

SMITH & NEPHEW PLC  
Form 20-F  
March 04, 2016  
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**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, 2015**

**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:**

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

\* 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: 915,447,263 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

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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  Other  
International Accounting Standards Board

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

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2015

[www.smith-nephew.com](http://www.smith-nephew.com)

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Smith & Nephew supports healthcare professionals in more than 100 countries in their daily efforts to improve the lives of their patients.

We do this 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.

Front cover image:

The ACCU-PASS<sup>®</sup> DIRECT was designed with size in mind, allowing surgeons to suture through the smallest tissues. To keep

the operative site in focus, our Arthroscopes and VideoArthroscopes utilise wide-angle lens technology for optimal depth of field.

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\* These sections and pages 49, 113, 115, 117 and 171 to 194 form the Director s Report.

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OVERVIEW	OUR BUSINESS	OUR PERFORMANCE	GOVERNANCE	OUR FINANCIALS
CHAIRMAN'S STATEMENT				

A strong performance, demonstrating our actions are translating into positive outcomes

Dear Shareholder,

I am delighted to present Smith & Nephew's 2015 Annual Report. During the year the Group made good financial and strategic progress. The increase in underlying revenue growth, trading profit margin and adjusted earnings year-on-year reflect management's actions to improve both our commercial performance and operational efficiency.

Revenue was \$4.6 billion, up 4% on an underlying basis before adjusting for currency and the benefits from acquisitions. Trading profit was \$1.1 billion. The trading profit margin was 23.7%, up 80bps on the previous year. Adjusted earnings per share were 85.1¢, up 2%.

Strategy

We have continued to pursue the same strategy as in previous years, building a strong position in Established Markets, focusing on Emerging Markets, innovating for value, simplifying and improving our operating model and supplementing organic growth with acquisitions. The Board's oversight ensures that management remains focused on these strategic priorities and that investments are made in line with these objectives

In 2015, the Board has continued our programme of understanding the business more deeply. We scheduled a number of sessions at the Board meetings held in 2015 looking at different aspects of our business,

Members of the Board also attend significant management meetings. For instance, during 2015, I attended the Managing Director's meeting and Robin Freestone attended the CEO led meeting for top talent. We also attend investor presentations.

Corporate governance

As a Board, we feel strongly that good corporate governance lies at the heart of a well-run Company. Openness and transparency, accountability and responsibility should run through everything that we do, both as a Board and throughout the business as a whole. The Board and I aim to set the tone at the top which pervades throughout the organisation.



The Board is proposing a final dividend for the year of 19.0¢ per share, giving a total dividend distribution for 2015 of 30.8¢, up 4% year-on-year and slightly ahead of earnings growth, reflecting our confidence in the business.

including reviews of our European business with a focus on Iberia, our Emerging Markets business with a focus on China, and the development of products for the mid-tier. Our Board site visit to Durban, South Africa gave us insights into one of our oldest and fastest growing overseas businesses.

Our annual Strategy Review in September included presentations and discussions on a wide range of different areas of our business. This meeting underpins our confidence in management's strategic priorities and future progress.

Later in this report, as well as the standard corporate governance disclosures we are required to make, you will find reports from Ian Barlow, Michael Friedman, myself and Joseph Papa, the Chairmen of our Board Committees on the activities of these committees throughout the year (pages 68 to 79). These reports explain where we focused our work in 2015 and our plans for 2016.

[Risk management and the Viability Statement](#)

During 2015, we spent time considering what work would need to be done to make us feel comfortable in making the new Viability Statement. Both the Board and the Audit Committee received papers from the Group Risk Officer during the year and we discussed risk in depth at our Annual Strategy Meeting in September.

[Smith & Nephew's transformation is delivering stronger growth.](#)

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**FINANCIAL HIGHLIGHTS**

**Board succession planning**

We continued the work we started in 2014 in refreshing the Board following the retirement of some longer-serving directors. Vinita Bali joined the Board at the end of 2014. She was followed by Erik Engstrom in January 2015 and Robin Freestone in September 2015. After the changes to Board composition made over the past two years, we are confident that we now have a Board with the appropriate balance of skills, experience and diversity to lead Smith & Nephew through the next stage of our history.

**Olivier Bohuon**

In February we announced that our Chief Executive Officer, Olivier Bohuon, had been diagnosed with a highly treatable form of cancer. Olivier will remain Chief Executive Officer and be actively involved in running the Company through much of his treatment period, which is expected to be completed by late autumn. The Board has approved provisional governance procedures to ensure the effective operation of Smith & Nephew during the treatment period, and I will provide executive oversight if required.

**Sir John Buchanan**

It is with great sadness that we learnt of the passing of our former Chairman of the Board, Sir John Buchanan, during the year. Sir John was a wise, distinguished and respected colleague who served Smith & Nephew and many other companies with great distinction. His legacy of integrity, strong values and high standards will live on here at Smith & Nephew.

Thank you for placing your trust in us as a Board by holding shares in Smith & Nephew. The Board takes our responsibilities very seriously and look forward to continuing to govern the Company in 2016 and returning good results for you, our shareholders.

Yours sincerely,

**Roberto Quarta**

Chairman

REVENUE<sup>1</sup>

\$4,634m

+4%

TRADING PROFIT<sup>1,2</sup>

\$1,099m

+5%

DIVIDEND PER SHARE

30.8¢

+4%

OPERATING PROFIT

\$628m

-16%

ADJUSTED EARNINGS PER SHARE

EPSA<sup>2</sup>

85.1¢

+2%

EARNINGS PER SHARE

EPS

45.9¢

-18%

CASH CONVERSION

85%

+15%

R&D EXPENDITURE AS A  
PERCENTAGE OF REVENUE

5%

OUR PERFORMANCE

ON PAGES 12 TO 13

DETAIL OF NON-GAAP MEASURES

ON PAGES 177 TO 178

- 1 The underlying percentage increases/decreases are after adjusting for the effects of currency translation and the inclusion of the comparative impact of acquisitions and exclusion of disposals.
- 2 These are non-GAAP financial measures. Explanations of these non-GAAP financial measures are provided on pages 177 to 178.

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CHIEF EXECUTIVE  OFFICERS REVIEW				

2015 was a good year

These strong results demonstrate the anticipated positive effects of our actions coming through across the Group. Where we have invested to improve existing businesses we are beginning to reap the benefits.

Dear Shareholder,

Smith & Nephew delivered an improved performance in 2015 through focused innovation, better commercial execution and greater efficiency. We began to reap the benefits of our investments and operational improvements across the Group as we continued to deliver against our strategic priorities.

A stronger commercial performance

Geographically, we drove growth in all of our regions in 2015. In our Established Markets we delivered 5% growth in the United States, our largest market, a significant improvement on the previous year. We

successfully stabilised our European business which delivered a better outturn year-on-year, and our Australia, New Zealand and Japan region delivered good growth, led by the Advanced Wound Management businesses.

In the Emerging Markets we delivered 11% revenue growth in 2015 despite the slow-down in China. Whilst we expect growth in China to remain below previous levels in the near term, it remains a very attractive market and we are committed to building our business here. We continued to successfully deliver strong revenue growth across the rest of the Emerging Markets.

Global franchise highlights in 2015 included the performance of Sports Medicine, which was strengthened by the ArthroCare acquisition. The Advanced Wound Management businesses delivered a significantly better outcome following new management initiatives. Orthopaedic Reconstruction grew ahead of the market driven by our Knee Implant franchise.



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We are further strengthening our commercial platform by aligning under a newly created role of Chief Commercial Officer tasked with driving commercial excellence across the organisation globally. We are also bringing all of our US Orthopaedic Reconstruction, Sports Medicine, Trauma and Advanced Wound Management businesses under one leader, completing the roll-out of our single managing director model globally.

**Focused on innovation**

We continue to innovate for value. Through our Research and Development ( R&D ) strategy we deliver pioneering products and services, and drive innovation across the markets we serve. In 2015, we reiterated our commitment to innovation by announcing a single global R&D organisation, to be led by a new President of Global R&D, reporting to me.

We launched many new products in 2015 and made good progress with our innovative business models, including Syncera<sup>®</sup>, our value solution for orthopaedic reconstruction. We have a strong new product line-up for this year. With increased focus on R&D we will apply more resource to the development of disruptive products and services that increasingly define Smith & Nephew and will help drive our success in the future.

**Successful acquisition track record**

Smith & Nephew has established a successful acquisition track record in recent years. With Healthpoint Biotherapeutics, acquired in 2012, our third year return on capital has exceeded our weighted average cost of capital, despite certain issues we had to address with regard to facilities acquired. ArthroCare, acquired in 2014, is performing in-line with our expectations and we are ahead of our plan to deliver \$85 million of synergies by 2017.

In 2015, we continued to invest in acquisitions that provide opportunities to supplement our organic growth, strengthening our technology and product portfolios and our Emerging Markets business. Blue Belt Technologies, announced in October 2015, has given us a leading position in the fast-growing area of robotics-assisted orthopaedic surgery. In Russia we acquired a trauma and orthopaedics distribution business that includes mid-tier manufacturing. In Colombia, one of the largest economies in Latin America, we acquired our distributor for orthopaedic reconstruction, trauma and sports medicine products.

**Proud of our heritage**

Smith & Nephew is 160 years old. From our roots in Hull, UK, we have become a global business that is proud to support healthcare professionals in their daily efforts to improve their patients' lives in more than 100 countries.

Our longevity is due in large part to the excellence of our employees. As I visit our sites and meet our teams I am

constantly impressed by their integrity and dedication to our core values of innovation, trust and performance. I thank them all for their work. I know we were all proud when our commitments to act sustainably and responsibly were again recognised by the FTSE4Good and Dow Jones Sustainability indices.

### Excited by our prospects

Whilst we are pleased with our progress in 2015, it was just one step on our journey. I am confident that we will continue to build an ever more successful company, a medical device company that is truly like no other.

Yours sincerely,

**Olivier Bohuon**

Chief Executive Officer

## OUR PERFORMANCE

### ON PAGES 12 TO 13

- 1 The underlying percentage increases/decreases are after adjusting for the effects of currency translation and the inclusion of the comparative impact of acquisitions and exclusion of disposals.
- 2 This is a non-GAAP financial measure. Explanations of non-GAAP financial measures are provided on pages 177 to 178.

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CHIEF FINANCIAL OFFICER'S REVIEW				

**Re-invigorating Smith & Nephew**

Striving to achieve ever greater efficiencies is an important element of Smith & Nephew's strategy. It liberates resources for investment, and benefits our margin.

**Dear Shareholder,**

Group revenue in 2015 was \$4,634 million (2014 \$4,617 million), an increase of 4% on an underlying basis and flat on a reported basis. Foreign exchange movements reduced revenue by 8% partially offset by acquisitions, which added 4% to the reported growth rate.

Revenue growth was 5% in the US, 1% across our Other Established Markets and 11% in the Emerging Markets.

Trading profit was \$1,099 million (2014 \$1,055 million). The trading profit margin was 23.7% (2014 22.9%), up 80bps, reflecting the benefits from the Group Optimisation programme and

synergies from the ArthroCare acquisition.

Reported operating profit of \$628 million (2014 \$749 million) is after integration and acquisition costs, as well as restructuring and rationalisation costs, amortisation and impairment of acquired intangibles and legal and other items incurred in the full year. The 2015 operating profit was lowered by a \$203 million accounting charge relating to a legal settlement and provision explained below.

The tax rate for the full year is 26.8% on trading results (2014 27.7%), a 90bps reduction year-on-year. We expect the tax rate on trading results to be 26.5% or slightly lower for 2016, barring any changes to tax legislation.

Adjusted earnings per share was 85.1¢ (170.2¢ per American Depositary Share ( ADS )) compared to 83.2¢ last year, up 2%, which would have been up 9% at constant exchange rates. Basic earnings per share was 45.9¢ (91.8¢ per ADS) (2014 56.1¢), primarily in recognition of the metal-on-metal accounting charge.

Trading cash flow was \$936 million in the year. The trading profit to cash conversion ratio was 85% (2014 74%), a year-on-year improvement in working capital management.

