deferred acquisition consideration of $27m due to settlement of the BlueSky Medical Group Inc. (BlueSky) deferred consideration, an increase of $38m in the deferred tax liability and an increase in provisions of $20m due to a change in the expected time frame to settlement which has resulted in a reclassification from current liabilities.

Current liabilities

Current liabilities increased by $51m from $863m in 2009 to $914m in 2010. This was due to an increase in bank overdrafts and current borrowings of $12m, an increase in trade and other payables of $21m and an increase in current tax payable of $36m, offset by a decrease in provisions of $18m.

Total equity

Total equity increased by $594m from $2,179m in 2009 to $2,773m in 2010. The principal movements were an increase of $615m due to attributable profit, currency translation and hedging gains of $53m, an increase of $26m relating to actuarial gains on retirement benefit obligations, offset by a decrease of $7m relating to deferred taxation and a decrease of $132m due to dividends paid during the year.

	Total equity $ million
1 January 2010	2,179
Attributable profit	615
Currency translation gains	52
Hedging gains	1
Actuarial gain on retirement benefit obligations	26
Dividends paid during the year	(132)
Taxation on Other Comprehensive Income and equity items	(7)
Net share based transactions	39
31 December 2010	2,773

Going concern

The Group s business activities, together with the factors likely to affect its future development, performance and position are set out in the Business Review section on pages 30 to 40. The financial position of the Group, its cash flows, liquidity position and borrowing facilities are described under Financial position, liquidity and capital resources within the Business Review section set out on page 25. In addition, the notes to the financial statements include the Group s objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments and hedging activities; and its exposure to credit risk and liquidity risk.

The Group has considerable financial resources and its customers and suppliers are diversified across different geographic areas. As a consequence, the Directors believe that the Group is well placed to manage its business risk successfully despite the on-going uncertain economic outlook.

The Directors have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. Thus they continue to adopt the going concern basis for accounting in preparing the annual financial statements.

Management also believes that the Group has sufficient working capital for its present requirements.

Payment policies

It is the Group s and Company s policy to ensure that suppliers are paid within agreed terms. At the year-end the Company had no trade creditors.

Financial review continued

Factors affecting Smith & Nephew s results of operations

Government economic, fiscal, monetary and political policies are all factors that materially affect the Group s operation or investments of shareholders. Other factors include sales trends, currency fluctuations and innovation. Each of these factors is discussed in further in Our business, marketplace and other factors that could affect us on pages 14 to 18 and Taxation information for shareholders on pages 147 to 148.

Critical accounting policies

The Group s significant accounting policies are set out in Notes 1 to 24 of the Notes to the Group accounts. Of those, the policies which require the most use of management s judgement are as follows:

Inventories

A feature of the Orthopaedics business segment (whose finished goods inventory makes up approximately 74% of the Group total finished goods inventory) is the high level of product inventory required, some of which is located at customer premises and is available for customers immediate use. Complete sets of product, including large and small sizes, have to be made available in this way. These sizes are used less frequently than standard sizes and towards the end of the product life cycle are inevitably in excess of requirements. Adjustments to carrying value are therefore required to be made to orthopaedic inventory to anticipate this situation. 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 involve management judgements on customer demand, effectiveness of inventory deployment, length of product lives, phase-out of old products and efficiency of manufacturing planning systems.

Impairment

In carrying out impairment reviews of goodwill, intangible assets and property, plant and equipment a number of significant assumptions have to be made when preparing cash flow projections. These include the future rate of market growth, discount rates, the market demand for the products acquired, the future profitability of acquired businesses or products, levels of reimbursement and success in obtaining regulatory approvals. If actual results should differ or changes in expectations arise, impairment charges may be required which would adversely impact operating results.

Retirement benefits

A number of key judgements have to be made in calculating the fair value of the Group s defined benefit pension plans. These assumptions impact the Balance Sheet liability, operating profit and other finance income/costs. The most critical assumptions are the discount rate and mortality assumptions to be applied to future pension plan liabilities. For example as of 31 December 2011, a 0.5% increase in discount rate would have reduced the combined UK and US pension plan deficit by $96m whilst a 0.5% decrease would have increased the combined deficit by $109m. A 0.5% increase in discount rate would have decreased profit before taxation by $5m whilst a 0.5% decrease would have increased it by $5m. A one year increase in the assumed life expectancy of the average 60 year old male pension plan member in both the UK and US would have increased the combined deficit by $36m. In making these judgements, management takes into account the advice of professional external actuaries and benchmarks its assumptions against external data.

The discount rate is determined by reference to market yields on high quality corporate bonds, with currency and term consistent with those of the liabilities. In particular for the UK and US, the discount rate is derived by reference to an AA yield curve derived by the Group s actuarial advisers.

See Note 19 of the Notes to the Group accounts for a summary of how the assumptions selected in the last five years have compared with actual results.

Contingencies and provisions

The recognition of provisions for legal disputes is subject to a significant degree of estimation. Provision is made for loss contingencies when it is considered probable that an adverse outcome will occur and the amount of the loss can be reasonably estimated. In making its estimates, management takes into account the advice of internal and external legal counsel. Provisions are reviewed regularly and amounts updated where necessary to reflect developments in the disputes. The ultimate liability may differ from the amount provided depending on the outcome of court proceedings and settlement negotiations or if investigations bring to light new facts.

The Group operates in numerous tax jurisdictions around the world. Although it is Group policy to submit its tax returns to the relevant tax authorities as promptly as possible, at any given time the Group has unagreed years outstanding and is involved in disputes and tax audits. Significant issues may take several years to resolve. In estimating the probability and amount of any tax charge, management takes into account the views of internal and external advisors and updates the amount of provision whenever necessary. The ultimate tax liability may differ from the amount provided depending on interpretations of tax law, settlement negotiations or changes in legislation.

Legal proceedings

The Company and its subsidiaries are parties to various legal proceedings, some of which include claims for substantial damages. The outcome of these proceedings cannot readily be foreseen, but management believes none of them will result in a material adverse effect on the financial position of the Group. The Group provides for outcomes that are deemed to be probable and can be reliably estimated. There is no assurance that losses will not exceed the provision or will not have a significant impact on the Group s results of operations or financial condition in the period in which they are realised.

Product liability claims

In August 2003, the Group withdrew voluntarily from all markets the macrotextured versions of its OXINIUM femoral knee components. A number of related claims have been filed, most of which have been settled. The aggregate cost at 31 December 2011 related to this matter is approximately $214m. The Group has sought recovery from its primary and excess insurers for costs of resolving the claims. The primary insurance carrier has paid $60m in full settlement of its policy liability. However, the excess carriers have denied coverage, citing defences relating to the wording of the insurance policies and other matters. In December 2004, the Group brought suit against them in the US District Court for the Western District of Tennessee, and trial is expected to commence in 2013. An additional $22m was received from a successful settlement with a third party.

A charge of $154m was recorded in 2004 for anticipated expenses in connection with macrotexture claims. Most of that amount has since been applied to settlements of such claims. Management believes that the $17m provision remaining is adequate to cover remaining claims. Given the uncertainty inherent in such matters, there can be no assurance on this point.

The Group faces other claims from time to time for alleged defects in its products and has on occasion recalled products to minimise risk of harm or claims. The Group maintains product liability insurance subject to limits and deductibles that management believes are reasonable.

Business practice investigations

In March 2005 the US Attorney s Office in Newark, New Jersey issued subpoenas to the five largest sellers of hip and knee implants to US orthopaedic surgeons, including the Group s Orthopaedic business, asking for information regarding arrangements with orthopaedic reconstructive surgeons. In September 2007, the Group (and the other four companies involved) settled the charges that could have resulted from this investigation, without admitting any wrongdoing as part of the settlement. At the same time, the Group entered into a Corporate Integrity Agreement with the Office of the Inspector General (OIG) of the US Department of Health and Human Services which requires certain compliance efforts. This agreement is in effect for five years, until September 2012. If the Group meets its terms, the OIG will not attempt to exclude it from receiving Medicare payments for its products. The Group has devoted substantial effort to comply with this agreement and to enhance its compliance programme across all of its business segments.

In September 2007, the SEC notified the Group that it was conducting an informal investigation of companies in the medical devices industry, including the Group, regarding possible violations of the Foreign Corrupt Practices Act (FCPA) in connection with the sale of products in certain countries outside of the US. The US Department of Justice (DOJ) subsequently joined the SEC s request.

During quarter four of 2011, the Group established a provision of $23m in relation to this investigation.

On 6 February 2012, Smith & Nephew announced that it had reached settlement with the SEC and DOJ in connection with this matter. Smith & Nephew has committed to pay slightly less than $23m in fines and profit disgorgement, and committed to maintain an enhanced compliance programme and appoint an independent monitor for at least 18 months to review and report on its compliance programme to both the SEC and DOJ. The settlement agreements impose detailed reporting, compliance and other requirements on Smith & Nephew for a three-year term. Failure to comply with these requirements, or any other violation of law, could have severe consequences for the Group.

Intellectual property disputes

The Group is engaged, as both plaintiff and defendant, in litigation with various competitors and others over claims of patent infringement and, in some cases, breach of licence agreement. These disputes are being heard in courts in the United States and other jurisdictions and also before agencies that examine patents. Outcomes are rarely certain and costs and settlements are often significant.

Since the Group s entry into the negative pressure wound therapy business in 2007, Kinetic Concepts, Inc. (KCI) has pursued claims of patent infringement against the Group in the US, UK, Germany and other jurisdictions. In one case in the US District Court for the Western District of

Texas a jury found that patents exclusively licensed to KCI by Wake Forest University (Wake Forest) were valid but not infringed by the Group. That ruling was upheld on appeal in February 2009. In a subsequent case in the same court, relating to the Group s foam product, a jury concluded in March 2010 that asserted Wake Forest patents were valid and infringed. But the court determined the relevant patent claims were invalid and entered judgement in favour of the Group. Wake Forest has appealed the court s judgement. If Wake Forest were to prevail, the Group could be prevented from selling that foam product in the US until patent expiration in 2014. KCI has also pursued patent infringement claims in certain countries relating to pumps, canisters and other negative pressure wound therapy accessories.

The Group has won jury verdicts against Arthrex Inc., (Arthrex) for infringement of the Group s patents relating to suture anchors (in the US District Court for Oregon) and femoral fixation devices for ACL reconstruction (in the US District Court for the Eastern District of Texas). Arthrex appealed both decisions. The Texas case was reversed on appeal with judgement entered in favour of Arthrex. The Oregon decision was reversed on appeal and remanded to the District Court for a new trial. The Group secured a jury verdict in its favour that was subsequently reversed by the Oregon court post-trial. The Group plans to proceed with an appeal of the Oregon court s ruling.

Other matters

In April 2009, the Group was served with a subpoena by the US Department of Justice in Massachusetts requiring the production of documents from 1995 to 2009 associated with the marketing and sale of the Group s EXOGEN bone growth stimulator. Similar subpoenas have been served on a number of competitors in the bone growth stimulator market. Around the same time a qui tam or whistleblower complaint concerning the industry s sales and marketing of those products, originally filed in 2005 against the primary manufacturers of bone growth stimulation products (including Smith & Nephew), was unsealed in federal court in Boston, Massachusetts. A motion to dismiss that complaint was denied in December 2010.

In June 2010, the Group was served with a subpoena by the US Department of Justice in Massachusetts requiring the production of documents relating to the distribution of samples of the Group s SUPARTZ joint fluid therapy product.

The Group is subject to country of origin requirements under the US Buy American and Trade Agreements Acts with regard to sales to certain US government customers. The Group has voluntarily disclosed to the US Veterans Administration and the US Department of Defence that a small percentage of the products sold to the US government in the past, primarily from the Orthopaedics business, may have originated from countries that are not eligible for such sales except with government consent. Government auditors subsequently conducted an on-site visit at the Group s Orthopaedics business. In December 2008, three months after Smith & Nephew s initial voluntary disclosure, a whistleblower suit was filed in the US District Court for the Western District of Tennessee alleging these violations. Smith & Nephew s motion to dismiss the suit was denied in November 2010.

Table of Contents

Business segment reviews

In August 2011, the Group announced its new strategic priorities. Part of this framework was the implementation of an organisational change. Smith & Nephew has brought together the Orthopaedics and Endoscopy business segments, creating the Advanced Surgical Devices division (ASD), which will sit alongside the Advanced Wound Management division (AWM). These two divisions will serve the Established Markets and will support our newly created Emerging Markets (focusing on China, India, Brazil and Russia) and International Markets organisations. For reporting purposes, the two division structure will replace the current three business segment structure during 2012.

Business segment analysis

Organisation

During 2011, internally the Group has reported as three business segments: Orthopaedics, Endoscopy and Advanced Wound Management. Included within the Orthopaedics business segment are biologics activities, which comprise research and development projects under the direction of a committee representing all operating segments.

Revenue by business segment and geographic market and trading and operating profit by business segment are set out below:

	2011 $m	2010 $m	2009 $m
Revenue by business segment			
Orthopaedics	**2,312**	2,195	2,135
Endoscopy	**939**	855	791
Advanced Wound Management	**1,019**	912	846
Total revenue	**4,270**	**3,962**	**3,772**
Revenue by geographic market			
United States	**1,756**	1,707	1,664
Europe (Continental Europe and United Kingdom)	**1,409**	1,315	1,313
Africa, Asia, Australasia and other America	**1,105**	940	795
Total revenue	**4,270**	**3,962**	**3,772**
Trading profit by business segment			
Orthopaedics	**492**	536	508
Endoscopy	**222**	200	189
Advanced Wound Management	**247**	233	160

Total trading profit	**961**	**969**	**857**
Operating profit by business segment			
Orthopaedics	**415**	503	410
Endoscopy	**215**	197	169
Advanced Wound Management	**232**	220	144
Total operating profit	**862**	**920**	**723**

Business segment revenue

	$m
A Orthopaedics	2,312
B Endoscopy	939
C Advanced wound management	1,019

Geographic revenue

	$m
A US	1,756
B Europe	1,409
C Rest of World	1,105

A head office team in London, UK directs the overall business and supports the business segments, primarily in the areas of business development, legal, company secretarial, finance, human resources and investor relations.

Table of Contents

VERILAST s use of OXINIUM, oxidized Zirconium, results in a knee

which has been proven to last 30 years, twice the current industry

standard of 15 years.

Orthopaedics

Overview

During 2011, the Orthopaedics business was managed worldwide from Memphis, Tennessee, the site of its main development and manufacturing facility, with a European headquarters in Baar, Switzerland. Products are also manufactured at smaller facilities in Switzerland, Germany, China and the UK as well as by third-party manufacturers.

Products

Orthopaedic reconstruction implants include hip, knee and shoulder joints as well as ancillary products such as bone cement. Orthopaedic trauma fixation products consist of internal and external devices and other products, including various fixation and orthobiological materials used in the stabilisation of severe fractures and deformity correction procedures. Clinical therapies products are those that are applied in an orthopaedic office or a clinic setting, in particular bone growth stimulation and joint fluid therapies.

Knee implant systems

The Orthopaedics business offers a range of products for specialised knee procedures. The LEGION/GENESIS II Total Knee System is a comprehensive system designed to allow surgeons to address a wide range of knee procedures from primary to revision. LEGION TKS features VERILAST Technology, an advanced bearing surface. The JOURNEY Active Knee Solutions, a family of advanced, customised products designed to treat early to mid-stage osteoarthritis patients, provides more normal feeling and motion through bone ligament preservation and anatomic replication. LEGION/GENESIS II and JOURNEY also utilise VISIONAIRE Patient-Matched Instrumentation, a technology platform of patient-matched cutting blocks for total knee procedures.

Hip implant systems

The Orthopaedics business offers a broad range of hip replacement systems. In particular, the R3 Acetabular System includes a modular acetabular cup that provides a variety of advanced bearings within a single system. The BIRMINGHAM HIP Resurfacing System is a system for hip resurfacing, a bone conserving approach, which utilises proven low wear metal-on-metal bearing surface technology. Other hip systems include the SYNERGY Hip System, ANTHOLOGY Hip System and the SL-PLUS Hip Family System.

Bearing surfaces

The Orthopaedics business utilises a range of bearing surfaces in its implant systems, including its proprietary OXINIUM Technology. Oxidized Zirconium, branded OXINIUM, combines the enhanced wear resistance of a ceramic bearing with the superior durability of a metallic bearing. When combined with highly cross-linked polyethylene (XLPE) it results in the Group s VERILAST Technology. The LEGION Primary Knee, with VERILAST Technology, is the only knee system with a 30 year wear performance claim approved by the United States Food and Drug Administration (FDA) more than double the performance expectation for wear compared to conventional technologies.

Trauma implant systems

The principal fixation products are the TRIGEN Intramedullary Nailing system, TRIGEN META-NAIL with expanded fixation and technique options, TRIGEN INTERTAN Intertrochanteric Antegrade nails for hip fractures, TRIGEN SURESHOT Distal Targeting System for Intramedullary Nailing and PERI-LOC Periarticular Locked Plating system which offers a comprehensive family of fracture specific plate and screw products for the upper and lower extremities.

For external fixation and limb restoration, Orthopaedics offers the TAYLOR SPATIAL FRAME Circular Fixation System and JET-X BAR Unilateral Fixator.

Clinical Therapies

The principal clinical therapies products offered include the EXOGEN Ultrasound Bone Healing System which utilises low-intensity pulsed ultrasound to accelerate the healing of fresh fractures and to heal non unions. DUROLANE Joint Fluid Therapy and SUPARTZ Joint Fluid Therapy are non-surgical, non-pharmacological pain-relieving therapies for osteoarthritis of the knee.

Strategy

Under the new ASD structure, the Group will continue to focus on product innovation, sales excellence and physician education. Whether through extending the life of implants, improving operating room efficiency, or promoting faster healing and other clinical outcomes, Smith & Nephew s innovations differentiate it and provide solutions to active patients seeking to regain quality of life while enhancing economic value for customers. For its ASD products, Smith & Nephew provides peer-to-peer medical education, through KLEOS, tailored to individual surgeon needs utilising the world s top orthopaedic specialists and key opinion leaders.

The emerging markets continue to be an important growth opportunity. China remains a focus, with further progress and growth achieved during 2011. Outside China, ASD is investing in sales teams in other emerging markets, extending physician training via KLEOS, developing tailored products to meet local needs and improving local infrastructure and logistics.

Under the ASD structure, the business aligns its organisation and develops its talent for consistent execution on the Group s plans. Compensation for executives, managers and staff are carefully aligned to the execution of their objectives.

