SMITH & NEPHEW PLC
Form 20-F
March 06, 2017
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

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

For the fiscal year ended December 31, 2016

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: 903,723,205 Ordinary Shares of 20¢ each

Indicate by check mark if the registrant is a well seasoned issuer, as defined in Rule 405 of the Securities Act Yes 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

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 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 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 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

Table of Contents

Table of Contents

The Strategic Report, which has been prepared in accordance with the requirements of the Companies Act 2006, comprises the above sections and has been approved and signed on behalf of the Board.

The Directors Report comprises pages 33 to 34, 36 to 38, 47 to 75, 102, 110, 112, 114 and pages 169 to 190 of the Annual Report.

OVERVIEW

CHAIRMAN S STATEMENT

CEO REVIEW OF STRATEGY

FINANCIAL REVIEW

RISK

GOVERNANCE

COMPANY ACCOUNTS

NOTES TO THE COMPANY ACCOUNTS

GROUP INFORMATION

OTHER FINANCIAL INFORMATION

INFORMATION FOR SHAREHOLDERS

GLOSSARY OF TERMS

Front cover: WEREWOLFâ COBLATIONâ System, our next generation COBLATION platform delivers an unparalleled range of performance capabilities and advanced safety features for soft tissue ablation.

online

www.smith-nephew.com

Table of Contents

We are driven by pushing innovation through the business and into our products. We look to challenge the status quo of how our industry supports a healthcare market facing major economic and social challenges. Every one of us is focused on delivering greater value by finding ways to meet the new needs of our customers. We are all proud of our history of innovation, and excited by our strong portfolio of products and new ways of working.

Table of Contents

CHAIRMAN S STATEMENT

Succeeding in challenging times

In 2016 Smith & Nephew faced and overcame challenges.

DEAR SHAREHOLDER,

A good Board pressure tests strategy, provides leadership on matters of governance and ensures their company is equipped to handle risk. In 2016 Smith & Nephew faced and overcame challenges in all these areas, confirming my strong belief that this is a Company set well to succeed in challenging times.

In early 2016 we announced that our Chief Executive Officer, Olivier Bohuon, had been diagnosed with cancer, and would require treatment across much of the year. We were delighted to welcome him back to work full time in October.

During the intervening months my Board colleagues and I were able to provide additional support to the executive team. I attended the Managing Directors annual meeting, and engaged with various members of the executive team, supporting them on a number of matters. The Board met with numerous commercial and operational leaders across the year. This culminated in a visit to our Andover, Massachusetts site in November where we saw first-hand the exciting progress being made by our Sports Medicine business.

These meetings gave Board members first-hand experience of the high quality team that has been assembled by Olivier to deliver on his strategy to transform Smith & Nephew. Following a number of changes implemented in recent years, the structure of the organisation is fully aligned to the strategic priorities, and the commitment and dedication to the business at all levels was evident for us to see.

FINANCIAL PERFORMANCE

Smith & Nephew s financial performance is shown on these pages.

Although the Group delivered revenue growth in 2016, the outturn is below where we had set our sights at the start of the year. Whilst some geographies and franchises performed well, we were buffeted by trading conditions in the Gulf States and China, as well as a few areas where we believe we can execute better in 2017. We faced a headwind in China entering the year, and it is pleasing to see how management delivered the improvements in this market as they said they would.

The Board continues to have great confidence in the business and is proposing a final dividend for the year of 18.5¢ per share, giving a total dividend distribution for 2016 of 30.8¢. In-line with our dividend policy, the declared dividend is flat year-on-year despite the decline in adjusted earnings per share.

Directors biographies start on page 48

Table of Contents

GOVERNANCE AND CULTURE

Corporate governance, especially Director responsibilities, remuneration and diversity, has been in the spotlight in 2016. The Board has welcomed our discussions with shareholders around such important topics and we are mindful of how the landscape is changing in some areas. The Board is committed to continuing to refine our governance structure and practices to reflect what is in the best interests of all stakeholders.

Culturally, we believe that openness and transparency, accountability and responsibility should run throughout the Company. The Board takes matters of ethics and compliance very seriously, and aims to set a tone at the top which pervades throughout the organisation. We review processes and practices and oversee quality and regulatory matters. We take great interest in how we attract, retain and develop talent and the work underway to make Smith & Nephew a great place to work for all employees.

Our Chief Financial Officer, Julie Brown, left the Company in January 2017. We are grateful for her contribution during her four years at Financial Officer on 1 March 2017 when he will also be appointed to the Board as an Executive Director. Having held multiple senior roles at AstraZeneca and elsewhere, I have no doubt that he will successfully ensure effective financial stewardship and I welcome him to Smith & Nephew.

Brian Larcombe will be retiring from the Board at the Annual General Meeting on 6 April 2017. Brian has served Smith & Nephew for many years, as our Senior Independent Director since 2014, and as a member of the Audit, Nomination & Governance and Remuneration Committees. I am personally grateful that he agreed to stay on one extra year to provide continuity while Olivier was receiving treatment. We will miss his great wisdom and experience. On behalf of the whole Board I thank him for his service. We are fortunate that Ian Barlow has agreed to become Senior Independent Non-Executive Director. Ian has been a Non-Executive Director since 2010, and has been a diligent Chair of our Audit Committee. Robin Freestone will be appointed Chairman of the Audit Committee in his place.

Finally, Joe Papa has graciously agreed to stay on beyond his nine-year term as we undertake a search for a new Chair of the Remuneration Committee. As we make this, and indeed all appointments, we are conscious of the need to continue to seek individuals who bring diversity in its broadest sense, including background, thinking and gender.

In conclusion, 2016 has been a year where we have continued to make progress in the face of a number of headwinds. As a result, I believe we enter 2017 as a stronger business. There is no doubt that the world is facing a period of greater geo-political risk and companies need to be robust. The Board takes its responsibilities very seriously, to ensure that we perform financially, strategically and ethically against this changing and challenging backdrop. We thank you for your continued support and look forward to serving you in 2017.

Yours sincerely,

Smith & Nephew and wish her well in her new career at Burberry plc. Graham Baker will join as Chief

Roberto Quarta

Chairman

Financial review page 39

$4,669m +1% +2%

Revenue Reported Underlying[1]

Group revenue was $4,669 million, up 1% on a reported basis and 2% on an underlying basis. Reported growth includes a foreign exchange headwind of -1%, whilst acquisitions added 1% and disposals 1%.

30.8¢ 0%

Dividend per share

In-line with our dividend policy, the declared dividend is flat year-on-year despite the decline in adjusted earnings.

$801m +28%

Operating profit

Operating profit margin of 17.2% is before one-off $326 million gain from Gynaecology disposal.

$1,020m -7%

Trading profit[1]

Trading profit margin of 21.8% reflects previously disclosed transactional FX headwind, loss of leverage from lower sales growth and investment in Blue Belt, offset by efficiencies.

88.1¢ +92%

Earnings per share EPS

The increase in EPS is mainly due to benefit from the 2016 Gynaecology disposal and the absence of a 2015 legal metal-on-metal charge.

82.6¢ -3%

Adjusted Earnings per share EPSA[1]

5%

R&D expenditure

The reduction in EPSA from the prior period reflects the reduction in adjusted attributable profit.

To drive innovation, we maintain our investment in R&D at around 5% of Group revenue.

1 The non-IFRS financial measures are explained and reconciled to the most directly comparable financial measure prepared in accordance with IFRS on pages 175-177.

Table of Contents

CEO REVIEW OF STRATEGY

Innovative products and deep customer relationships

We now have the right structure and capability in place and are focused on improving execution across the Group.

DEAR SHAREHOLDER,

In 2016 I was pleased with our performance in areas such as Sports Medicine and Knee Implants, where we maintained strong momentum. However, whilst we delivered growth in 2016, it was not at the level we had wanted. Market conditions in China and the Gulf States together shaved more than a percentage point of growth off the Group in the year.

As we enter 2017, I am confident we now have the right structure and capability in place and are focused on improving execution across the Group, with a clear set of actions underway. As a result, I expect us to deliver a stronger performance in 2017.

COMMERCIAL PROGRESS

In our Established Markets, 2016 highlights included the performance across Sports Medicine, where we continue to reap the benefits of the acquisition of ArthroCare. PICO[à], our novel single-use Negative Pressure Wound Therapy (NPWT) system, is transforming the use of this therapy option. Our world class Knee Implant portfolio was further strengthened by the acquisition of NAVIO[à], an exciting robotics-assisted surgery platform, from which we delivered more than 50% revenue growth in 2016.

We have spent the last five years reshaping Smith & Nephew to make the Company more agile, stronger, more efficient and simpler. We are proud of what we have done.

Directors Biographies start on page 48

Table of Contents

Most of our Emerging Markets businesses generated double-digit growth as we benefited from our investments in recent years. In China, the slow-down in end-markets seen since mid-2015 was compounded by destocking in the distributor channel. By the end of the year most franchises had returned to positive growth as the level of stock in the channel was adjusted. In the oil-dependent Gulf States we also saw difficult trading conditions. As a matter of course we expect to see some volatility in the Emerging Markets, but we continue to see significant long-term growth potential and are very well positioned in our chosen markets.

DELIVERING INNOVATION

We continue to innovate for value with new product launches and disruptive business models. A number of important new platforms were introduced in 2016. In Sports Medicine we successfully launched our new LENSà Surgical Imaging System and the WEREWOLFà COBLATIONà System for resecting soft tissue. We also introduced the ULTRABUTTONà Adjustable Fixation Device which provides advanced fixation strength for soft tissue to bone fixation in ACL/PCL repair and reconstruction.

FOCUSED ON EXECUTION

Over the last few years we have undertaken a fundamental restructuring of Smith & Nephew to improve both our ability to serve our customers in market, and our efficiency. This has included changing the management structure and teams in every market to bring them under a single country managing director, a process we completed in 2016. This has not been without disruption, partly caused by some office re-locations, but now the new teams are bedding into their new roles. We now have the appropriate structure to succeed and are focused on serving our customers without any distractions in 2017.

We are also developing the tools to support better execution. In 2016 we strengthened our commercial platform by creating a global commercial organisation under a newly created role of Chief Commercial Officer. Tasked with driving commercial performance across the Group, this organisation includes our commercial regions and the global marketing teams for our product franchises. It also includes a Commercial Excellence team which is focused on bringing material improvements in

We are well set to deliver a stronger performance, generating higher revenue growth and a better trading profit margin in the future.

THANK YOU

As you know I undertook medical treatment during 2016 and I want to thank shareholders and employees who sent me their best wishes during this time. Moreover, I want to thank all of our employees who continue to strive to deliver on our commitments, embodying a Smith & Nephew culture immersed in our values of innovation, trust and performance. It is good to be back at work full-time amongst such inspiring people.

We have spent the last five years reshaping Smith & Nephew to make the Company more agile, stronger, more efficient and simpler. We are proud of what

In Knee Implants we began limited market release of our JOURNEY à II XR, an innovative bi-cruciate retaining knee and the newest addition to the JOURNEY II Active Knee family. We also conducted the first total knee procedures on the NAVIO platform in 2016. In Hip Implants we added to the REDAPT à Revision System with a new Acetabular Fully Porous Cup designed for cases where compromised bone makes implant fixation and stability more difficult.

In 2016 we also delivered significant efficiencies. Our Group Optimisation programme realised the expected $120 million of savings one year ahead of schedule.

And we created compelling value when we divested our Gynaecology business for $350 million. We returned the proceeds to shareholders through a $300 million share buy-back.

areas such as pricing strategy and sales force excellence across the Group, starting in 2017.

We are targeting an increase in disruptive innovation. In 2016 I appointed a President of Research and Development, reporting directly to me, to lead a newly formed single global R&D organisation. In addition to executing our technology pipeline, this leader will be responsible for driving breakthrough innovation and defining a clear path from concept to market. In 2017 the team is focused on increasing productivity, improving processes and better leveraging our resources and expertise.

A more aligned organisation has also allowed us to centralise our approach to developing evidence that demonstrates the clinical and economic benefits of our products, supporting our commercial teams in positioning our products more effectively.

Finally, we will continue to drive efficiency, with programmes underway to optimise global manufacturing, strengthen our supply chain, upgrade our IT infrastructure and deliver shared business services across the Group.

See our strategic update

on the following pages

we have done. 2017 will see a strong emphasis on execution. Beyond this, with our innovative products and deep customer relationships, we are well set to deliver a stronger performance, generating higher revenue growth and a better trading profit margin in the future.

I am energised by our prospects and I look forward to updating you on our progress during the year.

Yours sincerely,

Olivier Bohuon

Chief Executive Officer

Table of Contents

WHO WE ARE

One global business

selling nine product franchises

	Revenue	% of Group
KNEE IMPLANTS	$932m	
Smith & Nephew offers an innovative range of products for specialised knee replacement procedures. Knee replacement surgery involves replacing the worn, damaged or diseased portion of a knee with an artificial joint.	Reported +6%	Underlying[1] +4%
HIP IMPLANTS	$597m	
Our Hip Implant franchise offers a range of specialist products for reconstruction of the hip joint. This may be necessary due to conditions such as arthritis, causing persistent pain, and/or as a result of hip fracture.	Reported -1%	Underlying[1] -1%

SPORTS MEDICINE JOINT REPAIR **$587m**

We offer surgeons a broad array of instruments, technologies and implants necessary to perform minimally invasive surgery of the joints, including the repair of soft tissue injuries and degenerative conditions of the knee, hip and shoulder.

Reported	Underlying[1]
+7%	+8%

ARTHROSCOPIC ENABLING TECHNOLOGIES **$631m**

Products in this franchise are often used in conjunction with products from Sports Medicine Joint Repair to facilitate access to joint spaces, visualise the patient s anatomy, resect degenerated or damaged tissue and prepare the joint for a soft tissue repair.

Reported	Underlying[1]
+0%	+2%

TRAUMA & EXTREMITIES **$475m**

Our Trauma & Extremities franchise supports healthcare professionals with pioneering solutions used by surgeons to stabilise severe fractures, correct bone deformities, treat arthritis and heal soft tissue complications.

Reported	Underlying[1]
-4%	-4%

OTHER SURGICAL BUSINESSES **$214m**

The Other Surgical Businesses franchise includes our Ear, Nose & Throat (ENT) business and the NAVIOâ robotic surgical business, acquired at the start of 2016. It included our Gynaecology business until its disposal in August 2016.

Reported	Underlying[1]
+5%	
	+15%

ADVANCED WOUND CARE **$719m**

The Advanced Wound Care franchise consists of several groups of brands, including exudate management, infection management and our cornerstone ranges of products.

	Reported	Underlying[1]
	-5%	-3%

ADVANCED WOUND BIOACTIVES **$342m**

Our Advanced Wound Bioactives franchise comprises novel, cost-effective biopharmaceuticals that provide a unique approach to debridement, dermal repair and tissue regeneration.

	Reported	Underlying[1]
	-1%	0%

ADVANCED WOUND DEVICES **$172m**

Our Advanced Wound Devices franchise is comprised of our Negative Pressure Wound Therapy (NPWT) and surgical debridement businesses.

	Reported	Underlying[1]
	+3%	+5%

1 The non-IFRS financial measures are explained and reconciled to the most directly comparable financial measure prepared in accordance with IFRS on pages 175-177.

Table of Contents

Table of Contents

BUSINESS MODEL

How we create value

Smith & Nephew aims to bring together the sharpest minds in the industry to create and supply the most exciting and differentiated products and services to our customers, supporting them in the most noble of missions: to improve the lives of patients worldwide.

Resources

A key differentiator is our drive to push innovation throughout the business

RESEARCH & DEVELOPMENT

Innovation is part of our culture and we invest 5% of our revenue to develop new products that will help improve people s lives.

OUR VALUE PROPOSITION

Our mission is to support healthcare professionals by providing advanced medical devices that they use in their daily efforts to improve the lives of their patients.

PIONEERING APPROACH

We take a pioneering approach to the design of our products and services.

ETHICS & COMPLIANCE

We are committed to doing business the right way and apply strict business principles to the way we deal with our clients and partners.

MANUFACTURING & QUALITY

We operate our global manufacturing efficiently, and at the highest possible standards, to ensure product quality at sensible pricing.

TRAINING & EDUCATION

Every year, thousands of healthcare professionals attend our training courses around the world. Education is a fundamental part of our vision.

SALES & MARKETING

We support our customers in over 100 countries. Our commercial teams are highly specialised with an in-depth knowledge across the full range of product franchises.

OUR PEOPLE

Engaging, developing and retaining our 15,000+ employees is important to us and we work hard to be a great place to work as well as a responsible corporate citizen.

OUR VALUES AND HOW WE ACT

Our resources section starts on page 27

Our values shape everything that we do as a business and form the basis of our relationships with all our stakeholders.

Our values are included in our people section on page 33

PERFORMANCE

Performance means being responsive to the needs of our customers, setting ourselves clear goals and standards and achieving them.

Table of Contents

Outputs

ENSURING WIDER ACCESS

We strive to secure wide access to our diverse technologies for more customers globally.

ENABLING BETTER OUTCOMES

We enable better outcomes for patients and healthcare systems.

FINANCIAL PERFORMANCE

Targeting higher revenue growth and a better trading profit margin.

$4,669m

Revenue

$801m
Operating Profit

$1,020m[1]
Trading Profit

CAPITAL ALLOCATION FRAMEWORK

Prioritising the use of cash and ensuring an appropriate capital structure.

$279m
Dividend

$300m
Share buy-back

IMPROVED QUALITY OF PATIENT LIVES
Providing our advanced medical devices in more than 100 countries.

100+ countries

TRAINING AND EDUCATION
Supporting HCPs and ensuring the safe and effective use of our products.

40,000 surgeon training instances

GREAT PLACE TO WORK
Supporting and encouraging employees to live our values.
15,000+ employees

A SUSTAINABLE BUSINESS
Working in a sustainable, ethical and responsible manner everywhere we operate.

160+ years of proud history

INNOVATION TRUST

Innovation means being energetic, creative and passionate about everything we do, anticipating customers needs and overcoming barriers and developing opportunities.

Trust is something we understand that we have to earn and we strive to operate with integrity and take an ethical approach to business.

1 The non-IFRS financial measures are explained and reconciled to the most directly comparable financial measure prepared in accordance with IFRS on pages 175-177.

Table of Contents

STRATEGIC PRIORITIES

Maximising

our performance

Smith & Nephew has a clear vision to build a successful, sustainable business. This vision is encapsulated in our corporate value proposition supporting healthcare professionals by taking a pioneering approach to the design of our advanced medical products and services, by securing wider access to our diverse technologies for more customers globally, and by enabling better outcomes for patients and healthcare systems.

Moreover, we are focused on transforming the growth profile of the business while delivering this proposition. We are working to rebalance the Group towards higher growth. Over the last five years, Smith & Nephew has materially improved the mix of higher growth potential to lower growth businesses, shifting from one-third higher growth to over 50% today.

OUR STRATEGIC PRIORITIES

BUILD A STRONG POSITION

IN ESTABLISHED MARKETS

Build on existing strong positions, win market share through greater product and commercial innovation and drive efficiencies to liberate resources.

FOCUS ON

EMERGING MARKET

Our strategic priorities, introduced in 2011, guide our actions in delivering these twin aspirations of supporting healthcare professionals and transforming our growth profile.

Deliver leadership in the Emerging Markets by building strong, direct customer relationships, widening access to our premium products and developing portfolios designed for the economic mid-tier population.

INNOVATE FOR VALUE

Deliver pioneering products and business models that improve clinical and economical outcomes and widen access across geographies and patient groups.

SIMPLIFY AND IMPROVE

OUR OPERATING MODEL

Pursue maximum efficiency in everything we do, streamline our operations and manufacturing, remove duplication and build strong global functions to support our commercial teams.

SUPPLEMENT ORGANIC

GROWTH WITH ACQUISITIONS

Build our platform by acquiring complementary technologies, manufacturing and distribution capabilities in the Emerging Markets and complementary

products or businesses in our higher growth segments.

Table of Contents

Build a strong position in Established Markets

We delivered 4% reported and 3% underlying growth in the United States, our largest market.

Established Markets for Smith & Nephew are Australia, Canada, Europe, Japan, New Zealand and the US.

Smith & Nephew delivered 85% of its revenue from these Established Markets in 2016. Within this, we delivered 4% reported growth and 3% underlying revenue growth in the United States, our largest market. Reported Growth was down -1% and underlying growth was flat across our other Established Markets. Overall, reported revenue growth was 1% and underlying revenue growth was 2% across all our Established Markets.

The Sports Medicine franchises continue to perform strongly as we build on our broad portfolio of joint repair products, instruments and enabling technologies. It is now two years since we completed the acquisition of ArthroCare. The expected benefits are coming through and we are on track to deliver the expected $85 million of sales synergies by the end of 2017.

Our Reconstruction business continues to have good momentum, driven by our Knee Implant franchise. The Knee Implant portfolio was further strengthened by the acquisition of NAVIO, an exciting robotics platform, from which we delivered more than 50% revenue growth in 2016, in line with previous guidance.

In early 2016 we undertook further changes to our organisational structure, creating a single Commercial Organisation led by Mike Frazzette, Chief Commercial Officer, who is overseeing all commercial activities (sales, marketing, market access, and commercial strategy) across the Group for our full line of business. Its mission is to define and drive best practice in commercial execution across our geographies and in marketing across the franchises.

IMPROVING PATIENT OUTCOMES

Unplanned readmissions are costly to hospitals, surgeons and patients and, in the US, can result in significant financial implications for hospitals and other healthcare organisations under the Comprehensive Care for Joint Replacement Model (CJR) and Bundled Payments for Care Improvement (BPCI) initiative. For patients, an unplanned readmission can complicate and extend the recovery period and the resumption of normal activities. For hospitals and surgeons focused on value, as defined by quality outcomes achieved through efficiency, unplanned readmissions can

negatively influence overall quality scores.

We also brought all of our US franchises under one leader, completing the roll-out of our single managing director (MD) model globally. The single MD model is enabling us to improve our customer focus, commercial agility and operating efficiency.

In response, Smith & Nephew pioneered its Episode of Care Assurance Program (eCAP), an innovation designed to mitigate risk for our customers. It pairs together Smith & Nephew s entire line of primary total hip and knee reconstructive systems with two of its most innovative wound care products: PICOà Single Use NPWT and ACTICOATà Flex 7 Silver-coated Antimicrobial Barrier Dressing. Smith & Nephew warrants that the products will perform as expected, based on the product labels. If a patient is readmitted within 90 days following a procedure for a surgical site infection or to revise the implant due to a failure of a Smith & Nephew product, we will pay a hospital s unreimbursed costs for the readmission up to the aggregate purchase prices of the implant, PICO and ACTICOAT Flex 7.

$3,978m
Revenue from Established Markets

+1%
Reported

+2%
Underlying[1]

85%
Of Group revenue

Why is the KPI important?

Track the relative strength of our position in these markets.

How have we performed?

Whilst we grew in 2016, we did not grow as fast as we wanted and underperformed the market.

1 The non-IFRS financial measures are explained and reconciled to the most directly comparable financial measure prepared in accordance with IFRS on pages 175-177.

Table of Contents

STRATEGIC PRIORITIES

Focus on Emerging Markets

Our Emerging Markets represent 15% of Smith & Nephew s revenue, up from 8% in 2010.

Our Emerging Markets represent those outside the Established Markets, including the BRIC group of Brazil, Russia, India and China. These countries represent 15% of Smith & Nephew s revenue, up from 8% in 2010.

In the Emerging Markets revenue was down -3% on a reported basis and flat on an underlying basis. Most of our Emerging Markets businesses continue to generate double-digit growth as we benefit from our investments in our business platform in recent years.

through 2016, Sports Medicine returned to growth and Trauma followed. We expect Advanced Wound Management to continue to be impacted in the first half of 2017. Strategically, the growth prospects in China remain very attractive and we believe current end-market growth rates are solid double-digit. We are confident that we have taken all necessary measures and that China remains a very attractive market in which we are committed to building our business.

ANTHEMà TOTAL KNEE LAUNCHES IN EMERGING MARKETS

2016 saw the commercial launch of the ANTHEM Total Knee System. This platform

In China, the slow-down in end-markets first seen in mid-2015 was compounded by destocking in the distributor channel during 2016. We first saw this in Sports Medicine, subsequently followed by Trauma and Advanced Wound Management. The effect was not so visible in the more mature Reconstruction market, where stock levels were not geared to a rapid market expansion. As we progressed

In the oil-dependent Gulf States we saw very difficult trading conditions, particularly in our tender business, which are likely to persist.

As a matter of course we expect to see some volatility in the Emerging Markets, but we continue to see significant long-term growth potential and are very well positioned in our chosen markets.

was developed specifically to address the needs of patients and surgeons across Asia, the Middle East, Africa and Latin America. The unique design creates a knee offering fit for all ethnicities based on both intraoperative measurements and the analysis of CT images from patients across the world.

ANTHEM utilises the ORTHOMATCH[à] instrumentation platform which reduces weight, footprint and unnecessary cost without compromising on quality or clinical outcomes.

Smith & Nephew has partnered with Touch Surgery to develop a surgical simulation app for the ANTHEM Total Knee System, providing surgeons and healthcare professionals with a virtual training platform to learn, simulate and rehearse the knee replacement procedure in a 3D operating room environment. ANTHEM, ORTHOMATCH and Touch Surgery together provide an advanced and globally relevant knee implant that is accessible to all orthopaedic surgeons and patients in the Emerging Markets.

$691m	**-3%**	**0%**	**15%**
Revenue from Emerging Markets	Reported	Underlying[1]	Of Group revenue

Why is the KPI important?

Track underlying growth of Emerging Markets to global growth.

How have we performed?

Double digit growth across most markets was offset by China and the Gulf States.

1 The non-IFRS financial measures are explained and reconciled to the most directly comparable financial measure prepared in accordance with IFRS on pages 175-177.

Table of Contents

Innovate for value

In 2016 we took a significant step to increase our disruptive innovation.

We continue to innovate for value with new product launches and disruptive business models. A number of exciting new platforms were introduced in 2016.

In Sports Medicine we introduced our new LENS™ Surgical Imaging System and WEREWOLF™ COBLATION™ System for resecting soft tissue. We also launched the ULTRABUTTON™ Adjustable Fixation Device which provides advanced fixation strength for soft tissue to bone fixation in ACL/PCL repair and reconstruction.

In Knee Implants we began limited market release of our JOURNEY™ II XR, an innovative bi-cruciate retaining knee and the newest addition to the JOURNEY II Active Knee family. We are augmenting our own work with acquisitions, such as the purchase of NAVIO™, which has given us an exciting robotics platform with opportunities across the spectrum of knee reconstruction. We conducted the first total knee procedures using our NAVIO surgical robotics platform in 2016.

In Hip Implants we added to the REDAPT™ Revision System with a new Acetabular Fully Porous Cup designed for cases where compromised bone makes implant fixation and stability more difficult.

In 2016 we took a significant step to increase our disruptive innovation, appointing a President of Research and Development, Vasant Padmanabhan, to lead a newly formed single global R&D organisation. In addition to executing our technology pipeline, this leader will be responsible for driving breakthrough innovation and defining a clear path from concept to market. In 2017 the team is focused on increasing productivity, improving processes and better leveraging our resources and expertise. A more aligned organisation has also allowed us to centralise our approach to developing evidence that demonstrates the clinical and economic benefits of our products, supporting our commercial teams in positioning our products more effectively.

$230m
R&D expenditure

4.9%
Of Group revenue

Why is the KPI important?

Through this KPI we monitor our underlying investment in R&D.

How have we performed?

We met our target to keep investment in R&D at around 5% of Group revenue.

INNOVATING IN

THE OPERATING ROOM

Developed in-house and launched in 2016, the LENS™ Integrated Visualisation System provides integrated three in one design, incorporating a Console (which consists of the Camera Control Unit, LED Light Source and Image Management System), Camera Head (1080p broadcast grade image technology), and iPad® Application.

Employing the latest in CMOS chip technology, the LENS System captures High Definition images and produces clear live video. The Camera Head is autoclavable, durable and ergonomic, and the Smith & Nephew proprietary iPad® application takes media management and versatility to a whole new level.

New innovations such as LENS and the WEREWOLF™ COBLATION™ System are vital components to advance our operating room (OR) tower strategy. A tower is made up of visualisation or camera system, COBLATION resection controllers, mechanical resection or blade controllers and fluid management or pump components. Customers look at a tower as a solution to complete an arthroscopic procedure and Smith & Nephew is well positioned with our new products and established strength in DYONICS™ Shaver Blades and GoFLO™ Pumps.

Table of Contents

STRATEGIC PRIORITIES

Simplify and improve

our operating model

Focusing on efficiencies has

realised annual savings of $120 million.

In 2016 we continued to simplify and improve our operating model and delivered significant efficiencies. In Manufacturing, our Global Operations leadership team is focused on supporting the Group s strategic priorities by ensuring our footprint and expertise are ready to respond to geographical growth, new product development, greater external regulatory scrutiny and the commercial pressure to be ever more efficient. We made good progress across these areas in the year. Highlights included the opening of a new state-of-the-art facility in Costa Rica, which will provide a more efficient operation for current products as well as valuable capacity for future growth. We also created more than 100 positions for newly qualified graduate engineers across facilities in the US and elsewhere.

Quality has always been paramount to Smith & Nephew. We have a unified Quality Assurance and Regulatory Affairs team to ensure

consistency across our country business units. Requirements of global regulatory agencies have become more stringent in recent years and we expect them to continue to do so. We are continuing to expand our portfolio globally through new product development and by registering our existing products in new markets. In order to meet the expectations of regulators and support this added complexity we continued to invest in our Quality and Regulatory

expertise in 2016.

The Group Optimisation Plan was announced in May 2014 with a stated savings target of annualised benefits of $120 million by the end of 2017. We delivered ahead of plan and reached our target at the end of 2016. These savings have been driven by our focus on efficient procurement, the greater agility of the single country managing director model and rationalisation of our facility footprint in a number of countries.

Operating Profit

17.2%

Operating Profit Margin

Operating profit increased by $173m from $628m in 2015 to $801m in 2016. This movement in 2016 was primarily driven by the absence of costs recognised in 2015 relating to anticipated and settled metal-on-metal hip claims.

Trading Profit[1]

21.8%

Trading Profit Margin[1]

Why is the KPI important?

We use this KPI to track our underlying profit growth and trading profitability.

How have we performed?

2016 Trading profit margin reflects transactional FX headwind, loss of leverage from lower sales growth and investment in Blue Belt, offset by efficiencies.

NEW MANUFACTURING FACILITY OPENS

In 2016 we opened a new manufacturing facility in Costa Rica. The new plant will support the global demand for Smith & Nephew s COBLATION® technology. COBLATION is an arthroscopic procedure that involves the creation and application of an energy field, which is used for the precise removal of soft tissue with minimal damage to untargeted tissue.

Smith & Nephew s position within the global sports medicine market was strengthened significantly in 2014, with the acquisition of ArthroCare Corporation. The transaction added highly complementary products to the existing portfolio, as well as manufacturing expertise in Costa Rica.

1 The non-IFRS financial measures are explained and reconciled to the most directly comparable financial measure prepared in accordance with IFRS on pages 175-177.

Table of Contents

Supplement organic

growth with acquisitions

Our two largest acquisitions are

delivering good returns.

In recent years we have undertaken a number of acquisitions, strengthening both our technology and product portfolio and our Emerging Markets business. We have delivered good returns with the success of our two larger acquisitions, Healthpoint and ArthroCare, establishing a strong track record in Mergers and Acquisitions (M&A).

With Healthpoint Biotherapeutics, acquired in 2012 for $782 million, our third year return on capital has exceeded our expectations. ArthroCare, acquired in 2014 for $1.5 billion, is performing in line with our expectations. We are ahead of our plan to deliver $85 million of synergies by 2017 and have achieved almost all our targeted cost savings.

In 2016, we continued to invest in acquisitions. The acquisition of Blue Belt Technologies, completed in January, has given us a leading position in the fast growing area of robotics-assisted orthopaedic surgery. Its NAVIOâ surgical system provides robotics-assistance in partial knee replacement surgery and we intend to expand it into total knee, bi-cruciate retaining knee and revision knee implants, potentially delivering further upside. The expansion of our NAVIO robotics platform is progressing at pace, with the first total knee completed in 2016.

In addition, we created compelling value by selling our Gynaecology business for $350 million (2015 revenue: $56 million) in August 2016. We had built this business rapidly on the back of Smith & Nephew s resection technology and expertise. We completed the associated $300 million share buy-back programme in December 2016, returning the value created directly to shareholders.

The Board periodically reviews acquisitions to evaluate longer-term performance and capture lessons learned to help improve strategy and process. As you would expect, some of our recent smaller acquisitions have out-performed our initial expectations, whereas others have underperformed. Collectively we are pleased with the performance of the technology and Emerging Markets acquisitions we have made.

Table of Contents

OUR MARKETPLACE

Our marketplace is driven by longer-term trends

The major trends that drive the markets in which Smith & Nephew operates have remained consistent for many years. Ageing populations, together with obesity, diabetes and other lifestyle diseases (often linked with increased prosperity), all contribute to rising demand for healthcare.

According to the World Health Organisation (WHO), between 2015 and 2050 the proportion of the world s population over 60 years will nearly double from 12% to 22%. In 2014, the WHO estimated that more than 1.9 billion adults were overweight. Of these, over 600 million were classified as obese, a major risk factor for diseases such as diabetes and musculoskeletal disorders.

organisations funded by tax revenues. In the US, our 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 treatment regimes. In the Emerging Markets, demand is driven by self-pay patients.

New commercial purchasing models are being adopted by health systems as a solution to improving resource allocation. One notable trend is the greater focus on payment-for-outcomes rather than fee-for-service reward models, particularly in the US where the Comprehensive Care

Pricing of products is largely influenced in most developed markets by governmental reimbursement programmes. Initiatives sponsored by government agencies, legislative bodies and the private sector to limit the growth of healthcare costs are ongoing and include price regulation, excise taxes and competitive pricing. Governments and healthcare providers are increasingly requesting health economic data to justify the pricing of products and procedures or reimbursement requests. More collaboration between industry and data research institutions is emerging as a result.

REGULATORY STANDARDS AND COMPLIANCE IN THE

Additionally, the WHO estimates that by 2020, people aged 60 years and older around the world will outnumber children younger than five. This changing dynamic will decrease the level of funds available for healthcare raised through taxes. As a result governments and healthcare providers are under pressure to look for ways to reduce their overall healthcare expenditure, while at the same time maintaining the quality of care and treatment provided. Healthcare reform therefore is near the top of many national agendas.

CUSTOMERS

Our customers include surgeons, nurses, healthcare payers and administrators, and healthcare systems and procurement groups.

In certain parts of the world, including the UK, much of Continental Europe, Canada and Japan, healthcare providers are often government

for Joint Replacement (CJR) model began on 1 April 2016. The CJR model aims to drive better and more efficient care by incentivising hospitals, physicians, and post-acute care providers to work together through a bundled payment system.

There is also a desire for more patients to be treated in an outpatient or community setting. Treatment in hospitals, often entailing operating room time and overnight stays, is expensive. New models such as ambulatory care centres now offer outpatient orthopaedic treatment and there is pressure for more wound care to be provided in the community setting.

Product innovation remains of vital importance with increasing focus on products which simplify and increase the efficiency of procedures as well as robotics which increase precision and enhance procedure outcomes.

Pricing pressures also remain pertinent. In many cases, highly regulated markets employ various controls on pricing.

HEALTHCARE INDUSTRY

Alongside healthcare provision and payment becoming more complex, the regulation of the medical device industry is also intensifying. Regulatory requirements are important in determining whether substances and materials can be developed into effective products in an environmentally sustainable way.

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 their placement on market and that such authorisation or registration be subsequently maintained. The industry is focusing its resources on meeting the increased regulatory pressure around the world.

600 million **2020** **22%**

Obese adults in 2014, a major risk factor for diseases such as diabetes and musculoskeletal disorders (WHO).

The WHO estimates that by 2020, people aged 60 years and older around the world will outnumber children younger than five.

Proportion of the world s population over 60 years will nearly double from 12% to 22% by 2050 (WHO).

Table of Contents

The major regulatory agencies for Smith & Nephew s products include the Food and Drug Administration (FDA) in the USA, the Medicines and Healthcare products Regulatory Agency in the UK, the Ministry of Health, Labour and Welfare in Japan, the China Food and Drug Administration and the Australian Therapeutic Goods Administration.

In general, with the aforementioned industry trends, safety standards and regulations in the medical device industry are becoming more stringent. Regulatory agencies are intensifying audits of manufacturing facilities and the approval time for new products has lengthened. Regulation for marketing medical devices in the European Union will tighten with the introduction of the Medical Device Regulations (MDR), a draft of which was published in June 2016 and is expected to be fully implemented by late 2019.

Legislation covering corruption and bribery, such as the UK Bribery Act and the US Foreign Corrupt Practices Act, also applies to all our global operations. We are committed to ensuring regulatory compliance and to doing business with integrity and we welcome the trend towards higher standards in the healthcare industry. We and other companies in the industry are subject to regular inspections and audits by regulatory agencies and notified bodies, and in some cases remediation activities have required and will continue to require significant financial and resource investment.

SEASONALITY

Orthopaedic and sports medicine procedures tend to be higher in the winter months when accidents and sports related injuries are highest. Elective procedures tend to slow down in the summer months due to holidays. Due to the nature of our product range, there is little seasonal impact on our Advanced Wound Management franchises.

In the US out-of-pocket costs for health insurance plans are tied to medical expenses in a calendar year. As a result, households who have reached their deductible (or out-of-pocket) cap may find that accessing care later in the year comes at a lower cost, which can encourage more of them to try and schedule any required treatments or procedures in the final months of any given year.

$5bn +6%

Market size **Sports Medicine**[1]

	Range
A SMITH & NEPHEW	20-24%
B ARTHREX	29-33%
C DEPUY (MITEK) [2]	12-16%
D STRYKER	9-13%
E OTHERS	Balance

$15bn +3%
Market size **Hips & Knees (Recon)**

	Range
A SMITH & NEPHEW	9-11%
B ZIMMER BIOMET	34-36%
C DEPUY SYNTHES [2]	20-22%
D STRYKER	19-21%
E OTHERS	Balance
$8bn	+4%
Market size **Advanced Wound Management**	

	Range
A SMITH & NEPHEW	14-18%
B ACELITY	17-21%
C MOLNLYCKE	9-13%
D CONVATEC	5-9%
E OTHERS	Balance

$5bn
Market size **Trauma & Extremities**

+3%

		Range
A	SMITH & NEPHEW	6-10%
B	DEPUY SYNTHES [2]	44-48%
C	STRYKER	23-27%
D	ZIMMER BIOMET	9-13%
E	OTHERS	Balance

Data: 2016 estimates generated by Smith & Nephew based on publicly available sources and internal analysis.

1 Representing access, resection and repair products.

2 A division of Johnson & Johnson.

Table of Contents

THE PRODUCTS WE TAKE TO MARKET

SMITH & NEPHEW HAS NINE GLOBAL PRODUCT FRANCHISES

Revenue by product

A	KNEE IMPLANTS	$932m
B	HIP IMPLANTS	$597m
C	SPORTS MEDICINE JOINT REPAIR	$587m
D	ARTHROSCOPIC ENABLING TECHNOLOGIES	$631m
E	TRAUMA & EXTREMITIES	$475m

F	OTHER SURGICAL BUSINESSES	$214m
G	ADVANCED WOUND CARE	$719m
H	ADVANCED WOUND CARE BIOACTIVES	$342m
I	ADVANCED WOUND DEVICES	$172m

KNEE IMPLANTS

$932m **Revenue**	**+6%** Reported	**+4%** Underlying[1]

Smith & Nephew offers an innovative range of products for specialised knee replacement procedures. Knee replacement surgery involves replacing the worn, damaged or diseased portion of a knee with an artificial joint. Every year more than two million patients receive total, partial or revision knee replacements.

Smith & Nephew s knee systems include the LEGION GENESIS à II Total Knee System, a comprehensive system designed to allow surgeons to address a wide range of knee procedures, and our JOURNEY à II family of Active Knees. JOURNEY II has been engineered to empower patients with a renewed active lifestyle by breaking through traditional knee replacement barriers and delivering function, motion and durability through PHYSIOLOGICAL MATCHING à.

In 2016 we began limited market release of our JOURNEY II XR product, an innovative bi-cruciate retaining knee implant, which is designed to retain the anterior and posterior cruciate ligaments (ACL/PCL) and deliver normal proprioception and muscle control[2].

These systems also feature VERILAST à Technology, our advanced bearing surface. The LEGION à Primary Knee with VERILAST Technology has been laboratory-tested to 30 years of simulated wear. While lab testing is not the same as clinical performance, the tests showed significant reduction in wear compared to conventional technologies.

Our knee systems utilise our VISIONAIRE™ Patient-Matched Instrumentation, whereby a patient s MRI and X-rays are used to create customised cutting guides that allow the surgeon to achieve optimal alignment of the new implant.

In 2016 we launched the ANTHEM™ Total Knee System. This was designed from both intraoperative measurements and the analysis of CT images from patients, to create a knee offering fit for all ethnicities. ANTHEM utilises the ORTHOMATCH™ instrumentation platform, reduces weight, footprint and unnecessary cost without compromising on quality or clinical outcomes.

During 2015, we acquired the Zimmer® Unicompartmental High Flex Knee (ZUK) system in the US market, giving us a strong position in the attractive partial knee joint reconstruction segment.

In early 2016 we completed the acquisition of Blue Belt Technologies, securing a leading position in the fast-growing area of orthopaedic robotics assisted surgery. Blue Belt s NAVIO® surgical system provides robotics assistance in partial knee replacement surgery. We anticipate significant upside from a range of new product launches that will expand into indications beyond partial knees, the first of which is the total knee application with the first procedures being completed in 2016.

1 The non-IFRS financial measures are explained and reconciled to the most directly comparable financial measure prepared in accordance with IFRS on pages 175-177.

2 Moro-Oka, Taka-Aki, Marc Muenchinger, Jean Pierre Canciani, and Scott A Banks. Comparing in Vivo Kinematics of Anterior Cruciate-retaining and Posterior Cruciate-retaining Total Knee Arthroplasty . Knee Surgery, Sports Traumatology, Arthroscopy 15.1. (2007):93:99 Web.

Table of Contents

HIP IMPLANTS

$597m	**-1%**	**-1%**
Revenue	Reported	Underlying[1]

Smith & Nephew s Hip Implant franchise offers a range of specialist products for reconstruction of the hip joint. This may be necessary due to conditions such as arthritis, causing persistent pain, and/or as a result of hip fracture. Every year more than two million patients worldwide undergo total, resurfacing and revision hip replacement procedures.

For Hip Implants, Smith & Nephew has developed a range of primary hip systems. Core systems include the ANTHOLOGY à Hip System, SYNERGY à Hip System, the POLARSTEM à Femoral Hip System, the R3 à Acetabular System and the POLARCUP à Dual Mobility Hip System. This diversity exemplifies our commitment to providing surgeons with implant and instrumentation options that meet the specific demands of their patients and preferred surgical approach, most notably the direct anterior or posterolateral approach. We also market the BIRMINGHAM HIP à Resurfacing (BHR) System, an important option for surgeons treating suitable patients.

1 The non-IFRS financial measures are explained and reconciled to the most directly comparable financial measure prepared in accordance with IFRS on pages 175-177.

Table of Contents

THE PRODUCTS WE TAKE TO MARKET

HIP IMPLANTS continued

TRAUMA &
EXTREMITIES

Smith & Nephew s portfolio includes the new REDAPT Revision Femoral System. The need to perform a revision can occur for a variety of reasons including infection, dislocation, or failure of the implants to achieve biologic fixation. REDAPT is designed to turn such complex hip revisions into efficient, reproducible surgeries, allowing surgeons to effectively recreate a patient s unique functionality, while quickly and easily addressing issues such as poor bone quality. The REDAPT Revision Femoral System comprises a monolithic stem and a Fully Porous Shell. The use of additive manufacturing (also called 3D printing) to create a titanium shell, with first to market features that improve intraoperative usability and greatly enhance implant stability, was received with great enthusiasm amongst hip surgeons.

Making good technology spectacular

The REDAPT[à] Fully Porous Acetabular Cup with CONCELOC[à] Technology was launched in 2016. To allow ingrowth, an additive, or 3D printing, manufacturing process is used to produce an entirely porous implant that mimics the structure of cancellous bone. New variable-angle locking screws can be used to enhance implant stability and minimise micromotion after surgery, which when coupled with placement of hole patterns, optimises surgical flexibility and access, particularly in difficult to reach areas of revision cases.

The 3D printing method allows for complex design geometries that would be difficult, expensive or impossible to achieve with traditional manufacturing methods. For example, solid reinforcements can be built directly into the porous structure to provide extra strength in precise locations.

$475m	**-4%**	**-4%**
Revenue	Reported	Underlying[1]

Our Trauma & Extremities franchise supports healthcare professionals by pioneering solutions for surgeons to stabilise severe fractures, correct bone deformities, treat arthritis, and heal soft tissue complications. Performance in 2016 in this franchise was held back by the destocking in our China business and reduced tender activity in the Gulf States.

For Trauma, the principal internal fixation products are the TRIGEN[à] family of intramedullary (IM) nails (TRIGEN META-NAIL[à] System, TRIGEN Humeral Nail System and TRIGEN INTERTAN[à]), EVOS[à] Plating System and the PERI-LOC[à] Plating System. In 2016 we unveiled new evidence showing that the TRIGEN INTERTAN hip fracture system allows patients to experience lower risk of implant failure and re-operation; faster time to fracture union; and a high return to pre-fracture status[2].

Table of Contents

SPORTS MEDICINE JOINT REPAIR

The EVOS Mini Fragment Plate and Screw System is a dedicated Trauma mini fragment system. This is a stainless steel highly versatile system with a multitude of plate geometries and longer screw lengths than standard mini fragment systems. Complementing this is our VLPâ MINI-MODâ Small Bone Plating System for the fixation of small bones and small bone fragments, specifically designed to match the contour of small bones needed in treating hand, wrist, elbow, foot and ankle fractures.

For extremities and limb restoration, we offer the TAYLOR SPATIAL FRAMEâ Circular Fixation System as well as a range of plates, screws, arthroscopes, instrumentation, resection and suture anchor products for orthopaedic surgeons including foot and ankle and hand and wrist specialists, and trauma surgeons. This year, TAYLOR SPATIAL FRAME External Fixator celebrated its 20 year anniversary, and we conducted a systematic review of the clinical outcomes. The results showed post-operative success in more than 99% of patients[3].

2016 saw the first implantation of the ATLAS HF Nail in South Africa and India. It is the first Smith & Nephew nail specifically designed for the Emerging Markets.

$587m	+7%	+8%
Revenue	Reported	Underlying[1]

Our Sports Medicine Joint Repair franchise offers surgeons a broad array of instruments, technologies and implants necessary to perform minimally invasive surgery of the joints, including the repair of soft tissue injuries and degenerative conditions of the knee, hip and shoulder. Our franchise operates in a large, growing market where unmet clinical needs lend room for procedural and technological innovation. Smith & Nephew is well positioned both to innovate and to reach customers globally.

We produced double-digit growth in the US in 2016, driven by the benefits of our combined portfolio following the 2014 acquisition of ArthroCare. Our overall performance was held back by conditions in China in the first half of the year, where we saw a slowdown in capital and consumable sales compounded by de-stocking in our distribution channel.

Key products in this franchise include the FAST-FIX™ family of meniscal repair systems, the ENDOBUTTON™ family for knee ligament reconstruction, HEALICOIL™ PK, FOOTPRINT™ PK and TWINFIX™ Suture anchors for repairs of the hip and rotator cuff. The open architecture of the HEALICOIL™ PK Suture Anchor allows for new bone to fill the fenestrations between threads and into the central channel. The SUTUREFIX™ Ultra soft suture anchor is an attractive option for procedures in which anatomic space is very limited[4] while still delivering high fixation strength[5-7].

Smith & Nephew also offers products made from REGENESORB™, an advanced biocomposite shown to be absorbed and completely replaced by bone within 24 months in pre-clinical studies[8,9].

Smith & Nephew markets a suite of products for Rotator Cuff Repair (RCR), one of the most common sports medicine procedures. These include ULTRATAPE™, a suture that provides greater tendon-to-bone contact when compared to traditional #2 suture, and may enhance repair[10]; FIRSTPASS™ ST, a sterile-packaged retrograde suture passer that eliminates the steps of loading and unloading needles and cartridges; and MULTIFIX™ S, an all-PEEK knotless screw-in anchor. All these recently launched products can be used together or in conjunction with existing products from the Smith & Nephew portfolio in a single procedure, significantly expanding the breadth of our RCR Solutions. The Q-FIX™ All-Suture Anchor is ideal for a variety of arthroscopic shoulder and hip repairs, offering fixation performance superior to commonly used all-suture anchors and traditional anchors[11,12].

1 The non-IFRS financial measures are explained and reconciled to the most directly comparable financial measure prepared in accordance with IFRS on pages 175-177.

2 05036 V1 INTERTAN Claims Brochure 0616.

3 07037 V1 Bone & Joint Outcome. The TAYLOR SPATIAL FRAME for External Fixation. A Systematic Literature Review Following 20 Years of Clinical Outcomes. 1016.

4 Smith & Nephew Evaluation Reports 15002113, 15002112, 15002117.

5 Smith & Nephew 2011. Validation REPORT ULTRABRAID II SUTURE BIOCOMPATIBILITY 15001076.

6 Smith & Nephew 2013. Competitive Claims REPORT, SutureFix 15002059.

7 Smith & Nephew 2013. Validation REPORT, Hip Suturefix XL 15001076.

8 Data on File, Smith & Nephew report 15000897.

9 Results of in vivo simulation have not been shown to quantitatively predict clinical performance.

10 Potter L, Moore C. Increased contact area utilizing the ULTRATAPE Suture for rotator cuff repair. Bone&JointScience: Our Innovation in Focus. 2014;4(3):1-4. Lit no: 02056.

11 ArthroCare Report #P/N 54231-01 Rev. A; ArthroCare Report #P/N 49193-01 Rev. A; ArthroCare Report #P/N 51963-01 Rev. A.

12 Douglass NP, Behn AW, Safran MR. Cyclic and Load to Failure Properties of All-Suture Anchors in Synthetic Acetabular and Glenoid Cancellous Bone. Arthroscopy. 26 January 2017.

Table of Contents

Table of Contents

ARTHROSCOPIC ENABLING TECHNOLOGY

OTHER SURGICAL BUSINESSES

$631m	**0%**	**+2%**
Revenue	Reported	Underlying[1]

Our Arthroscopic Enabling Technologies (AET) franchise offers a high performance array of minimally invasive surgery-enabling systems and devices.

AET platforms work in concert to facilitate access to various joint spaces, visualise the patient s anatomy, resect degenerated or damaged tissue and prepare the joint for a soft tissue repair. Products in this franchise are often used in conjunction with products from our Sports Medicine Joint Repair franchise.

Systems include high definition imaging solutions, industry leading energy based and mechanical resection platforms, fluid management and access portfolios, along with anatomic repair-aiding limb positioners and holders.

1 The non-IFRS financial measures are explained and reconciled to the most directly comparable financial measure prepared in accordance with IFRS on pages 175-177.

Key products include the LENS[à] Integrated system which provides an integrated three in one design incorporating the Console (CCU, LED Light Source and Image Management System), Camera Head and iPad app. Also, WEREWOLF[à] and Quantum 2[à] COBLATION[à] controllers and a wide range of high performance COBLATION Technology radio frequency (RF) wands ablate, resect and coagulate soft tissue and enable haemostasis of blood vessels.

We also market the DYONICS[à] Shaver blades, handpiece, and controller, which provide superior resection due to their sharpness and reduce clogging with their debris evacuation capabilities, GoFLO[à] and DoublePump fluid management consoles that distend joint space while providing haemostasis and a medium to perform arthroscopic

procedures, SPIDER2à/T-MAX procedure-enabling limb positioning systems, and ACUFEXà Hand Held Instruments.

Within an operating room our AET products are typically kept in tower, often comprising a visualisation or camera system, COBLATION or energy based resection controllers, mechanical resection or blade controllers and fluid management or pump components. Our customers often think about a tower solution to complete an arthroscopic procedure more than the individual components that make up this tower. Our strategy is to showcase our industry leading tower components, such as COBLATION wands and DYONICS shaver blades, when selling the LENS camera system and GoFLO Pump. We articulate this through our Own the Tower strategy.

$214m	+5%	+15%
Revenue	Reported	Underlying[1]

The Other Surgical Businesses franchise includes our Ear, Nose & Throat (ENT) business and the NAVIOà robotic surgical business, acquired at the start of 2016. This franchise included our Gynaecology business sold in August 2016.

Within ENT we offer a wide variety of products including our COBLATION Technology for tissue removal and haemostasis, various articulating instruments and implants for sinus surgery such as balloon sinuplasty, and our RAPID RHINOà Carboxymethylcellulose (CMC) Technology which is featured in both dissolvable and removable nasal and sinus dressings, and epistaxis treatment products. Our NASASTENTà Dissolvable Nasal Dressing is a structural intranasal splint used to minimise bleeding and prevent post-operating adhesions after sinus surgery. Unlike other nasal dressings which fragment as they degrade, once the NASASTENT dressing absorbs sufficient nasal fluid, it converts into hydrocolloidal gel that simply drains from the cavity as part of the natural outflow.

The acquisition of Blue Belt Technologies was announced in October 2015 and completed in January 2016. This has given us a leading position in the fast growing area of robotics-assisted orthopaedic surgery. Its NAVIO surgical system provides robotics-assistance in partial knee replacement surgery through a unique hand-held, bone-shaping device. NAVIO and our own partial knee implant portfolio form a strong combined business from which to accelerate growth in this attractive area of surgery. Additionally, we intend to expand NAVIO into total knee, bi-cruciate retaining knee and revision knee implants, delivering significant further upside.

Table of Contents

THE PRODUCTS WE TAKE TO MARKET

ADVANCED WOUND CARE

Consistent and accurate results

In July we announced the first surgical case for our robotics-assisted total knee replacement procedure. The new approach can use the NAVIO® Surgical System to implant the JOURNEY® II BCS and CR total knee systems.

During a total knee replacement surgery, the NAVIO system is designed to deliver consistent and accurate results through the utilisation of a robotics-assisted hand piece, navigation and NAVIO specific cut guides, all of which enable better patient outcomes. The NAVIO intraoperative planning software uses 3D surface capture and kinematic registration to predict joint laxity, enable precise implant positioning, and define a patient specific surgical plan. Unlike other robotics-assisted platforms, the NAVIO system does not require a pre-operative CT scan.

This new indication has the potential to increase system utilisation, as approximately 80% of global knee replacement procedures are primary total knee replacements, compared to less than 10% for partial knee replacements.

$719m	-5%	-3%
Revenue	Reported	Underlying[1]

The Advanced Wound Care (AWC) franchise consists of several groups of brands, including exudate management, infection management and our cornerstone range of products. Performance in this franchise in 2016 reflected the effect of destocking in China and weakness in a couple of European countries, which more than offset the performance in the US.

Exudate management products focus on providing appropriate wound fluid absorption and evaporation properties to promote optimal wound healing environment. This will reduce the burden a wound has on the patients and help them to get on with their lives and at the same time diminish costs for materials and nursing time.

Our key growth brand in this space is ALLEVYN à Life, an innovative dressing designed to improve the quality of life for patients with chronic wounds, as well as helping healthcare professionals reduce the costs of frequent dressing changes. During the year we announced the publication of a new research paper showing how a comprehensive ulcer prevention programme which included the use of ALLEVYN Life can significantly decrease hospital-acquired pressure ulcers (HAPUs) by 69% in an adult intensive care unit[2].

Two core technologies drive our infection management portfolio: silver and iodine.

Our silver-based products (ACTICOAT à, DURAFIBER à Ag and ALLEVYN Ag) provide clinicians a range of solutions to address individual patient needs in managing wound infection. ACTICOAT is very well positioned to address the need for highly effective, fast-acting local antimicrobials in the care of serious wound infection on a wide range of wounds including surgical incisions and chronic wounds.

Our iodine based product, IODOSORB à, has a unique mode of action to deliver low level, slow release elemental iodine without cytotoxic effects.

Smith & Nephew s cornerstone range offers a wide selection of wound care products, which means we have one of the most comprehensive ranges of wound care solutions in the industry. These products include our film and post-operative dressings, skincare products and gels.

OPSITE à is one of our most successful and pioneering products and has become the global standard of care in post-operative dressings. IV3000 à, a specialist premium dressing for intravenous lines, continues to perform well. SECURA à is a proven preventative skin care product which helps maintain and protect skin integrity.

1 The non-IFRS financial measures are explained and reconciled to the most directly comparable financial measure prepared in accordance with IFRS on pages 175-177.

2 Swafford K, Culpepper R, Dunn C. Use of a Comprehensive Program to Reduce the Incidence of Hospital-Acquired Pressure Ulcers in an Intensive

Care Unit. Am J Crit Care. 2016;25(2):152-5.

Table of Contents

ADVANCED WOUND BIOACTIVES

No idea in wound management is bigger than aiming to get closer to zero pressure ulcer incidence, zero delay in wound healing, zero surgical site complications, zero venous ulcer recurrence, zero diabetic amputations, zero waste of healthcare resources. Zero is the only target worth aiming for, and we strive to help our customers get closer to it.

This is why in 2016 we introduced Closer to Zero , our new communication platform for the wound business, which demonstrates how these franchises contribute towards our overall corporate vision of supporting healthcare professionals. Closer to Zero was launched at the World Union of Wound Healing Societies global meeting in Florence, Italy, in October 2016.

$342m **Revenue**	**-1%** Reported	**0%** Underlying[1]

Our Advanced Wound Bioactives (AWB) franchise focuses on the development and commercialisation of novel, cost-effective biopharmaceuticals to provide a unique approach to debridement, dermal repair and tissue regeneration.

Currently, our Advanced Wound Bioactives products on the market include Collagenase SANTYL® Ointment (the only FDA-approved biologic enzymatic debriding agent for chronic dermal ulcers and severe burns), OASIS® Wound Matrix and Ultra Tri-Layer Matrix (a naturally-derived, extracellular matrix replacement products indicated for the management of both chronic and traumatic wounds) and REGRANEX® (becaplermin) Gel 0.01% (an FDA-approved platelet-derived growth factor for the treatment of Diabetic Foot Ulcers).

Our most significant product by sales is SANTYL Ointment, which plays an integral role in removing necrotic or dead tissue in chronic dermal ulcers (such as pressure ulcers, diabetic ulcers, and venous ulcers) and severely burned patients. In 2016 we continued to see significant growth in the use of SANTYL Ointment by office-based physicians while we experienced some challenges in the long-term care market as patients experienced shorter stays in nursing homes and transitioned to care in home health. We are concentrated on further establishing the value of SANTYL Ointment in treating patients despite the shift of cost from insurers to the patients. This is being supported through cost-effectiveness data focused on patient outcomes and overall treatment costs. This information is assisting us to further educate physicians, patients, and payers on the critical role that SANTYL Ointment plays in moving the healing process forward.

The wound bioactives market growth has been impacted by changes in the reimbursement landscape that are driving increases in co-pay, deductibles and access in general across the sites of care.

The US is the largest market and represents the current focus for our AWB franchise. SANTYL Ointment is also available in Canada. OASIS is accessible in a number of other Established Markets.

1 The non-IFRS financial measures are explained and reconciled to the most directly comparable financial measure prepared in accordance with IFRS on pages 175-177.

Table of Contents

THE PRODUCTS WE TAKE TO MARKET

ADVANCED WOUND DEVICES

$172m	+3%	+5%
Revenue	Reported	Underlying[1]

Our Advanced Wound Devices (AWD) franchise is comprised of our Negative Pressure Wound Therapy (NPWT) and surgical debridement businesses.

The PICO[à] system, our pioneering single-use, canister-free NPWT solution, performed strongly in 2016. PICO brings the effectiveness of traditional NPWT in a modern, small portable system[2]. It is designed for both open wounds and closed incisions and leverages our leading dressing technology. More than one million PICO systems have now been used to treat patients, changing the treatment landscape for NPWT.

A number of new pieces of evidence supporting PICO were published in 2016. This included new clinical evidence highlighting improved patient outcomes when using PICO following orthopaedic surgery[3], as well as evidence and expert opinion highlighting the clinical and aesthetic benefits of PICO in mammoplasty and oncological breast reconstructive surgery[4].

In traditional NPWT, we secured regulatory approval for both RENASYS GO[à] and RENASYS TOUCH[à] in the US and Europe in 2016. RENASYS TOUCH is in a limited launch in Europe and US and we are re-supplying existing US customers with RENASYS GO.

This franchise also includes the VERSAJETâ Hydrosurgery system, a mechanical debridement device used by surgeons to excise and evacuate non-viable tissue, bacteria and contaminants from wound, burns and soft tissue injuries.