Net debt was \$1,361 million, down from \$1,613 million at the end of Q4 2014. This represents a reported net debt/EBITDA ratio of 1.0x. The Blue Belt acquisition was completed after the year end for \$279 million.

1 The underlying percentage increases/decreases are after adjusting for the effects of currency translation and the inclusion of the comparative impact of acquisitions and exclusion of disposals.

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**Legal settlement and provision**

During the fourth quarter of 2015, Smith & Nephew settled the majority of US metal-on-metal hip claims, without admitting liability with the net cash cost after insurance recoveries being \$25 million. These claims principally related to Smith & Nephew's portfolio of modular metal-on-metal hip products (such as the R3 metal liner), which are no longer on the market.

We have taken an accounting charge of \$203 million to cover both this net cost and also the present value of the estimated costs to resolve all other known and anticipated claims over the coming years. This amount does not include associated legal fees or any possible insurance recovery on these other claims as such recoveries cannot be recognised for accounting purposes until virtually certain. The Group carries considerable product liability insurance and we will continue to defend claims vigorously. The estimate is based on an actuarial model with assumptions relating to the number of claims and outcomes, and is subject to revision as circumstances evolve.

**Enhancing Group efficiency**

We continue to simplify and improve our operating model, becoming more efficient in 2015. Our programme to realise more than \$120 million of annual savings is progressing ahead of plan, and had delivered \$100 million of annualised benefits at year end. The suspension of the Medical Device Excise Tax will present us with opportunities to accelerate investment in our quality and regulatory systems and health economics teams, particularly in support of the US market.

**Acquisitions**

We completed the acquisition of ArthroCare on 29 May 2014, further strengthening our Sports Medicine franchises. This business 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. Revenue synergies will continue to be delivered over

**Outlook**

In 2016, we expect to deliver continued good underlying revenue growth as we benefit from our investments in existing businesses, acquisitions and pioneering technologies.

We would have expected our trading profit margin to reach or exceed 24% in 2016, including the 60bps dilution from investing in the Blue Belt Technologies product pipeline. However, our margin will be reduced by a significant 120bps transactional currency headwind based on current exchange rates, as highlighted in our Q3 results.

We have a clear strategy that is re-invigorating Smith & Nephew and I am confident that we will continue to execute successfully in 2016 and beyond.

Yours sincerely,

the coming years.

## 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.

Just after the year end, on 4 January 2016, we acquired Blue Belt Technologies for \$279 million, giving us a leading position in the fast-growing area of orthopaedic robotics-assisted surgery. We expect strong revenue growth from Blue Belt Technologies. Investment in the combined R&D programmes and supportive clinical evidence will dilute Group trading profit margin by around 60bps in 2016, with the BlueBelt Technologies business becoming profitable in 2018.

**Julie Brown**

Chief Financial Officer

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



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	OUR GLOBAL BUSINESS			

Smith & Nephew is a leading global medical technology business

We continue to invest in acquisitions that provide opportunities to supplement organic growth, strengthen our technology and product portfolios and further establish our business in the Emerging Markets.

TECHNOLOGY ACQUISITION	COLOMBIA ACQUISITION	RUSSIA ACQUISITION
Acquisition of Blue Belt Technologies, securing a leading position in the fast-growing area of orthopaedic robotics-assisted surgery.	Acquisition of EuroCiencia Colombia, Smith & Nephew's sole distributor for orthopaedic reconstruction, trauma and sports medicine products in Colombia since 2006.	Acquisition of the trauma and orthopaedics business of DeOst LLC and DC LLC, a manufacturing company in the DeOst Group which has distributed Smith & Nephew's products in Russia since 2009.



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Products from our nine franchises are used by healthcare professionals in more than 100 countries.

We manage our business through global functions and regional selling businesses, meeting the distinct needs of both our Established and Emerging Markets.

REVENUE

KNEE IMPLANTS

\$883m

HIP IMPLANTS

\$604m

SPORTS MEDICINE JOINT REPAIR

\$606m

ARTHROSCOPIC ENABLING  
TECHNOLOGIES

\$573m

TRAUMA & EXTREMITIES

\$497m

OTHER SURGICAL BUSINESSES

\$205m

ADVANCED WOUND CARE

\$755m

ADVANCED WOUND DEVICES

\$167m

ADVANCED WOUND BIOACTIVES

\$344m

[SEE MORE ABOUT THE PRODUCTS](#)

[WE TAKE TO MARKET ON PAGE 16](#)

UNITED STATES

The United States is the Group's largest market. Due to its commercial importance to the Group its revenue is reported separately. The United States is also home to a number of manufacturing facilities.

REVENUE	EMPLOYEES
\$2,217m	5,868

OTHER ESTABLISHED MARKETS

Other Established Markets comprise commercial operations in Australia, Canada, Europe, Japan and New Zealand, which accounted for 37% of Group revenue in 2015. We have manufacturing facilities in Canada and Europe.

REVENUE	EMPLOYEES
\$1,702m	4,706

### EMERGING MARKETS

Emerging Markets includes our commercial businesses in China, Asia, India, Russia, Middle East, Africa and Latin America. These generated 15% of Group revenue in 2015. We have manufacturing facilities in China, India and Russia.

REVENUE	EMPLOYEES
\$715m	5,070

[SEE MORE ABOUT OUR GEOGRAPHIC](#)

[MARKET AREAS ON PAGE 40](#)

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	OUR BUSINESS MODEL			

We support healthcare professionals in their  
daily efforts to improve the lives of their patients

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	OUR KPIS			

How we performed

**BUILD A STRONG POSITION  
IN ESTABLISHED MARKETS**

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

Geographically, we delivered 5% growth in the United States, our largest market, a significant improvement on the previous year. We successfully stabilised our European business, which delivered a better outcome year-on-year, and our Australia, New Zealand and Japan region delivered good growth, led by the

**FOCUS ON EMERGING MARKETS**

Our Emerging Markets represent those outside of the Established Markets, including the BRIC group of Brazil, Russia, India and China. These countries now represent 15% of Smith & Nephew's revenue, up from 8% in 2010, reflecting our continuing effort to rebalance our business and build share in higher growth markets. The overall percentage of Group revenue in 2015 compared to 2014 has been impacted by the strengthening of the US dollar.

Advanced Wound Management businesses.

Global franchise highlights included good performances from Sports Medicine, strengthened by the ArthroCare acquisition; the Advanced Wound Management businesses, following new management initiatives; and Orthopaedic Reconstruction, which grew ahead of the market driven by our Knee Implant franchise.

We are further strengthening our commercial platform by aligning under a newly created role of Chief Commercial Officer, tasked with driving commercial excellence across the organisation. We are also bringing all of our US Orthopaedic Reconstruction, Sports Medicine, Trauma and Advanced Wound Management franchises under one leader, completing the roll-out of our single managing director model globally.

In the Emerging Markets we delivered 11% revenue growth in 2015 despite the significant slow-down in China. Whilst we expect growth in China to remain below previous levels in the near-term, it remains a very attractive market and we are committed to building our business there.

We continued to deliver strong revenue growth across the rest of the Emerging Markets, led by South Africa, India and the Middle East. Excluding China, Emerging Markets growth would have been in-line with the trend of the last five years.

We enhanced our commercial footprint and product portfolio. In Russia we acquired a trauma and orthopaedics distribution business that includes mid-tier manufacturing. In Colombia, one of the largest economies in Latin America, we acquired our distributor for orthopaedic reconstruction, trauma and sports medicine products.

REVENUE FROM  
ESTABLISHED MARKETS<sup>1</sup>

+3%

REVENUE FROM EMERGING  
& INTERNATIONAL  
MARKETS<sup>1</sup>

\$715m

+11%

\$3,919m

[Redacted]

AS A PERCENTAGE OF GROUP  
REVENUE

15%

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**INNOVATE FOR VALUE**

We continued to innovate for value in 2015. Through our Research and Development ( R&D ) strategy we deliver pioneering products and services, and drive innovation across the markets we serve. Products such as the JOURNEY<sup>™</sup> II Total Knee System and our VERILAST<sup>™</sup> bearing surface provide our customers with unique features and successfully differentiate Smith & Nephew.

We launched many new products in 2015 and have a strong new product line-up for 2016 as the result of our internal programmes and recent acquisitions. We also made good progress with

**SIMPLIFY AND IMPROVE OUR OPERATING MODEL**

During 2014, we launched a Group Optimisation programme to target \$120 million of efficiencies. We identified four main areas of activity:

- 1) Examining our supporting functions such as Finance, HR, IT and Legal to ensure that we are operating most effectively to support business growth.
- 2) Driving procurement savings to get the most value from the money we spend.
- 3) Optimising our footprint

**SUPPLEMENT ORGANIC GROWTH WITH ACQUISITIONS**

Smith & Nephew has established a successful acquisition track record in recent years. Our two largest acquisitions are performing strongly. With Healthpoint Biotherapeutics, acquired in 2012 for \$782 million, our third year return on capital has exceeded our plan and also our weighted average cost of capital, despite certain issues we had to address with regard to facilities acquired. ArthroCare, acquired in 2014 for \$1.5 billion, is performing in-line with our expectations 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 2015, we continued to invest in acquisitions that provide opportunities to supplement our

our innovative business models, including Syncera, our value solution for orthopaedic reconstruction. This completed its US pilot, and we now have a number of trained and fully operational customer sites. We are encouraged by the reception from healthcare providers.

The total investment in R&D in the year was reduced when we stopped the phase 3 programme for HP802-247 (announced 2014).

In 2015, we reiterated our commitment to innovation by announcing a single global R&D organisation to be led by a new President of Global R&D. With increased focus on R&D we will apply more resource to the development of disruptive products and services that increasingly define Smith & Nephew and will help drive our success in the future.

to ensure it matches our strategy and future aspirations.

4) Further simplifying our operating model, including aligning our management structure so that we can make decisions more quickly and effectively.

We have made significant progress delivering this programme, and at the end of 2015 were ahead of plan, having realised \$100 million of annualised benefits.

We continue to look at opportunities to improve efficiency, creating global commercial and R&D organisations and implementing our single managing director model in the US at the start of 2016. The suspension of the Medical Device Excise Tax will present us with opportunities to accelerate investment in our quality and regulatory systems and health economics teams, particularly in support of the US market.

organic growth, strengthening our technology and product portfolios and our Emerging Markets business. Blue Belt Technologies announced in October 2015, has given us a leading position in the fast growing area of robotics-assisted orthopaedic surgery. Its NAVIO<sup>™</sup> 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 significant further upside.

We also completed the acquisition of the ZUK<sup>™</sup> partial knee system in the US market during the year. This has given us access to many new customers and is highly complementary to Blue Belt Technologies.

R&D EXPENDITURE<sup>1</sup>

TRADING PROFIT<sup>1,2</sup>

ACQUISITION PERFORMANCE

<p>\$222m</p>	<p>\$1,099m <span style="color: orange;">+5%</span></p>	<p style="text-align: center;"><b>Healthpoint</b> Third year return on capital exceeded our weighted average cost of capital.</p>
<p style="text-align: center;">AS A PERCENTAGE OF GROUP REVENUE</p> <p>4.8%</p>	<p style="text-align: center;">TRADING PROFIT MARGIN<sup>2</sup></p> <p>23.7% <span style="color: orange;">+80bps</span></p>	<p>1 The underlying percentage increases/decreases are after adjusting for the effect of currency translation and the inclusion of the comparative impact of acquisitions and exclusion of disposals.</p> <p>2 Explanations of these non-GAAP financial measures are provided on pages 177 to 178.</p>

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	OUR GLOBAL MARKET			

**Our marketplace is driven by longer-term trends**

Ageing populations are placing greater burdens on healthcare systems as chronic diseases become more prevalent.

It is expected that by 2050, the number of people aged 60 or over will total 2 billion. However, although we are living longer, we are not necessarily as healthy. In 2014, the World Health Organisation ( WHO ) estimated that more than 1.9 billion adults were overweight. Of these, over 600 million were classified as obese. Overweight and obesity are the major risk factors for diseases such as diabetes and musculoskeletal disorders.

Additionally, WHO estimates that by 2020, people aged 60 years and older around the world will outnumber children younger than five years. This changing dynamic will decrease the level of funds available for healthcare raised through taxes.