On 4 January 2012, the Group announced it had entered into an agreement with Essex Woodlands for the disposal of the Group s Clinical Therapies business. After disposal, the Group will retain a 49% investment in the newly formed company, Bioventus LLC, which will be reported as an associate. At 31 December 2011, the assets and liabilities of the Clinical Therapies business, $125m and $19m respectively, are disclosed as held for sale. In 2011, the Clinical Therapies business contributed $237m to revenue and $48m to trading profit. The Group expects to recognise a profit before tax in excess of $250m on the transaction on completion.

Table of Contents

Business segment reviews continued

Orthopaedics continued

New products

In Trauma, Orthopaedics launched STRUCSURE CP, an advanced injectable, hard-setting bone graft substitute designed to gradually resorb while being replaced by natural bone.

Reconstructive Orthopaedics continued the extension of its VISIONAIRE Patient-Matched Instrumentation into its knee portfolio, with its roll-out of VISIONAIRE for the TC-PLUS knee system. With VISIONAIRE, the patient s MRI and X-rays are used to create customised cutting blocks that allow the surgeon to achieve optimal mechanical axis alignment as well as saving time and reducing instruments in the operating room. Also launched was the SMF Short Modular Femoral Hip System, a primary hip stem that is substantially shorter than traditional length stems, yet maintains optimal fixation and stability. The SMF Hip complements the newly launched Direct Anterior retractor set, an instrument set and technique that allows orthopaedic surgeons to enter the hip socket through the front, or anterior, which results in far less soft tissue disruption and post-operative pain than traditional techniques.

Regulatory approvals

During 2011, the Orthopaedics business obtained regulatory clearances/approvals for several key products.

In the US, 510(k) clearance was obtained for the TAYLOR SPATIAL FRAME V4.1 Software, TRIGEN SURESHOT Distal Targeting System V2.1, and the SMF Hip Stem Line Additions.

Several products were approved in Japan, which included the 10/12 TAPER OXINIUM Femoral Heads, LARGE COCR Femoral Heads, REFLECTION XLPE Acetabular Liners, BHR Resurfacing Hip System, BHR Modular Head System with 10/12 Taper Sleeves, SL-PLUS Hip Stems, SLR-PLUS Hip Stems, and SL-PLUS Mia Hip Stems.

Seasonality

Orthopaedic reconstruction and trauma procedures tend to be higher in the winter months (quarter one and quarter four) where accidents and sports related injuries are highest. Conversely, elective procedures tend to slow down in the summer months due to holidays.

Market and competition

Smith & Nephew estimates that the global orthopaedic segment, excluding clinical therapies, served by the Group grew by approximately 2% in 2011 and is currently worth approximately $17.8 billion per annum. Management believes that the Smith & Nephew Orthopaedics business holds an 11% share of this segment by value. Principal global competitors in orthopaedics are Zimmer, Stryker, Johnson & Johnson and Biomet.

Global orthopaedics competitor share (i) (ii)

	%
A Smith & Nephew	11

B Zimmer	19
C Stryker	18
D DePuy/Johnson & Johnson (iii)	17
E Synthes (iii)	12
F Biomet	9
G Others	14

(i) The global orthopaedics segment served by the Group consists of orthopaedic reconstruction and orthopaedic trauma.

(ii) Competitor shares are based on estimates for selected segments and competitors, and may not be comprehensive.

(iii) Synthes is the subject of a takeover from Johnson & Johnson which is expected to complete in 2012.

In 2011, weaker economic conditions worldwide continued to create several challenges for the overall orthopaedic market, including continued deferrals of joint replacement procedures and heightened pricing pressures. These factors contributed to the lower overall growth of the worldwide orthopaedic market compared to historic comparables. However, over the medium-term, several catalysts are expected to continue to drive sustainable growth in orthopaedic device sales, including the growing and ageing population, rising rates of co-morbidities such as obesity and diabetes, technology improvements allowing surgeons to treat younger, more active patients, and the increasing strength of the demand for healthcare in emerging markets. Both the orthopaedic trauma and clinical therapies markets are expected to continue to grow due to a global population increasingly at risk from fractures due to age, osteoporosis, obesity and diabetes and also due to continuous advancements in the surgical treatment of fractures, and the need to manage pain in younger, more active patients.

Orthopaedics financial performance

Revenue

Orthopaedics revenue

	$m
A Orthopaedic Reconstruction	1,618
B Orthopaedic Trauma	457
C Clinical Therapies	237

2011

Orthopaedics revenue increased by 5% to $2,312m from $2,195m in 2010. Of this increase, 2% is attributable to underlying growth and 3% is due to favourable currency movements.

Underlying growth in Orthopaedic revenue reconciles to reported growth, the most directly comparable financial measure calculated in accordance with IFRS, as follows:

	2011	**2010**
	%	%
Reported growth	**5**	3
Constant currency exchange effect	**(3)**	(1)
Underlying growth	**2**	2

In the US, revenue increased by $28m to $1,204m (2%), all of which was due to underlying growth. The main factor was the continued growth of the Group s knee products including VERILAST and VISIONAIRE.

Outside the US, revenue increased by $89m to $1,108m (9%). This movement is attributable to underlying growth of 2% and favourable foreign currency translation of 7%.

Global knee revenue increased by $63m to $869m (8%), representing underlying revenue growth of 5% and favourable foreign currency translation of 3%. There has been continued pressure from the challenging environment on higher specification and early intervention hip and knee implant systems. Nevertheless, the Group s knee franchise and in particular the LEGION Knee Systems delivered strong growth. This was driven by VERILAST and by VISIONAIRE Patient Matched Instrumentation sets.

Global hip revenue increased by $16m to $704m (2%), representing a 1% underlying revenue decline and 3% due to favourable foreign currency translation. Both traditional and new products have continued to perform well, led by the R3 Acetabular System. Sales of BIRMINGHAM HIP Resurfacing System have continued to decline.

Global trauma revenue increased by $23m to $457m (5%), representing underlying revenue growth of 3% and 2% favourable foreign currency translation. Trauma underperformed in the second half of the year and the Group has taken actions to address this. The expiry of an agreement under which Smith & Nephew received royalties in the US has also had a negative impact on Trauma revenue in the second half of the year.

In Clinical Therapies, revenue grew from $223m to $237m (7%) which was represented by underlying growth of 6% and favourable currency movements of 1%.

Underlying revenue growth for key product lines is:

	2011	2010
	%	%
Reconstruction		
Knees	**5**	5
Hips	**(1)**	
Trauma	**3**	3
Clinical therapies	**6**	(5)

Business segment reviews continued

Orthopaedics continued

2010

Orthopaedics revenue increased by 3% to $2,195m from $2,135m in 2009. Of this increase, 2% is attributable to underlying growth and 1% is due to favourable currency movements.

In the US, revenue increased by $22m to $1,176m (2%), all of which was due to underlying growth. The main factors were the growth of products launched in the year including VERILAST and VISIONAIRE.

Outside the US, revenue increased by $38m to $1,019m (4%). This movement is attributable to underlying growth of 2% and favourable foreign currency translation of 2%.

Global knee revenue increased by $45m to $806m (6%), representing underlying revenue growth of 5% and favourable foreign currency translation of 1%. There was continued pressure from the challenging environment on higher specification and early intervention hip and knee implant systems. Nevertheless, the Group s knee franchise and in particular the LEGION Knee Systems delivered strong growth. This was driven by the FDA clearance to claim that VERILAST bearing technology for knee replacement provides wear performance sufficient for 30 years of actual use under typical conditions and by VISIONAIRE Patient Matched Instrumentation sets.

Global hip revenue increased by $7m to $688m (1%), all of which was due to favourable foreign currency translation. In the Group s hip franchise, both traditional and new products continued to perform well, led by the R3 Acetabular System. Sales of BIRMINGHAM HIP Resurfacing Systems were weaker.

Global trauma revenue increased by $20m to $434m (5%), representing underlying revenue growth of 3% and 2% favourable foreign currency translation. This improvement is attributable to management s actions to provide additional support and training to the sales force.

In Clinical Therapies, EXOGEN Ultrasound Bone Healing System achieved double digit revenue growth for the year. The joint fluid therapies franchise continued to perform well despite the increased competitive environment in the US. Early in 2010 the Group sold its niche pain management business and terminated the small spine distribution business in Germany, which reduced Orthopaedics revenue growth by approximately 1%.

Trading profit

2011

Trading profit decreased by $44m (8%) to $492m from $536m in 2010. Trading profit margin decreased from 24.4% to 21.3%. This decrease is due to continuing pricing pressure, adverse mix and some delay in the execution of our efficiency programme.

2010

Trading profit increased by $28m (6%) to $536m from $508m in 2009. Trading profit margin increased from 23.8% to 24.4%. This increase is due to cost management and further investment in improving the efficiency and effectiveness of the main processes.

Operating profit

2011

Operating profit decreased by $88m to $415m. This comprises the decrease in trading profit of $44m discussed above, an increase of $3m in the amortisation of acquisition intangibles, an $18m increase in restructuring and rationalisation costs and $23m in respect of the legal provision.

Operating profit, the most directly comparable financial measure calculated in accordance with IFRS, reconciles to trading profit as follows:

	2011	2010
	$ million	$ million
Operating profit	**415**	503
Restructuring and rationalisation costs	**26**	8
Amortisation of acquisition intangibles	**28**	25
Legal provision	**23**	
Trading profit	**492**	536

Orthopaedics trading profit and operating profit as a percentage of Group trading profit and operating profit was as follows:

	2011	**2010**	2009
	%	**%**	%
Trading profit	**51**	55	59
Operating profit	**48**	55	57

2010

Operating profit increased by $93m to $503m. This comprises the increase in trading profit of $28m discussed above, a $26m reduction in acquisition related costs, a reduction of $21m in the amortisation of acquisition intangibles and impairments and an $18m reduction in costs associated with the Earnings Improvement Programme (EIP).

The FAST-FIX 360 Meniscal Repair System offers exceptional fixation strength and enhanced control to optimise the chances of a successful meniscus repair.

Endoscopy

Overview

Smith & Nephew s Endoscopy business develops and commercialises endoscopic (minimally invasive surgery) techniques, educational programmes and value-added services for surgeons to treat and repair soft tissue and articulating joints. The business focuses on the arthroscopy (sometimes referred to as sports medicine) sector of the endoscopy market. Arthroscopy is the minimally invasive surgery of joints, in particular the knee, shoulder and hip.

In 2011, the Endoscopy business was headquartered in Andover, Massachusetts and manufacturing facilities are located in Mansfield, Massachusetts, and Oklahoma City, Oklahoma. Major service centres are located in the US, UK, Germany, Japan and Australia.

Products

The Endoscopy business offers surgeons endoscopic technologies for surgery of the joints and ligament repair, including: specialised devices and fixation systems to repair damaged tissue; fluid management equipment for surgical access; digital cameras, digital image capture, scopes, light sources and monitors to assist with visualisation; radiofrequency wands, electromechanical and mechanical blades, and hand instruments for resecting damaged tissue.

Key products in repair are the FAST-FIX family of meniscal repair systems, ENDOBUTTON for cruciate fixation, and the FOOTPRINT PK and TWINFIX Suture Anchors for rotator cuff repair. Key products in resection are the wide range of DYONICS shaver blades, ACUFEX handheld instruments, and a range of radiofrequency (RF) probes.

Strategy

Smith & Nephew s strategic intent is to grow the business as the leading provider of endoscopic techniques and technologies for joint and ligament repair. Management believes that the business capitalises on the growing acceptance of endoscopy as a preferred surgical choice among surgeons, patients and payors, enhanced by a customer-led approach to growing the arthroscopy market.

To sustain growth and enhance its market position, the ASD business supports its strategy with investment in surgeon education programmes, global fellowship support initiatives, partnerships with professional associations and surgeon advisory boards. The emerging markets, especially China, are expected to be a major driver of growth in future, and the business is investing funds to accelerate this growth.

The business has a commitment to, and track record of, driving efficiencies, through a formal operational excellence programme as well as a culture of continuous process improvement.

The Endoscopy business aligns its organisation to ensure all employees are working on common objectives, and to ensure consistent execution against the Group s wider objectives.

New products

In 2011, Smith & Nephew continued to expand its arthroscopic sports medicine portfolio with the launch of new repair, resection and visualisation products.

The FAST-FIX 360 Meniscal Repair System is designed to optimise the chances of a successful repair with exceptional fixation strength, small insertion points, convenient implant deployment and a built-in depth limiter. It is the built on the proven FAST-FIX platform which set the standard for minimally invasive, all-inside meniscal repair.

The DYONICS PLATINUM Series Shaver Blades are single-use blades that provide superior resection, debris evacuation and sharpness.

BIORAPTOR and OSTEORAPTOR CURVED Guide Systems for Shoulder optimise anchor placement helping surgeons to overcome the challenges associated with instability repair. The systems provide increased access to the repair site in the glenohumeral joint, improve the trajectory of drilling and lead to optimised anchor placement in glenoid bone which helps surgeons operate with confidence.

Recent regulatory approvals

During 2011, the Endoscopy business obtained regulatory clearances for the following products in most major markets, except Japan where the approval process is more lengthy: ULTRABRAID II Suture, ENDOBUTTON DIRECT, OSTEORAPTOR and BIORAPTOR CURVED Guide Systems and the ACUFEX DIRECTOR Guide System, all designed for use in the reattachment of ligaments, tendons or soft tissues to bone in knees, shoulders or other articulating joints; and various other arthroscopy instruments, devices and sterilisation trays. In addition, the Endoscopy business obtained regulatory clearance in the United States and Europe for the TRUCLEAR Operative Hysteroscopy System for use in office based procedures. In Japan, regulatory approvals included TWINFIX AB, TWINFIX TI, TWINFIX Ultra PK and FOOTPRINT Ultra PK Suture Anchors as well as BONECUTTER ELECTROBLADE and various arthroscopy surgical instruments.

Business segment reviews continued

Endoscopy continued

Seasonality

Arthroscopy procedures tend to be higher in the winter months (quarter one and quarter four) where accidents and sports related injuries are highest. Conversely, elective procedures tend to slow down in the summer months due to holidays.

Market and competition

Smith & Nephew estimates that the global arthroscopy segment (the combination of repair and resection products) in which the business principally participates is worth approximately $3.8 billion per annum and has recently been growing at approximately 8% annually. Arthroscopy growth rates are driven by increasing numbers of sports injuries, longer and more active lifestyles, patient desire for minimally invasive procedures, innovative technological developments and a need for cost-effective procedures. The arthroscopy segment has a particular focus on arthroscopic repair of the knee and shoulder using a broad range of technologies. The Group also expects to benefit from the demand for less invasive approaches to arthroscopic hip repair.

Management believes that Smith & Nephew has a 21% share of the global arthroscopy segment as at 31 December 2011. Smith & Nephew s main competitors were Arthrex, Mitek/Johnson & Johnson, Stryker, Arthrocare and Linvatec/ConMed.

Global arthroscopy competitor share (i)

	%
A Smith & Nephew	21
B Arthrex	25
C Mitek/Johnson & Johnson	16
D Stryker	11
E Linvatec/ConMed	6
F Arthrocare	5
G Others	16

(i) Competitor shares are based on estimates for selected segments and competitors, and may not be comprehensive.

Endoscopy financial performance

Revenue

Endoscopy revenue

	$m
A Arthroscopy	807
B Visualisation	107
C Other	25

2011

Endoscopy revenue increased by $84m, or 10%, to $939m in 2011 from $855m in 2010, comprising 4% favourable currency translation and 6% underlying growth.

Underlying growth in Endoscopy revenue reconciles to reported growth, the most directly comparable financial measure calculated in accordance with IFRS, as follows:

	2011 **%**	**2010** **%**
Reported growth	**10**	8
Constant currency exchange effect	**(4)**	(1)
Underlying growth	**6**	7

In the US, revenue increased by $10m to $363m in 2011 (3%), all of which represents underlying growth.

Outside the US, revenue increased by $74m to $576m in 2011 (15%), of which 8% was underlying growth and 7% was due to favourable foreign currency translation.

Global revenue of sports medicine repair products increased by $57m to $448m (15%), of which 10% was underlying growth and 5% favourable foreign currency translation. The repair business benefited from launch of the FAST-FIX 360 Meniscal Repair System and BIORAPTOR CURVED guide systems during the year.

Revenue in the global resection products sector increased by $21m to $303m (7%), of which 4% represents underlying revenue growth and 3% of favourable foreign currency translation. The resection franchise benefited from sales of the Group s new DYONICS PLATINUM range of speciality blades.

Global Visualisation revenue reduced by $5m to $107m (-4%), of which -7% represents negative underlying growth, partially offset by 3% of favourable foreign currency translation. This decrease reflects the Group s strategy to focus only on those capital items which are closely aligned with the core resection and repair businesses.

Underlying revenue growth for key product lines is:

	2011	**2010**
	%	%
Arthroscopy	**7**	9
Visualisation	**(7)**	(9)

2010

Endoscopy revenue increased by $64m, or 8%, to $855m from $791m in 2009, comprising 1% favourable currency translation and 7% underlying growth.

In the US, revenue increased by $4m to $353m (1%), all of which represents underlying growth.

Outside the US, revenue increased by $60m to $502m (14%), of which 11% was underlying growth and 3% was due to favourable foreign currency translation.

Global revenue of sports medicine repair products increased by $46m to $391m (13%), of which 11% was underlying growth and 2% favourable foreign currency translation.

Revenue in the global resection products sector increased by $17m to $282m (7%), of which 6% represents underlying revenue growth and 1% of favourable foreign currency translation. The resection franchise benefited from the introduction of a new range of radio-frequency ablation probes early in the year.

Global Visualisation revenue reduced by $9m to $112m (-7%), of which -9% represents negative underlying growth, partially offset by 2% of favourable foreign currency translation. This decrease reflects the Group s strategy to focus only on those capital items which are closely aligned with the core resection and repair businesses.

Trading profit

2011

Trading profit increased by $22m (11%) to $222m from $200m in 2010. Trading profit margin increased from 23.3% to 23.6%. This is driven by strong sales and good cost-control.

2010

Trading profit increased by $11m (6%) to $200m from $189m in 2009. Trading profit margin decreased from 23.9% to 23.3%. This reflects the increased investment in product development and in the sales force, particularly in the US.

Operating profit

2011

Operating profit increased by $18m to $215m from $197m in 2010. This comprises the $22m increase in trading profit set out above, offset by an increase of $4m in restructuring and rationalisation costs.