More than a million PICO systems

In 2011, Smith & Nephew launched a breakthrough in NPWT the PICO Single Use NPWT System. In 2016, the millionth application of PICO was used to treat a patient.

The revolutionary four-layer multi-function dressing technology makes the PICO System canister-free and disposable. Each layer works together to ensure that negative pressure is delivered to the wound bed and exudate is removed through absorption and evaporation[1].

Today PICO is used in the community and hospitals to treat patients. PICO is as easy to apply as a conventional wound dressing, reducing the need for the staff time, intensive training and administrative paperwork associated with traditional NPWT.

For the patient, the PICO system s one-button pump is easy-to-use and its small size and silent operation provide a discreet, unobtrusive way to carry on daily life with NPWT. For the payer, the PICO system is more affordable than traditional NPWT, and can significantly reduce therapy costs associated with traditional NPWT.

1 Malmsjo, M; Huddleston, E; Martin, R; Biological Effects of a Disposable, Canisterless Negative Pressure Wound Therapy System; Eplasty 2014.

1 The non-IFRS financial measures are explained and reconciled to the most directly commparable financial measure prepared in accourdance with IFRS on pages 175-177.

2 Bullough L, Burns S, Timmons J, Truman P, Megginson S. Reducing C-Section wound complications. Clinical Svcs J 2015;Apr:43-47.

3 Karlakki SL, Hamad AK, Whittall C, Graham NM, Banerjee RD, Kuiper JH. Incisional negative pressure wound dressings (NPWTd) in routine primary hip and knee replacements A randomised controlled trial. Bone Joint Res. 2016;5:328-337.

4 Galiano R, Djohan R, Shin J, et al. The effects of a single use canister-free Negative Pressure Wound Therapy (NPWT) System* on the prevention of postsurgical wound complications in patients undergoing bilateral breast reduction surgery. Poster presented at: British Association of Aesthetic Plastic Surgeons (BAAP s) 30th Annual

Scientific Meeting; September 2014; London, UK.

Table of Contents

THE RESOURCES WE NEED TO DELIVER OUR PRODUCTS

RESEARCH & DEVELOPMENT

RESEARCH & DEVELOPMENT

Innovation is part of our culture and we invest 5% of our revenue to find new products that will help improve people s lives.

See opposite

ETHICS & COMPLIANCE

We are focused on doing business the right way and apply strict business principles to the way we deal with our clients and partners.

More on page 28

MANUFACTURING & QUALITY

We operate our global manufacturing efficiently, and to the highest possible standards, to ensure product quality at sensible pricing.

More on page 30

TRAINING & EDUCATION

Every year, thousands of healthcare professionals attend our training courses around the world. Education is a fundamental part of our vision.

More on page 31

SALES & MARKETING

We support our customers in over 100 countries. Our commercial teams are highly specialised with an in-depth knowledge across the full range of product franchises.

More on page 32

OUR PEOPLE

Engaging, developing and retaining our 15,000+ employees is important to us and we work hard to be a great place to work as well as a responsible corporate citizen.

More on pages 33 to 35

Our Research & Development (R&D) strategy is at the heart of our business model. Through it we strive to deliver innovation that matters, pioneering products and services that bring value to our customers and the Company.

In 2016 we made significant changes to create a single global R&D structure, led by a new President of Global R&D, reporting directly to the Chief Executive Officer. The new global function has moved quickly to sharpen our focus onto the three areas which will accelerate the value created by R&D.

First, we are refining our R&D roadmap to identify and support projects that will make a meaningful difference to our customers and their patients. This includes continuing to invest in incremental innovation to improve existing products in a way that improves outcomes. It also involves driving greater efficiency through innovation, potentially reducing our costs of goods. By making instrument sets more procedure and patient-specific, we will reduce complexity and cost, to the benefit of customers and the Company. Finally, by seeking more meaningfully disruptive products and services, we will harness transformational innovation to provide access to new technologies to people across the world.

Second, the team is challenging itself to execute flawlessly. This means developing the right product at the right cost and quality, supported by clinical evidence, in a timely manner. Our R&D experts in the UK, US, Europe, China and India have extensive customer and sector knowledge, which is augmented by ongoing interaction with our marketing teams. Strict criteria are applied to ensure new products fulfil an unmet clinical need, have a strong commercial rationale, and are technologically feasible. The R&D function works closely with the manufacturing and supply chain management teams to ensure we can produce new products to clinical, cost and time specification.

INVESTMENT IN

RESEARCH &

DEVELOPMENT in 2016

$230m

Finally, we will ensure our pioneering innovations are supported by compelling evidence of clinical and economic value. The global R&D function includes our Medical and Scientific Affairs team, led by the Chief Medical Officer, ensuring that, from conception, plans are developed to support product launches with the evidence increasingly required by our customers both clinicians and payers. Our products undergo clinical and health economic assessments both during their development and post-launch.

Science is at the heart of ensuring our products are safe and efficacious. In 2016 we made important investments to support and develop our scientific expertise. In Hull, UK, we announced plans to invest $10 million in creating a new R&D centre. More than a 100 roles will be based here and the breadth and scale of scientific specialties housed in the new centre will make us one of the most capable and well equipped centres in Europe for Medical Device R&D. The new centre will allow us to strengthen links with regional universities to support research & recruitment activities. The Hull facility will be fully operational by the second quarter of 2017.

We also continue to invest in scouting for new technologies, identifying complementary opportunities in our core and adjacent segments. We also invest in small companies developing compelling technologies in our franchise areas through our incubation fund. In addition to funding, we provide our expertise to help the development process, including supporting clinical studies, and typically secure preferred access to technology as it nears market readiness.

In 2016, we invested $230 million in R&D, in-line with our commitment, set out in 2011, to maintain our investment level at around 5% of revenue. We expect to maintain this proportion going forward, but to realise greater benefit through our new structure and strategic focus.

Table of Contents

THE RESOURCES WE NEED TO DELIVER OUR PRODUCTS

ETHICS & COMPLIANCE

CODE OF CONDUCT AND BUSINESS PRINCIPLES

Smith & Nephew earns trust with patients, customers, healthcare professionals, government authorities and the public by acting in an honest and fair manner in all aspects of its operations.

We expect the same from those with whom we do business, including vendors who provide us with services and distributors and independent agents that sell our products. Our Code of Conduct and Business Principles governs the way we operate to achieve these objectives.

Smith & Nephew takes into account ethical, social, environmental, legal and financial considerations as part of its operating methods. We have a robust whistle-blowing system in all jurisdictions in which we operate. We are committed to upholding our promise in our Code of Conduct that we will not retaliate against anyone who makes a report in good faith.

GLOBAL COMPLIANCE PROGRAMME

Smith & Nephew has implemented a world-class Global Compliance Programme that helps our businesses comply with laws and regulations. Our comprehensive compliance programme includes: Board and executive oversight committees; global policies and procedures; on-boarding and annual training for employees and managers; training for distributors and agents and higher risk vendors; monitoring and auditing processes; reporting channels and recognition for demonstrating our values.

Through our global intranet, we provide resources and tools to guide employees to make decisions that comply with the law, local industry code and our Company Code of Conduct. We conduct review and approval in advance for significant interactions with healthcare professionals or government officials. We regularly assess existing and emerging risks in the countries in which we operate.

Country managing directors are required to complete an annual certification to the Chief Executive Officer to confirm the implementation of required policies. Managers and employees make an annual compliance certification and conflict of interest disclosure, and executive management, managers and employees have a compliance performance objective customised to their role.

New distributors and other higher-risk third parties are subject to screening and are contractually obligated to comply with applicable laws and our Code of Conduct. Compliance training and certifications are included in this process. In 2016, we made compliance resources, including customisable templates for use by our distributors and agents, available via the Smith & Nephew external website. Our third parties can use these resources to develop an appropriate compliance programme based on their company s size and risk areas. We also updated the Additional Compliance Standards, first launched in March 2015, to provide more specific compliance restrictions and requirements. We also continue our oversight of independent agents and distributors with on-site assessments to review compliance controls and audits of books and records.

In 2016 we expanded the Compliance Ambassador Programme into additional markets. This programme is a key part of our strategy to embed ethical values and compliance standards in the business. Respected sales managers are nominated to become Compliance Ambassadors and act as a mentor to their peers and their teams, providing practical solutions to compliance challenges based on real life experience.

We have continued to recognise employees who earn trust with their actions with our Spotlight on Trust Programme, whereby employees nominate their peers for actions that earn trust.

We also began conducting increased follow-up with internal reporters of potential compliance issues. The follow-up process includes several touchpoints with the reporter during the investigation process, as well as a follow-up call with the reporter approximately 60 days after the close of the investigation. The goal of the programme is to ensure that reporters understand their concerns are being actively investigated, and to confirm after the close of the investigation whether the reporter has feedback on the process or any additional concerns to raise.

We had positive feedback on our approach to the annual manager certification, so we followed the same model in 2016. Managers were required to have an ethics/compliance conversation with some of their direct reports. They were given centrally-created materials focusing on the importance of earning trust and then provided with specific, topic-based scenarios to discuss with their staff actions that would demonstrate this core Smith & Nephew value. This model enhanced dialogue on ethics, compliance and the importance of earning trust between managers and staff.

Finally, we continue to improve our controls testing universe. We refreshed our programme to require auditors to dig deeper when they encounter potential risks. We also moved to a new reporting format that allows the auditors to provide more detail about their testing process and the results. We continued with our early warning Local Monitoring Programme, where Regional Compliance Officers test higher-risk activities within their markets.

Table of Contents

Table of Contents

THE RESOURCES WE NEED TO DELIVER OUR PRODUCTS

MANUFACTURING & QUALITY

GLOBAL OPERATIONS

Smith & Nephew takes great pride in its expertise in manufacturing products to the highest quality and ensuring they reach our customers in a timely manner. We operate manufacturing facilities in a number of countries across the globe, and a number of central distribution facilities in key geographical areas. Products are shipped to individual country locations which hold small amounts of inventory locally for immediate supply to meet customer requirements.

Manufacturing is a dynamic process and our Global Operation leadership team is focused on successfully supporting delivery of the Group s strategic priorities by ensuring our footprint and expertise is ready to respond to geographical growth, new product development, greater external regulatory scrutiny and the commercial pressure to be ever more efficient.

In 2016 we made good progress across these priorities. Highlights included the opening of a new state-of-the-art facility in Costa Rica which will provide a more efficient operation for current products as well as valuable space for future growth. We also created more than 100 positions for newly qualified graduate engineers across facilities in the US and elsewhere. These individuals, who began their careers with us in 2016, will deliver the pioneering advanced medical devices that enable our healthcare professional customers to continue to improve outcomes for patients during the years to come.

Quality has always been paramount to Smith & Nephew. We have a unified Quality Assurance and Regulatory Affairs team to ensure consistency across our country business units. Requirements of global regulatory agencies have become more stringent in recent years and we expect them to continue to do so. We are continuing to expand our portfolio globally through new product development and by registering our existing products in new markets. In order to meet the expectations of regulators and support this added complexity we continued to invest in our Quality and Regulatory expertise in 2016.

OUR MANUFACTURING FACILITIES

Our largest manufacturing operation is based in Memphis, Tennessee, USA. The Memphis facilities produce key products and instrumentation in our Knee Implant, Hip Implant and Trauma franchises. These include the JOURNEY™ II and LEGION™ knees, the ANTHOLOGY™ Primary Hip System and key Trauma products such as the PERI-LOC™ Ankle Fusion Plating System and TRIGEN™ Intramedullary Nails. In addition to this, Memphis is home to the design and manufacturing process of the VISIONAIRE patient matched instrumentation sets, and OXINIUM™ Oxidised Zirconium, a patented metal alloy available for many of our knee and hip implant systems.

Our Mansfield, Massachusetts, US facility focuses on Sports Medicine related products for minimally invasive surgery including the FAST FIX™ 360 Meniscal Repair System, FOOTPRINT™ PK Suture Anchor, DYONICS Platinum Shaver Blades, ENDOBUTTON™ CL Ultra and the HEALICOIL™ PK suture anchor. Our new Costa Rica facility manufactures COBLATION technology.

The Aarau, Switzerland; Tuttlingen, Germany; Beijing, China; and Devrukh, India facilities manufacture a number of surgical device products including key reconstruction and trauma products, the PLUS™ knee and hip range. The Warwick, UK facility produces the BIRMINGHAM™ Hip Resurfacing System.

Our Oklahoma City, Oklahoma, USA facility produces and services electro/mechanical capital equipment as well as single use sterile devices and also assembles our NPWT devices using components brought in from third parties.

The majority of our wound management products are manufactured at our facilities in Hull, UK; Suzhou, China; and Curaçao.

In Hull we manufacture some of the most high-technology wound care products on the market. Over the last few years we have introduced pioneering products such as PICO, DURAFIBER and ALLEVYN Life, all of which are manufactured in Hull. Since 2011, we have invested approximately £50 million in capital projects at our Hull site. This has included bringing the manufacturing of our complex silver coating technology for ACTICOAT to Hull and installing a Film Extrusion manufacturing line. We run second lines for some of our products in Suzhou, China, and this site also manufactures our wound care products for the mid-tier in the Emerging Markets.

Manufacturing of our Advanced Wound Bioactive products takes place in Curaçao and at various third party facilities in the US.

PROCUREMENT

We procure raw materials, components, finished products and packaging materials from suppliers in various countries. These purchases include metal forgings and castings for orthopaedic products, optical and electronic sub-components for sports medicine products, active ingredients and semi-finished goods for Advanced Wound Management as well as packaging materials across all product ranges.

Suppliers are selected, and standardised contracts negotiated, by a centralised procurement team wherever possible, with a view to ensuring value for money based on the total spend across the Group. On an ongoing basis, we work closely with our key suppliers to ensure high quality, delivery performance and continuity of supply.

We outsource certain parts of our manufacturing processes where necessary to obtain specialised expertise or to lower cost without undue risk to our intellectual property. Suppliers of outsourced products and services are selected based on their ability to deliver products and services to our specification, and adhere to and maintain an appropriate quality system. Our specialist teams work with and monitor suppliers through on-site assessments and performance audits to ensure the required levels of quality, service and delivery.

GLOBAL SUPPLY CHAIN

Our Global Supply Chain function ensures that our products reach our internal and external customers where and when they are needed, in a compliant and efficient manner. Bringing together people, knowledge and expertise helps us meet our objectives and our customers expectations, driving us to become more competitive, responsive and integrated.

We operate three main holding warehouses, one in each of Memphis (Tennessee, US), Baar (Switzerland) and Singapore. These facilities consolidate and ship to local country and distributor facilities. Our distribution hubs for advanced wound products are located in Neunkirchen (Germany), Derby (UK) and Lawrenceville (Georgia, USA).

Table of Contents

TRAINING & EDUCATION

Smith & Nephew is dedicated to helping healthcare professionals improve the quality of care for patients. We are proud to support the development of surgeons and nurses by providing skills training and education on our products and techniques.

Every year, thousands of customers attend our state-of-the-art training centres in the US, UK and China and Smith & Nephew courses at multiple hospitals and facilities around the world.

In 2016, we provided training to more than 40,000 surgeons. Working under expert guidance, attendees learn new techniques and refine skills, to ensure the safe and effective use of our products. These courses are attended by residents, fellows and practicing surgeons who work together to review, discuss and train on current and forward-looking surgical techniques in their areas of clinical expertise. Our courses help up-and-coming surgeons develop trust and gain the experience and confidence

necessary to become experts in their field.

We also support nurses across the world, with many thousands receiving face-to-face training from our representatives every year. For instance, in 2016 we completed our first Wound Care Academy for the Kingdom of Saudi Arabia. The week long intensive course was a theoretical and practical based learning initiative that aimed to enhance the wound care knowledge of local healthcare professionals.

We also support healthcare professionals through our online resources such as the Global Wound Academy, The Wound Institute and, for surgeons, our Education and Evidence website. In 2016 more than 90,000 healthcare professionals trained digitally with Smith & Nephew.

Table of Contents

THE RESOURCES WE NEED TO DELIVER OUR PRODUCTS

SALES & MARKETING

Starting conversations with clinical evidence

In September 2016, Smith & Nephew served as a Diamond Sponsor at the World Union of Wound Healing Societies 2016 (WUHWS) conference held in Florence, Italy. Known as the Olympics of Wound Care , the conference unites the greatest thought-leaders in wound management under one roof every four years.

This year, our Sales & Marketing team combined their efforts with the Scientific & Medical Affairs (SMA) team, conducting hundreds of on-stand product demonstrations as well as three well-attended symposia presented in front of more than 1,000 delegates, each delivering a strong message based on clinical data and evidence. Working together enabled us to engage visitors in evidence-based conversations, reinforcing our position as thought-leaders in wound healing.

Our customers are the providers of medical and surgical treatments and services in over 100 countries worldwide.

We serve our customers through our sales force. Our sales representatives are highly trained and skilled individuals. Becoming a sales representative requires intense training, including passing a strict certification programme, before engaging in discussions with, and ultimately selling products to, customers. Depending on their area of specialism, representatives must be able to demonstrate a detailed knowledge of all the surgical instruments used to implant a device, or have specific understanding of the various surgical techniques a customer might use. In our advanced wound franchises, sales representatives will have a detailed understanding of how patients live with wounds and how

clinicians seek to prevent and treat them, as well as deep knowledge of the clinical and economic benefits of using our products within treatment protocols.

Once a sales representative is certified, they typically spend the majority of their time working directly with and supporting customers, or identifying and contacting new customers. They help to provide in-hospital support to aid in the effective use of our range of advanced medical technologies and techniques.

Our Global Commercial Organisation, led by the Chief Commercial Officer, oversees all commercial activities (sales, marketing, market access, and commercial strategy) across the Group for our full line of business. Its mission is to define and drive best practice in commercial execution across our geographies and in marketing across the franchises.

Our sales force is structured by region, with three commercial organisations serving the US, Europe & Canada, and Asia Pacific and the Emerging Markets. Each is led by a regional President, who reports to the Chief Commercial Officer.

Our US sales forces are specialised by channel. They consist of a mixture of independent contract workers and employees. Sales agents are contractually prohibited from selling products that compete with our products. In most Established Markets outside of the US, country-specific commercial organisations led by the country managing director lead employee sales forces directly. The largest single customer worldwide is the National Health Service (NHS) and associated purchasing groups in the UK,

in the UK, which represent less than 5% of our worldwide revenue in 2016. In our Emerging Markets we operate through direct selling and marketing operations led by country managing directors, and/or through distributors.

Smith & Nephew has three global marketing teams who set the strategic direction of our businesses and develop all the promotional assets and guidance to commercialise our products in Advanced Wound Management, Sports Medicine and Orthopaedics. For that they utilise a variety of traditional and novel means to market to our customers. For example, congresses (educational conferences or trade shows) represent a traditional and efficient way for Smith & Nephew to reach a large number of healthcare professionals at once, often in terms of both advertising/promotion and education. From an awareness perspective, Smith & Nephew displays its latest innovative products and, from an educational standpoint, may also provide satellite symposia or other forms of medical education around these products.

The Global Commercial Organisation also includes a global Commercial Excellence team, who support both the commercial teams and the global marketing teams with several expertise groups. These include strategic planning, business intelligence and market research, digital marketing, pricing, sales force excellence and marketing communications.

We also leverage digital media to connect with our customers. Our digital communications activities have been evolving as technologies and user habits evolve. Content and messaging is currently delivered via global market websites, social media channels and mobile applications. One core use of digital technology to communicate and market to our customers has been Education & Evidence, a membership-driven clinical education website.

What was most pleasing, from a Scientific and Medical Affairs point of view, was the level of spontaneous attendance we received at the booth. The team, comprising both internal and external experts, were challenged with inquisitive questions which led to numerous constructive conversations on improving clinical outcomes.

Vice President of Scientific & Medical Affairs

Table of Contents

OUR PEOPLE

BUILDING CULTURE BY LIVING OUR VALUES

Smith & Nephew is proud of its culture. This culture both endures and evolves, having been shaped by thousands of employees over more than 160 years. Today, it is framed by our values of trust, innovation and performance.

Our Chief Executive Officer, Olivier Bohuon, is responsible for ensuring that we support and encourage our employees to live these values. This includes the multiple programmes and actions that align how we work our culture with what we do our strategy.

VALUE:

We build trust

COMMUNICATION

Building trust requires open and transparent sharing of information through regular and timely communication. We clearly communicate our business goals and performance standards and also provide employees with the training and information that empowers them to succeed. We listen to our employees, holding regular surveys, open dialogue at town hall meetings and focus groups and small group discussions on topics of importance to employees and our business.

Two years ago, Smith & Nephew conducted its biennial employee survey. The Company had recently reorganised to a less siloed but more matrixed structure, moving from Global Business Units to a regional structure with centralised global functions. The results of the survey showed employees wanted a greater feeling of team and connectivity at our major sites. In response to this, site Leadership Councils were formed at our major locations. These councils were dedicated to enhancing the Smith & Nephew culture and making our Company a great place to work. Each council includes representatives from various functional areas across the site location. Each organises site and community events, and takes ownership for ensuring that employees at the site feel informed and engaged.

CODE OF CONDUCT AND BUSINESS PRINCIPLES

Our Code of Conduct and Business Principles defines our expectations for ethical and legal behaviour not only for our employees but to all who conduct business on our behalf. In this way we build trust with our customers, and with each other. All employees review and reaffirm their commitment to the Code of Conduct on an annual basis. The positive impact of clearly defined expectations and regular training has been evident in the results of our Global Employee Survey, which shows employees know and understand the expectations for ethical behaviour and how to report behaviour that does not meet our high standards.

RECOGNITION

To reinforce our core value of trust, we regularly recognise employees who go above and beyond to earn trust through our Spotlight on Trust awards programme. At the same time, we encourage employees to report incidents of noncompliance or misconduct, and ensure they are protected from retaliation. This process applies to all employees, suppliers, agents, contractors and customers alike.

EMPLOYEE WELLNESS

As a Company we are committed to ensuring our employees work in a safe and healthy environment. Smith & Nephew offers wellness programmes which include annual wellness days, fitness support and healthy eating support. For example, the Virgin Pulse programme offered to US-based employees, promotes health and wellness by helping them track their activity, providing fun wellness challenges and allowing them to earn discounts on their healthcare plans. Global Employee Assistance Programmes (EAPs) also support wellness by helping employees manage stress and work/life issues and problems. Through EAP, we provide counselling, webinars and web tools and other resources across many work/life topics. Counselling can span from traditional EAP counselling to financial, legal and everyday family assistance.

VALUE:

We innovate

We view innovation as an essential skill to be demonstrated by all employees. Everyone is empowered to innovate in their job, to question the status quo, to propose new solutions, to continuously improve and to seek the best for the benefit of our customers.

OBJECTIVE SETTING

Innovation is captured formally in the annual objective setting process and employees are encouraged to continuously and pro-actively innovate to improve our costs, processes, services and products.

RECOGNITION

Our annual CEO Award, open to all employees, recognises employees who deliver exceptional results in line with our core values, encouraging innovation and a spirit of continuous improvement at all levels. In 2016 the winners included Bill McGee, who saved the Company $500,000 by suggesting enhancements to our shaver blade manufacturing process in Mansfield, US and Nham Nguyen, who works at our Oklahoma City facility and was instrumental in

improving productivity by 20% in her unit.

Our global employee recognition programme, Going the Extra Mile (GEM), encourages employees to recognise the performance of colleagues and the demonstration of our values of Performance, Innovation and Trust. The GEM programme includes non-monetary and monetary options based on the level of achievement from a simple note of thanks to valuable merchandise. Going the Extra Mile also serves as our platform for a global Long Service Award programme.

Table of Contents

THE RESOURCES WE NEED TO DELIVER OUR PRODUCTS

OUR PEOPLE continued

EXECUTIVE SPONSORSHIP

Each year we hold a CEO Forum for our Top Talent, providing them with the opportunity to work closely with our executive team and with their peers on strategic challenges. One recent output from the Forum has been the creation of the Innovation Task Force to define what innovation looks like in Smith & Nephew and the characteristics that we should seek to embed to encourage innovation across the organisation.

DIVERSITY

We believe that diversity fuels innovation. We are committed to employment practices based on equality of opportunity, regardless of colour, creed, race, national origin, sex, age, marital status, sexual orientation or mental or physical disability unrelated to the ability of the person to perform the essential functions of the job. Our Valuing Difference programme is designed to reinforce this belief and to feature examples of the value of diversity across our business.

Our local Valuing Difference Councils are run by passionate and dedicated people. They meet as a global team quarterly and work to translate strategy to local needs, execute specific actions and share best practice. In 2016 we implemented Communication Toolkits which provide interactive exercises for teams to improve their awareness and education, along with employee case studies placed on the Company s intranet. We also launched an

online development programme for female professionals and eLearning programmes with a specific focus on Valuing Difference.

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

employees to freedom of association, freedom of expression and the right to be heard.

VALUE:

We perform

TALENT AND CAPABILITY DEVELOPMENT

Attracting the best talent and developing our employees is critical to achieving our business objectives. We are committed to working with employees to develop each individual s talents, skills and abilities. Employee advancement is merit-based, reflecting performance as well as demonstration of core competencies which include our values, with an emphasis on ethics and integrity. We prioritise the development

and promotion of our existing employees whenever possible.

Each year Smith & Nephew conducts a comprehensive global development and capability review process to identify high-potential employees and ensure they have robust career development plans. Employees are provided with opportunities to develop their skills and career through new assignments and on the job experiences. In addition, the Board reviews succession plans for key executive roles and succession plans are in place for other critical positions across our business.

PERFORMANCE MANAGEMENT

We provide fair recognition and reward based on performance. Our performance management process ensures all employees set objectives which align to our overall business goals and have clear line-of-sight to how their individual contributions benefit the Company. Our performance management system assesses and rewards both performance and behaviour, in line with our Code of Conduct. All employees have a specific annual objective to adhere to the Code of Conduct and to complete training certifying their compliance with this Code.

NUMBER OF EMPLOYEES[1]

11	804	15,644
Board of Directors	**Senior Managers[2] and above in 2016**	**Total employees in 2016**

A	MALE	8	**A**	MALE	594	**A**	MALE	9,230
B	FEMALE	3	**B**	FEMALE	210	**B**	FEMALE	6,414

Table of Contents

For information on the composition of our Board, see page 48

GREAT PLACE TO WORK

Being a Great Place to Work is one of our goals as a Company. To earn this recognition, employees in each country must complete the Great Place to Work Trust Index survey and country management must participate in a Culture Audit. Both evaluate performance on key dimensions of engagement: Credibility, Respect, Fairness, Pride and Camaraderie.

Smith & Nephew uses the Great Place to Work Institute s Trust Index as the basis for our Global Employee Survey. Our last full survey was in 2014, which demonstrated improvement from 2012 across all four areas of focus; understanding of our Strategic Direction improved by 10%, Empowerment by 20%, Cross-business coordination by 12% and Customer focus by 27%. We are conducting our current employee survey in two waves: Wave 1 was completed in some countries in 2016 and all other countries where Smith & Nephew operates will take part in Wave 2 during 2017.

In 2016 Canada, Denmark and Greater China joined Spain and Italy as countries where we have been recognised. As the Great Place to Work Institute did not have an accreditation component in South Africa at that time, we carried out a similar survey there that does have accreditation capabilities Deloitte s Best Company to Work for Survey following which South Africa received a Gold Seal from Deloitte.

In Canada, a winning attitude, improved communications and celebrating successes have created a team spirit based on trust. For Denmark, initiatives such as 30 minutes with management and activities focused on day-to-day employee wellbeing and career development have led to a strong culture. In Greater China, recognition was achieved through initiatives such as regular town halls, a People Development Forum, an employee Juice Club and communicating via the WeChat platform.

A Family Day, quarterly employee town halls and leadership team lunches with new starters, along with a successful graduate internship programme and the day to day focus on employee wellbeing, are examples of why South Africa achieved this recognition.

For Smith & Nephew, being a Great Place to Work means having a workplace where employees are proud and excited to come to work each day because they are making a difference for customers and patients. It is not about programmes or initiatives, it is about people and we believe our people make Smith & Nephew a Great Place to Work.

A place where employees enjoy their work

In the US alone, more than 150 employees volunteer their time to manage Camaraderie Councils. These councils lead and uphold the Smith & Nephew culture through various team and charitable activities. Their primary objective is to make the Company a place where employees enjoy their work, as well as take pride in the work they do.

A critical aspect of the Council is helping our teams support dozens of local non-profit organisations. For example, Smith & Nephew s Fort Worth, Texas site conducted a community clean up event where 20 employees volunteered on a Saturday to paint houses in a local neighbourhood. In Andover, Massachusetts, the site celebrated Volunteer Month in May where employees could choose from a number of scheduled activities or coordinate their own event. The site also hosted its first 5K Fun Run where more than 90 employees, friends and family took part in support of a local children s hospital.

In Austin, Texas, employees volunteered to create a menu, grocery shop, and prepare meals for families staying at the local Ronald McDonald House, a global not-for-profit organisation. Our Memphis, Tennessee employees conducted community focused events every month in 2016 including taking part in a Walk to Cure Arthritis where more than 100 employees attended. The US Field Camaraderie Council manages community outreach events for Smith & Nephew s more than 2,000 sales representatives across the nation. Since inception in June 2016 it has hosted more than 15 events in support of 15 different non-profit organisations. Thanks to the efforts of the US Camaraderie Councils, we improve morale, promote camaraderie and make a positive impact on the communities where we live and work.

1 Number of employees as at 31 December 2016 including part time employees and employees on leave of absence.

2 Senior Managers and above includes all employees classed as Directors, Senior Directors, Vice Presidents and Executive Officers and includes all statutory directors and Directors of our subsidiary companies.

Table of Contents

SUSTAINABILITY

A Future Focus

TAKING SUSTAINABILITY TO THE CORE OF THE BUSINESS

We significantly advanced our commitment to sustainability in 2016 through ratification of a Group Sustainability Strategy which is fully aligned to the Group Business Strategy. The Group Sustainability Strategy both drives and is driven by implementation of the Group Business Strategy, ensuring that all three main aspects of sustainability economic prosperity, social responsibility and environmental stewardship advance as one. This shift in focus communicates clearly that in order to be successful we must advance simultaneously in all three aspects.

This is a summary report of our sustainability activities and progress in 2016. Our annual Sustainability Report, to be published in April 2017, will provide further detail regarding our 2016 progress, describe the Group Sustainability Strategy and its associated goals, and specify targets to move our performance toward these goals.

GROUP SUSTAINABILITY STRATEGY

Smith & Nephew has been committed to working in a sustainable, ethical and responsible manner everywhere we do business. We are proud of our achievements over many years, as witnessed by our recurring inclusion in leading indices such as FTSE4Good and the Dow Jones Sustainability Index.

Sustainability is a journey, and in 2016 we thought deeply about our destination for the longer-term. The result was a new Group Sustainability Strategy. At the heart of this are ten long-term aspirational goals. These encompass all aspects of our business, and will inform and drive our business strategy for years to come. The Board has endorsed these and executive management is behind them. These goals are set out on this page.

The Board has evaluated the social and environmental risks as part of their ongoing risk management duties and has concluded that none of these risks are material in the context of the Group as a whole.

Of course, longer-term goals need medium term SMART targets to ensure we are making the right progress. We are finalising these for the next five years and will provide more detail in our Sustainability Report, due to be published in April 2017.

2016 was not just a year of planning. We continued to focus on delivering improvements across many areas of our business such as health, safety and environment, energy and water consumption and waste management. The highlights are found on the opposite page, and much greater detail will also be included in the 2016 Sustainability Report.

Our ten long-term aspirational goals

Zero work-related injuries and illnesses across the value chain

Water: Total water impacts of our products and solutions are balanced with local human and ecosystem needs

Waste: All materials are either shipped as part of product or returned for beneficial use

Carbon: 80% absolute reduction in total life cycle greenhouse gas emissions by 2050

Ethical Business Practices: All activities are conducted in compliance with applicable International Labour Organisation (ILO) conventions, involve no environmental degradation, and are free from corruption

Zero product-related and service-related patient injuries

Robust social responsibility programmes which contribute to the attraction and retention of top talent

Products and services are aligned to market economic, social and environmental expectations and anticipate future market conditions:

All products have identified and clearly-described sustainability attributes

R&D and New Product Development (NPD) processes deliver environmental-, social-, and healthcare economically-advantaged innovations

Strategic risks and opportunities are understood and business activities are aligned to risk appetite

Environmental, social, and economic impacts of (1) potential acquisitions, (2) technologies to be extended to Emerging Markets, (3) innovative business models, (4) cost of quality reduction initiatives, and (5) manufacturing siting, functional optimisation and site utilisation alternatives are fully understood and appropriately balanced

Table of Contents

2016 SUSTAINABILITY ACTIVITIES AND PROGRESS

Employee safety, wellness and volunteering

A healthy and safe working environment is fundamental to the way we work at Smith & Nephew. We must ensure that the safety of our employees and those who work with us is given the highest priority when we perform our daily activities in our offices around the world, when we visit customers and in our manufacturing environment.

Engagement with the communities in which we operate was significantly extended through employee volunteering and we have strengthened and deepened employee wellness programmes with a focus on enabling healthy lifestyle choices.

In 2016, our employee total incident rate (TIR), or recordable injury rate, reduced by 4% to 0.52, from 0.54 which continues to confirm our position in the top quartile of safety performance in our sector. This was achieved through the implementation of our sustainability management system, an active Internal Audit programme, a number of behavioural based safety campaigns and robust incident reporting and investigation systems across the Group. This was offset by a slight increase in the accident severity as there was an increase in our lost time incident frequency rate (LTIFR) of 15% to 0.23, from 0.20. There were no employee or contractor fatalities.

Our headline safety performance includes all employees and supervised contractors, it excludes unsupervised contractors. We adopt the industry standard USA Occupational Safety and Health Administration (OSHA) system to record incidents of occupational injury and ill-health.

Lost-time incidents are defined as those which result in a person not being able to report for work on the day or shift following the incident. Performance is expressed as a rate of the number of incidents per 200,000 hours worked.

Waste

Growth and acquisitions within the business have resulted in a wider environmental footprint. As a direct result the volume of waste arising from our operations increased by 11% in 2016. We continue to identify recycling opportunities and ways of diverting our waste away from landfill. In 2016, we recycled 74% of our waste, including waste diverted for energy recovery.

Water

Significant progress was made in 2016 to reduce our water consumption, particularly at our Memphis, US manufacturing location where we replaced water-cooled air compressor units with air-cooled radiator units. This investment reduced water consumption by the equivalent of the volume of fifteen Olympic-sized swimming pools, contributing to an annual reduction in water usage across the Group of 11%.

Energy and greenhouse gas emissions

Over the past year our energy use has increased by 5% with a corresponding 5% increase in carbon dioxide equivalent (CO_2e) emissions, driven by organic growth, acquisitions and changes in our manufacturing footprint.

Methodology, materiality and scope

The data reported relates to areas of largest environmental impact including manufacturing sites, warehouses, research and offices. Smaller locations representing less than 2% of our overall emissions are not included. Acquisitions completed before 2016 are included in the data. Each year we work with an independent partner to verify our sustainability data and gain assurance.

All emissions fall within the scope of our consolidated financial statement and we have used the Greenhouse Gas Protocol: A Corporate Accounting and Reporting Standard (Revised Edition) as guidance for this process. Primary data from energy suppliers has been used wherever possible. The acquisitions of Blue Belt Technologies and DC Manufacturing in Russia are included in 2016 for the first time, this is in line with our established policy for integration of acquired assets.

0.52 **-4%**

Total recordable incident rate, TIR

0.23 **+15%**

Lost time incident frequency rate, LTIFR

10,122 +11%

Total waste (t)

Table of Contents

SUSTAINABILITY

Our emissions have been calculated by using specific emissions factors for each country outside the USA and regional factors within the USA. We have used the US EPA Emissions & Generation Resource Integrated Database (eGRID) for US regions and the UK Government DEFRA Conversion Factors for Greenhouse Gas Reporting for elsewhere. The emissions from 2015 were calculated using the most up to date factors available and likewise in 2016.

Direct emissions include fugitive emissions from the manufacturing and research locations and arise from the losses of refrigerant gases, they also include the combustion of fuels on site for the operation of facilities. Indirect emissions include purchased electricity.

	2016	2015	2014
CO_2e Emissions (tonnes) from:			
Direct emissions	9,822	11,011	11,208
Indirect emissions	82,415	77,191	74,178

Total	92,237	88,202	85,386
Intensity ratio			
CO_2e (t) per $m sales revenue	19.6	19.2	19.4
CO_2e (t) per full-time employee	5.9	6.0	6.9

Revenue 2016: $4.7bn; 2015: $4.6bn; 2014: $4.4bn.

Full-time employee data 2016: 15,584; 2015: 14,698; 2014: 12,437.

Notes

2014 data adjusted to exclude ArthroCare.

2015 data adjusted to exclude recent acquisitions in

Russia and Colombia.

2016 data includes all data, including acquisitions since 2015. Direct CO_2e emissions exclude purchased steam at one manufacturing location, which has now been correctly included in indirect emissions.

Target Zero

In 2016, we ran various campaigns to improve employee safety awareness. These included launching an HSE brand to promote health, safety and environmental matters across the business. This was called Target Zero : No Incidents, No Injuries, No Harm. We also provided useful safety posters called safety splashes that could be printed or used at locations on video screens in our buildings for employees, contractors and visitors to read.

682.7 -11%
Water (1,000m^3)

207 **Energy (GWh)**	+5%
92,237 **Greenhouse gas emissions, CO_2e (t)**	+5%

Table of Contents

FINANCIAL REVIEW

Strong platform to build on

REVENUE

Group revenue in 2016 was $4,669 million (2015: $4,634 million), an increase of 1% on a reported basis and 2% on an underlying basis[1].

In 2016, we delivered reported revenue growth of 4% and underlying revenue growth[1] of 3% in the United States. Revenue growth on a reported basis was -1% and on an underlying basis[1] was flat across our other Established Markets, although Japan and France delivered strong performances. In our Emerging Markets reported revenue growth was -3% and underlying growth[1] was flat in 2016. Most of our Emerging Markets businesses generated double-digit growth which was offset by weakness in China and the Gulf States. In China, the slow-down in end-markets seen since mid-2015 was compounded by destocking in the distributor channel during 2016. By the end of 2016 most franchises in China had returned to growth as the level of stock in the channel was adjusted, although we expect Advanced Wound Management to continue to be impacted in the first half of 2017. In the oil-dependent Gulf States we saw very difficult trading conditions, particularly in our tender business, which are likely to persist. As a matter of course we expect to see some volatility in the Emerging Markets, but we continue to see significant long-term growth potential and are very well positioned in our chosen markets.

The global product franchise highlights in 2016 included our strong performance across Sports Medicine, where we continue to reap the benefits of the acquisition of ArthroCare. PICO[à], our novel single-use NPWT system, is transforming the use of this therapy option. Our world class Knee Implant portfolio was further strengthened by the acquisition of NAVIO[à], an exciting robotics platform, from which we delivered more than 50% reported revenue growth in 2016.

PROFIT

Operating profit of $801 million (2015: $628 million) includes acquisition and disposal related items, as well as restructuring and rationalisation costs, amortisation and impairment of acquisition intangibles and legal and other items incurred in the year. The 2016 operating profit is before a one-off $326 million gain from the disposal on the Gynaecology business in August 2016. The operating profit margin increased to 17.2% (2015: 13.6%) primarily driven by the costs in 2015 relating to anticipated and settled metal-on-metal hip claims.

Trading profit[1] was $1,020 million (2015: $1,099 million). The trading profit margin[1] was 21.8% (2015: 23.7%). This reduction primarily reflects the significant transactional currency headwind seen in 2016 resulting from the sustained strength of the US Dollar. Additionally, we lost some operational leverage from the lower than anticipated sales

growth and our investment in Blue Belt Technologies was dilutive. These factors were somewhat offset by the Group Optimisation programme.

Selling, general and administrative expenses decreased by $275 million (10%) from $2,641 million in 2015 to $2,366 million in 2016. In 2016, administrative expenses included amortisation of software and other intangible assets of $61 million (2015: $66 million), $62 million of restructuring and rationalisation expenses (2015: $65 million), an amount of $178 million relating to amortisation and impairment of acquired intangibles

(2015: $204 million), $9 million of acquisition related costs (2015: $12 million) and $30 million net credit primarily related to a $44 million curtailment credit on UK post-retirement benefits (2015: $190 million charge for legal and other charges). Excluding the above items, selling, general and administrative expenses were $2,086 million in 2016, a decrease of $18 million from $2,104 million in 2015.

Research and development expenditure as a percentage of revenue remained broadly consistent at 4.9% in 2016 (2015: 4.8%). Actual expenditure was $230 million in 2016 compared to $222 million in 2015. The Group continues to invest in innovative technologies and products to differentiate it from competitors.

PROFIT ON DISPOSAL

The Group realised a profit on the disposal of its Gynaecology business of $326 million. The business had been primarily internally generated and the disposed assets had a net book value of $10 million. The proceeds were $350 million with associated disposal related costs of $7 million and liabilities of $7 million.

TAXATION

Our reported tax rate of 26.2% (2015: 26.7%) includes the one-off benefit of a US tax settlement which is partly offset by the tax rate on the disposal of the predominantly US Gynaecology business.

1 These non-IFRS financial measures are explained and reconciled to the most directly comparable financial measure prepared in accordance with IFRS on pages 175-177.

Table of Contents

FINANCIAL REVIEW

$4,669m +1%

Revenue

$1,020m -7%

Trading profit[1]

$801m +28%

Operating profit

21.8% -190 bps

Trading profit margin[1]

17.2% +370bps

Operating profit margin

88.1¢ +92%

Earnings per share		
82.6¢		**-3%**
Earnings per share adjusted[1]		

The underlying increase in revenues, by market, reconciles to reported growth, the most directly comparable financial measure calculated in accordance with International Financial Reporting Standards (IFRS), as follows:

					Reconciling items	
	2016 $ million	2015 $ million	Reported growth %	Underlying growth %	Acquisitions/ Disposals %	Currency impact %
US	2,299	2,217	4	3	1	
Other Established Markets	1,679	1,702	(1)			(1)
Emerging Markets	691	715	(3)		2	(5)
Total	4,669	4,634	1	2		(1)

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

	2016 $ million	2016 %	2015 $ million	2015 %
Operating profit	801	17.2%	628	13.6%
Acquisition related costs	9	0.2%	12	0.2%
Restructuring and rationalising costs	62	1.3%	65	1.4%
Amortisation of acquisition intangible and impairments	178	3.8%	204	4.4%
Legal and other	(30)	(0.7)%	190	4.1%
Trading profit	1,020	21.8%	1,099	23.7%

1 The non-GAAP measures are explained and reconciled to the most directly comparable financial measure prepared in accordance with IFRS on pages 175-177 and page 173.

Table of Contents

CAPITAL RETURNS

The efficient use of capital on behalf of shareholders is important to Smith & Nephew. The Board believes in maintaining an efficient, but prudent, capital structure, while retaining the flexibility to make value enhancing acquisitions. This approach is set out in our Capital Allocation Framework which we used to prioritise the use of cash and ensure an appropriate capital structure.

Our commitment, in order of priority, is to:

1. continue to invest in the business to drive organic growth;

2. maintain our progressive dividend policy;

3. realise acquisitions in-line with strategy; and

4. return any excess capital to shareholders.

This is underpinned by maintaining leverage ratios commensurate with solid investment grade credit metrics.

ENHANCING GROUP EFFICIENCY

In 2016 we continued to simplify and improve our operating model and delivered significant efficiencies. In Manufacturing, our Global Operations leadership team is focused on supporting the Group s strategic priorities by ensuring our footprint and expertise are ready to respond to geographical growth, new product development, greater external regulatory scrutiny and the commercial pressure to be ever more efficient. We made good progress across these areas in the year. The Group Optimisation Plan was announced in May 2014 with a stated savings target of annualised benefits of $120 million by the end of 2017. We delivered ahead of plan and reached our target at the end of 2016. These savings have been driven by our focus on efficient procurement, the greater agility of the single country managing director model and rationalisation of our facility footprint in a number of countries.

SUCCESSFUL ACQUISITION

TRACK RECORD

In recent years we have undertaken a number of acquisitions, strengthening both our technology and product portfolio, and our Emerging Markets business. We have delivered good returns, establishing a strong track record in M&A. With Healthpoint, acquired in 2012 for $782 million, our third year return on capital exceeded our expectations. ArthroCare, acquired in 2014 for $1.5 billion, is performing well. We have achieved our targeted cost savings and are ahead of our plan to deliver $85 million of synergies by the end of 2017.

In 2016, we continued to invest in acquisitions such as Blue Belt Technologies with its NAVIO robotics surgical platform. In addition, we created compelling value by selling our Gynaecology business for $350 million (2015 revenue: $56 million). We had built this business rapidly on the back of Smith & Nephew s resection technology and expertise. We completed the associated $300 million share buy-back programme in December 2016, returning the value created directly to shareholders.

MEASURING PERFORMANCE

In 2016 we have worked to develop Return On Invested Capital (ROIC) as a performance metric for the Group. In response to feedback from investors, this metric is proposed as an element of our Performance Share Plan beginning in 2017.

NEW CFO

Julie Brown was the CFO during 2016 until she left Smith & Nephew in January 2017. During her time at Smith & Nephew the Finance function was refocused as a global function supporting the commercial business and providing excellence in finance operations and specialist areas. From March 2017 the Finance function will be led by Graham Baker who will join Smith & Nephew from Alvogen.

OUTLOOK

We expect the dynamics in our markets to be similar in 2017 to those seen in 2016. Against this backdrop, the Group expects to deliver higher underlying revenue growth and an improved trading profit margin in 2017.

Our reported revenue growth is a combination of underlying revenue growth, impact of acquisitions and disposals and foreign exchange. We expect reported revenue growth in the range of 1.2%-2.2% at prevailing[1] exchange rates. We expect 2017 underlying revenue growth to be in the 3-4% range, reflecting not only the dissipation of the headwinds we faced in China and the Gulf States but also, most importantly, our improving execution.

1 Prevailing exchange rates as at 31 January 2017.

Table of Contents

RISK REPORT

Our approach

to risk

OUR RISK MANAGEMENT PROCESS

The following chart shows how our risk management process is an integral part of our business. Individual risk owners within the business areas carry out day-to-day risk management activities within the framework established by the Group Risk Office, including the identification of risks, undertaking risk assessments and treating them. These activities are reviewed by Internal Audit and other control functions, which provide assurance to the Group Risk Committee chaired by the Chief Executive Officer and then to the Board and its committees.

BOARD OF DIRECTORS AND BOARD COMMITTEES

Responsible for regular oversight of risk management and for annual strategic risk review	Monitors risks through Board processes (Strategy Review, Disclosures, M&A, Investments, Disposals) and Committees (Audit and Ethics & Compliance), management reports and deep dives of selected risk areas	Audit Committee reviews effectiveness with support from Internal Audit

GROUP RISK COMMITTEE

Reviews external/internal environment for emerging risks

Reviews risk register updates from Business Areas

Identifies significant risks and assess effectiveness of mitigating actions

BUSINESS AREA

Carries out day-to-day risk management activities

Identifies and assesses risk

Implements strategy and actions to treat risk within business area

Assigns Risk Owners to lead treatment actions

Assigns Risk Champions to support regular risk register updates

GROUP RISK OFFICE

Establishes risk management framework

Facilitates implementation and coordination through Risk Champions

Provides resources and training to support process

Prepares Board and Group Risk Committee reports based on Business Area and other updates

Assessment of effectiveness of the risk management process

INTERNAL AUDIT AND CONTROL FUNCTIONS

Reviews risk management process periodically

All Control Functions (Legal, Compliance, HSE, Quality & Regulatory) provide independent assurance to management and Board on assertions of risk exposure

OUR RISK APPETITE

The Group operates in global markets with long-term growth potential. We are pursuing ambitious growth targets and are prepared to accept a certain level of risk to remain competitive and to continue operating in an ever-changing world. We are very clear about the specific risks our businesses face and the level of risk that we are prepared to accept in each part of our business. We have put in place robust plans for managing those risks, through elimination, avoidance, sharing or mitigation.

Our approach to each risk varies depending on the circumstances and we accept that, over time, our approach towards each risk might change as our business or the external environment evolves.

During the year, the Board undertook an exercise to evaluate its tolerance for risk, recognising that our appetite for risk varies depending on the category of commercial risk. Even within categories of risk, our tolerance for risk may vary from one to another. Our tolerance for each risk is set out opposite in our table of Principal Risks.

Table of Contents

Our Principal Risks

Our risk management programme has identified a broad range of risks which we believe could seriously impact the profitability or future prospects of the Company. We define our Principal Risks as those risks which could threaten our business model or the future long-term performance, solvency or liquidity of the Company. These are listed below and each is linked to one or more of our Strategic Priorities as detailed below.

PRICING AND REIMBURSEMENT

Our success depends on governments providing adequate funding to meet increasing demands arising from demographic trends. The prices we charge are therefore impacted by budgetary constraints and our ability to persuade governments of the economic value of our products, based on clinical data, cost, patient outcomes and comparative effectiveness.

In implementing innovative pricing strategies, we have a moderate to high tolerance for risk and are willing to accept certain risks in pursuit of new business opportunities.

Link to strategy

Our Strategic Priorities to Build a Strong Position in Established Markets and to Focus on Emerging Markets depends on our ability to sell our products profitably in spite of increased pricing pressures from governments.

Examples of risks

Actions taken by management

Developing innovative economic product and service solutions for both Established and Emerging Markets, such as Syncera[à].

Maintaining an appropriate breadth of portfolio and geographic spread to mitigate exposure to localised risks.

Reduced reimbursement levels and increasing pricing pressures.	Incorporating health economic components into the design and development of new products. Emphasising value propositions tailored to specific stakeholders and geographies through strategic investment and marketing programmes.
Reduced demand for elective surgery.	Holding prices within acceptable ranges through global pricing corridors.
Lack of compelling health economics data to support reimbursement requests.	
Trading margin will be impacted when the currencies in our main manufacturing countries (US, UK, Costa Rica and China) move against the currencies in the rest of the world where our products are sold.	

PRODUCT INNOVATION, DESIGN AND DEVELOPMENT

The medical devices industry has a history of rapid new product innovation. The sustainability of our business depends on finding and developing suitable products and solutions to meet the needs of our customers and patients to support long-term growth.

In acquiring and developing new technologies and products, we have a moderate to high tolerance for risk and are willing to accept certain risks in pursuit of innovation, whilst having a very low tolerance for product safety risk.

Link to strategy	**Actions taken by management**
Our Strategic Priority to Innovate for Value depends heavily on our ability to continue to develop new innovative products and bring them to market.	R&D processes focused on identifying new products and potentially disruptive technologies and solutions.

Examples of risks	Increasing prioritisation and allocation of funds for R&D.
Insufficient innovation due to low R&D investment, R&D skills gap or poor product development execution.	Pursuing business development opportunities, which augment our portfolio.
Competitors introduce disruptive technologies or business models.	Implementing efficient processes to roll out new products to customers.
Inability to prioritise and focus on key projects, investments and strategic initiatives.	Monitoring of external market trends and collation of customer insights to develop product strategies.
	Ensuring that design for manufacture is embedded into product development.

Table of Contents

RISK REPORT

OPERATIONAL RISKS QUALITY AND BUSINESS CONTINUITY

The Company faces a number of operational risks. Many of our products are implanted or used within the human body. Product safety and quality is therefore of critical importance. Our business also depends on smart procurement of materials, efficient manufacturing, controlled inventory management and the timely supply of our products to our customers. Some of our key products are reliant on one production facility or one supplier for raw materials, components, finished products and packaging materials.

In operating our business, managing our suppliers, and managing our facilities, we have a very low tolerance for risk. We aim to be as efficient as possible and adopt a cautious approach, but recognise that we need to accept certain risks in order to take full advantage of the opportunities open to us.

The Company implements and certifies its Quality Management Systems to accepted national and international standards in order to assure the quality of our products. To manage our exposure to disruptive incidents that could threaten business continuity, we operate a comprehensive framework of emergency management, incident management and business continuity management.

Link to strategy

Our Strategic Priority to Simplify and Improve our Business Model requires us to operate effectively and efficiently, to

Actions taken by management

Ensuring that we have comprehensive product quality processes and controls from design to

produce products of quality and to ensure continuity of supply of products and services to customers.	customer supply.
Examples of risks	Ensuring emergency and incident management and business recovery plans are in place at major facilities and for key products and key suppliers.
Defects in design or manufacturing of products supplied to, and sold by, the Company could lead to product recalls or product removal or result in loss of life or major injury and also cause negative financial and reputational impacts.	Validating second sources for critical components or products.
Failure or performance issues at a critical/single source facility or supplier of key products or services may impact revenues or profits.	Undertaking risk based review programmes for critical suppliers.
If a key facility were rendered unusable by a catastrophe, or we lost a number of leaders or employees in a catastrophe, business plans and targets may not be met.	Enhancing travel security and protection programme.

MERGERS AND ACQUISITIONS

As the Company grows to meet the needs of our customers and patients, we recognise that we are not able to develop all the products and services required using internal resources and therefore need to undertake mergers and acquisitions in order to expand our offering and to complement our existing business. In other areas, we may divest businesses which are no longer core to our activities. It is crucial for our long term success that we make the right choices around acquisitions and divestments.

In acquiring new businesses and business models, we have a moderate to high tolerance for commercial risk and are willing to accept certain risks in pursuit of new business. However, we have an extremely low tolerance for regulatory or compliance risk.

We have a well-defined cross-functional process for managing risks associated with mergers and acquisitions that is subject to scrutiny from executive management and the Board of Directors.

Link to strategy	Actions taken by management
Our Strategic Priority to Supplement Organic Growth with Acquisitions depends on our ability to identify the right acquisitions, to conduct thorough due diligence and to integrate acquisitions effectively.	Acquisition activity is aligned with corporate strategy and prioritised towards products, franchises and markets identified to have the greatest long-term potential.
Examples of risks	
Failure to identify appropriate acquisitions or to conduct effective acquisition due diligence.	Clearly defined investment appraisal process based on return on capital, in accordance with Capital Allocation Framework.
Failure to integrate newly acquired businesses effectively.	Undertaking detailed and comprehensive cross-functional due diligence prior to acquisitions.
Inheriting regulatory or compliance risks from previous owners.	Implementing consistent integration processes designed to identify and mitigate risks in the early stages post completion.
Failure to embed Company standards, policies and financial controls quickly enough following acquisition.	Early embedding of our desired standards of compliance with laws, internal policies and controls.
Failure to allocate capital resources effectively.	Comprehensive post-acquisition review programme.
	Proactively clearing new products from competitive patents and monitoring.
	Compliance risks included as part of due diligence reviews, integration plans and reporting for acquisitions.

Table of Contents

LEGAL, REGULATORY AND COMPLIANCE RISKS

The Company operates in an industry which is subject to heavy regulation in multiple jurisdictions. There is increasing public scrutiny of ethics in business and doing the right thing has become part of our licence to operate. We also seek to secure appropriate protection for our intellectual property and defend against claims of infringement by others. National regulatory authorities enforce a complex pattern 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 and may inspect them for compliance with appropriate standards, including those relating to Quality Management Systems or Good Manufacturing Practice regulations.

In complying with laws and regulations, including those relating to bribery and corruption, product safety and patient and employee safety, we have an extremely low tolerance for risk. Despite our efforts, we recognise that, as in any human system, compliance mistakes may occur. We respond to issues as they arise and revise our programme as appropriate.

Link to strategy

Compliance with applicable laws and regulations and doing the right thing is part of our licence to operate and underlies all our Strategic Priorities.

Examples of risks

Failure to act in an ethical manner consistent with our Code of Conduct.

Actions taken by management

Leadership from the top with Ethics & Compliance Committees at Board and executive level overseeing our ethical and compliance practices.

All employees are required to certify compliance on an annual basis with our Code of Conduct and Business Principles.

Violation of anti-corruption or healthcare laws, breach by employee or third party representative.	Training programmes are in place for all employees, and third parties with ethical and compliance responsibilities; plus monitoring and auditing programmes to verify implementation.
Competitors may assert patents or other intellectual property rights against the Company, or fail to respect the Company s intellectual property rights.	Confidential independent reporting channels for employees and third parties to report concerns.
Significant non-compliance with policy, regulations or standards governing products and operations regarding registration, manufacturing, distribution, sales or marketing.	Careful attention to intellectual property considerations.
Failure to obtain proper approvals for new or changed technologies, products or processes.	Standardising and monitoring compliance with quality management and practices through Global Quality Assurance and Regulatory Affairs organisation.
Failure to implement programmes and supporting resources to ensure product quality and regulatory compliance, including analysis of customer complaints and adverse event data.	Incident management teams in place to respond in the event of an incident relating to patient safety.
	Reviewing product safety and complaint data.

OTHER RISKS

Other risks, foreseen or unforeseen, may also threaten the profitability or future prospects of the Company, either in the short-term or like the risks set forth above more profoundly. Following, are examples of other such risks.

Risk	Response

Cyber security	We have analysed the possible impact of a cyber security attack on the Company and recognise that this could cause significant disruption and reputational damage.
Political and economic forces	We have analysed the implications of Brexit, the changing political landscape in the US and political and economic conditions in a number of other countries. Whilst the changing environment in some of these countries could be expected to impact our revenues and profits, we believe that our business is sufficiently geographically diverse.
Talent management	We recognise that people management, effective succession planning and the ability to attract and retain talent is of great importance to the success of our Company.

Table of Contents

RISK REPORT

RISK MANAGEMENT ACTIVITIES IN 2016

The Board and its Committees undertook a number of risk management activities throughout the year as follows:

IDENTIFICATION OF RISKS

We review risk through two processes:

The bottom-up process undertaken by the Risk Champions in the business areas and functions across the Group to identify and manage the risks in their areas; and

The top-down process undertaken by the members of the executive committee to identify the key risks to the strategic priorities, top products and product platforms.

During the year, the key risks identified through these two processes were mapped against each other and regrouped to produce a revised schedule of Significant

ASSESSMENT OF MANAGEMENT ACTIONS

The effectiveness of actions undertaken by management to address the key risks identified is assessed in a number of ways:

The Risk Champions in the business areas and functions across the Group assess the effectiveness of mitigating actions being undertaken locally and regionally;

All control functions provide independent assurance to management, the Audit Committee and the Board on the effectiveness of management actions and the Internal Audit function periodically reviews the risk management process; and

Risks, which were discussed at the Strategy Review in September. Each Board member was then interviewed to ascertain tolerance for each principal risk.

We have undertaken a number of deep dives at Board and Committee level into the management of the risks being examined (see below).

DEEP DIVES INTO RISKS

We have reviewed at the Board and its Committees a number of different topics during the year relating to risk, including the following areas:

Strategic: R&D presentation to the Board, hands on demonstrations of innovative products at site visits, presentations to the Board and the Audit Committee on China and the Gulf

Operational: Presentations to the Board on inventory and the supply chain, the manufacturing network and dependency on single manufacturing sites, regular reports on quality issues, and complaints to the Ethics & Compliance Committee, pricing and commercial excellence presentation to the Board

Financial: Presentations to the Audit Committee on the tax and treasury functions

IT/cyber: Report to the Audit Committee on IT and cyber security

Compliance and legal: Regular reports on compliance matters and risks to the Ethics & Compliance Committee, covering M&A compliance risk and third party distributors, regular legal reports to the Board including updates on intellectual property and litigation

Talent management: Annual discussion on succession planning at the Board, presentation on culture and values at the Strategy Review.

SINCE THE YEAR END

In February 2017, the Board reviewed the effectiveness of the risk management process, considering the Principal Risks, actions taken by management to manage those risks and the Board s risk appetite in respect of each risk. The Board considered that the risk management process was effective. We recognise that this is an ongoing process and work will continue in 2017 and beyond to ensure that this remains the case.

RISK MANAGEMENT PLAN FOR 2017

In 2017, we shall be further developing our approach of looking at risk management through a product focused lens. We have identified the key products which will drive our multi-year strategic plan and have formed cross functional risk working groups for each of these products and product platforms. Each risk working group consists of members from the commercial, operational, R&D and risk functions and is headed by a senior product risk leader. The risk

working groups will evaluate all the risks which could impact the product or product platform through its life from design and development, sourcing of raw materials, the manufacturing process, product launch, marketing, commercialisation, regulatory, legal and compliance risks. The risk working groups will also ensure that appropriate treatment actions are in place. The Risk Champions will continue their work to ensure that any non-product related risks continue to be appropriately identified and managed. Further work will also be undertaken in reviewing the effectiveness of the risk management programme.

Table of Contents

Our Viability Statement

During the year, the Board has carried out a robust assessment of the Principal Risks affecting the Company, particularly those which could threaten the business model. These risks and the actions being taken to manage or mitigate them are explained in detail on pages 43 to 46 of this Annual Report.

Having assessed the principal risks, the Board has determined that we have a reasonable expectation that the Company will be able to continue in operation and meet its liabilities as they fall due over a period of three years from 1 January 2017. In our long term planning we consider horizons of both five and ten years. However, as most of our efforts are focused on the coming three years, we have chosen this period when considering our viability.