Therefore, 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.

**Customers**

We market our products largely to healthcare providers.

In certain parts of the world, including the UK, much of Continental Europe, Canada and Japan, healthcare providers are often government 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. There is a shift towards payment for performance schemes, where financial incentives are provided to healthcare administrators as well as surgeons to increase better health outcomes and reduce the overall cost of delivery. Healthcare providers are implementing incentives for reduced hospital stay or preventing readmissions.

However, 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.

With this increased focus on health outcomes, governments are beginning to impose penalties on healthcare facilities holding them accountable for acute patient re-admissions or for infections acquired within the health system.

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

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 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 the 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.



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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.

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. Legislation covering corruption and bribery such as the UK Bribery Act and the US Foreign Corrupt Practices Act also apply to all our global operations. We are committed to ensuring a high level of 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. See [Legal proceedings](#) on page 147.

**Seasonality**

Orthopaedic and sports medicine procedures tend to be higher in the winter months when accidents and sports related injuries are highest. Conversely, 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.

**Competitors**

We compete against both local and multinational corporations in the global medical devices market, including some with greater financial, marketing and other resources. Our competitors vary across our franchises as illustrated in the market segment and leadership charts.

### HIPS & KNEES

PRODUCT STREAMS	%
A ZIMMER BIOMET	34.9
B DEPUY SYNTHES <sup>2</sup>	20.8
C STRYKER	19.2
D OTHERS	12.8
E SMITH & NEPHEW	10.3
F MICROPORT	1.2
G EXACTECH	0.8

### TRAUMA & EXTREMITIES

PRODUCT STREAMS	%
A DEPUY SYNTHES <sup>2</sup>	45.9
B STRYKER	24.7
C ZIMMER BIOMET	11.3

D SMITH & NEPHEW	9.1
------------------	-----

E OTHERS	9.0
----------	-----

SPORTS MEDICINE<sup>1</sup>

PRODUCT STREAMS	%
-----------------	---

A ARTHREX	30.4
-----------	------

B SMITH & NEPHEW	23.3
------------------	------

C DEPUY MITEK <sup>2</sup>	14.6
----------------------------	------

D OTHERS	12.9
----------	------

E STRYKER	10.7
-----------	------

F LINVATEC	4.7
------------	-----

G ZIMMER BIOMET	3.4
-----------------	-----

## ADVANCED WOUND MANAGEMENT

PRODUCT STREAMS	%
-----------------	---

A OTHERS	37.0
----------	------

B ACELITY	21.0
-----------	------

C SMITH & NEPHEW	18.0
------------------	------

D MOLNLYCKE	12.0
-------------	------

E CONVATEC	8.0
------------	-----

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F COLOPLAST

4.0

Data: 2015 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.

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**The products we take to market**

Smith & Nephew has nine global product franchises.

**Knee implants****REVENUE BY PRODUCT**

GLOBAL PRODUCT FRANCHISES	\$4,634m
A KNEE IMPLANTS	\$883m
B HIP IMPLANTS	\$604m
C SPORTS MEDICINE JOINT REPAIR	\$606m
D ARTHROSCOPIC ENABLING	\$573m
TECHNOLOGIES	
E TRAUMA & EXTREMITIES	\$497m
F OTHER SURGICAL BUSINESSES	\$205m
G ADVANCED WOUND CARE	\$755m
H ADVANCED WOUND DEVICES	\$167m
I ADVANCED WOUND BIOACTIVES	\$344m

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. It is a routine operation for knee pain most commonly caused by arthritis. Every year more than two million patients receive total, partial or revision knee replacements.

2015	2014	2013
\$ million	\$ million	\$ million

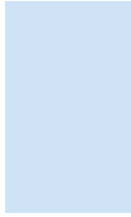
A KNEE IMPLANTS	883	873	865
B HIP IMPLANTS	604	654	653
C SPORTS MEDICINE JOINT REPAIR	606	576	496
D ARTHROSCOPIC ENABLING TECHNOLOGIES	573	542	441
E TRAUMA & EXTREMITIES	497	506	486
F OTHER SURGICAL BUSINESSES	205	147	74
G ADVANCED WOUND CARE	755	805	843
H ADVANCED WOUND DEVICES	167	192	213
I ADVANCED WOUND BIOACTIVES	344	322	280
<b>Total</b>	<b>4,634</b>	<b>4,617</b>	<b>4,351</b>

Smith & Nephew's knee systems include the LEGION<sup>®</sup>/GENESIS<sup>®</sup> II Total Knee System, a comprehensive system designed to allow surgeons to address a wide range of knee procedures from primary to revision and our JOURNEY 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<sup>™</sup>.

These systems also feature VERILAST Technology, our advanced bearing surface. The LEGION Primary Knee with VERILAST Technology has been laboratory-tested to 30 years of simulated wear.

Our knee systems also utilise our VISIONAIRE<sup>®</sup> Patient-Matched Instrumentation. With VISIONAIRE Instrumentation, a patient's MRI and X-rays are used to create customised cutting guides that allow the surgeon to achieve optimal mechanical axis alignment of the new implant. VISIONAIRE cutting guides also help to save time by reducing the number of procedural steps and instruments used in the operating room.

Our Knee Implant franchise delivered a strong performance in 2015. We grew revenue by 5% globally. In the US, our largest market, revenue growth of 6% was driven by our JOURNEY II Total



Knee System and the benefits of a US marketing campaign for VERILAST Technology, featuring both hips and knees.

1 The underlying percentage increases/decreases are after adjusting for the

effects of currency translation and the inclusion of the comparative impact of acquisitions

and exclusion of disposals. Explanations of non-GAAP financial measures are provided

on pages 177 to 178.

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During 2015, we acquired the Zimmer® Unicompartmental High Flex Knee ( ZUK ) system in the US market. ZUK is a clinically proven uni knee replacement introduced globally in 2004, and expands our access to the attractive area of partial knee joint reconstruction.

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 Technologies Navio® surgical system provides robotics assistance in partial knee replacement surgery.

For Smith & Nephew, this acquisition is expected to create a strong combined partial knee portfolio from which to accelerate our growth in partial knee replacement surgery. We anticipate significant upside from a range of new product launches that will expand into indications beyond partial knees. These include a total knee system, due to launch in 2017,

Increased value and efficiency to hospitals and ASCs

**In August 2014 we announced Syncera, a disruptive orthopaedic supply chain model providing increased value and efficiency to hospitals and ambulatory surgery centres ( ASC ) performing knee and hip replacement surgeries.**

By using Syncera, a hospital performing 400 total hip and knee surgeries over a 3-year period, can realise estimated savings of \$4 million.

Since launching our pilot in the



and revision knee and bi-cruciate retaining knee systems.

ANTHEM GLOBAL KNEE

**The unique design of the ANTHEM Total Knee System creates a knee offering fit for all ethnicities.** Based on both intraoperative measurements and the analysis of CT images from patients.

ANTHEM utilises the ORTHOMATCH instrumentation platform, reduces weight, footprint and unnecessary cost without compromising on quality or clinical outcomes. Currently in limited market release, ANTHEM will provide an advanced and globally relevant knee implant that is accessible to all orthopaedic surgeons and patients in emerging markets.

Syncera offers a different channel strategy providing attractive economics through clinically proven products and cutting-edge technology solutions within the primary reconstructive hip and knee marketplace. Its innovative business model brings value solutions to the operating room ( OR ) with pioneering point-of-care technology that links and interfaces with the entire hospital or ASC supply chain systems. Recently acquired Syncera software platforms improve training time for OR staff and drive down cost in instrument sterilisation.

United States, we have secured strong reference sites with hospital and surgeon advocates, now trained and fully operational with Syncera. These sites have purchased instruments and implant inventory and are using our software.

In August 2015 we had Syncera customers with potential to perform more than 3,000 annualised Syncera procedures. Our progress has also given us confidence to move forward with our plans outside of the US, with pilots launched in Europe in 2015.

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The products we take to market continued

### Hip implants

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 undergo total, resurfacing and revision hip replacement procedures.

1 The underlying percentage increases/decreases are after adjusting for the effects of currency translation and the inclusion of the comparative impact of acquisitions and exclusion of disposals. Explanations of non-GAAP financial measures are provided on pages 177 to 178.

For Hip Implants, Smith & Nephew has developed a range of primary hip systems. Core systems include the ANTHOLOGY<sup>™</sup> Hip System, SYNERGY<sup>™</sup> Hip System, the SMF<sup>™</sup> Femoral Hip System, POLARSTEM<sup>™</sup> Femoral Hip System, the R3<sup>™</sup> Acetabular System and the POLARCUP<sup>™</sup> Dual Mobility Hip System. This diversity exemplifies our commitment to providing surgeons with implant and

instrumentation options that meet the specific demands of their preferred surgical approach, most notably the direct anterior or posterolateral approach.

Smith & Nephew's portfolio includes the 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 turns 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.

In 2015, we announced our decision voluntarily to remove from the market certain smaller sizes of the BIRMINGHAM HIP Resurfacing ( BHR ) System. This was a decision we made based on our own post-market surveillance and clinical follow-up. Many thousands of patients have benefited from BHR over the years. It continues to demonstrate very good clinical performance in male patients under 65 years of age and remains an important option for surgeons treating these patients.

Our Hip Implants franchise revenue remained flat in 2015. Excluding the headwind from the changes to BHR, performance would have increased by 1%.

This year saw the launch of collared and valgus versions of our popular POLARSTEM Cementless Hip Stem System. These new stem options join the expanding POLARSTEM family of implants which has been in use clinically

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since 2002.

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The products we take to market continued

Shaping the future of surgery with robotics

**In 2015, we announced the acquisition of Blue Belt Technologies, securing a leading position in the fast-growing area of robotics-assisted surgery. Robotics is expected to become increasingly mainstream across orthopaedic reconstruction in the foreseeable future.**

Blue Belt Technologies Navi<sup>®</sup> surgical system provides

strong combined partial knee portfolio from which to accelerate growth in the attractive area of partial knee replacement surgery, with further opportunities for a range of new products. A total knee variant is due to be launched in 2017, bringing Navio to surgeons performing total knee procedures and supporting Smith & Nephew products such as JOURNEY II. A revision knee version is in the pipeline to bring this technology to this highly

The combination of Blue Belt Technologies with Smith & Nephew's Knee Implant franchise has a powerful rationale. It reinforces our distinctive orthopaedic reconstruction strategy, which combines cutting edge innovation, disruptive business models and a strong Emerging Markets platform to drive outperformance.

robotics-assistance in unicondylar or partial knee replacement surgery through a unique hand-held, robotic bone-shaping device. Navio brings a high degree of implant placement accuracy, combined with attractive economics and ease of use.

The acquisition will complement existing products and R&D programmes, creating a platform from which we can shape this exciting new area of surgery. It creates a

complex and fast-growing area currently not served by robotics. A bi-cruciate retaining knee programme will support our existing development work in this potential major new market. Bi-cruciate knee implants are technically demanding, and we expect they will offer patients more natural motion and greater stability by preserving the anterior and posterior cruciate ligaments.

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**Sports Medicine Joint Repair**

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.

Our position within the global Sports Medicine Joint Repair market was strengthened significantly in 2014, with the acquisition of ArthroCare Corporation. The transaction added technology and highly complementary products to our existing portfolio, including new shoulder anchor innovation.

Sports Medicine Joint Repair delivered revenue growth of 7% in 2015. We produced double-digit growth in the US, driven by the benefits of our combined portfolio following the acquisition of ArthroCare. Our overall performance was held back by conditions in China, where we saw a slowdown in capital and consumable sales compounded by de-stocking in our distribution channel.

In 2015, Smith & Nephew launched its Q-FIX<sup>™</sup> All-suture anchor for procedures like rotator cuff repair in the shoulder and labral repair in the shoulder and hip, all procedures in which anatomic space is very limited. The new anchor delivers performance characteristics that meet or exceed those of much larger, hard anchors.<sup>2</sup>

ROTATOR CUFF REPAIR



Key products in this franchise include the FAST-FIX<sup>™</sup> family of meniscal repair systems, the ENDOBUTTON<sup>™</sup> family for knee ligament reconstruction, HEALICOIL<sup>™</sup> PK, FOOTPRINT<sup>™</sup> PK and TWINFIX<sup>™</sup> Suture anchors for repairs of the hip and rotator cuff.