Operating profit, the most directly comparable financial measure calculated in accordance with IFRS, reconciles to trading profit as follows:

	2011 **$ million**	2010 **$ million**
Operating profit	**215**	197
Restructuring and rationalisation costs	**6**	2
Amortisation of acquisition intangibles	**1**	1
Trading profit	**222**	200

Endoscopy trading profit and operating profit as a percentage of Group trading profit and operating profit was as follows:

	2011 **%**	2010 %	2009 %
Trading profit	**23**	21	22
Operating profit	**25**	21	23

2010

Operating profit increased by $28m to $197m from $169m in 2009. This comprises the $11m increase in trading profit set out above, a reduction of $14m in amortisation of acquisition intangibles and impairments and a $3m reduction in restructuring costs.

Business segment reviews continued

PICO is a small portable pump, providing 7 days effective Negative Pressure Wound Therapy yet is small enough to fit discreetly into a pocket.

Advanced Wound Management

Overview

Smith & Nephew s Advanced Wound Management business offers a range of products from initial wound bed preparation through to full wound closure. These products are targeted at chronic wounds associated with the older population, such as pressure sores and venous leg ulcers. There are also products for the treatment of wounds such as burns and from invasive surgery that impact the wider population.

The Advanced Wound Management business has its global headquarters in Hull, UK and its North American headquarters in St Petersburg, Florida. The products are manufactured at facilities in Hull and Gilberdyke, UK, Suzhou in China, and also by third party manufacturers around the world.

Products

The main products within the Advanced Wound Management business are for exudate management, predominantly the ALLEVYN brand and the recently added DURAFIBER products, infection management, including the ACTICOAT brand and Negative Pressure Wound Therapy (NPWT).

The ALLEVYN hydrocellular dressings range has been considerably enhanced by new versions, introduced in recent years, which management believes provide efficient fluid management and an optimal moist wound environment that promotes faster healing of the wound, reduced risk of maceration and protection from infection. The range includes ALLEVYN Ag, a range of dressings combining the infection management capabilities of silver with ALLEVYN.

The ACTICOAT range incorporates the smallest crystallised silver used in the treatment of wounds and burns. The silver reduces the risk of bacterial colonisation and acts to kill micro-organisms that can cause infection and prevent or delay healing.

NPWT delivers vacuum-assisted pressure to help promote healing. It consists of a wound dressing, a drainage tube, and a transparent film that is connected to a suction device. Smith & Nephew offers the RENASYS EZ and RENASYS GO pump systems together with a range of foam and gauze dressing kits. The NPWT range was enhanced with the introduction of PICO, the first of its kind a fully disposable NPWT system.

Advanced Wound Management also offers a range of other advanced products including films, such as OPSITE and IV3000, skin care treatments and gels.

Strategy

Advanced Wound Management s strategy is to be customer-led and invest for growth by focusing on high growth, high value segments, in particular exudate and infection management, through improved wound bed preparation, moist and active healing and penetration of the NPWT market.

There has been a continued focus on operational efficiency and excellence. Since 2007, efficiency improvements have been delivered through various projects including support function consolidation, outsourcing of manufacturing to low cost suppliers, distribution rationalisation projects and the start of manufacturing in Suzhou, China.

Advanced Wound Management s strategic focus builds from an understanding of the increasing tensions between clinical and financial imperatives and looks for the ground that resolves them optimally. Advanced Wound Management is committed to improving wound outcomes for patients, and at the same time conserve resources for health care systems.

An aligned approach across Advanced Wound Management is designed to ensure that employees are developed and work on common objectives to deliver consistent execution of the Group s plan.

New products

New in 2011 was the introduction of PICO, the first fully disposable NPWT system. The innovative design provides the clinical benefits of NPWT while simplifying the functionality and presentation of the product, allowing for an entirely disposable and cost effective system. The design allows greater access to therapy, reduces service and support costs, and significantly improved cost effectiveness compared to traditional NPWT therapy.

In addition, the NPWT range was enhanced with the launch of RENASYS Soft Port to improve application and administration of therapy. Further line extensions were introduced to support customer requests for broader application of therapy.

VERSAJET II (hydro-surgery debridement) was introduced as a next generation upgrade, incorporating improved ease of use and functionality to the existing system. VERSAJET II enhances the Group s unique position in the hydro-surgical debridement market segment.

2011 saw the launch of DURAFIBER a gelling fibre dressing, which expands the footprint of the exudate management portfolio.

DURAFIBER has category leading performance and was designed to manage moderate to heavily exuding cavity wounds, working in synergy with the ALLEVYN hydrocellular dressing range.

The ALLEVYN range was further expanded with anatomically shaped dressings designed to address multiple wound sites reducing the number of products a customer needs to stock, making dressing choice simpler with the opportunity to reduce costs. This further reinforces Advanced Wound Management s position as the supplier with the most comprehensive foam dressing solution.

Recent regulatory approvals

During 2011, Advanced Wound Management secured approval in US, Europe and Australia for PICO, single use Negative Pressure Wound Therapy System. In the US clearance was also gained for DURAFIBER Ag. Regulatory approvals were received in the EU and US for a range of NPWT dressing kits, including RENASYS Soft Port and the hydro-surgery debridement product, VERSAJET II.

Approval was received in Europe for a number of significant product changes including ALLEVYN Silver Non Adhesive for Germany and ACTICOAT Surgical. Pro Two, a two layer compression bandaging system was also cleared for sale.

Approval was secured in China for a number of existing marketed products OPSITE Incise, OPSITE Flexigrid, OPSITE POST OP, ALLEVYN Thin and ALLEVYN Adhesive.

Seasonality

Due to the nature of its product range there is little seasonal impact on the Advanced Wound Management business.

Market and competition

Management estimates that the sales value of the advanced wound management segment worldwide was $5.5 billion in 2011, an underlying increase of around 3% from 2010. During 2011, the segment growth rate slowed slightly due to the weaker economic conditions. The advanced wound management market is focused on the treatment of chronic wounds of the older population and other hard-to-heal wounds such as burns and certain surgical wounds and is therefore also expected to benefit from demographic trends. Growth is driven by an ageing population and by a steady advance in technology and products that are more clinically efficient and cost effective than their conventional counterparts. The market for advanced wound versus traditional wound treatments is relatively un-penetrated and it is estimated that the potential for advanced wound management is significantly larger than the current market suggests. Management believes that the market will continue the trend towards advanced wound products with its ability to accelerate healing rates, reduce hospital stay times and cut the cost of clinician and nursing time as well as aftercare in the home.

Management estimates that Smith & Nephew had an 18% share of the advanced wound management segment as at 31 December 2011. Worldwide competitors in advanced wound management in 2011 include Convatec, Mölnlycke, Systagenix and Kinetic Concepts, who are active exclusively in the NPWT market.

Global advanced wound management competitor share (i)

	%
A Smith & Nephew	18
B Kinectic Concepts	26
C Mölnlycke	11
D Convatec	9
E 3M	6
F Others	30

(i) Competitor shares are based on estimates for selected segments and competitors, and may not be comprehensive.

Advanced Wound Management financial performance

Revenue

2011

Revenue increased by $107m, or 12%, to $1,019m from $912m in 2010, comprising 5% favourable currency translation and 7% underlying growth. Exudate management grew in underlying terms by 2% and infection management by 4%, as targeted marketing investments in Europe delivered good returns. The Group s NPWT portfolio has had another good year with excellent feedback since the launch of PICO during 2011. This was launched in the US during January 2012.

Underlying growth in Advanced Wound Management revenue reconciles to reported growth, the most directly comparable financial measure calculated in accordance with IFRS, as follows:

	2011	**2010**
	%	%
Reported growth	**12**	8
Constant currency exchange effect	**(5)**	(1)
Underlying growth	**7**	7

In the US, revenue increased by $11m to $189m (6%), all of which is attributable to underlying revenue growth.

Outside the US, revenue increased by $96m to $830m (13%). This is represented by an underlying growth of 7% and 6% of favourable foreign currency translation. European revenue increased by $39m to $493m (9%) of which 4% was underlying growth coupled with 5% of favourable currency translation.

Table of Contents

Business segment reviews continued

Advanced Wound Management continued

Underlying revenue growth for key product lines is:

	2011 %	2010 %
Exudate management	**2**	2
Infection management	**4**	3

2010

Revenue increased by $66m, or 8%, to $912m from $846m in 2009, comprising 1% favourable currency translation and 7% underlying growth. A significant portion of the growth came from the Group s NPWT product range, which continued to expand to offer customers a wide range of clinical options. The Exudate and Infection Management franchises continue to benefit from new products and line extensions.

In the US, revenue increased by $17m to $178m (11%), all of which is attributable to underlying revenue growth.

Outside the US, revenue increased by $49m to $734m (7%). This is represented by an underlying growth of 6% and 1% of favourable foreign currency translation. European revenue increased by $6m to $454m (1%) of which 5% was underlying growth partly offset by 4% of unfavourable currency translation.

Trading profit

2011

Trading profit increased by $14m (6%) to $247m from $233m in 2010 and trading profit margin decreased from 25.6% to 24.3%. As set out below, the comparative was assisted by a $25m settlement in respect of BlueSky. Ignoring the impact of this in the comparatives, the equivalent margin for 2010 was 22.8%. The increase in margin in 2011 is driven by the increase in underlying revenues.

2010

Trading profit increased by $73m (46%) to $233m from $160m in 2009 and trading profit margin increased from 18.9% to 25.6%. The settlement in the year with the vendors of BlueSky Medical Group, Inc. with regard to legal expenses in defending the NPWT intellectual property position increased trading profit by $25m. During the year, Advanced Wound Management also benefited from a full year s production at the new manufacturing facility in China, reducing manufacturing costs.

Operating profit

2011

Operating profit increased by $12m to $232m. This comprises an increase in trading profit of $14m and a reduction of $1m in the amortisation of acquisition intangibles. These were offset by an increase of $3m in restructuring and rationalisation costs.

Operating profit, the most directly comparable financial measure calculated in accordance with IFRS, reconciles to trading profit as follows:

	2011	2010
	$ million	$ million
Operating profit	**232**	220
Restructuring and rationalisation costs	**8**	5
Amortisation of acquisition intangibles	**7**	8
Trading profit	**247**	233

Advanced Wound Management trading profit and operating profit as a percentage of Group trading profit and operating profit was as follows:

	2011	**2010**	2009
	%	%	%
Trading profit	**26**	24	19
Operating profit	**27**	24	20

2010

Operating profit increased by $76m to $220m. This comprises the increase in trading profit of $73m and a reduction of $6m in restructuring and rationalisation costs partially offset by an increase of $3m in the amortisation of acquisition intangibles following the acquisition of Nucryst in December 2009.

Table of Contents

Outlook and trend information

The discussion below contains certain forward-looking statements that may or may not prove accurate. For example, statements regarding expected revenue growth and trading margins, market trends and our product pipeline are forward looking statements. Phrases such as aim , plan , intend , anticipate , well placed , believe , estimate , target , consider , and similar expressions are generally intended to identify forward lo statements. Forward-looking statements involve known and unknown risks and uncertainties and other important factors that could cause actual results to differ materially from those projected in forward-looking statements. For Smith & Nephew, these factors include: economic and financial conditions in the markets we serve, especially those affecting health care providers, payors and customers; price levels for established and innovative medical devices; developments in medical technology; regulatory approvals; reimbursement decisions or other government actions; products defects or recalls; litigation relating to patent or other claims; legal compliance risks and related investigative, remedial or enforcement actions; strategic actions, including acquisitions and depositions and our success in integrating acquired businesses; and numerous other matters which affect us or our markets, including those of a political, economic business or competitive nature.

For additional information on factors that could cause the Group s actual results to differ from estimates reflected in these forward-looking statements, can be found under Risk factors within the Business Review section on pages 16 to 18.

Information regarding the recent and longer term market growth trends is given for each of the Group s global business units in the relevant Market and competition sections under Business segment reviews on pages 30 to 40.

Smith & Nephew delivered a good revenue performance in 2011, set against a challenging market backdrop. The Group expects that the macro-economic climate will continue to influence both patient and payor behaviour and, as a result, it seems likely that tough market conditions will persist throughout the year ahead.

During 2012, the Group expects its sports medicine franchises to slightly outperform the market. It also expects to continue to grow at above the market rate in Advanced Wound Management. This will be driven by Smith & Nephew s substantial negative pressure portfolio and a series of innovative new product releases.

Smith & Nephew expects Orthopaedic Reconstruction to grow at close to the market rate. Strong growth in the sales of premium knee implant products will continue to annualise and on-going negative metal-on-metal perceptions will affect hip implant sales.

In Orthopaedic Trauma, the Group expects the continuing 2% headwind from the reduction in royalty income in the US to lead to growth slightly below market growth.

Finally, Smith & Nephew expects to complete the transaction to create Bioventus LLC in the first half of 2012. This will be modestly earnings dilutive.

The Group delivered on its trading profit margin expectation for the last quarter of 2011 and consequently the full year Group trading profit margin was 22.5%. Smith & Nephew expects to achieve a modest increase in trading profit margin in 2012.

In August 2011, Smith & Nephew set out the five strategic priorities designed to drive the Group s future success. Smith & Nephew is reshaping its business to deliver against these priorities. The Group is targeting structural efficiency savings of at least $150 million per annum as part of this process. The costs of achieving this are anticipated to be approximately $160 million in cash and $40 million in non-cash costs. It is expected that more than half the costs and approximately half the benefits will be achieved by the end of 2012, with the full costs and benefits being realised within three years.

From the first quarter of 2012, Smith & Nephew intends to report as two divisions, Advanced Surgical Devices global and Advanced Wound Management global. Advanced Surgical Devices global will comprise the current Orthopaedics and Endoscopy business units. This structure will provide visibility on progress in the Emerging and International Markets, as well as the performance of its product franchises in the Established Markets.

Table of Contents

Business Review

Sustainability

Smith & Nephew s commitment to people, the planet and sustainable profitability.

Highlights and strategy

Smith & Nephew is proud of much of its sustainability performance in 2011. The Group achieved continued improvements in its sustainability KPIs: energy, CO_2, waste and water reduction and increased recycling. The employee accident rate increased 1% year-on-year.

The Group s on-going success is also recognised by a number of highly regarded third party organisations. Smith & Nephew had another year of strong ranking in the Dow Jones Sustainability Index (DJSI) and FTSE4Good, achieved a top 20% ranking in the UK Carbon Reduction Commitment (CRC) obligation and third party verification by the Carbon Trust Standard.

Smith & Nephew constantly strives to improve its performance year-on-year. This year, the appointment of the Group s new Chief Executive Officer, Olivier Bohuon, and the focus of the business around new strategic priorities, provided an opportunity to take a further step in defining our sustainability vision and developing multi-year targets.

Sustainability vision and strategy

Smith & Nephew has been measuring, improving and reporting its sustainability performance since 2001. During this time the Group has made good progress, and is proud of what has been achieved.

Adapting and accelerating sustainability performance is an important element of the Group s overall business strategy. During 2011, Smith & Nephew invested considerable effort re-evaluating the fundamental issues that underpin its approach to sustainability.

Sustainability vision

Collaborate with external and internal customers to develop efficient and innovative sustainable business solutions to help differentiate and grow the business

Top priorities

Sustainability is a multi-faceted subject and developing an executable strategy requires focus on the issues of greatest importance to the Group. To assist with this, the Group conducted extensive consultation with a diverse array of internal and external stakeholders to obtain their insights on topics of importance. These included employees throughout the business, customers, industry peers, investor rating agencies, community partners, and sustainability thought leaders. The Group also evaluated these topics in terms of their potential impact on the business. This materiality analysis identified the focus areas for the sustainability strategy. Those key focus areas are outlined below.

Materiality Analysis

Strategic development

The Group is in the process of refining its strategy for sustainability and the priorities for the next five years, incorporating the materiality analysis work. The Board has actively participated in this discussion and supports the further development of Smith & Nephew s sustainability agenda. Once the Board has agreed the priorities, they will be detailed in the 2011 Sustainability Report to be published later this year.

Hazardous

waste

25%

Close attention to improved manufacturing processes and better sorting of waste streams

2011 Progress

Environmental, health and safety performance

In 2011, the Group accelerated the sustainability commitment by incorporating Group-wide energy, waste and water reduction best practices throughout its operations.

While the Group collects absolute performance data, in this document, data is normalised for changes related to cost of production (using 2010 as base year) to facilitate better year-on-year comparisons. 2011 performance relative to the previous year for the key sustainability parameters is illustrated in the chart below.

2011 Key Performance Indicators

Smith & Nephew is achieving continued improvements in its sustainability KPIs: energy, CO_2, waste and water reduction, and recycling.

% change compared to 2010

*LTAFR Lost time accident frequency rate

Energy consumption for the Group decreased by over 3% in 2011. This was largely attributable to a focus at all sites on energy efficiency projects and despite opening a substantial new commercial building in Memphis and additional production in the new Beijing plant.

The Group s carbon dioxide emissions were reduced by slightly more than 1% over the previous year. This figure is calculated from both direct emissions from the combustion of fossil fuels on Smith & Nephew s sites and secondary emissions from utility company power generation for Smith & Nephew s energy needs. The decrease was linked directly to reduced energy consumption, but the magnitude of the decrease was less than for energy because of the composition of the energy sources some of which are more carbon intensive than others.

The business s total waste production in 2011 declined by nearly 4% over the previous year. This was attributable to disciplined waste reduction projects at all sites. Importantly, within the Group s total waste stream, the hazardous waste output was 25% less than 2010, resulting from close attention to improved manufacturing processes and better sorting of waste streams. Of additional encouragement was the Group s almost 6% increase in waste directed to recycling. As of the end of 2011, the Group is now directing almost 48% of all waste to recycling efforts.

Water consumption, while not substantial, showed a modest decline (-1%) relative to 2010 despite the opening of a significant new commercial building in Memphis.

The one area where the Group fell short in the key measures of performance was in workplace safety, after demonstrating improved performance in 2010. The Lost Time Accident Frequency Rate (LTAFR) increased marginally (1%) over 2010, but the numbers of days lost was higher than last year reflecting a higher accident severity. While quite a number of these accidents were related to unusually severe winter weather, the Group also experienced more accidents within its manufacturing facilities. Considering this, in the fourth quarter of 2011, the Group developed a new workplace safety training protocol that is being implemented in 2012 to help drive improved, long-term safety performance.

People

Smith & Nephew s vision is to be the best at improving people s lives. This vision includes its own employees. In 2011, the Smith & Nephew employee workforce included nearly 11,000 people in approximately 32 countries worldwide.