In reaching this conclusion, we have undertaken the following process:

significant risks which they believed could seriously impact the profitability and future prospects of the Company and the principal risks that would threaten its business model, future performance, solvency or liquidity.

For the purpose of stress testing the viability of the Company, we have undertaken a robust assessment of the principal risks and some other risks, which could threaten the viability or existence of the Company. The principal and other risks we have identified in this process are:

Pricing and reimbursement pressures or currency exchange volatility (Principal Risk) leading to a major loss of revenues and profits;

Operational risk (Principal Risk):

We have carried out a scenario analysis of these principal and significant risks to evaluate the impact of a severe but plausible combination of these risks actually occurring over the three year period.

We have considered and discussed a report setting out the terms of our current financing arrangements and potential capacity for additional financing should this be required in the event of one of the scenarios modelled occurring.

We are satisfied that we have robust mitigating actions in place as detailed on pages 43-46 of this Annual Report.

We recognise, however, that the long-term viability of the Company could also be impacted by other, as yet unforeseen, risks or that the mitigating actions we have put in

The Audit Committee reviewed the risk management process at their meetings in February, July and November, receiving presentations from the Group Risk function, explaining the processes followed by management in identifying and managing risk throughout the business.

As part of the annual Strategy Review in September, the Board considered and discussed the principal risks which could impact the business model over the next three years and discussed with the management team how these risks were being managed and mitigated.

Throughout the year, a number of deep dives into different risks were conducted by the Board, the Audit Committee and the Ethics & Compliance Committee looking into the nature of the risks and how they were mitigated, as detailed on page 46 of this Annual Report.

Towards the end of the year, a series of detailed one-to one discussions were held with each member of the Board and the Company Secretary and the Group Risk Director. In these discussions, the Directors were asked to consider the

Execution risk meaning that we were unable to launch new products and lose significant market share to the competition;

Product liability claims giving rise to significant claims and legal fees; or

Temporary loss of key production capability meaning that we were unable to manufacture a key product for a period of time;

Legal regulatory and compliance risks (Principal Risk):

Regulatory measures impacting our ability to continue to sell a key product;

Bribery and corruption claims giving rise to a significant fine;

Other risks:

Cyber security for example meaning that we were unable to issue invoices or collect money for a period of time;

Political and economic forces for example political upheaval, which

place could turn out to be less effective than intended. Based on this analysis, the Directors have a reasonable expectation that the Company will be able to continue in operation and meet its liabilities as they fall due over the three-year period of their assessment.

Our conclusion is based on our current Strategic Plan approved by the Board in September 2016, having regard to longer-term strategic intentions, yet to be formulated in detail. However, we operate in a changing marketplace, which might cause us to adapt our Strategic Plans. In responding to changing external conditions, we will continue to evaluate any additional risks involved which might impact the business model.

By order of the Board, 22 February 2017

Susan Swabey

Company Secretary

could cause us to withdraw from a major market for a period of time;

Table of Contents

OUR BOARD OF DIRECTORS

ROBERTO QUARTA (67)

CHAIRMAN

Joined the Board in December 2013 and appointed Chairman following election by shareholders at the April 2014 Annual General Meeting. He was also appointed Chairman of the Nomination & Governance Committee and a Member of the Remuneration Committee on that day.

CAREER AND EXPERIENCE

Roberto is a graduate and a former Trustee of the College of the Holy Cross, Worcester (MA), US. He started his career as a manager trainee at David Gessner Ltd, before moving on to Worcester Controls Corporation and then BTR plc, where he was a divisional Chief Executive. Between 1985 and 1989 he was Executive VP of Hitchiner Manufacturing Co. Inc. He returned to BTR plc in 1989 as Divisional Chief Executive, where he was appointed to the main board. From here he moved to BBA Aviation plc, as CEO and then as Chairman, until 2007. He has held several board positions, including NED of Powergen plc, Equant N.V., BAE Systems plc and Foster Wheeler AG. His previous Chairmanships include Italtel SpA, Rexel S.A. and IMI plc. He was also a Member of the Investment Committee of Fondo Strategico Italiano until 31 March 2016. He is currently Chairman of WPP plc and SPIE SA and a partner at Clayton Dubilier & Rice.

SKILLS AND COMPETENCIES

Roberto s career in private equity brings valuable experience to Smith & Nephew, particularly when evaluating acquisitions and new business opportunities. He has an in-depth understanding of differing global governance requirements having served as a director and Chairman of a number of UK and international companies. Since his appointment as Chairman in April 2014, he has conducted a comprehensive review into the composition of the Board and its Committees, and conducted the search for new Non-Executive Directors, resulting in the appointment of Vinita Bali in 2014, Erik Engstrom and Robin Freestone during 2015.

NATIONALITY

American/Italian

OLIVIER BOHUON (58)

CHIEF EXECUTIVE OFFICER

Joined the Board and was appointed Chief Executive Officer in April 2011. He resigned as a Member of the Nomination & Governance Committee on 3 February 2016.

CAREER AND EXPERIENCE

Olivier holds a doctorate in Pharmacy from the University of Paris and an MBA from HEC, Paris. He started his career in Morocco with Roussel Uclaf S.A. and then, with the same company, held a number of positions in the Middle East with increasing levels of responsibility. He joined Abbott in Chicago as head of their anti-infective franchise with Abbott International before becoming Pharmaceutical General Manager in Spain. He subsequently joined GlaxoSmithKline, rising to Senior Vice President & Director for European Commercial Operations. He then re-joined Abbott as President for Europe, became President of Abbott International), and then President of their Pharmaceutical Division. He joined Smith & Nephew from Pierre Fabre, where he was Chief Executive.

SKILLS AND COMPETENCIES

Olivier has extensive international healthcare leadership experience within a number of significant pharmaceutical and healthcare companies. His global experience provides the skillset required to innovate a FTSE 100 company with a deep heritage and provide inspiring leadership. He is a Non-Executive Director of Virbac Group and Shire plc, where he is also a member of the Remuneration Committee.

NATIONALITY

French

GRAHAM BAKER (48)

CHIEF FINANCIAL OFFICER

Joining the Board as Chief Financial Officer in March 2017.

CAREER AND EXPERIENCE

Graham holds an MA degree in Economics from Cambridge University and qualified as a Chartered Accountant and Chartered Tax Advisor with Arthur Andersen. In 1995, he joined AstraZeneca PLC where he worked for 20 years, holding multiple senior roles, including Vice President, Finance, International (2013-2015) with responsibility for all emerging markets, Vice President, Global Financial Services (2011-2013) and Vice President Finance & Chief Financial Officer, North America (2008-10). Most recently, Graham was Chief Financial Officer of generic pharmaceuticals company Alvogen.

SKILLS AND COMPETENCIES

Graham has deep sector knowledge and has had extensive exposure to established and emerging markets which will be extremely relevant to his role at Smith & Nephew. He has a strong track record of delivering operational excellence and has relevant experience across major finance roles and geographic markets, leading large teams responsible for significant budgets.

NATIONALITY

British

Table of Contents

VINITA BALI (61)

INDEPENDENT NON-EXECUTIVE DIRECTOR

Appointed Independent Non-Executive Director in December 2014 and Member of the Remuneration Committee and Ethics & Compliance Committee.

CAREER AND EXPERIENCE

Vinita holds an MBA from the Jamnalal Bajaj Institute of Management Studies, University of Bombay and a BA in Economics from the University of Delhi. She commenced her career in India, and subsequently worked with Cadbury Schweppes plc in the UK, Nigeria and South Africa. She joined the Coca-Cola Company in 1994 and held senior positions in marketing and general management, based in the USA and Latin America, becoming President of the Andean Division in 1999 and VP, Corporate Strategy in 2001. In 2003, she joined Zyman Group, LLC, a US based consultancy, as Managing Principal. From 2005 to 2014 Vinita was MD and CEO of Britannia Industries Limited, a leading Indian publicly listed company. Currently, Vinita is NED of Syngenta AG, Titan Company Ltd and Credit Rating Information Services of India Ltd. She is also Chair of the board of Global Alliance for Improved Nutrition and a member of the Advisory Board of PwC India.

SKILLS AND COMPETENCIES

Vinita has an impressive track record of achievement with blue-chip global corporations in multiple geographies including India, Africa, Latin America, US and UK, all key markets for Smith & Nephew. Additionally, her strong appreciation of customer service and marketing brings deep insight as we continue to develop innovative ways to serve our markets and grow our business.

NATIONALITY

Indian

IAN BARLOW (65)

INDEPENDENT NON-EXECUTIVE DIRECTOR

Appointed Independent Non-Executive Director in March 2010, Chairman of the Audit Committee in May 2010 and Member of the Ethics & Compliance Committee in October 2014.

CAREER AND EXPERIENCE

Ian is a Chartered Accountant with considerable financial experience both internationally and in the UK. He was a Partner at KPMG, latterly Senior Partner, London, until 2008. At KPMG, he was Head of UK tax and legal operations. He has also been Chairman of WSP Group plc, and currently is NED and Chairman of the Audit Committees of The Brunner Investment Trust PLC, Foxtons Group plc and Urban&Civic plc.

SKILLS AND COMPETENCIES

Ian s longstanding financial and auditing career and extensive board experience add value to his role as Chairman of the Audit Committee. His appointment as a member of the Ethics & Compliance Committee has proved useful in coordinating the oversight role of both Committees. His work for a number of international companies gives added insight when reviewing our global businesses.

NATIONALITY

British

THE RT. HON BARONESS VIRGINIA BOTTOMLEY OF NETTLESTONE DL (68)

INDEPENDENT NON-EXECUTIVE DIRECTOR

Appointed Independent Non-Executive Director in April 2012 and Member of the Remuneration Committee and Nomination & Governance Committee in April 2014.

CAREER AND EXPERIENCE

Virginia gained her MSc in Social Administration from the London School of Economics following her first degree. She was appointed a Life Peer in 2005 following her career as a Member of Parliament between 1984 and 2005. She served successively as Secretary of State for Health and then Culture, Media and Sport. Virginia was formerly a director of Bupa and AkzoNobel NV. She is currently a director of International Resources Group Limited, member of the International Advisory Council of Chugai Pharmaceutical Co, Chancellor of University of Hull and Sheriff of Hull and Trustee of The Economist Newspaper. She is the Chair of Board & CEO Practice at Odgers Berndtson.

SKILLS AND COMPETENCIES

Virginia s extensive experience within government, particularly as Secretary of State for Health, brings a unique insight into the healthcare system both in the UK and globally, whilst her experience on the Board of Bupa brings an understanding of the private healthcare sector and an insight into the needs of our customers. Her experience running the board practice at a search firm gives her a valuable skillset as a member of the Nomination & Governance Committee and Remuneration Committee. Her long association with Hull, the home of many of our UK employees, also brings an added perspective.

NATIONALITY

British

Table of Contents

OUR BOARD OF DIRECTORS

ERIK ENGSTROM (53)

INDEPENDENT NON-

EXECUTIVE DIRECTOR

Appointed Non-Executive Director on 1 January 2015 and Member of the Audit Committee.

CAREER AND EXPERIENCE

Erik is a graduate of the Stockholm School of Economics (BSc) and of the Royal Institute of Technology in Stockholm (MSc). In 1988, he graduated with an MBA from Harvard Business School as a Fulbright Scholar. Erik commenced his career at McKinsey & Company and then worked in publishing, latterly as President and COO of Random House Inc. and as President and CEO of Bantam Doubleday Dell, N America. In 2001 he moved on to be a partner at General Atlantic Partners, a private equity investment firm. Between 2004 and 2009 he was CEO of Elsevier, the division specialising in scientific and medical information and then from 2009 CEO of RELX Group.

SKILLS AND COMPETENCIES

Erik has successfully reshaped RELX Group s business in terms of portfolio and geographies. He brings a deep understanding of how technology can be used to transform a business and insight into the development of new commercial models that deliver attractive economics. His experience as a CEO of a global company gives him valuable insights as a member of our Audit Committee.

NATIONALITY

Swedish

ROBIN FREESTONE (58)

INDEPENDENT NON-EXECUTIVE DIRECTOR

Appointed Independent Non-Executive Director and Member of the Audit Committee and the Remuneration Committee on 1 September 2015.

CAREER AND EXPERIENCE

Robin graduated with a BA in Economics from The University of Manchester and later qualified and commenced his career as a Chartered Accountant at Deloitte. He held a number of senior financial positions throughout his career, including at ICI plc, Henkel Ltd and at Amersham plc. Robin was the Deputy CFO and then later the CFO of Pearson plc between 2006 and August 2015, where he was heavily involved with the transformation and diversification of Pearson. He was previously NED at eChem Ltd, Chairman of the 100 Group and Senior Independent Director and Chairman of the Audit Committee of Cable and Wireless Communications plc from 2015 until May 2016. Robin is a NED and Chairman of the Audit Committee at Moneysupermarket.com Group plc and a NED at Michael Kors Holdings Ltd. Currently, Robin sits on the advisory panel to the ICAEW s Financial Reporting Committee.

SKILLS AND COMPETENCIES

Robin has been a well-regarded FTSE 100 CFO who has not only been heavily involved with transformation and diversification, but also the healthcare industry at Amersham, where his acquisition experience will be of value to Smith & Nephew as it continues to grow globally and in different markets. He brings financial expertise and insight to the Audit Committee and an understanding of how to attract and retain talent in a global business to the Remuneration Committee.

NATIONALITY

British

MICHAEL FRIEDMAN (73)

INDEPENDENT NON-EXECUTIVE DIRECTOR

Appointed Independent Non-Executive Director in April 2013 and Chairman of the Ethics & Compliance Committee in August 2014.

CAREER AND EXPERIENCE

Michael graduated with a Bachelor of Arts degree, magna cum laude from Tulane University and a Doctorate in Medicine from the University of Texas Southwestern Medical Center. He completed postdoctoral training at Stanford University and the National Cancer Institute, and is board certified in Internal Medicine and Medical Oncology. In 1983, he joined the Division of Cancer Treatment at the National Cancer Institute and went on to become the Associate Director of the Cancer Therapy Evaluation Program. Michael was most recently CEO of City of Hope in California, and also served as Director of the institution s cancer centre and held the Irell & Manella Cancer Center Director s Distinguished Chair. He was formerly Senior VP of research, medical and public policy for Pharmacia Corporation and also Deputy Commissioner and Acting Commissioner at the US Food and Drug Administration (FDA). He has served on a number of Boards in a non-executive capacity, including Rite Aid Corporation. Currently, Michael is a NED of Celgene Corporation, NED of MannKind Corporation and Intuitive Surgical, Inc.

SKILLS AND COMPETENCIES

Michael understands the fundamental importance of research, which is part of Smith & Nephew s value creation process. His varied career in both the public and private healthcare sector has given him a deep insight and a highly respected career. In particular his work with the FDA and knowledge relating to US compliance provides the skillset required to Chair the Ethics & Compliance Committee.

NATIONALITY

American

Table of Contents

JOSEPH PAPA (61)

INDEPENDENT NON-EXECUTIVE DIRECTOR

Appointed Independent Non-Executive Director in August 2008 and Chairman of the Remuneration Committee in April 2011, Member of the Audit Committee and Ethics & Compliance Committee.

CAREER AND EXPERIENCE

Joe graduated with a Bachelor of Science degree in Pharmacy from the University of Connecticut and MBA from Northwestern University s Kellogg Graduate School of Management. In 2012, he received an Honorary Doctor of Science degree from the University of Connecticut School of Pharmacy. He began his career at Novartis International AG as an Assistant Product Manager and eventually rose to VP, Marketing, having held senior positions in both Switzerland and US. He moved on to hold senior positions at Searle Pharmaceuticals and was later President & COO of DuPont Pharmaceuticals and later Watson Pharma, Inc. He was previously Chairman and CEO of Cardinal Health Inc. and Chairman and CEO of Perrigo Company plc from 2006 to April 2016. Joe was appointed Chairman and CEO of Valeant Pharmaceuticals International, Inc. in May 2016.

SKILLS AND COMPETENCIES

With over 30 years experience in the global pharmaceutical industry, Joe brings deep insight into the wider global healthcare industry and the regulatory environment. As Chairman and Chief Executive of a significant US company, Joe has a comprehensive understanding both of how to attract and retain global talent and use remuneration arrangements that incentivise performance, leading to maximum returns for investors.

NATIONALITY

American

DIRECTORS WHO SERVED DURING THE YEAR, NOT SEEKING RE-ELECTION

BRIAN LARCOMBE (63)

INDEPENDENT NON-EXECUTIVE DIRECTOR

(Retiring from the Board on 6 April 2017). Appointed Independent Non-Executive Director in March 2002, Senior Independent Director in April 2014, Member of the Audit Committee, Nomination & Governance Committee and Remuneration Committee.

CAREER AND EXPERIENCE

Brian graduated with a Bachelor s of Commerce degree from University of Birmingham. He spent most of his career in private equity with 3i Group plc, becoming Finance Director and then Chief Executive of the Group following its flotation. He has held a number of Non-Executive Directorships and is currently Non-Executive Director of Kodak Alaris Holdings Limited and Cape plc.

NATIONALITY

British

JULIE BROWN (54)

CHIEF FINANCIAL OFFICER

Chief Financial Officer (to 11 January 2017).

CAREER AND EXPERIENCE

Julie is a graduate, Chartered Accountant and Fellow of the Institute of Taxation. She qualified with KPMG before working with AstraZeneca plc, where she served as Vice President Group Finance, and ultimately, as Interim CFO. Prior to that she undertook Commercial and Strategic roles and was Regional VP Latin America, Marketing Company President AstraZeneca Portugal, and Vice President Corporate Strategy and R&D CFO. Julie is a member of the Board of Directors of Roche Holding Ltd and Chair of the Audit Committee. She has also fulfilled two Non-Executive Directorships with the NHS in the UK and the British Embassy.

NATIONALITY

British

SUSAN SWABEY (55)

COMPANY SECRETARY

Appointed Company Secretary in May 2009.

SKILLS AND EXPERIENCE

Susan has 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, Group risk management, share registration, listing obligations, corporate social responsibility, pensions, insurance and employee and executive share plans. Susan is joint Vice-Chair of the GC100 Group, a member of the CBI Companies Committee and is a frequent speaker on corporate governance and related matters. She is also a Trustee of ShareGift, the share donation charity.

NATIONALITY

British

Table of Contents

OUR LEADERSHIP TEAM

GRAHAM BAKER (48)

CHIEF FINANCIAL OFFICER

Joining the Board as Chief Financial Officer in March 2017. Graham holds an MA degree in Economics from Cambridge University and qualified as a Chartered Accountant and Chartered Tax Advisor with Arthur Andersen. He will be based in London.

SKILLS AND COMPETENCIES

Graham has deep sector knowledge and has had extensive exposure to established and emerging markets which will be extremely relevant to his role at Smith & Nephew. He has a strong track record of delivering operational excellence and has relevant experience across major finance roles and geographic markets, leading large teams responsible for significant budgets.

NATIONALITY

British

MICHAEL FRAZZETTE (55)

CHIEF COMMERCIAL OFFICER

Joined Smith & Nephew in July 2006 as President of the Endoscopy Global Business Unit. From 2011 to 2015, he headed up the Advanced Surgical Devices division with responsibility for the Orthopaedic Reconstruction, Trauma, Sports Medicin, GYN and ENT Global Franchises, as well as the ASD commercial business in the US. The scope of

Mike s role was expanded in 2014 to include the Latin American commercial business, together with Advanced Wound Management. Mike is based in London.

SKILLS AND EXPERIENCE

Mike has held a number of senior positions within the global medical devices industry. Prior to joining Smith & Nephew, he was President and CEO of MicroGroup, a privately held US manufacturer of medical devices, and he spent 15 years at Tyco Healthcare (Coviden) in various commercial and operating roles including President of the Patient Care and Health Systems divisions. Mike also spent four years serving on the AdvaMed Board of Directors and chaired the Orthopaedic Sector committee.

NATIONALITY

American

BRAD CANNON (49)

PRESIDENT, EUROPE AND CANADA

Joined Smith & Nephew in 2012 and became President, Europe and Canada in March 2016. He is based in Baar, Switzerland.

SKILLS AND EXPERIENCE

Brad was most recently President of Global Orthopaedic Franchises, leading Smith & Nephew s Reconstruction, Endoscopy, Trauma and Extremities businesses. Prior to Smith & Nephew, Brad worked in Medtronic s Spine and Biologics division. From 2009 he was responsible for Spine s International division and held positions heading US sales and global commercial operations. Brad is a graduate of Washington and Lee University, and the Wharton School of Business at the University of Pennsylvania.

NATIONALITY

American

RODRIGO BIANCHI (57)

PRESIDENT, ASIA PACIFIC AND

EMERGING MARKETS

Joined Smith & Nephew in July 2013 with responsibility for Greater China, India, Russia, Asia, Middle East and Africa, focusing on continuing our strong momentum in these regions. He is based in Dubai. With effect from 1 January 2016, Rodrigo became responsible, not only for the IRAMEA markets, but Latin America, Australia, New Zealand and Japan as well.

SKILLS AND EXPERIENCE

Rodrigo s experience in the healthcare industry includes 26 years with Johnson & Johnson in progressively senior roles. Most recently, he was Regional Vice President for the Medical Devices and Diagnostics division in the Mediterranean region and prior to that President of Mitek and Ethicon. He started his career at Procter & Gamble Italy.

NATIONALITY

Italian

GLENN WARNER (54)

PRESIDENT, US

Joined Smith & Nephew in June 2014 with responsibility for Advanced Wound Management s global franchise strategy, marketing and product development, as well as its US commercial business. With effect from 1 January 2016, Glenn became the President of Smith & Nephew s US business responsible for all the US commercial business. He is based in Fort Worth.

SKILLS AND EXPERIENCE

Glenn has a broad-based background in pharmaceuticals and medical products including extensive international experience, having served most recently as AbbVie Vice President and Corporate Officer, Strategic Initiatives, where he was responsible for the development and execution of pipeline and asset management strategies. Prior to that he was President and Officer, Japan Commercial Operations in Abbott s international pharmaceutical business and Executive Vice President, TAP Pharmaceutical Products, Inc. Additional senior level roles included international positions in Germany and Singapore for Abbott s Diagnostics business.

NATIONALITY

American

Table of Contents

JACK CAMPO (62)

CHIEF LEGAL OFFICER

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

SKILLS AND EXPERIENCE

Prior to joining Smith & Nephew, Jack held a number of senior legal roles within the General Electric Company, including seven years at GE Healthcare (GE Medical Systems) in the US and Asia. He began his career with Davis Polk & Wardwell LLP.

NATIONALITY

American

CYRILLE PETIT (46)

CHIEF CORPORATE DEVELOPMENT OFFICER AND PRESIDENT,

GLOBAL BUSINESS SERVICES

Joined Smith & Nephew in May 2012 and leads the Corporate Development function and from October 2015 the Global Business Services. He is based in London.

SKILLS AND EXPERIENCE

Cyrille spent the previous 15 years of his career with General Electric Company, where he held progressively senior positions beginning with GE Capital, GE Healthcare and ultimately as the General Manager, Global Business Development of the Transportation Division. Cyrille s career began in investment banking at BNP Paribas and then

Goldman Sachs.

NATIONALITY

French

ELGA LOHLER (49)

CHIEF HUMAN

RESOURCES OFFICER

Joined Smith & Nephew in 2002 and became Chief Human Resources Officer in December 2015. Elga leads the Global Human Resources, Internal Communication and Sustainability Functions. She is based in London.

SKILLS AND EXPERIENCE

Prior to being appointed as Chief Human Resources Officer, Elga held progressively senior positions in Human Resources at Smith & Nephew in Wound Management, Operations, Corporate Functions and Group. Elga has more than 25 years Human Resources experience.

NATIONALITY

American/South African

MATTHEW STOBER (49)

PRESIDENT, GLOBAL OPERATIONS

Joined Smith & Nephew on 1 October 2015 with responsibility for global manufacturing, supply chain, distribution, quality assurance, regulatory affairs, direct procurement, and manufacturing IT optimisation. Initially based in Memphis, Matt is now based in Andover, Massachusetts.

SKILLS AND EXPERIENCE

Matt has more than 25 years experience in healthcare manufacturing operations for global companies including Merck & Co., Inc. and GlaxoSmithKline plc. Most recently, he served as Senior Vice President, Corporate Officer and Member of the Executive Committee at Hospira Pharmaceuticals. As a senior pharmaceutical operations executive with extensive technical and cross functional experience in start-up and complex challenging environments, Matt has led global and multi-company development projects, new product launches, critical quality-related turnarounds, network rationalisations and organisational transformations. He also has extensive experience working directly with external regulatory bodies, such as the US Food and Drug Administration.

NATIONALITY

American

VASANT PADMANABHAN (50)

PRESIDENT OF

RESEARCH & DEVELOPMENT

Joined Smith & Nephew in August 2016 and is responsible for Research and Innovation, New Product Development, Safety Affairs, Clinical Affairs, Medical Device/Pharmacovigilance and Clinical Operations. He is based in Andover, Massachusetts.

SKILLS AND EXPERIENCE

Vasant brings extensive experience in research & development and technology. Prior to Smith & Nephew, Vasant was Senior Vice President of Technical Operations at Thoratec Corporation, a leader in mechanical circulatory support solutions for the treatment of heart failure. In this role, he provided leadership to a 600 member team, with responsibility for global R&D, Program Management, Operations and Quality.

Prior to Thoratec, Vasant had an 18-year career at Medtronic, starting as a Staff Scientist and, progressing through more senior roles, ultimately becoming Vice President of Product Development for the Implantable Defibrillator Business.

Vasant holds a Ph.D degree in Biomedical Engineering from Rutgers University, USA and an MBA degree from the Carlson School of Management, Minnesota.

NATIONALITY

American

Table of Contents

OVERVIEW

Committed to the highest standards of corporate governance

We maintain these standards through a clear definition of our roles, continuing development and evaluation and accountability through the work of the Board Committees.

LEADERSHIP	EFFECTIVENESS	ACCOUNTABILITY
The Board sets the tone at the top of the Company through:	**The Board carries out its duties through:**	**The Board delegates some of its detailed work to the Board Committees:**
A clear definition of the roles of the individual members of the Board.	Regular meetings focusing on the oversight of strategy, risk, including viability and succession planning.	Each Committee meets regularly and reports back to the Board on its activities.

A comprehensive corporate governance framework.

Defined processes to ensure the independence of Directors and the management of conflicts of interest.

An annual review into the effectiveness of the Board.

A comprehensive programme of development activities throughout the year.

The terms of reference of each Committee may be found on the Company website at www.smith-nephew.com

A report from the Chairman of each Committee is included in this Annual Report.

Read more about our Board s Leadership on pages 55 to 59

Read more about our Board s Effectiveness on pages 60 to 64

Read more about our Board s Accountability on pages 65 to 75

REMUNERATION

Having a formal and transparent procedure for developing policy on remuneration for Executive Directors is crucial. Our Remuneration Policy aims to attract, retain and motivate by linking reward to performance. In this section you will find information on the Remuneration Policy to be presented to shareholders for approval at the Annual General Meeting on 6 April 2017 and how we implemented our Remuneration Policy in 2016 and plan to implement it in 2017.

Read more about our Board s Remuneration on pages 76 to 100

The Board is committed to the highest standards of corporate governance and we comply with all the provisions of the UK Corporate Governance Code 2014 (the Code). The Company s American Depositary Shares are listed on the New York Stock Exchange (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 Securities Exchange Commission (SEC) applicable to foreign private issuers. We comply with the requirements of the NYSE and SEC. We shall explain in this Corporate Governance Statement and in the reports on the Audit Committee, the Nomination & Governance Committee, the Ethics & Compliance Committee and the Remuneration Committee, how we have applied the provisions and principles of the Financial Conduct Authority s (FCA) Listing Rules, Disclosure & Transparency Rules (DTRs) and the Code throughout the year. The Code can be found at
https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Corporate-Governance-Code-April-2014.pdf

In addition, we have reviewed the requests of the UK Corporate Governance Code 2016 and believe that we comply with all the provisions in that code, which will be effective for the next financial year.

The Directors Report comprises pages 33 to 34, 36 to 38, 47 to 75, 102, 110, 112, 114 and pages 169 to 190 of the Annual Report.

Table of Contents

COMPOSITION & ROLES

LEADERSHIP

COMPOSITION OF BOARD

AS AT 31 DECEMBER 2016

We believe the Board s composition gives us the necessary diversity, skills and experience to ensure we continue to run the business effectively and deliver sustainable growth.

Diversity		
A	EXECUTIVE	2

B	NON-EXECUTIVE	8
C	CHAIRMAN	1
Gender		
A	MALE	8
B	FEMALE	3

Years of service

A	LESS THAN ONE YEAR	0
B	ONE TO THREE YEARS	3
C	THREE TO SIX YEARS	5
D	SIX TO NINE YEARS	2
E	OVER NINE YEARS	1

Board nationality

5	2	1	1	1	1
BRITISH	AMERICAN	FRENCH	INDIAN	AMERICAN/	SWEDISH

ITALIAN

CHANGES TO THE BOARD

During the year to 31 December 2016, there were no changes to the Board. However, since the end of the year, the following changes have been made or announced:

Julie Brown retired from the Board on 11 January 2017

Graham Baker to be appointed Chief Financial Officer on 1 March 2017

Robin Freestone to be appointed Chairman of the Audit Committee, succeeding Ian Barlow on 1 March 2017

Ian Barlow to be appointed Senior Independent Director, succeeding Brian Larcombe on 6 April 2017

Table of Contents

RESPONSIBILITY & ACTIVITY

LEADERSHIP continued

ROLE 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 of the Chairman and the Chief Executive Officer are clearly defined.

The roles of the Non-Executive Directors, Senior Independent Director and the Company Secretary are defined as follows:

CHAIRMAN

Building a well-balanced Board.

Chairing Board meetings and setting Board agendas.

Ensuring effectiveness of Board and enabling the annual review of effectiveness.

Encouraging constructive challenge and facilitating effective communication between Board members.

Promoting effective Board relationships.

Ensuring appropriate induction and development programmes.

Ensuring effective two-way communication and debate with shareholders.

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 updated 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.

Day-to-day running of the business.

CHIEF FINANCIAL OFFICER

Supporting the Chief Executive Officer in developing and implementing the Group strategy.

Leading the global finance function, developing key finance talent and planning for succession.

Ensuring effective financial reporting, processes and controls are in place.

Recommending the annual budget and five-year strategic and financial plan.

Maintaining relationships with shareholders.

NON-EXECUTIVE DIRECTORS

Providing effective challenge to management.

Assisting in development and approval of strategy.

Serving on the Board Committees.

Providing advice to management.

SENIOR INDEPENDENT DIRECTOR

Chairing meetings in the absence of the Chairman.

Acting as a 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 the annual evaluation into the Board s effectiveness.

Leading the search for a new Chairman, if necessary.

COMPANY SECRETARY

Advising the Board on matters of corporate governance.

Supporting the Chairman and Non-Executive Directors.

Point of contact for investors on matters of corporate governance.

Ensuring good governance practices at Board level and throughout the Group.

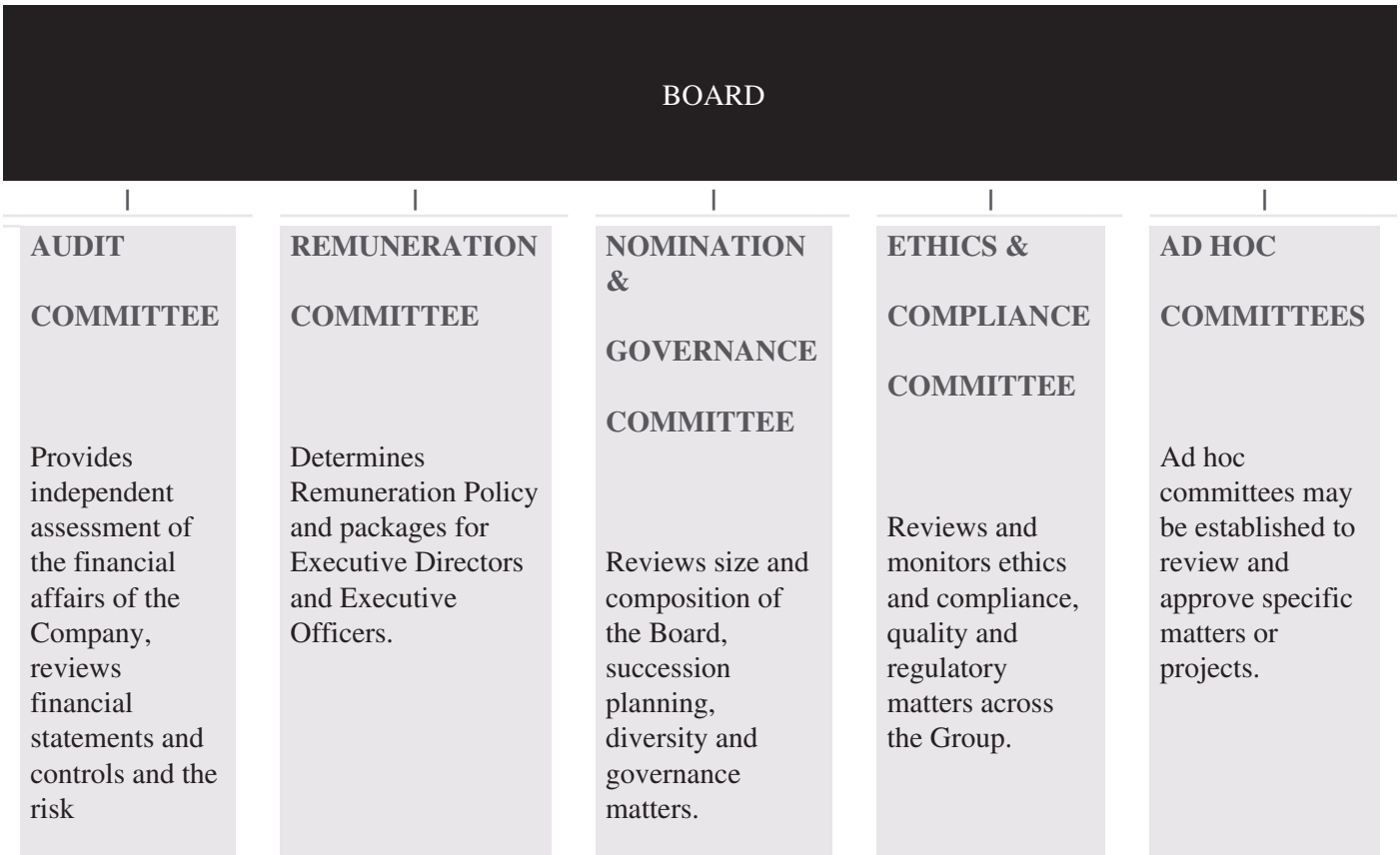
Table of Contents

CORPORATE GOVERNANCE FRAMEWORK

The Board is responsible to shareholders for approving the strategy of the Group, for overseeing the performance of the Group and evaluating and monitoring the management of risk.

Each member of the Board has access collectively and individually to the Company Secretary and is also entitled to obtain independent professional advice at the Company s expense, should they decide it is necessary in order to fulfil their responsibilities as Directors.

The Board delegates certain matters, as follows, to Board Committees, consisting of members of the Board:



management process. Manages use of internal and external auditors. **Read more** See page 69	**Read more** See page 88	**Read more** See page 65	**Read more** See page 67	

The Board delegates the day-to day running of the business to Olivier Bohuon, Chief Executive Officer, who is assisted in his role by the Executive Committee comprising the Executive Officers who are shown on pages 52 to 53 and certain other senior executives. In January 2016, the governance framework below the Executive Committee was rearranged to reflect the new organisational structure as follows:

EXECUTIVE COMMITTEE

nds and implements strategy, approves budget and three-year plan, ensures liaison between commercial and corporate functions, receiv
om sub-committees, reviews major investments, divestments and capital expenditure proposals and approves business development proj

RCIAL **TTEE** nds and implements r global commercial and regions, sales, marketing, cess and commercial nd identifying and new processes, nd practices to perational efficiency rcial regions.	**CORPORATE FUNCTIONS** **COMMITTEE** Recommends and implements strategy for corporate functions identifying and executing new processes, systems and practices to improve operational efficiency in corporate functions.	**PORTFOLIO** **INNOVATION BOARD** Defines portfolio allocation principles, reviewing and challenging current shape of portfolio, identifying gaps and opportunities	**REGIONAL** **STAFF MEETINGS** Regional management through committees to drive regional performance.	**FUNCTIO** **STAFF ME** Functional l teams to dri functional performance

		and re-prioritising segments and geographies.		
E & BANKING **TTEE** banking and treasury uarantees, Group hanges, acquisitions als.	**DISCLOSURES** **COMMITTEE** Approves release of communications to investors and Stock Exchanges.	**MERGERS & ACQUISITIONS** **COUNCIL** Oversees Corporate Development Strategy, monitors status of transactions and approves various stages in acquisition process.	**GROUP RISK** **COMMITTEE** Reviews risk registers and risk management programme.	**GROUP ET** **COMPLIA COMMITT** Reviews co matters and business uni function co reports.
TY & INCLUSION **L** ts strategies to iversity and	**GLOBAL BENEFITS** **COMMITTEE** Oversees all policies and processes relating to pensions and employee benefit plans.	**HEALTH, SAFETY &** **ENVIRONMENT COMMITTEE** Oversees health, safety and environmental matters.	**IT GOVERNANCE** **BOARD** Oversees IT and cyber security.	**CAPITAL GOVERNA** **BOARD** Determines monitors ca expenditure with corpor strategy.

Table of Contents

RESPONSIBILITY & ACTIVITY CONTINUED

LEADERSHIP continued

SPECIAL GOVERNANCE ARRANGEMENTS DURING THE YEAR

During the year, the Chief Executive Officer, Olivier Bohuon, successfully underwent treatment for cancer. During his period of treatment, whilst he remained in touch on a regular basis and was kept advised of all developments in the business, he was unable to travel and to fulfil his full duties for a period. We therefore put in place a governance structure to ensure continued oversight of the business during his period of absence. The Executive Committee continued to meet on a monthly basis and additional Executive Leadership Team meetings were arranged in the intervening weeks so that the executive team could handle matters collectively as they arose. The Chairman, Roberto Quarta, was also in touch with both Olivier Bohuon and other members of the executive team throughout this period of absence, providing advice, guidance and counsel. Whilst the Chairman was available to step into the role as Chief Executive Officer had the need arisen, this contingency was not actually required as Olivier Bohuon was able to remain sufficiently in contact with the executive team to be able to continue to run the business whilst away from the office. Olivier Bohuon returned to work and led the executive team at the Board Strategy Review in September 2016.

INDEPENDENCE OF DIRECTORS

We require our Non-Executive Directors to remain independent from management so that they are able to exercise independent oversight and effectively challenge management. We therefore continually assess the independence of each of our Non-Executive Directors. The Executive Directors have determined that all our 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. None of them receives additional remuneration apart from Directors fees, nor do they participate in the Group s share plans or pension schemes. None of them serve as directors of any companies or affiliates in which any other Director is a director.

More importantly, each of our Non-Executive Directors is prepared to question and challenge management, to request more information and to ask the difficult questions. They insist on robust responses both within the Boardroom and, sometimes, between meetings. The Chief Executive Officer is open to challenge from the Non-Executive Directors and uses this positively to provide more detail and to reflect further on issues.

Brian Larcombe has served as an independent Non-Executive Director for a period of 14 years and will be retiring from the Board at the Annual General Meeting. Throughout 2016, Brian Larcombe continued to maintain an independent view within Board discussions and his experience on the Board, wise counsel and corporate memory was valued by the rest of the Board. We thank Brian for his years of service to the Board and to the Company.

MANAGEMENT OF CONFLICTS OF INTEREST

None of our Directors or their 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 22 February 2017.

Each Director 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 might conflict with the interests of the Company. This duty is in addition to the existing duty owed to the Company to disclose to the Board any interest in a transaction or arrangement under consideration by the Company.

If any Director becomes aware of any situation which might give rise to a conflict of interest, they must, and do, inform the rest of the Board immediately and the Board is then permitted under the Company s Articles of Association to authorise such conflict. This information is then recorded in the Company s Register of Conflicts, together with the date on which authorisation was given. In addition, each Director certifies on an annual basis that the information contained in the Register of Conflicts is correct.

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

OUTSIDE DIRECTORSHIPS

We encourage our Executive Directors to serve as a Non-Executive Director of external companies. We believe that the work they do as Non-Executive Directors of other companies has benefits for their executive roles with the Company, giving them a fresh insight into the role of a Non-Executive Director. Olivier Bohuon is a Non-Executive Director of Shire plc and of Virbac Group. Olivier Bohuon discussed his external roles with the Chairman prior to accepting these appointments and the Chairman was satisfied that he had the capacity for the time commitment required.

RE-APPOINTMENT OF DIRECTORS

In accordance with the Code, all Directors offer themselves to shareholders for re-election annually, except those who are retiring immediately after the Annual General Meeting. Each Director may be removed at any time by the Board or the shareholders.

Table of Contents

DIRECTOR 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 ongoing 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 Board meets with retail investors at the Annual General Meeting and responds to many letters and emails from shareholders throughout the year.

The Executive Directors also meet regularly with institutional 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 2016, the Executive Directors held meetings with institutional investors, including investors representing approximately 41% of the share capital.

During the year, in line with good practice, an Investor perception survey was undertaken by an independent third party, Investor Perceptions. This survey sought the views of 20 shareholders holding approximately 21.8% of the Company s shares, on a range of topics relating to the Company, its performance and management. These views were shared anonymously with the Chief Executive Officer and the Board and led to refinements in our ongoing investor relations programme.

During 2016, Roberto Quarta met with investors to hear their views of the Company. He held 12 meetings and telephone calls with investors holding just over 20% of the share capital.

Joseph Papa, the Chairman of the Remuneration Committee also met with key institutional investors during 2016. Ahead of the Annual General Meeting in April 2016, he engaged with 24 shareholders holding just under 30% of the share capital. In September and October, he offered to meet with our top 30 shareholders and all institutional shareholders who had contacted us around the time of the Annual General Meeting to discuss the vote on

remuneration. As a result of this offer, he met, held telephone calls and exchanged views by email with 24 shareholders holding just under 40% of the share capital. At these meetings, he presented the Remuneration Committee s proposals for our remuneration arrangements going forward and discussed investor views regarding different performance measures. These discussions have helped to formulate the Remuneration Policy which will be presented to shareholders for approval at the Annual General Meeting in April this year.

Ian Barlow, the Chairman of the Audit Committee, met with investors to discuss audit related matters. He held one meeting with an investor holding approximately 1.5% of the share capital.

Members of the Board are always happy to engage with investors, if they have matters they wish to raise with the non-executive team. Please contact the Company Secretary to arrange a suitable time to meet.

A short report on our major shareholders and any significant changes in their holdings since the previous meeting is reviewed at each Board meeting. The Chairman and Non-Executive Directors report back to the Board following their meetings with investors. Olivier Bohuon routinely reports on any concerns or issues that shareholders have raised with him in their meetings. Copies of the analyst reports on the Company and its peers are also circulated to Directors.

PURCHASE OF ORDINARY SHARES

In order to avoid shareholder dilution, shares allotted to employees through employee share schemes are bought back on a quarterly basis and subsequently cancelled as we stated in Note 19.2 of the accounts on page 152.

Table of Contents

RESPONSIBILITY & ACTIVITY CONTINUED

EFFECTIVENESS

RESPONSIBILITY OF THE BOARD

The work of the Board falls into the following key areas:

STRATEGY

Approving the Group strategy including major changes to corporate and management structure.

Approving acquisitions, mergers, disposals, capital transactions in excess of $50 million.

Setting priorities for capital investment across the Group.

Approving annual budget, financial plan, five-year business plan.

Approving major borrowings and finance and banking arrangements.

Approving changes to the size and structure of the Board and the appointment and removal of Directors and the Company Secretary.

Approving Group policies relating to sustainability, health and safety, Code of Conduct and Code of Share Dealing and other matters.

Approving the appointment and removal of key professional advisers.

PERFORMANCE

Reviewing performance against strategy, budgets and financial and business plans.

Overseeing Group operations and maintaining a sound system of internal control.

Determining the dividend policy and dividend recommendations.

Approving the appointment and removal of the external auditor on the recommendation of the Audit Committee.

Approving significant changes to accounting policies or practices.

Overseeing succession planning at Board and Executive Officer level.

Approving the use of the Company s shares in relation to employee and executive share incentive plans on the recommendation of the Remuneration Committee.

RISK

Overseeing the Group s risk management programme.

Regularly reviewing the risk register.

Overseeing risk management processes (see pages 42 to 46 for further details).

SHAREHOLDER COMMUNICATIONS

Approving preliminary announcement of annual results, the publication of the Annual Report, the half-yearly report, the quarterly financial announcements, the release of price sensitive announcements and any listing particulars, circulars or prospectuses.

Approving the Sustainability Report prior to publication.

Maintaining relationships and continued engagement with shareholders.

PROVIDING ADVICE

Using experience gained within other companies and organisations to advise management both within and between Board meetings.

The Schedule of Matters Reserved to the Board describes the role and responsibilities of the Board more fully and can be found on our website at www.smith-nephew.com

Table of Contents

BOARD TIMETABLE 2016

EARLY FEBRUARY

Approval of Preliminary Announcement

Reviewed the results for the full year 2015 and the preliminary announcement and approved the final dividend to be recommended to shareholders for approval.

Reviewed and approved the annual risk management report.

Reviewed and approved the payment of the dividend.

Approved the Budget for 2016 and the Long-Range Plan for 2016-2020.

Received updates on the business in China and Saudi Arabia.

Reviewed the Group Optimisation Plan.

Reviewed the results of the review into the effectiveness of the Board in 2016 and agreed action points for 2016.

Reviewed and accepted an increase in the fees paid to Non-Executive Director Fees.

LATE FEBRUARY (VIA VOICE CONFERENCE)

Approval of Financial Statements

Reviewed and approved the Annual Report and Accounts for 2015, having determined that they were fair, balanced and understandable.

Reviewed and approved the Notice of Annual General Meeting and related documentation.

APRIL

Received a review of recent acquisitions.

Approved the Sustainability Report.

Prepared for the Annual General Meeting to be held later that day.

MAY (VIA VOICE CONFERENCE)

Reviewed the results for the first quarter 2016 and approved the Q1 trading statement announcement.

JULY

Reviewed the results for the first half 2016 and approved the H1 announcement, having considered management s judgement in a number of areas, and approved payment of the interim dividend.

Received and considered a report analysing the progress of recent acquisitions against expectations at the time of acquisition.

Received and discussed the annual review of Group Insurances.

Reviewed the North American Process Optimisation Project.

SEPTEMBER (IN NICE, FRANCE)

Strategy Review

Received an update on Corporate Development.

Approved the renewal of the Directors and Officers Liability insurance.

EARLY NOVEMBER (IN BOSTON, MASSACHUSETTS)

Approval of Q3 Trading Statement

Reviewed the results for the third quarter 2016 and approved the Q3 trading statement announcement.

Received an update on Research & Development.

Received an update on the Compliance Programme.

Approved the Sustainability Policy 2020.

LATE NOVEMBER

Approval of Budget

Approved the Budget for 2017.

Received an update relating to the UK Defined Benefit Pension Plan.

Received an update on Latin America.

Reviewed the annual Succession Planning Report.

Reviewed the Report on Sales Force Excellence.

Table of Contents

RESPONSIBILITY & ACTIVITY CONTINUED

EFFECTIVENESS continued

Since the year end, we have also approved the Annual Report and Accounts for 2016 and have concluded that, taken as a whole, they are fair, balanced and understandable. We have approved the Notice of Annual General Meeting, recommended the final dividend to shareholders and have received and discussed the report on the effectiveness of the Board in 2016.

Each meeting was preceded by a meeting between the Chairman and the Non-Executive Directors without the Executive Directors and management in attendance. Unless otherwise stated, meetings are held in London, UK.

At each meeting, we approved the minutes of the previous meetings, reviewed matters arising and received reports and updates from the Chief Executive Officer, the Chief Financial Officer, the Chief Corporate Development Officer, the Chief Legal Officer and the Company Secretary. We also received reports from the chairmen of the Board Committees on the activities of these Committees since the previous meeting.

BOARD AND COMMITTEE ATTENDANCE

Director	Board Member since	Board meetings (8 meetings)	Audit Committee meetings (7 meetings)	Remuneration Committee meetings (6 meetings)	Nomination & Governance Committee meetings (5 meetings)	Ethics & Compliance Committee meetings (4 meetings)
Roberto Quarta	December 2013	8/8		6/6	5/5	
Olivier Bohuon[1]	April 2011	6/8				
Julie Brown	February 2013	8/8				
Vinita Bali[2]	December 2014	7/8		5/6		4/4
Ian Barlow	March 2010	8/8	7/7			4/4
Virginia Bottomley	April 2012	8/8		6/6	5/5	
Erik Engstrom	1 January 2015	8/8	7/7			
Robin Freestone	1 September 2015	8/8	7/7	6/6		
Michael Friedman	April 2013	8/8				4/4
Brian Larcombe[3]	March 2002	7/8	5/7	5/6	5/5	
Joseph Papa	August 2008	8/8	7/7	6/6		4/4

1 Olivier Bohuon missed two Board meetings due to illness.

2

Vinita Bali missed one Board meeting and one meeting of the Remuneration Committee, on the same day, due to a prior appointment.

3 Brian Larcombe missed one Board meeting, one meeting of the Audit Committee, and one meeting of the Remuneration Committee, all on the same day, due to a prior appointment. He also missed one meeting of the Audit Committee due to a funeral.

Table of Contents

BOARD EFFECTIVENESS REVIEW

The last externally facilitated Board Effectiveness Review was carried out in 2015 by Independent Audit. Progress against the areas identified for attention last year are shown in the table below.

The Board Effectiveness Review in 2016 was internally facilitated by Brian Larcombe, Senior Independent Director assisted by the Company Secretary. The 2016 review comprised a questionnaire completed by each member of the Board. This questionnaire focused on the progress made addressing the issues raised in previous Board Evaluations as well as looking into how the Board had handled particular topics throughout the year. Brian Larcombe then conducted individual interviews with each Board member. He also chaired a meeting of the Non-Executive Directors specifically to discuss the performance of the Chairman.

In January 2017, he prepared a report, detailing his findings, which he shared with the Chairman. The report was then discussed by the full Board in February 2017.

In discussion, we concluded that the Board was a committed and engaged Board and that there were good processes in place to enable the directors to fulfil their duties responsibly. We noted that a number of enhancements had been made to some of these processes during the year to enable the Board to perform more effectively and efficiently. Overall, we were satisfied that effective controls were in place.

However, we also observed that the financial performance of the Company had been below our expectations in 2016. This had led us to consider whether the Board was actually as effective as our processes implied. We then considered ways in which we as a Board could better support management to improve performance, help frame future action plans and to hold management more accountable for delivery. The areas for improvement we have identified for 2017 are:

- Gaining a deeper understanding of why our competitors are enjoying superior growth rates compared with us so that we can help management identify, acquire and develop the resources they need to compete more effectively in our chosen markets.

Gaining a better understanding of the changing market dynamics in our chosen markets, focusing on identifying the different categories of customer and the pricing and reimbursement drivers which are in play, so that we can support and challenge management more effectively when they seek approval for projects to address these changing conditions.

Playing a more active role in supporting management develop the robust succession plans for senior executive positions.

Encouraging management to develop metrics and dashboards on a wider range of issues beyond financial metrics, particularly in the areas of Human Resources and R&D and ensuring that we regularly monitor progress against these metrics.

The areas for attention identified in the 2015 review have been addressed as follows:

ACTIONS IDENTIFIED	ACTION TAKEN
Further opportunities to be identified to enable greater engagement with the Non-Executive Directors for them to provide input on matters brought before the Board.	There have been increased opportunities during the year for Non-Executive Directors to work more closely with management, providing guidance and expertise between Board meetings, particularly in the areas of determining appropriate measures for incentive plans and enhancing the risk management programme. However, both the Board and the executive team recognise that this is an area which could be developed further in 2017.
The development of a programme for Non-Executive Directors to get to know the business better outside the scheduled Board visits.	During the year, some of the Non-Executive Directors have accompanied our sales representatives on hospital visits, have met with surgeons using our products and observed operations. The Board recognises that this is an area which could be developed further in 2017.
Continuous review of the Board agenda to ensure sufficient time is devoted to HR and people related matters, risk and mitigations and the innovation pipeline.	A comprehensive review of agenda planning was carried out during the year to ensure that sufficient time was set aside at Board and Committee meetings throughout the year to discuss the matters identified at the previous Board Evaluation. In addition, the Strategy Review in September included sessions on our culture and values, the development of new products and our risk management programme.

Table of Contents

RESPONSIBILITY & ACTIVITY CONTINUED

EFFECTIVENESS continued

BOARD DEVELOPMENT PROGRAMME

Our Board Development Programme is directed to the specific needs and interests of our Directors. We focus the development sessions on facilitating a greater awareness and understanding of our business rather than formal training in what it is to be a Director. We value our visits to the different Smith & Nephew sites around the world, where we meet with the local managers of our businesses and see the daily operations in action. Meeting our local managers helps us to understand the challenges they face and their plans to meet those challenges. We also take these opportunities to look at our products and in particular the new products being developed by our R&D teams. This direct contact with the business in the locations in which we operate around the world helps us to make investment and strategic decisions. Meeting our local managers also helps us when making succession planning decisions below Board level.

During the course of the year, we receive updates at the Board and Committee meetings on external corporate governance changes likely to impact the Company in the future. In 2016, we particularly focused on the new requirements under the European Market Abuse Regulations.

New Directors receive tailored induction programmes when they join the Board, although there were no new Directors appointed in 2016. All Non-Executive Directors are encouraged to visit our overseas businesses, if they happen to be travelling for other purposes. Our local management teams enjoy welcoming Non-Executive Directors to their business and it emphasises the interest the Board takes in all our operations. The Chairman regularly reviews the development needs of individual Directors and the Board as a whole.

SUCCESSION PLANNING

The Board is responsible for ensuring that there are effective succession plans in place to ensure the orderly appointment of Directors to the Board, as and when vacancies arise. The report from the Nomination & Governance Committee on pages 65 to 66 explains the process the Board and the Nomination & Governance Committee followed in 2016 to build a balanced Board for the future in undertaking the search for new Non-Executive Directors.

Building a successful executive team is the responsibility of the Chief Executive Officer, although this process is also overseen by the Board. The Chief Executive Officer and Chief Human Resources Officer present a report to the Board on Succession Planning on an annual basis, at which the performance and potential of members of the executive team are discussed and considered. The Board is also given a number of opportunities during the course of the year to meet key members of the executive team at the Strategy Review held annually in September and at the site visits held in November each year. Executive Officers and their direct reports also make regular presentations on different aspects of the business. The Board recognises the importance of getting to know the executive team below Board level both for the purpose of understanding the business better but also in order to plan for executive succession.

DEVELOPMENT ACTIVITIES

The following development sessions covering both the Smith & Nephew business and wider market issues were held during the year:

APRIL

Internal presentation on the competitive landscape facing the Company.

JULY

Presentation from our Auditor, KPMG, on External Reporting trends, covering changing accounting standards and updates on financial reporting, the SEC and corporate governance changes relating to Audit Committees and Auditors.

SEPTEMBER

Presentations from the entire executive team as part of the Board s Strategy Review.

Board discussion on Risk as part of the Board s Strategy discussions.

NOVEMBER

Visit to the Company s site in Andover, Massachusetts and meetings with the US executive team.

Series of presentations from our Sports Medicine management team and leading surgeons in the field on developments and innovation in sports medicine and looking at our response to changing demands in this area and the development of new products to address these demands.

Presentation on the US Wound business.

By order of the Board, on 22 February 2017

Roberto Quarta

Chairman

Table of Contents

NOMINATION & GOVERNANCE COMMITTEE REPORT

ACCOUNTABILITY

Nomination & Governance Committee

CURRENT MEMBERS IN 2016

	Member since	Meetings attended
Roberto Quarta (Chairman)	April 2014	5/5
Virginia Bottomley	April 2014	5/5
Brian Larcombe[1]	April 2011	5/5

1 Brian Larcombe will retire from the Board at the Annual General Meeting. He will be replaced as Senior Independent Director and member of the Nomination & Governance Committee by Ian Barlow.

2017 FOCUS

Continue the search for a Non-Executive Director to join the Board during 2017 and to replace Joseph Papa as Chairman of the Remuneration Committee on his retirement from the Board in 2018.

DEAR SHAREHOLDER,

I am pleased to present the 2016 report of the Nomination & Governance Committee.

ROLE OF THE NOMINATION & GOVERNANCE COMMITTEE

Our work falls into the following two areas:

Board Composition

Reviewing the size and composition of the Board.

Overseeing Board succession plans.

Recommending the appointment of Directors.

Monitoring Board diversity.

Corporate Governance

Overseeing governance aspects of the Board and its Committees.

Overseeing the review into the effectiveness of the Board.

Considering and updating the Schedule of Matters Reserved to the Board and the Terms of Reference of the Board Committees.

Monitoring external corporate governance activities and keeping the Board updated.

Overseeing the Board Development Programme and the induction process for new Directors.

The terms of reference of the Nomination & Governance Committee describe our role and responsibilities more fully and can be found on our website: www.smith-nephew.com

ACTIVITIES OF THE NOMINATION & GOVERNANCE COMMITTEE IN 2016 AND SINCE THE YEAR END

In 2016, we held three physical meetings and one via voice conference. Each meeting was attended by all members of the Committee. The Company Secretary also attended by invitation. In between each meeting, various discussions were held between members of the Nomination & Governance Committee and the external search agent. Our programme of work in 2016 was as follows:

EARLY FEBRUARY

Activities related to the year end

Considered and approved the re-appointment of Directors who had completed three or six years service and the annual appointment of Directors serving in excess of nine years.

Reviewed the composition of each committee.

Reviewed and noted the Schedule of Matters Reserved to the Board and the Terms of Reference of the Board Committees.

Reviewed the proposed Governance Structure of executive committees.

JULY

Resignation of Julie Brown (via voice conference)

Received and accepted the resignation of Julie Brown as Chief Financial Officer.

Agreed to begin a search for a new Chief Financial Officer.

MID NOVEMBER

Appointment of new Chief Financial Officer

Resolved to recommend to the Board that Graham Baker be offered the position of Chief Financial Officer.

Table of Contents

NOMINATION & GOVERNANCE COMMITTEE REPORT

ACCOUNTABILITY continued

LATE NOVEMBER

Appointment of Chief Financial Officer and Committee Chairs

Received an update that Graham Baker had accepted the position of Chief Financial Officer, effective 1 March 2017.

Resolved that Robin Freestone should replace Ian Barlow as Chairman of the Audit Committee effective 1 March 2017.

Received an update regarding potential replacements for Joseph Papa as Chairman of the Remuneration Committee.

Received an update from the Chairman regarding the appointment of a new Senior Independent Director in 2017.

Since the year end, we have also discussed the future structure of the Board.

CHIEF FINANCIAL OFFICER

In July 2016, Julie Brown resigned as Chief Financial Officer to take up an alternative position outside the Company, in January 2017. The Nomination & Governance Committee together with Olivier Bohuon (Chief Executive Officer) and Elga Lohler (Chief Human Resources Officer) and, advised by Russell Reynolds, undertook a search for her replacement. A number of candidates were interviewed by the Chief Executive Officer, the Chairman of the Board, the Chairman of the Audit Committee and a number of other Non-Executive Directors. Graham Baker will be joining the Board on 1 March 2017 as Chief Financial Officer. In the interim period, members of the finance team have been carrying out the duties of the Chief Financial Officer. They have been supported in this by Robin Freestone.

NON-EXECUTIVE DIRECTORS

Following a number of appointments in 2015, there were no changes to the Non-Executive Directors in 2016. In February 2016, we asked Brian Larcombe to remain as Senior Independent Director for an additional year in order to support me as Chairman, should I have been required to provide additional executive oversight during the Chief Executive Officer s period of illness. Now that Olivier Bohuon has fully returned to work and I will not be called upon to carry out any executive duties, Brian Larcombe will retire from the Board at the Annual General Meeting on 6 April 2017 after 16 years service to the Company, a period during which we have all been indebted to him for his wise counsel, advice and insight. Ian Barlow will replace Brian Larcombe as Senior Independent Director on 6 April 2017, subject to his re-election at the Annual General Meeting.

Ian Barlow has served on our Board as Chairman of the Audit Committee since 2010. He knows the Company well and has a sound understanding of the governance and regulatory requirements of the Board. He has also met some of our shareholders in his previous role.

Robin Freestone will take over the role of Chairman of the Audit Committee from Ian Barlow with effect from 1 March 2017. Robin has served as a Non-Executive Director of the Board and member of the Audit Committee and the Remuneration Committee for a period of 18 months. Prior to his appointment to the Board, he was a well-regarded FTSE 100 Chief Financial Officer and he has brought relevant expertise and insight to the Audit Committee. His appointment as Chairman of the Audit Committee is designed to coincide with the appointment of Graham Baker to enable the Chief Financial Officer and Chairman of the Audit Committee to build a constructive working relationship together.