2015 also saw the launch of a suite of products for Rotator Cuff Repair ( RCR ), including ULTRATAPE<sup>™</sup> suture (available loose or pre-loaded into Smith & Nephew implants) that provides greater tendon-to-bone contact and may enhance repair; FIRSTPASS<sup>™</sup> ST, a sterile-packaged retrograde suture passer that eliminates the steps of loading and unloading needles and cartridges; and MULTIFIX<sup>™</sup> S, an all-PEEK knotless screw-in anchor that accommodates multiple suture limbs and/or ULTRATAPE. All of these new 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 Rotator Cuff Repair Solutions.

**SEE THE FULL RANGE OF PRODUCTS**

**ONLINE  
[WWW.SMITH-NEPHEW.COM](http://WWW.SMITH-NEPHEW.COM)**

- 1 The underlying percentage increases/decreases are after adjusting for the effects of currency translation and the inclusion of the comparative impact of acquisitions and exclusion of disposals. Explanations of non-GAAP financial measures are provided on pages 177 to 178.
- 2 (P/N 54231-01 Rev. A; P/N 49193-01 Rev. A; P/N 51963-01 Rev. A)

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The products we take to market continued

**Arthroscopic Enabling Technologies**

**Trauma & Extremities**

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 construct. Products in this franchise are often used in conjunction with products from our Sports Medicine Joint Repair franchise.

Systems include anatomic

repair-aiding limb positioners and holders, high definition endoscopes and image capture systems, Key products include the SPIDER2/T-MAX procedure-enabling limb positioning systems, DYONICS<sup>™</sup> Shaver Blades, single-use blades that provide superior resection due to their sharpness and virtually eliminate clogging with their debris evacuation capabilities, DYONICS large and small bone cordless powered instruments and accessories, ACUFEX<sup>™</sup> Hand Held Instruments, and a wide range of high performance COBLATION<sup>™</sup> Technology radio frequency ( RF ) probes that ablate, resect and coagulate soft tissue and enable hemostasis of blood vessels.

1 The underlying percentage increases/decreases after adjusting for the effects of currency translation and the inclusion of the comparative impact of acquisitions and exclusion of disposals. Explanations of non-GAAP financial measures are provided on pages 177 to 178.

#### COBLATION TECHNOLOGY

In 2015, COBLATION Technology made a strong contribution to AET's overall performance.

The COBLATION process involves the creation and application of an energy field called glow discharge plasma, which acts to ablate molecules in the tissue.

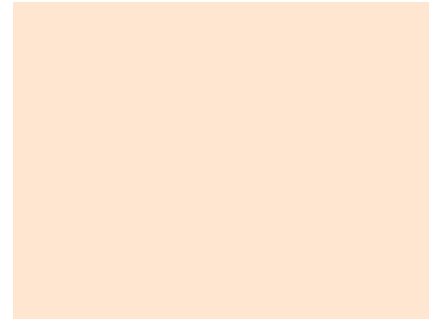
#### THE EVOS MINI FRAGMENT PLATE

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

(up to 80 mm).

Complementing this is our VLP MINI-MOD 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.

COBLATION Technology provides advantages to the surgeon by operating at lower temperatures than other RF-based technologies, and allowing for precise removal of soft tissue with minimal damage to untargeted tissue.



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**Other Surgical Businesses**

Our Trauma & Extremities franchise offers both internal and external fixation and tissue repair devices, as well as other products used in the stabilisation of severe fractures and deformity correction procedures. In 2015, the franchise delivered 2% revenue growth.

For extremities and limb restoration, we offer the TAYLOR SPATIAL FRAME<sup>™</sup> 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.

For Trauma, the principal internal fixation products are the TRIGEN<sup>™</sup> family of IM nails (TRIGEN META-NAIL System, TRIGEN Humeral Nail System, TRIGEN SURESHOT<sup>™</sup>, and TRIGEN INTERTAN<sup>™</sup>), EVOS<sup>™</sup> Plating System and the PERI-LOC<sup>™</sup> Plating System.

The Other Surgical Businesses franchise includes our Gynaecology and our Ear, Nose & Throat ( ENT ) businesses. This franchise delivered revenue growth of 10% in 2015.

Our primary Gynaecology product is the TRUCLEAR<sup>™</sup> System, a first-of-its kind hysteroscopic tissue removal system, providing safe, efficient, effective removal of intra-uterine tissue. Backed by proprietary intellectual property and strong clinical evidence differentiating it from the competition, the TRUCLEAR System has established itself as a leader in hysteroscopic tissue removal. The pioneering solution includes a total hysteroscopy system that allows surgeons to see and treat simultaneously. This approach is designed to enable a shift to in-office treatment, supporting a reduction in total healthcare expenditures.

Within ENT we offer a wide variety of products including our COBLATION

Exclusively for our TAYLOR SPATIAL FRAME<sup>™</sup> device, our new iADJUST<sup>™</sup> was released this year and is an easy-to-use and one-of-a-kind mobile app designed to simplify the frame adjustment process for both physicians and patients.

We introduced the TRIGEN META-TAN<sup>™</sup> Nail System. This expands the clinically proven TRIGEN Nail portfolio with a versatile design that addresses a wide range of femoral fractures ranging from specific hip fractures to mid-shaft fractures and challenging fractures near the knee.

Technology for tissue removal and hemostasis, various articulating instruments and implants for sinus surgery such as balloon sinuplasty, and our RAPIDRHINO<sup>™</sup> Carboxymethylcellulose ( CMC ) Technology which is featured in both dissolvable and removable nasal and sinus dressings, and epistaxis treatment products.

During 2015, we launched our new NASASTENT<sup>™</sup> Dissolvable Nasal Dressing, 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 Ear, Nose & Throat ( ENT ) business

we acquired as part of ArthroCare

improved its growth rate under new

management in 2015.

1 The underlying percentage increases/decreases are after adjusting for the effects of currency translation and the inclusion of the comparative impact of acquisitions and exclusion of disposals. Explanations of non-GAAP financial measures are provided on pages 177 to 178.

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The products we take to market continued

### Advanced Wound Care

The Advanced Wound Care (AWC) franchise consists of several groups of brands, including exudate management, infection management and our Cornerstone range of products. As a whole, this franchise produced revenue growth of 8% in 2015.

Exudate management products focus on effectively locking away wound fluid and thus helping to create an optimal wound healing environment. This will reduce the burden a wound has on the patient 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<sup>®</sup> Life, an innovative dressing designed to improve the quality of life for patients with chronic wounds, as well as helping

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

Our silver-based products (ACTICOAT<sup>®</sup>, DURAFIBER<sup>®</sup> Ag and ALLEVYN Ag) continue to gain market share due to their overall ability to reduce wound infection, their rapid onset of action (ACTICOAT) and their ease of use. ACTICOAT is very well positioned to address urgent cases at risk for infection such as burns, which are highly prevalent in developing countries, or acute trauma.

Our iodine based product IODOSORB<sup>®</sup> has a long history of accumulating clinical evidence for its potentially transformative role in combating biofilms (layers of bacteria and other forms of infection) which

healthcare professionals reduce the costs of frequent dressing changes.

are cited as impeding the healing of chronic wounds in 60% of cases globally. Through its unique mode of action, IODOSORB has proven to be very effective on addressing the issue of biofilms.

During 2015, we continued to invest in significant new clinical and health economic evidence with a number of studies being published demonstrating superior outcomes for ALLEVYN LIFE. This includes a UK study showing how ALLEVYN LIFE enabled a reduction in home care nurse visits from three to one per week<sup>2</sup>, and a US study showing a 69% reduction in hospital acquired pressure ulcers saving a facility over \$1 million per annum<sup>3</sup>.

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.

#### ALLEVYN LIFE

ALLEVYN Life dressing is a multi-layered design incorporating hydrocellular foam, hyper-absorber lock away core and masking layer which has been designed for people and their everyday life. Its unique protection properties also mean it is a powerful tool when used prophylactically to help prevent pressure ulcers which are a preventable condition. In the US, pressure ulcer care is estimated to approach \$11 billion annually, with a cost of between \$500 and \$70,000 per individual pressure ulcer<sup>4</sup>.

OPSITE<sup>®</sup> is one of our most successful and pioneering franchises and has become the global standard of care in post-operative dressings. IV3000, a specialist premium dressing for intravenous lines, continues to perform well. SECURA<sup>®</sup> and PROSHIELD<sup>®</sup> are proven preventative skin care products which help maintain and protect skin integrity.

1 The underlying percentage increases/decreases are after adjusting for the effects of currency translation and the inclusion of the comparative impact of acquisitions and exclusion of disposals. Explanations of non-GAAP financial measures are provided on pages 177 to 178.

2 Joy, H. et al. A collaborative project to enhance efficiency through dressing change practice. Poster presented at Wounds UK 2014.

3 Swafford, K., Culpepper, R. and Dunn, C. Use of a comprehensive pressure ulcer prevention programme to reduce the incidence of hospital-acquired pressure ulcers in an intensive care unit setting. E-Poster presented at EWMA 2015.

4 National Pressure Ulcer Advisory Panel, European Pressure Ulcer Advisory Panel and Pan Pacific Pressure Injury Alliance. Prevention and Treatment of Pressure Ulcers: Clinical Practice Guideline. Emily Haesler (Ed.) Cambridge Media; Osborne Park, Western Australia; 2014.



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## Wound education and excellence

**Smith & Nephew is proud to support its customers in the Emerging Markets through professional education. In this way we ensure the safe and effective use of our products and help healthcare professionals create better outcomes for patients.**

In India, we have invested in a Nursing Education and Excellence in Wound Care programme that brings senior nursing Key Opinion Leaders ( KOL ) together with the aim of expanding knowledge and education in wound care. This supports the evolving trend towards more highly skilled and empowered wound care nurses and tissue viability nurses in hospitals.

Management of wounds is also an increasing area of focus for surgeon customers. In Turkey, our Approaches in General Surgery Training course, run in conjunction with the Turkish Surgery Association, provided a forum to learn about wound healing. Attendees were able to learn about the benefits of Smith & Nephew advanced wound care products.

Improving the skills of burn surgeons is also an important focus for Smith & Nephew. In South Africa, our courses are led by KOL surgeons and cover the entire burn continuum, including burn wound infection, anaesthesia in burns, fluid resuscitation, pain management, inhalational burns and theatre time. We also run a

<p>Through training and education, we seek to ensure the safe and effective use of our products to create better outcomes for patients.</p>	<p>bi-annual Burns &amp; Scientific Symposium , providing an academic forum for burn surgeons to congregate and share best practice.</p>	
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## The products we take to market continued

## Advanced Wound Devices

Our Advanced Wound Devices ( AWD ) franchise is comprised of our Negative Pressure Wound Therapy ( NPWT ) and surgical debridement businesses. In 2015, revenue from this franchise fell by 3%.

In 2014, our traditional NPWT RENASYS system experienced challenges as a result of the FDA requiring suspension of commercial activity in the US while new product approvals were obtained. During 2015, we made progress securing the required approvals and began supporting existing customers. The impact of the RENASYS distribution hold was a significant headwind to overall performance in this franchise in 2015.

Outside the US, RENASYS maintained its strong presence. The RENASYS product

In Q4, 2015 we launched outside the US the next generation of RENASYS called TOUCH<sup>™</sup> offering touchscreen technology. We expect to launch in 2016 in the US. We are also in the final stages of developing the first NPWT device to communicate continuously through the cloud. This will enable more efficient fleet management for institutions and care providers, lower maintenance costs and the provision of clinically relevant information in real time.

Our PICO<sup>™</sup> system, our single-use, canister-free NPWT solution, performed strongly in 2015. PICO brings the effectiveness of traditional NPWT in a modern, small portable system<sup>2</sup>. It is designed for both open wounds and closed incisions and leverages our leading dressing technology.

offering now includes multiple device options, a choice of foam or gauze dressings, along with a range of drains and specialty kits.