The management is firmly committed to the benefits of a diverse and balanced workforce across the Group. It appoints on merit and values diversity in its broadest sense, whilst highlighting that the percentage of women Executive Officers in the Group has increased and is now 20%. Additionally, as noted elsewhere in this Report, the Board recognises the importance of diversity. The Board is currently comprised of 20% women and the Group aspire to increase the number of women on the Board to around 25% by 2015.

During 2011, Smith & Nephew introduced a new strategy and operating model to increase its competitiveness in the face of changing economies and health care environments. The Group continues to pursue this strategy, which includes simplifying its operating model, whilst at the same time ensuring all employees are engaged in its future and success.

Smith & Nephew is committed to attracting, retaining and developing talented employees who are dedicated to its core values of Performance, Innovation and Trust. These values represent the foundation of the Group s culture.

Sustainability continued

Suzhou manufacturing facility focuses on energy use reduction.

Despite working in a relatively new facility, our advanced wound product team in China is constantly exploring opportunities for continuous improvement. A wide array of energy efficiency projects including HVAC enhancements and building management protocols were established that resulted in a 27% decrease in energy used in 2011.

2011 Progress continued

We perform

Smith & Nephew and its employees set ambitious goals and seek to achieve them. The Group fosters this through a rigorous performance management process. Feedback to employees is not an annual event but instead an on-going discussion between supervisor and employee. Using a combination of face to face discussion and online tools, objectives are set and aligned at the beginning of each year to support the overall Group strategy, so that every employee can see the link between his or her work and the Group s overall success. CEO Forums are held twice a year and are designed to develop key talent by providing exposure to the broader business and also the opportunity to interact with senior leadership in a small group setting. An Annual General Managers meeting ensures that those closest to Smith & Nephew s markets and customers are fully engaged in the Group s strategy and goals from the start of each year. In 2011, Smith & Nephew initiated annual CEO Awards to reward exceptional contributions to the Group s strategy. This award is open to all employees throughout the Group below executive level.

We innovate

Smith & Nephew encourages and supports new ideas. The Group always seeks solutions to the challenges of its customers and their patients by offering valuable and effective health care products and services. This same innovation applies to Smith & Nephew s practices to recruit, engage and develop its employees. The application process is facilitated through online application. New employees are welcomed through an online global induction program, shortening their learning curve and maximising their opportunities for success. Smith & Nephew believes diversity fuels innovation and is committed to providing equal opportunity to all employees without discrimination. This includes support of employees who are disabled or have become disabled during the course of their employment. In these cases, it is Group policy to provide continuing employment wherever practical in the same or a suitable alternative position.

Each year, Smith & Nephew conducts a comprehensive talent review to identify employees with high potential and ensure they receive the development needed for their success and also develop future leaders for critical roles. As a measure of this success the percentage of vacancies filled by internal applicants in 2011 averaged 35% (2010 32%). The Group s target for all employees continues to be 40% including management positions.

We earn trust

Trust is the foundation on which Smith & Nephew is built and it is the hall-mark of its interactions with stakeholders both inside and outside the Group. A Code of Conduct defines the standards of behaviour for the Group s employees as well as suppliers, contractors and distributors authorised to do business on the Group s behalf. In 2011, Smith & Nephew continued to strengthen its comprehensive compliance program which includes both annual and on-going training for its employees around the world. Smith & Nephew also initiated its first global ethics and compliance survey to serve as a benchmark for on-going improvement efforts.

Smith & Nephew fosters trust through open communication and a collaborative environment where ideas are encouraged, recognised and rewarded. Formal communication channels include Group-wide and divisional newsletters and intranet platforms as well as variety of forums for open dialogue including quarterly reports from the CEO and quarterly employee meetings on the state of the Group and important initiatives.

Ensuring a healthy and safe work environment

Smith & Nephew is committed to a healthy, supportive and safe work environment for its employees. Smith & Nephew does not use any form of forced, compulsory or child labour. The Group s global risk management process ensures that potential issues are identified and mitigated. Smith & Nephew adheres to all local and country regulations and employs a range of applicable health, safety and security measures. Smith & Nephew protects the health of its employees through work-based strategies such as safety and ergonomics, minimising the risk of work-related injury and ensuring that sufficient resources and systems are in place to address health and safety matters. The Group involves all employees in continuous improvement including applicable training, reporting and review of health and safety matters.

Measuring our progress

Smith & Nephew monitors its own internal culture through Employee Engagement Surveys. The Group uses the results of these surveys to identify areas of opportunity and develop and execute action plans to address them. Regular reporting is maintained on some key metrics of engagement. One of the key measures is the average voluntary labour turnover rate. The Group s US and UK employee population (approximately 60% of total employees) have the most established and robust data collection processes in place.

During 2011, the voluntary labour turnover rate in these regions was 8.8%, a slight increase from 7.2% in 2010. Average involuntary labour turnover was 6.3% (2010: 5.1%), which reflects organisational changes taken as part of Smith & Nephew s new strategy and operating model. The average voluntary turnover for employees leaving the Group within two years of joining was 3.7% for 2011, compared to 10.9% in 2010.

Table of Contents

Investment in communities

$14m

$14m was given in support for community charitable causes, grants, sponsorships, medical education and disaster relief.

Investment in R&D

$167m

The Group invested $167m (2010 $151m) in Research and Development to develop improved products and services.

Employee numbers

The average numbers of full-time equivalent employees in 2011 was 10,743, of whom 1,670 were located in the UK, 4,404 were located in the US and 4,669 were located in other countries. The Group does not employ a significant number of temporary employees.

The average number of employees for the past three years by business segment was:

	2011	2010	2009
Orthopaedics	**5,280**	5,045	4,853
Endoscopy	**2,331**	2,134	1,888
Advanced Wound Management	**3,132**	2,993	3,023
	10,743	10,172	9,764

Where the Group has collective bargaining arrangements in place with labour unions, these reflect local market circumstances.

Smith & Nephew operates share option plans that are available to the majority of employees (for further information see Note 24 of the Notes to the Group accounts). The Group has no share plans in which shares have rights with regard to control of the Company that are not exercisable directly by employees.

Our communities

Smith & Nephew is committed to being a strong corporate citizen across its sphere of influence and in particular, in the communities where we work and live. This includes monetary support (cash and donated products) and support of its employees to volunteer for community causes. In 2011, Smith & Nephew s support for community charitable causes, grants, sponsorships, medical education and disaster relief totalled $13,640,000, comprised of $9,101,000 in cash and $4,539,000 in product donations. As a matter of policy, Smith & Nephew makes no political contributions.

Smith & Nephew is committed to establishing mutually beneficial relationships with its suppliers, customers and business partners. The Group works only with partners it believes adhere to business principles and health, safety, social and environmental standards consistent with its own. In 2011, the Group commenced implementation of a formal sustainability performance questionnaire for a sub-set of its supply chain partners.

The Group has also continued to promote diversity objectives through long-term relationships with local or small business enterprises and minority-owned and women-owned business enterprises.

Economic contribution

Sustainability by definition includes positive economic performance. The Group is committed to providing innovative, cost-effective healthcare solutions benefiting patients, healthcare professionals, reimbursement agencies and their patients through improved treatment, ease and speed of product use. The Group s business policies are designed to achieve long-term growth and profits which in turn bring continued economic benefits to shareholders, employees, suppliers and local communities. Highlights for 2011 included:

- Group revenue in 2011 amounted to $4.3 billion (2010 $4.0 billion);
- Smith & Nephew s employment of nearly 11,000 people globally is a substantial economic-generator; total wages and salaries in 2011 amounted to $930m (2010 $817m); and
- The Group invested $167m (2010 $151m) in Research and Development to develop improved products and services.

Looking ahead

A more complete analysis of Smith & Nephew s 2011 sustainability performance will be included in the 2011 Sustainability Report to be published later this year.

Table of Contents

Chairman s introduction to corporate governance

Sir John Buchanan

Chairman

Smith & Nephew is a Group which takes great pride not only in what we do, but in how we do it

Table of Contents

Dear shareholder,

Smith & Nephew is a Group which takes great pride not only in what we do, but in how we do it. The Board of Smith & Nephew is committed to this principle and leads from the top in setting a tone that we expect from all employees across the Group.

Seeking best practice in corporate governance is important to us. All Board members are active contributors to the proper and responsible way of running the Group. The Corporate Governance Statement that follows explains in technical detail how we, as a Board, comply with the corporate governance principles.

However, we feel there is value in highlighting those particular aspects of governance we have dealt with during the year. This gives our shareholders an insight into what governance means at Smith & Nephew.

Board changes

Olivier Bohuon joined the Board on 1 April 2011 and took over as Chief Executive Officer on 14 April following last year s Annual General Meeting, when David Illingworth retired. I have paid tribute to David elsewhere in this Annual Report.

This year, at our Annual General Meeting, Rolf Stomberg will be retiring from the Board after 14 years service. We are truly indebted to Rolf for his enormous contribution and commitment during his time on the Board. He served as Chairman of the Remuneration Committee for 10 years, Senior Independent Director for 9 years and played a major part in the CEO succession process. We have benefited greatly from his experience and wisdom.

We were delighted to welcome Ajay Piramal to the Board in January 2012. Ajay is one of India s most respected businessmen and brings both a wealth of global healthcare experience and, of course, expertise in the emerging markets. It is a major achievement to have attracted Ajay to Smith & Nephew.

Development of strategy

You will have read elsewhere in this Annual Report how Olivier has been redefining our strategic priorities. His work is making a positive impact on the business, our customers, the definition of our KPIs, the analysis of the risks we face and the way we choose to pay and incentivise our employees. Olivier works closely with the Board in this process. We debated the issues extensively at our Strategy Review in September, including analysing the risks that might prevent us meeting our strategic priorities.

Diversity in the Boardroom

We value the diversity of views in our Boardroom. My Board colleagues all come from different backgrounds and each brings unique capabilities and perspectives to our discussions. We have a wide geographical spread and a mix of professional backgrounds. We are committed to maintaining a diverse Board and whilst it is our expectation that 25% of the Board will be female by 2015, we will appoint on merit and value diversity in its broadest forms.

Directors development and effectiveness

The Board and I value the opportunity to visit our multiple locations, learning first-hand about the specific challenges our business faces in

different parts of the world. Visiting our manufacturing, distribution, training or sales and marketing offices and sites gives us a more detailed perspective and interacting with our talented people stimulates ideas. The visits to Shanghai, York and Hull in 2011 gave us valuable insights into these Group operations.

The Board evaluates its own effectiveness. In 2011, Richard De Schutter, our Senior Independent Director led this evaluation process. We felt that in a year of such change, we would benefit more from an internally facilitated evaluation, with an external evaluation scheduled for 2012. The review s conclusions are summarised on page 55.

Director independence

We value the independence of our Non-Executive Directors. It is important that the Chief Executive Officer and the Chief Financial Officer are challenged in the Boardroom, leading to wider debate and better proposals and decisions. This leads to an improved articulation of strategy and enhanced assessment of risk and opportunities.

This can only be done effectively if the Non-Executive members of the Board are prepared to ask the difficult questions, to insist on sound responses and to spend time understanding the key drivers and challenges faced by the Group. Our Non-Executive Directors do this both at formal Board meetings and, on occasion, between meetings.

We value the longevity of our long-serving members, who have a deep understanding of the Group. However, we are also mindful of our need to plan for the future and the need to refresh our Board structure. We shall continue to look for new Non-Executive Directors to ensure that we have a balanced Board with the capabilities fit for taking us into the future and its new challenges.

Ethics and Compliance

You will note that we have a specific Board Committee focused on Ethics and Compliance. This is an area of intense focus for us, given our responsibility to our healthcare customers and their patients and the close scrutiny that the industry faces from regulators. We believe that all our employees should act appropriately and ethically. We have detailed policies and training programmes in force covering all employees in all the territories in which we operate and also our third party sellers.

It is important to set the tone from the top and our Ethics and Compliance Committee therefore reviews all Group activities in this area and takes a lead in enforcing compliance and encouraging good practice.

Finally, while governance sets the vital framework, we are aware that the Board s prime responsibility is to promote the long-term success of the Company for the benefit of customers, employees and shareholders.

Sir John Buchanan

Chairman

22 February 2012

Table of Contents

The Board of Directors

1 Sir John Buchanan

Chairman

Joined the Board as an Independent Non-Executive Director in 2005, appointed Chairman and Chairman of Nominations Committee in April 2006.

Sir John has broad international experience gained in large and complex international businesses. He has substantial experience in the petroleum industry and knowledge of the international investor community. He has held various leadership roles in strategic, financial, operational and marketing positions, including executive experience in different countries. He is a former Executive Director and Group Financial Officer of BP, serving on the BP Board for six years.

Other Directorships

Senior Independent Director and Deputy Chairman of Vodafone Group Plc

Senior Independent Director of BHP Billiton Plc

Chairman of International Chamber of Commerce (UK) Ltd

Member of Advisory Board of Ondra Bank

Chairman of UK Trustees for the Christchurch Earthquake appeal

Board Committee Membership

Nominations Committee

3 Adrian Hennah

Chief Financial Officer

Joined the Board as Chief Financial Officer in June 2006.

Adrian has had extensive financial and management experience in a number of companies including GlaxoSmithKline and Invensys, where he held the position of Chief Financial Officer. His role at Smith & Nephew is strategic as well as financial and he is responsible for driving margin performance and addressing operational improvements.

Other Directorships

Non-Executive Director of Reed Elsevier PLC

Member of Supervisory Board of Reed Elsevier NV

Board Committee Membership

None

4 Ian Barlow

Independent Non-Executive Director

Chairman of Audit Committee

Appointed Non-Executive Director in March 2010 and Chairman of Audit Committee in May 2010.

5 Geneviève Berger

Independent Non-Executive Director

Appointed Non-Executive Director in March 2010.

Geneviève is a scientist with a PhD in Physics and Biology as well as being an MD, and has held a number of senior business roles as Chairman of the Health Advisory Board for the European Commission and Professor at the University of Paris, Le Pitié-Sapêtrière Teaching Hospital and Director General of the French Centre National de La Recherche Scientifique. She is currently, Chief Research & Development Officer at Unilever plc and NV which she originally joined as a Non-Executive Director.

Other Directorships

None

Board Committee Membership

Ethics & Compliance Committee

6 Richard De Schutter

Senior Independent Non-Executive Director

Appointed Non-Executive Director in January 2001 and Senior Independent Director in April 2011.

2 Olivier Bohuon

Chief Executive Officer

Joined the Board and appointed Chief Executive Officer in April 2011.

Olivier has had extensive international experience within a number of pharmaceutical and healthcare companies. Prior to joining Smith & Nephew, he was President of Abbott Pharmaceuticals, a division of Abbott Laboratories based in the US, where he was responsible for the entire business, including R&D, Global Manufacturing and global support functions.

Other Directorships

Non-Executive Director of Virbac Group

Board Committee Membership

Nominations Committee

Ian is a Chartered Accountant and has had extensive financial experience both internationally and in the UK. Prior to his retirement in 2008, he was Senior Partner, London at KPMG and previously Head of their UK tax and legal operations. During his career with KPMG, he acted as Lead Partner for many large international organisations operating extensively in North America, Europe and Asia.

Other Directorships

Chairman of WSP Group plc

Non-Executive Director and Chairman of the Audit Committee of the PA Consulting Group

Non-Executive Director and Chairman of the Audit Committee of Brunner Investment Trust

Chairman of The Racecourse Association

Non-Executive Director of the Board of Her Majesty s Revenue and Customs

Board Committee Membership

Audit Committee

Richard has had extensive US corporate experience at Chief Executive and Chairman level in a number of major corporations with primarily a scientific, chemical, engineering or pharmaceutical focus including GD Searle, Monsanto, Pharmacia Corporation and DuPont Pharmaceuticals.

Other Directorships

Non-Executive Chairman of Incyte Corporation

Non-Executive Director of Navicure Inc

Non-Executive Director of Sprout Pharmaceuticals

Board Committee Membership

Nominations Committee

Audit Committee

Ethics & Compliance Committee

Remuneration Committee

7 Pamela Kirby

Independent Non-Executive Director

Chairman of the Ethics &

Compliance Committee

Appointed Non-Executive Director in March 2002 and Chairman of Ethics and Compliance Committee in April 2011.

Pamela has extensive commercial and product development experience within the international pharmaceutical and healthcare industry. Her last executive position was Chief Executive of Quintiles Transnational Corp in the USA, having previously held senior positions in various pharmaceutical companies including AstraZeneca and F. Hoffmann- La Roche. She is now a Non-Executive Director of a number of international companies.

Other Directorships

Non-Executive Chairman of Scynexis Inc.

Non-Executive Director of Informa plc

Non-Executive Director of Victrex plc

Non-Executive Member of the Board of Simmons & Simmons LLP

Board Committee Membership

Ethics & Compliance Committee

Remuneration Committee

9 Joseph Papa

Independent Non-Executive Director

Chairman of the Remuneration Committee

Appointed Non-Executive Director in August 2008 and Chairman of Remuneration Committee in April 2011.

Joseph has had nearly 30 years experience in the pharmaceutical industry working for a number of companies both in the US and Switzerland. He is now Chairman and Chief Executive of Perrigo, one of the largest over the counter pharmaceutical companies in the US, having held senior positions at Novartis, Cardinal Health Inc. and Pharmacia.

Other Directorships

Chairman and Chief Executive of Perrigo Company

Board Committee Membership

Remuneration Committee

Audit Committee

Ethics and Compliance Committee

10 Ajay Piramal

Independent Non-Executive Director

Appointed Non-Executive Director in January 2012.

11 Rolf Stomberg

Independent Non-Executive Director

Appointed Non-Executive Director in 1998. Retiring from the board following the Annual General Meeting on 14 April 2012.

Rolf has a wide board experience within a range of diverse international industries. He held a number of leadership positions at BP over a number of years until his retirement in 1997, when he was Chief Executive Officer of BP Oil and a member of the BP Board. He is now a Non-Executive Director of a number of international companies.

Other Directorships

Chairman of Lanxess AG

Non-Executive Director of Hoyer GmbH,

Non-Executive Director of Biesterfeld AG

Non-Executive Director of Severstal OAU

Non-Executive Director of Ruspetro Plc

Board Committee Membership

Nominations Committee

Audit Committee

Remuneration Committee

12 Susan Henderson

Company Secretary

8 Brian Larcombe

Independent Non-Executive Director

Appointed Non-Executive Director in March 2002.

Brian spent his career in private equity with 3i Group. After leading the UK investment business for a number of years, he became Finance Director and then Chief Executive of the Group following its flotation. He is well known in the City and has held a number of Non-Executive Directorships.