In August 2017, Joseph Papa will have served on the Board for nine years, the past six years as Chairman of the Remuneration Committee. We are in the process of conducting a search for his successor. The intention is

that we shall appoint a new Non-Executive Director who will join the Board and serve for a period of one year, before taking over from Joseph Papa as Chairman of the Remuneration Committee sometime in 2018, at which point Joseph Papa will retire from the Board. In selecting this new Board member, we are following a similar process as in previous years, advised by Zygos. Candidates will be interviewed by myself and a number of Non-Executive Directors. We will announce the appointment in due course, when a final decision has been made.

DIVERSITY

We aim to have a Board which represents a wide range of backgrounds, skills and experiences. We also value a diversity of outlook, approach and style in our Board members. We believe that a balanced Board is better equipped to consider matters from a broader perspective and therefore come to decisions that have considered a wider range of issues and perspectives than would be the case in a more homogenous Board. Diversity is not simply a matter of gender, ethnicity or other easily measurable characteristics. Diversity of outlook and approach is harder to measure than gender or ethnicity but is equally important. A Board needs a range of skills from technical adherence to governance or regulatory matters to understand the business in which we operate. It needs some members with a long corporate memory and others who bring new insights from other fields. There needs to be both support and challenge on the Board as well as a balance of gender and commercial and international experience. When selecting new members for the Board, we take these considerations into account, as well as professional background. A new Board member needs to fit in with their fellow Board members, but also needs to provide a new way of looking at things.

In 2012, we stated that our expectation would be that by 2015, 25% of our Board would be female and we have met this expectation. During 2016, 27% of our Board was female. However, with the departures of Julie Brown and Brian Larcombe from the Board and the upcoming appointment of Graham Baker as the new Chief Financial Officer, this percentage will drop to 20%. We have always recognised that the number of Board members will fluctuate from time to time and that we would not necessarily expect to replace any retiring Director with a new Director of the same gender. We have continued to appoint our Directors on merit, valuing the unique contribution that they will bring to the Board, regardless of gender. We are still committed to the principles of diversity and would aim to meet or exceed the expected target of 25% of the Board being female as future appointments are made. Looking forward, we shall work towards a Board with 33% being female in line with the Hampton-Alexander Review.

GOVERNANCE

During the year, the Nomination & Governance Committee also addressed a number of governance matters. We also received updates from the Company Secretary on new developments in corporate governance and reporting in both the UK and Europe. We reviewed the independence of our Non-Executive Directors, considered potential conflicts of interest and the diversity of the Board and made recommendations concerning these matters to the Board.

Roberto Quarta

Chairman of the Nomination & Governance Committee

Table of Contents

ETHICS & COMPLIANCE COMMITTEE REPORT

Ethics & Compliance Committee

CURRENT MEMBERS IN 2016

	Member since	Meetings attended
Michael A. Friedman (Chairman)	August 2014	4/4
Vinita Bali	April 2015	4/4
Ian Barlow	October 2014	4/4
Joseph Papa	April 2008	4/4

2017 FOCUS

- Continue to enhance oversight of quality and regulatory matters, including review of data for trends and patterns and proactively working to minimise associated risks.
- Continue to review potentially significant compliance issues detected through the auditing, monitoring and reporting processes.
- Continue to review compliance process enhancements and improvements, including revised standards for healthcare professional interaction and for distributors and agents.

DEAR SHAREHOLDER,

I am pleased to present the 2016 report of the Ethics & Compliance Committee.

ROLE OF THE ETHICS & COMPLIANCE COMMITTEE

Our work falls into the following two general areas:

Ethics & Compliance

- Overseeing ethics and compliance programmes.
- Monitoring ethics and compliance policies and training programmes.
- Reviewing compliance performance based on monitoring, auditing and internal and external investigations data.
- Reviewing allegations of significant compliance issues.
- Receiving reports from the Group s Ethics & Compliance Committee meetings and from the Chief Compliance Officer and the Chief Legal Officer.

Quality Assurance and Regulatory Affairs (QARA)

- Overseeing the processes by which regulatory and quality risks relating to the Company and its operations are identified and managed.

- Receiving and considering regular functional reports and presentations from the President of Global Operations, SVP of Quality Assurance and other Officers.

The terms of reference of the Ethics & Compliance Committee describe our role and responsibilities more fully and can be found on our website: www.smith-nephew.com

ACTIVITIES OF THE ETHICS & COMPLIANCE COMMITTEE IN 2016 AND SINCE THE YEAR END

In 2016, we held four physical meetings. Each meeting was attended by all members of the Committee. The Company Secretary, the Chief Legal Officer, the Chief Compliance Officer, the SVP of Quality and the President of Global Operations also attended all of the meetings by invitation.

Our programme of work in 2016 included the following:

FEBRUARY

- Noted that the Deferred Prosecution Agreement entered into by ArthroCare had expired on 7 January 2016 and the related criminal case was dismissed on 12 January 2016.

- Received an update regarding the QARA function.

- Noted the Compliance Programme performance measures for 2015 and reviewed update on China compliance.

APRIL

Received a report regarding the compliance programme in India.

Received a report regarding the Third Party Seller compliance programme.

Received an updated regarding the QARA function.

JULY

Received an update regarding the QARA function.

Table of Contents

ETHICS & COMPLIANCE COMMITTEE REPORT

ACCOUNTABILITY continued

NOVEMBER (IN BOSTON, MASSACHUSETTS)

Received an update regarding the QARA function.

Received a report on Product Complaints.

Received a report reviewing the lessons learned from the Mergers & Acquisitions process.

Received a report on distributor levels and growth and audit findings.

At each meeting we noted and considered the activities of compliance and enforcement agencies and investigation of possible improprieties. We also reviewed a report on the activities of the Group Ethics & Compliance Committee and reviewed the progress of the Global Compliance Programme.

Since the year end, we have also reviewed the work of the Group Ethics & Compliance Committee meeting held in November 2016, considered the compliance implications of recent acquisitions and continued our oversight of the QARA function.

OVERSIGHT OF QUALITY AND REGULATORY

Product safety is at the heart of our business. Regulatory authorities across the world enforce a complex series of laws and regulations that govern the design, development, approval, manufacture, labelling, marketing and sale of healthcare products. During the year, we oversaw the quality and regulatory activities of our business. At each meeting, we received a report on quality and regulatory matters from the SVP Quality and the President of Global Operations.

We reviewed the results of inspections carried out by the US Food and Drug Administration and other regulators and monitored the progress of improvement works required following some of these inspections, using a dashboard which highlighted progress being made. We also monitored the work being undertaken to help our manufacturing sites to prepare for future inspections.

We requested an in-depth report from management into our complaint handling process. This report explained our approach to complaint handling, our progress at reducing a backlog of complaints, how we categorised different complaints and how we trained our staff to recognise and escalate complaints received by the business appropriately.

We reviewed the results of quality audits undertaken during the year, approved follow up actions and monitored progress made to address these actions.

OVERSIGHT OF ETHICS & COMPLIANCE

Doing the right thing is part of our licence to operate. Business practices in the healthcare industry are subject to increasing scrutiny by government authorities in many countries. During the year, we oversaw the ethics and compliance activities of our business. At each meeting we received a report on ethics and compliance matters from the Chief Compliance Officer and a legal update on these matters from the Chief Legal Officer.

We continually review our compliance programme as it relates to third party sellers (such as distributors and sales agents), particularly in higher risk markets. This programme includes due diligence, contracts with compliance terms, compliance training, site assessments to check compliance controls and monitoring visits to review books and records.

During the year, we undertook a review into our third party sellers in India.

We ensure that comprehensive due diligence is carried out prior to an acquisition and throughout the acquisition process to ensure that new businesses are integrated into the Smith & Nephew compliance culture as soon and as consistently as possible and that all new employees are immediately aware of how we do things at Smith & Nephew. During the year, we received a report from management on the ethics and compliance lessons learned from our mergers and acquisitions process.

We oversee the employee compliance training programme, ensuring that all new employees are trained on our Code of Conduct, which sets out our basic legal and ethical principles for conducting business. We are updated on significant calls made to our whistle-blower line, which enables employees and members of the public to contact us anonymously through an independent provider (where allowed by local law) and are updated on any potentially significant improprieties and the Company s response. We received reports from management on the number of employees not completing required ethics and compliance training on time.

Michael A. Friedman

Chairman of the Ethics & Compliance Committee

Table of Contents

AUDIT COMMITTEE REPORT

Audit Committee

CURRENT MEMBERS IN 2016

	Member since	Meetings attended
Ian Barlow (Chairman)[1,2]	May 2010	7/7
Erik Engstrom	January 2015	7/7

Robin Freestone[1,2]	September 2015	7/7
Brian Larcombe[3]	January 2003	5/7
Joseph Papa	February 2011	7/7

1 Robin Freestone will be appointed Chairman of the Audit Committee on 1 March 2017, succeeding Ian Barlow, who will remain as a member of the Committee.

2 Designated financial expert.

3 Brian Larcombe will be retiring from the Board and the Audit Committee at the Annual General Meeting to be held on 6 April 2017.

2017 FOCUS

To provide assurance over the next phase of the Group s ERP implementation across the North American businesses.

To extend the breadth of the assurance activities to include other risk areas such as product risk linking into the Group s top risk items.

DEAR SHAREHOLDER,

Your Audit Committee has had another busy year, meeting seven times. Aside from the routine matters that form the backbone of the Committee s activities, which are detailed in our report, we spent significant time monitoring a

number of improvement initiatives summarised below.

We continue to benefit from an experienced set of Committee members comprising Robin Freestone and I, with significant accounting and finance backgrounds and our three other members, Joe Papa and Erik Engstrom, both serving Chief Executive Officers of large listed global companies and Brian Larcombe, a former FTSE 100 Chief Executive Officer and Chief Financial Officer. Brian will be retiring as a Director at this year s AGM and I would like to thank him for his support over many years on this Committee.

Our Head of Internal Audit, Jenny Morgan, is also leaving us this spring. She had done a great job in improving the capabilities and scope of our Internal Audit function and, on behalf of our Committee, I would like to thank her for her leadership and wish her well in her future career.

With the appointment of a new Chief Financial Officer, Graham Baker, and prospectively of a new Head of Internal Audit, I thought it was the right time after serving for seven years to hand on the Chairmanship of the Committee to Robin Freestone, a former Chief Financial Officer of a large listed company and now Audit Chairman of a listed company. I will remain as a member of the Committee. These changes are effective from 1 March 2017.

Our auditor, KPMG, has completed their second year s audit and continue to provide robust challenge and to suggest areas where we can improve our internal controls. You will see more detail of their work and conclusions in their audit report.

The main non-routine matters we dealt with during the year were:

Improvements in our risk management; led by Susan Swabey, Company Secretary, who has assumed leadership for risk management, developing our processes for risk management, our approach to risk appetite and improving alignment between the Board s assessment of risk and the underlying risk registers generated by management. This work will continue into 2017 with deep dives planned for the Board to examine risk through the lens of our products and also considering risk from a cross functional perspective.

Further improvements in our internal controls to ensure Sarbanes-Oxley compliance under robust challenge from our external auditors.

Monitoring the Company s Minimum Acceptable Practices (MAPs) for internal control which are most relevant to our smaller markets which are outside the scope of Sarbanes-Oxley. We have set a goal of 100% compliance (currently 95%, as self-assessed by management) with these practices and expect this to be achieved during 2017.

Monitoring the Finance Transformation project which is planned to deliver significant cost savings and improvements to internal control and be completed by the end of 2018.

Reviewing correspondence with the US Securities and Exchange Commission (SEC) ensuring any necessary action is reflected in the 2016 Annual Report and 20-F.

Ian Barlow

Chairman of the Audit Committee

Table of Contents

AUDIT COMMITTEE REPORT

ACCOUNTABILITY continued

ROLE OF THE AUDIT COMMITTEE

Our work falls into the following six areas:

Financial reporting

Reviewing significant financial reporting judgements and accounting policies and compliance with accounting standards.

Ensuring the integrity of the financial statements and their compliance with UK and US statutory requirements.

Ensuring the Annual Report and Accounts are fair, balanced and understandable and recommending their adoption by the Board.

Monitoring announcements relating to the Group s financial performance.

Internal controls

Monitoring the effectiveness of internal controls and compliance with the UK Corporate Governance Code 2016 and the Sarbanes-Oxley Act, specifically sections 302 and 404.

Reviewing the operation of the Group s risk management processes and the control environment over financial risks.

Risk management

On behalf of the Board, reviewing and ensuring oversight of the processes by which risks are managed, through regular functional reports and presentations, and reporting any issues arising out of such reviews to the Board.

Reviewing the process undertaken and deep-dive work required to complete the Viability Statement and recommending its adoption to the Board.

Fraud and whistle-blowing

Receiving reports on the processes in place to prevent fraud and to enable whistle-blowing.

If required, receiving reports of fraud incidents.

Internal audit

Agreeing Internal Audit plans and reviewing reports of Internal Audit work.

Monitoring the effectiveness of the Internal Audit function.

Reviewing the control observations made by the Internal Auditor, the adequacy of management s response to recommendations and the status of any unremediated actions.

External audit

Overseeing the Board s relationship with the external auditor.

Monitoring and reviewing the independence and performance of the external auditor and evaluating their effectiveness.

Making recommendations to the Board for the appointment or reappointment of the external auditor.

The terms of reference of the Audit Committee describe our role and responsibilities more fully and can be found on our website, www.smith-nephew.com, where further information can be found for permitted non-audit services.

ACTIVITIES OF THE AUDIT COMMITTEE IN 2016 AND SINCE THE YEAR END

In 2016, we held five physical meetings and two meetings via voice conference. Each meeting was attended by all appointed members of the Committee (except Brian Larcombe, who missed two meetings this year). The Chairman, the Chief Executive Officer, the Chief Financial Officer, the Head of Internal Audit, the external auditor, and key members of the finance function, the Company Secretary and Deputy Company Secretary also attended by invitation. We also met with the external auditor and the Internal Auditor without management present. Our programme of work in 2016 was as follows:

EARLY FEBRUARY

Approval of Preliminary Announcement

Reviewed the results for the full year 2015 and the preliminary announcement and recommended them for adoption by the Board.

Reviewed the effectiveness of financial controls and of the risk management process and identified areas for improvement in 2016.

Reviewed compliance with UK Corporate Governance and US Corporate Governance.

Received the Internal Audit Report and approved the Internal Audit progress report for 2016.

Received a report from Internal Audit regarding operations in China.

Received the Quality Assurance Report and approved the Quality Assurance work programme for 2016.

Received the fraud report and reviewed whistle-blowing procedures.

Received the Viability Statement and confirmed that the Company is a viable entity for the assessed forthcoming three-year period.

Confirmed the independence of KPMG as external auditor.

Approved KPMG external audit fees and the policy for approval of KPMG non-audit tax fees and noted fees paid to other major audit firms.

LATE FEBRUARY (VIA VOICE CONFERENCE)

Approval of Financial Statements

Reviewed and approved the Annual Report and Accounts for 2015, having agreed that they were fair balanced and understandable, and recommended them for adoption by the Board.

Considered the effectiveness of the external auditor and concluded that their work had been effective.

Reviewed the implementation process for Minimum Acceptable Practices for the Finance function and other control initiatives.

Table of Contents

APRIL

Reviewed the control themes and observations of the external auditor and concluded that they had met expectations.

Approved the Sustainability Report and its verification process.

Received a corporate governance update for 2017 corporate reporting.

MAY (VIA VOICE CONFERENCE)

Approval of Q1 Trading Statement

Reviewed the Q1 2016 Trading Report and approved the Q1 announcement.

Approved the Company s policy and report on Conflict Minerals for submission to the NYSE.

JULY

Approval of H1 results

Reviewed the results for the first half 2016 and approved the H1 announcement.

Reviewed and approved the external auditor s Integrated Audit Plan for 2016.

Received an update regarding the progress made on moving UK operations to Croxley Park.

Reviewed accounting for disposal of Gynaecology business.

EARLY NOVEMBER (IN BOSTON, MASSACHUSETTS)

Approval of Q3 Trading Statement

Reviewed the Q3 2016 Trading Report and approved the Q3 announcement.

Reviewed the Progress Reports from the external auditor on Q3 2016 and from Internal Audit on their work.

Received an update on new reporting, regulatory and governance requirements.

Approved the risk management process.

Approved the year-end certification process.

Received a report regarding Cyber Risk.

Reviewed the progress of recent transactions against expectations at the time of the acquisition.

LATE NOVEMBER

Review of Functional Reports

Received and discussed a report on the Finance Transformation project.

Received a report from the Internal Audit function focusing on instances of fraud.

Reviewed and approved the layout and design of the Annual Report 2016.

Received and discussed a report on Group tax strategy and management of risk.

Reviewed the process being undertaken to support the making of the Viability Statement.

Considered and approved critical accounting policies and judgements in advance of the 2016 year end.

Received an update from KPMG on the external audit and preliminary Sarbanes-Oxley findings.

Since the year end, we have also reviewed the Annual Report and Accounts for 2016 and have concluded that taken as a whole, they are fair, balanced and understandable and have advised the full Board accordingly. In coming to this conclusion, we have considered the description of the Group s strategy and key risks, the key elements of the business model, which is set out on pages 8 to 9, risks and the key performance indicators and their link to the strategy.

Table of Contents

AUDIT COMMITTEE REPORT

ACCOUNTABILITY continued

SIGNIFICANT MATTERS RELATED TO THE FINANCIAL STATEMENTS

We considered the following key areas of judgement in relation to the 2016 accounts and at each half-year and quarterly trading report, which we discussed in all cases with management and the external auditor:

Valuation of inventories

A feature of the orthopaedic business model (whose finished goods inventory makes up 79% 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.

Our action

At each quarter end, we received reports from, and discussed with, management the level of provisioning and material areas at risk. The provisioning level was 20% at 31 December 2016 (21% as at 31 December 2015). We challenged the basis of the provisions and concluded that the proposed levels were appropriate and have been consistently estimated.

Liability provisioning

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 and timing 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 or settlement negotiations or if new facts come to light. The level of provisioning for contingent and other liabilities is an issue where management and legal judgements are important.

Our action

As members of the Board, we receive regular updates from the Chief Legal Officer. These updates form the basis for the level of provisioning. The Group carries a provision relating to potential liabilities arising on its portfolio of modular metal-on-metal hip products of $163 million as of 31 December 2016. We received detailed reports from management on this position, including the actuarial model used to estimate the provision, and challenged the key assumptions, including the number of claimants and projected value of each settlement. The legal judgements have not moved materially during the year, with some cases having been resolved, and some new matters arising. We have determined that the proposed levels of provisioning at year end of $225 million included within provisions in Note 17.1 in 2016 ($271 million in 2015) were appropriate in the circumstances.

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.

Our action

We reviewed management s reports on the key assumptions with respect to goodwill, acquisition intangible assets and investments in associates particularly the forecast future cash flows and discount rates used to make these calculations. We noted the impairment charge of $48 million that has been recorded in 2016, the principal component of which related to the Oasis brand. We challenged the key assumptions used in the assessment, especially in light of this being a second impairment charge and concluded that the external facts that had impacted management judgement were appropriately considered. We have also considered the disclosure surrounding these reviews, and concluded that the review and disclosure were appropriate.

Taxation

The Group operates in numerous tax jurisdictions around the world and at any given time the Group has years outstanding and is involved in disputes and tax audits. In estimating the probability and amount of any tax charge, management takes into account the views of internal and external advisers and updates the amount of provision whenever necessary.

Our action

We annually review our processes and approve the principles for management of tax risks. We review quarterly reports from management evaluating existing risks and tax provisions. Based on a thorough report from management of tax liabilities and our challenge of the basis of any tax provisions recorded, we concluded that the levels of provisions and disclosures were appropriate.

Business combinations

The Group has identified growth through acquisitions as one of its Strategic Priorities.

Our action

For completed acquisitions, we received a report from management setting out the significant assets and liabilities acquired, details of the provisional fair value adjustments applied, an analysis of the intangible assets acquired, the assumptions behind the valuation of these acquired intangible assets and the proposed useful economic life of each intangible asset class. For material acquisitions, management engage third party specialists to perform a detailed analysis, summaries of which are included in management reports. We reviewed, discussed, challenged and approved these summaries for Blue Belt Technologies. During 2016, we also considered and concurred with management that there had been no changes to the provisional fair values recognised in the 2015 acquisitions in Colombia and Russia.

Table of Contents

EXTERNAL AUDITOR

Independence of external auditor

The independence of our external auditor is critical for the integrity of the audit. Following a competitive tender in 2014, KPMG LLP were appointed the Company s external auditor for the 2015 audit replacing Ernst & Young LLP who had been the Company s auditor for a number of years. We are satisfied that KPMG LLP are fully independent from the Company s management and free from conflicts of interest. Our Auditor Independence Policy, which ensures that this independence is maintained, is available on the Company s website.

We believe that the implementation of this policy helps ensure that auditor objectivity and independence is safeguarded. The policy also governs our approach when we require our external auditor to carry out non-audit services, and all such services are strictly governed by this policy.

The Auditor Independence Policy also governs the policy regarding audit partner rotation with the expectation that the audit partner will rotate at least every five years. The Audit Committee confirms it has complied with the provision of the Competition and Markets Authority Order which came into effect from 1 January 2015.

Effectiveness of external auditors

We conducted a review into the effectiveness of the external audit as part of the 2016 year end process, in line with previous years. We sought the views of key members of the finance management team, considered the feedback from this process and shared it with management.

During the year, we also considered the inspection reports from the Audit Oversight Boards in the UK and US and determined that we were satisfied with the audit quality provided by KPMG.

Overall therefore, we concluded that KPMG had carried out their audit for 2016 effectively.

Appointment of external auditors at Annual General Meeting

Resolutions will be put to the Annual General Meeting to be held on 6 April 2017 proposing the re-appointment of KPMG LLP as the Company s auditor and authorising the Board to determine their remuneration, on the

recommendation of the Audit Committee.

Disclosure of Information to the Auditor

In accordance with Section 418 of the Companies Act 2006, the Directors serving at the time of approving the Directors Report confirm that, to the best of their knowledge and belief, there is no relevant audit information of which the auditor, KPMG, 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 auditor is aware of such information.

Non-Audit Fees Paid to the Auditor

Non-audit fees are subject to approval in line with the Auditor Independence Policy which is reviewed annually and forms part of the terms of reference of the Audit Committee.

The Audit Committee recognise the importance of the independence of the external auditor and ensures that the Auditor s independence should not be breached. The Audit Committee ensures that the Auditor does not receive a fee from the Company or its subsidiaries that would be deemed large enough to impact its independence or be deemed a contingent fee. The total fees for permitted non-audit services shall be no more than 70% of the average of the fees paid in the last three consecutive financial years for the statutory audits of the Company and its subsidiaries. In light of the Financial Reporting Council s revised Ethical Standards, we have revised our Auditor Independence Policy.

Any pre-approved aggregate, individual amounts up to $25,000 may be authorised by the Senior Vice-President Tax and Senior Vice-President Group Finance respectively and amounts up to $50,000 by the Chief Financial Officer. Any individual amount over $50,000 must be pre-approved by the Chairman of the Audit Committee. If unforeseen additional permitted services are required, or any which exceed the amounts approved, again pre-approval by the Chairman of the Audit Committee is required.

The following reflects the non-audit fees incurred with KPMG in 2016:

Both the below pieces of work were approved by the Chairman of the Audit Committee:

		2016 $ million
Tax compliance services	Assistance with tax compliance in a number of smaller markets; Singapore, Malaysia, Thailand, India and Finland.	0.10
Pension advice	Advice on the impact of changes to pension benefits for the UK defined benefit scheme.	0.50
Other		0.04

Tax compliance services conducted by KPMG will be discontinued in 2017 with the exception of countries where it is required by law for the auditor to conduct these services.

The ratio of non-audit fees to audit fees for the year ended 31 December 2015 was 0.25. The ratio of non-audit fees to audit fees for the year ended 31 December 2016 is 0.25.

Full details are shown in Note 3.2 of the Notes to the Group accounts.

Table of Contents

AUDIT COMMITTEE REPORT

ACCOUNTABILITY continued

Audit Fees paid to the Auditor

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

	2016 $ million	2015 $ million
Audit	4	4
Audit-related fees	4	4
Total		

INTERNAL AUDIT

Our Internal Audit function reports directly to the Audit Committee. The Internal Audit function carries out work across the Group acting as a third line of defence. The audit coverage is based on risk with the focus for 2016 being assurance over the Group s SAP implementation, finance transformation, US inventory processes and core financial controls across the Group. Non-financial reviews included Group Complaints and Compliance in addition to an increased focus on IT audit and post implementation reviews.

During the year, they completed 40 reviews across the business. The Audit Committee receives a quarterly report of the activities of the Internal Audit function and reviews the results of the Internal Audit reports, looking in detail at any reports with unsatisfactory ratings. We also receive a quarterly report detailing any un-remediated and overdue control recommendations and oversee the effective and timely remediation of any recommendations.

Of particular note in 2016 were the Internal Audit reviews conducted in China and the LATAM region. Each review was discussed at the Audit Committee with presentations from Internal Audit and Executive Regional management. Remediation of agreed actions is monitored by the Audit Committee at each Committee meeting. There has been continued focus on Emerging Markets, with reviews of Brazil, Mexico, Saudi Arabia, Turkey and Russia.

In 2017, we will continue to monitor Internal Audit s scope of work and operational methods to ensure that it continues to play a full role in providing assurance over the Group s identification and management of risk and its associated controls.

RISK MANAGEMENT PROGRAMME

Whilst the Board is responsible for ensuring oversight of strategic risks relating to the Company, determining an appropriate level of risk appetite, and monitoring risks through a range of Board and Board Committee processes, the Audit Committee is responsible for ensuring oversight of the processes by which operational risks, relating to the Company and its operations are managed and for reviewing financial risks and the operating effectiveness of the Group s risk management process.

During the year, we reviewed our risk management processes at our meetings in February, July and November. We approved the risk management programme for 2016 and monitored performance against that plan specifically reviewing the work undertaken by the risk champions across the Group, identifying the risks which could impact their areas of our business. We also reviewed and evaluated the work undertaken by the executive team in identifying the specific risks which could impact the strategic priorities and the key products in their area.

We also undertook deep dives into key risks impacting our business including the economic conditions impacting our business in China, our plans for addressing IT and Cyber Security risks, our processes for handling of product complaints, and the impact of moving many of our corporate head office roles out of London.

Since the year end, we have reviewed a report from the Internal Audit function into the effectiveness of the risk management programme throughout the year. We considered the principal risks, the actions taken by management to review those risks and the Board risk appetite in respect of each risk.

We concluded that the risk management process during 2016 and up to the date of approval of this Annual Report was effective. Work will continue in 2017 and beyond to continue to enhance the process.

See pages 42 to 46 for further information on our risk management process.

VIABILITY STATEMENT

We also reviewed management s work in conducting a robust assessment of those risks which would threaten our business model and the future performance or liquidity of the Company, including its resilience to the threats of viability posed by those risks in severe but plausible scenarios. This assessment included stress and sensitivity analyses of these risks to enable us to evaluate the impact of a severe but plausible combination of risks. We then considered whether additional financing would be required in such eventualities. Based on this analysis, we recommended to the Board that it could approve and make the Viability Statement on page 47.

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 Financial review and principal risks section on pages 39 to 46. The financial position of the Group, its cash flows, liquidity position and borrowing facilities are described under Commentary on the Group cash flow statement section set out on page 114.

In addition, the Notes to the Group accounts 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.

Table of Contents

EVALUATION OF INTERNAL CONTROLS

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 US Securities Exchange Act of 1934.

There is an established system of internal control throughout the Group and our country business units. The main elements of the internal control framework are:

The management of each country is responsible for the establishment and review of effective financial controls within their business unit.

The Group Finance manual sets out financial and accounting policies. The Group s Minimum Acceptable Practices (MAPs) have been enhanced further to cover financial and operational controls. The business is required to self-assess their level of compliance with the MAPs and remediate any gaps. MAPs compliance is validated by both external audit and Internal Audit visits.

During the year there has been an exercise to standardise and simplify our core financial controls. In 2017 there will be a focus on the use of data analytics, automation and robotic tools to strengthen controls further.

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

The Audit Committee reviews reports from Internal Audit on their findings on internal financial controls, including compliance with MAPs and from the Senior Vice President, Group Finance and the heads of the Financial Controls and Compliance, Taxation and Treasury functions.

The Audit Committee reviews regular reports from the Financial Controls and Compliance function with regard to compliance with the Sarbanes-Oxley Act including the scope and results of management s testing and progress regarding any remediation.

The Audit Committee reviews the Group whistle-blower procedures.

The Audit Committee received and reviewed a report on the progress of the Finance Transformation during 2016 and the mitigation of the associated risks.

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 limitation, our internal controls over financial reporting may not prevent or detect all misstatements. 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. Entities where the Company does not hold a controlling interest have their own processes of internal controls similar to that of the Company.

We have reviewed the system of internal financial control and satisfied ourselves that we are meeting the required standards both for the year ended 31 December 2016 and up to the date of approval of this Annual Report. No concerns were raised with us in 2016 regarding possible improprieties in matters of financial reporting.

This process complies with the Financial Reporting Council s Guidance on Risk Management, Internal Control and Related Financial and Business Reporting on the UK corporate governance code and additionally contributes to our compliance with the obligations under the Sarbanes-Oxley Act and other internal assurance activities.

There has been no change 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.

The Board is responsible overall for reviewing and approving the adequacy and effectiveness of the risk management framework and the system of internal controls over financial, operational (including quality management and ethical compliance) processes operated by the Group. The Board has delegated responsibility for this review to the Audit Committee. The Audit Committee, through the Internal Audit function, reviews the adequacy and effectiveness of internal control procedures and identifies any weaknesses and ensures these are remediated within agreed timelines. The latest review covered the financial year to 31 December 2016 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 the former Chief Financial Officer evaluated the effectiveness of the design and operation of the Group s disclosure controls and procedures as at 31 December 2016. Based upon this evaluation, the Chief Executive Officer concluded on 22 February 2017 that the disclosure controls were effective as at 31 December 2016.

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 2016 in accordance with the requirements in the US under s404 of the Sarbanes-Oxley Act. In making that 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 2016, 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.

KPMG LLP, an independent registered public accounting firm issued an audit report on the Group s internal control over financial reporting as at 31 December 2016.

CODE OF ETHICS FOR SENIOR FINANCIAL OFFICERS

We have adopted a Code of Ethics for Senior Financial Officers, which applies to the Chief Executive Officer, the Chief Financial Officer, the Senior Vice President Group Finance and the Group s senior financial officers. There have been no waivers to any of the Code s provisions nor have there been any amendments to the Code during 2016 or up until 22 February 2017. A copy of the Code of Ethics for Senior Financial Officers can be found on our website at www.smith-nephew.com

In addition, every individual in the finance function certifies to the Chief Financial Officer that they have complied with the Finance Code of Conduct.

EVALUATION OF EFFECTIVENESS OF THE AUDIT COMMITTEE

The effectiveness of the Audit Committee was evaluated as part of the review into the effectiveness of the Board conducted at the end of 2016.

This review found that the Audit Committee was becoming increasingly effective, but recognising the increased responsibilities of the Audit Committee suggested that the time needed for each meeting could be increased.

Table of Contents

REMUNERATION

DEAR SHAREHOLDER,

2016 was a year when we faced challenges including pricing pressures, currency headwinds and disappointing performance in China and the Gulf. In other areas, particularly Sports Medicine and Knee Implants, we maintained a strong momentum and generally made good progress as we continued to execute on our five strategic priorities. The performance on the measures we currently use in our variable plans was as follows:

Revenue at $4,669 million showed reported growth of 1% (2% underlying);

Trading profit at $1,020 million showed reported growth of -7%;

We also engaged with the holders of over 40% of our shares to talk to them about their views of our remuneration arrangements. We reached out to our top 20 shareholders and to all institutional investors who had contacted us before or around the time of the AGM to talk about our 2016 decisions and the subsequent shareholder vote. We are extremely grateful to the shareholders who engaged with us and shared their views. As a result of these discussions, we are proposing a Remuneration Policy which reflects your comments and views.

Conclusions from our executive and shareholder engagement programme

Our engagement programme showed overwhelming support from executives and from shareholders for our Remuneration Policy, the structure of our remuneration packages and the balance between the various elements of pay. We have therefore chosen to make no substantial

Trading cash flow was $765 million with the year trading profit to cash ratio of 75%;

Revenues from Emerging Markets were $691 million;

Share price improved from 1,208p to 1,221p during the year.

As a result of the financial performance in 2016 and over the three-year period ending 31 December 2016, Olivier Bohuon has received a cash bonus of 45.45% of salary, an Equity Incentive award of 50% of salary and the Performance Share Award vested at 8% of maximum. Whilst the Remuneration Committee recognises that Olivier Bohuon met or exceeded his business targets during the year, which would have led to a cash bonus of 50.5%, we are also mindful that the financial targets have not been met. We have therefore exercised our discretion downwards to reduce the total cash bonus by 10%. In aggregate this has resulted in a reduction of Olivier Bohuon s 2016 total remuneration of over $2 million or 39%, relative to 2015. Further details are set out on page 90.

2016 Annual General Meeting

You will all be aware that we only received the support of 47% of shareholders on the Remuneration Report vote at the 2016 Annual General Meeting. This was a great disappointment to the Remuneration Committee and the Board as a whole, as we genuinely believed that exercising our discretion was in shareholders interest and was the right thing to do, better aligning rewards with the performance of the Company and the shareholder experience for all plan participants. However, 53% of our shareholders disagreed and this led us to critically review our remuneration arrangements during 2017. We undertook an extensive exercise talking to our senior executives to understand their views on our remuneration arrangements and in particular the extent to which they successfully drive performance across the strategic aims we have identified for the future success of the Company.

changes to the Remuneration Policy you approved in 2014, although following feedback from shareholders in recent years, we have made some minor changes to the operation of the Performance Share Programme (PSP).

For PSP awards made from 2017 onwards, we will apply a two year post-vesting holding period. This will ensure that Executive Directors are aligned with the shareholder experience for five years from the date of each grant and over time will build up a sizeable shareholding in the Company.

Additionally, we have adjusted some of the performance measures used in our short and long term incentive plans and the weighting between these measures. The result of these changes is a greater emphasis on financial measures in our Annual Incentive Programme and a balance of measures more closely linked to our strategic aims. The measures we have chosen are detailed below and on the opposite page.

You will note that we have introduced a new Return on Invested Capital (ROIC) measure into our Performance Share Plan. This is a measure which resonated strongly with the shareholders we met and which we believe will help to drive the performance we are aiming for. ROIC was introduced internally as a reporting measure in 2016, given its role in successfully executing our strategic pillars. It incentivises better financial discipline, rewards enhanced operating performance and provides a link to an area that our shareholders have identified as a high priority for improvement. Its introduction as a formal performance metric was the natural next step.

ROIC will be defined as:

Net Operating Profit less Adjusted Taxes

(Opening Net Operating Assets + Closing Net Operating Assets)/2

Average ROIC over the three year performance period will be compared to the targets set at the beginning of the performance period. You will find further information on this measure on page 95.

Graham Baker Chief Financial Officer

We welcome Graham Baker, who will join the Company as Chief Financial Officer on 1 March 2017. During the year, we considered and approved his remuneration package, which we announced on 30 November 2016. These arrangements are in line with the Remuneration Policy approved by shareholders in 2014. You will find further details in the Remuneration Report. No sign-on or buy-out awards have been made in connection with his appointment.

Table of Contents

Julie Brown former Chief Financial Officer

Julie Brown left the Company on 11 January 2017, at which point all outstanding awards lapsed. Further details are set out on page 91.

Shareholding Requirements

We also reviewed and increased our shareholding requirements. The Chief Executive Officer is now required to build up a holding of shares in the Company to the value of three times his annual base salary. The requirement for the Chief Financial Officer remains at two times his annual base salary. These shareholding requirements are normally expected to be met within five years of joining the Company.

Looking forward

The Remuneration Committee will continue to be guided by the principles we have followed in the past:

Performance measures linked to our strategic priorities;

Alignment of executive and shareholder interests; and

Simplicity.

We passionately believe that engagement is important both for the Company and for our shareholders. Engagement is more than just voting. I would therefore like to reinforce my gratitude to those of our shareholders who took the time to provide their thoughts on our Remuneration Policy and the changes we proposed during the course of 2016. Your Remuneration Committee believes that the incremental changes proposed ensure continued alignment to our evolving strategic pillars and will incentivise and reward our Executive Directors, and broader senior executive team, for delivering strong performance for our shareholders in the years ahead.

Joseph Papa

Chairman of the Remuneration Committee

Compliance statement

We have prepared this Directors Remuneration Report (the Report) in accordance with The Enterprise and Regulatory Reform Act 2012-2013 (clauses 81-84) and The Large and Medium-Sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013 (the Regulations). The Report also meets the relevant requirements of the Financial Conduct Authority (FCA) Listing Rules.

The first part of the Report (pages 78 to 87) is the Directors Remuneration Policy Report (the Policy Report) which will be presented to shareholders for approval at the Annual General Meeting to be held on 6 April 2017. The Policy Report describes our Remuneration Policy as it relates to the Directors of the Company. All payments we make to any Director of the Company will be in accordance with this Remuneration Policy. We intend that this Remuneration Policy will remain in place unchanged for the next three years and will next be put to shareholder vote at the Annual General Meeting to be held in 2020.

The second part of the Report (pages 88 to 100) is the annual report on remuneration (the Implementation Report). The Implementation Report will be put to shareholders for approval as an advisory vote at the Annual General Meeting on 6 April 2017. The Implementation Report explains how the Remuneration Policy was implemented during 2016 and also how it is currently being implemented in 2017. The financial tables on pages 90 to 96, the Directors interest table on page 97 and the tables on pages 98 to 99 have been audited by KPMG LLP.

MEASURES IN OUR VARIABLE PAY PLANS

FINANCIAL MEASURES IN ANNUAL INCENTIVE PLAN

Revenue (35%)	Revenue is a key driver of profit growth.

Trading Profit Margin (25%)	Replaces absolute trading profit. Trading profit margin is a critical measure both for the business and our shareholders and delivering margin improvements is a core commitment under our strategy.

new

Trading Cash Flow (15%)	Cash flow from our Established Markets is necessary in order to fund growth in Emerging Markets, innovation, organic growth and acquisitions.

BUSINESS OBJECTIVES IN ANNUAL INCENTIVE PLAN	
Business Process (8.3%)	We need to release resources from the businesses through improved structures, efficiencies and business processes in order to re-invest in our higher growth areas, including Emerging Markets, Innovation, organic growth and acquisitions.
People (8.3%)	We need to attract and retain the right people to achieve our strategy through improving our operating model and drive the right behaviours for all of our people globally.
Customer (8.3%)	Our mission is to deliver advanced medical technologies that help healthcare professionals, our customers, improve the quality of life of their patients.

PERFORMANCE MEASURES IN OUR PERFORMANCE SHARE PLAN	
Relative TSR (25%)	If we execute our strategy successfully, this will lead to an increased return for our shareholders, whether you invest in the healthcare sector or in the FTSE.

modified

Cumulative Cash Flow (25%)	Cash flow from our Established Markets is necessary in order to fund growth in Emerging Markets, innovation, organic growth and acquisitions.
Sales Growth (25%)	Sales growth is a key driver of profit growth.

modified

Return on Invested Capital (25%)	Return on investment is a high priority for our shareholders which will drive better financial discipline and enhanced operating performance.

new

Detailed further on pages 78 to 82

Table of Contents

REMUNERATION continued

THE POLICY REPORT

FUTURE POLICY TABLE EXECUTIVE DIRECTORS

The following table and accompanying notes explain the different elements of remuneration we pay to our Executive Directors:

BASE SALARY AND BENEFITS

BASE SALARY

We are a FTSE 50 listed company, operating in over 100 countries around the world. Our strategy to generate cash from Established Markets in order to invest for growth in higher growth geographies and franchises means that we are competing for international talent and our base salaries therefore need to reflect what our Executive Directors would receive if they were to work in another international company of a similar size, complexity and geographical scope.

How the component operates	Maximum levels of payment	Framework in which performance is assessed
Salaries are normally reviewed annually, with any increase applying from 1 April. Salary levels and increases take account of: • Market movements within a peer group of similarly sized UK listed companies • Scope and responsibility of the position • Skill/experience and performance of the individual Director • General economic conditions in the relevant geographic market, and • Average increases awarded across the Company, with particular regard to increases in	The base salary of the Executive Directors with effect from 1 April 2017 will be as follows: Olivier Bohuon 1,179,490. Graham Baker £510,000. The factors noted in the previous column will be taken into consideration when making increases to base salary and when appointing a new Director. In normal circumstances, base salary increases for Executive Directors will relate to the geographic market and peer group. In addition, the average increases for employees across the Group will be taken into account. The Remuneration Committee retains the right to approve higher increases when there is a substantial change in the scope of the Executive Director s role. A full explanation will be provided in the Implementation Report	Performance in the prior year is one of the factors taken into account and poor performance is likely to lead to a zero salary increase.

the market in which the Executive is based.	should higher increases be approved in exceptional cases.

PAYMENT IN LIEU OF PENSION

In order to attract and retain Executive Directors with the capability of driving our corporate strategy, we need to provide market-competitive retirement benefits similar to the benefits they would receive if they were to work for one of our competitors.

At the same time, we seek to avoid exposing the Company to defined benefit pension risks, and where possible will make payments in lieu of providing a pension.

How the component operates	Maximum levels of payment	Framework in which performance is assessed
Current Executive Directors receive an allowance in lieu of membership of a Company-run pension scheme. Base salary is the only component of remuneration which is pensionable.	Up to 30% of base salary.	The level of payment in lieu of a pension paid to Executive Directors is not dependent on performance.

Table of Contents

BENEFITS

In order to attract and retain Executive Directors with the capability of driving our corporate strategy, we need to provide a range of market-competitive benefits similar to the benefits they would receive if they were to work for one of our competitors.

It is important that our Executive Directors are free to focus on the Company s business without being diverted by concerns about medical provision, risk benefit cover or, if required, relocation issues.

How the component operates	Maximum levels of payment	Framework in which performance is assessed
A wide range of benefits may be provided depending on the benefits provided for comparable roles in the location in which the Executive Director is based. These	The policy is framed by the nature of the benefits that the Remuneration Committee is willing to provide to Executive Directors. The maximum amount payable will depend on	The level and cost of benefits provided to Executive Directors is not dependent on performance but on the package of benefits provided to comparable roles within the relevant location.

benefits will include, as a minimum, healthcare cover, life assurance, long-term disability, annual medical examinations, company car or car allowance. The Committee retains the discretion to provide additional benefits where necessary or relevant in the context of the Executive s location.	the cost of providing such benefits to an employee in the location at which the Executive Director is based. Shareholders should note that the cost of providing comparable benefits in different jurisdictions may vary widely.
Where applicable, relocation costs may be provided in line with Company s relocation policy for employees, which may include removal costs, assistance with accommodation, living expenses for self and family and financial consultancy advice. In some cases such payments may be grossed up.	As an indication, the cost of such benefits provided in 2016 was as follows: Olivier Bohuon 150,511. Julie Brown £22,244.
	The maximum amount payable in benefits to an Executive Director, in normal circumstances, will not be significantly more than amounts paid in 2016 (or equivalent in local currency). The Remuneration Committee retains the right to pay more than this should the cost of providing the same underlying benefits increase or in the event of a relocation. A full explanation will be provided in the Implementation Report should the cost of benefits provided be significantly higher.

Table of Contents

REMUNERATION continued

THE POLICY REPORT

ALL-EMPLOYEE ARRANGEMENTS

ALL-EMPLOYEE SHARE PLANS

To enable Executive Directors to participate in all-employee share plans on the same basis as other employees.

How the component operates	Maximum levels of payment	Framework in which performance is assessed

Sharesave Plans are operated in the UK and 31 other countries internationally. In the US, an Employee Stock Purchase Plan is operated. These plans enable employees to save on a regular basis and then buy shares in the Company. Executive Directors are able to participate in such plans on a similar basis to other employees, depending on where they are located.	Executive Directors may currently invest up to £500 per month in the UK ShareSave Plan. The Remuneration Committee may exercise its discretion to increase this amount up to the maximum permitted by the HM Revenue & Customs. Similar limits will apply in different locations.	The potential gains from all-employee plans are not based on performance but are linked to growth in the share price.

ANNUAL INCENTIVES

ANNUAL INCENTIVE PLAN	CASH INCENTIVE
To motivate and reward the achievement of specific annual financial and business objectives related to the Company s strategy and sustained through a clawback mechanism explained more fully in the notes.	
The objectives which determine the payment of the annual cash incentive and the level of the annual equity award are linked closely to the Group strategy.	
The financial measures of Revenue, Trading Profit Margin and Trading Cash Flow underline our strategy for growth.	
The business objectives are also linked to the Group strategy. These change from year to year to reflect the evolving strategy, but will typically be linked to the Strategic Priorities set out in this Annual Report. The Implementation Report each year will explain how each objective is linked to a specific strategic priority.	

How the component operates	Maximum levels of payment	Framework in which performance is assessed
The Annual Incentive Plan comprises a cash and an equity component, both based on the achievement of financial and business objectives set at the start of the year.	The total maximum payable under the Annual Incentive Plan is 215% of base salary (150% Cash Incentive and 65% Equity Incentive).	The cash and share awards are subject to malus and clawback as detailed in the notes following this table.
The cash component is paid in full after the end of the performance year.	In respect of the Cash Incentive:	75% of the cash component is based on financial performance measures, which currently include Revenue (35%), Trading Profit Margin (25%) and Trading Cash Flow (15%).
At the end of the year, the Remuneration Committee determines the extent to which performance against these has been achieved and sets the award level.	150% salary awarded for maximum performance.	25% of the cash component is based on other business goals linked to the Company s strategy, which could include financial and non-financial measures.
	100% salary awarded for target performance.	The Remuneration Committee retains the discretion to adjust the relative weightings of the financial and business components, and to adopt any performance measure that is relevant to the Company.
	50% salary awarded for threshold performance.	
	Performance assessed against individual objectives and Group financial targets.	

Table of Contents

ANNUAL INCENTIVE PLAN EQUITY INCENTIVE

To drive share ownership and encourage sustained high standards through the application of a malus provision over three years, explained more fully in the notes.

How the component operates	Maximum levels of payment	Framework in which performance is assessed
The equity award component comprises conditional share awards (made at the time of the cash award), with vesting phased over the following three years.	In respect of the Equity Incentive: Performance is assessed against individual performance, which includes an element of Group financial targets.	The Remuneration Committee will use its judgement of the individual s performance based both on what has been achieved during the year and how it has been achieved in determining the level of equity award that may be awarded within the range of 0% to 65% of salary.
The equity component vests 1/3, 1/3, 1/3 on successive award anniversaries, only if		The equity component will vest in three equal tranches over a three-year period,

performance remains satisfactory over each of these three years; otherwise the award will lapse.	65% of salary awarded for maximum performance.	provided that satisfactory performance is sustained.
	50% of salary awarded for target performance.	
Participants will receive an additional number of shares equivalent to the amount of dividend payable per vested share during the relevant performance period.	0% of salary awarded for performance assessed to be below target.	

Table of Contents

REMUNERATION continued

THE POLICY REPORT

LONG-TERM INCENTIVES (AWARDS ACTIVELY BEING MADE)

PERFORMANCE SHARE PROGRAMME
To motivate and reward longer-term performance linked to the long-term strategy and share price of the Company. The performance measures which determine the level of vesting of the Performance Share Awards are linked to our corporate strategy.

How the component operates	Maximum levels of payment	Framework in which performance is assessed
The Performance Share Programme comprises conditional share awards which vest after three years, subject to the achievement of stretching performance targets linked to the Company s strategy.	Annual awards:	Currently:
	190% of salary for maximum performance.	25% of the award vests on achievement of a three-year cumulative free cash flow target.
	95% of salary for target performance.	
Awards may be subject to clawback in the event of material financial misstatement or misconduct.		25% of the award vests subject to three-year Total Shareholder Return (TSR) at median performance relative to Global Healthcare companies and to FTSE 100 companies.
	47.5% of salary for threshold performance.	
Participants will receive an additional number of shares equivalent to the amount of dividend payable per vested share during the relevant performance period.		25% of the award vests subject to the achievement of return on invested capital targets.
		25% of the award vests subject to total sales growth.
On vesting, a number of shares are sold to cover the tax liability. The remaining shares are required to be held by the Executive Director for a further two-year holding period.		These measures, the targets and performance against them are described more fully in the Implementation Report.
		The Performance Share Award will vest on the third anniversary of the date of grant, depending on the extent to which the performance conditions are met over the three-year period commencing in the year the award was made.

The Remuneration Committee retains the discretion to change the measures and their respective weightings to ensure continuing alignment with the Company s strategy.

The cash and share awards are subject to malus and clawback as detailed in the notes following this table.

Awards made prior to 2017 were subject to TSR against a sector peer group, cash flow and revenue in Emerging Markets targets.

Table of Contents

ILLUSTRATIONS OF THE APPLICATION OF THE REMUNERATION POLICY 2017

The following charts show the potential split between the different elements of the Executive Directors remuneration under three different performance scenarios.

Chief Executive Officer

Chief Financial Officer

Total Remuneration by Performance Scenario for 2017 Financial Year

Percentage split

Chief Executive Officer **Chief Financial Officer**

Data for the Chief Executive Officer assumes an exchange rate of 1 = £0.820.

MALUS AND CLAWBACK

The Remuneration Committee may determine that an unvested award or part of an award may not vest (regardless of whether or not the performance conditions have been met) or may determine that any cash bonus, vested shares, or their equivalent value in cash be returned to the Company in the event that any of the following matters is discovered:

- A material misstatement of the Company s financial results; or
- A material error in determining the extent to which any performance condition has been satisfied; or
- A significant adverse change in the financial performance of the Company, or a significant loss at a general level or at the country business unit or function in which a participant worked; or
- Inappropriate conduct (for example reputational issues), capability or performance by a participant, or within a team business area or profit centre.

These provisions apply to share awards under the Global Share Plan 2010 and cash amounts under the Annual Cash Incentive Plan.

POLICY ON RECRUITMENT ARRANGEMENTS

Our policy on the recruitment of Executive Directors is to pay a fair remuneration package for the role being undertaken and the experience of the Executive Director appointed. In terms of base salary, we will seek to pay a salary comparable, in the opinion of the Committee, to that which would be paid for an equivalent position elsewhere. The Remuneration Committee will determine a base salary in line with the policy and having regard to the parameters set out on in the future policy table. Incoming Executive Directors will be entitled to pension, benefit and incentive arrangements which are the same as provided to existing Executive Directors. On that basis, incentive awards would not exceed 405% of base salary.

We recognise that in the event that we require a new Executive Director to relocate to take up a position with the Company, we will also pay relocation and related costs as described in the future policy table, which is in line with the relocation arrangements we operate across the Group.

We also recognise that in many cases, an external appointee may forfeit sizeable cash bonuses and share awards if they choose to leave their former employer and join us. The Remuneration Committee therefore believes that we need the ability to compensate new hires for incentive awards they give up on joining us. The Committee will use its judgement in determining any such compensation, which will be decided on a case-by-case basis. We will only provide compensation which is no more beneficial than that given up by the new appointee and we will seek evidence from the previous employer to confirm the full details of bonus or share awards being forfeited. As far as possible, we will seek to replicate forfeited share awards using Smith & Nephew incentive plans or through reliance on Rule 9.4.2 in the Listing Rules, whilst at the same time aiming for simplicity.

If we appoint an existing employee as an Executive Director of the Company, pre-existing obligations with respect to remuneration, such as pension, benefits and legacy share awards, will be honoured. Should these differ materially from current arrangements, these will be disclosed in the next Implementation Report.

We will supply details via an announcement to the London Stock Exchange of an incoming Executive Director s remuneration arrangements at the time of their appointment.

Table of Contents

REMUNERATION continued

THE POLICY REPORT

SERVICE CONTRACTS

We employ Executive Directors on rolling service contracts with notice periods of up to 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 pay them an amount equivalent to the base salary and payment in lieu of pension and benefits they would have received if they had been required to work their notice period.

Under the terms of the Executive Director s service contract, Executive Directors are restricted for a period of 12 months after leaving the employment of the Company from working for a competitor, soliciting orders from customers and offering employment to employees of Smith & Nephew. The Company retains the right to waive these provisions in certain circumstances. In the event that these provisions are waived or the former Executive Director commences employment earlier than at the end of the notice period, no further payments shall be made in respect of the portion of notice period not worked. Directors service contracts are available for inspection at the Company s registered office: 15 Adam Street, London WC2N 6LA.

POLICY ON PAYMENT FOR LOSS OF OFFICE

Our policy regarding termination payments to departing Executive Directors is to limit severance payments to pre-established contractual arrangements. In the event that the employment of an Executive Director is terminated, any compensation payable will be determined in accordance with the terms of the service contract between the

Company and the Executive Director, as well as the rules of any incentive plans.

Under normal circumstances (excluding termination for gross misconduct) all leavers are entitled to receive termination payments in lieu of notice equal to base salary, payment in lieu of pension, and benefits. In some circumstances additional benefits may become payable to cover reimbursement of untaken holiday leave, repatriation and outplacement fees, legal and financial advice.

In addition, we may also in exceptional circumstances exercise our discretion to pay the Executive Director a proportion of the annual cash incentive they would have received had they been required to work their notice period. Any entitlement or discretionary payment may be reduced in line with the Executive Director s duty to mitigate losses, subject to applying our non-compete clause.

We will supply details via an announcement to the London Stock Exchange of a departing Executive Director s termination arrangements at the time of departure.

In the case of a change of control which results in the termination of an Executive Director or a material alteration to their responsibilities or duties, within 12 months of the event, the Executive Director would be entitled to receive 12 months base salary plus payment in lieu of pension and benefits. In addition, the Remuneration Committee has discretion to pay an Executive Director in these circumstances an annual cash incentive. For Directors appointed prior to 1 November 2012, an automatic annual cash incentive is payable at target.

In the event that an Executive Director leaves for reasons of ill-health, death, redundancy or retirement in agreement with the Company, then the vesting of any outstanding annual cash incentive and equity incentive awards will generally depend on the Remuneration Committee s assessment of performance to date. Performance share awards will be pro-rated for the time worked during the relevant performance period, and will remain subject to performance over the full performance period.

For all other leavers, the annual cash incentive will generally be forfeited and outstanding equity incentive awards and performance share awards will lapse.

One-off awards granted on appointment will normally lapse on leaving except in cases of death, retirement, redundancy, or ill-health. The Remuneration Committee has discretion to permit such awards to vest in other circumstances and will be subject to satisfactorily meeting performance conditions if applicable.

The Remuneration Committee retains discretion to alter these provisions on a case-by-case basis following a review of circumstances and to ensure fairness for both shareholders and Executive Directors.

We will supply details via an announcement to the London Stock Exchange of an out-going Executive Director s remuneration arrangements around the time of leaving.

CHANGES TO POLICY

The 2017 Remuneration Policy makes the following changes to the 2014 Remuneration policy:

Introduction of a two year holding period for vested Performance shares;

Flexibility to change measures;

Increased emphasis on financial objectives in the Annual Incentive Plan, increases from 70% to 75%;

Increased shareholding requirement to 300% of salary for the Chief Executive Officer.

Further details can be found in the letter from the Chairman of the Remuneration Committee on pages 76 to 77.

Table of Contents

POLICY ON SHAREHOLDING REQUIREMENTS

The Remuneration Committee believes that one of the best ways our Executive Directors can have a greater alignment with shareholders is for them to hold a significant number of shares in the Company. The Chief Executive Officer is therefore expected to build up a holding of Smith & Nephew shares worth three times their base salary and the Chief Financial Officer is expected to build up a holding of two times their basic salary. In order to reinforce this expectation, we require them to retain 50% of the shares (after tax) vesting under the equity incentive programmes until this holding has been met, recognising that differing international tax regimes affect the pace at which an Executive Director may fulfil the shareholding requirement. When calculating whether or not this requirement has been met, we will include ordinary shares or ADRs held by the Executive Director and their immediate family. Ordinarily, we would expect this required shareholding to have been built up within a period of five years from the date of appointment.

Furthermore, from awards made in 2017, we require our Executive Directors to retain all the shares (after tax) vesting under the Performance Share Programme for a period of two years after vesting.

STATEMENT OF CONSIDERATION OF EMPLOYMENT CONDITIONS ELSEWHERE IN THE COMPANY AND DIFFERENCES TO THE EXECUTIVE DIRECTOR POLICY

All employees across the Group have performance-based pay linked to objectives derived from the strategic priorities, which underpin the performance metrics in the Executive Director Incentive Plans.

Executive Director base salaries will generally increase at a rate in line with the average salary increases awarded across the Company. Given the diverse geographic markets within which the Company operates, the Committee will generally be informed by the average salary increase in both the market local to the Executive and the UK, recognising the Company s place of listing, and will also consider market data periodically.

A range of different pension arrangements operate across the Group depending on location and/or length of service. Executive Directors and Executive Officers either participate in the legacy pension arrangements relevant to their local market or receive a cash payment of 30% of salary in lieu of a pension. Senior executives who do not participate in a local Company pension plan receive a cash payment of 20% of salary in lieu of pension. Differing amounts apply for lower levels within the Company.

The Company has established a benefits framework under which the nature of benefits varies by geography. Executive Directors participate in benefit arrangements similar to those applied for employees within the applicable location.

All employees are set objectives at the beginning of each year, which link through to the objectives set for the Executive Directors. Annual cash incentives payable to employees across the Company depend on the satisfactory completion of these objectives as well as performance against relevant Group and country business unit financial targets relating to revenue, trading profit and trading cash, similar to the financial targets set for the Executive Directors.

Executive Officers and senior executives (61 as at 2017) participate in the annual Equity Incentive Programme and the Performance Share Programme. The maximum amounts payable are lower, but the performance conditions are the same as those that apply to the Executive Directors.

No specific consultation with employees has been undertaken relating to Director remuneration. However, regular employee surveys are conducted across the Group, which cover a wide range of issues relating to local employment conditions and an understanding of Group-wide strategic matters. As at 2017, around 5,000 employees in 63 countries participate in one or more of our global share plans.

Table of Contents

REMUNERATION continued

THE POLICY REPORT

FUTURE POLICY TABLE CHAIRMAN AND NON-EXECUTIVE DIRECTORS

The following table and accompanying notes explain the different elements of remuneration we pay to our Chairman and Non-Executive Directors. No element of their remuneration is subject to performance. All payments made to the Chairman are determined by the Remuneration Committee, whilst payments made to the Non-Executive Directors are determined by the Directors who are not themselves Non-Executive Directors, currently the Chairman, the Chief Executive Officer and the Chief Financial Officer.

ANNUAL FEES

BASIC ANNUAL FEE

To attract and retain Directors by setting fees at rates comparable to what would be paid in an equivalent position elsewhere.

A proportion of the fees are paid in shares in the third quarter of each year in order to align Non-Executive Directors fees with the interests of shareholders.

How the component operates	**Maximum levels of payment**
Fees will be reviewed periodically. In future, any increase will be paid in shares until 25% of the total fee is paid in shares. Fees are set in line with market practice for fees paid by similarly sized UK listed companies. Annual fees are set and paid in UK Sterling or US Dollars depending on the location of the Non-Executive Director. If appropriate, fees may be set and paid in alternative currencies.	Annual fees are currently as follows: £63,000 in cash plus £5,135 in shares; or $120,000 in cash plus $9,780 in shares. Chairman fee: £309,000 plus £103,000 in shares. Whilst it is not expected to increase the fees paid to the Non-Executive Directors and the Chairman by more than the increases paid to employees generally, in exceptional circumstances higher fees might become payable. The total maximum aggregate fees payable to the Non-Executive Directors will not exceed £1.5 million as set out in the Company s Articles of Association.

FEE FOR SENIOR INDEPENDENT DIRECTOR AND COMMITTEE CHAIRMEN

To compensate Non-Executive Directors for the additional time spent as Committee Chairmen or as the Senior Independent Director.

How the component operates	**Maximum levels of payment**
A fixed fee is paid, which is reviewed periodically.	£20,000 in cash; or $35,000 in cash. Whilst it is not expected that the fees paid to the Senior Independent Director or Committee Chairmen will exceed the increases paid to employees generally, in exceptional circumstances, higher fees might become payable.

INTERCONTINENTAL TRAVEL FEE

To compensate Non-Executive Directors for the time spent travelling to attend meetings in another continent.

How the component operates	**Maximum levels of payment**
A fixed fee is paid, which is reviewed periodically.	£3,500 in cash; or

$7,000 in cash.

Whilst it is not expected to increase these fees by more than the increases paid to employees generally, in exceptional circumstances, higher fees might become payable.