2015 has seen PICO growth accelerate in markets around the world, driven by strong value proposition that resonates with healthcare payers and providers. PICO reduces the risk of infection and other complications and lowers readmissions for surgical site infections<sup>2</sup>. It also offers simpler logistics and lower cost and may reduce nursing time and complexity<sup>3</sup> as well as increasing patient mobility<sup>4</sup>.

#### PICO SYSTEM

Easy to use, PICO simplifies the application of NPWT and provides an active intervention to help promote healing, leading to improved outcomes in more wound types. 2015 has seen PICO growth accelerate in markets around the world, driven by strong clinical and health economic evidence.

The VERSAJET 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, also performed well in 2015.

- 1 The underlying percentage increases/decreases are after adjusting for the effects of currency translation and the inclusion of the comparative impact of acquisitions and exclusion of disposals. Explanations of non-GAAP financial measures are provided on pages 177 to 178.
- 2 Bullough L, et al. Reducing C-Section wound complications. *Clinical Svcs J* 2015 Apr: 43-47.
- 3 Hurd, T. Evaluating the costs and benefits of innovation in chronic wound care products and practices. *Ostomy Wd Mgt* June 2013; S2-15.
- 4 Hurd, T. Use of a portable, single-use negative pressure wound therapy device in home care patients with low to moderately exuding wounds. *Ostomy Wd Mgt* Mar 2014; 30-36.

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**Advanced Wound Bioactives**

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.

The acquisition of Healthpoint Biotherapeutics in 2012 gave us a strong position in this fast growing segment.

Bioactives represent the fastest growing segment of chronic wound care, illustrating how greater understanding of wound biology is driving the development of new biopharmaceuticals designed to stimulate the body's own regenerative processes. The AWB business is well-positioned to benefit from this market growth with its focus on generating clinical evidence, a highly trained specialised sales force, strong performance of best-in-class products and award winning educational resources. AWB revenue growth in 2015 was 7%.

Currently, 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

**SANTYL®**

For some patients living with wounds can be challenging. SANTYL Ointment is an FDA-approved prescription medicine that removes dead tissue from wounds so they can start to heal.

Healthcare professionals have prescribed SANTYL Ointment for more than 20 years to help clean many types of wounds, including chronic dermal ulcers (such as pressure ulcers, diabetic ulcers, and venous ulcers) and severely burned areas. SANTYL is available in the US and Canada.

Tri-Layer Matrix (a naturally-derived, extracellular matrix replacement products indicated for the management of both chronic and traumatic wounds) and REGRANEX<sup>®</sup> (becaplermin) Gel 0.01% (an FDA-approved platelet-derived growth factor for the treatment of Diabetic Foot Ulcers).

The US is the largest market and represents the current focus for our AWB franchise. Smith & Nephew is also committed to advancing the care and treatment of wounds through the development of potential new Bioactives and support of industry-leading continuing education from THE WOUND INSTITUTE<sup>®</sup>.

1 The underlying percentage increases/decreases are after adjusting for the effects of currency translation and the inclusion of the comparative impact of acquisitions and exclusion of disposals. Explanations of non-GAAP financial measures are provided on pages 177 to 178.

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The resources we need to deliver our products

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.

[READ MORE](#)

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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.

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[THE FOLLOWING PAGE](#)

MANUFACTURING & QUALITY

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

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## TRAINING & EDUCATION

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

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## SALES & MARKETING

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

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## OUR PEOPLE

Engaging, developing and retaining our 15,000 employees is important to us and we work hard to be an employer of choice as well as a responsible corporate citizen.

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## Research & Development

Our Research and Development ( R&D ) strategy is at the heart of our business model. Through it we deliver pioneering products and services, and drive innovation across the markets we serve.

In 2015, we reiterated our commitment to R&D by announcing a single global organisation to be led by a new President of Global Research and Development, reporting directly to the Chief Executive Officer.

The new global R&D team will focus on delivering a broader portfolio of more meaningfully disruptive products and services, as well as a greater utilisation of digital technologies in medical devices. It will also enable better product life cycle management and alignment and sharing of resources across our franchises.

We are already highly disciplined in project selection. 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. Our products undergo clinical and health economic assessments both during their development and post launch.

With increased focus on R&D, we will apply more resource to the development of disruptive products and services that increasingly define Smith & Nephew and will help drive our success in the future.

In 2015, we invested \$222 million in R&D, in-line with our commitment, set out in 2011, to increase our investment level to around 5% of revenue. We expect to maintain this proportion going forward, but to realise greater benefit through our new structure. We have a strong new product pipeline for 2016, with many innovations scheduled.

We invest in scouting for new technologies, identifying complementary opportunities in our core and adjacent segments. The acquisition of robotics-assisted surgical business Blue Belt Technologies, announced in 2015, is an example of this activity.

We also invest in small companies developing compelling technologies in our franchise areas through our incubation fund. In addition to funding, we bring our expertise to help the development process, including supporting clinical studies, and typically secure preferred access to technology as it nears market readiness. Recent investments include exciting early-stage but high-potential technologies in sports medicine, extremities and trauma.

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**Ethics & Compliance**

**Code of Conduct and**

**Business Principles**

Smith & Nephew earns trust with patients, customers, healthcare professionals, 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 distributors and independent agents that sell our products. Our Code of Conduct and Business Principles ( Code ) 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 that we will not retaliate against anyone who makes a report in good faith.

New employees receive training on our Code, and we assign annual compliance training to employees. We also require our distributor and agents or higher-risk vendors and suppliers to complete training on our Code. Finally, we assign role-based training to targeted groups including people managers, distributor or agent relationship managers, members of our Finance team and selected Sales groups.

### 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 global policies and procedures; on-boarding and annual training for employees and managers; 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 both with the law and our Code. We conduct advance review and approval for significant interactions with healthcare professionals or government officials. We regularly assess existing and emerging risks in the countries in which we operate.

Managing directors are required to complete an annual certification to the CEO 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 and seniority.

In order to reinforce our value of trust, in 2015, we implemented a programme where employees nominate their peers for actions that earn trust. Approximately 30 Spotlight on Trust Certificates were awarded to employees from more than 10 countries. Two employees received additional recognition from the CEO.

Secondly, during our annual manager certification this year, 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 with our actions between managers and staff.

Finally, we launched a new face-to-face training programme for managers in the Sales & Marketing functions. The key objectives of this workshop are to teach managers how to build a culture of trust within their department and how to identify and respond appropriately to compliance questions and ethical dilemmas.

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 2015, we created a Code of Conduct module that was designed specifically to address the needs of our distributors and agents. We also introduced Additional Compliance Standards to provide greater details on Code requirements. We continue our oversight of independent agents and distributors with on-site assessments to review compliance controls

and monitor books and records.

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Manufacturing & Quality

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**Global Operations**

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. We have a defined manufacturing and facility footprint plan in-line with our commercial strategy, which is reviewed on a regular basis.

We continue to implement improved processes such as Lean Manufacturing throughout our factories, the global supply chain and the supporting operations to improve and sustain the levels of safety, quality, delivery, productivity and efficiency. We have numerous Core Competences including materials technology, precision machining, high volume and automated manufacturing for various products from our franchises.

**Our manufacturing facilities**

Our largest manufacturing operation is based in Memphis, Tennessee US. The Memphis facilities produce key products and instrumentation in our Knee Implants, Hip Implant and Trauma franchises. These include the JOURNEY II and LEGION<sup>™</sup> knees, the ANTHOLOGY<sup>™</sup> Primary Hip System and key Trauma products such as the PERI-LOC<sup>™</sup> Ankle Fusion Plating System and TRIGEN<sup>™</sup> Intramedullary Nails. In addition to this, Memphis is home to the design and manufacturing process of the VISIONAIRE patient matched instrumentation sets, and OXINIUM<sup>™</sup> Oxidized 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<sup>™</sup> 360 Meniscal Repair System, FOOTPRINT<sup>™</sup> PK Suture Anchor, DYONICS Platinum Shaver Blades, ENDOBUTTON<sup>™</sup> CL Ultra and the HEALICOIL<sup>™</sup> PK suture anchor.

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

Our Oklahoma City, Oklahoma, US facility produces and services electro/mechanical capital equipment as well as single use sterile devices and also assembles our NPWT devices using components which are brought in from third parties. Our Costa Rica facility manufactures COBLATION technology.

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

Curaçao.

The products manufactured at our Hull site cover the therapies of exudate management (foam products principally ALLEVYN), burns treatment (ACTICOAT) and wound closure (OPSITE film products). In 2015, we closed our facility in Alberta (Canada) which provided specific expertise in the addition of silver coatings onto the ACTICOAT burns range and transferred the process to our Hull site.

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

The products are distributed from a third party logistics facility in San Antonio, Texas US.



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### 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

In 2015, we further centralised and realigned our Global Supply Chain function. We made these enhancements to ensure 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) and Derby (UK) for international distribution, Bedford (UK) for UK domestic distribution and Lawrenceville (Georgia, US) for US distribution.

### Quality Assurance and Regulatory Affairs

Smith & Nephew takes a global approach to managing quality to ensure we have the same high standards everywhere we do business. This includes having strong manufacturing quality management in place at every Smith & Nephew location. With a single organisation and Quality Management System, manufacturing quality processes can be harmonised with quality controls that are applied consistently and to a very high standard across all locations. This ensures ever-improving product quality and a more stable and predictable supply chain for our customers.

The same holds true for our suppliers, who provide a substantial part of our products. A single Supplier Quality Assurance (QA) organisation is being built to harmonise suppliers' QA requirements across the globe, while instituting Scorecard-style performance reports to them and working with, or replacing, those that do not meet our quality standards.

We also take a global approach to Regulatory Affairs, coordinating product registration across our geographic markets. With the increased frequency of regulatory visits this global approach and a close working relationship with our Quality team are vital. The suspension of the Medical Device Excise Tax in the US will present us with opportunities to accelerate investment in our quality and regulatory systems and health economics teams, particularly in support of the US market.

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**Training & Education**

Smith & Nephew is dedicated to helping healthcare professionals improve the quality of care for patients. We are proud to support the professional development of surgeons and nurses by providing them with medical education and training on our Advanced Surgical Devices and Advanced Wound Management products.

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 2015, we provided training to more than 40,000 surgeons. Working under expert guidance, attendees refine techniques and learn new skills, to ensure the effective use of our products. We also support healthcare professionals

The Wider Scope of Arthroscopy

Every year, Smith & Nephew hosts a Sports Medicine fellowship meeting, The Wider Scope of Arthroscopy, at its Andover, Massachusetts facility. The meeting unites promising new doctors (fellows) together with renowned orthopaedic

The curriculum focuses on the fundamentals of joint repair but also on forward-looking topics such as Inventive Approach to AC Joint Reconstruction and Alternative Management Options in Instability Surgery.

through our online resources such as the Global Wound Academy, The Wound Institute and, for surgeons, our Education and Evidence website.

surgeons to review, discuss and practice current and forward-looking surgical techniques in the areas of hip, knee and shoulder repair. The forum helps up-and-coming surgeons develop trust and gain the experience and confidence necessary to become experts in their field.

Held in mid-September 2015, The Wider Scope of Arthroscopy was attended by nearly 140 fellows and distinguished faculty, making it one of the largest fellowship meetings Smith & Nephew has ever held. Over the years, The Wider Scope of Arthroscopy has earned a reputation as one of the most valuable and admired medical education events in the industry, according to our customers.

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**Sales & Marketing**

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.

Once a sales representative is certified, they typically spend the majority of their time working directly with and supporting customers. They help to provide in-hospital support to aid in the effective use of our implants, instruments and medical products and techniques.

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 manage employee sales forces directly. In our Emerging Markets we operate through direct selling and marketing operations led by country managing directors, and/or through distributors.

The largest single customer worldwide is a purchasing group based in the UK that represented less than 5% of our worldwide revenue in 2015.

Increasingly, we are developing opportunities for sales forces to cross sell complementary products from other franchises. An example would be an orthopaedic reconstruction sales representative introducing a surgeon customer to the benefits of PICO, our single use Negative Pressure Wound Therapy device, in the prevention of post-operative infections.

Smith & Nephew utilises 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.

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 surgeon education website.