Other Directorships

Non-Executive Director of gategroup Holdings AG

Non-Executive Director of Incisive Media Holdings Limited

Board Committee Membership

Audit Committee

Remuneration Committee

Ajay is one of India s most respected businessmen. He enabled the Piramal Group to transform from a textile centric group to a $2.0bn conglomerate in diversified areas. He has extensive industry and market knowledge and international experience particularly in India and China. He has held a number of global healthcare leadership positions in both India and internationally.

Other Directorships

Chairman of Piramal Healthcare, Piramal Glass, Allergan India Limited, IndiaREIT fund advisors and IndiaVentures Advisors

Chairman of Board of Governors of Indian Institute of technology, Indore

Member of Board of Dean s Advisors at Harvard Business School

Chairman of Pratham India

Board Committee Membership

None

Appointed Company Secretary in May 2009.

Susan has nearly 30 years experience as a company secretary in a wide range of companies including Prudential plc, Amersham plc and RMC Group plc. Her work has covered Board support, corporate governance, corporate transactions, share registration, listing obligations, corporate social responsibility, pensions, insurance and employee and executive share plans. Susan is a member of the GC100 Group Executive Committee and the CBI Companies Committee and is a frequent speaker on corporate governance related matters.

Table of Contents

Corporate Governance

Executive Officers

Olivier Bohuon is supported in the day-to-day management of the Group by a strong team of Executive Officers:

Mike Frazzette

President, Advanced Surgical Devices

Joined Smith & Nephew in July 2006 as President of the Endoscopy business. Since July 2011, he has headed up our Advanced Surgical Devices division and is responsible for the Orthopaedic, Trauma and Endoscopy business in Established Markets. He is based in Andover, Massachusetts.

Previous Experience

Mike has held a number of senior positions within the US medical devices industry. He was President and Chief Executive Officer of Micro Group, a US manufacturer of medical devices and spent 15 years at Tyco Healthcare becoming President of each of the Patient Care and Health Systems divisions.

Mark Augusti

Helen Maye

President, Clinical Therapies/Biologics

Joined Smith & Nephew in 2003 and since January 2008, has led the Clinical Therapies and Biologics businesses. He is based in Raleigh, North Carolina. He will leave the Group on completion of the Clinical Therapies disposal announced on 4 January 2012.

Previous Experience

Mark has held a number of senior positions within the Orthopaedics and Biologics businesses of Smith & Nephew. Prior to joining Smith & Nephew, he worked for GE Medical Systems in the US and Asia. Mark is also a Non-Executive Director of Hutchinson Technology Inc.

Head of Group Human Resources

Joined Smith & Nephew in July 2011. She is based in London and leads the Global Human Resources and Internal Communications functions.

Previous Experience

Helen has more than 30 years experience across a variety of international and global roles in medical devices and pharmaceuticals, including manufacturing, supply chain and human resources. Previously, she was Divisional Vice President of Human Resources at Abbott Laboratories.

Table of Contents

Roger Teasdale

President, Advanced Wound Management

Joined Smith & Nephew in 1989 within the Wound Management business. He was appointed President of Advanced Wound Management in May 2009. He is based in Hull.

Previous Experience

Roger has held a number of key roles within the Smith & Nephew Group in both the UK and the US and has been responsible for leading the transformation of the wound business in recent years.

Francisco Canal Vega

President, Emerging Markets

Joined Smith & Nephew in January 2012. He is based in Dubai and leads the Emerging Markets division, focusing particularly on achieving market leading growth in Brazil, Russia, China and India.

Previous Experience

Francisco has held senior management positions in global companies including Gambro AB, Excelsior and Baxter International and has lived and worked in many countries including China, Japan, US and Spain. Francisco was also formerly a Board Member of EUCOMED.

Kelvin Johnson

President, International Markets

Joined Smith & Nephew in 1980 and was appointed to lead the International Markets division, covering all countries outside the Established and Emerging Markets in 2011. He is based in Dubai.

Previous Experience

Kelvin has held a number of key international roles with Smith & Nephew, firstly in South Africa and then leading the Emerging Market strategy. He has spent some time leading the Group s increased focus in China.

Ros Rivaz

Chief Technology Officer

Joined Smith & Nephew in November 2011. She is responsible for global operations, IT systems, Corporate Sustainability and Regulatory and Quality Affairs and is focused on improving efficiency in Smith & Nephew s processes. Ros is based in London.

Previous Experience

Ros has held senior management positions in global companies in the areas of supply chain management, logistics, manufacturing, procurement and systems, including, Imperial Chemical Industries, Tate & Lyle, Diageo and Premier Foods. She has 30 years experience across all areas of operational excellence.

Gordon Howe

Senior Vice President,

Global Planning and Development

Joined Smith & Nephew in 1998 and, since August 2007, has headed up the Global Planning and Business Development teams. He is based in Memphis, Tennessee.

Previous Experience

Gordon has held a number of senior management positions within the Smith & Nephew Group firstly in the Orthopaedics division and more recently at Group Level. Prior to joining the Company, he held senior roles at United Technologies Corporation.

Jack Campo

Chief Legal Officer

Joined Smith & Nephew in June 2008 and heads up the Global Legal function. Since late 2011 he has been based in Andover, Massachusetts.

Previous Experience

Prior to joining Smith & Nephew, Jack held a number of senior legal roles within the General Electric Company including 7 years at GE Healthcare (GE Medical Systems) in the US and Asia.

Corporate Governance Statement

Compliance Statement

We are committed to the highest standards of corporate governance and comply with all the provisions of the UK Corporate Governance Code (the Code). The Company s American Depositary Shares are listed on the NYSE and we are therefore subject to the rules of the NYSE as well as to the US securities laws and the rules of the SEC applicable to foreign private issuers. We comply with the requirements of the SEC and NYSE except that the Nominations Committee is not comprised wholly of independent Directors, as required by the NYSE, but consists of a majority of independent Directors in accordance with the Code. We shall explain in this Corporate Governance Statement and in the Directors Remuneration Report how we have applied the provisions and principles of the FSA Listing Rules, the Disclosure & Transparency Rules (DTR), and the Code throughout the year.

Board

The Board is responsible for determining the strategy of the Chief Executive Officer and his Executive team implement that strategy. The chart on the next page gives more detail about the structure of the Board, the matters we deal with and the key activities we undertook in 2011.

Roles of Directors

Whilst we all share collective responsibility for the activities of the Board, some of our roles have been defined in greater detail. In particular, the roles and responsibilities of the Chairman and Chief Executive Officer are clearly defined.

Chairman

- Building a well balanced Board
- Chairing Board meetings and setting Board agenda
- Ensuring effectiveness of the Board and ensuring annual review undertaken

Encouraging constructive challenge and facilitating effective communication in the Board

Promoting effective Board relationships

Ensuring appropriate induction and development programmes

Ensuring effective two way communication and debate with shareholders

Setting the tone at the top with regard to compliance and sustainability matters

Promoting high standards of corporate governance

Maintaining appropriate balance between stakeholders

Chief Executive Officer

Developing and implementing Group strategy

Recommending the annual budget and five year strategic and financial plan

Ensuring coherent leadership of the Group

Managing the Group s risk profile and establishing effective internal controls

Regularly reviewing organisational structure, developing executive team and planning for succession

Ensuring the Chairman and Board are kept advised and up to date regarding key matters

Maintaining relationships with shareholders and advising the board accordingly

Setting the tone at the top with regard to compliance and sustainability matters

The Non-Executive Directors meet regularly prior to each Board meeting without management in attendance. The roles of Non-Executive Directors and in particular the Senior Independent Non- Executive Director are defined as follows:

Non-Executive Directors

Providing effective challenge to management

Assist in development of strategy

Serve on the Board Committees

Senior Independent Non-Executive Director

Chairing meetings in the absence of the Chairman

Acting as sounding board for the Chairman on Board related matters

Acting as an intermediary for the other Directors where necessary

Available to shareholders on matters which cannot otherwise be resolved

Leading annual evaluation into the Board s effectiveness

Leading search for a new Chairman, as necessary

Independence of Non-Executive Directors

We are sensitive to the need for our Non-Executive Directors to remain independent from management in order to exercise our independent oversight and effectively challenge management as necessary. The Board has determined that all Non-Executive Directors are independent in accordance with both UK and US requirements. None of our Non-Executive Directors or their immediate families has ever had a material relationship with the Group either directly as an employee or as a partner, shareholder or officer of an organisation that has a relationship with the Group. None of them receive additional remuneration apart from Directors fees, nor do they participate in the Group s share option plans, performance related pay schemes or pension schemes. Nor do they serve as Directors of any companies or affiliates in which any other Director is a Director.

Now that Olivier Bohuon has settled into his new role and we are beginning to implement our new strategy, we are in a position to analyse the appropriate Board balance and structure for the future. We know that we will need different skills and experiences and, in particular, we would like to have a greater representation from Emerging Markets, which is a key Strategic Priority for us. The appointment of Ajay Piramal at the beginning of 2012 goes some way towards achieving this.

Rolf Stomberg has served on the Board for 14 years and will be retiring from the Board following this year s Annual General Meeting. We are continuing to look for suitable Non-Executive Directors and, in due course, other longer serving Directors will step down.

Table of Contents

Board Membership

Non-Executive Chairman Sir John Buchanan

Chief Executive Officer Olivier Bohuon (appointed on 1 April 2011)

Chief Financial Officer Adrian Hennah

8 Independent Non-Executive Directors

- Richard De Schutter (Senior Independent Director)
- Ian Barlow
- Geneviève Berger
- Pamela Kirby
- Brian Larcombe
- Joseph Papa
- Ajay Piramal (appointed 1 January 2012)
- Rolf Stomberg (to retire on 12 April 2012)

(David Illingworth retired as Chief Executive on 14 April 2011)

Role of the Board as set out in the schedule of matters reserved to the Board

Strategy
Approving the Group strategy including major changes to corporate and management structure, acquisitions, mergers, disposals, capital transactions over $10m, annual budget, financial plan, business plan, major borrowings and finance and banking arrangements
Approving changes to the size and structure of the Board, overseeing succession planning and the appointment and removal of Directors and the Company Secretary
Approving Group polices relating to corporate social responsibility, health and safety, Code of Conduct and Code of Share Dealing and other matters
Performance
Reviewing performance against strategy, budgets and financial and business plans
Overseeing Group operations and maintaining a sound system of internal control
Determining dividend policy and dividend recommendations
Approving the appointment and removal of the auditors and other professional advisors and approving significant changes to accounting policies or practices
Approving the use of the Company s shares in relation to employee and executive incentive plans
Risk
Determining risk appetite, regularly reviewing risk register and risk management processes
Shareholder Communications
Approving preliminary announcement of annual results, annual report, half yearly report, quarterly interim management statements, the release of price sensitive announcements and any listing particulars, circulars or prospectuses
Maintaining relationships and continued engagement with shareholders

Key activities in 2011 (in addition to regular annual activities)

Appointment of Olivier Bohuon as Chief Executive Officer

Approval of new strategy and updated organisational structure

Approval of risk management programme

Approval of five year plan

Review of effectiveness of Board

Review of on-going Board composition

9 Scheduled meetings

3 Telephone Update Calls

4 Day Strategy Review and visit to our China operations

2 Day visit to our York and Hull operations

Corporate Governance Statement continued

Board and Committee attendance

The table below details attendance of Directors at Board and Committee meetings held throughout the year:

	Board 9 meetings	Remuneration Committee 4 meetings	Audit Committee 6 meetings	Nominations Committee 4 meetings	Ethics and Compliance Committee 4 meetings
Sir John Buchanan	9			4	
Olivier Bohuon (i)	7		3		
David J. Illingworth (ii)	3			1	
Adrian Hennah	9				
Ian Barlow	9		6		
Geneviève B. Berger (iii, iv)	8				2
Pamela J. Kirby	9	4			4
Brian Larcombe	9	4	6		
Joseph C. Papa	9	4	6		4
Richard De Schutter	9	4	6	4	4
Rolf W. H. Stomberg	9	4	6	4	

(i) Appointed to the Board on 1 April 2011.

(ii) Retired from the Board on 14 April 2011.

(iii) Appointed to the Ethics and Compliance Committee on 14 April 2011.

(iv) Attended all scheduled meetings and was unable to attend some meetings arranged at short notice because of prior commitments.
From time to time Directors also attend Committee meetings at the invitation of the Committee Chairman, even if they are not members of the Committee, in order to gain a better understanding of the activities of that Committee.

Board development programme

In 2011, the Board development programme focused on continuing to increase our understanding of the business and markets in which the Group operates. Throughout the year, we receive regular updates from our business operations across the world. It is however very much more real to visit these operations, to view the processes and to meet the people running and working in the businesses. This gives us an in-depth understanding of the opportunities and challenges employees face on a daily basis and helps to inform our decisions. Meeting our key employees around the world also helps us with succession planning.

We have commenced an induction programme for Ajay Piramal who joined the Board on 1 January 2012. He has received a briefing on the responsibilities and duties of a Director of a UK Listed company as well as a number of key corporate documents. A programme of events is being planned for his first visit to London as a member of our Board, when he will meet with senior employees and have the opportunity to visit some of our key UK locations.

Month	Activity
September	Visit to Advanced Wound Management Factory in Suzhou, China
	Visit to Emerging Markets Head Office in Shanghai, China
	Presentation on the opportunities and challenges of doing business in China
	Presentation on the challenges of developing a Strategy in emerging markets
November	Visit to Surgical Skills Centre in York
	Visit to Advanced Wound Manufacturing factory and Head Office in Hull

Board evaluation

Towards the end of 2011, Richard De Schutter, the Senior Independent Director led a review into the effectiveness of the Board and its Committees as a whole as well as reviewing individual contributors. He asked us to complete an online questionnaire and then interviewed each of us individually. With the appointment of a new Chief Executive Officer during the year and the subsequent development of the updated Strategic Priorities and organisational structure, we felt that it would be more beneficial to use an external facilitator for our effectiveness review in 2012, once some of the changes have had time to settle. Richard De Schutter reported back to us on his findings, which we discussed in detail in February 2012.

The review concluded that the Board works effectively and has an appropriate balance of experience and skills. Non-Executive Directors particularly valued receiving regular reports from Olivier Bohuon between meetings and having meetings with myself without management present prior to each Board meeting. We were also satisfied with the positive start made by Olivier Bohuon as Chief Executive Officer and welcomed the progress he was making in implementing the new strategy and in building a strong team.

We identified certain areas for continued improvement throughout 2012:

- Ensuring that we spend more time in Board meetings on key strategic issues and not allowing time to be spent on operational matters that impact that priority
- Implementing a more streamlined process for the appointment of Non-Executive Directors
- Gaining a better understanding of succession planning below Board level
- Taking more time to review our competitors and their strategies better
- Reviewing our past decisions on a systematic basis

Company Secretary and Independent Advice

The Company Secretary, Susan Henderson, is responsible to the Board for ensuring that we comply with all corporate governance requirements and are kept updated on our responsibilities. We all have access to her, individually and collectively.

We may also, from time to time, obtain independent professional advice, at the Company s expense, if we judge it necessary in order to fulfil our responsibilities as Directors. If we are unable to attend a Board meeting or Board Committee meeting, we ensure that we are familiar with the matters to be discussed and make our views known to the Chairman or the Chairman of the relevant Committee prior to the meeting.

Management of Conflicts of Interest

None of us nor our connected persons has any family relationship with any other Director or officer nor has a material interest in any contract to which the Company or any of its subsidiaries are or were a party during the year or up to 21 February 2012.

Each of us has a duty under the Companies Act 2006 to avoid a situation in which we have or may have a direct or indirect interest that conflicts or possibly may conflict with the interests of the Company. This duty is in addition to the existing duty that we owe to the Company to disclose to the Board any transaction or arrangement under consideration by the Company. If we become aware of any situation which may give rise to a conflict of interest, we inform the rest of the Board immediately and the Board is then permitted under the articles of association to authorise such conflict. The information is recorded in the Company s Register of Conflicts together with the date on which authorisation was given. In addition, we certify, on an annual basis, that the information contained in the Register is correct.

When the Board decides whether or not to authorise a conflict, only the Directors who have no interest in the matter are able to participate in the discussion and a conflict is only authorised if we believe that it would not have an impact on our ability to promote the Company s success in the long-term. Additionally, we may, as a Board determine that certain limits or conditions must be imposed when giving authorisation. We have identified no actual conflicts which have required approval by the Board. We have, however, identified seven situations which could potentially give rise to a conflict and these have been duly approved by the Board and are reviewed on an annual basis.

Re-appointment of Directors

In accordance with the Code, with effect from the Annual General Meeting held in 2011, all Directors, including Ajay Piramal who was appointed on 1 January 2012, offer ourselves to shareholders for re-election annually. In 2012 Rolf Stomberg will be retiring from the Board and will not offer himself for re-election as noted previously. Retiring Directors retain office until the conclusion of the Annual General Meeting. In addition, each Director may be removed at any time by the Board or the shareholders.

Corporate Governance Statement continued

Directors Indemnity Arrangements

Each Director is covered by appropriate directors and officers liability insurance and there are also Deeds of Indemnity in place between the Company and each Director. These Deeds of Indemnity mean that the Company indemnifies Directors in respect of any proceedings brought by third parties against them personally in their capacity as Directors of the Company. The Company would also fund on-going costs in defending a legal action as they are incurred rather than after judgement has been given. In the event of an unsuccessful defence in an action against them, individual Directors would be liable to repay the Company for any damages and to repay defence costs to the extent funded by the Company.

Liaison with shareholders

The Executive Directors meet regularly with investors to discuss the Company s business and financial performance both at the time of the announcement of results and at industry investor events. During 2011, the Executive Directors held meetings with institutional investors, including investors representing approximately 47% of the share capital as at December 2011.

As part of this programme of investor meetings, during 2011, as Chairman of the Company, I met with investors representing 13.5% of the share capital. Over the last three years, I have met investors representing in aggregate 22.8% of the share capital. Also during 2011, Joseph Papa met with shareholders holding 14.3% of the share capital to discuss remuneration policies and plans and to introduce himself as the new Chairman of the Remuneration Committee.

We receive a short report at every Board meeting reviewing our major shareholders and any significant changes in their holdings since the previous meeting. Olivier Bohuon and Adrian Hennah routinely advise us of any concerns or issues that shareholders have raised with them in their meetings. We also receive copies of analysts reports on the Company and our peers between Board meetings.