Table of Contents

NOTES TO FUTURE POLICY TABLE NON-EXECUTIVE DIRECTORS

Changes to Remuneration Policy

There have been no changes to our Remuneration Policy as it applies to Non-Executive Directors, since the Policy was initially approved by shareholders in April 2014.

Additional duties undertaken by Non-Executive Directors

In the event that the Chairman or a Non-Executive Director is required to undertake significant additional executive duties in order to support the Executive Directors during a period of absence due to illness or a gap prior to the appointment of a permanent Executive Director, the Remuneration Committee is authorised to determine an appropriate level of fees which shall be payable. These fees will not exceed the amounts which would normally be paid to a permanent Executive Director undertaking such duties and shall not include participation in short- or long-term incentive arrangements or benefit plans.

Policy on recruitment arrangements

Any new Non-Executive Director shall be paid in accordance with the current fee levels on appointment, in line with the Policy set out above. With respect to the appointment of a new Chairman, fee levels will take into account market rates, the individual s profile and experience, the time required to undertake the role and general business conditions. In addition, the Remuneration Committee retains the right to authorise the payment of relocation assistance or an accommodation allowance in the event of the appointment of a Chairman not based within the UK.

Letters of appointment

The Chairman and Non-Executive Directors have letters of appointment which set out the terms under which they provide their services to the Company and are available for inspection at the Company s registered office: 15 Adam Street, London WC2N 6LA. The appointment of Non-Executive Directors is not subject to a notice period, nor is there any compensation payable on loss of office, for example, should they not be re-elected at an Annual General Meeting. The appointment of the Chairman is subject to a notice period of six months.

The Chairman and Non-Executive Directors are required to acquire a shareholding in the Company equivalent in value to one times their basic fee within two years of their appointment to the Board.

STATEMENT OF CONSIDERATION OF SHAREHOLDER VIEWS

The broad outline of our remuneration arrangements have remained largely unchanged since 2012. As our strategy has evolved, we have altered some of the measures we use in our short- and long-term incentive plans, but the overall structure of our remuneration arrangements has remained the same. Shareholders formally approved the Remuneration Policy in respect of our Executive Directors at the Annual General Meeting in 2014. Joseph Papa, Chairman of the Remuneration Committee, has met with shareholders before the policy was approved and every year since, in order to ascertain shareholder views on our remuneration arrangements.

Ahead of the Annual General Meeting in 2016, Mr Papa held meetings and calls with 28 shareholders holding approximately 33% of the Company s Share Capital. Although the holders of 47% of our shares voted against the Remuneration Report in 2016, our engagement ahead of the 2016 Annual General Meeting had shown us that shareholders were broadly supportive of our Remuneration Policy and those who opposed the Remuneration Report were primarily voting against the use of discretion rather than any aspect of the Remuneration Policy.

During 2016, following the Annual General Meeting, Mr Papa continued to engage extensively with shareholders. In Autumn 2016, he met with or held telephone calls with 28 shareholders holding around 41% of the Company s shares. The shareholders he met ranged from some of our top 20 shareholders down to smaller active and engaged shareholders holding fewer than one million shares. He discussed our proposals to continue with the same overall remuneration arrangements, whilst altering the performance measures used in the short- and long-term incentive plans. We found the discussions with shareholders at this time useful in helping to understand the measures and targets which were important to our shareholders, and those which shareholders did not support. As a result of these discussions, some updated performance measures have been incorporated into our incentive plans for 2017 and a two-year holding period will now apply on the vesting of performance shares for our Executive Directors.

Table of Contents

IMPLEMENTATION REPORT

REMUNERATION continued

Remuneration Committee

CURRENT MEMBERS IN 2016

	Member since	Meetings Attended
Joseph Papa (Chairman)	April 2011	6/6

Vinita Bali	April 2015	5/6
Virginia Bottomley	April 2014	6/6
Robin Freestone	September 2015	6/6
Brian Larcombe[1]	September 2010	5/6
Roberto Quarta	April 2014	6/6

1 Brian Larcombe will be retiring from the Board at the Annual General Meeting to be held on 6 April 2017.

2017 FOCUS

To monitor the effectiveness of the new performance measures, particularly ROIC, in driving performance.

To complete search for Remuneration Committee Chairman elect.

To continue to evaluate the competitiveness of pay.

To monitor external developments relating to remuneration, particularly the green paper on Corporate Governance.

The Remuneration Committee presents the annual report on remuneration (the Implementation Report), which, together with the annual statement from the Chairman of the Remuneration Committee, will be put to shareholders for an advisory vote at the Annual General Meeting to be held on 6 April 2017.

ROLE OF THE REMUNERATION COMMITTEE

Our work falls into the following three areas:

Determination of Remuneration Policy and Packages

Determination of Remuneration Policy for Executive Directors and senior executives.

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

Consideration of remuneration policies and practices across the Group.

Approval of appropriate performance measures for short-term and long-term incentive plans for Executive Directors and senior executives.

Determination of pay-outs under short-term and long-term incentive plans for Executive Directors and senior executives.

Oversight of all Company Share Plans

Determination of the use of long-term incentive plans and overseeing the use of shares in executive and all-employee plans.

Reporting and Engagement with shareholders on Remuneration Matters

Approval of the Directors Remuneration Report ensuring compliance with related governance provisions.

Continuation of constructive engagement on remuneration matters with shareholders.

The terms of reference of the Remuneration Committee describe our role and responsibilities more fully and can be found on our website: www.smith-nephew.com

ACTIVITIES OF THE REMUNERATION COMMITTEE IN 2016 AND SINCE THE YEAR END

In 2016, we held six meetings and determined three matters by written resolution. Each meeting was attended by all members of the Committee (except Vinita Bali and Brian Larcombe who each missed one meeting this year). The Chief Executive Officer, the Chief Human Resources Officer and the Senior Vice President, Global Reward, key members of the finance function and the Company Secretary also attended all or part of some of the meetings, except when their own remuneration was being discussed. We also met with the independent Remuneration Consultants, Willis Towers Watson, without management present. Our programme of work in 2016 was as follows:

Table of Contents

EARLY FEBRUARY

Approval of salaries, awards and payouts in 2016

Noted the financial results for 2015 against the targets under the short-term and long-term incentive plans.

Agreed the targets for the short-term and long-term incentive plans for 2016.

The Audit Committee joined the Remuneration Committee for both the above agenda items to answer any questions regarding audited numbers and provide assurance.

Approved the quantum of cash payments to Executive Directors and Executive Officers under the Annual Incentive Plan and awards under the Equity Incentive Programme and the Performance Share Programme.

Approved the vesting of share awards granted in 2013 and reviewed the performance of long-term awards granted in 2013 and 2014. Exercised our discretion to authorise the vesting at threshold of the element of the performance share awards subject to TSR performance.

Reviewed benchmark data increases to salaries across the Group and approved salary increases for Executive Directors and Executive Officers with effect from 1 April 2016.

Approved the text of the Remuneration Report.

LATE FEBRUARY

Final approval of the Remuneration Report (via voice conference)

Approved the final targets for the short-term and long-term incentive plans for 2016.

Approved the final text of the Remuneration Report.

JULY

Mid-year Review of Remuneration Arrangements

Reviewed the shareholder response to the Remuneration Report at the Annual General Meeting and noted shareholders comments that would be addressed in this report.

Reviewed the performance of long-term awards granted in 2014, 2015 and 2016.

Discussed and planned programme of engagement with institutional investors on remuneration.

Considered the Executive Director remuneration packages in comparison to our peers.

Reviewed adherence to shareholding guidelines by Executive Directors, Executive Officers and senior executives.

Monitored dilution limits and the number of shares available for use in respect of executive and all-employee share plans.

Discussed preliminary review of senior executive remuneration framework and measures.

EARLY NOVEMBER

Received a report from the Chairman of the Remuneration Committee on recent engagement with shareholders.

Discussed comments from members of the Audit Committee in determining the definition and ranges for proposed metrics for short and long-term incentive plans.

Approved the Remuneration Policy to be put to shareholders at the Annual General Meeting to be held in April 2017, including the revised metrics for the short and long-term incentive plans and the introduction of a post-vesting two year holding period for the Performance Share Awards.

Reviewed first draft of the Remuneration Report for 2017.

LATE NOVEMBER

Review of Remuneration Strategy

Reviewed and considered the principles for determining payouts under the long-term plans due to vest in 2017.

Approved the final Remuneration Strategy for 2017.

Reviewed market data for the Executive Directors and Executive Officers prepared in accordance with the agreed methodology.

An additional meeting was held in April to consider shareholder views immediately ahead of the Annual General Meeting and additional matters were approved by written resolution.

Since the year end, we have also reviewed the financial results for 2016 against the targets under the short-term and long-term incentive arrangements jointly with the Audit Committee, and have agreed the targets for the short-term and long-term incentive plans for 2017. We have also approved increases to the salaries of Executive Directors and Executive Officers and determined cash payments under the Annual Incentive Plan, awards under the Equity Incentive Programme and the Performance Share Programme, and the vesting of awards under the Performance Share Programme granted in 2014. Finally, we approved the wording of this Directors Remuneration Report.

During the year, the Remuneration Committee received information and advice from Willis Towers Watson, an independent executive remuneration consultancy firm appointed by the Remuneration Committee in 2011 following a full tender process. They provided advice on market trends and remuneration issues in general, attended Remuneration Committee meetings, assisted in the review of the Directors Remuneration Report, provided market benchmark data on compensation design and levels, undertook calculations relating to the PSP performance conditions and supported a review of the Remuneration Policy. The fees paid to Willis Towers Watson for Remuneration Committee advice during 2016, charged on a time and expense basis was £214,939 in total. Willis Towers Watson also provided other human resources and compensation advice to the Company for the level below the Board. Willis Towers Watson comply with the Code of Conduct in relation to Executive Remuneration Consulting in the United Kingdom and the Remuneration Committee is satisfied that their advice is objective and independent.

Table of Contents

IMPLEMENTATION REPORT

REMUNERATION continued

SINGLE TOTAL FIGURE ON REMUNERATION

The amounts for 2016 have been converted into US$ for ease of comparability using the exchange rates of £ to US$1.349 and to US$1.106 (2015: £ to US$1.5281 and to US$1.1089).

			Fixed pay	Annual variable pay	Hybrid	Long-term variable pay	
Director	Base salary	Payment in lieu of pension	Taxable benefits	Annual Incentive Plan cash	Annual Incentive Plan equity	Performance Share Plan	Total
Olivier Bohuon Appointed 1 April 2011							
2016	$1,295,017	$388,505	$166,465	$592,902	$652,258	$227,174	$3,322,321

2015	$1,260,594	$378,178	$228,698	$1,419,192	$825,396	$1,230,319	$5,342,377

Julie Brown Appointed 4 February 2013

(resigned with effect from 11 January 2017)

2016	$730,257	$219,078	$30,007				$979,342
2015	$803,116	$240,936	$29,862	$843,482	$444,954	$678,497	$3,040,847

Base salary: the actual salary receivable for the year.

Payment in lieu of pension: the value of the salary supplement paid by the Company in lieu of a pension.

Benefits: the gross value of all taxable benefits (or benefits that would be taxable in the UK) received in the year.

Annual Incentive Plan cash: the value of the cash incentive payable for performance in respect of the relevant financial year.

Annual Incentive Plan equity: the value of the equity element awarded in respect of performance in the relevant financial year, but subject to an ongoing performance test as described on pages 91 to 92 of this report.

Performance Share Plan: the value of shares vesting that were subject to performance over the three-year period ending on 31 December in the relevant financial year, based on an estimated share price of 1,167.51p per share, which was the average price of a share over the last quarter of 2016. The value of the 2013 share awards that vested in 2016 have now been restated with the share price on the date of actual vesting being 1,130p per share on 9 March 2016. The value of the 2014 Share Awards that will vest in March 2017 are calculated in the table by using the Q4 average share price of 1,167.51p per share.

Total: the sum of the above elements.

All data is presented in our reporting currency of US$. Amounts for Olivier Bohuon and Julie Brown have been converted from EURO and GBP respectively using average exchange rates. Given currency volatility in 2016, this may give the impression of changes that are misleading. Data is presented in local currency in the subsequent sections in the interests of full transparency.

Table of Contents

Resignation of Julie Brown as Chief Financial Officer

Julie Brown resigned as Chief Financial Officer with effect from 11 January 2017 in order to take up a position at another company. She will therefore receive no cash or equity awards under the Annual Incentive Plan in respect of her service during 2016. Her awards under the Equity Incentive Programme and the Performance Share Programme all lapsed with effect from 11 January 2017.

Graham Baker will be appointed Chief Financial Officer on 1 March 2017 and will receive a base salary of £510,000. He will be entitled to participate in the incentive plans as detailed below.

BASE SALARY

With effect from 1 April 2016, Executive Directors were paid the following base salaries, reflecting an increase of 3%:

	2015	2016
Olivier Bohuon	1,145,135	1,179,490
Julie Brown	£529,420	£545,303

In February 2017, we reviewed the base salaries of the Executive Directors, having considered general economic conditions and average salary increases across the rest of the Group, which have averaged at 3.5%. The Remuneration Committee has agreed that there will be no increase to the base salary of the Executive Directors.

PAYMENT IN LIEU OF PENSION

In 2016, both Olivier Bohuon and Julie Brown received a salary supplement of 30% of their basic salary to apply towards their retirement savings, in lieu of membership of one of the Company s pension schemes. The same arrangement will apply in 2017 for Olivier Bohuon and for Graham Baker, following his appointment on 1 March 2017.

BENEFITS

In 2016, both Olivier Bohuon and Julie Brown received death in service cover of seven times basic salary, of which four times salary is payable as a lump sum with the balance used to provide for any spouse and dependent persons. They also received health cover for themselves and their families, a car allowance and financial consultancy advice. Olivier Bohuon also received assistance with travel costs between London and Paris. The same arrangements will apply in 2017 for Olivier Bohuon and for Graham Baker. The following table summarises the value of benefits on an element-by-element basis in respect of 2015 and 2016.

	Olivier Bohuon		Julie Brown	
	2015	2016	2015	2016
Health cover	£15,040	£15,672	£1,144	£1,440
Car and fuel allowance	21,344	18,292	£14,640	£14,640
Financial consultancy advice	£95,052	£66,572	£3,758	£6,164
Travel costs	£20,961	£23,814		
Subscriptions	£3,120	£2,344		

ANNUAL INCENTIVE PLAN 2016

During 2016, 70% of the Annual Incentive Plan for Executive Directors was based on the achievement of specific financial objectives and 30% of the award depended on the achievement of specific business objectives.

Financial Objectives

The financial measures on which performance was assessed in 2016 were revenue, trading profit and trading cash. For each of these measures, the Committee determined threshold, target and maximum performance in February 2016. In February 2017, the Committee reviewed performance against each of these objectives and determined the percentage of the award which would vest in respect of each of the objectives, all as detailed in the table below.

	Threshold	Target	Maximum	Actual[1]
Revenue	$4,641m	$4,785m	$4,929m	$4,647m

Trading profit	$1,052m	$1,108m	$1,163m	$1,023m
Trading cash	$833m	$926m	$1,019m	$779m

1 At constant exchange rates. See page 175.
This resulted in a bonus achievement of 16% of salary in respect of the financial objectives.

	Weight	Achieved % of target	Award % of salary
Revenue[1]	30%	97.1%	16%
Trading profit[1]	30%	92.3%	0%
Trading cash[1]	10%	84.1%	0%
		Total	16%

1 At constant exchange rates. See page 175.
Accordingly, the following amounts have been earned by Olivier Bohuon under the cash element of the annual incentive plan in respect of his financial objectives.

Olivier Bohuon	188,718

Business Objectives

When setting business objectives for the upcoming year, the Board looks not only at the expected financial performance for the year, but also at the actions it expects the Executive Director to carry out in the year to build a solid foundation for financial performance over the longer term. In reviewing performance against these objectives at the end of the year, the Board is mindful that there is not a necessary correlation between financial performance and the achievement of business objectives and that business objectives may well be achieved in a year when financial performance for that year has not been outstanding.

The table on the following page sets out how Olivier Bohuon has performed against the business objectives of Business Process, People and Customer.

Table of Contents

IMPLEMENTATION REPORT

REMUNERATION continued

BUSINESS PROCESS

Improved inventory turn by 7.75% over the previous year, against a target of 8%.

Improved service and supply levels to 95% against a target of 92%.

Continued in line with target to improve and simplify Quality Management System resulting in reduction in backlog of complaints, fewer internal audit and third party findings and increased rate of closure of findings.

PEOPLE

Continued roll-out of Great Place to Work programme, achieved accreditation in Canada, China, Denmark and South Africa against target of three countries.

Achieved target of strengthening commercial platform by implementing new global commercial organisation under a Chief Commercial Officer, centralised pricing and sales-force excellence to drive commercial excellence.

Achieved target of extending single country managing director model to the US, completing spans and layers restructure of Group to improve decision making and deliver efficiency.

Achieved target of appointing President of Research and Development to lead a newly formed single global R&D organisation, with team structure implemented.

Achieved target of updating succession and identifying candidates.

CUSTOMER

Achieved target of implementing new sustainability strategy including robust metrics.

Achieved 8 out of 15 sustainability targets including: an 11% reduction in water usage; and maintain top quartile safety performance in our sector.

Set tone from the top and championed ethics and compliance programme, achieving 99% of worldwide compliance training completed in line with target.

OTHER ACHIEVEMENTS

In addition, Olivier had other achievements, which were not envisaged when setting objectives at the beginning of the year, notably: above plan ArthroCare revenue synergies; and the disposal of the Gynaecology business resulting in a $300 million share buy-back for shareholders.

Olivier Bohuon level of award business objectives

406,924 representing 34.5% of salary (30% target award).

The Remuneration Committee has however considered whether in the context of the Company s financial performance during 2016, it would be appropriate to make a cash payment at this level, given the lack of alignment with shareholder interests. The Remuneration Committee has therefore determined to exercise its discretion and modify the total payment downwards by 10%. This reduces the total payment to be made under the Cash Incentive Plan to 45.45% of salary (536,078).

Equity Incentive Award

The individual performance of all employees in the Group is assessed on two bases. The first looks at what has been achieved, namely the extent to which the employee has performed against the financial and business objectives set at the beginning of the year. The second looks at how this performance has been achieved, reflecting the right culture and values. Against each, the employee is rated as having performed below, in line or above expectations.

The Remuneration Committee has considered the performance of Olivier Bohuon in exactly the same way as other employees in the Group when determining the level of Equity Award to be made to him. In assessing his performance against the same financial and business objectives used to determine the level of his cash award, the Remuneration Committee has determined that on the first criterion (assessing what he has achieved) Olivier Bohuon has mostly met his objectives throughout the year. On the second criterion (assessing how he has achieved), the Remuneration Committee has determined that he has performed in line with expectations. A rating of in line with expectations on both bases results in an Equity award of 50% of salary.

In summary, as a result of the financial performance described on page 91 and the performance described in the table on this page, the Remuneration Committee determined that the following awards be made under the Annual Incentive Plan in respect of performance in 2016:

	Cash Component		Equity Component	
Executive Director	% of salary	Amount	% of salary	Amount
Olivier Bohuon	45.45%	536,078	50%	589,745
Julie Brown	0%	£0	0%	£0

These figures are converted into dollars and included under Annual Incentive Plan (cash) and (equity) in the single figure table on page 90.

As a result of the 2016 performance assessment for Olivier Bohuon, the first tranche of the Equity Incentive Award made in 2016, the second tranche of the Equity Incentive Award made in 2015 and the third tranche of the Equity Incentive Award made in 2014 will vest.

ANNUAL INCENTIVE PLAN 2017

Cash Element

During the year, the Remuneration Committee reviewed the operation of the Annual Incentive Plan and for 2017 onwards have made changes to the performance measures and weightings which will apply to the cash element of the Annual Incentive Plan. These changes place a greater emphasis on financial goals reflecting the importance we place on achievement of financial measures. The financial measures now comprise 75% of the total award (2016: 70%) and are split between revenue (35%), trading profit margin (25%), and trading cash flow (15%). We have selected these measures because revenue and trading profit margin constitute the key drivers of profit growth, and trading cash flow is a key measure of how efficiently we turn our assets into cash. We have introduced trading profit margin replacing the previous trading profit measure as margin is a critical measure both for the business and our investors and delivering margin improvements is a core commitment under our strategy.

The remaining 25% of the total award are individual business objectives, similar to previous years, tied to our strategic priorities. For 2017, these business objectives fall into the categories of Business process, People and Customer.

Table of Contents

The weighting of the performance measures for 2017 can be summarised as follows:

Financial objectives	**75%**
Revenue	35%
Trading profit margin	25%
Trading cash flow	15%
Business objectives	**25%**
Business process	8.33%
People	8.33%
Customer	8.33%

The Board has determined that the disclosure of performance targets at this time is commercially sensitive. These targets are determined within the context of a five-year plan and the disclosure of these targets could give information to our competitors about details of our strategy which would enable them to compete more effectively with us to the detriment of our performance. These targets, together with threshold and maximum will however be disclosed in next year s Annual Report, when the Committee will discuss performance against the targets. For the financial performance

measures, Target is set at target performance as approved by the Board in the Budget for 2017. Threshold and Maximum are set at +/-3% from the target for revenue, at +/-0.45 percentage points for the trading profit margin measure and at +/-10% for the trading cash flow measure.

Equity Award Element

The Equity Award element will operate in 2017 in exactly the same way as in 2016 and previous years. The Remuneration Committee will assess what has been achieved by the Executive Directors against the same financial and business objectives used to determine the level of their cash awards. The Remuneration Committee will assess how the Executive Directors have achieved their objectives by considering the role played by the Executive Directors in establishing an appropriate culture and set of values throughout the organisation. The level of Equity Incentive Award to be made will be determined according to the following matrix:

		Assessment of how Executive Directors have achieved		
		Below expectations	In line with expectations	Above expectations
Assessment of what has been achieved	Below expectations	No Award	No Award	No Award
	In line with expectations	No Award	Award of 50% of Salary	Award of 55% of Salary
	Above expectations	No Award	Award of 55% of Salary	Award of 65% of Salary

DETAILS OF AWARDS MADE UNDER THE EQUITY INCENTIVE PROGRAMME DURING 2016

Details of conditional awards over shares, granted as part of the Annual Equity Incentive Programme to Executive Directors under the rules of the Global Share Plan 2010 for their 2015 performance (awarded in 2016) are shown

below. The performance conditions and performance periods applying to these awards are detailed above.

Date granted	Number of shares under award	Date vesting
Olivier Bohuon		
7 March 2016	50,159	1/3 on 7 March 2017 1/3 on 7 March 2018 1/3 on 7 March 2019
Julie Brown		
7 March 2016	25,342	This award has lapsed in its entirety on 11 January 2017

The precise awards granted in 2017 to Olivier Bohuon in respect of service in 2016 will be announced when the awards are made and will be disclosed in the 2017 Annual Report. No awards will be made to Julie Brown or to Graham Baker.

Graham Baker will participate in the Annual Incentive Plan (Cash and Equity) from 1 March 2017, the date of his appointment.

PERFORMANCE SHARE PROGRAMME 2016 GRANTS

Performance share awards in 2016 were made to Executive Directors under the Global Share Plan 2010 to a maximum value of 190% of salary (95% for target performance). Performance will be measured over the three financial years beginning in 2016 and will vest subject to performance and continued employment in 2019. 50% of the award will vest subject to cumulative free cash flow performance, 25% to revenue in Emerging Markets and 25% to relative TSR.

Cumulative free cash flow is defined as net cash inflow from operating activities, less capital expenditure, less the cash flow input of certain adjusted items. Free cash flow is the most appropriate measure of cash flow performance

because it relates to cash generated to finance additional investments in business opportunities, debt repayments and distribution to shareholders. This measure includes significant elements of operational financial performance and helps to align Executive Director awards with shareholder value creation.

The 50% of the award that will be subject to cumulative free cash flow performance will vest as follows:

Cumulative free cash flow	Award vesting as % of salary
Below $1.585bn	Nil
$1.585bn	23.75%
$1.822bn	47.5%
$2.059bn or more	95%

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

Table of Contents

IMPLEMENTATION REPORT

REMUNERATION continued

Revenue in Emerging Markets is defined as cumulative revenue over a three-year period beginning 1 January 2016 from our Emerging Markets. The 25% of the award that will be subject to revenue in Emerging Market performance will vest as follows:

Revenue in Emerging Markets	Award vesting as % of salary
Below Threshold	Nil
Threshold	11.875%
Target	23.75%
Maximum or above	47.5%

It is not possible to disclose precise targets for revenue growth in Emerging Markets as this will give commercially sensitive information to our competitors concerning our growth plans in Emerging Markets, which they could use against us to launch new products and enter new markets. This would be detrimental to our business in Emerging Markets, which are key to our success overall. This target however will be disclosed in the 2018 Annual Report, when the Committee will discuss performance against the target.

25% of the award will vest based on the Company s Total Shareholder Return (TSR) performance relative to a bespoke peer group of companies in the medical devices sector over a three-year period commencing 1 January 2016 as follows:

Relative TSR ranking	Award vesting as % of salary
Below median	Nil
Median	11.875%
Upper quartile	47.5%

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.

The bespoke peer group for the 2016 awards comprises the following companies: Baxter International, Becton, Dickinson and Company, Boston Scientific Corporation, C. R. Bard, Coloplast A/S, CONMED Corporation, Edwards Lifesciences Corporation, Essilor International SA, Getinge AB, GN Store Nord A/S, Medtronic, Stryker, Shire plc, Sonova Holding AG, St Jude Medical, William Demant and Zimmer Biomet.

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

PERFORMANCE SHARE PROGRAMME 2017

A performance share award will be made in 2017 to Olivier Bohuon and Graham Baker under the Global Share Plan 2010 to a maximum value of 190% of salary (95% for target performance).

During 2016, the Remuneration Committee reviewed the operation of the Performance Share Programme and have made changes to the performance measures and weightings which will apply to awards going forward.

Performance will be measured over the three financial years commencing 1 January 2017 and will vest subject to performance and continued employment in 2020. Subject to shareholder approval of the new Remuneration Policy at the Annual General Meeting to be held on 6 April 2017, on vesting, sufficient shares will be sold to cover taxation obligations and the Executive Directors will be required to hold the net shares for a further period of two years.

We have selected four equally weighted performance measures relative TSR, return on invested capital, sales growth and cumulative free cash flow. We have selected these measures because of their link to our strategic priorities and the alignment with the shareholder experience. The four measures are defined as follows:

Relative TSR provides accountability and alignment to shareholders. 25% of the award will vest based on the Company s TSR performance relative to constituents of two separate indices over a three-year period commencing 1 January 2017 as follows:

TSR relative to the peer groups	Award vesting as % of salary
Below median	Nil
Median	11.875%
Upper quartile	47.5%

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.

The two equally weighted peer groups against which the Company s TSR performance will be measured will be defined at the start of each performance period based on constituents of the following:

A sector-based peer group based on those companies classified as the S&P 1200 Global Healthcare subset comprising medical devices, equipment and supplies companies (official industry classifications of Health Care Equipment and Supplies, Life Sciences Tools & Services and Health Care Technology . This is a broader sector-based peer group than in previous years, so that we maintain a focus on outperforming our broad sector without being impacted by the volatility of a smaller group.

FTSE 100 constituents excluding financial services and commodities companies. This is in response to shareholders who assess our performance not based on sector, but instead based on the index we operate in.

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

Table of Contents

Return on invested capital (ROIC) adds focus on enhancing operating performance and reducing the under-performing asset base. The introduction of ROIC as a performance measure will incentivise better financial discipline, reward enhanced operating performance and provide a link to an area that our shareholders have identified as a high priority for improvement. 25% of the award will be subject to ROIC and will vest as follows:

ROIC will be defined as:

Net Operating Profit[1] less Adjusted Taxes[2]

(Opening Net Operating Assets + Closing Net Operating Assets[3])/2

ROIC will be measured each year of the three year performance period and a simple average of the three years will be compared to the targets below (precise numbers will be included in the Remuneration Report prospectively). The Remuneration Committee will have the discretion to adjust ROIC targets in the case of significant events such as material mergers, acquisitions and disposals and that such adjustment will be consistent with the deal model and approved by the Board at the time of the transaction.

1 Operating profit is as disclosed in the Group income statement in the Annual Report.
2 Adjusted Taxes represents our Taxation charge per the Group income statement adjusted for the impact of tax on items not included in Operating profit notably interest income and expense, other finance costs and share of results of associate.
3 Net Operating Assets comprises net assets from the Group balance sheet (Total assets less Total liabilities) excluding the following items: Investments, Investments in associates, Retirement benefit assets and liabilities, Long term borrowings, Bank overdrafts and loans, and Cash at bank.

Return on Invested Capital

	Award vesting as % of salary

Below Threshold 11.1%	Nil
Threshold 11.1% (-1.9% of target)	11.875%
Target 13% (as derived from the Strategic Plan)	23.75%
Maximum or above 14.9% (+1.9% of target)	47.5%

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

Sales growth focuses on growth in both Established Markets and Emerging Markets. This is a broadening of the previous sales growth measure to focus beyond our emerging markets. 25% of the award will be subject to sales growth and will vest as follows:

Sales growth over three year period commencing 1 January 2017	Award vesting as % of salary
Below Threshold	Nil
Threshold (-3% of target)	11.875%
Target	23.75%
Maximum or above (+3% of target)	47.5%

It is not possible to disclose precise targets for sales growth as this will give commercially sensitive information to our competitors concerning our growth plans and is potentially price sensitive information. This target however will be disclosed in the 2019 Annual Report, when the Committee will discuss performance against the target.

Cumulative cash flow is important as it is derived from increased revenues and healthy trading profits. Having a healthy cash flow will enable us to continue to grow and invest. 25% of the award will be subject to cumulative free cash flow performance and will vest as follows:

Cumulative free cash flow	Award vesting as % of salary

Below $1,482m	Nil
$1,482m (-13% of target)	11.875%
$1,703m	23.75%
$1,924m or more (+13% of target)	47.5%

VESTING OF AWARDS MADE IN 2014

Since the end of the year, the Remuneration Committee has reviewed the vesting of conditional awards made to Executive Directors under the Global Share Plan 2010 in 2014. Vesting of the conditional awards made in 2014 was subject to performance conditions based on TSR, revenue in Emerging Markets and cumulative free cash flow measured over a three-year period commencing 1 January 2014.

25% of the award was based on the Company s TSR relative to a bespoke group of 15 medical devices companies. Against this peer group, the Company s TSR performance ranked below median meaning that this part of the award therefore vested at 0%.

50% of the award was based on cumulative free cash flow performance. Over the three-year period, the adjusted cumulative free cash flow was $1.624 billion below the threshold required for vesting. These adjustments include items such as Board approved M&A, including the acquisitions of Healthpoint and ArthroCare and Board approved Business Plans such as the Group Optimisation programme, the Regranex inventory and metal-on-metal settlements. This part of the award therefore vested at 0%.

25% of the award was based on revenues in Emerging Markets. The threshold set in 2014 was $2,133 million with a target of $2,510 million. Over the three year period, the adjusted revenues in Emerging Markets were $2,244 million. These adjustments include Board-approved M&A. This part of the award therefore vested at 64% of target (32% of maximum).

Overall therefore, the conditional awards made in 2014 will vest at 8% of maximum (16% of target) on 7 March 2017 as follows:

Director	Date of grant	Number of shares under award at maximum	Number vesting
Olivier Bohuon	7 March 2014	180,304	14,424
Julie Brown	7 March 2014	100,688	This award has lapsed in its entirety on 11

January 2017

Table of Contents

IMPLEMENTATION REPORT

REMUNERATION continued

SUMMARY OF SCHEME INTERESTS AWARDED DURING THE FINANCIAL YEAR

	Olivier Bohuon		Julie Brown[1]	
Basis on which award is made	Number of shares	Face value	Number of shares	Face value
Annual Equity Incentive Award (see page 93)	50,159	744,358	25,342	£291,181
Performance Share Award at maximum (see page 93)	146,620	2,175,756	87,544	£1,005,898
190% base salary at maximum				

1 Awards lapsed in full on 11 January 2017 when Julie Brown left the Company.
Please see Policy Table on pages 81 to 82 for details of how the above plans operate. The number of shares is calculated using the closing share price on the day before the grant, which for the awards granted on 7 March 2016 was 1,149p.

DETAILS OF OUTSTANDING AWARDS MADE UNDER THE PERFORMANCE SHARE PROGRAMME

Details of conditional awards over shares granted to Executive Directors subject to performance conditions are shown below. These awards were granted under the Global Share Plan 2010. The performance conditions and performance periods applying to these awards are detailed on page 93.

	Date granted	Number of ordinary shares under award at maximum	Date of vesting
Olivier Bohuon	7 March 2014[1]	180,304	7 March 2017
	9 March 2015	133,156	9 March 2018
	7 March 2016	146,620	7 March 2019
Julie Brown	7 March 2014[2]	100,688	7 March 2017
	9 March 2015[2]	85,366	9 March 2018
	7 March 2016[2]	87,544	7 March 2019

1 On 7 February 2017, 92% of the award granted at maximum to Olivier Bohuon lapsed following completion of the performance period.
2 On 11 January 2017, these awards lapsed in their entirety on Julie Brown ceasing to be an employee of the Company.

DETAILS OF OPTION GRANTS UNDER THE ALL-EMPLOYEE SHARESAVE PLAN

Details of options held by Executive Directors under the Smith & Nephew ShareSave Plan (2012) are shown below.

rector	Date granted	Number of shares under option	Date of vesting		Exercise period	Option pric
lie own	17 September 2013	2,400 Ordinary Shares	1 November 2018	1 November 2018	30 April 2019	£6.2

These options lapsed in their entirety in January 2017, when Julie Brown left the Company.

SINGLE TOTAL FIGURE ON REMUNERATION

Chairman and Non-Executive Directors

Director	Basic annual fee[1]		Non-Executive Director/ Committee fee		Intercontinental travel fee		Total	
	2015	2016	2015	2016	2015	2016	2015	2016
Roberto Quarta	£400,000	£409,750	N/A	N/A	£3,500	£3,500	£403,500	£413,250
Vinita Bali	£63,000	£63,000	N/A	N/A	£17,500	£21,000	£80,500	£84,000
	$6,000	$9,780					$6,000	$9,780
Ian Barlow	£66,150	£68,135	£15,000	£18,750	£3,500	£3,500	£84,650	£90,385
Virginia Bottomley	£66,150	£68,135	N/A	N/A	£3,500	£3,500	£69,650	£71,635
Erik Engstrom	£66,150	£68,135	N/A	N/A	£3,500	£3,500	£69,650	£71,635
Robin Freestone	£21,000	£68,135	N/A	N/A	£3,500	£3,500	£24,500	£71,635
Michael Friedman	$126,000	$129,780	$27,000	$33,000	$42,000	$35,000	$195,000	$197,780
Brian Larcombe	£66,150	£68,135	£15,000	£18,750	£3,500	£3,500	£84,650	£90,385
Joseph Papa	$126,000	$129,780	$27,000	$33,000	$35,000	$35,000	$188,000	$197,780

1 The basic annual fee includes shares purchased for the Chairman and Non-Executive Directors in lieu of part of the annual fee, details of which can be found on the table on page 86.

Table of Contents

Chairman and Non-Executive Director Fees

In February 2016, the Remuneration Committee reviewed the fees paid to the Chairman and the Board reviewed the fees paid to the Non-Executive Directors and determined that with effect from 1 April 2016, the fees paid would be as follows:

Annual fee paid to the Chairman	£412,000 of which £103,000 paid in shares (increase of 3%)
Annual fee paid to Non-Executive Directors	£68,135 of which £5,135 paid in shares (increase of 3%) Or $129,780 of which $9,780 paid in shares (increase of 3%)
Intercontinental travel fee (per meeting)	£3,500 or $7,000 (unchanged)
Fee for Senior Independent Director and Committee Chairman	£20,000 or $35,000 reflecting increased responsibilities.

In February 2017, the Remuneration Committee reviewed the fees paid to the Chairman and the Board reviewed the fees paid to the Non-Executive Directors and determined that with effect from 1 April 2017, the fees paid would remain unchanged.

Chief Executive Officer s remuneration compared to employees generally

The percentage change in the remuneration of the Chief Executive Officer between 2015 and 2016 compared to that of employees generally is as follows:

	Base salary % change 2016	Benefits % change 2016	Annual cash bonus % change 2016
Chief Executive Officer	2.7%	-27%	-58%
Average for all employees	3.5%	N/A	N/A

The average cost of wages and salaries for employees generally decreased by 3.1% in 2016 (see Note 3.1 to the Group accounts). Figures for annual cash bonuses are included in the numbers.

Payments made to past Directors

No payments were made to former Directors in the year.

Payments for loss of office

No payments were made in respect of a Director s loss of office in 2016.

Service contracts

Executive Directors are employed on rolling service contracts with notice periods of up to 12 months from the Company and six months from the Executive Director. Further information can be found on page 84 of the Policy Report.

Outside directorships

Olivier Bohuon is a Non-Executive Director of Virbac SA and received 21,000 in respect of this appointment. He is also a Non-Executive Director of Shire Plc and received 160,397 in respect of this appointment. Julie Brown is a Non-Executive Director of Roche Holding Ltd and received a fee of CHF310,000.

Directors interests in ordinary shares

Beneficial interests of the Executive Directors in the ordinary shares of the Company are as follows:

	Olivier Bohuon			Julie Brown		
	1 January 2016	31 December 2016	17 February 2017[1]	1 January 2016	31 December 2016	17 February 2017[1]
Ordinary shares	338,183	424,288	424,288[3]	42,945	90,040	N/A
Share options	0	0	0	2,400	2,400	N/A
Performance share awards[2]	554,388	460,080	294,200	318,920	273,598	N/A
Equity Incentive awards	107,142	96,417	96,417	42,377	50,649	N/A
Other awards	0	0	0	25,000	0	N/A

1 The latest practicable date for this Annual Report.
2 These share awards are subject to further performance conditions before they may vest, as detailed on pages 91 to 92.
3 The ordinary shares held by Olivier Bohuon on 17 February 2017 represent 527.82% of his base annual salary.
The beneficial interest of each Executive Director is less than 1% of the ordinary share capital of the Company. In addition, Olivier Bohuon holds 50,000 deferred shares. Following the redenomination of ordinary shares into US Dollars on 23 January 2006, the Company issued 50,000 deferred shares. These shares are normally held by the Chief Executive Officer and are not listed on any stock exchange and have extremely limited rights attached to them.

Table of Contents

IMPLEMENTATION REPORT

REMUNERATION continued

Beneficial interests of the Chairman and Non-Executive Directors in the ordinary shares of the Company are as follows:

Director	1 January 2016 (or date of appointment) if later	31 December 2016 (or date of retirement if earlier)	17 February 2017[1]	Shareholding as % of annual fee[2]
Roberto Quarta[3]	19,765	24,156	24,156	70.53
Vinita Bali[4]	6,186	6,522	6,522	111.69
Ian Barlow	18,556 18,219	18,786 18,473	18,786 18,473	331.69 273.19

Virginia Bottomley				
Erik Engstrom	15,140	15,350	15,350	271.02
Robin Freestone	15,000	15,310	15,310	270.32
Michael Friedman[4]	9,014	9,476	9,476	118.49
Brian Larcombe	40,508	40,718	40,718	718.92
Joseph Papa[4]	13,197	13,547	13,547	169.40

1 The latest practicable date for this Annual Report.
2 Calculated using the closing share price of 1,203p per ordinary share and $30.44 per ADS on 17 February 2017, and an exchange rate of £1/$1.2195.
3 All Non-Executive Directors held the required shareholding during the year except the Chairman.
4 Vinita Bali, Michael Friedman and Joseph Papa hold some of their shares in the form of ADS.
The beneficial interest of each Non-Executive Director is less than 1% of the ordinary share capital of the Company.

Relative importance of spend on pay

The following table sets out the total amounts spent in 2016 and 2015 on remuneration, the attributable profit for each year and the dividends declared and paid in each year.

	For the year to 31 December 2016	For the year to 31 December 2015	% change
Attributable profit for the year	$784m	$410m	91.2%
Dividends paid during the year	$279m	$272m	2.6%
	$368m	$77m	378%

Share buyback[1]			
Total Group spend on remuneration	$1,227m	$1,193m	-2.8%

1 Shares are bought in the market in respect of shares issued as part of the executive and employee share plans. Following the disposal of the Gynaecology business in August 2016, the Company commenced a $300m share buy-back programme. See Note 19.2 for further information.

Total Shareholder Return

A graph of the Company s TSR performance compared to that of the FTSE 100 index is shown below in accordance with Schedule 8 to the Regulations.

Eight-year Total Shareholder Return

(measured in UK Sterling, based on monthly spot values)

Table of Contents

However, as we compare the Company s performance to a tailored sector peer group of medical devices companies (see page 94), when considering TSR performance in the context of the Global Share Plan 2010, we feel that the following graph showing the TSR performance of this peer group is also of interest.

Eight-year Total Shareholder Return

(measured in US Dollars, based on monthly spot values)

Table of historic data

The following table details information about the pay of the Chief Executive Officer in the previous nine years:

				Long-term incentive vesting rates against maximum opportunity	
Year	Chief Executive Officer	Single figure of total remuneration $	Annual Cash Incentive payout against maximum %	Performance shares %	Options %
2016	Olivier Bohuon	$3,322,321	30	8	N/A
2015	Olivier Bohuon	$5,342,377[4]	75	33.5	N/A
2014	Olivier Bohuon	$6,785,121	43	57	N/A
2013	Olivier Bohuon	$4,692,858	84	0	N/A
2012	Olivier Bohuon	$4,956,771	84	N/A	N/A
2011	Olivier Bohuon[1,2]	$7,442,191	68	N/A	N/A
2011	David Illingworth[3]	$3,595,787	37	27	27
2010	David Illingworth	$4,060,707	57	70	61
2009	David Illingworth	$4,406,485	59	46	59

1 Appointed Chief Executive Officer on 1 April 2011.
2 Includes recruitment award of 1,400,000 cash and a share award over 200,000 ordinary shares with a value of 1,410,000 on grant.
3 Resigned as Chief Executive Officer on 1 April 2011.
4 Prior years are restated to reflect amounts not known at the date of signing the previous Annual Report.
5 Calculated as 45.45% (actual payout) disclosed on page 92 divided by the maximum potential payout of 150%.

Implementation of Remuneration Policy in 2017

Shareholders will be asked to approve the new Remuneration Policy at the Annual General Meeting on 6 April 2017. This policy is detailed on pages 78 to 87. The new Remuneration Policy is broadly the same as the policy approved by shareholders in 2014; the only changes being the measures used for the short and long term incentive programmes and the introduction a holding period for shares vesting under the Performance Share Programme. The main differences therefore to the way that the Remuneration Policy will be implemented in 2017 are as follows:

The financial measures be used for the Annual Incentive Plan will be Revenue (35%), Trading profit margin (25%) and Trading cash flow (15%).

The business objective measures be used for the Annual Incentive Plan will be Business process (8.3%), People (8.3%) and Customer (8.3%).

The performance measures to be used for the Performance Share Plan will be Cumulative cash flow (25%), Relative TSR (25%), Sales growth (25%) and Return on Invested Capital (25%).

There are no changes to salary, pensions or opportunities under the Incentive Plan for 2017. Equally, there are no changes in the provided benefits, although the disclosed value will vary based on the underlying cost of providing them.

Table of Contents

IMPLEMENTATION REPORT

REMUNERATION continued

Statement of voting at Annual General Meeting held in 2016

At the Annual General Meeting held on 14 April 2016, votes cast by proxy and at the meeting and votes withheld in respect of the votes on the Directors Remuneration Report were as follows:

Resolution	Votes for	% for	Votes against	% against	Total votes validly cast	Votes withheld
Approval of the Directors Remuneration Report	272,923,229	46.99	307,890,596	53.01	580,913,825	52,488,566

During 2016, Joseph Papa, Chairman of our Remuneration Committee has undertaken an extensive programme of engagement with investors, which is detailed in the Policy Report on page 87.

Other remuneration matters

Graham Baker will be appointed Chief Financial Officer on 1 March 2017. He will receive a base salary of £510,000 and will participate in the Annual Incentive Plan for 2017 as detailed above. He will also receive a Performance Share Award as detailed above and a payment in lieu of pension equivalent to 30% of his base salary, as well as standard benefits, including a car allowance, healthcare cover and if applicable financial consultancy advice. His notice period will be 6 months from him and 12 months from the Company. No additional payment will be made on his joining the Company.

Senior management remuneration

The Group s administrative, supervisory and management body (senior management) is comprised for US reporting purposes, of Executive Directors and Executive Officers. Details of the current Executive Directors and Executive Officers are given on pages 52 to 53.

Compensation paid to senior management in respect of 2016, 2015 and 2014 was as follows:

	2014	2015	2016
Total compensation (excluding pension emoluments, but including cash payments under the performance-related incentive plans)	$12,725,000	$13,971,000	$12,874,000
Total compensation for loss of office	$2,664,000	0	0
Aggregate increase in accrued pension scheme benefits	$16,000	0	0
Aggregate amounts provided for under supplementary schemes	$507,000	$698,000	$1,112,000

As at 17 February 2017, the senior management owned 301,797 shares and 57,303 ADSs, constituting less than 0.1% of the share capital of the Company. Details of share awards granted during the year and held as at 17 February 2017 by members of senior management are as follows:

	Share awards granted during the year	Total share awards held as at 17 February 2017
Equity Incentive awards	164,526	248,381
Performance Share awards	152,008	284,505
Conditional share awards under the Global Share Plan 2010	49,526	59,469
Options under Employee ShareSave plans	1,009	0
Options under the Global Share Plan 2010	0	52,577

Dilution headroom

The Remuneration Committee ensures that at all times the number of new shares which may be issued under any share-based plans, including all-employee plans, does not exceed 10% of the Company s issued share capital over any rolling ten-year period (of which up to 5% may be issued to satisfy awards under the Company s discretionary plans). The Company monitors headroom closely when granting awards over shares taking into account the number of

options or shares that might be expected to lapse or be forfeited before vesting or exercise. In the event that insufficient new shares are available, there are processes in place to purchase shares in the market to satisfy vesting awards and to net-settle option exercises.

Over the previous 10 years (2007 to 2016), the number of new shares issued under our share plans has been as follows:

All-employee share plans	7,552,785 (0.86% of issued share capital as at 17 February 2017)
Discretionary share plans	35,681,391 (4.07% of issued share capital as at 17 February 2017)

By order of the Board, on 22 February 2017

Joseph Papa

Chairman of the Remuneration Committee

Table of Contents

GROUP FINANCIAL STATEMENTS

GROUP FINANCIAL STATEMENTS

NOTES TO THE GROUP ACCOUNTS

OTHER NOTES TO THE ACCOUNTS

Table of Contents

GROUP FINANCIAL STATEMENTS

STATEMENT OF DIRECTOR S RESPONSIBILITIES IN RESPECT OF THE ANNUAL REPORT AND THE FINANCIAL STATEMENTS

The Directors are responsible for preparing this Annual Report and Form 20-F Information and the Group and Parent Company Financial Statements, in accordance with applicable law and regulations.

Company law requires the Directors to prepare Group and Parent Company Financial Statements for each financial year; the Group Financial Statements are required to be prepared in accordance with IFRSs, as adopted by the EU, and applicable law and the Directors have elected to prepare the Parent Company Financial Statements in accordance with UK Accounting Standards, including FRS 101 *Reduced Disclosure Framework*.

Under company law Directors must not approve Financial Statements unless they are satisfied that they give a true and fair view of the state of affairs of a group and Parent Company and of their profit or loss for that period. In preparing each of the Group and Parent Company Financial Statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- for the Group Financial Statements, state whether they have been prepared in accordance with IFRSs, as adopted by the EU;

for the Parent Company Financial Statements, state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the Parent Company Financial Statements; and

prepare the Financial Statements on the going concern basis unless it is inappropriate to presume that the Group and the Parent Company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Parent Company s transactions and disclose with reasonable accuracy at any time the financial position of the Parent Company and enable them to ensure that its Financial Statements comply with the Companies Act. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the Directors are also responsible for preparing a compliant Strategic Report, Directors Report, Directors Remuneration Report and Corporate Governance Statement.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company s website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

RESPONSIBILITY STATEMENT OF THE DIRECTORS IN RESPECT OF THE ANNUAL REPORT

We confirm that to the best of our knowledge:

the Financial Statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Group; and

the Strategic Report and Directors Report includes a fair review of the development and performance of the business and the financial position of the Group, together with a description of the principal risks and uncertainties that they face.

We consider the Annual Report and Financial Statements, taken as a whole, are fair, balanced and understandable and provide the information necessary for shareholders to assess the Group s position and performance, business model and strategy.

The strategic report, which has been prepared in accordance with the requirements of the Companies Act 2006, comprises the following sections:

Overview (pages 2 to 7);

Our Business and Marketplace (pages 8 to 17);

Operational Review (pages 18 to 38);

Financial Review (pages 39 to 41);

Risk (pages 42 to 46);

And has been approved and signed on behalf of the Board.

By order of the Board, 22 February 2017

Susan Swabey

Company Secretary

Table of Contents

INDEPENDENT AUDITOR S US REPORT

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRMS

The Board of Directors and Shareholders Smith & Nephew plc:

We have audited the accompanying Group balance sheets of Smith & Nephew plc and subsidiaries as of 31 December 2016 and 2015 and the related Group income statements, Group statements of comprehensive income, Group cash flow statements and Group statements of changes in equity, for each of the years then ended. We also have audited Smith & Nephew plc s internal control over financial reporting as of 31 December 2016, based on criteria established in Internal Control Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Smith & Nephew plc s management is responsible for these Group financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Evaluation of Internal Controls. Our responsibility is to express an opinion on these Group financial statements and an opinion on the Company s internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the Group financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorised acquisition, use, or disposition of the company s assets that could have a

material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to 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.

In our opinion, the Group financial statements referred to above present fairly, in all material respects, the financial position of Smith & Nephew plc and subsidiaries as of 31 December 2016 and 2015, and the results of their operations and their cash flows for each of the years then ended, in conformity with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board and in conformity with IFRS as adopted by the European Union. Also in our opinion, Smith & Nephew plc maintained, in all material respects, effective internal control over financial reporting as of 31 December 2016, based on criteria established in Internal Control Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

As discussed in Note 2 to the Group financial statements, in 2015 Smith & Nephew plc elected to change the composition of its reportable segments. We also have audited the adjustments to the 2014 Group financial statements to retrospectively reflect the change in composition of reportable segments. In our opinion, such adjustments are appropriate and have been properly applied. We were not engaged to audit, review, or apply any procedures to the 2014 Group financial statements of Smith & Nephew plc and subsidiaries other than with respect to the adjustments and, accordingly, we do not express an opinion or any other form of assurance on the 2014 Group financial statements taken as a whole.

KPMG LLP

London, United Kingdom

22 February 2017

Table of Contents

GROUP FINANCIAL STATEMENTS

THIS PAGE IS INTENTIONALLY BLANK

Table of Contents

THIS PAGE IS INTENTIONALLY BLANK

Table of Contents

GROUP FINANCIAL STATEMENTS

THIS PAGE IS INTENTIONALLY BLANK

Table of Contents

THIS PAGE IS INTENTIONALLY BLANK

Table of Contents

GROUP FINANCIAL STATEMENTS

CRITICAL ACCOUNTING POLICIES

The Group prepares its consolidated financial statements in accordance with IFRS as issued by the IASB and IFRS as adopted by the EU, the application of which often requires judgements to be made by management when formulating the Group s financial position and results. Under IFRS, the Directors are required to adopt those accounting policies most appropriate to the Group s circumstances for the purpose of presenting fairly the Group s financial position, financial performance and cash flows.

In determining and applying accounting policies, judgement is often required in respect of items where the choice of specific policy, accounting estimate or assumption to be followed could materially affect the reported results or net asset position of the Group; it may later be determined that a different choice would have been more appropriate.

The Group s significant accounting policies are set out in Notes 1 to 23 of the Notes to the Group accounts. Of those, the policies which require the most use of management s judgement are as follows:

VALUATION OF INVENTORIES

A feature of the Orthopaedic Reconstruction and Trauma & Extremities franchises (whose finished goods inventory make up approximately 78.4% of the Group s 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 products, 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 judgement 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.

LIABILITY PROVISIONING

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.

TAXATION

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 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 advisers 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.

BUSINESS COMBINATIONS

The Group has identified growth through acquisitions as one of its Strategic Priorities. During 2016, we acquired Blue Belt Technologies; the determination of the balance sheet fair value acquired is dependent upon the understanding of the circumstances at acquisition and estimates of the future results of the acquired business and management judgement is a factor in making these determinations.

Table of Contents

GROUP INCOME STATEMENT

	Notes	Year ended 31 December 2016 $ million	Year ended 31 December 2015 $ million	Year ended 31 December 2014 $ million
Revenue	2	4,669	4,634	4,617
Cost of goods sold		(1,272)	(1,143)	(1,162)
Gross profit		3,397	3,491	3,455
Selling, general and administrative expenses	3	(2,366)	(2,641)	(2,471)
Research and development expenses	3	(230)	(222)	(235)
Operating profit	2 & 3	801	628	749
Interest income	4	6	11	13
Interest expense	4	(52)	(49)	(35)
Other finance costs	4	(16)	(15)	(11)
Share of results of associates	11	(3)	(16)	(2)
Profit on disposal of business	21	326		
Profit before taxation		1,062	559	714
Taxation	5	(278)	(149)	(213)
Attributable profit for the year[1]		784	410	501

Earnings per ordinary share[1]	6			
Basic		88.1¢	45.9¢	56.1¢
Diluted		87.8¢	45.6¢	55.7¢

GROUP STATEMENT OF COMPREHENSIVE INCOME

	Notes	Year ended 31 December 2016 $ million	Year ended 31 December 2015 $ million	Year ended 31 December 2014 $ million
Attributable profit for the year[1]		784	410	501
Other comprehensive income:				
Items that will not be reclassified to income statement				
Re-measurement of net retirement benefit obligations	18	(81)	(8)	(94)
Taxation on other comprehensive income	5	10	10	19
Total items that will not be reclassified to income statement		(71)	2	(75)
Items that may be reclassified subsequently to income statement				
Cash flow hedges interest rate derivatives				
losses arising in the year				(5)
Cash flow hedges forward foreign exchange contracts				
gains/losses) arising in the year		(15)	34	31
losses/(gains) transferred to inventories for the year		20	(50)	(14)
Fair value remeasurement of available for sale asset		10		
Exchange differences on translation of foreign operations		(134)	(176)	(196)
Total items that may be reclassified subsequently to income statement		(119)	(192)	(184)
		(190)	(190)	(259)

Other comprehensive expense for the year, net of taxation			
Total comprehensive income for the year[1]	594	220	242

1 Attributable to equity holders of the Company and wholly derived from continuing operations.

THE NOTES ON PAGES 116 TO 164 ARE

AN INTEGRAL PART OF THESE ACCOUNTS.

Table of Contents

GROUP FINANCIAL STATEMENTS

COMMENTARY ON THE GROUP INCOME STATEMENT AND GROUP STATEMENT OF COMPREHENSIVE INCOME

REVENUE

Group revenue increased by $35m, 1% on a reported basis, from $4,634m in 2015 to $4,669m in 2016.

The underlying increase is 2%, after adjusting for 1% attributable to the unfavourable impact of currency movements.

COST OF GOODS SOLD

Cost of goods sold increased by $129m, 11% on a reported basis, from $1,143m in 2015 to $1,272m in 2016. The movement is primarily due to underlying trading.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses decreased by $275m (10% on a reported basis) from $2,641m in 2015 to $2,366m in 2016.

In 2016, administrative expenses included amortisation of software and other intangible assets of $61m (2015: $66m), $62m of restructuring and rationalisation expenses (2015: $65m), an amount of $178m relating to amortisation and impairment of acquired intangibles (2015: $204m), $9m of acquisition related costs (2015: $12m) and $30m net credit primarily related to a $44m curtailment credit on UK post-retirement benefits (2015: $190m charge for legal and other charges).

Excluding the above items, selling, general and administrative expenses were $2,086m in 2016, a decrease of $18m from $2,104m in 2015.

RESEARCH AND DEVELOPMENT EXPENSES

Research and development expenditure as a percentage of revenue remained broadly consistent at 4.9% in 2016 (2015: 4.8%). Expenditure was $230m in 2016 compared to $222m in 2015. The Group continues to invest in innovative technologies and products to differentiate it from competitors.

OPERATING PROFIT

Operating profit increased by $173m from $628m in 2015 to $801m in 2016.

This movement in 2016 was primarily driven by the absence of costs recognised in 2015 relating to anticipated and settled metal-on-metal hip claims.

INTEREST INCOME/(EXPENSE)

Net interest expense increased by $8m from a net $38m expense in 2015 to a net $46m expense in 2016. This movement is primarily due to an increase in the effective interest rate and the increase in net debt due to the acquisition of Blue Belt Technologies.

OTHER FINANCE COSTS

Other finance costs in 2016 increased by $1m and principally relates to costs associated with the Group s retirement benefit schemes.

PROFIT ON DISPOSAL OF BUSINESS

A profit on disposal of $326m was recognised in 2016 following the sale of the Gynaecology business.

TAXATION

The taxation charge increased by $129m to $278m from $149m in 2015 principally due to the tax charge on the disposal of the Gynaecology business.

Our reported tax rate of 26.2% (2015: 26.7%) includes the one-off benefit of a US tax settlement which is partly offset by the tax rate on the disposal of the predominantly US Gynaecology business.

THE FINANCIAL COMMENTARY ON THIS PAGE FORMS PART OF THE BUSINESS REVIEW AND IS UNAUDITED.

SEE PAGES 178 TO 179 FOR COMMENTARY ON THE 2015 FINANCIAL YEAR.

Table of Contents

GROUP BALANCE SHEET

	Notes	At 31 December 2016 $million	At 31 December 2015 $million
Assets			
Non-current assets			
Property, plant and equipment	7	982	932
Goodwill	8	2,188	2,012
Intangible assets	9	1,411	1,502
Investments	10	25	13
Investments in associates	11	112	115
Retirement benefit asset	18		13
Deferred tax assets	5	97	105
		4,815	4,692
Current assets			
Inventories	12	1,244	1,217
Trade and other receivables	13	1,185	1,138
Cash at bank	15	100	120
		2,529	2,475
		7,344	7,167

Total assets			
Equity and liabilities			
Equity attributable to owners of the Company			
Share capital	19	180	183
Share premium		600	590
Capital redemption reserve		15	12
Treasury shares	19	(432)	(294)
Other reserves		(375)	(256)
Retained earnings		3,970	3,731
Total equity		3,958	3,966
Non-current liabilities			
Long-term borrowings	15	1,564	1,434
Retirement benefit obligations	18	164	184
Other payables	14	82	29
Provisions	17	134	133
Deferred tax liabilities	5	94	77
		2,038	1,857
Current liabilities			
Bank overdrafts and loans	15	86	46
Trade and other payables	14	884	842
Provisions	17	147	193
Current tax payable		231	263
		1,348	1,344
Total liabilities		3,386	3,201
Total equity and liabilities		7,344	7,167

The accounts were approved by the Board and authorised for issue on 22 February 2017 and are signed on its behalf by:

Roberto Quarta **Olivier Bohuon**

Chairman Chief Executive Officer

THE NOTES ON PAGES 116 TO 164 ARE

AN INTEGRAL PART OF THESE ACCOUNTS.

Table of Contents

GROUP FINANCIAL STATEMENTS

COMMENTARY ON THE GROUP BALANCE SHEET

NON-CURRENT ASSETS

Non-current assets increased by $123m to $4,815m in 2016 from $4,692m in 2015. This is principally attributable to the following:

Property, plant and equipment increased by $50m from $932m in 2015 to $982m in 2016. There were $320m of additions together with $2m acquired with the Blue Belt acquisition which was partially offset by $21m of assets disposed. Depreciation of $224m was charged during 2016 and there were unfavourable currency movements of $27m.

Goodwill increased by $176m from $2,012m in 2015 to $2,188m in 2016. This movement relates to additions of $211m from the acquisition of Blue Belt and BST-CarGel. This was partially offset by unfavourable currency movements of $35m.

Intangible assets decreased by $91m from $1,502m in 2015 to $1,411m in 2016. There were additions of $72m in 2016 relating to intellectual property, distribution rights and software acquired together with $85m acquired with the Blue Belt and BST-CarGel acquisitions. Amortisation and impairment during 2016 was $239m and there were unfavourable currency movements of $9m.

Investments increased to $25m from $13m in 2015. The increase was attributable to additions of $2m and fair value remeasurement of $10m.

Deferred tax assets decreased by $8m in the year from $105m in 2015 to $97m in 2016. The net deferred tax asset position is $3m (2015: asset of $28m). The decrease of $25m is due to tax accrual to tax return adjustments and current year utilisation of net deferred tax assets offset by the impact of acquisitions of $15m.