Our marketing teams also support product development. For instance, our Advanced Wound Management brand teams provide strategic direction to the brands from development to commercial execution. In addition, the Therapeutic Excellence team drives our portfolio approach across brands to drive our strategy to move from product to integrated solution.

#### ONE SMITH & NEPHEW

#### FOR ANZ CUSTOMERS

In Australia and New Zealand we are identifying synergies across our advanced surgical and wound management portfolios to support our customers, grow our business and drive success.

An example of this was a recent Professional Education event at Macquarie University in Sydney, which was attended by over 20 Orthopaedic surgeons from across ANZ. In addition to covering training related to knee arthroscopy products, the attendees also had the opportunity to learn about using PICO<sup>®</sup>, Single Use Negative Pressure Wound Therapy in a surgical setting.





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**Our people**

Engaging, developing and retaining our 15,000 employees is important to us. During 2015, we made major strides in meeting our commitment to be an employer of choice, as well as a responsible corporate citizen.

On 31 December 2015, Smith & Nephew had the following breakdown of employees:

	NUMBER OF EMPLOYEES <sup>1</sup>	
Board of Directors		11
Senior Managers and above <sup>2</sup>		796

Total employees

15,644

1 Number of employees as at 31 December 2015 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.

### Engaging with employees

Smith & Nephew strives to create a more engaged and productive workforce and focuses on measures to drive employee engagement.

This includes open and transparent communication with employees through regular and timely information and consultation. We clearly communicate our business goals and performance standards and also provide training, information and authority to achieve them. We also listen to our employees, by holding regular surveys and focus groups.

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.

Since December 2012, more than 3,100 new employees have joined Smith & Nephew as a result of acquisitions. We attach great importance to the introduction of these new employees to Smith & Nephew, and work hard to achieve successful integration and engagement.

### Developing talent

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. We provide encouragement to learn and continuously improve. 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.

### Retaining our people

Investing in retaining our people helps ensure the long-term sustainability of our business.

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.

Smith & Nephew offers a large number of wellness programmes, including annual wellness days, fitness support and healthy eating programmes. These are designed from a perspective that blends health and wellbeing, improving the lives of our employees.

Global Employee Assistance Programs ( EAPs ) focus on stress and work/life issues and problems, providing 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.

### Changing the way change happens

To ensure we have organisation change readiness capability, we recently put in place a structured programme, which deploys a change management model and methodology. This is designed to focus on our employees during the implementation of major strategic initiatives in order to support our employees and reduce the financial and operational risks associated with such organisational changes.

Training is the cornerstone to this success. To ensure effective change throughout Smith & Nephew, we have trained and certified internal methodology masters and change agents. All leaders at an executive level will have participated in a programme specially designed for sponsors of change. The Change Awareness e-lesson for all employees was successfully launched in 2015, to assist them when working in partnership with sponsors and change agents.

Employees will be consistently trained and coached to embed the change management methodology into our culture.

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**Diversity at Smith & Nephew**

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.

Smith & Nephew has a Human Resource Global Standard for diversity and inclusion in the workplace and is committed to creating an inclusive environment that embraces and promotes diversity.

The Board and Executive Officers continue to recognise the importance of diversity. Three of our 11 Board members are female.

We recruit, employ and promote employees on the sole basis of the

Developing &  
retaining talent

**The best and the brightest**

We aim to bring together the sharpest minds in the industry. We recognise that to achieve this

to identify high potential employees and ensure they have robust career development plans. Talented employees are provided with opportunities to develop their skills and career through new

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 are committed to building diversity in a working environment where there is mutual trust and respect and where everyone feels responsible for the performance and reputation of our Company.

We are committed to providing healthy and safe working conditions for all employees. We achieve this by ensuring that health and safety and the working environment are managed as an integral part of the business, and we recognise employee involvement as a key part of that process.

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.

we need to create an environment where talented people have the opportunity to develop and continue to grow. We have an ongoing focus on keeping our talent and leadership pipeline filled to ensure it is a sustainable, self-reinforcing cycle, creating more opportunities for growth.

**Talent development**

Our development philosophy is based on the 70:20:10 Model for Learning and Development. This is a form of transformational development that engages people and mirrors how they learn, helping to create change within the individual and infuse change into the organisation.

We have a comprehensive global development and capability review process

assignments and on the job experiences.

In 2015, we ran our CEO Forum for our Top Talent, providing them with the opportunity to work closely with our executive team and work together on strategic challenges. We also launched a modular Managing Director programme to further enhance the skills and career opportunities of key individuals pursuing a career in this critical area.

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 performance management system assesses and rewards both performance and behaviour.

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OVERVIEW	OUR BUSINESS	OUR PERFORMANCE	GOVERNANCE	OUR FINANCIALS
		SUSTAINABILITY		

**Our future focus**

We continue to embed sustainability into all our business operations, focusing our efforts on delivering affordable and effective products to our customers. We achieve this by caring for our employees, the society in which we operate and the environment around us.

This is a summary report of our sustainability activities and progress in 2015. Our annual Sustainability Report will be published in April 2016.

We made some great progress on our sustainability journey in 2015 since we laid out aggressive sustainability targets in 2011. Our employee lost time incident frequency rate declined a further 49% through continued implementation of behaviour-based safety and robust incident reporting and investigation systems across the Group. Waste sent to landfill was further reduced, enabled by the thorough understanding of our waste streams delivered by the conduct of detailed waste audits. Sustainability considerations were formalised and extended in our supply chain, ensuring that our vendors are committed to achieving the same high standards of sustainable operation as we are. 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.

The learnings from the 2012-2015 period provide an opportunity for insight to our sustainability journey. It is clear that we were successful in achieving targets in areas which are closely aligned to the purpose of the Company – health and wellbeing, diversity and inclusion, providing wider access to quality healthcare, and building trust. We have fallen short where we have not yet successfully built bridges from our targets to our values and strategy. We commit to fully examining these latter areas in 2016, developing a sustainability strategy which more fully reconciles our purpose, values and strategy to the wider needs of society and the environment.

In 2015, our Lost Time Incident Frequency Rate ( LTIFR ) reduced by 49% to 0.20. There were no employee or contractor fatalities and our recordable injury rate also fell by 41% to 0.54. Compared to the previous year, total waste decreased by 2% but is 27% higher than in our baseline year, 2011. However, as we identified more recycling opportunities, the amount of waste disposed to landfill has fallen by a further 4% over the last year, a total of 39% reduction since 2011. Energy consumption has increased by 2% over the last year mainly all driven by organic growth, acquisitions, changes in footprint, and limited resource efficiency focus.

The Board has evaluated the social, environmental and ethical risks and have concluded that other than the risk of Bribery and Corruption, which is explained in greater detail in the Group Risk section on page 48, none of these risks is material in the context of the Group as a whole.

## OUR DONATIONS

We donated approximately \$11.5 million in philanthropic activities, of which \$1.4 million was in product donations and charitable gifts. Volunteering programmes were active in most of our locations around the world and employees and local communities were able to benefit from the increased level of involvement.

### Safety

Ensuring the safety of our employees and those who work with us is at the forefront of the way we carry out our activities both on the manufacturing sites and also in our commercial activities.

The implementation of our integrated management system, an active internal audit programme and a number of behavioural-based safety campaigns have enabled us to report safety rates which are amongst the best in our sector.

Our headline safety performance includes all employees and supervised contractors and 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

As the footprint of the business has expanded, coupled with growth and acquisitions since 2011, our total waste has increased by 27%. The actions raised by our 2014 waste audits are now gaining momentum and we reported a 2% annual decrease in 2015, a trend we aim to continue. Significant improvements were again made by diverting waste away from landfill in 2015 with 75% of our waste streams now being recycled or sent for energy recovery.

### Energy and greenhouse gas emissions

Over the past year our energy use has increased by 2% with a corresponding 3% increase in CO<sub>2</sub> emissions all driven by organic growth, acquisitions and changes in footprint. The effect of the recently acquired business (ArthroCare) accounted for 6.4 GWh of the increase, without which energy use would have decreased by 2%.

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 2015 are included in the data. Each year we work with an independent partner to verify our sustainability data and gain assurance.



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The scope for measuring emissions is in line with the scope of businesses covered in our consolidated financial statement. We have used Greenhouse Gas Protocol to measure our emissions. A Corporate Accounting and Reporting Standard (Revised Edition) is guidance for this process. Primary data from energy suppliers has been used wherever possible. Data from the ArthroCare acquisition is included in 2015 for the first time. Recent acquisitions in 2015 are excluded and this is in line with our established policy for integration of acquired assets.

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 elsewhere. The emissions from 2014 have been recalculated using the most up-to-date factors available in 2015 and may therefore differ slightly from those published previously.

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.

	2015	2014
<b>CO<sub>2</sub>e Emissions (tonnes) from:</b>		
Direct emissions	11,011	11,208
Indirect emissions	77,191	74,178
<b>Total</b>	<b>88,202</b>	<b>85,386</b>
<b>Intensity ratio</b>		
CO <sub>2</sub> e (t) per \$m sales revenue	19.2	19.4
CO <sub>2</sub> e (t) per full-time employee	6.0	6.9
Revenue 2015 \$4.6 billion, 2014 \$4.4 billion.		

Full-time employee data 2015 14,698, 2014 12,437.

2014 data adjusted to exclude ArthroCare, 2015 data adjusted to exclude recent acquisitions in Russia and Colombia.

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		FINANCIAL REVIEW		

**Financial review**

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:

	2015 \$ million	2014 \$ million	Reported growth in revenue %	Constant currency exchange effect %	Acquisitions/ Disposals effect %	Underlying growth in revenue %
US	2,217	2,012	10		(5)	5
Other Established Markets	1,702	1,928	(12)	15	(2)	1
Emerging Markets	715	677	6	9	(4)	11

<b>Total</b>	4,634	4,617	0	8	(4)	4
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Trading profit reconciles to operating profit, the most directly comparable financial measure calculated in accordance with IFRS, as follows:

	2015 \$ million	2014 \$ million
Operating profit	628	749
Acquisition related costs	12	118
Restructuring and rationalising costs	65	61
Amortisation of acquisition intangible and impairments	204	129
Legal and other	190	(2)
Trading profit	1,099	1,055

Explanations of these non-GAAP financial measures are defined on pages 177 to 178.

1 The underlying percentage increases/decreases are after adjusting for the effects of currency translation and the inclusion of the comparative impact of acquisitions and exclusion of disposals.

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**Revenue**

Group revenue for the full year was \$4,634 million, an increase of 4% on an underlying basis and flat on a reported basis from \$4,617 million in 2014. Foreign exchange movements reduced revenue by 8% partially offset by acquisitions, primarily the acquisition of ArthroCare in May 2014 which has a full year of sales in 2015 and added 4% to the reported growth rate.

In 2015, we achieved revenue growth in all of our geographical selling regions in 2015. In our Established Markets we delivered 5% growth in the United States, our largest market, a significant improvement on the previous year.

We successfully stabilised our European business which delivered a better outturn year-on-year, and our Australia, New Zealand and Japan region delivered good growth, led by the Advanced Wound Management businesses resulting in a 1% increase across our Other Established Markets.

In the Emerging Markets we delivered 11% revenue growth in 2015 despite the slow-down in China. Whilst we expect growth in China to remain below previous levels in the near-term, it remains a very attractive market and we are committed to building our business here. We continued to successfully deliver strong revenue growth across the rest of the Emerging Markets.

Global franchise highlights in 2015 included the performance of Sports Medicine, which was strengthened by the ArthroCare acquisition. The Advanced Wound Management businesses delivered a significantly better outcome driven by the actions of new management initiatives. Orthopaedic Reconstruction grew ahead of the market driven by our Knee Implant franchise.

We are further strengthening our commercial platform by aligning under a newly-created role of Chief Commercial Officer tasked with driving commercial excellence across the organisation globally. We are also bringing all of our US Orthopaedic Reconstruction, Sports Medicine, Trauma and Advanced Wound Management franchises under one leader, completing the roll-out of our single managing director model globally.