The Company s website (www.smith-nephew.com) contains information of interest to both institutional investors and private shareholders, including financial information and webcasts of the results presentations to analysts for each quarter, as well as specific information for private shareholders relating to the management of their shareholding.

Share capital

As at 21 February 2012, the Company s total issued share capital with voting rights consisted of 895,845,540 Ordinary Shares of 20 US cents each. 60,322,610 Ordinary Shares are held in treasury and are not included in the above figure.

As at 21 February 2012, notification had been received from the undernoted investors under the DTR in respect of interests in 3% or more of the issued Ordinary Shares with voting rights of the Company.

	Number of Shares	%
Invesco	44,901,016	5.02
BlackRock, Inc.	44,811,205	5.02
Newton Investment Management Limited	44,337,465	4.98
Legal and General Group plc	35,675,739	3.99

In addition to the above the Company is aware that Walter Scott & Partners Limited hold approximately 38m Ordinary Shares (4.2%). Otherwise, the Company is not aware of any person who has a significant direct or indirect holding of securities in the Company and is not aware of any persons holding securities which may control the Company. There are no securities in issue which have special rights as to the control of the Company.

Dividend

The Board has proposed a final dividend of 10.80 US cents per share which, together with the interim dividend of 6.60 US cents, makes a total for 2011 of 17.40 US cents. The final dividend is expected to be paid, subject to shareholder approval, on 9 May 2012 to shareholders on the register of Members at the close of business on 20 April 2012.

Annual General Meeting

The Company s Annual General Meeting is to be held on 12 April 2012 at 2pm at The Royal Society, 6-9 Carlton House Terrace, London, SW1Y 5AG. Registered shareholders have been sent either a Notice of Annual General Meeting or notification of availability of the Notice of Annual General Meeting, as appropriate.

Code of Ethics for senior financial officers

We have adopted a Code of Ethics for senior financial officers, which is available on the Group s website (www.smith-nephew.com) and on request. This applies to the Chief Executive Officer, Chief Financial Officer, Group Financial Controller and the Group s senior financial officers. There have been no waivers to any of the Code s provisions nor any amendments made to the Code during 2011 or up until 21 February 2012.

Table of Contents

Evaluation of internal controls procedures

Management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934.

We, as a Board, are responsible overall for reviewing and approving the adequacy and effectiveness of internal controls operated by the Group, including financial, operational and compliance controls and risk management. We have delegated responsibility for the review of financial, ethical compliance and quality management systems controls to the Audit Committee, which reviews the internal control process, on an annual basis and evaluates its effectiveness to ensure that it remains robust and to identify any control weaknesses. The latest review covered the financial year to 31 December 2011 and included the period up to the approval of this Annual Report. The main elements of this annual review are as follows:

The Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of the design and operation of the Group s disclosure controls and procedures as at 31 December 2011. Based upon this evaluation, the Chief Executive Officer and Chief Financial Officer concluded on 22 February 2012 that the disclosure controls and procedures were effective as at 31 December 2011.

Management is responsible for establishing and maintaining adequate internal control over financial reporting. Management assessed the effectiveness of the Group s internal control over financial reporting as at 31 December 2011 in accordance with the requirements in the US under s404 of the Sarbanes-Oxley Act. In making this assessment, they used the criteria set forth by the Committee of Sponsoring Organisations of the Treadway Commission in Internal Control-Integrated Framework. Based on their assessment, management concluded and reported that, as at 31 December 2011, the Group s internal control over financial reporting is effective based on those criteria.

Having received the report from management, the Audit Committee reports to the Board on the effectiveness of controls.

Ernst & Young LLP, an independent registered public accounting firm issued an audit report on the Group s internal control over financial reporting as of 31 December 2011. This report appears on page 83.

There is an established system of internal control throughout the Group and our divisions. The main elements of the internal control framework are as follows:

The management of each Division is responsible for the establishment and review of effective internal financial controls within their Division.

The Group Finance Manual sets out, amongst other things, financial and accounting policies and minimum internal financial control standards.

The Internal Audit function agrees an annual work plan and scope of work with the Audit Committee.

The Audit Committee reviewed reports from the internal auditors on their findings on internal financial controls.

The Audit Committee reviews the Group Whistleblower procedures.

The Audit Committee reviews regular reports from the Group Financial Controller and the Taxation and Treasury functions.

This system of internal control has been designed to manage rather than eliminate material risks to the achievement of our strategic and business objectives and can provide only reasonable, and not absolute, assurance against material misstatement or loss. Because of inherent limitations, our internal controls over financial reporting may not prevent or detect all mis-statements. In addition, our projections of any evaluation of effectiveness in future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. This process complies with the Turnbull working party guidance, revised October 2005 and additionally contributes to our compliance with the obligations under the Sarbanes-Oxley Act 2002 and other internal assurance activities. There has been no change in the Group s internal control over financial reporting during the period covered by this Annual Report that has materially affected, or is reasonably likely to materially affect, the Group s internal control over financial reporting.

Principal accountant fees and services

Fees for professional services provided by Ernst & Young LLP, the Group s independent auditors in each of the last two fiscal years, in each of the following categories were:

	2011 **$ million**	**2010** **$ million**
Audit	3	3
Audit related fees		
Tax	2	2
Other		
	5	**5**

Audit fees include fees associated with the annual audit and local statutory audits required internationally. A more detailed breakdown of audit fees may be found in Note 3 of the Notes to the Group accounts.

Disclosure of information to the auditors

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 auditors, Ernst & Young LLP, are 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 auditors are aware of such information.

Auditors

Ernst & Young LLP have expressed their willingness to continue as auditors and resolutions proposing their reappointment and to authorise the Directors to determine their remuneration will be proposed at the Annual General Meeting as approved by the Audit Committee.

Directors Report

The Directors Report includes the following sections; Business Review (pages 14 to 45), Corporate Governance (pages 46 to 76) and Investor Information (pages 137 to 150).

Corporate headquarters and registered office

The corporate headquarters is in the UK and the registered office address is: Smith & Nephew plc, 15 Adam Street, London WC2N 6LA, UK. Registered in England and Wales No. 324357. Tel: +44 (0) 20 7401 7646. Website: www.smith-nephew.com.

Table of Contents

Corporate Governance Statement continued

Committees of the Board

We delegate some of the Board s detailed work to four Committees. Each of these has their own terms of reference, which may be found on the Group s website at www.smith-nephew.com. The Company Secretary or her designate is secretary to each of the Committees. The Chairman of each Committee reports orally to the Board and minutes of the meetings are circulated to all members of the Board.

Audit Committee

Ian Barlow

Membership

Ian Barlow (Chairman) (Independent and financial expert)

Brian Larcombe (Independent)

Joseph Papa (Independent)

Richard De Schutter (Independent)

Rolf Stomberg (Independent)

Six Meetings

Main Responsibilities

Ensure Integrity of financial statements, reviewing significant financial reporting judgments and compliance with accounting standards, policies and practices ensuring compliance with UK and US statutory requirements

Monitor announcements relating to Group s financial performance

Monitor effectiveness of internal controls and compliance with s404 Sarbanes Oxley

Review operation of Group s risk management processes and the control environment mitigating compliance and quality management system risk

Recommend the re-appointment of the external auditors, monitor and review their performance, and the effectiveness of the audit process

Receive reports on fraud and whistleblowing

Agree internal audit plans and review internal audit reports

Monitor the effectiveness of the internal audit function

Key Activities in 2011 (in addition to main responsibilities)

Reviewed plans for reformatting the Annual Report

Reviewed the risk management process

Assumed responsibility for the review of the audit of Quality Management Systems

Considered the management of strategic risk by the Tax function

Reviewed the operations of the Disclosures Committee

Received and considered a report from the Treasury function

Received and considered an external report on the effectiveness of the internal audit function

Remuneration Committee

Joseph Papa

Membership

Joseph Papa (Chairman) (Independent)

Brian Larcombe (Independent)

Pamela Kirby (Independent)

Richard De Schutter (Independent)

Rolf Stomberg (Independent)

Four Meetings

Three matters agreed by written resolution

Main Responsibilities

Determine remuneration policy for Executive Directors and senior executives

Approve individual remuneration packages for Executive Directors and Executive Officers at least annually and any major changes to individual packages throughout the year

Determine the use of long-term incentive plans and oversee the use of shares in all executive and employee plans

Approve appropriate performance measures for short-term and long-term incentive plans for Executive Directors and senior executives

Determine pay-outs under short-term and long-term incentive plans for Executive Directors and senior executives

Approve Directors Remuneration Report ensuring compliance with related governance provisions

Maintain constructive engagement on remuneration issues with shareholders

Have regard to remuneration policies and practices across the Group

Key Activities in 2011 (in addition to main responsibilities)

Approved package for incoming Chief Executive Officer and retirement arrangements for outgoing Chief Executive

Approved joining and leaving packages for all direct reports to Chief Executive Officer

Undertook comprehensive review of remuneration arrangements for top 70 senior executives to align remuneration with the updated Group strategy

Undertook engagement programme with major shareholders to explain new remuneration arrangements

Ethics & Compliance Committee

Pamela Kirby

Membership

- Pamela Kirby (Chairman) (Independent)
- Joseph Papa (Independent)
- Richard De Schutter (Independent)
- Geneviève Berger (Independent)

Four Meetings

Main Responsibilities

- Review ethics and compliance programmes
- Review policies and training programmes
- Review compliance performance based on monitoring auditing and investigations data

Review hotline issues and calls

Review Group s internal and external communications relating to ethical and compliance issues

Review external developments and compliance activities

Receive reports from the Executive ethics and compliance meetings and from the Chief Compliance Officer and the Chief Legal Officer

Key Activities in 2011 (in addition to main responsibilities)

Reviewed implications of UK Bribery Act and approved updates to processes as appropriate

Reviewed updates on compliance programme for distributors

Reviewed internal reports into the effectiveness of our compliance arrangements in China

Nominations Committee

Sir John Buchanan

Membership

Sir John Buchanan (Chairman) (Independent on appointment)

Olivier Bohuon

Richard De Schutter (Independent)

Rolf Stomberg (Independent)

Four Meetings

One matter agreed by written resolution

Main Responsibilities

Review size and composition of Board

Oversee Board succession plans

Recommend Director appointments

Key Activities in 2011 (in addition to main responsibilities)

Undertook the search for a new Chief Executive Officer and recommended the appointment of Olivier Bohuon

Reviewed and updated the parameters for the search for additional Non-Executive Directors. Recommended changes to the composition and chairmanship of Board Committees

Recommended the appointment of Ajay Piramal as Non-Executive Director

Considered the implications of the Davies Report and revised policy on building a diverse Board

Reviewed our use of search firms

Corporate Governance Statement continued

Audit Committee

Dear shareholder,

I am pleased to present my report on the activities of the Audit Committee in 2011. The membership and the principal duties of the Committee are set out in the table on page 58 of this report.

The members are all independent Directors and bring relevant expertise to the committee from their current or prior roles as Chief Executives of substantial businesses both in the UK and USA and from their roles as Non-Executive Directors at other corporations. I myself am the designated finance expert being a Chartered Accountant and former senior partner at KPMG UK, retiring in 2008.

In addition to the usual matters, which fall to the Audit Committee, such as approving the financial results for the year, half year and the quarterly interim management statements and the review of applicable accounting policies and going concern assumptions, the Audit Committee reviewed a number of topics during 2011.

Review of format of Annual Report

As you will have noticed, we undertook a thorough review of the style and format of the Annual Report during 2011. We wanted to present our Group to you in a clearer more user friendly manner, so that you could find your way more easily around the document to the information you need. We have explained our Strategic Priorities and their relation to our Key Performance Indicators, risk and remuneration policies. We have included more tables, charts and pictures and adopted a more personal style in explaining our approach to governance. We are mindful of proposals from the Department of Business Innovation And Skills regarding Narrative Reporting and regard the work done in refocusing the Annual Report this year, as being a good base on which to build the report of the future.

Review of accounting policies

As noted we reviewed and concluded on the appropriateness of the Group s principal accounting policies, practices and accounting judgments concentrating on the critical accounting policies requiring management s judgement, namely the valuation of inventory, review of the carrying value of goodwill, intangible and tangible assets and the valuation of retirement benefits, contingencies and provisions.

Compliance

We reviewed compliance with accounting standards, accounting policies and practices, accounting and reporting issues, going concern assumptions and the UK Corporate Governance Code and section 404 of the Sarbanes Oxley Act. No concerns were raised with us in 2011 about possible improprieties in matters of financial reporting or other matters.

Review of Internal Audit function

We reviewed the Internal Audit function, its programme of work and its resourcing requirements, specifically in the area of internal controls over financial reporting, ethical compliance, quality management systems (see below), assessing the effectiveness of the risk management process and the prevention and detection of fraud. We were assisted in this by an external review carried out by PricewaterhouseCoopers. This concluded that the internal audit function was effective and respected across the Group having adapted successfully to an expanding remit to address the changing needs of the business.

Quality Management Systems audit

In 2010, our Internal Audit function assumed responsibility for the review of our quality management systems, for our systems that monitor our manufacturing activities for compliance with standards set by regulatory authorities, including the FDA in the US, the MHRA in the UK and other comparable bodies worldwide. We continued to review the work of the Internal Audit function in this area in 2011. This work included monitoring controls that mitigate quality management system risk.

Review of risk management process

We examined and updated the way we manage risk within the organisation and undertook a mapping exercise to link the key risks identified within our businesses with the key risks identified by the Board at our Strategy Review. We then linked these risks back to our

Strategic Priorities and identified the mitigating action in place to control these risks. This will assist the Board and senior management to concentrate on the key strategic risks and their management faced by the Group. These are both downside risks (something going wrong) and upside risk (missed opportunities).

We continued to review the Group s approach to internal financial control and the operation of the risk management process. We also evaluated the effectiveness of the Group s systems to identify and manage material risks.

Receipt of functional reports

During the year, we received reports from the Tax and Treasury functions including how they manage risk.

Review of the work of the external auditors

We assessed the performance of Ernst & Young, our external auditors. This was done throughout the year through review of their regular reports on the scope and outcomes of their work. These reports included accounting matters, governance and control and accounting developments. In addition we utilised formal year-end feedback from all our operating units as a result of which we asked for improvements to be made in two operating locations. We reviewed the inspection reports from the Auditor Oversight Boards in the UK and the US. We also ensured that the audit-related, tax and other services received from the external auditors were pre-approved in accordance with the Auditor Independence Policy described below. Finally we reviewed the fees of the auditors using benchmarking against groups of comparable size and complexity. Our conclusions were that the external audit was carried out effectively and with the necessary objectivity and independence and this is the basis for our recommendation to the Board and shareholders that Ernst & Young be reappointed.

Auditor Independence Policy

We have determined a schedule of approved non-audit services for the Group external auditors to undertake. Our Auditor Independence Policy prohibits the external auditors from performing services which would result in the auditing of their own work, participating in activities normally undertaken by management, acting as advocates for the Group and creating a mutuality of interest between the auditors and the Group by, for example, being remunerated through a success fee structure. On an annual basis, we pre-approve the budget for fees relating to audit and non-audit work, including taxation compliance services, in accordance with a listing of particular services. In the event that limits for these services are expected to be exceeded or the Group wants the external auditors to perform services that have not been pre-approved, my approval is required. The Committee is subsequently advised of any such services and fees. In this way all services provided by the external auditors during the year were pre-approved by the Audit Committee. The Auditor Independence Policy also governs the policy regarding the audit partner rotation in accordance with the Auditing Practices Board Ethical Standards in the UK and the SEC rules in the US. During the year the second partner on the account was replaced under these rules, a transition that was handled well by Ernst & Young. Partners and senior audit staff may not be recruited by the Group unless two years have expired since their previous involvement with the Group. No such recruitment has occurred.

Internal control and risk management

On behalf of the Board, we reviewed the system of internal financial control and satisfied ourselves that we are meeting required standards both for the year ended 31 December 2011 and up to the date of approval of this Annual Report.

Ian Barlow

Chairman of Audit Committee

Nominations Committee

Dear shareholder,

I am pleased to present my report on the activities of the Nominations Committee in 2011. The membership and the principal duties of the Committee are set out in the table on page 59 of this report.

We dealt with the following important matters in 2011.

Appointment of Olivier Bohuon

We completed the search for a new Chief Executive Officer, recommending to the Board in February that Olivier Bohuon be appointed. Olivier joined the Board in April and became Chief Executive Officer on 14 April 2011 following the Annual General Meeting.

Review of Board composition

We reviewed the composition of the Board, recognising that whilst stability was important through a period of change, it was also important to refresh and build a Board for the future.

We have identified that Rolf Stomberg, Richard De Schutter, Pamela Kirby and Brian Larcombe have all served on the Board for over 9 years and that, therefore, some may consider their independence to be impaired. We have analysed the skills that the Board would lose when these Directors leave the Board and the skills we will need to ensure we have the most effective Board to see us into the future. We have identified that the Board needs the following skills and experience:

Emerging market experience, ideally in China or India

US medical devices experience

European healthcare experience

Our search, is therefore focusing on these three key areas. As and when we find suitable candidates willing to join our Board, we can replace some of the longer serving Directors. We are reluctant to release hard working and experienced colleagues who are active contributors to our boardroom discussions until we appoint suitable Directors to take their place.

Appointment of Ajay Piramal

We completed the search for an additional Non-Executive Director and recommended to the Board in December that Ajay Piramal be appointed. We approached Ajay directly to consider joining our Board, because of his well-established and renowned track record both in the Healthcare industry and specifically in the Emerging Markets of India and China, which we identified as one of our Strategic Priorities.

Use of search firms

During the year, we reviewed our use of search firms. When briefing search firms, we explain the importance to us of building a diverse board and request that shortlists include candidates from a wide range of backgrounds.

Consideration of diversity issues

We also considered the Davies Report into Women on Boards and our response to the issues it raised.

We are strongly committed to diversity in its broadest sense and over the years have attempted to recruit Board members from a wide range of backgrounds.

We already have two female Directors Pamela Kirby and Geneviève Berger and aspire to increase the number of women on the Board to around 25% by 2015.

We will, however, continue to recruit on merit and for us gender is only one diversity measure. We welcome the existing diversity on our Board where we enjoy a broad perspective given our differing skills and experiences. This includes professionals, with backgrounds ranging from UK and US corporate careers to notable scientists who are vital in bringing understanding of the importance of innovation and the scientific challenges we face as a business. We also have a broad range of nationalities represented on our Board, from UK, US, India, Europe and New Zealand.