CURRENT ASSETS

Current assets increased by $54m to $2,529m from $2,475m in 2015. The movement relates to the following:

Inventories rose by $27m to $1,244m in 2016 from $1,217m in 2015. This movement is driven by inventory increases in distribution hubs and general increase across the Emerging Markets. This was offset by unfavourable currency movements of $26m.

The level of trade and other receivables increased by $47m to $1,185m in 2016 from $1,138m in 2015. The movement primarily relates to increased trade receivables of $39m and $10m decrease in the bad debt provision as well as unfavourable currency movements.

Cash at bank has decreased by $20m from $120m in 2015 to $100m in 2016. Refer to the Group cash flow statement and related commentary on pages 113 and 114 for further detail.

NON-CURRENT LIABILITIES

Non-current liabilities increased by $181m from $1,857m in 2015 to $2,038m in 2016. This movement principally relates to:

Long-term borrowing increased from $1,434m in 2015 to $1,564m in 2016 principally due to acquisitions made in 2016.

The retirement benefit obligation decreased from $184m in 2015 to $164m in 2016 due to past service cost adjustments arising from plan amendments in the UK, favourable asset movements partially offset by decreases in discount rates.

Deferred tax liabilities increased by $17m from $77m in 2015 to $94m in 2016. Refer to commentary within non-current assets for explanation of the net deferred tax position movement.

Other payables increased by $53m from $29m in 2015 to $82m in 2016 due to deferred consideration on acquisitions made in 2016.

CURRENT LIABILITIES

Current liabilities increased by $4m from $1,344m in 2015 to $1,348m in 2016. This movement is attributable to:

Bank overdrafts and loans increased by $40m from $46m in 2015 to $86m in 2016.

Trade and other payables increased by $42m from $842m in 2015 to $884m in 2016 primarily due to deferred consideration for acquisitions made in 2016.

Provisions decreased by $46m from $193m in 2015 to $147m in 2016 primarily due to utilisation of the legal provision for known and anticipated metal-on-metal hip claims.

Current tax payables decreased by $32m from $263m in 2015 to $231m, mainly attributable to differences in the timing of cash tax payments year-on-year.

TOTAL EQUITY

Total equity decreased by $8m from $3,966m in 2015 to $3,958m in 2016. The principal movements were:

	Total equity $million
1 January 2016	3,966
Attributable profit	784
Currency translation losses	(134)
Hedging reserves	5
Fair value remeasurement of available for sale assets	10
Actuarial losses on retirement benefit obligations	(81)
Dividends paid during the year	(279)
Purchase of own shares	(368)
Taxation on other comprehensive income and equity items	12
Net share-based transactions	43
31 December 2016	3,958

THE FINANCIAL COMMENTARY ON THIS PAGE FORMS PART OF THE BUSINESS REVIEW AND IS UNAUDITED.

SEE PAGES 178 TO 179 FOR COMMENTARY ON THE 2015 FINANCIAL YEAR.

Table of Contents

GROUP CASH FLOW STATEMENT

	Notes	Year ended 31 December 2016 $ million	Year ended 31 December 2015 $ million	Year ended 31 December 2014 $ million
Cash flows from operating activities				
Profit before taxation		1,062	559	714
Net interest expense	4	46	38	22
Depreciation, amortisation and impairment		463	493	427
Loss on disposal of property, plant and equipment and software		15	15	11
Distribution from trade investments			3	1
Share-based payments expense (equity settled)	23	27	29	32
Share of results of associates	11	3	16	2
Profit on disposal of manufacturing facility	21			(9)
Profit on disposal of business	21	(326)		
Net movement in post-retirement benefit obligations		(85)	(57)	(81)
Increase in inventories		(47)	(83)	(168)
Increase in trade and other receivables		(74)	(26)	(76)
(Decrease)/increase in trade and other payables and provisions		(49)	216	86

Cash generated from operations[1]		1,035	1,203	961
Interest received		3	8	3
Interest paid		(48)	(44)	(36)
Income taxes paid		(141)	(137)	(245)
Net cash inflow from operating activities		849	1,030	683
Cash flows from investing activities				
Acquisitions, net of cash acquired	21	(214)	(44)	(1,572)
Capital expenditure	2	(392)	(358)	(375)
Investment in associate	11		(25)	(2)
Purchase of investments	10	(2)	(2)	(4)
Proceeds from associate loan redemption				188
Proceeds on disposal of manufacturing facility	21			20
Proceeds on disposal of business	21	343		
Tax on disposal of business		(118)		
Net cash used in investing activities		(383)	(429)	(1,745)
Cash flows from financing activities				
Proceeds from issue of ordinary share capital		10	16	40
Purchase of own shares		(368)	(77)	(75)
Proceeds from borrowings due within one year	20	34	42	30
Settlement of borrowings due within one year	20	(38)	(26)	(52)
Proceeds from borrowings due after one year	20	890	831	3,390
Settlement of borrowings due after one year	20	(759)	(1,062)	(2,068)
Proceeds from own shares		6	5	4
Settlement of currency swaps	20	(25)	(15)	(11)
Equity dividends paid	19	(279)	(272)	(250)
		(529)	(558)	1,008

Net cash (used in)/from financing activities				
Net (decrease)/increase in cash and cash equivalents		(63)	43	(54)
Cash and cash equivalents at beginning of year	20	102	65	126
Exchange adjustments	20	(1)	(6)	(7)
Cash and cash equivalents at end of year[2]		38	102	65

1 Includes $62m (2015: $52m, 2014: $60m) of outgoings on restructuring and rationalisation expenses, $24m (2015: $36m, 2014: $112m) of acquisition-related costs and $36m (2015: $3m, 2014: $23m) of legal and other costs.
2 Cash and cash equivalents is net of bank overdrafts of $62m (2015: $18m, 2014: $28m).

THE NOTES ON PAGES 116 TO 164 ARE
AN INTEGRAL PART OF THESE ACCOUNTS.

Table of Contents

GROUP FINANCIAL STATEMENTS

COMMENTARY ON THE GROUP CASH FLOW STATEMENT

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

NET CASH INFLOW FROM OPERATING ACTIVITIES

Cash generated from operations in 2016 of $1,035m (2015: $1,203m, 2014: $961m) is after paying out $24m (2015: $36m, 2014: $112m) of acquisition-related costs, $62m (2015: $52m, 2014: $60m) of restructuring and rationalisation expenses and $36m (2015: $3m, 2014: $23m) relating to legal and other costs.

Inventory turn improved slightly supported by the benefits from the Global inventory transformation program. For trade receivables there was a slight deterioration in days of sales outstanding. Movements in trade and other payables and provisions were impacted in 2015 by the recognition of a $185m provision relating to the estimated costs to resolve all known and anticipated metal-on-metal hip claims.

CAPITAL EXPENDITURE

The Group s ongoing 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 2016, capital expenditure on tangible and intangible assets represented approximately 8% of continuing Group revenue (2015: 8%, 2014: 8%).

In 2016, capital expenditure amounted to $392m (2015: $358m, 2014: $375m). 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 2016, $64m (2015: $24m, 2014: $34m) of capital expenditure had been contracted but not provided for which will be funded from future cash inflows.

ACQUISITIONS AND DISPOSALS

During the year ended 31 December 2016, the Group acquired Blue Belt Technologies Inc. and BST-CarGel for consideration, net of cash acquired, of $214m. The Gynaecology business was disposed of for proceeds of $350m less expenses of $7m and taxes of $118m.

During the year ended 31 December 2015, the Group acquired businesses in Colombia and Russia for consideration, net of cash acquired, of $44m. In November 2015, the Group invested $25m in its associate, Bioventus.

SHARE BUY-BACKS

During the year ended 31 December 2016, the Group purchased a total of 24.0m (2015: 4.4m) ordinary shares at a cost of $368m (2015: $77m), which in 2016 included a $300m share buy-back announced following the disposal of the Gynaecology business.

DIVIDENDS

The 2015 final dividend of 19.0 US cents per ordinary share totalling $170m was paid on 11 May 2016. The 2016 interim dividend of 12.3 US cents per ordinary share totalling $109m was paid on 25 October 2016.

LIQUIDITY AND CAPITAL RESOURCES

The Group s policy is to ensure that it has sufficient funding and facilities in place to meet foreseeable borrowing requirements.

At 31 December 2016, the Group held $38m (2015: $102m, 2014: $65m) in cash net of bank overdrafts. The Group had committed facilities available of $2,425m at 31 December 2016 of which $1,560m was drawn. 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 $7m (2015: $10m).

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 2017, as well as its other known or expected commitments or liabilities, can be met from its existing resources and facilities. The Group s net debt increased from $1,361m at the beginning of 2016 to $1,550m at the end of 2016, representing an overall increase of $189m.

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

THE FINANCIAL COMMENTARY ON THIS PAGE FORMS PART OF THE BUSINESS REVIEW AND IS UNAUDITED.

SEE PAGES 178 TO 179 FOR COMMENTARY ON THE 2015 FINANCIAL YEAR.

Table of Contents

GROUP STATEMENT OF CHANGES IN EQUITY

	Share capital $ million	Share premium $ million	Capital redemption reserve $ million	Treasury shares[2] $ million	Other reserves[3] $ million	Retained earnings $ million	Total equity $ million
At 31 December 2013	184	535	10	(322)	120	3,520	4,047
Attributable profit for the year[1]						501	501
Other comprehensive expense					(184)	(75)	(259)
Equity dividends declared and paid						(250)	(250)
Share-based payments recognised						32	32
Purchase of own shares				(75)			(75)
Cost of shares transferred to beneficiaries				25		(21)	4
Cancellation of treasury shares	(1)		1	57		(57)	
Issue of ordinary share capital[4]	1	39					40

At 31 December 2014	184	574	11	(315)	(64)	3,650	4,040
Attributable profit for the year[1]						410	410
Other comprehensive (expense)/income					(192)	2	(190)
Equity dividends declared and paid						(272)	(272)
Share-based payments recognised						29	29
Taxation on share-based payments						5	5
Purchase of own shares				(77)			(77)
Cost of shares transferred to beneficiaries				38		(33)	5
Cancellation of treasury shares	(1)		1	60		(60)	
Issue of ordinary share capital[4]		16					16
At 31 December 2015	183	590	12	(294)	(256)	3,731	3,966
Attributable profit for the year[1]						784	784
Other comprehensive expense					(119)	(71)	(190)
Equity dividends declared and paid						(279)	(279)
Share-based payments recognised						27	27
Taxation on share-based payments						2	2
Purchase of own shares				(368)			(368)
Cost of shares transferred to				40		(34)	6

beneficiaries							
Cancellation of treasury shares	(3)		3	190		(190)	
Issue of ordinary share capital[4]		10					10
At 31 December 2016	180	600	15	(432)	(375)	3,970	3,958

1 Attributable to equity holders of the Company and wholly derived from continuing operations.
2 Refer to Note 19.2 for further information.
3 Other reserves comprises gains and losses on cash flow hedges, foreign exchange differences on translation of foreign operations and net changes on fair value of trading investments. The cumulative translation loss within other reserves at 31 December 2016 was $388m (2015: $254m loss, 2014: $78m loss).
4 Issue of ordinary share capital as a result of options being exercised.

THE NOTES ON PAGES 116 TO 164 ARE
AN INTEGRAL PART OF THESE ACCOUNTS.

Table of Contents

NOTES TO THE GROUP ACCOUNTS

1 BASIS OF PREPARATION

Smith & Nephew plc (the Company) is a public limited company incorporated in England and Wales. In these accounts, the Group means the Company and all its subsidiaries. The principal activities of the Group are to develop, manufacture, market and sell medical devices and services.

As required by the European Union s IAS Regulation and the Companies Act 2006, the Group has prepared its accounts in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU) effective as at 31 December 2016. The Group has also prepared its accounts in accordance with IFRS as issued by the International Accounting Standards Board (IASB) effective as at 31 December 2016. IFRS as adopted by the EU differs in certain respects from IFRS as issued by the IASB. However, the differences have no impact for the periods presented.

The preparation of accounts in conformity with IFRS requires management to use estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the accounts and the reported amounts of revenues and expenses during the year. The accounting policies requiring management to use significant estimates and assumptions are: inventories, impairment, taxation, liability provisions and business combinations. These are discussed under Critical accounting policies on page 108. Although these estimates are based on management s best knowledge of current events and actions, actual results ultimately may differ from those estimates. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to estimates are recognised prospectively.

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

As described in Note 15, the Group meets its funding requirements through a mixture of shareholders funds, bank borrowings and private placement notes. At 31 December 2016, the Group had committed borrowing facilities of $2.4bn and total liquidity of $0.9bn, including net cash and cash equivalents of $38m and undrawn committed

borrowing facilities of $0.9bn. The earliest expiry date of the Group s committed borrowing facilities is in respect of a $300m bilateral term loan facility due to expire in April 2019.

The Group s forecasts and projections, taking into account reasonably possible changes in trading performance, show that the Group has sufficient financial resources. The Directors have reasonable expectation that the Company and the Group are well placed to manage their business risks and to continue in operational existence for a period of at least three years from the date of the approval of the financial statements. Accordingly, the Directors continue to adopt the going concern basis (in accordance with the guidance Going Concern and Liquidity Risk: Guidance for Directors of UK Companies 2009 issued by the FRC) in preparing the consolidated financial statements.

There have been no new accounting pronouncements impacting the Group in 2016.

A number of new standards, amendments to standards and interpretations are effective for the Group s annual periods beginning on or after 1 January 2017, and have not been applied in preparing these consolidated accounts. The new leasing standard IFRS 16 *Leases* will become effective from 1 January 2019 and is expected to have a significant effect on the consolidated accounts of Group. The impact of these new standards is still being determined.

1.1 Consolidation

The Group accounts include the accounts of Smith & Nephew plc and its subsidiaries for the periods during which they were members of the Group.

Subsidiaries are entities controlled by the Group. The Group controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Subsidiaries are consolidated in the Group accounts from the date that the Group obtains control, and continue to be consolidated until the date that such control ceases. Intra-group balances and transactions, and any unrealised income and expenses arising from intra-group transactions, are eliminated on consolidation. All subsidiaries have year ends which are co-terminus with the Groups, with the exception of jurisdictions whereby a different year end is required by local legislation.

When the Group loses control over a subsidiary, it derecognises the assets and liabilities of the subsidiary and any related components of equity. Any resulting gain or loss is recognised in profit or loss. Any retained interest in the former subsidiary is measured at fair value.

1.2 Foreign currencies

Functional and presentation currency

The Group accounts are presented in US Dollars, which is the Company s functional currency.

Foreign currency transactions

Transactions in foreign currencies are translated to the respective functional currencies of Group companies at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are retranslated to the functional currency as at the exchange rate at the reporting date. Non-monetary items are not retranslated.

Foreign operations

Balance sheet items of foreign operations, including goodwill and fair value adjustments arising on acquisition are translated into US Dollars on consolidation at the exchange rates at the reporting date. Income statement items and the

cash flows of foreign operations are translated at average rates as an approximation to actual transaction rates, with actual transaction rates used for large one off transactions.

Foreign currency differences are recognised in Other comprehensive income and accumulated in Other reserves within equity. These include: exchange differences on the translation at closing rates of exchange of non-US Dollar opening net assets; the differences arising between the translation of profits into US Dollars at actual (or average, as an approximation) and closing exchange rates; to the extent that the hedging relationship is effective, the difference on translation of foreign currency borrowings or swaps that are used to finance or hedge the Group s net investments in foreign operations; and the movement in the fair value of forward foreign exchange contracts used to hedge forecast foreign exchange cash flows.

Table of Contents

Foreign operations continued

The exchange rates used for the translation of currencies into US Dollars that have the most significant impact on the Group results were:

	2016	2015	2014
Average rates			
Sterling	1.35	1.53	1.65
Euro	1.11	1.11	1.33
Swiss Franc	1.02	1.04	1.09
Renminbi	0.15	0.16	0.16
Year end rates			
Sterling	1.23	1.48	1.56
	1.05	1.09	1.21

Euro			
Swiss Franc	0.98	1.00	1.01
Renminbi	0.14	0.15	0.16

2 BUSINESS SEGMENT INFORMATION

Development, manufacturing, supply chain and central functions are managed globally for the Group as a whole. Sales are managed through three geographical selling regions, with each having a president who is responsible for the commercial view of that region. The Executive Committee (ExCo), comprises the Chief Commercial Officer, geographical presidents and certain heads of function and is chaired by the CEO. The ExCo is the body through which the CEO uses the authority delegated to him by the Board of Directors to manage the operations and performance of the Group. All significant operating decisions regarding the allocation of the Group s resources and assessment of the Group s performance are made by the ExCo, and whilst the members have individual responsibility for the implementation of decisions within their respective areas, it is at the ExCo level that these decisions are made. Accordingly, the ExCo is considered to be the Group s chief operating decision maker as defined by IFRS 8, Operating Segments.

In making decisions about the allocation of the Group s resources, the ExCo review financial information on an integrated basis for the Group as a whole and determines the best allocation of resources to group-wide projects. This information is prepared substantially on the same basis as the Group s IFRS financial statements aside from the adjustments described in Note 2.2.

In assessing performance, the ExCo also consider financial information presented on a geographical selling region and product franchise basis for revenue. Financial information for corporate and functional costs is presented on a group-wide basis. When applying the requirements of IFRS 8, the Group considers that the allocation of resources by the ExCo being determined at Group level on a project by project basis determines that the Group has one operating segment.

The types of products and services offered by the Group s global business segment are as follows:

Sports Medicine Joint Repair, which offers surgeons a broad array of instruments, technologies and implants necessary to perform minimally invasive surgery of the joints;

Arthroscopic Enabling Technologies, which offers healthcare providers a variety of technologies such as fluid management equipment for surgical access, high definition cameras, digital image capture, scopes, light sources and monitors to assist with visualisation inside the joints, radio frequency wands, electromechanical and mechanical blades, and hand instruments for removing damaged tissue;

Trauma & Extremities, consisting of internal and external devices used in the stabilisation of severe fractures and deformity correction procedures;

Other Surgical Businesses, which includes robotics-assisted surgery, various products and technologies to assist in surgical treatment of the ear, nose and throat, and gynaecological instrumentation, until the Gynaecology business

disposal in August 2016.

Knee Implants, which offers an innovative range of products for specialised knee replacement procedures;

Hip Implants, which offers a range of specialist products for reconstruction of the hip joint;

Advanced Wound Care, which includes products for the treatment of acute and chronic wounds, including leg, diabetic and pressure ulcers, burns and post-operative wounds;

Advanced Wound Bioactives, which includes biologics and other bioactive technologies that provide unique approaches to debridement and dermal repair/regeneration; and

Advanced Wound Devices, which consists of traditional and single-use Negative Pressure Wound Therapy and hydrosurgery systems.

The segment information is prepared in conformity with the accounting policies of the Group and the accounting standard IFRS 8 Operating Segments.

The segment profit measure reported to the Chief Executive Officer and his Commercial and Operations Committee team for the purposes of resource allocation and assessment is trading profit before interest, and related income tax expense and excludes the effects of non-recurring income and expenditure from one-off items as discussed in Note 2.2. Group financing (including interest receivable and payable) is managed on a net basis outside of the business segment. In 2015, the Group changed its operating segments following its transition to a new commercial organisational structure. Consequently the 2014 comparatives presented were restated in 2015 to conform to the one global segment view.

The results and other information as required of the single segment are shown in Note 2.

Table of Contents

NOTES TO THE GROUP ACCOUNTS

2 BUSINESS SEGMENT INFORMATION continued

2.1 Revenue by business segment and geography

ACCOUNTING POLICY

Revenue comprises sales of products and services to third parties at amounts invoiced net of trade discounts and rebates, excluding taxes on revenue. Revenue from the sale of products is recognised upon transfer to the customer of the significant risks and rewards of ownership. This is generally when goods are delivered to customers. There is no significant revenue associated with the provision of discrete services. Sales of inventory located at customer premises and available for customers immediate use are recognised when notification is received that the product has been implanted or used. Appropriate provisions for returns, trade discounts and rebates are deducted from revenue. Rebates comprise retrospective volume discounts granted to certain customers on attainment of certain levels of purchases from the Group. These are accrued over the course of the arrangement based on estimates of the level of business expected and adjusted at the end of the arrangement to reflect actual volumes.

Segment revenue reconciles to statutory revenues and other income from continuing operations as follows:

	2016 $ million	2015 $ million	2014 $ million

Reportable segment revenue			
Revenue from external customers	4,669	4,634	4,617

The table below shows revenue by product type from continuing operations. Included within the 2015 and 2014 analyses are reclassifications of $58m and $54m respectively of product sales formerly included in the Sports Medicine Joint Repair franchise which have now been included in the Arthroscopic Enabling Technologies franchise in order to present analysis in line with 2016 management reporting on a consistent basis.

	2016 $ million	2015 $ million	2014 $ million
Revenue by product from continuing operations			
Sports Medicine Joint Repair	587	548	522
Arthroscopic Enabling Technologies	631	631	596
Trauma & Extremities	475	497	506
Other Surgical Businesses	214	205	147
Knee Implants	932	883	873
Hip Implants	597	604	654
Advanced Wound Care	719	755	805
	342	344	322

Advanced Wound Bioactives			
Advanced Wound Devices	172	167	192
Consolidated revenue from continuing operations			
	4,669	4,634	4,617

In presenting information on the basis of geographical segments, segment revenue is based on location of Smith & Nephew businesses:

	2016 $ million	2015 $ million	2014 $ million
Geographical segment revenue			
United Kingdom	266	301	299
United States of America	2,299	2,217	2,012
Other[1]	2,104	2,116	2,306
Consolidated revenue from continuing operations			
	4,669	4,634	4,617

1 No other country represents more than 5% of consolidated sales revenue from continuing operations.

Major customers

No single customer generates revenue greater than 10% of the consolidated revenue.

Table of Contents

2.2 Trading and operating profit by business segment

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 and impairment of acquisition intangibles; significant restructuring programmes; gains and losses arising from legal disputes; and other significant items. Further detail is provided in Notes 3.3, 3.4 and 3.5. Trading profit reconciles to operating profit as follows:

	2016 $ million	2015 $ million	2014 $ million
Trading profit of the business segment	1,020	1,099	1,055
Acquisition-related costs	(9)	(12)	(118)
Restructuring and rationalisation expenses	(62)	(65)	(61)
Amortisation of acquisition intangibles and impairments	(178)	(204)	(129)
Legal and other	30	(190)	2
Operating profit of the business segment	801	628	749
Net interest expense	(46)	(38)	(22)
Other finance costs	(16)	(15)	(11)
Share of results of associates	(3)	(16)	(2)
Profit on disposal of business	326		
Taxation	(278)	(149)	(213)

Attributable profit for the year of the business segment	784	410	501

2.3 Assets and liabilities by business segment and geography

	2016 $ million	2015 $ million	2014 $ million
Reconciliation of assets of the business segment to the consolidated group			
Assets of the business segment	7,147	6,929	7,129
Unallocated corporate assets:			
Deferred tax assets	97	105	77
Retirement benefit assets		13	7
Cash at bank	100	120	93
Total assets of the consolidated group	7,344	7,167	7,306

Segment assets are based on the location of the assets:

	2016 $ million	2015 $ million	2014 $ million
United Kingdom	335	366	379
United States of America	3,145	2,982	3,104
Other	1,238	1,226	1,299
Non-current assets by geographical location[1]	4,718	4,574	4,782

1 Non-current assets excludes retirement benefit assets and deferred tax assets.

Table of Contents

NOTES TO THE GROUP ACCOUNTS

2 BUSINESS SEGMENT INFORMATION continued

	2016 $ million	2015 $ million	2014 $ million
Reconciliation of liabilities of the business segment to the consolidated group			
Liabilities of the business segment	1,247	1,197	1,012
Unallocated corporate liabilities:			
Long-term borrowings	1,564	1,434	1,666
Retirement benefit obligations	164	184	233
Deferred tax liabilities	94	77	98
Bank overdrafts and loans due within one year	86	46	39
Current tax payable	231	263	218
Total liabilities of the consolidated group	3,386	3,201	3,266
Depreciation, amortisation and impairment of the business segment			
Depreciation of property, plant and equipment	224	226	222
Amortisation of acquired intangibles	130	153	129

Amortisation of other intangible assets	61	66	62
Total depreciation and amortisation	415	445	413
Impairment losses on property, plant and equipment[1]			14
Impairment losses on acquired intangibles[1]	48	51	
Impairment reversal on trade investments[1]		(3)	
Total non-cash items	463	493	427

1 Impairments recognised in operating profit, within the administrative expenses line.

Segment acquisition of property, plant and equipment and intangibles reconciles to that of the consolidated group, and comprises the following:

	2016	2015	2014
	$ million	$ million	$ million
Additions to property, plant and equipment	320	303	298
Additions to intangibles	72	55	77
Capital expenditure (excluding business combinations)	392	358	375
Trade investments	2	2	4
Acquisitions Goodwill	211	34	844
Acquisitions Intangible assets	85	19	833
Acquisitions Property, plant and equipment	2	6	62
Capital and acquisition expenditure	692	419	2,118

Table of Contents

3 OPERATING PROFIT

ACCOUNTING POLICIES

Research and development

Research expenditure is expensed as incurred. Internal development expenditure is only capitalised if the recognition criteria in IAS 38 *Intangible Assets* have been satisfied. The Group considers that the regulatory, technical and market uncertainties inherent in the development of new products mean that in most cases development costs should not be capitalised as intangible assets until products receive approval from the appropriate regulatory body.

Payments to third parties for research and development projects are accounted for based on the substance of the arrangement. If the arrangement represents outsourced research and development activities the payments are generally expensed except in limited circumstances where the respective development expenditure would be capitalised under the principles established in IAS 38. By contrast, the payments are capitalised if the arrangement represents consideration for the acquisition of intellectual property developed at the risk of the third party.

Capitalised development expenditures are amortised on a straight-line basis over their useful economic lives from product launch.

Advertising costs

Advertising costs are expensed as incurred.

	2016 $ million	2015 $ million	2014 $ million
Revenue	4,669	4,634	4,617
Cost of goods sold[1,2]	(1,272)	(1,143)	(1,162)
Gross profit	3,397	3,491	3,455
Research and development expenses	(230)	(222)	(235)
Selling, general and administrative expenses:			
Marketing, selling and distribution expenses	(1,712)	(1,735)	(1,670)
Administrative expenses[3,4,5,6]	(654)	(906)	(801)
	(2,366)	(2,641)	(2,471)
Operating profit	801	628	749

1 2016 includes $nil of restructuring and rationalisation expenses (2015: $nil, 2014: $12m).

2 2016 includes $nil of acquisition-related costs (2015: $nil, 2014: $23m).

3 2016 includes $61m of amortisation of software and other intangible assets (2015: $66m, 2014: $62m).

4 2016 includes $62m of restructuring and rationalisation expenses and $178m of amortisation and impairment of acquisition intangibles (2015: $65m of restructuring and rationalisation expenses and $204m of amortisation of acquisition intangibles, 2014: $49m of restructuring and rationalisation expenses and $129m of amortisation of acquisition intangibles).

5 2016 includes $30m credit relating to legal and other exceptionals (2015: $190m charge, 2014: $2m credit).

6 2016 includes $9m of acquisition-related costs (2015: $12m, 2014: $95m).

Note that items detailed in 1, 2, 4, 5 and 6 are excluded from the calculation of trading profit, the segment profit measure.

Operating profit is stated after charging/(crediting) the following items:

	2016 $ million	2015 $ million	2014 $ million
Other operating income	(25)	(41)	(9)
Amortisation of intangibles	191	219	191
Impairment of intangible assets	48	51	
Depreciation of property, plant and equipment	224	226	222
Loss on disposal of property, plant and equipment and intangible assets	15	15	11
Operating lease payments for land and buildings	39	37	38
Operating lease payments for other assets	19	20	18
Advertising costs	88	91	96

In 2016 other operating income primarily relates to insurance recovery relating to metal-on-metal claims (2015: net gain relating to patent litigation).

Table of Contents

NOTES TO THE GROUP ACCOUNTS

3 OPERATING PROFIT continued

3.1 Staff costs and employee numbers

Staff costs during the year amounted to:

	Notes	2016 $ million	2015 $ million	2014 $ million
Wages and salaries		1,227	1,193	1,237
Social security costs		129	135	127
Pension costs (including retirement healthcare)[1]	18	23	58	17
Share-based payments	23	27	30	32
		1,406	1,416	1,413

1 In 2016, pension costs include the past service cost credit of $49m arising primarily from the closure of the UK defined benefit scheme to future accrual.

During the year ended 31 December 2016, the average number of employees was 15,584 (2015: 14,686, 2014: 13,469).

3.2 Audit Fees information about the nature and cost of services provided by auditor

	2016 $ million	2015 $ million	2014 $ million
Audit services:			
Group accounts	2	2	2
Local statutory audit pursuant to legislation	2	2	1
Other services:			
Non-audit services	1	1	
Taxation services:			
Compliance services			1
Advisory services			1
Total auditor s remuneration	5	5	5
Arising:			
In the UK	2	2	3
Outside the UK	3	3	2
	5	5	5

Audit fees for the current year and 2015 are those relating to KPMG LLP, the Group s auditor. In 2014, fees relate to Ernst & Young LLP, the Group s former auditor.

3.3 Acquisition-related costs

Acquisition-related costs of $9m (2015: $12m, 2014: $118m) were incurred within operating profit in 2016. These costs relate to the costs associated with the purchase and integration of Blue Belt Technologies and other acquisitions.

3.4 Restructuring and rationalisation expenses

Restructuring and rationalisation costs of $62m (2015: $65m, 2014: $61m) were incurred in 2016. These costs primarily related to the ongoing implementation of the Group Optimisation Plan that was announced in May 2014 and has now completed.

3.5 Legal and other

The legal and other credit within operating profit of $30m (2015: $190m charge, 2014: $2m credit) recognised primarily related to a $44m curtailment gain arising on UK post-retirement benefits. Also included is a net $1m gain

in respect of insurance recoveries of $24m and legal expenses of $23m, relating to the ongoing metal-on-metal hip claims. This was partially offset by legal expenses relating to patent litigation.

Table of Contents

4 INTEREST AND OTHER FINANCE COSTS

4.1 Interest income/(expense)

	2016 $ million	2015 $ million	2014 $ million
Interest income	6	11	13
Interest expense:			
Bank borrowings	(9)	(9)	(19)
Private placement notes	(37)	(37)	(14)
Other	(6)	(3)	(2)
	(52)	(49)	(35)
Net interest expense	(46)	(38)	(22)

4.2 Other finance costs

	Notes	2016 $ million	2015 $ million	2014 $ million
Retirement benefit net interest expense	18	(7)	(11)	(10)
Unwinding of discount		(9)	(3)	

Other		(1)	(1)
	(16)	(15)	(11)

Other finance costs

Foreign exchange gains or losses arose primarily on the translation of intercompany and third party borrowings and amounted to a net $22m gain in 2016 (2015: net $11m gain, 2014: net $21m gain). These amounts were matched by the fair value gains or losses on currency swaps held to manage this currency risk.

5 TAXATION

ACCOUNTING POLICY

The charge for current taxation is based on the results for the year as adjusted for items which are non-assessable or disallowed. It is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

The Group operates in multiple tax jurisdictions around the world and records provisions for taxation liabilities and tax audits when it is considered probable that a tax charge will arise and the amount can be reliably estimated. Although Group policy is to submit its tax returns to the relevant tax authorities as promptly as possible, at any time the Group has years outstanding and is involved in disputes and tax audits. Significant issues may take many years to resolve. In estimating the probability and amount of any tax charge, management takes into account the views of internal and external advisers and updates the amount of the 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.

Deferred tax is recognised in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.

Deferred tax is not recognised for: temporary differences related to investments in subsidiaries and associates where the Group is able to control the timing of the reversal of the temporary difference and it is probable that this will not reverse in the foreseeable future; on the initial recognition of non-deductible goodwill; and on the initial recognition of an asset or liability in a transaction that is not a business combination and that, at the time of the transaction, does not affect the accounting or taxable profit.

Deferred tax assets are recognised to the extent that it is probable that future taxable profits will be available against which they can be used. Deferred tax assets are reviewed at each reporting date.

Deferred tax is measured on an undiscounted basis, and at the tax rates that have been enacted or substantively enacted by the reporting date that are expected to apply in the periods in which the asset or liability is settled. It is recognised in the income statement except when it relates to items credited or charged directly to other comprehensive income or equity, in which case the deferred tax is also recognised within other comprehensive income or equity respectively.

Deferred tax assets and liabilities are offset when they relate to income taxes levied by the same taxation authority, when the Group intends to settle its current tax assets and liabilities on a net basis and that authority permits the Group to make a single net payment.

Table of Contents

NOTES TO THE GROUP ACCOUNTS

5 TAXATION continued

5.1 Taxation charge attributable to the Group

	2016 $ million	2015 $ million	2014 $ million
Current taxation:			
UK corporation tax at 20% (2015: 20.3%, 2014: 21.5%)	23	31	39
Overseas tax	261	219	235
Current income tax charge	284	250	274
Adjustments in respect of prior periods	(53)	(56)	(6)
Total current taxation	231	194	268

Deferred taxation:			
Origination and reversal of temporary differences	24	(73)	(52)
Changes in tax rates		(3)	
Adjustments to estimated amounts arising in prior periods	23	31	(3)
Total deferred taxation	47	(45)	(55)
Total taxation as per the income statement	278	149	213
Taxation in other comprehensive income	(10)	(10)	(19)
Taxation in equity	(2)	(5)	
Taxation attributable to the Group	266	134	194

The 2016 net prior period adjustment benefit of $30m (current tax credit of $53m offset by a deferred tax charge of $23m) mainly relates to a provision release following agreement reached with the IRS on a US tax matter, other provision releases on the expiry of statute of limitations and tax accrual to tax return adjustments offset by an increase in certain other tax provisions. The 2015 net prior period adjustment benefit of $25m (current tax credit of $56m offset by a deferred tax charge of $31m) mainly relates to provision releases after settlement with tax authorities or the expiry of statute of limitations and tax accrual to tax return adjustments.

Total taxation as per the income statement increased by $48m (2015: $130m reduction and 2014: $71m reduction) as a consequence of acquisition and disposals, restructuring and rationalisation costs, amortisation and impairment of acquisition intangibles and legal and other (see Note 6).

Factors affecting future tax charges

The Group operates in numerous tax jurisdictions around the world and is subject to factors that may affect future tax charges including potential US tax reform, implementation of the OECD s BEPS actions, tax rate changes, tax legislation changes and resolution of tax audits and disputes. At any given time the Group has unagreed years outstanding in various countries and is involved in tax audits and disputes, some of which may take several years to resolve. The ultimate tax liability may differ from the amount provided depending on interpretations of tax law, settlement negotiations or changes in legislation. The Group believes that it has made adequate provision in respect of additional tax liabilities that may arise from these unagreed years, tax audits and disputes, the majority of which relate to transfer pricing matters as would be expected for a Group operating internationally. However, the actual liability for any particular issue may be higher or lower than the amount provided resulting in a negative or positive effect on the tax charge in any given year.

In December 2016, the Group appealed to the First-Tier Tribunal in the UK against a decision by HM Revenue and Customs (HMRC) relating to the tax deductibility of certain historical foreign exchange losses. The decision of the Tribunal was released on 8 February 2017 and it upheld the Group s appeal. HMRC has 56 days from 8 February 2017 to decide whether to appeal this decision. No tax benefit has been recognised to date in respect of these foreign exchange losses. In the event that HMRC decide not to appeal or if they do and the Group is ultimately successful in the Courts following an appeal, then the Group s tax charge would be reduced, in the year of success, as a result.

In 2016, the UK Government enacted legislation to reduce the main rate of UK statutory corporation tax to 19.0% from 1 April 2017 and 17.0% from 1 April 2020.

Table of Contents

The UK standard rate of corporation tax for 2016 is 20% (2015: 20.3%; 2014: 21.5%). Overseas taxation is calculated at the rates prevailing in the respective jurisdictions. The table below reconciles the expected tax charge at the UK statutory rate with the actual tax charge:

	2016 $ million	2015 $ million	2014 $ million
Profit before taxation	1,062	559	714
Expected taxation at UK statutory rate of 20% (2015: 20.3%, 2014: 21.5%)	212	113	154
Differences in overseas taxation rates[1]	52	61	63
Disposal of the Gynaecology business (mainly at the US tax rate)	56		
Benefit of US Manufacturing deduction	(7)	(7)	(10)
R&D credits	(3)	(6)	(5)
Tax losses not recognised	1	11	11
Utilisation of previously unrecognised tax losses	(9)		
Expenses not deductible for tax purposes[2]	6	2	9
Adjustments in respect of prior years[3]	(30)	(25)	(9)
Total taxation as per the income statement	278	149	213

1 Mainly relates to profits taxed in the US at a rate higher than the UK statutory rate.
2 Includes the impact of intra-group loans provided to finance US acquisitions and business operations.
3 The 2016 and 2015 credits of $30m and $25m respectively are explained above.

5.2 Deferred taxation

Movements in the main components of deferred tax assets and liabilities were as follows:

	Accelerated tax depreciation $ million	Intangibles $ million	Retirement benefit obligation $ million	Macrotexture $ million	Inventory, provisions and other differences $ million	Total $ million
At 1 January 2015	(70)	(226)	70	52	153	(21)
Exchange adjustment	(1)	7	(1)		(7)	(2)
Reclassifications	(1)	(53)	(19)		73	
Movement in income statement current year	4	41	(19)		47	73
Movement in income statement prior years	6	9	(1)		(45)	(31)
Movement in other comprehensive income			9		1	10
Movement in equity					(1)	(1)
Changes in tax rate		2			1	3
Acquisitions		(3)				(3)
At 31 December 2015	(62)	(223)	39	52	222	28
Exchange adjustment		2			(3)	(1)
Movement in income statement current year		34	(16)		(42)	(24)
Movement in income statement prior years	(11)	6	(2)		(16)	(23)
Movement in other comprehensive income			7		(1)	6
Movement in equity					2	2

Changes in tax rate		1			(1)	
Acquisitions		(29)			44	15
At 31 December 2016	(73)	(209)	28	52	205	3

Represented by:

	2016	2015
	$ million	$ million
Deferred tax assets	97	105
Deferred tax liabilities	(94)	(77)
Net position at 31 December	3	28

The Group has unused gross trading tax losses of $146m (2015: $103m) and gross unused capital losses of $122m (2015: $196m) available for offset against future profits. A deferred tax asset has been recognised in respect of $94m (2015: $29m) of the trading tax losses. No deferred tax asset has been recognised on the remaining unused tax losses as they are not expected to be realised in the foreseeable future.

The aggregate amount of temporary differences in respect of investments in subsidiaries and associates for which deferred tax liabilities have not been recognised is approximately $483m (2015: $467m).

Table of Contents

NOTES TO THE GROUP ACCOUNTS

6 EARNINGS PER ORDINARY SHARE

ACCOUNTING POLICIES

Earnings per share

Basic earnings per share is calculated by dividing the profit attributable to equity holders by the weighted average number of ordinary shares in issue during the year, excluding shares held by the Company in the Employees Share Trust or as treasury shares.

Diluted earnings per share

Diluted earnings per share is calculated by adjusting the basic earnings per share for the effect of conversion to ordinary shares associated with dilutive potential ordinary shares, which comprise share options and awards granted to employees.

Adjusted earnings per share

Adjusted earnings per share 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. Adjusted attributable profit is the numerator used for this measure. The Group has identified the following items as those to be excluded when arriving at adjusted attributable profit: acquisitions and disposals related items including amortisation and impairment of acquisition intangible assets; significant restructuring programmes; significant gains and losses arising from legal disputes and other significant and taxation thereon.

The calculations of the basic, diluted and adjusted earnings per ordinary share are based on the following attributable profit and numbers of shares:

	2016 $ million	2015 $ million	2014 $ million
Earnings			
Attributable profit for the year	784	410	501
Adjusted attributable profit (see below)	735	761	743

Attributable profit is reconciled to adjusted attributable profit as follows:

	Notes	2016 $ million	2015 $ million	2014 $ million
Attributable profit for the year		784	410	501
Acquisition-related costs		9	25	125
Restructuring and rationalisation expenses	3	62	65	61
Amortisation and impairment of acquisition intangibles	9	178	204	129
Legal and other[1]		(20)	187	(2)

Profit on disposal of business	21	(326)		
Taxation on excluded items	5	48	(130)	(71)
Adjusted attributable profit		735	761	743

1 Legal and other credit includes $30m within operating profits (refer to Note 3.5), a $5m charge within other finance costs for unwinding of the discount on the provision for known, anticipated and settled metal-on-metal hip claims, and a $5m charge within share of results of associates for expenses incurred by Bioventus for an aborted initial public offering of shares.

The numerators used for basic and diluted earnings per ordinary share are the same. The denominators used for all categories of earnings for basic and diluted earnings per ordinary share are as follows:

	2016	2015	2014
Number of shares (millions)			
Basic weighted number of shares	890	894	893
Dilutive impact of share options outstanding	3	5	6
Diluted weighted average number of shares	893	899	899
Earnings per ordinary share			
Basic	88.1¢	45.9¢	56.1¢
Diluted	87.8¢	45.6¢	55.7¢
Adjusted[2]	82.6¢	85.1¢	83.2¢

2 Adjusted earnings per share is calculated using the basic weighted number of shares.

Table of Contents

7 PROPERTY, PLANT AND EQUIPMENT

ACCOUNTING POLICIES

Property, plant and equipment

Items of property, plant and equipment are stated at cost less accumulated depreciation and any accumulated impairment losses.

Depreciation is calculated to write off the cost of items of property, plant and equipment less their estimated residual values using the straight-line method over their estimated useful lives, and is generally recognised in profit or loss. Leased assets are depreciated over the shorter of the lease term and their useful lives unless it is reasonably certain that the Group will obtain ownership by the end of the lease term. Freehold land is not depreciated. The estimated useful lives of items of property, plant and equipment is 3 20 years and for buildings is 20 50 years.

Assets in course of construction are not depreciated until they are available for use.

Depreciation methods, useful lives and residual values are reviewed at each reporting date and adjusted if appropriate.

Finance costs relating to the purchase or construction of property, plant and equipment and intangible assets that take longer than one year to complete are capitalised based on the Group weighted average borrowing costs. All other finance costs are expensed as incurred.

Impairment of assets

The carrying values of property, plant and equipment are reviewed for impairment when events or changes in circumstances indicate the carrying value may be impaired. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of impairment loss. Where it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash-generating unit to which it belongs.

An asset s recoverable amount is the higher of an asset s or cash-generating unit s fair value less costs to sell and its value-in-use. In assessing value-in-use, its estimated future cash flow is discounted to its present value using a pre-tax discount rate that reflects the current market assessment of the time value of money and the risks specific to the asset.

Table of Contents

NOTES TO THE GROUP ACCOUNTS

7 PROPERTY, PLANT AND EQUIPMENT continued

	Notes	Land and buildings: Freehold $ million	Land and buildings: Leasehold $ million	Plant and equipment: Instruments $ million	Plant and equipment: Other $ million	Assets in course of construction $ million	Total $ million
Cost							
At 1 January 2015		149	54	1,060	963	134	2,360
Exchange adjustment		(3)	(1)	(63)	(26)	(1)	(94)
Acquisitions	21			6			6
Additions		4	1	152	78	68	303
Disposals		(1)	(1)	(113)	(47)		(162)
Transfers		5	5		35	(45)	
At 31 December 2015		154	58	1,042	1,003	156	2,413
Exchange adjustment		(6)		(22)	(46)	(5)	(79)
Acquisitions	21			2			2
Additions		1	1	166	72	80	320
Disposals	21			(76)	(39)	(3)	(118)
Transfers		16	60	4	33	(113)	

At 31 December 2016	165	119	1,116	1,023	115	2,538
Depreciation and impairment						
At 1 January 2015	45	32	744	637	11	1,469
Exchange adjustment	(1)		(43)	(19)		(63)
Charge for the year	5	4	137	80		226
Disposals	(1)	(1)	(106)	(43)		(151)
At 31 December 2015	48	35	732	655	11	1,481
Exchange adjustment	(3)		(15)	(34)		(52)
Charge for the year	5	7	131	81		224
Disposals			(67)	(30)		(97)
At 31 December 2016	50	42	781	672	11	1,556
Net book amounts						
At 31 December 2016	115	77	335	351	104	982
At 31 December 2015	106	23	310	348	145	932

Land and buildings includes land with a cost of $19m (2015: $19m) that is not subject to depreciation. Assets held under finance leases with a net book value of $5m (2015: $6m) are included within land and buildings.

Group capital expenditure relating to property, plant and equipment contracted but not provided for amounted to $55m (2015: $20m).

The amount of borrowing costs capitalised in 2016 and 2015 was minimal.

Table of Contents

8 GOODWILL

ACCOUNTING POLICY

Goodwill is not amortised but is reviewed for impairment annually. Goodwill is allocated to the cash-generating unit (CGU) that is expected to benefit from the acquisition. The recoverable amount of CGUs to which goodwill has been allocated is tested for impairment annually. The CGUs identified by management are at the aggregated product franchise levels of Reconstruction, Other Surgical Devices and Advanced Wound Management, in the way the core assets are used to generate cash flows.

If the recoverable amount of the CGU is less than its carrying amount then an impairment loss is determined to have occurred. Any impairment losses that arise are recognised immediately in the income statement and are allocated first to reduce the carrying amount of goodwill and then to the carrying amounts of the other assets of the CGU.

In carrying out impairment reviews of goodwill 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.

	Notes	2016 $ million	2015 $ million
Cost			

At 1 January		2,012	2,027
Exchange adjustment		(35)	(49)
Acquisitions	21	211	34
At 31 December		2,188	2,012
Impairment			
At 1 January and 31 December			
Net book amounts		2,188	2,012

Management has identified four CGUs in applying the provisions of IAS 36 Impairment of Assets: Reconstruction, Other Surgical Devices, Advanced Wound Care & Devices and Bioactives.

For the purpose of goodwill impairment testing, the Advanced Wound Care & Devices and Bioactives CGUs have been aggregated (Advanced Wound Management), as this is the level at which goodwill is monitored and level at which the economic benefits relating to the goodwill within these CGUs is realised.

Goodwill is allocated to the Group s CGUs as follows:

	2016 $ million
Reconstruction	551
Other Surgical Devices	1,351
Advanced Wound Management	286
	2,188

Impairment reviews were performed in September 2016 and September 2015 by comparing the recoverable amount of each CGU with its carrying amount, including goodwill. These were updated during December, taking into account any significant events that occurred between September and December.

For each CGU, the recoverable amounts are based on value-in-use which is calculated from pre-tax cash flow projections for five years using data from the Group s budget and strategic planning process, the results of which are reviewed and approved by the Board. These projections exclude any estimated future cash inflows or outflows

expected to arise from future restructurings. The five-year period is in-line with the Group s strategic planning process.

In determining the growth rates used in the calculations of the value-in-use, management considered annual revenue growth. Projections are based on anticipated volume and value growth in the markets served by the Group and assumptions as to market share movements. Each year the projections for the previous year are compared to actual results and variances are factored into the assumptions used in the current year. The discount rates used in the value-in-use calculations reflect management s assessment of risks specific to the assets of each CGU.

8.1 Reconstruction CGU

The sales growth and trading profit margin used in the value-in-use calculation for the Reconstruction CGU, which includes the Trauma and Extremities business, reflects management s distinctive orthopaedic reconstruction strategy, which combines cutting edge innovation, disruptive business models and a strong Emerging Markets platform to drive outperformance.

Revenue growth rates for the five-year period ranged from 1.0% to 2.45% for the various components of the Reconstruction CGU. The weighted average growth rate used to extrapolate the cash flows beyond the five-year period in calculating the terminal value is 1.9%. The pre-tax discount rate used in the Reconstruction CGU value-in-use calculation is 10.5%.

Table of Contents

NOTES TO THE GROUP ACCOUNTS

8 GOODWILL continued

8.2 Other Surgical Devices CGU

The value-in-use calculation for the Other Surgical Devices CGU reflects growth rates and trading profit margins consistent with management s strategy to rebalance Smith & Nephew towards higher growth areas such as, for example, Sports Medicine.

Revenue growth rates for the five-year period ranged from 1.0% to 8.1% for the various components of the Other Surgical Devices CGU. The weighted average growth rate used to extrapolate the cash flows beyond the five-year period in calculating the terminal value is 5.0%. The pre-tax discount rate used in the Other Surgical Devices CGU value-in-use calculation is 10.5%.

8.3 Advanced Wound Management CGU

The aggregated Advanced Wound Management CGU comprises the Advanced Wound Care & Devices and Bioactives CGUs.

In performing the value-in-use calculation for this combined CGU, management considered the Group s focus across the wound product franchises, focusing on widening access to the customer, the higher added value sectors of healing chronic wounds and tissue repair using bioactives, and by continuing to improve efficiency.

Revenue growth rates for the five-year period ranged from 1.0% to 14.5% for the various components of the Advanced Wound Management CGU. The weighted average growth rate used to extrapolate the cash flows beyond the five-year period in calculating the terminal value is 4.3%. The pre-tax discount rate used in the Advanced Wound Management CGU value-in-use calculation is 10.5%.

8.4 Sensitivity to changes in assumptions used in value-in-use calculations

The calculations of value-in-use for the identified CGUs are most sensitive to changes in discount and growth rates. Management s consideration of these sensitivities is set out below:

Growth of market and market share management has considered the impact of a variance in market growth and market share. The value-in-use calculations shows that if the assumed long-term growth rates were reduced to nil, the recoverable amount of each CGU would still be greater than its carrying value.

Discount rate management has considered the impact of an increase in the discount rate applied to the value-in-use calculations. This sensitivity analysis shows that for the recoverable amount of each CGU to be less than its carrying value, the discount rate would have to be increased to 13.2% for the Reconstruction CGU, 17.2% for the Other Surgical Devices CGU and 21.6% for the Advanced Wound Products CGU.

9 INTANGIBLE ASSETS

ACCOUNTING POLICIES

Intangible assets

Intangible assets acquired separately from a business combination (including purchased patents, know-how, trademarks, licences and distribution rights) are initially measured at cost. The cost of intangible assets acquired in a material business combination (referred to as acquisition intangibles) is the fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. All intangible assets are amortised on a straight-line basis over their estimated useful economic lives. The estimated useful economic life of an intangible asset ranges between three and 20 years depending on its nature. Internally-generated intangible assets are expensed in the income statement as incurred. Purchased computer software and certain costs of information technology projects are capitalised as intangible assets. Software that is integral to computer hardware is capitalised as plant and equipment.

Contingent consideration

Contingent consideration receivable associated with the sale of product rights and other assets outside of a business combination is recognised at the time of sale to the extent that the future event upon which the contingent consideration is conditional is within the Group s control, or to the extent that is it considered to be virtually certain that the contingent consideration will become due. If the contingent consideration is outside of the Group s control or it cannot be considered virtually certain that it will become due, an asset and corresponding entry in profit and loss is recognised only once it becomes virtually certain that the contingent consideration will become due.

Contingent consideration payable associated with the purchase of product rights and other assets outside of a business combination is recognised at the time of sale to the extent that the future event upon which the contingent

consideration is conditional is under the control of the seller and it is considered probable that the contingent consideration will become due. Contingent consideration associated within a contingent condition that is within the Group s control is recognised at the point when the contingent condition is met.

Impairment of intangible assets

The carrying values of intangible assets are reviewed for impairment when events or changes in circumstances indicate the carrying value may be impaired. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of impairment loss. Where it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the CGU to which it belongs. An asset s recoverable amount is the higher of an asset s or CGU s fair value less costs to sell and its value-in-use. In assessing value-in-use, its estimated future cash flow is discounted to its present value using a pre-tax discount rate that reflects the current market assessments of the time value of money and the risks specific to the asset.

In carrying out impairment reviews of intangible assets 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 should arise, impairment charges may be required which would adversely impact operating results.

Table of Contents

	Technology $ million	Product-related $ million	Customer and distribution related $ million	Software $ million	Total $ million
Cost					
At 1 January 2015	244	1,884	113	267	2,508
Exchange adjustment	(9)	(31)	(13)	(8)	(61)
Acquisitions[1]			19		19
Additions		17		38	55
Disposals		(6)		(8)	(14)
At 31 December 2015	235	1,864	119	289	2,507
Exchange adjustment	(2)	(20)	2	(8)	(28)
Acquisitions[1]	68	17			85
Additions		24		48	72
Disposals		(36)			(36)

At 31 December 2016	301	1,849	121	329	2,600
Amortisation and impairment					
At 1 January 2015	10	564	57	130	761
Exchange adjustment		(11)	(3)	(2)	(16)
Charge for the year amortisation	11	159	15	34	219
Charge for the year impairment		51			51
Disposals		(4)		(6)	(10)
At 31 December 2015	21	759	69	156	1,005
Exchange adjustment		(16)	1	(4)	(19)
Charge for the year amortisation	48	98	10	35	191
Charge for the year impairment		48			48
Disposals		(36)			(36)
At 31 December 2016	69	853	80	187	1,189
Net book amounts					
At 31 December 2016	232	996	41	142	1,411
At 31 December 2015	214	1,105	50	133	1,502

1 In 2016 this relates to technology and product related intangibles acquired with the purchase of Blue Belt Technologies Inc. and BST-CarGel. In 2015 this balance relates to customer relationships acquired with the purchase of distributors in Colombia and Russia.

Amortisation and impairment of acquired intangibles is set out below:

	2016	2015
	$ million	$ million
Technology	48	11
Product-related	126	188
Customer and distribution related	4	5
Total	178	204

Group capital expenditure relating to software contracted but not provided for amounted to $9m (2015: $4m).

Two product-related intangible assets were determined to have a value in use below their carrying value, resulting in an impairment charge being recognised. The impairment charge primarily relates to $32m from Oasis, calculated using a discount rate of 10.3% (2015: 11.2%), a product right acquired with the Healthpoint acquisition in 2012. During the year, continued reimbursement pressure has resulted in revenues not increasing at the previously expected rate. The remaining carrying value of $9m is supported by the present value of anticipated future cash flows. The second product-related intangible asset has no residual carrying value.

Table of Contents

NOTES TO THE GROUP ACCOUNTS

10 INVESTMENTS

ACCOUNTING POLICY

Investments, other than those related to associates, are initially recorded at fair value plus any directly attributable transaction costs on the trade date. The Group has investments in an entity that holds mainly unquoted equity securities, which by their nature have no fixed maturity date or coupon rate. These investments are classed as available-for-sale carried at fair value. The fair value of these investments are based on the underlying fair value of the equity securities: marketable securities are valued by reference to closing prices in the market; and non-marketable securities are estimated considering factors including the purchase price; prices of recent significant private placements of securities of the same issuer and estimates of liquidation value. Changes in fair value are recognised in other comprehensive income except where management considers that there is objective evidence of an impairment of the underlying equity securities. Objective evidence would include a significant or prolonged decline in the fair value of the investment below its cost less any impairment loss previously recognised. Impairment losses are recognised by reclassifying the losses accumulated in other reserves to profit or loss.

	2016 $ million	2015 $ million
At 1 January	13	5

Additions	2	2
Fair value remeasurement	10	3
Transfer from investments in associates		6
Distributions		(3)
At 31 December	25	13

11 INVESTMENTS IN ASSOCIATES

ACCOUNTING POLICY

Investments in associates, being those entities over which the Group has a significant influence and which is neither a subsidiary nor a joint venture, are accounted for using the equity method, with the Group recording its share of the associates profit and loss and other comprehensive income. The Group s share of associates profit or loss is included in one separate income statement line and is calculated after deduction of their respective taxes.

At 31 December 2016 and 31 December 2015, the Group holds 49% of Bioventus LLC (Bioventus). Bioventus is a limited liability company operating as a partnership. The Company s headquarters is located in Durham, North Carolina, US. Bioventus focuses its medical product development around its core competencies of orthobiologic therapies and orthopaedic diagnostics from which it develops and markets clinically proven orthopaedic therapies and diagnostic tools, including osteoarthritis pain treatments, bone growth stimulators and ultrasound devices. Bioventus sells bone healing stimulation devices and is a provider of osteoarthritis injection therapies. The Group s ability to recover the value of its investment is dependent upon the ongoing clinical and commercial success of these products. The loss after taxation recognised in the income statement relating to Bioventus was $3m (2015: loss after taxation $18m).

The carrying amount of this investment was reviewed for impairment as at the balance sheet date. For the purposes of impairment testing the recoverable amount of this investment was based on its fair value less cost to sell, estimated using discounted cash flows.

The amounts recognised in the balance sheet and income statement for associates are as follows:

	2016	2015

	$ million	$ million
Balance sheet	112	115
Income statement loss	(3)	(16)

Table of Contents

Summarised financial information for significant associates

Set out below is the summarised financial information for Bioventus, adjusted for differences with Group accounting policies:

	2016	2015
	$ million	$ million
Summarised balance sheet		
Non-current assets	364	389
Current assets	105	93
Non-current liabilities	(258)	(235)
Current liabilities	(53)	(80)
Net assets	158	167
Group s share of net assets at 49%	77	82
Group adjustments[1]	32	30
Group s carrying amount of investment at 49%	109	112

	2016	2015
		$ million

	$ million	
Summarised statement of comprehensive income		
Revenue	282	256
Attributable loss for the year	(21)	(41)
Group adjustments[1]	15	5
Total comprehensive loss	(6)	(36)
Group share of loss for the year at 49%	(3)	(18)

1 Group adjustments include an adjustment to align the useful life of intangible assets with Group policy.
At December 2016, the Group held an equity investment in one other associate (2015: one) with a carrying value of $3m (2015: $3m).

12 INVENTORIES

ACCOUNTING POLICY

Finished goods and work-in-progress are valued at factory cost, including appropriate overheads, on a first-in first-out basis. Raw materials and bought-in finished goods are valued at purchase price. All inventories are reduced to net realisable value where lower than cost. Inventory acquired as part of a business acquisition is valued at selling price less costs to sell and a profit allowance for selling efforts.

Orthopaedic instruments are generally not sold but provided to customers and distributors for use in surgery. They are recorded as inventory until they are deployed at which point they are transferred to plant and equipment and depreciated over their useful economic lives of between three and seven years.

A feature of the orthopaedic business is the high level of product inventory required, some of which is located at customer premises and is available for customers immediate use (referred to as consignment inventory). Complete sets of product, including large and small sizes, have to be made available in this way. These outer 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 or forecast 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 involves management judgements on effectiveness of inventory deployment, length of product lives, phase-out of old products and efficiency of manufacturing planning systems.

	2016 $ million	2015 $ million	2014 $ million
Raw materials and consumables	213	205	214
Work-in-progress	55	84	82
Finished goods and goods for resale	976	928	885
	1,244	1,217	1,181

Reserves for excess and obsolete inventories were $303m (2015: $322m, 2014: $317m). The decrease in reserves of $19m in the year comprised $12m credited to the reserve on the write-off of inventory and foreign exchange movements of $7m.

The cost of inventories recognised as an expense and included in cost of goods sold amounted to $1,131m (2015: $961m, 2014: $1,013m). In addition, $85m was recognised as an expense within cost of goods sold resulting from inventory write-offs (2015: $73m, 2014: $55m).

Notwithstanding inventory acquired within acquisitions, no inventory is carried at fair value less costs to sell in any year.

Table of Contents

NOTES TO THE GROUP ACCOUNTS

13 TRADE AND OTHER RECEIVABLES

ACCOUNTING POLICY

Trade and other receivables are carried at amortised cost, less any allowances for uncollectible amounts. They are included in current assets, except for maturities greater than 12 months after the balance sheet date. These are classified as non-current assets.

The Group manages credit risk through credit limits which require authorisation commensurate with the size of the limit and which are regularly reviewed. Credit limit decisions are made based on available financial information and the business case. Significant receivables are regularly reviewed and monitored at Group level. The Group has no significant concentration of credit risk, with exposure spread over a large number of customers and geographies. Furthermore, the Group s principal customers are backed by government and public or private medical insurance funding, which historically represent a lower risk of default. The maximum exposure to credit risk at the reporting date is the fair value of each class of receivable. The Group does not hold any collateral as security.

	2016 $ million	2015 $ million	2014 $ million

Trade receivables	1,042	1,003	1,015
Less: provision for bad and doubtful debts	(54)	(64)	(47)
Trade receivables net	988	939	968
Derivatives forward foreign exchange, currency swaps and interest rate contracts	48	33	49
Other receivables	76	83	51
Prepayments and accrued income	73	83	98
	1,185	1,138	1,166

Trade receivables are classified as loans and receivables. Management considers that the carrying amount of trade and other receivables approximates to the fair value.

The provision for bad and doubtful debts is based on specific assessments of risk and reference to past default experience. The bad debt expense for the year was $7m (2015: $25m expense, 2014: $4m credit). Amounts due from insurers in respect of the macrotextured claim of $144m (2015: $144m, 2014: $143m) are included within other receivables and have been provided in full.