**Trading profit**

Our gross margin for the full year was 75.3%, 30 basis points down on the prior year. This is a combination of price erosion, currency headwinds and offsetting manufacturing efficiencies. On price, we faced similar overall pressures of between 1% and 2%. This was offset by cost of goods improvement programmes. On currency, we are seeing headwinds as a result of transactional exchange, although in 2015 this was mostly offset by hedging gains.

Our selling, general and administration expenses reduced by 80 basis points to 46.8% of sales, largely due to savings

within general and administration. These savings were primarily driven by benefits from the Group Optimisation programme and also synergies from our ArthroCare acquisition. We continue to simplify and improve our operating model, becoming more efficient in 2015. Our Group Optimisation Programme to release at least \$120 million of annual savings is progressing ahead of plan, and had delivered \$100 million of annualised benefits at year end. Through this programme, we have simplified the organisation through the rollout of Single Managing Director:

we have realised benefits and improved management information through optimising our enabling functions, including Finance, IT, Legal and HR;

we have delivered good results from procurement initiatives across the group; and

we have rationalised our footprint of office locations in a number of major markets including Australia, Germany and the US.

In respect of ArthroCare, when we announced the acquisition we said that we were targeting \$85 million of synergies by 2017, of which three quarters would come from cost savings. We are ahead of plan and have now achieved almost all our targeted cost savings. Revenue synergies will continue to be delivered over the coming years.

The suspension of the Medical Device Excise Tax will present us with opportunities to accelerate investment in our quality and regulatory systems and health economics teams, particularly in the US market.

Research and development expenses reduced by \$13 million to \$222 million in the full year, reducing as a percentage of sales to 4.8%. This is primarily due to the closure of the HP802 programme, as we announced in 2014.

Overall trading profit was \$1,099 million in the year, an increase of 5% on an underlying basis and up \$44 million from the prior year. Our trading margin for the full year increased 80 basis points delivering on our commitment of margin improvement.

### Operating profit

Operating profit was \$628 million for the year, a decrease of \$121 million from the prior year. Operating profit is the most directly comparable financial measure under IFRS to trading profit and reconciles as indicated on the left hand page.

Acquisition related costs primarily relate to the remainder of integration costs relating to the ArthroCare acquisition which has reduced significantly when compared to the prior year as ArthroCare was acquired in May 2014.

The ongoing restructuring and rationalisation costs relate to the Group Optimisation programme, which was announced in 2014. Costs include redundancy and site rationalisation charges from the simplification of our operating model to establish a single structure under a single managing director as well as consultancy spend in delivering improved systems and processes.

Amortisation and impairment of acquisition intangibles of \$204 million in 2015 includes a full year of the ArthroCare intangible assets as well as \$51 million relating to the impairments of product related acquisition intangible assets, including a \$40 million impairment of Oasis, a brand acquired with Healthpoint in 2012.

Included within Legal and other in 2015 is a total charge of \$203 million relating to metal-on-metal hip claim settlements and associated legal costs of \$21 million. Following the settlement of the majority of the US claims in late

2015 for net \$25 million after insurance recoveries, a provision for the estimated value of current and anticipated claims of \$185 million was recognised at 31 December 2015.

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		PRINCIPAL RISKS		

**Our approach to risk****Our risk appetite**

The Group operates in global markets with long-term high 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 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 took the opportunity as part of our Strategy Review to review our risk appetite in respect of our principal risks. The results of our deliberations can be summarised in the adjacent table.

CATEGORY OF RISK	RISK PARAMETERS
------------------	-----------------

<b>Strategic</b>	In acquiring and developing new products and business models, moving into adjacent
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Moderate to high	markets and technologies, organically or through acquisitions, and implementing innovative pricing strategies, we have a moderate to high tolerance for risk. We are willing to take certain risks in pursuit of innovation and new business.
<b>Operational</b>  Low to moderate	In operating our business, managing our suppliers, keeping control of inventory and managing our talent and our facilities, we have a low to moderate tolerance for risk. We aim to be as efficient as possible and adopt a cautious approach, but recognise that we need to take certain risks in order to take full advantage of the opportunities open to us.
<b>Financial</b>  Low	We recognise that sound financial controls are necessary in order to manage our business as effectively as possible. We therefore have a low tolerance for risk relating to financial controls and require all our operations to comply with our minimum acceptable practices.
<b>Compliance</b>  Extremely low	In complying with laws and regulations and in matters relating to bribery and corruption, product safety and patient and employee safety, we have an extremely low tolerance for risk. Whilst we attempt to eradicate this risk completely, we recognise that, as in any human system, compliance failures may occur. We will respond to issues as they arise and will reassess our business scope where needed, if we judge there to be risk in these areas, which we can't manage.

### Risk Management Activities in 2015

#### FINANCIAL REPORTING COUNCIL CHANGES

We reviewed the Financial Reporting Council changes to the Corporate Governance Code.

In May, Deloitte assisted us in reviewing our risk management programme in light of these changes.

In July 2015, the Audit Committee considered the recommendations from this review and how best to incorporate these changes into the Company's processes.

This work was followed up in October 2015, when the Audit Committee further considered the reporting requirements around risk.



## RISK APPETITE

We spent time at the Strategy Review meeting in September re-appraising our risk appetite for each of our principal risks.

We undertook a 'black swan' exercise, thinking about possible, yet unlikely, risks which could have a major impact on the Group were they to occur.

In December 2015, the Board Development Session focused on risk management and we further developed our tolerance for each risk.

## DEEP DIVES

In December 2015, the Audit Committee conducted a deep-dive into the processes to manage IT and Cyber Security risks as a follow up to work undertaken in 2014.

The deep dives planned for 2016 are; dependency on single source or single site product supply; product quality and liability; and pricing and reimbursement.

## PRINCIPAL RISKS AND RISK MANAGEMENT

We have expanded the annual certification to the Chief Executive Officer on compliance with policies provided by all senior division management to include risk management.

We have agreed to develop Key Risk Indicators ( KRI ) to provide information on the status of key risks and to assist with tracking on a regular basis.

We have taken further risk specific actions, which are detailed in the risk table on pages 44 to 48.

Since the year end, in February 2016, the Board has 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 2016 and beyond to ensure that this remains the case.

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**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 risk management office, including the identification of risks, undertaking risk assessments and implementing mitigating actions. These activities are reviewed by internal audit and other control functions, which provide assurance to the Group Risk Committee chaired by the Chief Executive and then to the Board and its committees.

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Our approach to risk continued

The principal risks we have identified

We have developed a detailed risk matrix, which is designed to rate any given risk. We rate our risks according to the likelihood of occurrence and the impact. The potential impact is assessed using the criteria below and others relating to matters such as Legal and other impacts:

Financial	Reputation	Regulatory and environment & safety	Business interruption
<b>HIGH</b>			
Significant profit impact or significant reduction of market value	Extensive US/EU national/international media scrutiny	Product withdrawal or non-approval of key product; forced closure of critical facilities; material safety or	Interruption to critical activities for long term

environmental failures

MEDIUM

Moderate profit impact or reduction in market value	Short-term national (non US/EU) media coverage and disruption to stakeholder confidence	Key product delayed or withdrawn for intermediate period; short-term environmental damages	Interruption to critical activities in short-term
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LOW

Low impact to revenue profit or market value	Localised annoyance/ concern/ complaints; no media coverage	Regulatory action with fewer issues, smaller products involved; minor injuries or environmental impact	Impact can be absorbed within normal business operations
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The following pages provide an overview of what the Board considers to be our principal risks together with the actions management is taking to address them. These are the risks, which could cause the Group’s business, financial position and results of operations to differ materially and adversely from expected and historical levels. Additional detail may be found on pages 171 and 174 under Group Risk Factors .

PRODUCT PORTFOLIO DEVELOPMENT

The medical devices industry has 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 and securing appropriate protection for and defending our intellectual property.

**Underlying risks**

Insufficient innovation due to low R&D investment, R&D skills gap or poor product development execution.

Competitors may introduce a disruptive technology or business model.

Competitors may obtain patents or other intellectual property rights that affect the Group’s competitive position.

**Actions taken by management**

Processes are focused on identifying new products and potentially disruptive technologies and solutions.

Increasing prioritisation and allocation of funds for research and development.

Pursuing business development opportunities, which augment our portfolio.

Failure to receive regulatory approval to commercialise a pipeline product successfully.

Claims by third parties regarding infringement of their intellectual property rights.

Implementing efficient processes to roll new products out to consumers.

Proactively clearing new products from competitive patents and monitoring pending competitor patent applications.

Monitoring of external market trends and collation of customer insights to develop product strategies.

**Actions during 2015**

Acquisitions of Blue Belt technologies and distributorships in Russia and Colombia.

Progressed the implementation of the SYNCERA business model.

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**ACQUISITIONS AND BUSINESS DEVELOPMENT**

Failure to identify appropriate business development opportunities, to deliver value from our acquisitions or to integrate them effectively into the Group will impact our ability to achieve expected financial returns and lead to loss of reputation.

**Underlying risks**

**Actions taken by management**

<p>Failure to identify appropriate acquisitions.</p>	<p>Acquisition activity is aligned with corporate strategy and prioritised towards products, franchises and markets identified to have the greatest long-term potential.</p>
<p>Ineffective acquisition due diligence.</p>	<p>Clearly defined investment appraisal process based on return on capital, in accordance with Capital Allocation Framework.</p>
<p>Inflated forecasts or projections leading to over-valuation of transaction.</p>	<p>Undertaking detailed and comprehensive cross-functional due diligence prior to acquisitions.</p>
<p>Failure to embed Group standards, policies and financial controls quickly enough following acquisition.</p>	<p>Implementing consistent integration processes designed to identify and mitigate risks in the early stages post completion.</p>
<p>Integration process may identify practices that need to be ceased to meet Group standards.</p>	<p>Early embedding of our desired standards of</p>
<p>Failure to learn from past actions.</p>	<p></p>

compliance with laws, internal policies and controls.

Comprehensive post-acquisition review programme.

**Actions during 2015**

Thorough due diligence undertaken for the acquisitions of Blue Belt Technologies and the distributorships on Colombia and Russia.

Comprehensive Integration programme continued for the acquisition of ArthroCare in 2014.

Post-acquisition review template revised to enable acquisitions to be evaluated on consistent basis.

**GOVERNMENT ACTION, PRICING AND REIMBURSEMENT PRESSURE**

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

**Underlying risks**

Reduced reimbursement levels and increasing pricing pressures.

Reduced demand for elective surgery.

**Actions taken by management**

Developing innovative economic product and service solutions for both Established and Emerging Markets, such as SYNCERA.

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



Lack of compelling health economics data to support reimbursement requests.

Government policies favouring lower prices and locally sourced products.

Political upheavals prevent selling of products, receiving remittances of profit from a member of the Group or future investments in that country.

Economic downturn impacts demand and collections.

Trading margin will be impacted when the currencies in our manufacturing countries (US, UK, Costa Rica and China) strengthen against the currencies in the rest of the world where our products are exported.

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.

Optimising cost to serve to protect margins and liberate funds for investment.

Holding prices within acceptable ranges through global pricing corridors.

Transacting forward foreign currency commitments when firm purchase orders are placed to reduce exposure to currency fluctuations.

#### **Actions during 2015**

Launch of SYNCERA business model in Established Markets and commenced development of the SYNCERA range of mid-tier products in Emerging Markets.

Established Strategic Marketing programmes to develop the economic proposition to back the clinical data.

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		PRINCIPAL RISKS		

Our approach to risk continued

**BUSINESS OPERATIONS, SUPPLY CHAIN AND BUSINESS RECOVERY**

Our business depends on purchasing 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.

**Underlying risks**

Failure or performance issues at a critical/single source facility or supplier of key products or services may impact revenues or profits.

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.

**Actions taken by management**

Ensuring emergency and incident management and business recovery plans are in place at major facilities and for key products and key suppliers.

Validating second source for critical components or products.

Over production of product inventory and instruments sets may occur due to inadequate portfolio planning.

Undertaking of risk based review programmes for critical suppliers.

If we fail to properly manage our inventory and financial controls around inventory we may become overcapitalised or inaccurately forecast and report data.

Enhancing travel security and protection programme.

Developing improved regional inventory metrics to drive efficiency and harmonise demand signals with factory capacity constraints.