Sir John Buchanan

Chairman of Nominations Committee

Corporate Governance Statement continued

Ethics & Compliance Committee

Dear shareholder,

I am pleased to present my report on the activities of the Ethics & Compliance Committee in 2011. The membership and the principal duties of the Committee are set out in the table on page 59 of this report.

The following are some of the key issues we have focused on in 2011.

UK Bribery Act

We considered the implications of the UK Bribery Act on our operations and practices. We already had a well-developed global compliance programme in accordance with laws such as the US Foreign Corrupt Practices Act (FCPA) but recognised the need to make various changes to adapt our programme to reflect the requirements of the UK Bribery Act. We therefore discussed and approved applicable changes to our existing processes.

Compliance activities in Emerging Markets

We received regular reports from the Chief Compliance Officer on our compliance programme in China, the specific compliance challenges faced by our people in this region and the measures taken to address these challenges, particularly our work with third party sellers.

Oversight of ethics and compliance programmes

We continued to monitor the effectiveness of our global ethics and compliance programmes. This included reviewing Group policies in this area and considering compliance, monitoring and audit reports. We also received regular reports on the number and nature of investigations conducted and calls to our hotline.

Communication and training

In addition, we continued to monitor the Group s internal communications and training in relation to ethics and compliance policies and reviewed the materials used to train our third party sellers. All employees have received a copy of the Code of Conduct which sets out the basic legal and ethical principles for carrying out business and applies both to employees and those who act on the Group s behalf. It sets out in detail how persons covered by the Code of Conduct are expected to interact ethically with healthcare professionals and government officials. It also covers the broader issues of ethics and compliance throughout the business and includes a code of business principles. A copy of the Code of Conduct can be found on the Group s website (www.smith-nephew.com).

The Code of Conduct includes our whistle-blowing policy, which enables employees and members of the public to contact us anonymously through an independent provider. All calls and contacts are investigated and the appropriate action taken, including reports to senior management, or the Board, where warranted.

Settlement with US Securities and Exchange Commission (SEC) and US Department of Justice (DOJ)

In January 2012, we reviewed and approved the final terms of the settlement between the Company and the SEC and DOJ in connection with their FCPA investigation of the medical devices industry. This has been a matter that we, as a Committee have monitored closely since the formation of the Committee in 2008.

Pamela Kirby

Chairman of Ethics & Compliance Committee

Other Committees

Executive Risk Committee

Olivier Bohuon chairs our Executive Risk Committee which includes the Executive Directors and Executive Officers of the Group. As an integral part of our planning and review process, the management of each of our divisions identifies the risks applicable to their business, the probability of those risks occurring, the impact if they do occur and the actions required and being taken to manage and mitigate those risks. The Executive Risk Committee meets twice-a-year to review the major risks they identify across the Group and the mitigation processes and plans. As appropriate, the Executive Risk Committee may re-categorise risks or require further information or mitigating action to be undertaken. We receive an annual report from the Executive Risk Committee, which details the significant risks categorised by potential financial impact on profit and share price and by likelihood of occurrence. Details of new, key or significantly increased risks, along with actions put in place to mitigate such risks, are also reported to us as appropriate. We have provided further information on the principal risks identified through this process in Risk factors on pages 16 to 18 of this Annual Report.

Disclosures Committee

Olivier Bohuon chairs the Disclosures Committee which includes the Chief Financial Officer and various additional senior executives. The Committee meets as required and approves the release of all major communications to investors, to the UK Listing Authority and to the London and New York Stock Exchanges.

Sir John Buchanan

Chairman

22 February 2012

Directors Remuneration Report

Joseph Papa

Chairman of Remuneration Committee

We are building a remuneration framework to reinforce a new strategy and to drive performance for the benefit of our shareholders

Directors Remuneration Report

Dear shareholder,

I am pleased to present the report on the activities of the Smith & Nephew Remuneration Committee throughout 2011. This was a year of many changes for Smith & Nephew. I took over from Rolf Stomberg as Chairman of the Committee at the Annual General Meeting, the same day as Olivier Bohuon assumed the role of Chief Executive Officer. Elsewhere in this annual report, you will have read about the new strategy which Olivier is implementing across the Group. I shall now explain how the Remuneration Committee are building the remuneration framework for the Executive Directors and other senior executives that will reinforce that new strategy and drive performance for the benefit of you, our shareholders.

Our review has been driven by the following principles:

Restraint the total reward at target under the 2012 framework is broadly the same as under the 2011 framework.

Transparency the new framework is simpler and clearer to understand by all stakeholders.

Alignment with strategy the measures and targets in all our plans are linked back to our business goals.

The membership and the principal duties of the Committee are set out in the table on page 58 of this Annual Report. The formal Directors Remuneration Report that follows explains the technical details of our remuneration arrangements in 2011 and also looks forward to explain our remuneration strategy for 2012 and beyond. Firstly however, I should like to explain some of the main activities of the Committee in 2011 and the reasoning behind the new remuneration structure we are proposing.

New remuneration arrangements for the Executive Directors and Senior Executives

The main work of the Remuneration Committee this year has been the development of a remuneration strategy for our Executive Directors and Senior Executives which supports and reinforces the new strategy Olivier is pursuing. We want to put in place a remuneration framework that will focus our key executives to drive the new strategy over the short, medium and long-term which in turn will drive performance for our shareholders.

Following a review of our existing arrangements, which included feedback from our senior executives, it was felt that the plans previously in place were too complex and really did not work as effective incentives for the performance and behaviours we wished to drive. As a result, we are proposing a revised framework, which seeks to simplify remuneration at Smith & Nephew, provide a clear link to the business goals and strengthen the line of sight between reward and performance. The changes we are proposing have consciously been designed to be broadly neutral in value: for target performance the quantum available to our Executive Directors and Executive Officers will not change. However, we have rebalanced the package across the short, medium and long-term varying by level, to improve the link with our business strategy.

We have moved away from two long-term incentive arrangements to a simple performance share plan linked to the delivery of Total Shareholder Return relative to our peers and growth in free cash flow.

We have also amended the short-term incentive arrangements. The cash element will be linked to the achievement of business and strategic performance measures with an equity incentive linked to individual and business performance over the medium-term.

We have introduced measures to enable us to clawback payments and awards already made should a serious financial mis-statement come to light or a participant is found to have engaged in misconduct. We have also strengthened the rules around share ownership for our executives.

In December, I visited a number of our largest shareholders and UK Institutional bodies to discuss our new proposals. They were all broadly supportive of our moves towards increased transparency, simplification and alignment with our changing corporate strategy and most importantly shareholder interests. The suggestions made by these shareholders have been most useful in developing our final proposals.

Retirement arrangements for David Illingworth

Consideration was given to the retirement arrangements for David Illingworth who stepped down from the Board in April. We followed the provisions in his service contract and saw no need to make discretionary adjustments. David was employed for seven months of the year and will receive a bonus in respect of this employment period. Since his retirement David has continued to provide consultancy advice to Olivier and has received a consultancy fee in respect of this. Details of David s retirement and consultancy arrangements can be found in the report that follows.

UK and International ShareSave Plans

We have operated an all-employee ShareSave Plan in the UK for 30 years. In 2002 we introduced an International ShareSave Plan which now operates in 27 countries. The UK and International ShareSave Plans approved in 2002 have now expired and need to be renewed at the Annual General Meeting. These plans are very popular amongst our employees who are able to save on a regular basis and then buy shares in the Company. We have around 2,500 employees participating in the current plans around the world and are currently exploring ways of extending these arrangements to China and other emerging markets to enable us to attract and retain talent in these key areas.

Directors Remuneration Report continued

Compliance statement

We have prepared this Directors Remuneration Report (the Report) in accordance with The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (the Regulations). It also meets the relevant requirements of the Financial Services Authority (FSA) Listing Rules. As required by the Regulations, a resolution to approve the Report will be proposed at the Annual General Meeting on 12 April 2012.

As set out on page 58 of this Annual Report, my fellow members of the Remuneration Committee are Pamela Kirby, Brian Larcombe, Richard De Schutter and Rolf Stomberg who will be retiring from the Board on 12 April 2012. We would like to thank Rolf for all the work he did as Chairman of the Remuneration Committee for 10 years. Details concerning the number of meetings held and the scope and role of our duties may be found on this page. From time to time, we are advised by Olivier Bohuon, Chief Executive Officer, Susan Henderson, Company Secretary, Helen Maye, Head of Group Human Resources and Elizabeth Sohn, SVP Compensation and Benefits, who attend some or all of our meetings, except for when their personal remuneration is being discussed.

Independent advice

During the year, we conducted a review of our remuneration consultants. We felt that with a new Chief Executive Officer, a new Chairman of the Remuneration Committee and a new Head of Group Human Resources, it would also be appropriate to appoint a new Remuneration Consultant. Given our global business, we wanted a firm with an international presence and in particular one with an internal data service. After considering a number of firms, the Remuneration Committee appointed Towers Watson in September 2011. They have assisted us in developing the new remuneration packages in line with our new strategy. Throughout 2011, we were also advised by Deloitte LLP relating to long-term comparative performance and Towers Watson, Aon Hewitt, Mercer Limited relating to salary data. Towers Watson also provided other human resources and compensation advice to the Company for levels below Board level and Deloitte also provided taxation advice to the Group. All of these consultants have complied with the Code of Conduct for Remuneration Consultants and we are satisfied that their advice is objective and independent.

Remuneration policy

Our policy is designed to attract talent that will drive the strategy over the short, medium and long-term, which in turn will lead to performance for our shareholders. This report describes the remuneration arrangements which were in force during 2011, but it also looks forward to describe the remuneration arrangements we are applying in 2012 and beyond. We therefore thought that it would be helpful to provide a summary of these arrangements before focusing on the detail later in the report.

	2011	2012	Objective	Link to Business Strategy
Base Salary **and Benefits**	Base salary benchmarked to median for relevant geographic market. Benefits such as private healthcare, company car or allowance in line with local competitive practice. **Executive Directors** Non pensionable, non bonusable salary supplement of 30% base salary paid in lieu of pension contributions. Death in service cover of 7 times base salary, of which 4 times salary payable as lump sum. **Executive Officers** Pension plan entitlement based on local defined benefit and defined contribution arrangements.		To attract and retain high performing talent to the Group by setting base salary and benefits at rates comparable to what would be paid in an equivalent position elsewhere.	Ensure we have a strong team of executives to drive performance. Reflects responsibility of role and breadth of leadership of the Group.
Annual Cash Incentive One year	**Executive Directors** Target: 100% of salary Maximum: 150% of salary	**Executive Directors** Target: 100% of salary Maximum: 150% of salary	To motivate and reward the achievement of annual Group objectives.	Drives annual performance on our financial, operating and strategic KPIs.
	Executive Officers Target: 70% of salary Maximum: 140% of salary	**Executive Officers** Target: 55% of salary Maximum: 110% of salary	Focuses on reward for performance against specific Group goals.	Reinforces individual performance and accountability on the immediate annual goals which will provide a solid base for delivering sustained year on year

				growth over the longer-term.
Equity Incentive Award One-three years	**Not applicable**	**Executive Directors and Executive Officers** Target: 50% of salary Maximum: 65% of salary Vesting in equal annual tranches over three years, subject to sustained individual performance.	To motivate and reward sustained individual performance. To provide a strong retention element over the medium-term and reinforce the longer term view.	Weighted heavily towards financial performance at individual and Group level. Reinforces the Smith & Nephew principles of what and how to ensure that executives are delivering results in the right way, having regard for our people, reputation and ethics. Underscores individual performance and accountability to deliver results focusing on near-term milestones to provide the base for future growth.
Long-Term Incentives Three years	**Performance Share Plan**	**Performance Share Plan**	Reward for strong performance over the longer-term.	Awards continue to be linked to strong relative returns to shareholders and to maintaining long-term cash generation.
	Executive Directors Max Face value: 150% of salary + 1.5x multiplier, or 225% of salary	**Executive Directors** Target value: 95% of salary Max value: 190% of salary	From 2012, vesting depends on relative TSR ranking and free cash flow.	
	Executive Officers Max Face value: 75% of salary + 1.5x multiplier or 112.5% of salary	**Executive Officers** Target value: 55% of salary Max value: 110% of salary		
	Executive Option Plan	Removed	Removed	Removed
	Executive Directors and Executive Officers Face value: 100% of salary			

These arrangements are described in greater detail on pages 68 to 71.

Directors Remuneration Report continued

Base salary and benefits (including pensions)

We aim to pay base salaries taking into account the scope and responsibility of the position and performance potential of the individual by reference to the median salary for the relevant geographical market. We review salaries on an annual basis with effect from 1 April each year.

With effect from 1 April 2011, we approved the following base salaries for the Executive Directors:

Olivier Bohuon	1,050,000
Adrian Hennah	£ 580,000

In February 2012, we reviewed the base salaries of the Executive Directors having regard to average salary increases across the Group which will be around 3%. We considered increasing the salaries paid to the Executive Directors by a similar amount given their outstanding performance and contribution. The Executive Directors have however requested that at a time when we are driving cost efficiencies across the Group and a number of positions are being eliminated, no increase be made to Olivier Bohuon s salary and that Adrian Hennah s salary be increased by 1%. Their base salaries with effect from 1 April 2012 will therefore be:

Olivier Bohuon	1,050,000
Adrian Hennah	£585,800

We also provide benefits in line with local market practice in the countries in which we operate. Typically, these benefits include private healthcare, company car or allowance and where appropriate relocation expenses.

Pensions

We provide pension arrangements for employees across the Group. The nature of the arrangements differ depending on their location and in some cases their length of service depending on the arrangements in place when they first joined the Company.

Olivier Bohuon and Adrian Hennah both receive a salary supplement of 30% of basic salary to apply towards their retirement savings in lieu of membership of a company run pension scheme. Base salary is the only element of remuneration that is pensionable. They also receive death in service cover of seven times basic salary, of which four times salary is payable as a lump sum. Executive Officers who joined the company in 2003 or later are also entitled to receive a salary supplement or to join one of the Company s Defined Contribution Pension Plans depending on local practice.

Different arrangements are in place for employees and Executive Officers who joined the Company prior to 2003 as follows:

In the UK, such Executive Officers participate in the Smith & Nephew UK Pension Fund or the UK Executive Pension Scheme, under which pensions have been accrued in the year at an annual rate of one-thirtieth of final pensionable salary up to a limit based on service of two-thirds of final pensionable salary, subject to HM Revenue & Customs (HMRC) constraints. The normal retirement age is 62. Pensions in payment are guaranteed to increase by 5% per annum or the rate of inflation in the UK, if lower. Death in service cover of four times salary and a spouse s pension at the rate of two thirds of the member s pension are provided on death. A salary supplement partially compensates for the HMRC earnings cap on final pensionable salary which continues to apply in the defined benefit plans.

In the US such Executive Officers participate in either the defined benefit Smith & Nephew US Pension Plan or the defined contribution US Savings plan 401 (K) Plus. Under the US Pension Plan, pensions accrue at an annual rate of approximately one sixty-sixth of final pensionable salary up to a limit based on service of 53% of final pensionable salary. The plan also provides for a spouse s pension at

the rate of one half of the member s pension on death. Normal retirement age under the plan is 65. For executives in the defined benefit and defined contribution plans, a supplementary plan is used to provide additional retirement benefits and to compensate for the earnings cap imposed by the US Internal Revenue Code.

Short-term incentive arrangements

As I explained in my introductory letter, we reviewed all our remuneration arrangements in 2011. This review has resulted in a change to our short-term incentive arrangements. As you will have seen elsewhere in this Annual Report, our strategy has a number of near term goals, particularly in improving efficiencies and reducing costs in our established markets. We need to achieve these short-term goals before we can achieve our longer term objectives of investing in emerging markets and innovating for value. We therefore need a remuneration framework which incentivises our executives to drive short-term performance which will enable the Group to achieve the long term performance we want for our shareholders.

A proportion of Annual Incentive earned by Executive Directors and Executive Officers prior to 2011 was deferred into share awards. For 2012, we are moving away from a single Annual Incentive Plan, with a deferred element to two distinct elements comprising an Annual Cash Incentive and an Equity Incentive Award. The bonuses earned in 2011 have therefore been paid entirely in cash and a new short-term Equity Incentive Award will be made later in March 2012.

The arrangements which applied in 2011 and those which will apply from 2012 onwards are both described below.

Annual Incentive Plan in 2011

During 2011, we operated an Annual Incentive Plan across the Group. Executive Directors and Executive Officers participated in the same Annual Incentive Plan although the opportunities varied, reflecting their differing roles and levels of responsibility:

	Performance at target	Performance at maximum
Executive Directors	100%	150%
Executive Officers	70%	140%

The performance measures for the Annual Incentive Plan were linked to the four strategic pillars for success which drove our Strategy in 2011, namely Customer Led Efficient , Investing for Growth and Aligned . All employees across the Group were set performance objectives that linked back to these strategic pillars.

The incentive bonus in 2011 for Executive Directors was subject to performance measures relating to revenue (30% of incentive), trading profit/margin (30%) and trading cash flow (15%). The remaining 25% of the incentive payable was dependent on personal objectives.

Over the period, underlying revenue growth was 4%, underlying trading profit fell by 4%, trading margin fell by 200 bps and trading profit to cash conversion was 87%. Collectively these financial performance measures were just below target. The remaining part of the incentive bonus reflects the Executive Directors performance against their personal objectives. The Remuneration Committee reviewed the performance of Olivier Bohuon and Adrian Hennah against their agreed individual objectives for 2011 and determined that Olivier Bohuon had consistently exceeded his objectives for the year (in building a strong team and launching the new strategy) and that Adrian Hennah had consistently met his objectives for the year.

Table of Contents

The overall cash incentive bonuses were as follows:

	Total Cash Bonus
Olivier Bohuon(i)	807,709
Adrian Hennah	£548,680
David Illingworth(i)	$497,199

(i) Prorated to reflect active service with the Company.
(Olivier Bohuon appointed CEO in April 2011; David Illingworth retired in August 2011).

Annual Cash Incentive in 2012

From 2012 onwards, the Annual Incentive for Executive Directors and Executive Officers is divided into two parts: a) an Annual Cash Incentive and b) an Equity Incentive Award, which is a conditional award over ordinary shares, vesting in equal annual tranches over three years, provided that individual performance is sustained. The payment of the Annual Cash Incentive and the award and subsequent vesting of the Equity Incentive Award are dependent upon the same performance measures.

The Annual Cash Incentive is designed to reward employees for the annual achievement of Company financial and non-financial business goals. The level of Equity Incentive Award is governed by these same annual goals and vests only if an acceptable level of performance against these same goals is sustained in each of the following three years.