The amount of trade receivables that were past due was as follows:

	2016 $ million	2015 $ million	2014 $ million
Past due not more than three months	142	154	181
Past due more than three months and not more than six months	51	45	49
Past due more than six months and not more than one year	70	57	51
Past due more than one year	54	53	42
	317	309	323
Neither past due nor impaired	725	694	692
Provision for bad and doubtful debts	(54)	(64)	(47)
Trade receivables net	988	939	968

Movements in the provision for bad and doubtful debts were as follows:

	2016 $ million	2015 $ million	2014 $ million
At 1 January	64	47	57
Exchange adjustment	(3)	(3)	(4)
Net receivables provided/(provision released) during the year	7	25	(4)
Utilisation of provision	(14)	(5)	(2)
At 31 December	54	64	47

Trade receivables include amounts denominated in the following major currencies:

	2016 $ million	2015 $ million	2014 $ million
US Dollar	416	362	353
Sterling	57	58	92
Euro	193	192	225
Other	322	327	298
Trade receivables net	988	939	968

Table of Contents

14 TRADE AND OTHER PAYABLES

	2016 $ million	2015 $ million
Trade and other payables due within one year		
Trade and other payables	807	808
Derivatives forward foreign exchange, currency and interest swaps	39	26
Acquisition consideration	38	8
	884	842
Other payables due after one year		
Acquisition consideration	82	19
Other payables		10
	82	29

The acquisition consideration includes $56m contingent upon future events.

The acquisition consideration due after more than one year is expected to be payable as follows: $29m in 2018, $8m in 2019, $20m in 2020, $11m in 2021, and $14m due in over five years (2015: $7m in 2017, $7m in 2018 and $5m in 2019).

15 CASH AND BORROWINGS

15.1 Net debt

Net debt comprises borrowings and credit balances on currency swaps less cash at bank.

	2016 $ million	2015 $ million
Bank overdrafts and loans due within one year	86	46
Long-term bank borrowings and finance leases	440	308
Private placement notes	1,124	1,126
Borrowings	1,650	1,480
Cash at bank	(100)	(120)
Credit balance on derivatives currency swaps	1	2
Debit balance on derivatives interest rate swaps	(1)	(1)
Net debt	1,550	1,361

Borrowings are repayable as follows:

	Within one year or on demand $ million	Between one and two years $ million	Between two and three years $ million	Between three and four years $ million	Between four and five years $ million	After five years $ million	Total $ million
At 31 December 2016:							
Bank loans	22		300		135		457
Bank overdrafts	62						62
Finance lease liabilities	2	2	3				7
Private placement notes			125		264	735	1,124
	86	2	428		399	735	1,650
At 31 December 2015:							
Bank loans	26		300				326
Bank overdrafts	18						18
Finance lease liabilities	2	2	3	3			10
Private placement notes				125		1,001	1,126

	46	2	303	128	1,001	1,480

Table of Contents

NOTES TO THE GROUP ACCOUNTS

15 CASH AND BORROWINGS continued

15.2 Assets pledged as security

Assets are pledged as security under normal market conditions. Secured borrowings and pledged assets are as follows:

	2016 $ million	2015 $ million
Finance lease liabilities due within one year	2	2
Finance lease liabilities due after one year	5	8
Total amount of secured borrowings	7	10
Total net book value of assets pledged as security:		
Property, plant and equipment	5	6
	5	6

15.3 Liquidity risk exposures

The Board has established a set of policies to manage funding and currency risks. The Group uses derivative financial instruments only to manage the financial risks associated with underlying business activities and their financing.

Liquidity risk is the risk that the Group is not able to settle or meet its obligations on time or at a reasonable price. The Group s policy is to ensure that there is sufficient funding and facilities in place to meet foreseeable borrowing

requirements. The Group manages and monitors liquidity risk through regular reporting of current cash and borrowing balances and periodic preparation and review of short and medium-term cash forecasts, having regard to the maturities of investments and borrowing facilities.

The Group has available committed facilities of $2.4bn (2015: $2.4bn). The interest payable on borrowings under committed facilities is either at fixed or floating rates. Floating rates are typically based on the LIBOR (or other reference rate) relevant to the term and currency concerned.

The Company is subject to restrictive covenants under its principal facility agreements. These financial covenants are tested at the end of each half year for the 12 months ending on the last day of the testing period. As of 31 December 2016, the Company was in compliance with these covenants. The facilities are also subject to customary events of default, none of which are currently anticipated to occur.

The Group s committed facilities are:

Facility	Date due
$300 million bilateral, term loan facility	April 2019
$80 million 2.47% Senior Notes	November 2019
$45 million Floating Rate Senior Notes	November 2019
$75 million 3.23% Senior Notes	January 2021
$1.0 billion syndicated, revolving credit facility	March 2021
$190 million 2.97% Senior Notes	November 2021
$75 million 3.46% Senior Notes	January 2022
$50 million 3.15% Senior Notes	November 2022
$105 million 3.26% Senior Notes	November 2023 January 2024

$100 million 3.89% Senior Notes	
$305 million 3.36% Senior Notes	November 2024
$25 million Floating Rate Senior Notes	November 2024
$75 million 3.99% Senior Notes	
	January 2026

Table of Contents

15.4 Year end financial liabilities by contractual maturity

The table below analyses the Group s year end financial liabilities by contractual maturity date, including contractual interest payments and excluding the impact of netting arrangements:

	Within one year or on demand $ million	Between one and two years $ million	Between two and five years $ million	After five years $ million	Total $ million
At 31 December 2016					
Non-derivative financial liabilities:					
Bank overdrafts and loans	86		435		521
Trade and other payables	807				807
Finance lease liabilities	3	3	3		9
Private placement notes	36	36	491	800	1,363
Acquisition consideration	38	30	46	16	130
Derivative financial liabilities:					
Currency swaps/forward foreign exchange contracts outflow	2,284				2,284
Currency swaps/forward foreign exchange contracts inflow	(2,285)				(2,285)
	969	69	975	816	2,829

At 31 December 2015

Non-derivative financial liabilities:					
Bank overdrafts and loans	45		300		345
Trade and other payables	808	10			818
Finance lease liabilities	3	3	6		12
Private placement notes	36	36	230	1,098	1,400
Acquisition consideration	8	7	12		27
Derivative financial liabilities:					
Currency swaps/forward foreign exchange contracts outflow	2,279				2,279
Currency swaps/forward foreign exchange contracts inflow	(2,277)				(2,277)
	902	56	548	1,098	2,604

The amounts in the tables above are undiscounted cash flows, which differ from the amounts included in the balance sheet where the underlying cash flows have been discounted.

15.5 Finance leases

ACCOUNTING POLICY

Leases are classified as finance leases when the terms of the lease transfer substantially all the risks and rewards of ownership to the Group. All other leases are classified as operating leases.

The leased assets are measured initially at an amount equal to the lower of their fair value and the present value of the minimum lease payments. Assets held under finance leases are capitalised as property, plant or equipment and depreciated accordingly. Minimum lease payments are apportioned between the finance expense and the reduction in the outstanding liability. The finance expense is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

Table of Contents

NOTES TO THE GROUP ACCOUNTS

15 CASH AND BORROWINGS continued

Future minimum lease payments under finance leases together with the present value of the minimum lease payments are as follows:

	2016 $ million	2015 $ million
Within one year	3	3
After one and within two years	3	3
After two and within three years	3	3
After three and within four years		3
After four and within five years		
After five years		
Total minimum lease payments	9	12
Discounted by imputed interest	(2)	(2)
Present value of minimum lease payments	7	10

Present value of minimum lease payments can be split out as: $2m (2015: $2m) due within one year, $5m (2015: $8m) due between one to five years and $nil (2015: $nil) due after five years.

Liquidity and capital resources

The Group s policy is to ensure that it has sufficient funding and facilities to meet foreseeable borrowing requirements.

At 31 December 2016, the Group held $38m (2015: $102m, 2014: $65m) in cash net of bank overdrafts. The Group had committed facilities available of $2,425m at 31 December 2016 of which $1,560m was drawn. Smith & Nephew intends to repay the amounts due within one year using available cash and drawing down on the longer-term facilities. In addition, the Group has finance lease commitments of $7m.

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 2016, as well as its other known or expected commitments or liabilities, can be met from its existing resources and facilities. The Group s net debt increased from $1,361m at the beginning of 2016 to $1,550m at the end of 2016, representing an overall increase of $189m, due primarily to the acquisition of Blue Belt Technologies.

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

16 FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

ACCOUNTING POLICY

Derivative financial instruments

Derivative financial instruments are initially recognised at fair value on the date a derivative contract is entered into and are subsequently re-measured at their fair value at subsequent balance sheet dates.

Changes in the fair value of derivative financial instruments that are designated and effective as cash flow hedges of forecast third party and intercompany transactions are recognised in other comprehensive income until the associated asset or liability is recognised. Amounts taken to other comprehensive income are transferred to the income statement in the period in which the hedged transaction affects profit and loss. Where the hedged item is the cost of a non-financial asset, the amounts taken to other comprehensive income are transferred to the initial carrying value of the asset.

Currency swaps to match foreign currency net assets with foreign currency liabilities are fair valued at year end. Changes in the fair values of currency swaps that are designated and effective as net investment hedges are matched in other comprehensive income against changes in value of the related net assets.

Interest rate derivatives transacted to fix interest rates on floating rate borrowings are accounted for as cash flow hedges and changes in the fair values resulting from changes in market interest rates are recognised in other comprehensive income. Amounts taken to other comprehensive income are transferred to the income statement when the hedged transaction affects profit and loss.

Interest rate derivatives transacted to convert fixed rate borrowings into floating rate borrowings are accounted for as fair value hedges and changes in the fair values resulting from changes in market interest rates are recognised in the income statement.

Any ineffectiveness on hedging instruments and changes in the fair value of derivative financial instruments that do not qualify for hedge accounting are recognised in the income statement within other finance costs as they arise.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. At that point in time, any cumulative gain or loss on the hedging instrument recognised in other comprehensive income is retained there until the forecast transaction occurs. If a hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in other comprehensive income is transferred.

Table of Contents

16.1 Foreign exchange exposures

The Group operates in over 100 countries and as a consequence has transactional and translational foreign exchange exposure. It is Group policy for operating units not to hold material unhedged monetary assets or liabilities other than in their functional currencies.

Foreign exchange variations affect trading results in two ways. Firstly, on translation of overseas sales and profits into US Dollars and secondly, transactional exposures arising where some, or all of the costs of sale are incurred in a different currency from the sale. The principal transactional exposures arise as the proportion of costs in US Dollars, Sterling and Swiss Francs exceed the proportion of sales in each of these currencies and correspondingly the proportion of sales in Euros exceeds the proportion of costs in Euros.

The impact of currency movements on the cost of purchases is partly mitigated by the use of forward foreign exchange contracts. The Group uses forward foreign exchange contracts, designated as cash flow hedges, to hedge forecast third party and intercompany trading cash flows up to one year. When a commitment is entered into, forward foreign exchange contracts are normally used to increase the hedge to 100% of the exposure. Cash flows relating to cash flow hedges are expected to occur within 12 months of inception and profits and losses on hedges are expected to enter into the determination of profit (within cost of goods sold) within a further 12-month period. The principal currencies hedged by forward foreign exchange contracts are US Dollars, Euros and Sterling. At 31 December 2016, the Group had contracted to exchange within one year the equivalent of $1.8bn (2015: $1.9bn). Based on the Group s net borrowings as at 31 December 2016, if the US Dollar were to weaken against all currencies by 10%, the Group s net borrowings would decrease by $1m (2015: decrease by $1m) as the Group held a higher amount of foreign denominated cash than foreign denominated borrowings.

If the US Dollar were to weaken by 10% against all other currencies, then the fair value of the forward foreign exchange contracts as at 31 December 2016 would have been $51m lower (2015: $42m lower). Similarly, if the Euro were to weaken by 10% against all other currencies, then the fair value of the forward foreign exchange contracts as at 31 December 2016 would have been $17m higher (2015: $16m higher). Movements in the fair value of forward foreign exchange contracts would be recognised in other comprehensive income and accumulated in the hedging reserve.

A 10% strengthening of the US Dollar or Euro against all other currencies at 31 December 2016 would have had the equal but opposite effect to the amounts shown above, on the basis that all other variables remain constant.

The Group s policy is to hedge all actual foreign exchange exposures and the Group s forward foreign exchange contracts are designated as cash flow hedges. The net impact of transaction related foreign exchange on the income statement from a movement in exchange rates on the value of forward foreign exchange contracts is not significant. In addition, the movements in the fair value of other financial instruments used for hedging such as currency swaps for which hedge accounting is not applied, offset movements in the values of assets and liabilities and are recognised through the income statement.

16.2 Interest rate exposures

The Group is exposed to interest rate risk on cash, borrowings and certain currency and interest rate swaps which are at floating rates. When required the Group uses interest rate derivatives to meet its objective of protecting borrowing costs within parameters set by the Board. These interest rate derivatives are accounted for as cash flow hedges and, as such, changes in fair value resulting from changes in market interest rates are recognised in other comprehensive income and accumulated in the hedging reserve, with the fair value of the interest rate derivatives recorded in the balance sheet.

Additionally, the Group uses interest rate swaps to reduce the overall level of fixed rate debt, within parameters set by the Board. When used in this way, interest rate derivatives are accounted for as fair value hedges. The fair value movement of the derivative is offset in the income statement against the fair value movement in the underlying fixed rate debt.

Based on the Group s gross borrowings as at 31 December 2016, if interest rates were to increase by 100 basis points in all currencies then the annual net interest charge would increase by $7m (2015: $6m). A decrease in interest rates by 100 basis points in all currencies would have an equal but opposite effect to the amounts shown above.

16.3 Credit risk exposures

The Group limits exposure to credit risk on counterparties used for financial instruments through a system of internal credit limits. The financial exposure of a counterparty is determined as the total of cash and deposits, plus the risk on derivative instruments, assessed as the fair value of the instrument plus a risk element based on the nominal value and the historic volatility of the market value of the instrument. The Group does not anticipate non-performance of counterparties and believes it is not subject to material concentration of credit risk as the Group operates within a policy of counterparty limits designed to reduce exposure to any single counterparty.

The maximum credit risk exposure on derivatives at 31 December 2016 was $48m (2015: $33m), being the total debit fair values on forward foreign exchange contracts and currency swaps. The maximum credit risk exposure on cash at bank at 31 December 2016 was $100m (2015: $120m). The Group s exposure to credit risk is not material as the amounts are held in a wide number of banks in a number of different countries.

Credit risk on trade receivables is detailed in Note 13.

Table of Contents

NOTES TO THE GROUP ACCOUNTS

16 FINANCIAL INSTRUMENTS AND RISK MANAGEMENT continued

16.4 Currency and interest rate profile of interest bearing liabilities and assets

Short-term debtors and creditors are excluded from the following disclosures.

Currency and interest rate profile of interest bearing liabilities:

								Fixed rate liabilities
	Gross borrowings $ million	Currency swaps $ million	Interest rate swaps $ million	Total liabilities $ million	Floating rate liabilities $ million	Fixed rate liabilities $ million	Weighted average interest rate %	Weighted average time for which rate is fixed Years
At 31 December 2016								
US Dollar	(1,588)	(367)	(1)	(1,956)	(1,108)	(862)	3.5	6.8
Other	(62)	(81)		(143)	(129)			
Total interest bearing liabilities	(1,650)	(448)	(1)	(2,099)	(1,237)	(862)		
At 31 December 2015								

US Dollar	(1,439)	(310)	(1,749)	(884)	(865)	3.5	7.8
Other	(41)	(60)	(101)	(101)			
Total interest bearing liabilities	(1,480)	(370)	(1,850)	(985)	(865)		

At 31 December 2016, $7m (2015: $10m) of fixed rate liabilities related to finance leases. In 2016, the Group also had liabilities due for deferred acquisition consideration (denominated in US Dollars, Euros, Turkish Lira and Russian Rubles) totalling $120m (2015: $27m, 2014: $33m) on which no interest was payable (see Note 14). There were no other significant interest bearing financial liabilities.

Floating rates on liabilities are typically based on the one, three or six-month LIBOR (or other reference rate) relevant to the currency concerned. The weighted average interest rate on floating rate borrowings as at 31 December 2016 was 2% (2015: 2%).

Currency and interest rate profile of interest bearing assets:

	Interest rate swaps $ million	Cash at bank $ million	Currency swaps $ million	Total assets $ million	Floating rate assets $ million	Fixed rate assets $ million
At 31 December 2016						
US Dollars		29	83	112	112	
Other		71	366	437	437	
Total interest bearing assets		100	449	549	549	
At 31 December 2015						
US Dollars	1	72	55	128	127	1
Other		48	313	361	361	
Total interest bearing assets	1	120	368	489	488	1

Floating rates on assets are typically based on the short-term deposit rates relevant to the currency concerned.

Table of Contents

16.5 Fair value of financial assets and liabilities

ACCOUNTING POLICY

Measurement of fair values

A number of the Group s accounting policies and disclosures require the measurement of fair values, for both financial assets and liabilities and non-financial assets acquired in a business combination (see Note 21).

When measuring the fair value of an asset or liability, the Group uses market observable data as far as possible. Fair values are categorised into different levels in the fair value hierarchy based on the inputs used in the valuation techniques as follows: Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities; Level 2: inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and Level 3: inputs for the asset or liability that are not based on observable data (unobservable inputs).

The Group recognises transfers between the levels of the fair value hierarchy at the end of the reporting period during which the change has occurred.

The following table shows the carrying amounts and fair values of financial assets and financial liabilities, including their levels in the fair value hierarchy. It does not include fair value information for financial assets and financial liabilities not measured at fair value if the carrying amount is a reasonable approximation of fair value.

	Carrying amount	Fair value

At 31 December 2016	Designated at fair value $ million	Fair value hedging instruments $ million	Loans and receivables $ million	Available for sale $ million	Other financial liabilities $ million	Total $ million	Level 2 $ million	Level 3 $ million	Total $ million
Financial assets measured at fair value									
Forward foreign exchange contracts		45				45	45		45
Investments				25		25		25	25
Currency swaps	3					3	3		3
Interest rate swaps									
	3	45		25		73			
Financial liabilities measured at fair value									
Acquisition consideration	(56)					(56)		(56)	(56)
Forward foreign exchange contracts		(36)				(36)	(36)		(36)
Currency swaps	(2)					(2)	(2)		(2)
Interest rate swaps		(1)				(1)	(1)		(1)
Private placement debt			(199)			(199)	(199)		(199)

	(58)	(37)	(199)			(294)			
Financial assets not measured at fair value									
Trade and other receivables			1,064			1,064			
Cash at bank			100			100			
			1,164			1,164			
Financial liabilities not measured at fair value									
Acquisition consideration	(64)					(64)			
Bank overdrafts					(62)	(62)			
Bank loans					(457)	(457)			
Private placement debt					(925)	(925)	(935)		(935)
Finance lease liabilities					(7)	(7)			
Trade and other payables					(807)	(807)			
	(64)				(2,258)	(2,322)			

The fair value of the private placement notes is determined using a discounted cash flow model based on prevailing market rates.

Table of Contents

NOTES TO THE GROUP ACCOUNTS

16 FINANCIAL INSTRUMENTS AND RISK MANAGEMENT continued

	Carrying amount						Fair value		
At 31 December 2015	Designated at fair value $ million	Fair value hedging instruments $ million	Loans and receivables $ million	Available for sale $ million	Other financial liabilities $ million	Total $ million	Level 2 $ million	Level 3 $ million	Total $ million
Financial assets measured at fair value									
Forward foreign exchange contracts		31				31	31		31
Investments				13		13		13	13
Currency swaps	1					1	1		1
		1				1	1		1

Interest rate swaps							
	1	32		13	46		
Financial liabilities measured at fair value							
Acquisition consideration	(27)				(27)	(27)	(27)
Forward foreign exchange contracts		(23)			(23)	(23)	(23)
Currency swaps	(3)				(3)	(3)	(3)
Private placement debt			(201)		(201)		
						(201)	(201)
	(30)	(23)	(201)		(254)		
Financial assets not measured at fair value							
Trade and other receivables			1,022		1,022		
Cash at bank			120		120		
			1,142		1,142		
Financial liabilities not measured at fair value							
				(18)	(18)		

Bank overdrafts				
Bank loans	(326)	(326)		
Private placement debt	(925)	(925)	(949)	(949)
Finance lease liabilities	(10)	(10)		
Trade and other payables	(818)	(818)		
	(2,097)	(2,097)		

There has been no change in the classification of financial assets and liabilities, the method and assumptions used in determining fair value and the categorisation of financial assets and liabilities within the fair value hierarchy from those disclosed in the Annual Report for the year ended 31 December 2015.

The Group enters into derivative financial instruments with financial institutions with investment grade credit ratings. The fair value of forward foreign exchange contracts is calculated by reference to quoted market forward exchange rates for contracts with similar maturity profiles. The fair value of currency swaps is determined by reference to quoted market spot rates. As a result, foreign forward exchange contracts and currency swaps are classified as Level 2 within the fair value hierarchy.

The changes in counterparty credit risk had no material effect on the hedge effectiveness for derivatives designated in hedge relationships and other financial instruments recognised at fair value.

The fair value of contingent consideration is estimated using a discounted cash flow model. The valuation model considers the present value of expected payment, discounted using a risk-adjusted discount rate. The expected payment is determined by considering the possible scenarios, which relate to the achievement of established milestones and targets, the amount to be paid under each scenario and the probability of each scenario. As a result, contingent consideration is classified as Level 3 within the fair value hierarchy.

The fair value of investments is based upon third party pricing models for share issues. As a result, investments are considered Level 3 in the fair value hierarchy.

There were no transfers between Levels 1, 2 and 3 during 2016 and 2015.

For cash and cash equivalents, short-term loans and receivables, overdrafts and other short-term liabilities which have a maturity of less than three months, the book values approximate the fair values because of their short-term nature.

Long-term borrowings are measured in the balance sheet at amortised cost. As the Group s long-term borrowings are not quoted publicly and as market prices are not available, their fair values are estimated by discounting future contractual cash flows to net present values at the current market interest rates available to the Group for similar financial instruments as at the year end.

Table of Contents

17 PROVISIONS AND CONTINGENCIES

ACCOUNTING POLICY

In the normal course of business the Group is involved in various legal disputes. Provisions are made for loss contingencies when it is deemed probable that an adverse outcome will occur and the amount of the losses can be reasonably estimated. Where the Group is the plaintiff in pursuing claims against third parties, legal and associated expenses are charged to the income statement as incurred.

The recognition of provisions for legal disputes is subject to a significant degree of estimation. 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 or settlement negotiations or as new facts emerge.

A provision for onerous contracts is recognised when the expected benefits to be derived by the Group from a contract are lower than the unavoidable cost of meeting its obligations under the contract. For the purpose of calculating any onerous lease provision, the Group takes the discounted future lease payments (if any), net of expected rental income. Before a provision is established, the Group recognises any impairment loss on the assets associated with that contract.

A provision for rationalisation is recognised when the Group has approved a detailed and formal restructuring plan, and the restructuring either has commenced or has been announced publicly. Future operating losses are not provided for.

17.1 Provisions

	Rationalisation provisions $ million	Metal-on-metal $ million	Legal and other provisions $ million	Total $ million
At 1 January 2015	12		118	130
Charge to income statement	23	185	18	226
Utilised	(11)		(31)	(42)
Transfers			15	15
Exchange adjustment	(1)		(2)	(3)
At 31 December 2015	23	185	118	326
Net charge to income statement	12		(1)	11
Acquisitions			10	10
Unwinding of discount		5		5
Utilised	(14)	(27)	(30)	(71)
Exchange adjustment	(1)		1	
At 31 December 2016				
	20	163	98	281
Provisions due within one year	20	43	84	147
Provisions due after one year		120	14	134

At 31 December 2016					
		20	163	98	281
Provisions	due within one year	23	63	107	193
Provisions	due after one year		122	11	133
At 31 December 2015					
		23	185	118	326

The principal elements within rationalisation provisions relate to the Group Optimisation programme (mainly severance) announced in May 2014 and people costs associated with the structural and efficiency programme announced in August 2011.

Following the settlement of the majority of US metal-on-metal hip claims (discussed below) the Group has estimated a provision of $163m (2015: $185m) relating to the present value at 31 December 2016 of the estimated costs to resolve all other known and anticipated metal-on-metal hip claims. The estimated value of the provision has been determined using an actuarial model. Given the inherent uncertainty in assumptions relating to factors such as the number of claims and outcome the actual costs may differ significantly from this estimate. The provision does not include any possible insurance recoveries on these claims or legal fees associated with defending claims. The Group carries considerable product liability insurance, and will continue to defend claims vigorously.

The legal and other provisions mainly relate to various other product liability and intellectual property litigation matters.

All provisions are expected to be substantially utilised within five years of 31 December 2016 and none are treated as financial instruments.

Table of Contents

NOTES TO THE GROUP ACCOUNTS

17 PROVISIONS AND CONTINGENCIES continued

17.2 Contingencies

The Company and its subsidiaries are party to various legal proceedings, some of which include claims for substantial damages. The outcome of these proceedings cannot readily be foreseen, but except as described herein management believes none of them is likely to 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 provisions or will not have a significant impact on the Group s results of operations in the period in which they are realised.

In August 2003, the Group withdrew voluntarily from all markets the macrotextured versions of its OXINIUM femoral knee components. 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, and all claims have now been resolved. The aggregate cost at 31 December 2016 related to this matter is approximately $205m. 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, for which a trial has not yet begun. An additional $22m was received during 2007 from a successful settlement with a third party.

17.3 Legal proceedings

Product liability claims

The Group faces claims from time to time for alleged defects in its products and has on occasion recalled or withdrawn products from the market. Such claims are endemic to the medical device industry. The Group maintains product liability insurance subject to limits and deductibles that management believes are reasonable. All policies contain exclusions and limitations, however, and there can be no assurance that insurance will be available or adequate to cover all claims.

In recent years, there has been heightened concern about possible adverse effects of hip implant products with metal-on-metal bearing surfaces, and the Group has incurred, and will continue to incur expenses to defend claims in this area. As of February 2017, and giving effect to the US settlements described below, approximately 770 such claims were pending with the Group around the world, of which approximately 320 had given rise to pending legal proceedings. Most claims relate to the Group s Birmingham Hip Resurfacing (BHR) product and its two modular metal-on-metal components: the Birmingham Hip Modular Head (BHMH) and the optional metal liner component of the R3 Acetabular System (R3ML). The BHMH and R3ML are no longer on the market: the R3ML was withdrawn in 2012 and the BHMH was phased out in 2014. In 2015, the Group ceased offering smaller sizes of the BHR and restricted instructions for BHR use in female patients. These actions were taken to ensure that the BHR is only used in those patient groups where it continues to demonstrate strong performance.

In 2015 and 2016, the Group s US subsidiary settled the majority of its US metal-on-metal hip lawsuits in two group settlements, without admitting liability. Insurance receipts covered most of the amounts paid, with the net cash cost being $25m. These cases had been consolidated in a state court in Memphis, Tennessee and principally related to the Group s modular metal-on-metal hip components, which are no longer on the market. In February 2017, certain plaintiffs asked the US Judicial Panel on Multidistrict Litigation to transfer 31 cases pending in federal courts to the US District Court for the District of Maryland. In England and Wales, metal-on-metal hip implant claims against various companies have been consolidated for trials under group litigation orders in the High Court in London. The BHR and other claims pending against the Group have been stayed and will not be reactivated until the outcome of those trials is known.

The Group has requested indemnity from its product liability insurers for most of these metal-on-metal hip implant claims. Each insurer makes its own decision as to coverage issues, and the liability of some insurers depends on exhaustion of lower levels of coverage. The Group is working with all of the insurers to address any defences to coverage they have raised.

Litigation outcomes are difficult to predict and defence costs can be significant. The Group takes care to monitor the clinical evidence relating to its metal hip implant products and ensure that its product offerings are designed to serve patients interests.

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 other intellectual property matters. These disputes are being heard in courts in the US and other jurisdictions and also before agencies that examine patents. Outcomes are rarely certain and costs are often significant.

The Group prosecuted and defended a series of patent infringement suits against Arthrex in US federal courts in Oregon and Texas starting in 2004, principally relating to suture anchors for use in shoulder surgery. Arthrex paid $99m in June 2015 in connection with the Oregon litigation, and most of that award (net of various expenses) was recognised in the Group s operating profit at that time. The Group asserted the same patent against additional Arthrex products in a follow-up suit that was scheduled for trial in February 2017 in the Oregon court. Arthrex asserted its own suture anchor patents against Smith & Nephew in 2014 and 2015 in the US District Court for the Eastern District of Texas. In December 2016, the jury in that case decided that two of the Group s US subsidiaries infringed two asserted Arthrex patents and awarded Arthrex $17.4m. In February 2017, the parties reached a settlement resulting in the dismissal of all patent litigation in Oregon and Texas. Smith & Nephew agreed to pay Arthrex $8m, and each party agreed to additional payments contingent on the outcome of patent validity proceedings currently pending at the US Patent & Trademark Office relating to the asserted patents. The Group has fully provided for any possible additional payment relating to its historical sales.

In February 2016, ConforMIS, Inc. filed suit against the Group s US subsidiary in the Eastern Division of the US District Court for the District of Massachusetts, alleging that a number of its patents (generally directed to patient specific instrumentation associated with knee arthroplasty) are infringed by Smith & Nephew s Visionaire cutting guides and associated knee implants. The suit requests damages and an injunction. Smith & Nephew seeks to invalidate the asserted patents at the US Patent & Trademark Office and has also filed counterclaims for infringement by ConforMIS of the Group s US patents.

Table of Contents

17.4 Tax Matters

At any given time the Group has unagreed years outstanding in various countries and is involved in tax audits and disputes, some of which may take several years to resolve. The Group believes that it has made adequate provision in respect of related additional tax liabilities that may arise. See Note 5 for further details.

18 RETIREMENT BENEFIT OBLIGATIONS

ACCOUNTING POLICY

The Group sponsors defined benefit plans in a number of countries. A defined benefit pension plan defines an amount of pension benefit that an employee will receive on retirement or a minimum guaranteed return on contributions, which is dependent on various factors such as age, years of service and final salary. The Group s obligation is calculated separately for each plan by discounting the estimated future benefit that employees have earned in return for their service in the current and prior periods. The fair value of any plan assets is deducted to arrive at the net liability.

The calculation of the defined benefit obligation is performed annually by external actuaries using the projected unit credit method. Re-measurements arising from defined benefit plans comprise actuarial gains and losses and the return on the plan assets net of the costs of managing the plan assets. The Group recognises these immediately in other comprehensive income (OCI) and all other expenses, such as service cost, net interest cost, administration costs and taxes, are recognised in the income statement.

A number of key assumptions are made when calculating the fair value of the Group s defined benefit pension plans. These assumptions impact the balance sheet asset and liabilities, operating profit, finance income/costs and other comprehensive income. The most critical assumptions are the discount rate, the rate of inflation and mortality assumptions to be applied to future pension plan liabilities. The discount rate is based on the yield at the reporting date on bonds that have a credit rating of AA, denominated in the currency in which the benefits are expected to be paid and have a maturity profile approximately the same as the Group s obligations. In determining these assumptions management take into account the advice of professional external actuaries and benchmarks its

assumptions against external data.

The Group determines the net interest expense/(income) on the net defined benefit liability/(asset) for the period by applying the discount rate used to measure the defined benefit obligation at the beginning of the annual period to the net defined benefit liability/(asset).

The Group also operates a number of defined contribution plans. A defined contribution plan is a pension plan under which the Group and employees pay fixed contributions to a third party financial provider. The Group has no further payment obligations once the contributions have been paid. Contributions are recognised as an employee benefit expense when they are due.

18.1 Retirement benefit net (assets)/obligations

The Group s retirement benefit obligations comprise:

	2016 $ million	2015 $ million
Funded plans:		
UK Plan	4	(7)
US Plan	27	56
Other plans	52	48
	83	97
Unfunded plans:		
Other plans	55	44
Retirement healthcare	26	30
	164	171
Amount recognised on the balance sheet liability	164	184
Amount recognised on the balance sheet asset		(13)

The Group sponsors defined benefit pension plans for its employees in 16 countries and these are established under the laws of the relevant country. Funded plans are funded by the payment of contributions and the assets are held by separate trust funds or insurance companies. In countries where there is no Company-sponsored pension plan, state benefits are considered by management to be adequate. Employees retirement benefits are the subject of regular management review. The Group s defined benefit plans provide employees with an entitlement to retirement benefits varying between 1.3% and 66.7% of final salary on attainment of retirement age. The level of entitlement is dependent on the years of service of the employee.

The Group s two major defined benefit pension plans are in the UK and US. Both these plans were closed to new employees in 2003 and defined contribution plans are offered to new joiners. The US and UK Plans were closed to future accrual in March 2014 and December 2016 respectively.

The UK Plan operates under trust law and responsibility for its governance lies with a Board of Trustees. This Board is composed of representatives of the Group, plan participants and an independent trustee, who act on behalf of members in accordance with the terms of the Trust Deed and Rules and relevant legislation. The UK Plan s assets are held by the trust. Annual increases on benefits in payment are dependent on inflation. There is no legislative minimum funding requirement in the UK, however the Group has agreed with the Board of Trustees to pay a schedule of supplementary payments (see Note 18.8). The Trust Deed of the UK Plan states that any surplus is ultimately accessible by the Group as a refund.

Table of Contents

NOTES TO THE GROUP ACCOUNTS

18 RETIREMENT BENEFIT OBLIGATIONS continued

The US Plan is governed by a US Pension Committee which is comprised of both plan participants and representatives of the Group. In the US, the Pension Protection Act (2006) established both a minimum required contribution and a maximum deductible contribution. Failure to contribute at least the minimum required amount will subject the Company to significant penalties, and contributions in excess of the maximum deductible have negative tax consequences. The minimum funding requirement is intended to fully fund the present value of accrued benefits over seven years.

18.2 Reconciliation of benefit obligations and pension assets

The movement in the Group s pension benefit obligation and pension assets is as follows:

	2016			2015		
	Obligation $ million	Asset $ million	Total $ million	Obligation $ million	Asset $ million	Total $ million
Amounts recognised on the balance sheet at beginning of the period	(1,521)	1,350	(171)	(1,637)	1,411	(226)

Income statement expense:						
Current service cost	(19)		(19)	(20)		(20)
Past service credit	51		51	22		22
Settlements	7	(7)		30	(32)	(2)
Interest (expense)/income	(52)	48	(4)	(56)	50	(6)
Administration costs and taxes	(3)		(3)	(3)		(3)
Costs recognised in Income statement	(16)	41	25	(27)	18	(9)
Re-measurements:						
Actuarial gain due to liability experience	7		7	17		17
Actuarial (loss)/gain due to financial assumptions change	(301)		(301)	20		20
Actuarial gain due to demographic assumptions	33		33			
Return on plan assets greater than/(less than) discount rate		180	180		(45)	(45)
Re-measurements recognised in OCI	(261)	180	(81)	37	(45)	(8)
Cash:						
Employer contributions		60	60		66	66
Employee contributions	(4)	4		(5)	5	
Benefits paid directly by the Group, taxes and administration costs paid from scheme assets	3		3	3		3
Benefits paid	61	(64)	(3)	52	(55)	(3)
Net cash	60		60	50	16	66
Exchange rates	161	(158)	3	56	(50)	6
Amount recognised on the balance sheet	(1,577)	1,413	(164)	(1,521)	1,350	(171)
Amount recognised on the balance sheet liability	(1,577)	1,413	(164)	(691)	507	(184)
Amount recognised on the balance sheet asset				(830)	843	13

Represented by:

2016			2015		
Obligation $ million	Asset $ million	Total $ million	Obligation $ million	Asset $ million	Total $ million
(844)	840	(4)	(804)	811	7

UK Plan						
US Plan	(461)	434	(27)	(460)	404	(56)
Other Plans	(272)	139	(133)	(257)	135	(122)
Total	(1,577)	1,413	(164)	(1,521)	1,350	(171)

All benefits are vested at the end of each reporting period. The weighted average duration of the defined benefit obligation at the end of the reporting period is 22 years and 12 years for the UK and US Plans respectively.

Table of Contents

18.3 Plan assets

The market value of the US, UK and Other Plans assets are as follows:

	2016	2015	2014
	$ million	$ million	$ million
UK Plan:			
Assets with a quoted market price:			
Cash and cash equivalents	6	5	6
Equity securities	213	234	237
Other Bonds	38	43	
Liability driven investments	239	171	227
Diversified growth funds	130	144	155
	626	597	625
Other assets:			
Insurance contract	214	214	238
Market value of assets	840	811	863
US Plan:			
Assets with a quoted market price:			
Cash and cash equivalents			
Equity securities	178	166	167
Government bonds fixed interest	128	119	121
Corporate bonds	128	119	120

Market value of assets	434	404	408
Other Plans:			
Assets with a quoted market price:			
Cash and cash equivalents	4	9	6
Equity securities	35	35	33
Government bonds fixed interest	3	5	7
index linked	3	9	13
Corporate and other bonds	11	13	12
Insurance contracts	34	28	31
Property	12	8	6
Other quoted securities	2	1	3
	104	108	111
Other assets:			
Insurance contracts	35	27	29
Market value of assets	139	135	140
Total market value of assets	1,413	1,350	1,411

No plans invest directly in property occupied by the Group or in financial securities issued by the Group.

The US and UK Plan assets are invested in a diversified range of industries across a broad range of geographies. These assets include liability matching assets and annuity policies purchased by the trustees of each plan, which aim to match the benefits to be paid to certain members from the plan and therefore remove the investment, inflation and demographic risks in relation to those liabilities.

In December 2014, the low risk asset portfolio held by the UK Plan was transferred into liability driven investments (LDI). The UK Plan also has an insurance contract with Rothesay Life covering a subset of the UK Plan pensioner liabilities. The terms of this policy define that the contract value exactly matches the amount and timing of the pensioner obligations covered by the contract. In accordance with IAS19R *Employee Benefits,* the fair value of the insurance contract is deemed to be the present value of the related obligations which is discounted at the AA corporate bond rate.

Table of Contents

NOTES TO THE GROUP ACCOUNTS

18 RETIREMENT BENEFIT OBLIGATIONS continued

18.4 Expenses recognised in the income statement

The total expense relating to retirement benefits recognised for the year is $23m (2015: $58m, 2014: $17m). Of this cost recognised for the year, $48m (2015: $49m, 2014: $32m) relates to defined contributions and $25m net credit (2015: $9m net expense, 2014: $15m net credit) relates to defined benefit plans.

The cost charged in respect of the Group s defined contribution plans represents contributions payable to these plans by the Group at rates specified in the rules of the plans. These were charged to operating profit in selling, general and administrative expenses. There were $nil outstanding payments as at 31 December 2016 due to be paid over to the plans (2015: $nil, 2014: $nil).

The $25m net credit for the year includes a $44m curtailment gain arising from the closure of the UK Plan to future accrual and $5m past service credit relating to redundancies.

In 2015, the $9m net expense for the year includes a $16m past service cost credit arising from amendments to the US Retirement Healthcare plan and a $5m gain arising from benefit options offered to members of the UK Plan.

Defined benefit plan costs comprise service cost which is charged to operating profit in selling, general and administrative expenses and net interest cost and administration costs and taxes which are reported as other finance costs.

The defined benefit pension costs charged for the UK and US Plans are:

	2016	2015	2014

	UK Plan $ million	US Plan $ million	UK Plan $ million	US Plan $ million	UK Plan $ million	US Plan $ million
Service cost	7		9		10	2
Past service credit	(49)		(7)			(35)
Settlement loss/(gain)	1		2			(11)
Net interest cost, administration and taxes		3	3	4	3	3
	(41)	3	7	4	13	(41)

18.5 Principal actuarial assumptions

The following are the principal financial actuarial assumptions used at the reporting date to determine the UK and US defined benefit obligations and expense.

	2016 % per annum	2015 % per annum	2014 % per annum
UK Plan:			
Discount rate	2.6	3.8	3.7
Future salary increases	3.8	3.6	3.5
Future pension increases	3.3	3.1	3.0
Inflation (RPI)	3.3	3.1	3.0
Inflation (CPI)	2.3	2.1	2.0
US Plan:			
Discount rate	4.0	4.3	4.0
Future salary increases	n/a	n/a	n/a
Inflation	n/a	n/a	n/a

Table of Contents

Actuarial assumptions regarding future mortality are based on mortality tables. The UK uses the S1NA with projections in line with the CMI 2011 table and the US uses the RP2014 table with MP2016 scale. The current longevities underlying the values of the obligations in the defined benefit plans are as follows:

	2016 years	2015 years	2014 years
Life expectancy at age 60			
UK Plan:			
Males	29.7	29.6	29.4
Females	31.1	31.3	31.2
US Plan:			
Males	25.1	25.8	26.0
Females	27.4	28.2	28.5
Life expectancy at age 60 in 20 years time			
UK Plan:			
Males	32.5	32.6	32.4
Females	33.0	33.4	33.3
US Plan:			
Males	25.4	27.6	27.8
Females	27.9	29.9	30.2

18.6 Sensitivity analysis

The calculation of the defined benefit obligation is sensitive to the assumptions used. The following table summarises the increase/decrease on the UK and US defined benefit obligation and pension costs as a result of reasonably possible changes in some of the assumptions while holding all other assumptions consistent. The sensitivity to the inflation assumption change includes corresponding changes to the future salary increases and future pension increase assumptions. The analysis does not take into account the full distribution of cash flows expected under the plan.

Changes to the inflation assumption will not have any effect on the US Pension Plan as it was closed to future accrual in 2014.

	Increase in pension obligation		Increase in pension cost	
$ million	+50bps/+1yr	-50bps/-1yr	+50bps/+1 yr	-50bps/-1yr
UK Plan:				
Discount rate	-84.4	97.5	-2	+2
Inflation	88.1	-79.4	+2	-2
Mortality	33.3	-32.8	+1	-1
US Plan:				
Discount rate	-24.9	26.7	-1	+1
Inflation	n/a	n/a	n/a	n/a
Mortality	10.9	-10.9		

Table of Contents

NOTES TO THE GROUP ACCOUNTS

18 RETIREMENT BENEFIT OBLIGATIONS continued

18.7 Risk

The pension plans expose the Group to the following risks:

Interest rate risk	Volatility in financial markets can change the calculations of the obligation significantly as the calculation of the obligation is linked to yields on AA-rated corporate bonds. A decrease in the bond yield will increase the measure of plan liabilities, although this will be partially offset by increases in the value of matching plan assets such as bonds and insurance contracts. In the UK, the liability matching portfolio held in conventional and index-linked gilts was transferred into liability driven investments in order to reduce interest rate risk.
Inflation risk	The UK Plan is linked to inflation. A high rate of inflation will lead to a higher liability. This risk is managed by holding inflation-linked bonds and an inflation-linked insurance contract in respect of some of the obligation. In the UK, the liability matching portfolio held in conventional and index-linked gilts was transferred into liability driven investments in order to reduce inflation risk.

The UK and US Plans have been closed to future accrual which eliminates the exposure to this risk.

Investment risk

If the return on plan assets is below the discount rate, all else being equal, there will be an increase in the plan deficit.

In the UK, this risk is partially managed by a portfolio of liability matching assets and a bulk annuity, together with a dynamic de-risking policy to switch growth assets into liability matching assets over time.

The US Plan has a dynamic de-risking policy to shift plan assets into longer-term stable asset classes. The policy established 10 pre-determined funded status levels and when each trigger point is reached, the plan assets are re-balanced accordingly.

Longevity risk

The present value of the plans defined benefit liability is calculated by reference to the best estimate of the mortality of the plan participants both during and after their employment. An increase in the life expectancy

of plan participants above that assumed will increase the benefit obligation.

The UK Plan, in order to minimise longevity risk, has entered into an insurance contract which covers a portion of pensioner obligations.

Salary risk

The calculation of the defined benefit obligation uses the future estimated salaries of plan participants. Increases in the salary of plan participants above that assumed will increase the benefit obligation.

The exposure to salary risk in the UK and US has been eliminated with the closure of these Plans to future accrual.

18.8 Funding

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

UK Plan

The most recent full actuarial valuation of the UK Plan was undertaken as at 30 September 2015. Contributions to the UK Plan in 2016 were $32m (2015: $37m, 2014: $33m). This included supplementary payments of $26m (2015: $29m, 2014: $23m).

The Group has currently agreed to pay supplementary payments until 2021 and the agreed supplementary contribution for 2017 is $23m.

US Plan

A full actuarial valuation for the US Plan was last undertaken as at 20 September 2013 before the closure of the Plan to future accrual. Contributions to the US Plan were $20m (2015: $20m, 2014: $22m) which included supplementary payments of $20m.

The planned supplementary contribution for 2017 is $20m.

Table of Contents

19 EQUITY

ACCOUNTING POLICY

Incremental costs directly attributable to the issue of ordinary shares, net of any tax effects, are recognised as a deduction from equity.

When shares recognised as equity are repurchased, the amount of the consideration paid, which includes directly attributable costs, net of any tax effects, is recognised as a deduction from equity. Repurchased shares are classified as treasury shares and are presented in the treasury share reserve. When treasury shares are sold or reissued subsequently, the amount received is recognised as an increase in equity and the resulting surplus or deficit on the transaction is presented within share premium.

19.1 Share capital

	Ordinary shares (20¢)		Deferred shares (£1.00)		Total
	Thousand	$ million	Thousand	$ million	$ million
Authorised					

At 31 December 2014	1,223,591	245	50	245
At 31 December 2015	1,223,591	245	50	245
At 31 December 2016	1,223,591	245	50	245
Allotted, issued and fully paid				
At 1 January 2014	918,167	184	50	184
Share options	4,180	1		1
Shares cancelled	(4,405)	(1)		(1)
At 31 December 2014	917,942	184	50	184
Share options	1,855			
Shares cancelled	(4,350)	(1)		(1)
At 31 December 2015	915,447	183	50	183
Share options	1,283			
Shares cancelled	(13,007)	(3)		(3)
At 31 December 2016	903,723	180	50	180

The deferred shares were issued in 2006 in order to comply with English Company law. They are not listed on any stock exchange and have extremely limited rights and effectively have no value. These rights are summarised as follows:

The holder shall not be entitled to participate in the profits of the Company;

The holder shall not have any right to participate in any distribution of the Company s assets on a winding up or other distribution except that after the return of the nominal amount paid up on each share in the capital of the Company of any class other than the deferred shares and the distribution of a further $1,000 in respect of each such share there shall be distributed to a holder of a deferred share (for each deferred share held) an amount equal to the nominal value of the deferred share;

The holder shall not be entitled to receive notice, attend, speak or vote at any general meeting of the Company; and

The Company may create, allot and issue further shares or reduce or repay the whole or any part of its share capital or other capital reserves without obtaining the consent of the holders of the deferred shares.

The Group s objectives when managing capital are to ensure the Group has adequate funds to continue as a going concern and sufficient flexibility within the capital structure to fund the ongoing growth of the business and to take advantage of business development opportunities including acquisitions.

The Group determines the amount of capital taking into account changes in business risks and future cash requirements. The Group reviews its capital structure on an ongoing basis and uses share buy-backs, dividends and the issue of new shares to adjust the retained capital.

The Group considers the capital that it manages to be as follows:

	2016 $ million	2015 $ million	2014 $ million
Share capital	180	183	184
Share premium	600	590	574
Capital redemption reserve	15	12	11
Treasury shares	(432)	(294)	(315)
Retained earnings and other reserves	3,595	3,475	3,586
	3,958	3,966	4,040

Table of Contents

NOTES TO THE GROUP ACCOUNTS

19 EQUITY continued

19.2 Treasury shares

Treasury shares represents the holding of the Company s own shares in respect of the Smith & Nephew Employees Share Trust and shares bought back as part of the share buy-back programme. On 8 August 2016 the Group commenced a new $300m share buy-back programme following the sale of its Gynaecology business. The share buy-back programme was completed in December 2016. During 2016, a total of 24.0m (2.7%) ordinary shares were purchased at a cost of $368m and 13.0m (1.5%) ordinary shares were cancelled. During 2015, a total of 4.4m ordinary shares (0.5%) had been purchased at a cost of $77m and 4.4m (0.5%) had been cancelled.

The Smith & Nephew 2004 Employees Share Trust (Trust) was established to hold shares relating to the long-term incentive plans referred to in the Directors Remuneration Report . The Trust is administered by an independent professional trust company resident in Jersey and is funded by a loan from the Company. The cost of the Trust is charged to the income statement as it accrues. A dividend waiver is in place in respect of those shares held under the long-term incentive plans. The Trust only accepts dividends in respect of nil-cost options and deferred bonus plan shares. The waiver represents less than 1% of the total dividends paid.

The movements in Treasury shares and the Employees Share Trust are as follows:

	Treasury	Employees Share Trust	Total
	$ million	$ million	$ million

At 1 January 2015	314	1	315
Shares purchased	77		77
Shares transferred from treasury	(58)	58	
Shares transferred to Group beneficiaries	(9)	(29)	(38)
Shares cancelled	(60)		(60)
At 31 December 2015	264	30	294
Shares purchased	368		368
Shares transferred from treasury	(18)	18	
Shares transferred to Group beneficiaries	(13)	(27)	(40)
Shares cancelled	(190)		(190)
At 31 December 2016	411	21	432

	Number of shares million	Number of shares million	Number of shares million
At 1 January 2015	24.0	0.1	24.1
Shares purchased	4.4		4.4
Shares transferred from treasury	(4.4)	4.4	
Shares transferred to Group beneficiaries	(0.7)	(2.2)	(2.9)
Shares cancelled	(4.4)		(4.4)
At 31 December 2015	18.9	2.3	21.2
Shares purchased	24.0		24.0
Shares transferred from treasury	(1.2)	1.2	
Shares transferred to Group beneficiaries	(0.9)	(2.0)	(2.9)
Shares cancelled	(13.0)		(13.0)
At 31 December 2016	27.8	1.5	29.3

19.3 Dividends

	2016 $ million	2015 $ million	2014 $ million
The following dividends were declared and paid in the year:			
Ordinary final of 19.0¢ for 2015 (2014: 18.6¢, 2013: 17.0¢) paid 11 May 2016	170	166	152
Ordinary interim of 12.3¢ for 2016 (2015: 11.8¢, 2014: 11.0¢) paid 25 October 2016	109	106	98
	279	272	250

A final dividend for 2016 of 18.5¢ per ordinary share was proposed by the Board on 8 February 2017 and will be paid, subject to shareholder approval, on 10 May 2017 to shareholders on the Register of Members on 31 March 2017. The estimated amount of this dividend is $162m.

Table of Contents

20 CASH FLOW STATEMENT

ACCOUNTING POLICY

In the Group cash flow statement, cash and cash equivalents includes cash at bank, other short-term liquid investments with original maturities of three months or less and bank overdrafts. In the Group balance sheet, bank overdrafts are shown within bank overdrafts and loans under current liabilities.

Analysis of net debt

			Borrowings				
	Cash	Overdrafts	Due within one year	Due after one year	Net currency swaps	Net interest swaps	Total
	$ million	$ million	$ million	$ million	$ million	$ million	$ million
At 1 January 2014	137	(11)	(33)	(347)	1		(253)
Net cash flow impact	(35)	(19)	22	(1,322)	11		(1,343)
Exchange adjustment	(9)	2		3	(13)		(17)
At 31 December 2014	93	(28)	(11)	(1,666)	(1)		(1,613)
Net cash flow impact	34	9	(17)	231	15	1	273
Exchange adjustment	(7)	1		1	(16)		(21)

At 31 December 2015	120	(18)	(28)	(1,434)	(2)	1	(1,361)
Net cash flow impact	(18)	(45)	4	(129)	25	(2)	(165)
Exchange adjustment	(2)	1		(1)	(22)		(24)
At 31 December 2016	100	(62)	(24)	(1,564)	1	(1)	(1,550)

Reconciliation of net cash flow to movement in net debt

	2016 $ million	2015 $ million	2014 $ million
Net cash flow from cash net of overdrafts	(63)	43	(54)
Settlement of currency swaps	25	15	11
Net cash flow from borrowings	(127)	215	(1,300)
Change in net debt from net cash flow	(165)	273	(1,343)
Exchange adjustment	(24)	(21)	(17)
Change in net debt in the year	(189)	252	(1,360)
Opening net debt	(1,361)	(1,613)	(253)
Closing net debt	(1,550)	(1,361)	(1,613)

Cash and cash equivalents
For the purposes of the Group cash flow statement cash and cash equivalents at 31 December 2016 comprise cash at bank net of bank overdrafts.

	2016 $ million	2015 $ million	2014 $ million
Cash at bank	100	120	93
Bank overdrafts	(62)	(18)	(28)
Cash and cash equivalents	38	102	65

The Group operates in over 100 countries around the world, some of which impose restrictions over cash movement. These restrictions have only a minimal impact of the management of the Group s cash.

Table of Contents

NOTES TO THE GROUP ACCOUNTS

21 ACQUISITIONS AND DISPOSALS

ACCOUNTING POLICY

The Group accounts for business combinations using the acquisition method when control is transferred to the Group. The consideration transferred in the acquisition is measured at fair value, as are the identifiable net assets acquired. Any goodwill that arises is tested annually for impairment. Any gain on a bargain purchase is recognised in profit or loss immediately. Transaction costs are expensed as incurred, except if related to the issue of debt or equity securities.

Any contingent consideration payable is measured at fair value at the acquisition date. If the contingent consideration is classified as equity, then it is not re-measured and settlement is accounted for within equity. Otherwise, subsequent changes in the fair value of the contingent consideration are recognised in profit or loss.

21.1 Acquisitions

Year ended 31 December 2016

During the year ended 31 December 2016, the Group acquired two medical technology businesses deemed to be business combinations within the scope of IFRS 3 *Business Combinations*.

On 4 January 2016, the Group completed the acquisition of 100% of the share capital of Blue Belt Holdings Inc., a business specialising in robotic technologies. The acquisition secures a leading position in the fast growing area of Orthopaedic robotics-assisted surgery. The fair value of consideration is $265m and includes $51m deferred consideration. The fair values of assets acquired were:

	$ million
Aggregate identifiable assets acquired and liabilities assumed	
Intangible assets	70
Property, plant & equipment and inventory	13
Trade and other payable	(11)
Provisions	(10)
Deferred tax assets	16
Net assets	78
Goodwill	184
Consideration (net of $3m cash acquired)	262

The goodwill is attributable to the revenue synergies of providing a full robotic surgery offering and future applications of the technological expertise. The goodwill is not expected to be deductible for tax purposes.

On 8 January 2016 the Group completed the acquisition of BST-CarGel, a first-line cartilage repair product from Piramal Healthcare (Canada) Limited. The fair value of the consideration is $42m and included $37m of deferred and contingent consideration. The fair values of net assets acquired are: product intangible assets of $15m, inventory of $1m, and a deferred tax liability of $1m. The goodwill, which is expected to be deductible for tax purposes, arising on the acquisition is $27m, is attributable to the future penetration into new markets expected from the transaction.

During the year ended 31 December 2016, the contribution to revenue and attributable profit from these acquisitions is immaterial. If the acquisitions had occurred at the beginning of the year, their contribution to revenue and attributable profit would have also been immaterial.

Year ended 31 December 2015

During the year ended 31 December 2015, the Group acquired its distributor in Colombia and its distributor and a manufacturer in Russia. The acquisitions are deemed to be business combinations within the scope of IFRS 3 *Business Combinations*.

The aggregated total fair value of the consideration was $68m and included $23m of contingent consideration and $13m through the settlement of working capital commitments. The acquisition accounting was completed during 2016 with no measurement adjustments being made.

The following table summarises the aggregate consideration transferred and the aggregate fair value amounts of assets acquired and liabilities assumed at the acquisition date:

	$ million
Aggregate identifiable assets acquired and liabilities assumed	
Intangible assets	19
Other assets[1]	29
Liabilities	(14)
Net assets	34
Goodwill	34
Cost of acquisition	68

1 Including net cash of $1m.

Table of Contents

The aggregated estimate of goodwill arising on the acquisitions is $34m. This is attributable to the additional economic benefits expected from the transactions, including the assembled workforces, which have been transferred as part of the acquisitions. The goodwill recognised is not expected to be deductible for tax purposes.

The contribution to revenue and attributable profit from these acquisitions for the year ended 31 December 2015 was immaterial. If the acquisitions had occurred at the beginning of the year, their contributions to revenue and attributable profit for the year ended 31 December 2015 would also have been immaterial.

Year ended 31 December 2014

Acquisition of ArthroCare

On 29 May 2014, the Group acquired 100% of the shares of ArthroCare Corporation, an innovative medical device company with a highly complementary sports medicine portfolio. The purchase price was $48.25 per share, paid in cash with the fair value of the total consideration equalling $1,715m. The acquisition was financed through existing debt facilities and cash balances, including an existing $1bn revolving credit facility and a new two-year $1.4bn term loan facility, established in February 2014.

The acquisition is deemed to be a business combination within the scope of IFRS 3 *Business Combinations*. The acquisition accounting was completed during 2015. The fair values shown below include measurement period adjustments recognised during the period. The goodwill arising on the acquisition is $829m. It relates to the value of the additional economic benefits expected from the transaction, including synergies and the assembled workforce. The goodwill recognised is not expected to be deductible for tax purposes.

The following table summarises the consideration transferred, and the recognised amounts of assets acquired and liabilities assumed at the acquisition date.

	$ million
Identifiable assets acquired and liabilities assumed	
Property, plant and equipment	60
Inventories	66
Trade receivables and prepayments	54
Identifiable intangible assets	817
Investments in associates	4

Trade and other payables	(74)
Provisions	(19)
Current tax payable	(18)
Deferred tax liabilities	(173)
Net assets	717
Goodwill	829
Consideration (net of $169m of cash acquired)	1,546

For the year ended 31 December 2014, ArthroCare s contribution to Group revenue was $207m representing approximately seven months of sales. This gave rise to a pre-tax profit of $28m after amortisation of acquisition intangibles. Had ArthroCare been acquired on 1 January 2014, the Group s revenues for 2014 would have been $147m higher and pre-tax profit would have been $5m higher.

Acquisition of Brazilian distributor

On 17 March 2014, the Group acquired certain assets and liabilities related to the distribution business for its sports medicine, orthopaedic reconstruction, and trauma products in Brazil. The acquisition was deemed to be a business combination within the scope of IFRS 3 *Business Combinations*. The acquisition date fair value of the consideration was $31m and included deferred consideration of $26m and $5m in relation to the settlement of working capital commitments. The deferred consideration was subsequently settled during the second quarter of 2014.

The acquisition accounting was completed during 2015. As at the acquisition date, the fair value of the net assets acquired, which includes measurement period adjustments recognised during the period, was $16m. This includes trade and other receivables of $12m, identifiable intangible assets of $16m, inventory of $4m, property, plant and equipment of $2m, trade payables of $1m, provisions of $5m, current tax payable of $4m and deferred tax liabilities of $8m. As a result, the goodwill arising on the acquisition was $15m. This is attributable to the additional economic benefits expected from the acquisition, including the assembled workforce, which has been transferred as part of the acquisition. The goodwill is not expected to be deductible for tax purposes.

The contribution to revenue and attributable profit from this acquisition for the year ended 31 December 2014 was immaterial. If the acquisition had occurred at the beginning of the year its contribution to revenue and attributable profit for the year ended 31 December 2014 would also have been immaterial.

Table of Contents

NOTES TO THE GROUP ACCOUNTS

21 ACQUISITIONS AND DISPOSALS continued

21.2 Disposal of business

During the year ended 31 December 2016 the Group disposed of its Gynaecology business for cash consideration of $350m. The net assets disposed included $6m plant and equipment, and $4m inventory. Disposal related costs of $7m and liabilities of $7m resulted in a pre-tax gain on disposal of $326m.

For the year ended 31 December 2015, the Group did not dispose of any businesses.

During 2014, the Group disposed of a manufacturing facility in the UK for cash consideration of $20m, resulting in a pre-tax gain on disposal of $9m. The 2014 revenue and profit contribution of the disposed business was immaterial.

22 OPERATING LEASES

ACCOUNTING POLICY

Leases are classified as finance leases when the terms of the lease transfer substantially all the risks and rewards of ownership to the Group. All other leases are classified as operating leases.

Payments under operating leases are expensed in the income statement on a straight-line basis over the term of the lease. Lease incentives received are recognised as an integral part of the total lease expense, over the term of the lease.

Future minimum lease payments under non-cancellable operating leases fall due as follows:

	2016 $ million	2015 $ million
Land and buildings:		
Within one year	33	29
After one and within two years	27	20
After two and within three years	23	14
After three and within four years	16	11
After four and within five years	13	8
After five years	41	9
	153	91
Other assets:		
Within one year	15	16
After one and within two years	11	9
After two and within three years	6	5
After three and within four years	2	2
	34	32

Table of Contents

23 OTHER NOTES TO THE ACCOUNTS

23.1 Share-based payments

ACCOUNTING POLICY

The Group operates a number of equity-settled executive and employee share plans. For all grants of share options and awards, the fair value at the grant date is calculated using appropriate option pricing models. The grant date fair value is recognised over the vesting period as an expense, with a corresponding increase in retained earnings.