The performance measures for Executive Directors are based on a mix of financial goals and non-financial goals as follows:

Financial Goals	Revenue (30%) Trading Profit (30%) Trading Cash (10%)		70%
Non-Financial Goals	**Olivier Bohuon** R&D investment Development of product portfolio Succession Planning Employee engagement Compliance	**Adrian Hennah** R&D investment Shared Services Succession Planning Employee engagement Compliance	30%

The performance measures for Executive Officers and for all other employees in the Group are cascaded down from these goals, so that all employees are aligned with the same business goals.

For each of the above measures, we have determined the precise measurements for the achievement at threshold, target and maximum, which are directly linked with the Financial Plan for 2012. As such, these measurements are commercially sensitive. In next year s Report, we will disclose levels of performance against the measures.

The maximum Cash Incentive payable depends upon level within the Company. Maximum and target awards for Executive Directors and Executive Officers are as follows:

	Performance at target	Performance at maximum
Executive Directors	100%	150%
Executive Officers	55%	110%

Equity Incentive Award in 2012

Grant Conditions

We measure achievement against the goals in two different ways. Firstly we look at what the employee has achieved in the year and secondly we look at how they have performed in the year. It is important to us that as well as achieving their financial targets, our employees are displaying the right behaviours and values, that they are customer focused, operating compliantly and ethically and are treating their fellow employees fairly. Executive Directors and Executive Officers will receive an Annual Equity Incentive Award provided that they consistently meet the goals described above on both the how and what bases. If they fail to meet either of these ratings, they will receive no award and if they exceed their objectives on both measures, they will receive a higher award. The level of awards for Executive Directors and Executive Officers is as follows:

	Consistently meets how and what objectives	**Consistently exceeds how and what objectives**
Executive Directors	50% base salary	65% base salary
Executive Officers	50% of base salary	65% of base salary

Vesting Conditions

The Equity Award will be a conditional award over ordinary shares. This award will vest in equal annual tranches over three years subject to continued achievement of objectives. Each tranche will only vest if the Executive Director or Executive Officer has consistently met their objectives on both the how and the what basis in each year since the grant of the award. In the event that objectives in subsequent years are not met, the unvested portion of the Equity Incentive Awards granted in previous years will lapse.

Long term incentives

As I mentioned earlier, we have made changes to the overall remuneration framework for 2012. Prior to 2012, Executive Directors and Executive Officers received share option grants and performance share awards. From 2012, we shall only be making performance share awards. The arrangements which applied in 2011 and those which will apply from 2012 onwards are both described below.

Performance Share Awards prior to 2012

During 2011, we made conditional share awards to Executive Directors, Executive Officers and senior executives. Awards to Executive Directors were made under the 2004 Performance Share Plan and awards to other employees were made under the Global Share Plan 2010. In respect of the Performance Share Awards, these two plans operate in the same way. The level of the awards made to Executive Directors and Executive Officers were as follows:

	Market value of award as % of base salary
Executive Directors	150%
Executive Officers	75%

These share awards are subject to performance conditions measured over a three-year period. These awards will only vest if pre-determined levels of adjusted Earnings Per Share (EPSA) growth are achieved. The number of shares delivered to executives may then be increased subject to the achievement of superior Total Shareholder Return (TSR) measured against the major companies in the medical devices industry.

Directors Remuneration Report continued

The required EPSA levels used for the awards made in 2011 were as follows:

Growth in EPSA over the three years ending 31 December 2013	Percentage of award vesting	
EPSA growth of 15% (approximately 4.5% compounded annually over three years)	25%	Threshold
EPSA growth of 20% (approximately 6% compounded annually over three years)	50%	Target
EPSA growth of 30% (approximately 9% compounded annually over three years)	100%	Maximum

None of the awards will vest if the growth in EPSA over three years is less than threshold. For EPSA performance falling between the points given in the table above, awards will vest on a straight-line basis up to a maximum of 100%.

In addition, if the Company s TSR is positioned above median when compared with the TSR of medical devices companies, then the number of vested shares delivered to participants following the achievement of the EPSA targets will be increased by a multiplier as follows:

TSR Ranking within comparator group	Multiplier
Below or at Median	1.0x
Upper quartile	1.3x
Upper decile or above	1.5x

The multiplier increases on a straight line basis between the above points.

TSR is measured in a common currency, with values averaged over three months prior to the start and end of the performance period. We compare the Company s performance against a tailored sector peer group of medical devices companies. The companies in the comparator group for the awards made in 2011 are:

Arthrocare	KCI
Bard	Medtronic
Baxter	Nobel Biocare
Becton Dickinson	Nuvasive
Boston Scientific	Orthofix
Coloplast Group	Stryker
Conmed	St Jude Medical
Covidien	Synthes
Edwards Life Sciences Corp	Wright Medical
Johnson & Johnson	Zimmer

The Group s TSR performance and its performance relative to the comparator group is independently monitored and reported to the Remuneration Committee. The awards made in 2009 were subject to performance conditions determined at that time which were based on a relative EPSA measure with a relative TSR multiplier.

The targets for growth in EPSA were related to growth of relevant markets, taking into account both volume and price changes in each of our major markets, and weighted according to our relative turnover in these markets to provide an estimate of global market growth calculated on an annual basis for each year of the plan. The actual EPSA growth over the three years was then compared to the compounded EPSA growth targets to calculate the level of vesting. Global market growth is derived from a range of publicly available sources including individual competitor company press releases, quarterly results and analyst reports, as well as data purchased from a variety of industry surveys.

EPSA growth over the three years ending 31 December 2011 was 34% against the compounded market growth rate of 13%. Over the same period the Company was ranked 6th out of 20 companies in the medical devices comparator group which meant that a multiplier of 1.28 was applied to the number of shares vesting under the EPSA target. As a result the following awards will vest on 13 August 2012:

	Number of shares under 2009 award	Number of shares vesting in 2012
David Illingworth(i)(ii)	177,855	156,510
Adrian Hennah	161,273	141,920

(i) The award granted to David Illingworth will be settled prior to 15 March 2012 in accordance with S409A of the US Internal Revenue Code.

(ii) The number of shares under the 2009 award has been pro-rated for service during the performance period.

Share Options Grants prior to 2012

During 2011, we granted share options to Executive Directors, Executive Officers, senior executives and to certain high performing managers. Option grants to Executive Directors were made under the 2004 Executive Share Option Plan and option grants to other employees were made under the Global Share Plan 2010. Executive Directors and Executive Officers received options at market value of 100% of base salary.

Options granted to Executive Directors are subject to performance conditions measured over a three year period. These awards will only vest if pre-determined levels of TSR rank are achieved measured against the major companies in the medical devices industry.

The performance measurement for grants made in 2011 to Executive Directors was based on Total Shareholder Return. TSR is calculated on the same basis as for the Performance Share Awards. If the Company s TSR is positioned at or above median when compared with the TSR of those companies in our tailored sector peer group over a three year period commencing 1 January 2011, then the options become exercisable as follows:

TSR Ranking within comparator group	Percentage of options vesting
Below Median	Nil
Median	33%
Upper Quartile	100%

Options vest on a straight line basis between these points. If the Company s TSR performance is below median, no options vest. The comparator group is the same for the Performance Share Awards outlined above.

Options granted to Executive Officers and other employees in 2011 are not subject to performance conditions.

The options granted to Executive Directors in 2009 were subject to the same performance conditions as described above for options granted in 2011.

The Company s TSR performance and its performance relative to the comparator group is independently monitored and reported to the Remuneration Committee by Towers Watson.

Over the three year period ending 31 December 2011 the Company was ranked 6th out of 20 companies in the medical devices comparator group which meant that 96% of the options granted to Executive Directors in 2009 will vest on 13 August 2012 as follows:

	Number of options granted in 2009	Number of options vesting in 2012
David Illingworth(i)	118,570	113,825
Adrian Hennah	107,515	103,214

(i) The option granted in 2009 has been pro-rated for service during the performance period.

Long term incentive arrangements in 2012

In 2012, no share options will be granted to Executive Directors or Executive Officers. We will however make performance share awards to Executive Directors and Executive Officers under the Global Share Plan 2010. The level of the awards made to Executive Directors and Executive Officers will be as follows:

	Market value of award vesting at maximum as a % of base salary	Market value of award vesting at target as a % of base salary
Executive Directors	190%	95%
Executive Officers	110%	55%

These share awards will be subject to performance conditions measured over a three year period.

50% of the Award will vest depending on the Company s TSR performance relative to a selection of comparator companies and 50% of the award will vest subject to the achievement of the free cash flow target over a three year performance period.

The threshold, target and maximum levels for the 50% of the Award subject to TSR performance are based on the position of the Company s TSR ranking when compared with the TSR of a bespoke peer group of companies in the medical devices sector over a three year period commencing 1 January 2012 as follows:

TSR Ranking within comparator group	Percentage of Award vesting
Below Median	Nil
Median	25%
Upper Quartile	100%

Awards will vest on a straight line basis between these points. If the Company s TSR performance is below median, none of this part of the award will vest.

TSR will be measured relative to a bespoke peer group of companies operating in the medical devices sector. For the awards to be made in 2012, these companies are:

Arthrocare	Medtronic
Bard	Nobel Biocare
Baxter	Nuvasive
Becton Dickinson	Orthofix
Boston Scientific	Stryker
Coloplast Group	St Jude Medical
Conmed	Synthes
Covidien	Wright Medical
Edwards Life Sciences Corp	Zimmer

This group is slightly different from the group of companies used for plans in previous years, because of various corporate actions and acquisitions in the market over recent years. TSR will be calculated on the same basis as in 2011.

The Group s TSR performance and its performance relative to the comparator group will be independently monitored and reported to the Remuneration Committee by Towers Watson.

The cash flow target is a cumulative performance target over the three-year performance period. The inclusion of a cash measure in both the annual and long term plans reflects its importance over both timescales. The measure for the long-term target is free cash flow, which is defined as net cash inflows from operating activities, less capital expenditure. Free cash flow is considered to be the most appropriate measure of cash flow performance because it relates to the cash generated to finance additional investment in business opportunities, debt repayments and distributions to shareholders. This measure includes significant elements of operational and financial performance and helps to align executives rewards with shareholder value creation.

The threshold, target and maximum levels for the 50% of the award subject to free cash flow performance are as detailed below:

Cumulative Free Cash Flow	Percentage of Award vesting
Below $1.41 billion	Nil
$1.41 billion	25%
$1.62 billion	50%
$1.83 billion or more	100%

Awards will vest on a straight line basis between these points.

It is intended that the Committee should have the discretion to adjust, but on an exceptional basis only, the free cash flow target during the performance period for material factors that would otherwise distort the performance measure in either direction. For example, adjustments may be required to reflect exchange rate movements, significant acquisitions or divestments, or major legal and taxation settlements. Any major adjustments to the calculation will be disclosed to shareholders. There is no retesting of performance.

We feel that these changes to the long-term element of our remuneration framework simplify the previous arrangements, whilst continuing to drive strong cash flow performance and the delivery of superior relative returns to our shareholders.

Shareholding requirements

We believe that one of the best ways our senior executives can act and feel like shareholders is for them to hold a significant number of shares in Company. We therefore expect our Executive Directors and Executive Officers to build up a holding of shares in the Company. In order to reinforce this expectation, we require them to retain 50% of all shares vesting under Company share plans (after tax) until this holding has been met. We will take into account their progress towards this shareholding requirement when determining whether they will be allocated awards in the future. We require Executive Directors to hold shares equivalent in value to two times their base salary and for Executive Officers to hold shares equivalent in value to one and a half times their base salary. When calculating whether or not this requirement has been met, we will include Ordinary Shares or ADSs held by the individual or their immediate family and the intrinsic value of any vested but unexercised options.

As at 21 February 2012, Olivier Bohuon holds no shares, Adrian Hennah holds 167,968 shares to the value of 181% of his base salary.

Directors Remuneration Report continued

Total reward

The following chart shows the split between the different pay elements of the Executive Directors remuneration packages on an expected value basis in both 2011 and 2012:

Service contracts

We employ Executive Directors on service contracts with notice periods of 12 months from the Company and six months from the Executive Director. On termination of the contract, we may require the Executive Director not to work their notice period and as such pay them an amount equivalent to the salary, pension and benefits they would have received if they had been required to work their notice period. In addition, we may also, in exceptional circumstances, exercise our discretion to pay the Executive Director a proportion of the bonus that they would have received had they been required to work their notice period. The Executive Director will also be required, where possible, to mitigate the loss. We will also seek to enforce the non-compete clause in Executive Directors contracts. In the event that we dismiss an Executive Director for cause, no payment will be made as we have a policy of not rewarding failure.

In the case of a change in control which results in the termination of an Executive Director or a material alteration to their responsibilities or duties within 12 months of the change in control the Executive Directors would be entitled to receive 12 months base salary and 12 months bonus at target plus pension and benefits.

Executive Director	Date of Service Contract	Effective Date	Expiry Date	Notice period from company
Olivier Bohuon	9 February 2011	1 April 2011	3 January 2017	12 months
Adrian Hennah	1 February 2006	1 June 2006	12 November 2019	12 months

We encourage our Executive Directors to serve as a Non-Executive Director of a maximum of one external company. Such appointments are subject to the approval of the Nominations Committee and any fees earned are retained by the Executive Director. Currently Olivier Bohuon is a Non-Executive Director of Virbac and Adrian Hennah is a non-executive Director of Reed Elsevier. During 2011, Olivier Bohuon received 19,000 and Adrian Hennah received £38,475 in respect of these appointments.

Non-Executive Directors

Non-Executive Directors are engaged by the Company on the basis of letters of appointment. They are normally appointed for terms of three years, terminable at will, without notice by either the Group or the Director and without compensation. The Board reviews the pay of the Non-Executive Directors and aims to set fees that are competitive with other companies of equivalent size and complexity. Non-Executive Directors are not entitled to receive awards under the Company s long term incentive plans and no part of their fees is paid in shares.

Non-Executive Director fees were reviewed and increased in August 2011. Non-Executive Directors are paid a basic annual fee and the Chairmen of the Audit, Remuneration and Ethics and Compliance Committees and the Senior Independent Director each receive an extra fee in recognition of their additional responsibilities. An additional fee is also payable to Non-Executive Directors in cases where intercontinental travel is necessary to attend Board and Committee meetings. The fees currently paid to Non-Executive Directors are as follows:

	Fee in UK Sterling	Fee in US Dollars	Fee in Euros
Basic Annual Fee	£63,000	$120,000	84,250
Committee Chairman and Senior Independent Director Fee	£15,000	$27,000	20,000
Intercontinental Travel fee (per meeting)	£3,500	$7,000	5,000

The Remuneration Committee reviews the fee of the Chairman. The Chairman s fee was last reviewed in August 2011 and increased to £400,000, an increase of 6.7%, in recognition of his outstanding work in leading the Company through the period of searching and appointing a new Chief Executive Officer and mentoring him in his new role. The Chairman is engaged on a letter of appointment and has a six month notice period.

We also require our Non-Executive Directors to hold a personal stake in the Company equivalent to their basic annual fee. These shares may be held as Ordinary Shares or as ADSs held either by themselves or their immediate family.

Special issues in 2011

During 2011, we considered, reviewed and approved the proposed remuneration package for Olivier Bohuon, joining the Company as the new Chief Executive Officer and the retirement arrangements for David Illingworth. The key elements of these arrangements are as follows:

We employed Olivier on a standard package, participating in the same incentive plans and on the same basis as Adrian Hennah. As explained last year, on joining the Company, he also received a cash payment of 1,400,000 and a conditional award over 200,000 shares vesting in three equal tranches over three years. The first tranche of this award will vest on 1 April 2012.

David Illingworth worked a period of six months notice and retired from the Company on 10 August 2011 receiving pay and benefits in accordance with his service contract. He has also received a bonus in respect of the period he worked in 2011. The outstanding awards under the Company s long-term incentive plans have been pro-rated for time and vest at their normal vesting date subject to the applicable performance conditions. At the end of his period of employment, we continued to engage David in a consultancy capacity up to 10 February 2012 for a total fee of $180,000.

Table of Contents

Directors emoluments and pensions

The following sections of the Report up to Total Shareholder Return have been audited by Ernst & Young LLP in accordance with the Regulations.

a) Salaries and Fees

	Salaries and fees	Benefits (i)	Annual Incentive	Salary Supplement in lieu of pensions Thousands	Total 2011 (iii)	Total 2010 (iii)
Chairman (Non-Executive)						
Sir John Buchanan	£389	£31			£420	£373
Executive Directors						
Olivier Bohuon (iv)	788	(v) 1,675	808	236	3,507	
Adrian Hennah	£568	£21	£549	£170	£1,308	£1,157
David Illingworth (vi)	$893	$168	$497	(ii) $258	$1,816	$2,742
Non-Executive Directors						
Ian Barlow	£80				£80	£70
Geneviève Berger	87				87	83
Pamela Kirby	£75				£75	£64
Brian Larcombe	£65				£65	£64
Joseph Papa	$173				$173	$134
Richard De Schutter	$181				$181	$158
Rolf Stomberg	98				98	125

(i) Benefits shown in the table above include cash allowances and benefits in kind.

(ii) The amount provided under an international pension plan for David Illingworth is disclosed below.

(iii) Total Executive and Non-Executive Directors emoluments for 2011 amounted to $10,423,000 (2010 $6,044,000).

(iv) Appointed on 1 April 2011.

(v) Includes amounts for relocation expenses in first year of appointment and 1,400,000 received on appointment.

(vi) Retired on 9 August 2011.

b) Pensions

	Accrued Pension as at	Increase in	Increase in accrued	Accrued pension at	Transfer value of	Director s contribution	Increase in	Transfer value of

	1 Jan 2011	accrued pension excluding inflation	pension due to inflation	31 Dec 2011	accrued pension at 1 Jan 2011	during 2011	transfer value less Director s contribution	accrued pension at 31 Dec 2011
		$ thousands per annum				$ thousands		
David Illingworth	3			3	20		3	23

$nil (2010 $318,198) was provided under an International pension plan for David Illingworth.

No amounts have been paid to third parties in respect of Executive Directors services and no excess retirement benefits or compensation has been paid to past Executive Directors.

Directors Remuneration Report continued

c) Directors Share Options

	Options as at 1 January 2011 (number)	Granted during 2011 (number)	Exercise price of options granted	Exercised during 2011 (number)	Lapsed during 2011 (number)	Options as at 31 December 2011 (number)	Average exercise price	Range of exercisable dates of options held at 31 December 2011 (vi) (date)
Olivier Bohuon								