Employee plans

The Smith & Nephew Sharesave Plan (2002) (adopted by shareholders on 3 April 2002) (the Save As You Earn (SAYE) plan), the Smith & Nephew International Sharesave Plan (2002), Smith & Nephew France Sharesave Plan (2002), Smith & Nephew Sharesave Plan (2012) (the Save As You Earn (SAYE 2012) plan) (adopted by shareholders on 12 April 2012), Smith & Nephew International Sharesave Plan (2012) (adopted by shareholders on 12 April 2012) and Smith & Nephew France Sharesave Plan (2012) (adopted by shareholders on 12 April 2012) are together termed the Employee Plans .

The SAYE and SAYE 2012 plans are available to all employees in the UK employed by participating Group companies, subject to three months service. The schemes enable employees to save up to £250 per month on plans up to 2014 and £500 per month from 2015 onwards and give them an option to acquire shares based on the committed amount to be saved. The option price is not less than 80% of the average of middle market quotations of the ordinary shares on the three dealing days preceding the date of invitation. The Smith & Nephew International Sharesave Plan (2002) and Smith & Nephew International Sharesave Plan (2012) are available to employees in Australia, Austria, Belgium, Canada, China, Costa Rica, Denmark, Finland, France, Germany, Hong Kong, India, Ireland, Italy, Japan, Malaysia, South Korea, Mexico, the Netherlands, New Zealand, Norway, Poland, Portugal, Singapore, South Africa, Spain, Sweden, Switzerland and the United Arab Emirates. Employees in Turkey became eligible to join the plan in 2016. Puerto Rico participants were eligible to receive options under the International Plans up to 2011 and are eligible to receive phantom options from 2013 onwards. The Smith & Nephew France Sharesave Plans were available to all employees in France up to 2012. The International and French plans operate on a substantially similar basis to the SAYE plans.

Employees in the US are able to participate in the Employee Stock Purchase Plan, which gives them the opportunity to acquire shares, in the form of ADSs, at a discount of 15% (or more if the shares appreciate in value during the plan s quarterly purchase period) to the market price, through a regular savings plan.

Executive plans

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

Under the terms of the Executive Plans, the Remuneration Committee, consisting of Non-Executive Directors, may at their discretion approve the grant of options to employees of the Group to acquire ordinary shares in the Company. Options granted under the Smith & Nephew 2001 US Share Plan (the US Plan) and the Smith & Nephew 2004 Executive Share Option Plan are to acquire ADSs or ordinary shares. For Executive Plans adopted in 2001 and 2004, the market value is the average quoted price of an ordinary share for the three business days preceding the date of grant or the average quoted price of an ADS or ordinary share, for the three business days preceding the date of grant or the quoted price on the date of grant if higher. For the Global Share Plan adopted in 2010, the market value is the closing price of an ordinary share or ADS on the last trading day prior to the grant date. With the exception of options granted under the 2001 US Plan and the Global Share Plan 2010, the vesting of options granted from 2001 is subject to achievement of a performance condition. Options granted under the 2001 US Plan and the Global Share Plan 2010 are not subject to any performance conditions. Prior to 2008, the 2001 US Plan options became cumulatively exercisable as to 10% after one year, 30% after two years, 60% after three years and the remaining balance after four years. With effect from 2008, options granted under the 2001 US Plan became cumulatively exercisable as to 33.3% after one year, 66.7% after two years and the remaining balance after the third year. The 2001 UK Unapproved Share Option Plan was open to certain employees outside the US and the US Plan was open to certain employees in the US, Canada, Mexico and Puerto Rico. The Global Share Plan 2010 is open to employees globally. The 2004 Plan was open to Senior Executives only.

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

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

Table of Contents

NOTES TO THE GROUP ACCOUNTS

23 OTHER NOTES TO THE ACCOUNTS continued

At 31 December 2016, 5,779,861 (2015: 7,235,070, 2014: 8,708,000) options were outstanding under share option plans as follows:

	Number of shares thousand	Range of option exercise prices pence		Weighted average exercise price pence
Employee Plans:				
Outstanding at 1 January 2014	3,287	380.0	625.0	530.5
Granted	799		831.0	831.0
Forfeited	(289)	380.0	831.0	533.8
Exercised	(743)	380.0	625.0	436.2

Expired	(18)	461.0	556.0	465.7
Outstanding at 31 December 2014	3,036	380.0	831.0	632.7
Granted	1,622		949.0	949.0
Forfeited	(275)	380.0	949.0	683.6
Exercised	(744)	380.0	831.0	514.6
Expired	(45)	461.0	535.0	533.0
Outstanding at 31 December 2015	3,594	452.0	949.0	797.3
Granted	1,168		1,026.0	1,025.4
Forfeited	(295)	452.0	1,026.0	848.8
Exercised	(865)	452.0	949.0	599.1
Expired	(73)	452.0	625.0	616.2
Outstanding at 31 December 2016	3,529	452.0	1,026.0	920.9
Options exercisable at 31 December 2016	120	452.0	625.0	606.2
Options exercisable at 31 December 2015	82	461.0	556.0	521.4
Options exercisable at 31 December 2014	94	380.0	585.0	439.6
Executive Plans:				
Outstanding at 1 January 2014	10,314	409.5	680.5	591.1

Forfeited	(115)	599.0	650.0	645.0
Exercised	(4,114)	454.0	671.0	583.0
Expired	(413)	409.5	650.0	587.8
Outstanding at 31 December 2014	5,672	470.0	680.5	596.2
Forfeited	(8)	622.0	650.0	630.2
Exercised	(1,841)	479.0	680.5	602.2
Expired	(182)	479.0	650.0	604.2
Outstanding at 31 December 2015	3,641	470.0	650.0	592.7
Exercised	(1,311)	470.0	650.0	570.6
Expired	(79)	479.0	650.0	599.1
Outstanding at 31 December 2016	2,251	479.0	650.0	605.4
Options exercisable at 31 December 2016	2,251	479.0	650.0	605.4
Options exercisable at 31 December 2015	3,641	470.0	650.0	592.7
Options exercisable at 31 December 2014	4,713	470.0	680.5	585.3

The weighted average remaining contractual life of options outstanding at 31 December 2016 was 4.8 years (2015: 5.1 years, 2014: 5.8 years) for Executive Plans and 2.7 years (2015: 2.7 years, 2014: 2.5 years) for Employee Plans.

Table of Contents

	2016 pence	2015 pence	2014 pence
Weighted average share price	1,181.8	1,144.4	994.4

Options granted during the year were as follows:

	Options granted thousand	Weighted average fair value per option at grant date pence	Weighted average share price at grant date pence	Weighted average exercise price pence	Weighted average option life years
Employee Plans	1,168	301.2	1,217.0	1,026.0	3.8

The weighted average fair value of options granted under Employee Plans during 2015 was 293.9p (2014: 255.8p) and those under Executive Plans during 2015 was nil (2014: nil).

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

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

	Employee Plans		
	2016	2015	2014
Dividend yield %	2.0	2.0	2.0
Expected volatility %[1]	25.0	25.0	20.0
Risk free interest rate %[2]	1.3	1.3	1.3
Expected life in years	3.8	3.8	3.9

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

Share-based payments long-term incentive plans

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

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

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

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

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

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

The fair values of awards granted under long-term incentive plans are calculated using a binomial model. Performance Share awards under both the PSP and Global Share Plan 2010 contain vesting conditions based on TSR versus a comparator group which represent market-based performance conditions for valuation purposes and an assessment of vesting probability is therefore factored into the award date calculations. The assumptions include the volatilities for the comparator groups. A correlation of 35% (2015: 35%, 2014: 40%) has also been assumed for the companies in the medical devices sector as they are impacted by similar factors. The Performance Target for the Global Share Plan 2010 is a combination of Free Cash Flow growth, Revenue in Emerging & International Markets and the Group s TSR performance over the three-year performance period.

The other assumptions used are consistent with the Executive scheme assumptions disclosed earlier in this Note.

Table of Contents

NOTES TO THE GROUP ACCOUNTS

23 OTHER NOTES TO THE ACCOUNTS continued

At 31 December 2016, the maximum number of shares that could be awarded under the Group s long-term incentive plans was:

Number of shares in thousands

	Other Awards	EIA	PSP	Deferred Bonus Plan	Total
Outstanding at January 2014	1,449	1,284	5,197	44	7,974
Awarded	751	642	1,510		2,903
Vested	(583)	(751)		(44)	(1,378)
Forfeited	(96)	(24)	(2,188)		(2,308)
	1,521	1,151	4,519		7,191

Outstanding at 31 December 2014				
Awarded	661	592	1,393	2,646
Vested	(678)	(648)	(1,794)	(3,120)
Forfeited	(93)	(84)	(138)	(315)
Outstanding at 31 December 2015	1,411	1,011	3,980	6,402
Awarded	790	633	1,324	2,747
Vested	(800)	(608)	(1,035)	(2,443)
Forfeited	(88)	(38)	(773)	(899)
Outstanding at 31 December 2016	1,313	998	3,496	5,807

Other awards mainly comprises of conditional share awards granted under the Global Share Plan 2010.

The weighted average remaining contractual life of awards outstanding at 31 December 2016 was 1.2 years (2015: 1.1 years, 2014: 1.1 years) for the PSP, 1.7 years (2015: 1.6 years, 2014: 1.5 years) for the EIA and 2.0 years (2015: 1.9 years, 2014: 2.0 years) for the other awards.

Share-based payments charge to income statement

The expense charged to the income statement for share-based payments is as follows:

	2016 $ million	2015 $ million	2014 $ million
Granted in current year	9	11	9
Granted in prior years	18	19	23
Total share-based payments expense for the year[1]	27	30	32

1 The total share-based payments expense in 2015 comprised $29m taken through reserves as well as $1m cash settlements during the year.

Under the Executive Plans, PSP, EIA and CIP the number of ordinary shares over which options and share awards may be granted is limited so that the number of ordinary shares issued or that may be issued during the 10 years preceding the date of grant shall not exceed 5% of the ordinary share capital at the date of grant. The total number of ordinary shares which may be issuable in any 10-year period under all share plans operated by the Company may not exceed 10% of the ordinary share capital at the date of grant.

23.2 Related party transactions

Trading transactions

In the course of normal operations, the Group traded with its associates detailed in Note 11. The aggregated transactions, which have not been disclosed elsewhere in the financial statements are $nil (2015: $nil, 2014: $1m).

Key management personnel

The remuneration of executive officers (including Non-Executive Directors) during the year is summarised below:

	2016 $ million	2015 $ million	2014 $ million
Short-term employee benefits	15	16	14
Share-based payments expense	7	8	8
Pension and post-employment benefit entitlements	1	1	1
Other benefits			3
	23	25	26

Directors remuneration disclosures are included on pages 90 and 96.

Table of Contents

23.3 Group Companies

In accordance with Section 409 of the Companies Act 2006, a full list of subsidiaries, associates, joint arrangements, joint ventures and partnerships are listed below, including their country of incorporation. All companies are 100% owned, unless otherwise indicated. Unless otherwise stated, the share capital disclosed comprises ordinary shares which are indirectly held by Smith & Nephew plc.

Company name[1]	Country of operation and incorporation	Registered Office
UK[1]		
Blue Belt Technologies UK Limited	England & Wales	London
Michelson Diagnostic Limited[5] (13.4%)	England & Wales	Kent
Neotherix Limited[5] (24.9%)	England & Wales	London
Plus Orthopedics (UK) Limited[4]	England & Wales	London

Smith & Nephew (Overseas) Limited[2,3]	England & Wales	London
Smith & Nephew ARTC Limited	England & Wales	London
Smith & Nephew Beta Limited[4]	England & Wales	London
Smith & Nephew China Holdings UK Limited[3]	England & Wales	London
Smith & Nephew Collagenase Limited[4]	England & Wales	Hull
Smith & Nephew Employees Trustees Limited[4]	England & Wales	London
Smith & Nephew ESN Limited[4]	England & Wales	London
Smith & Nephew Extruded Films Limited[4]	England & Wales	Hull
Smith & Nephew Finance[4]	England & Wales	London
Smith & Nephew Finance Oratec[4]	England & Wales	London

Smith & Nephew Healthcare Limited[4]	England & Wales	Hull
Smith & Nephew Investment Holdings Limited[3]	England & Wales	London
Smith & Nephew Medical Fabrics Limited[4]	England & Wales	London
Smith & Nephew Medical Limited[4]	England & Wales	Hull
Smith & Nephew Nominee Company Limited[4]	England & Wales	London
Smith & Nephew Nominee Services Limited[4]	England & Wales	London
Smith & Nephew Orthopaedics Limited[4]	England & Wales	London
Smith & Nephew Pensions Nominees Limited[4]	England & Wales	London
Smith & Nephew Pharmaceuticals Limited[4]	England & Wales	Hull
Smith & Nephew Raisegrade Limited[3,4]	England & Wales	London

Smith & Nephew Rareletter Limited[4]	England & Wales	London
Smith & Nephew Trading Group Limited[3]	England & Wales	London
Smith & Nephew UK Executive Pension Scheme Trustee Limited[4]	England & Wales	London
Smith & Nephew UK Limited[2,3]	England & Wales	London
Smith & Nephew UK Pension Fund Trustee Limited[4]	England & Wales	London
Smith & Nephew USD Limited[3]	England & Wales	London
Smith & Nephew USD One Limited[3]	England & Wales	London
T.J.Smith and Nephew, Limited[3]	England & Wales	Hull
The Albion Soap Company Limited[4]	England & Wales	London
TP Limited[3]	Scotland	Edinburgh

Rest of Europe[1]

Company name[1]	Country of operation and	Registered Office
Smith & Nephew GmbH	Austria	Vienna
ArthroCare Belgium SPRL[4]	Belgium	Zaventem
Smith & Nephew S.A.-N.V	Belgium	Zaventem
Smith & Nephew A/S	Denmark	Hoersholm
Smith & Nephew France SAS[3]	France	Le Mans
Smith & Nephew S.A.S.	France	Le Mans
A2 Surgical	France	Le Mans
Smith & Nephew Oy	Finland	Helsinki

	incorporation	
Smith & Nephew Business Services GmbH & Co. KG[3]	Germany	Hamburg
Smith & Nephew Business Services Verwaltungs GmbH[3]	Germany	Hamburg
Smith & Nephew Deutschland (Holding) GmbH[3]	Germany	Hamburg
Smith & Nephew GmbH	Germany	Hamburg
Smith & Nephew Orthopaedics GmbH	Germany	Tuttlingen
Plus Orthopedics Hellas SA	Greece	Athens
Smith & Nephew Hellas S.A.	Greece	Athens
Smith & Nephew Limited	Ireland	Dublin 2
Smith & Nephew Finance Ireland Limited	Ireland	Dublin 1

Smith & Nephew S.r.l.[3]	Italy	Milan
ArthroCare Luxembourg Sarl[3] [4]	Luxembourg	Luxembourg
Smith & Nephew Finance S.a.r.l.[3]	Luxembourg	Luxembourg
Smith & Nephew International S.A.[3]	Luxembourg	Luxembourg
Smith & Nephew (Europe) B.V.[3]	Netherlands	Amsterdam
Smith & Nephew B.V.[3]	Netherlands	Amsterdam
Smith & Nephew Management B.V.[3]	Netherlands	Amsterdam
Smith & Nephew Nederland CV	Netherlands	Amsterdam
Smith & Nephew Optics B.V.[4]	Netherlands	Amsterdam
Smith & Nephew A/S	Norway	Oslo
Smith & Nephew sp. z.o.o.	Poland	Warsaw

Smith & Nephew Lda	Portugal	Lisbon
D-Orthopaedics LLC	Russian Federation	Moscow
LLC DC	Russian Federation	Puschino
LLC Smith & Nephew	Russian Federation	Moscow
Smith & Nephew S.A.U	Spain	Barcelona
Smith & Nephew Atkiebolag[3]	Sweden	Molndal
Lumina Adhesives AB[5] (11%)	Sweden	Gothenberg
Plus Orthopedics Holding AG[3]	Switzerland	Baar
Smith & Nephew Manufacturing AG	Switzerland	Aarau
Smith & Nephew Orthopaedics AG[3]	Switzerland	Baar

Smith & Nephew Schweiz AG	Switzerland	Baar
Smith & Nephew AG	Switzerland	Baar
US[1]		
Arthrocare Corporation[3]	United States	San Jose
Bioventus LLC[5] (49%)	United States	Wilmington
Blue Belt Holdings, Inc.[3]	United States	Minneapolis
Blue Belt Technologies, Inc.[3]	United States	Pittsburgh
Blue Sky Medical Group, Inc.	United States	Wilmington
Delphi Ventures V, L.P.[5] (6.9%)	United States	Menlo Park
Healicoil, Inc.	United States	Wilmington

Hipco, Inc.	United States	Wilmington
Kalypto Medical, Inc.	United States	Wilmington
LifeModeler, Inc.	United States	Tustin
Memphis Biomed Ventures I, LP[5] (4.61%)	United States	Delaware
Oratec Interventions, Inc.	United States	Concord
Orthopaedic Biosystems Ltd., Inc.	United States	Phoenix
OsteoBiologics, Inc.	United States	Dallas
Plus Orthopedics LLC	United States	Andover

Table of Contents

NOTES TO THE GROUP ACCOUNTS

23 OTHER NOTES TO THE ACCOUNTS continued

Company name[1]	Country of operation and incorporation	Registered Office
Sinopsys Surgical, Inc.[5] (11.3%)	United States	Boulder
Smith & Nephew AHP, Inc.[4]	United States	Wilmington
Smith & Nephew Consolidated, Inc.	United States	Amsterdam
Smith & Nephew OUS, Inc.[3]	United States	Wilmington

Smith & Nephew, Inc.[3]	United States	Wilmington
Surgical Frontiers Series I, LLC[5] (32%)	United States	Dover

Africa, Asia, Australasia and Other America[1]

Smith & Nephew Argentina S.R.L.[4]	Argentina	Buenos Aires
ArthroCare (Australasia) Pty Ltd[4]	Australia	North Ryde
Smith & Nephew Pty Limited	Australia	North Ryde
Smith & Nephew Surgical Holdings Pty Limited[3,4]	Australia	North Ryde
Smith & Nephew Surgical Pty Limited[3,4]	Australia	North Ryde
Smith & Nephew Comercio de Produtos Medicos LTDA	Brazil	São Paulo
Smith & Nephew do Brasil Participacoes S.A.[3]	Brazil	São Paulo

Smith & Nephew (Alberta) Inc.	Canada	Calgary
Smith & Nephew Inc.[3]	Canada	Toronto
Tenet Medical Engineering, Inc.	Canada	Calgary
Smith & Nephew Finance Holdings Limited	Cayman Islands	South Church Street, George Town
Smith & Nephew Medical (Shanghai) Limited[3]	China	Shanghai Free Trade Test Zone
Smith & Nephew Medical (Suzhou) Limited	China	Suzhou City
Smith & Nephew Orthopaedics (Beijing) Co., Ltd	China	Beijing Economic and Technical Development Area
S&N Holdings SAS[3]	Colombia	Bogota
Smith & Nephew Colombia S.A.S	Colombia	Bogota

ArthroCare Costa Rica Srl	Costa Rica	Costa Rica
Smith & Nephew Curaçao N.V.	Curaçao	Willemstad
Smith & Nephew Beijing Holdings Limited[3]	Hong Kong	Delta House, Hong Kong
Smith & Nephew Limited[3]	Hong Kong	Delta House, Hong Kong
Smith & Nephew Suzhou Holdings Limited[3]	Hong Kong	Delta House, Hong Kong
Adler Mediequip Private Limited	India	Pune
Smith & Nephew Healthcare Private Limited	India	Mumbai-59
Ortho-Space Ltd.[5] (16.8%)	Israel	Caesarea
Smith & Nephew Endoscopy KK	Japan	Tokyo
Smith & Nephew KK	Japan	Tokyo

Smith & Nephew Orthopaedics KK[3]	Japan	Tokyo
Smith & Nephew Wound Management KK	Japan	Tokyo
Smith & Nephew Chusik Hoesia	Korea, Republic of	Seoul
Smith & Nephew Healthcare Sdn Berhad	Malaysia	Kuala Lumpur
Smith & Nephew S.A. de C.V.	Mexico	Mexico City
Smith & Nephew Limited	New Zealand	Auckland
Smith & Nephew, Inc.	Puerto Rico	San Juan
Smith & Nephew Pte Limited[3]	Singapore	Singapore

Company name[1]	Country of operation and incorporation	Registered Office
ICEMBE Medical (pty) Ltd[5] (10%)	South Africa	Pinetown

Smith & Nephew (Pty) Limited[3]	South Africa	Westville
Smith & Nephew Pharmaceuticals (Proprietary) Limited	South Africa	Westville
Smith & Nephew Limited	Thailand	Huai Khwang District, Bangkok
Sri Siam Medical Limited[3,5] (48.9%)	Thailand	Lumpini Phatumwan, Bangkok
Smith ve Nephew Medikal Cihazlar Ticaret Limited Sirketi	Turkey	Sariyer, Istanbul
Smith & Nephew FZE	United Arab Emirates	Jebel Ali, Dubai

1 The activity of all companies listed above is the provision of medical devices, unless indicated otherwise.

2 Directly owned by Smith & Nephew plc.
3 Holding company.
4 Dormant company.
5 Not 100% owned by Smith & Nephew Group.

Table of Contents

Registered Office addresses

UK

London	15 Adam Street, London, WC2N 6LA
Kent	Ground Floor, Eclipse House, Eclipse Park, Sittingbourne Road, Maidstone, Kent, ME14 3EN
Hull	101 Hessle Road, Hull, HU3 2BN
Edinburgh	4th Floor, 115 George Street, Edinburgh, EH2 4JN

Rest of Europe

Vienna	Concorde Business Park, 1/C/3 2320, Schwechat, Austria
Zaventem	Hector Heenneaulaan 366, 1930 Zaventem, Belgium
Hoersholm	Slotsmarken 14, Hoersholm, DK-2970, Denmark
Le Mans	25 Boulevard Marie et Alexandre, Oyon, 72100, Le Mans, France
Helsinki	Ayritie 12 C, 01510, Vantaa, Finland
Hamburg	Friesenweg 4, Haus 21, 22763, Hamburg, Germany
Tuttlingen	Alemannenstrasse 14, 78532, Tuttlingen, Germany
Athens	Protopappa Street 43, GR 16346, Ilioupoli, Athens, Greece

Dublin 1	3rd Floor, Kilmore House, Park Lane, Spencer Dock, Dublin 1, Ireland
Dublin 2	Molyneux House, Bride Street, Dublin 2, Ireland
Milan	Via de Capitani 2A, 20864, Agrate Brianza (MI), Italy
Luxembourg	163, Rue de Kiem, L-8030 Strassen, Luxembourg
Amsterdam	Kruisweg 637, 2132 NB Hoofddorp, The Netherlands
Oslo	Nye Vakas vei 64, 1395, Hvalsted, Norway
Warsaw	Ul Osmanska 12, 02-823, Warsaw, Poland
Lisbon	Estrada Nacional no 10 ao Km. 131, Parque Tejo Bloco C, 2625-445 Forte de Casa, Vila Franca de Xira, Portugal

Moscow	9a, Bld, 10, 2nd Sinichkina Street, Moscow 111020, Russian Federation
Puschino	8/1 Stroiteley Street, 142290, City of Puschino, Moscow Region, Russian Federation
Barcelona	Edificio Conata I, c/ Fructuos Gelabert 2 y 4, San Joan Despi 08970, Barcelona, Spain
Molndal	PO Box 143, S-431 22 Molndal, Sweden
Baar	Oberneuhofstr 10d, Baar, 6340
Aarau	Schachenallee 29, 5000, Aarau, Switzerland
Gothenburg	Varbergsgatan 2A / 412 65 Göteborg / Sweden

US

San Jose	595 North Pastoria Avenue, Sunnyvale,

	California, 94086, USA
Minneapolis	2905 Northwest Blvd, Suite 40, Plymouth MN 55441, United States
Pittsburgh	2828 Liberty Ave, Suite 100, Pittsburgh PA 15222, United States

Registered Office addresses

Boulder	5480 Valmont Road, Suite 215, Boulder, Colorado, 90301
Wilmington	CT Corporation, 1209 Orange Street, Wilmington DE 19801, United States
Concord	C T Corporation, 9 Capitol Street, Concord, New Hampshire, 03301, USA
Phoenix	CT Corporation System, 3225 North Central Avenue, Phoenix AZ 85012, United States

Dallas	CT Corporation System, 350 North St. Paul Street, Dallas TX 75201, United States
Andover	150 Minuteman Road, Andover, MA, 01810, United States
Menlo Park	3000 Sand Hill Road, Building 1, Suite 135, Melo Park, California, 94025
Memphis	6075 Poplar Avenue, Suite 335, Memphis, Tennessee, 38119
Tustin	3002 Dow Avenue, Building 100, Unit 138, Tustin, California, 92780
Dover	160 Greentree Drive, Suite 101, Dover, Delaware, 19904

Africa, Asia, Australasia and Other America

Buenos Aires	Maipu 1300, 13th Floor, City of Buenos Aires, Argentina

North Ryde	85 Waterloo Road, North Ryde NSW 2113, Australia
São Paulo	Avenida do Cafe, 277, Centro Empresarial do Aco, Centro Empresarial do Aco, Torre B, 4 andar, conjuto, CEP 04311-000, São Paulo 403, Jabaquara, Brazil
Calgary	3500-855-2 Street SW, Calgary AB AB T2P 4J8, Canada
Toronto	199, Bay Street, 4000, Toronto, Ontario M5L 1A9, Canada
Shedden Road, Georgetown	Chartered Trust Services Limited, One Capital Place, Shedden Road, PO Box 1034 GT, Grand Cayman, Cayman Islands
South Church Street, Georgetown	c/o M&C Corporate Services Limited, Ugland House, South Church Street, P.O. Box 309, George Town, Grand Cayman, Cayman Islands
Chao Yang District, Beijing	Room 17-021, Internal B17 floor, B3-24th floor, No 3 Xin Yuan South Rd, Chao Yang District, Beijing, China
Shunyi District, Beijing	22 Linhe Avenue, Linhe Economic Development Zone, Shunyi District, Beijing, 101300, China

East City, Beijing	No. B-D, Floor 2, A Building, Beijing East Gate Plaza, No. 9, Dong Zhong Street, East City, Beijing, China
Guangzhou	Room 2502 No 33, 6th Jian She Rd, Yue Xiu District, Guangzhou, China
Shanghai	Room 1208-1209, No 168 Middle Xi Zang Rd, Shanghai, China
Shanghai Free Trade Test Zone	Part B, 4th Floor, Tong Yong Building, No 188 Ao Na Rd, Shanghai Free Trade Test Zone, Shanghai, China
Dong Cheng District, Beijing	Unit B1, 2/F, Tower A, East Gate Plaza No.9, Dongshong Street, Dong Cheng District, Beijing, China
Chengdu	No 5. 15th Floor, Unit 1, Building, 1 Li Bao Building, No 62 North Ke Hua Rd, Wu Hou District, Chengdu, China

Table of Contents

NOTES TO THE GROUP ACCOUNTS

23 OTHER NOTES TO THE ACCOUNTS continued

Registered Office addresses

Middle Xi Zang Rd, Shanghai	Room 1201-1207, No168 Middle Xi Zang Rd, Shanghai, China
Suzhou City	12, Wuxiang Road, West Area of Comprehensive Bonded Zone, Suzhou Industrial Park, Suzhou City, SIP, Jiangsu Province, China
Beijing Economic and Technical Development Area	No. 98 Kechuang Dongliujie, Beijing Economic and Technical Development Area, Beijing, China

Bogota	Calle 100 No. 7 33 to 1 P3, Bogota D.C., 0, Colombia
Costa Rica	Heredia-Heredia Aurora, Free Zone Global Park, Building 200, Costa Rica
Willemstad	Pietermaai 15, PO Box 4905, Curaçao
Delta House, Hong Kong	Unit 813 816, 8/F, Delta House, 3 On Yiu Street, Shatin, New Territories, Hong Kong
Pune	Sushrut House, Survey no.288, Phase II next to MIDC, Hinjewadi, at Mann, Taluka Mulshi, Pune, 411057, India
Mumbai	5A, Bakhtawar, 5th Floor, behind The Oberoi, Nariman Point, Mumbai, Maharashtra, 400021, India
Mumbai-59	501-B 509-B Dynasty Business Park, Andheri Kurla Road, Andheri East, Mumbai-59, Maharashtra, India
Caesarea	7 Halamarish, Caesarea, 3088900, Israel

Tokyo	2-4-1, Shiba -Koen, Minato-Ku, Tokyo 105-0011, Japan
Seoul	13th Floor, ASEM Tower, Gangnam-gu 13th Floor, ASEM Tower, 159-1 Samsung-dong, Seoul, Korea
Kuala Lumpur	Suite 11.01 B & 11.02 Level 11, Menara AmFIRST, No 1 Jalan 19/3 46300 Petaling Jaya, Selangor, Malaysia

Registered Office addresses

Mexico City	Av. Insurgentes Sur, numero 1602, Piso No.7, Oficina 702, Colonia Credito, Constructor, Delegacion Benito Juarez, C.P. 03940, Mexico
Auckland	621 Rosebank Road, Avondale, Auckland 6, New Zealand
San Juan	Edificio Cesar Castillo, Calle Angel Buonomo #361, Hato Rey, 00917, Puerto Rico
Singapore	50 Raffles Place, #32-01 Singapore Land Tower, 048623, Singapore

Pinetown	30 Gillitts Road, Pinetown, 3600, South Africa
Westville	30 The Boulevard, Westway Office Park, Westville, 3629, South Africa
Huai Khwang District, Bangkok	16th Floor Building A, 9th Tower Grand Rama 9, 33/4 Rama 9 Road, Huai Khwang District, Bangkok, 10310, Thailand
Lumpini Phatumwan, Bangkok	16th Floor, GPF Witthayu Tower A, 93/1 Wireless Road, Lumpini, Phatumwan, Bangkok, 10330, Thailand
Ankara	Mebusevleri Mah. Ergin Sk. No:24, 2 Çankaya, Ankara, Turkey
Sariyer, Istanbul	Bahcekoy Mah., Orkide Sok., No:8/E Bahcekoy, Sariyer Istanbil, Turkey
Bagcilar, Istanbul	Mahmutbey Mah. 16 Yol Sok., No: 127/1 DPL+ASM Bagcilar, Istanbul, Turkey

Jebel Ali, Dubai	PO Box 16993 LB02016, Jebel Ali, Dubai, United Arab Emirates
Dubai Health Centre, Dubai	401-404 & 406-407, Floor 4, B-47 Dubai Health Centre, Dubai, United Arab Emirates

Table of Contents

COMPANY FINANCIAL STATEMENTS

COMPANY BALANCE SHEET

	Notes	At 31 December 2016 $ million	At 31 December 2015 $ million
Fixed assets:			
Investments	3	5,322	5,322
Current assets:			
Debtors	4	824	2,234
Cash and bank	6	14	47
		838	2,281
Creditors: amounts falling due within one year:			
Borrowings	6	(41)	(3)
Other creditors	5	(814)	(1,881)

		(855)	(1,884)
Net current (liabilities)/assets		(17)	397
Total assets less current liabilities		5,305	5,719
Creditors: amounts falling due after one year:			
Borrowings	6	(1,559)	(1,425)
Total assets less total liabilities		3,746	4,294
Equity shareholders funds:			
Called up equity share capital		180	183
Share premium account		600	590
Capital redemption reserve		15	12
Capital reserve		2,266	2,266
Treasury shares		(432)	(294)
Exchange reserve		(52)	(52)
Profit and loss account		1,169	1,589
Shareholders funds		3,746	4,294

The accounts were approved by the Board and authorised for issue on 22 February 2017 and signed on its behalf by:

Roberto Quarta	**Olivier Bohuon**
Chairman	Chief Executive Officer

THE PARENT COMPANY FINANCIAL STATEMENTS OF SMITH & NEPHEW PLC ON PAGES 165 TO 168 DO NOT FORM PART OF THE SMITH & NEPHEW S ANNUAL REPORT ON FORM 20-F AS FILED WITH THE SEC.

Table of Contents

COMPANY FINANCIAL STATEMENTS

STATEMENT OF CHANGES IN EQUITY

								2016	2015
$ million	Share capital $ million	Share premium $ million	Capital redemption reserve $ million	Capital reserves $ million	Treasury shares $ million	Exchange reserves $ million	Profit and loss account $ million	Total shareholders funds $ million	Total shareholders funds $ million
At 1 January	183	590	12	2,266	(294)	(52)	1,589	4,294	4,484
Attributable profit for the year							58 1	58 1	107 1

Net gain on cash flow hedges									
Exchange adjustments							(3)	(3)	1
Equity dividends paid in the year							(279)	(279)	(272)
Share-based payments recognised							27	27	29
Cost of shares transferred to beneficiaries					40		(34)	6	5
New shares issued on exercise of share options		10						10	16
Cancellation of treasury shares	(3)		3		190		(190)		
Treasury shares purchased					(368)			(368)	(77)
At 31 December	180	600	15	2,266	(432)	(52)	1,169	3,746	4,294

Further information on the share capital of the Company can be found in Note 19.1 of the Notes to the Group accounts.

The total distributable reserves of the Company are $685m (2015: $1,243m). In accordance with the exemption permitted by Section 408 of the Companies Act 2006, the Company has not presented its own profit and loss account. The attributable profit for the year dealt with in the accounts of the Company is $58m (2015: $107m).

Fees paid to KPMG LLP for audit and non-audit services to the Company itself are not disclosed in the individual accounts because Group financial statements are prepared which are required to disclose such fees on a consolidated basis. The fees for the consolidated Group are disclosed in Note 3.2 of the Notes to the Group accounts.

THE PARENT COMPANY FINANCIAL STATEMENTS OF SMITH & NEPHEW PLC ON PAGES 165 TO 168 DO NOT FORM PART OF THE SMITH & NEPHEW S ANNUAL REPORT ON FORM 20-F AS FILED WITH THE SEC.

Table of Contents

NOTES TO THE COMPANY ACCOUNTS

1 BASIS OF PREPARATION

Smith & Nephew plc (the Company) is a public limited company incorporated in England and Wales.

The separate accounts of the Company are presented as required by the Companies Act 2006. On 1 January 2015, the Company transitioned from previously extant UK Generally Accepted Accounting Practices to Financial Reporting Standard 101 Reduced Disclosure Framework (Reduced Disclosure Framework). These financial statements and accompanying notes have been prepared in accordance with the Reduced Disclosure Framework for all periods presented. There were no transitional adjustments required on adoption of the new standard. The financial information for the Company has been prepared on the same basis as the consolidated financial statements, applying identical accounting policies as outlined throughout the Notes to the Group accounts. The directors have determined that the preparation of the Company financial statements on a going concern basis is appropriate as the Company receives dividend cash receipts from its subsidiary undertakings which enable it to meet its liabilities as they fall due.

In applying these policies, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the accounts and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on management s best knowledge of current events and actions, actual results ultimately may differ from those estimates.

In these financial statements, the Company has applied the exemptions available under FRS 101 in respect of the following disclosures:

A Cash Flow Statement and related notes;

Comparative period reconciliations for share capital and tangible fixed assets;

Disclosures in respect of transactions with wholly-owned subsidiaries;

Disclosures in respect of capital management;

The effects of new but not yet effective IFRSs; and

Disclosures in respect of the compensation of key management personnel.

As the consolidated financial statements include the equivalent disclosures, the Company has also taken the exemptions under FRS 101 available in respect of the following disclosures:

FRS 2 Share Based Payments in respect of group settled share based payments; and

Certain disclosures required by IFRS 13 Fair Value Measurement and the disclosures required by IFRS 7 Financial Instrument Disclosures.

The Company proposes to continue to adopt the reduced disclosure framework of FRS 101 in its next financial statements.

2 RESULTS FOR THE YEAR

As permitted by Section 408(4) of the Companies Act 2006, the Company has not presented its own profit and loss account. Profit for the year was $58m (2015: $107m).

3 INVESTMENTS

ACCOUNTING POLICY

Investments in subsidiaries are stated at cost less provision for impairment.

	2016	2015
	$ million	$ million
At 1 January and 31 December	5,322	5,322

Investments represent holdings in subsidiary undertakings.

In accordance with Section 409 of the Companies Act 2006, a listing of all entities invested in by the consolidated Group is provided in Note 23.3 of the Notes to the Group Accounts. Entities directly owned by Smith & Nephew plc are highlighted in that section.

4 DEBTORS

			2016 $ million	2015 $ million
Amounts falling due within one year:				
Amounts owed by subsidiary undertakings			735	2,169
Prepayments and accrued income			3	5
Current asset derivatives	forward foreign exchange contracts		45	30
Current asset derivatives	forward foreign exchange contracts	subsidiary undertakings	36	21
Current asset derivatives	currency swaps		1	
Current taxation			4	9
			824	2,234

THE PARENT COMPANY FINANCIAL STATEMENTS OF SMITH & NEPHEW PLC ON PAGES 165 TO 168 DO NOT FORM PART OF THE SMITH & NEPHEW S ANNUAL REPORT ON FORM 20-F AS FILED WITH THE SEC.

Table of Contents

NOTES TO THE COMPANY ACCOUNTS

5 OTHER CREDITORS

			2016 $ million	2015 $ million
Amounts falling due within one year:				
Amounts owed to subsidiary undertakings			715	1,813
Other creditors			17	15
Current liability derivatives	forward foreign exchange contracts		36	21
Current liability derivatives	forward foreign exchange contracts	subsidiary undertakings	45	30
Current liability derivatives	currency swaps			2
Current liability derivatives	interest rate swaps		1	
			814	1,881

6 CASH AND BORROWINGS

ACCOUNTING POLICY

Financial instruments

Currency swaps are used to match foreign currency net assets with foreign currency liabilities. They are initially recorded at fair value and then for reporting purposes remeasured to fair value at exchange rates and interest rates at subsequent balance sheet dates.

Changes in the fair value of derivative financial instruments are recognised in the profit and loss account as they arise.

	2016 $ million	2015 $ million
Bank loans and overdrafts due within one year or on demand	41	3
Bank loans due after one year	1,559	1,425
Borrowings	1,600	1,428
Cash and bank	(14)	(47)
Credit balance on derivatives forward exchange contracts and currency swaps	1	2
Interest rate swaps	(1)	
Net debt	1,586	1,383

All currency swaps are stated at fair value. Gross US Dollar equivalents of $449m (2015: $368m) receivable and $448m (2015: $370m) payable have been netted. Currency swaps comprise foreign exchange swaps and were used in 2016 and 2015 to hedge intra-group loans.

7 SHARE-BASED PAYMENTS

The Company operates a number of equity-settled executive and employee share plans. For all grants of share options and awards, the fair value as at the date of grant is calculated using an appropriate option pricing model and

the corresponding expense is recognised over the vesting period. Subsidiary companies are recharged for the fair value of share options that relate to their employees.

The disclosure relating to the Company is detailed in Note 23.1 of the Notes to the Group accounts.

8 CONTINGENCIES

	2016 $ million	2015 $ million
Guarantees in respect of subsidiary undertakings		

The Company gives guarantees to banks to support liabilities and cross guarantees to support overdrafts.

The Company operated defined benefit pension plans in 2004 but at the end of 2005 its pension plan obligations were transferred to Smith & Nephew UK Limited. The Company has provided guarantees to the trustees of the pension plans to support future amounts due from participating employers (see Note 18 of the Notes to the Group accounts).

THE PARENT COMPANY FINANCIAL STATEMENTS OF SMITH & NEPHEW PLC ON PAGES 165 TO 168 DO NOT FORM PART OF THE SMITH & NEPHEW S

ANNUAL REPORT ON FORM 20-F AS FILED WITH THE SEC.

Table of Contents

GROUP INFORMATION

BUSINESS OVERVIEW AND GROUP HISTORY

Smith & Nephew s operations are organised into geographical selling regions and product franchises within the medical technology industry.

The Group has a history dating back 160 years to the family enterprise of Thomas James Smith who opened a small pharmacy in Hull, UK in 1856. Following his death in 1896, his nephew Horatio Nelson Smith took over the management of the business.

By the late 1990s, Smith & Nephew had expanded into being a diverse healthcare conglomerate with operations across the globe, producing various medical devices, personal care products and traditional and advanced wound care treatments. In 1998, Smith & Nephew announced a major restructuring to focus management attention and investment on three global business units Advanced Wound Management, Endoscopy and Orthopaedics which offered high growth and margin opportunities. In 2011, the Endoscopy and Orthopaedics businesses were brought together to create an Advanced Surgical Devices division. In 2015, the Advanced Wound Management and Advanced Surgical Devices divisions were brought together to form a global business across nine product franchises, managed as three geographical selling regions with global functions for operations, R&D and corporate support functions.

Smith & Nephew was incorporated and listed on the London Stock Exchange in 1937 and in 1999 the Group was also listed on the New York Stock Exchange. In 2001, Smith & Nephew became a constituent member of the FTSE 100 index in the UK. This means that Smith & Nephew is included in the top 100 companies traded on the London Stock Exchange measured in terms of market capitalisation.

Today, Smith & Nephew is a public limited company incorporated and headquartered in the UK and carries out business around the world.

PROPERTY, PLANT AND EQUIPMENT

The table below summarises the main properties which the Group uses and their approximate areas.

	Approximate area (square feet 000 s)

Group head office in London, UK	22
Office and surgical training facility in Croxley Park, Watford, UK	60
Regional headquarters in Andover, Massachusetts, US	144
Manufacturing, research and office facility in Hull, UK	473
Manufacturing and office facilities in Memphis, Tennessee, US	968
Distribution facility in Memphis, Tennessee, US	248
Manufacturing facility in Aarau, Switzerland	121
Manufacturing facility in Beijing, China	192
Manufacturing facility in Tuttlingen, Germany	50
Distribution facility and regional headquarters in Baar, Switzerland	71
Manufacturing facility in Mansfield, Massachusetts, US	98
Manufacturing facility in Oklahoma City, Oklahoma, US	155
Manufacturing, research and office facility in Austin, Texas, US	157
Manufacturing facilities in La Aurora and Alajuela, Costa Rica	292
Research facility in Irvine, California, US	23
Manufacturing facility in Devrukh, India	74
Manufacturing facility in Suzhou, China	288
Bioactives headquarters and laboratory space in Fort Worth, Texas, US	165
Manufacturing facility in Curaçao, Dutch Caribbean	16

The Group Global Operations strategy includes ongoing assessment of the optimal facility footprint. The Advanced Surgical Devices manufacturing facilities in Memphis, Tennessee are largely freehold, a portion of Tuttlingen and the Advanced Wound Management facilities in Hull are freehold while other principal locations are leasehold. The Group has freehold and leasehold interests in real estate in other countries throughout the world, but no other is individually significant to the Group. Where required, the appropriate governmental authorities have approved the facilities.

OFF-BALANCE SHEET ARRANGEMENTS

Management believes that the Group does not have any off-balance sheet arrangements, as defined by the SEC in item 5E of Form 20-F, that have or are reasonably likely to have a current or future effect on the Group s financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors.

RELATED PARTY TRANSACTIONS

Except for transactions with associates (see Note 23.2 of Notes to the Group accounts), no other related party had material transactions or loans with Smith & Nephew over the last three financial years.

RISK FACTORS

There are known and unknown risks and uncertainties relating to Smith & Nephew s business. The factors listed on pages 170 to 172 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.

Table of Contents

GROUP INFORMATION

Highly competitive markets

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

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

There is a possibility of further consolidation of competitors, which could adversely affect the Group s ability to compete with larger companies due to insufficient financial resources. If any of the Group s businesses were to lose market share or achieve lower than expected revenue growth, there could be a disproportionate adverse impact on the Group s share price and its strategic options.

Competition exists among healthcare providers to gain patients on the basis of quality, service and price. There has been some consolidation in the Group s customer base and this trend is expected to continue. Some customers have joined group purchasing organisations or introduced other cost containment measures that could lead to downward pressure on prices or limit the number of suppliers in certain business areas, which could adversely affect Smith & Nephew s results of operations and hinder its growth potential.

Continual development and introduction of new products

The medical devices industry has a rapid rate of new product introduction. In order to remain competitive, the Group must continue to develop innovative products that satisfy customer needs and preferences or provide cost or other advantages. Developing new products is a costly, lengthy and uncertain process. The Group may fail to innovate due to low R&D investment, a R&D skills gap or poor product development. A potential product may not be brought to

market or not succeed in the market for any number of reasons, including failure to work optimally, failure to receive regulatory approval, failure to be cost-competitive, infringement of patents or other intellectual property rights and changes in consumer demand. The Group s products and technologies are also subject to marketing attack by competitors. Furthermore, new products that are developed and marketed by the Group s competitors may affect price levels in the various markets in which the Group operates. If the Group s new products do not remain competitive with those of competitors, the Group s revenue could decline.

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

Dependence on government and other funding

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

Pricing of the Group s products is largely governed in most markets by governmental reimbursement authorities. Initiatives sponsored by government agencies, legislative bodies and the private sector to limit the growth of healthcare costs, including price regulation, excise taxes and competitive pricing, are ongoing in markets where the Group has operations. This control may be exercised by determining prices for an individual product or for an entire procedure. The Group is exposed to government policies favouring locally sourced products. The Group is also exposed to changes in reimbursement policy, tax policy and pricing which may have an adverse impact on revenue and operating profit. Provisions in US healthcare legislation which previously imposed significant taxes on medical device manufacturers have been suspended for two years but may be reinstated. There may be an increased risk of adverse changes to government funding policies arising from deterioration in macro-economic conditions from time to time in the Group s markets.

The Group must adhere to the rules laid down by government agencies that fund or regulate healthcare, including extensive and complex rules in the US. Failure to do so could result in fines or loss of future funding.

World economic conditions

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

During 2016, 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 (notably in China) and increased uncertainty over the collectability of government debt, particularly those in the Emerging Markets and the oil-dependent Gulf States. 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 100 countries. Political upheaval in some of those countries or in surrounding regions may impact the Group s results of operations. Political changes in a country could prevent the Group from receiving remittances of profit from a member of the Group located in that country or from selling its products or investments in that country. Furthermore, changes in government policy regarding preference for local suppliers, import quotas, taxation or other matters could adversely affect the Group s revenue and operating profit. War, economic sanctions, terrorist activities or other conflict could also adversely impact the Group. These risks may be greater in Emerging Markets, which account for an increasing portion of the Group s business. During 2016, the outcome of the UK referendum regarding the EU and the pending change in administration in the United States have added to political uncertainty.

Table of Contents

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 revenue 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. However, the Group is exposed to medium to long-term adverse movements in the strength of currencies compared to the US Dollar.

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 Liquidity and capital resources on page 114.

Manufacturing and supply

The Group s manufacturing production is concentrated at main facilities in Memphis, Mansfield and Oklahoma City in the US, Hull and Warwick in the UK, Aarau in Switzerland, Tuttlingen in Germany, Devrukh in India, Suzhou and Beijing in China, La Aurora and Alajuela in Costa Rica, Puschino in Russia and Curaçao, in Dutch Caribbean. 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.

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

A supplier s failure to meet expected quality standards could create liability for the Group and adversely affect sales of the Group s related products.

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 will, from time to time, outsource the manufacture of components and finished products to third parties and will periodically relocate the manufacture of product and/or processes between existing facilities. While these are planned activities, with 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 revenue and operating profit would be adversely affected. Additionally, if the Group is unable to recruit, hire, develop and retain a talented, competitive workforce, it may not be able to meet its strategic business objectives.

Proprietary rights and patents

Due to the technological nature of medical devices and the Group s emphasis on serving its customers with innovative products, the Group has been subject to patent infringement claims and is subject to the potential for additional claims.

Claims asserted by third parties regarding infringement of their intellectual property rights, if successful, could require the Group to expend time and significant resources to pay damages, develop non-infringing products or obtain licences to the products which are the subject of such litigation, thereby affecting the Group s growth and profitability. Smith & Nephew attempts to protect its intellectual property and regularly opposes third party patents and trademarks where appropriate in those areas that might conflict with the Group s business interests. If Smith & Nephew fails to protect and enforce its intellectual property rights successfully, its competitive position could suffer, which could harm its results of operations.

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. During 2015, developments in the Group s metal-on-metal hip implant claims led to a $203m charge being recognised relating to known and future claims.

Regulatory standards and compliance in the healthcare industry

Business practices in the healthcare industry are subject to regulation and review by various government authorities. In general, the trend in many countries in which the Group does business is towards higher expectations and increased

enforcement activity by governmental authorities. While the Group is committed to doing business with integrity and welcomes the trend to higher standards in the healthcare industry, the Group and other companies in the industry have been subject to investigations and other enforcement activity that have incurred and may continue to incur significant expense. Under certain circumstances, if the Group were found to have violated the law, its ability to sell its products to certain customers could be restricted.

International regulation

The Group operates across the world and is subject to extensive legislation, including anti-bribery and corruption and data protection, in each country in which we operate. Our international operations are governed in part by the UK Bribery Act and the US Foreign Corrupt Practices Act (FCPA) which prohibit us or our agents from making, or offering, improper payments to government officials and other persons for the purpose of obtaining or maintaining business or product approvals. Enforcement of such legislation has increased in recent years with significant fines and penalties being imposed on companies and individuals. Our international operations, particularly in the Emerging

Table of Contents

GROUP INFORMATION

Markets, expose the Group to the risk that our employees or agents will engage in prohibited activities.

Regulatory approval

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

National regulatory authorities administer and enforce a complex series of laws and regulations that govern the design, development, approval, manufacture, labelling, marketing and sale of healthcare products. They also review data supporting the safety and efficacy of such products. Of particular importance is the requirement in many countries that products be authorised or registered prior to manufacture, marketing or sale and that such authorisation or registration be subsequently maintained. The major regulatory agencies for Smith & Nephew s products include the Food and Drug Administration (FDA) in the US, the Medicines and Healthcare products Regulatory Agency in the UK, the Ministry of Health, Labour and Welfare in Japan, the China Food and Drug Administration and the Australian Therapeutic Goods Administration. At any time, the Group is awaiting a number of regulatory approvals which, if not received, could adversely affect results of operations.

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.

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.

Failure to make successful acquisitions

A key element of the Group s strategy for continued growth is to make acquisitions or alliances to complement its existing business. Failure to identify appropriate acquisition targets or failure to conduct adequate due diligence or to integrate them successfully would have an adverse impact on the Group s competitive position and profitability. This could result from the diversion of management resources towards the acquisition or integration process, challenges of integrating organisations of different geographic, cultural and ethical backgrounds, as well as the prospect of taking on unexpected or unknown liabilities. In addition, the availability of global capital may make financing less attainable or more expensive and could result in the Group failing in its strategic aim of growth by acquisition or alliance.

Relationships with healthcare professionals

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

Reliance on sophisticated information technology

The Group uses a wide variety of information systems, programmes and technology to manage our business. Our systems are vulnerable to a cyber-attack, malicious intrusion, loss of data privacy or any other significant disruption. Our systems have been and will continue to be the target of such threats. We have systems in place to minimise the risk and disruption of these intrusions and to monitor our systems on an ongoing basis for current or potential threats. There can be no assurance that these measures will prove effective in protecting Smith & Nephew from future interruptions and as a result the performance of the Group could be materially adversely affected.

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.

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 further in the Our Marketplace on pages 16 to 17, Financial review on pages 39 to 41 and Taxation information for shareholders on pages 187 to 188.

Table of Contents

OTHER FINANCIAL INFORMATION

SELECTED FINANCIAL DATA

	2016 $ million	2015 $ million	2014 $ million	2013 $ million	2012 $ million
Income statement					
Revenue	4,669	4,634	4,617	4,351	4,137
Cost of goods sold	(1,272)	(1,143)	(1,162)	(1,100)	(1,070)
Gross profit	3,397	3,491	3,455	3,251	3,067
Selling, general and administrative expenses	(2,366)	(2,641)	(2,471)	(2,210)	(2,050)
Research and development expenses	(230)	(222)	(235)	(231)	(171)
Operating profit[1]	801	628	749	810	846
Net interest (payable)/receivable	(46)	(38)	(22)	4	2
Other finance (costs)/income	(16)	(15)	(11)	(11)	(11)
Share of results of associates	(3)	(16)	(2)	(1)	4
Profit on disposal of business and net assets held for sale	326				251
Profit before taxation	1,062	559	714	802	1,092
Taxation	(278)	(149)	(213)	(246)	(371)

Attributable profit for the year	784	410	501	556	721
Earnings per ordinary share					
Basic	88.1¢	45.9¢	56.1¢	61.7¢	80.4¢
Diluted	87.8¢	45.6¢	55.7¢	61.4¢	80.0¢
Adjusted attributable profit					
Attributable profit for the year	784	410	501	556	721
Acquisition related costs	9	25	125	31	11
Restructuring and rationalisation expenses	62	65	61	58	65
Legal and other	(20)	187	(2)		
Amortisation and impairment of acquisition intangibles	178	204	129	88	43
Profit on disposal of business and net assets held for sale	(326)				(251)
Taxation on excluded items	48	(130)	(71)	(40)	82
Adjusted attributable profit	735	761	743	693	671
Adjusted earnings per ordinary share (EPSA)[2]	82.6¢	85.1¢	83.2¢	76.9¢	74.8¢

1 Reconciliation of operating to trading profit is presented below.
2 Adjusted earnings per ordinary share is calculated by dividing adjusted attributable profit by the basic weighted number of shares.

	2016	2015	2014	2013	2012
	$ million	$ million	$ million	$ million	$ million
Operating profit	801	628	749	810	846
Acquisition related costs	9	12	118	31	11
Restructuring and rationalisation costs	62	65	61	58	65
Amortisation and impairment of acquisition intangibles	178	204	129	88	43

Legal and other	(30)	190	(2)		
Trading profit	1,020	1,099	1,055	987	965

Table of Contents

OTHER FINANCIAL INFORMATION

SELECTED FINANCIAL DATA continued

	2016 $ million	2015 $ million	2014 $ million	2013 $ million	2012 $ million
Group balance sheet					
Non-current assets	4,815	4,692	4,866	3,563	3,498
Current assets	2,529	2,475	2,440	2,256	2,144
Total assets	7,344	7,167	7,306	5,819	5,642
Share capital	180	183	184	184	193
Share premium	600	590	574	535	488
Capital redemption reserve	15	12	11	10	
Treasury shares	(432)	(294)	(315)	(322)	(735)

Retained earnings and other reserves	3,595	3,475	3,586	3,640	3,938
Total equity	3,958	3,966	4,040	4,047	3,884
Non-current liabilities	2,038	1,857	2,104	699	828
Current liabilities	1,348	1,344	1,162	1,073	930
Total liabilities	3,386	3,201	3,266	1,772	1,758
Total equity and liabilities	7,344	7,167	7,306	5,819	5,642
Group cash flow statement					
Cash generated from operations	1,035	1,203	961	1,138	1,184
Net interest paid	(45)	(36)	(33)	(6)	(4)
Income taxes paid	(141)	(137)	(245)	(265)	(278)
Net cash inflow from operating activities	849	1,030	683	867	902
Capital expenditure (including trade investments and net of disposals of property, plant and equipment)	(394)	(360)	(379)	(340)	(265)
Acquisitions and disposals	(214)	(44)	(1,552)	(67)	(782)
Proceeds on disposal of business (net of tax)	225				103
Investment in associate		(25)	(2)		(10)
Proceeds from associate loan redemption	6	5	188 4	3	6

Proceeds from own shares					
Equity dividends paid	(279)	(272)	(250)	(239)	(186)
Issue of ordinary capital and treasury shares purchased	(358)	(61)	(35)	(183)	77
Net cash flow from financing and investing activities	(165)	273	(1,343)	41	(155)
Exchange adjustments	(24)	(21)	(17)	(6)	5
Opening net debt	(1,361)	(1,613)	(253)	(288)	(138)
Closing net debt	(1,550)	(1,361)	(1,613)	(253)	(288)
Selected financial ratios					
Gearing (closing net debt as a percentage of total equity)	39%	34%	40%	6%	7%
Dividends per ordinary share[1]	30.8¢	30.8¢	29.60¢	27.40¢	26.10¢
Research and development costs to revenue	4.9%	4.8%	5.1%	5.3%	4.1%
Capital expenditure (including intangibles but excluding goodwill) to revenue	8.4%	7.7%	8.1%	7.8%	6.4%

1 The Board has proposed a final dividend of 18.5 US cents per share which together with the first interim dividend of 12.3 US cents makes a total for 2016 of 30.8 US cents.

Table of Contents

NON-GAAP FINANCIAL INFORMATION ADJUSTED MEASURES

These Financial Statements include financial measures that are not prepared in accordance with International Financial Reporting Standards (IFRS). These measures, which include trading profit, trading profit margin, trading cash flow, EPSA and underlying growth, exclude the effect of certain cash and non-cash items that Group management believes are not related to the underlying performance of the Group. These non-IFRS financial measures are also used by management to make operating decisions because they facilitate internal comparisons of performance to historical results on both a business segment and a consolidated Group basis.

Non-IFRS financial measures are presented in these Financial Statements as the Group s management believe that they provide investors with a means of evaluating performance of the business segment and the consolidated Group on a consistent basis, similar to the way in which the Group s management evaluates performance, that is not otherwise apparent on an IFRS basis, given that certain non-recurring, infrequent or non-cash items that management does not otherwise believe are indicative of the underlying performance of the consolidated Group may not be excluded when preparing financial measures under IFRS. These non-IFRS measures should not be considered in isolation from, as substitutes for, or superior to financial measures prepared in accordance with IFRS.

Underlying revenue growth

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 or disposed of and for movements in exchange rates. Underlying growth in revenue is not presented in the accounts prepared in accordance with IFRS and is therefore a measure not in accordance with Generally Accepted Accounting Principles (a non-GAAP measure).

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 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 and disposals 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 and is measured as the difference between: 1) the increase/decrease in the current year revenue translated into US Dollars at the current year average exchange rate and the prior revenue translated at the prior year rate; and 2) the increase/decrease being measured by translating current and prior year revenues into US Dollars using the prior year closing rate.

The acquisitions and disposals effect is the measure of the impact on revenue from newly acquired material business combinations and recent material business disposals. This is calculated by comparing the current year, constant currency actual revenue (which include acquisitions and exclude disposals from the relevant date of completion) with prior year, constant currency actual revenue, adjusted to include the results of acquisitions and exclude disposals for the commensurate period in the prior year. These sales are separately tracked in the Group s internal reporting systems and are readily identifiable.

Table of Contents

OTHER FINANCIAL INFORMATION

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

2016	Reported growth	Reconciling items Acquisitions/disposals	Currency impact	Underlying growth
Consolidated revenue by franchise	%	%	%	%
Sports Medicine, Trauma & Other	1	3	(1)	(1)
Sports Medicine Joint Repair	7	8		(1)
Arthroscopic Enabling Technologies		2		(2)
Trauma & Extremities	(4)	(4)	1	(1)
Other Surgical Businesses	5	15	(9)	(1)
Reconstruction	3	2	2	(1)
Knee Implants	6	4	3	(1)
	(1)	(1)		

Hip Implants				
Advanced Wound Management	(3)	(1)		(2)
Advanced Wound Care	(5)	(3)		(2)
Advanced Wound Bioactives	(1)			(1)
Advanced Wound Devices	3	5		(2)
Total	1	2		(1)

2015 **Consolidated revenue**	Reported growth %	Underlying growth %	Acquisitions/disposals %	Reconciling items Currency impact %
Total		4	4	(8)

Trading profit, trading profit margin and trading cash flow

Trading profit, trading profit margin and trading cash flow are trend measures, which present the long-term profitability of the Group excluding the impact of specific transactions that management considers affect the Group s short-term profitability and cash flows. The Group has identified the following items, where material, as those to be excluded from operating profit and cash generated from operations when arriving at trading profit and trading cash flow, respectively: acquisition and disposal related items arising in connection with business combinations, including amortisation of acquisition intangible assets, impairments and integration costs; restructuring events; gains and losses resulting from legal disputes; and significant uninsured losses. In addition to these items, gains or losses that materially impact the Group s profitability or cash flows on a short-term or one-off basis, are excluded from operating profit and cash generated from operations when arriving at trading profit and trading cash flow, respectively.

Table of Contents

Adjusted earnings per ordinary share (EPSA)

EPSA is a trend measure, which presents the long-term profitability of the Group excluding the post-tax 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. Adjusted attributable profit is the numerator used for this measure and is determined by adjusting attributable profit for the items that are excluded from operating profit when arriving at trading profit and items that are recognised below operating profit that affect the Group s short-term profitability. The most directly comparable financial measure calculated in accordance with IFRS is earnings per ordinary share (EPS).

	Revenue	Operating profit[1]	Taxation[2]	Attributable profit[3]	Cash generated from operating activities[4]	Earnings per share[5]
	$ million	$ million	$ million	$ million	$ million	¢
2016 Reported	4,669	801	(278)	784	1,035	88.1
Acquisition-related costs and profit on disposal		9	120	(197)	24	(22.2)
Restructuring and rationalisation costs		62	(14			