Managing continued reduction in SKUs through product phase outs and formal review of slow moving and obsolete inventory.

**Actions during 2015**

Appointed new dedicated President of Global Operations and strengthened the supply chain organisation.

**IT SYSTEM DISRUPTION AND CYBER CRIME**

Our business is heavily dependent on the integrity of our IT systems and the management of information. At the same time, cyber crime is growing exponentially in frequency and sophistication and many IT systems are exposed to these threats.

**Underlying risks**

**Actions taken by management**

IT systems which support our business may be disrupted by man-made or natural forces or in the process of upgrades or new process implementation.

Continuously improving the stability and reliability of IT systems and infrastructure.

A severe IT service interruption, a cyber attack, the unauthorised access to or a misuse of sensitive information could disable critical systems and cause loss of sensitive data with major impact for the Company, including substantial revenue or profit loss as well as material reputational damage.

Ensuring IT disaster and data recovery plans are in place to support overall business continuity plans.

Global management framework for the control and reporting of access to our critical IT systems.

Following HMG GCHQ guidance, implementing the Cyber security roadmap with oversight from the Group Cyber Security Steering Committee.

Continuously improving controls relating to mobile device and removable media, network security and monitoring and malware protection and secure configuration.

Policies covering the protection of both business and personal information and the uses of IT systems by our employees.

Comprehensive IT security training programmes in place for employees.

Controls in place around the secure transmission of data.

#### **Actions during 2015**

Board undertook a deep dive into IT security and cyber crime in December 2015, reviewing the plans we have in place to tackle cyber crime.

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**TALENT RETENTION AND ORGANISATIONAL CHANGE**

Our people are critical to the success of our business and we need to attract, motivate and retain the best talent we can, not only for our current needs, but also looking ahead to the organisation of the future. We therefore need effective succession planning at all levels and support for employees through periods of organisational change.

**Underlying risks**

**Actions taken by management**

Poor retention of high performing and high potential staff could jeopardise achieving objectives.

Operating robust talent systems and processes with focus on identifying key roles and successors.

Failure to ensure proactive talent management is undertaken effectively may result in business disruption.

Operating robust performance management programme, which includes regular performance reviews, underpinned by a common set of values.

Failure to support executives and employees affected through periods of organisational change could result in sub-optimal performance.

Enhancing hiring process with rigorous screening and checks.

Running annual talent review process the results of which are reported up to the Board to aid discussions on succession planning.

Designing competitive management incentive packages.

Holding annual managing directors meeting and CEO Forum for high potential managers to encourage and develop internal talent.

#### **Actions during 2015**

Results of talent management process fed into the organisational changes implemented at the end of 2015.

Coached Senior Executives and managers on how to manage effectively through change.

Comprehensive change management programme rolled-out at multiple levels across the organisation.

Further embedded succession planning of key roles at all levels.

### **PRODUCT SAFETY, QUALITY, REGULATION AND LITIGATION**

Many of our products are designed to be implanted or used within the human body. Product safety and quality is therefore of critical importance. National regulatory authorities 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 and may also inspect for compliance with appropriate standards, including those relating to Quality Management Systems or Good Manufacturing practice regulations.

**Underlying risks**

**Actions taken by management**

Defects in design or manufacturing products sold by the Group could lead to product recalls or product removal or result in loss of life or major injury, with negative financial and reputational impacts.

If there is significant non-compliance with policy, regulations and standards governing products and operations regarding registration, manufacturing, distribution, sales and marketing, then we could suffer fines and impacts to reputation.

Failure in the design or manufacture of products supplied to the Company can impact the quality of products sold by the Company.

Failure to obtain proper approvals for new or changed technologies, products or processes can result in product and registration deficiencies.

Failure to implement programmes and supporting resources to ensure product quality and regulatory compliance.

Failure to manage, process, respond to and analyse customer complaints and adverse event data could lead to further deficiencies and loss of reputation.

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

Ensuring that design for manufacture is embedded into product development.

Reviewing product safety and complaint data.

Standardising and monitoring compliance with Group quality management and practices through Global Quality Assurance Regulatory Assurance organisation.

Incident management teams in place to respond in the event of an incident relating to patient safety.

#### **Actions during 2015**

Appointed new dedicated President of Global Operations and strengthened the quality and regulatory function.

Improved performance of facilities undergoing audits by Federal Drug Administration.

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Our approach to risk continued

**REPUTATION, ETHICS, BRIBERY AND CORRUPTION**

There is increasing public scrutiny of ethics in business and doing the right thing has become part of our licence to operate. Business practices in the healthcare industry are subject to increasing scrutiny by government authorities in many countries. We are also expected to have in place strong compliance programs under global anti-corruption laws and US healthcare laws.

**Underlying risks**

**Actions taken by management**

Failure to act in an ethical manner consistent with our code of conduct can lead to reputational damage.

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

Violation of global anti-corruption and healthcare laws.

All employees globally are required to certify compliance with our Code of Conduct and Global



Cultures in certain geographies and in acquired businesses may not fully support the Group's code of conduct.

Failure to conduct adequate due diligence or to integrate appropriate internal controls into recently acquired businesses.

An instance of fraud could severely impact our finances and our reputation.

Serious compliance breach by employee or third party in an individual geography could threaten our ability to continue to operate in that geography.

Policies and Procedures which provide guidelines for ethical behaviour and controls for significant compliance risks.

Training programmes in place for employees and third parties with ethical and compliance responsibilities and monitoring and auditing programmes to verify implementation.

Independent reporting channels for employees and third parties to report concerns in confidence.

Compliance risks included as part of due diligence reviews, integration plans and reporting for acquisitions.

Controls in place to detect and prevent fraud.

#### **Actions during 2015**

Active engagement in due diligence and integration projects for acquisition of Blue Belt technologies, and the distributorships in Russia and Colombia.

Established spotlight on trust programme to recognise employees.

Implemented detailed additional compliance standards to distributors and agents.

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**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 44 to 48 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 2016. We have chosen a period of three years, as the detailed Strategic Plan, which we approve each year at our Strategy Review in September, is also for a three-year period. We also review longer-term plans for five and ten years, but our detailed review focuses on a three-year period.

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

The Audit Committee reviewed the risk management process at their meetings in February and July, receiving presentations from the Chief Compliance and Risk Officer, which explained 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 each of these risks were being managed and mitigated.

We have undertaken a robust assessment of those risks that would threaten our business model, future performance, solvency or liquidity of the Company, including its resilience to the threats to its viability posed by those risks in severe but plausible scenarios. We are satisfied that we have robust mitigating actions in place as detailed on pages 44 to 48 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 place could turn out to be less effective than intended. Therefore where appropriate, stress and sensitivity analysis of these risks was carried out to evaluate the impact of a severe but plausible combination of risks actually occurring and consider whether additional financing would be required. This assessment included quantitative and qualitative analyses.

We have considered and discussed a report from the Chief Financial Officer setting out the terms of our current financing arrangements and potential capacity for additional financing.

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 2015, 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 during the three-year period. 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, 24 February 2016

**Susan Swabey**

Company Secretary

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Governed by a Board with a wealth of skills

### Roberto Quarta (66)

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 Vice President of Hitchiner Manufacturing Co. Inc., where he helped the company to expand internationally. He returned to BTR plc in 1989 as Divisional Chief Executive, where he led the expansion in North America and was appointed to the main board. From here he moved to BBA Aviation plc, as CEO from 1993 to 2001 and then as Chairman, until 2007. He has held several board positions, including Non-Executive Director 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 is currently

Chairman of WPP plc. He is a partner at Clayton Dubilier & Rice and a member of the Investment Committee of Fondo Strategico Italiano SpA.

### **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 (57)**

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 4 February 2016.

### **Career and Experience**

Olivier has had a highly successful career in the pharmaceutical industry. He holds a doctorate from the University of Paris and an MBA from HEC, Paris. His career has been truly global. 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 spent 10 years with 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 (all countries outside of the US), and then President of their Pharmaceutical Division, which was a \$20 billion business, encompassing manufacturing, R&D and commercial operations. 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.

### **Nationality**

French

### **Julie Brown (53)**

Chief Financial Officer

Joined the Board as Chief Financial Officer in February 2013.

### **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 Chief Financial Officer. Prior to that she undertook Commercial and Strategic roles and was Regional Vice President Latin America, Marketing Company President AstraZeneca Portugal, and Vice President Corporate Strategy and R&D Chief Financial Officer. In both Julie's country and regional roles, trading margins increased significantly, improving the efficiency and profitability of the business. Her experience encompasses many areas of the healthcare value chain including Commercial, Operations, R&D and Business Development. She has led multi-billion dollar cost saving and restructuring programmes in Operations, R&D and the Commercial organisations and led major refinancing programmes, including the issuance of \$2 billion US bonds. Julie has fulfilled two Non-Executive Directorships with the NHS in the UK and the British Embassy. She is nominated for election as a new member of the Board of Directors of Roche Holding Ltd and Chair of the Audit Committee at the Annual General Meeting on 1 March 2016.

### **Skills and Competencies**

Julie has deep financial expertise and understanding of the healthcare sector, which has enabled her to lead a major transformation project at Smith & Nephew designed to simplify and improve the organisation and deliver margin accretion. She is a recognised leader with a proven ability to build teams. Her commercial experience in Latin America is of particular benefit as we continue to grow in Emerging Markets. She has held a number of senior commercial roles as well as financial positions, making her a versatile Chief Financial Officer.

### **Nationality**

British

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**Vinita Bali (60)**

Independent Non-Executive Director

Appointed Independent Non-Executive Director in December 2014 and Member of the Remuneration Committee and Ethics & Compliance Committee on 1 April 2015.

**Career and Experience**

Vinita holds an MBA from the Jamnalal Bajaj Institute of Management Studies, University of Bombay and a Bachelor's Degree in Economics from the University of Delhi. She commenced her career in India with the Tata Group, and then joined Cadbury India, subsequently working with Cadbury Schweppes plc in the UK, Nigeria and South Africa. From 1994, she held a number of senior global positions in marketing and general management at The Coca-Cola Company based in the US and South America, becoming President of the Andean Division in 1999 and Vice-President, Corporate Strategy in 2001. In 2003, she joined the consultancy, Zyman Group, LLC as Managing Principal, again based in the US. Vinita was Managing Director and Chief Executive Officer of Britannia Industries Limited, a leading Indian publicly listed food company, from 2005 to March 2014. Currently, Vinita is Non-Executive Director of Syngenta AG, Titan Company Ltd and CRISIL (Credit Rating Information Services of India) Ltd. She is also Chair of the board of GAIN (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, South America, the US and UK, all key markets for Smith & Nephew. Additionally, her strong appreciation of customer service and marketing brings deep insight to Smith & Nephew as we continue to develop innovative ways to serve our markets and grow our business.



## Nationality

Indian

### Ian Barlow (64)

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, and acted as Lead Partner for many large international organisations operating extensively in North America, Europe and Asia. Ian's previous appointments include Non-Executive Director and Chairman of the Audit Committee of PA Consulting Group and Non-Executive Director of Candy & Candy. He was Chairman of WSP Group plc, Think London, the inward investment agency and The Racecourse Association Ltd. He is currently Lead Non-Executive Director chairing the Board of Her Majesty's Revenue & Customs, Non-Executive Director of The Brunner Investment Trust PLC, Non-Executive Director of Foxtons Group plc and a Board Member of the China-Britain Business Council.

## 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. This has been particularly useful during 2015 as KPMG have undertaken their first year as our new external auditor. 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 (67)

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 Akzo Nobel 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

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**Erik Engstrom (52)**

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 1986, he was awarded a Fulbright scholarship to Harvard Business School, from where he graduated with an MBA in 1988. Erik commenced his career at McKinsey & Company and then worked in publishing, latterly as President and Chief Operating Officer of Random House Inc. and as President and Chief Executive Officer of Bantam Doubleday Dell, North America. In 2001, he moved on to be a partner at General Atlantic Partners, a private equity investment firm focusing on information technology, internet and telecommunications businesses. Between 2004 and 2009 he was Chief Executive of Elsevier, the division specialising in scientific and medical information and then from 2009 Chief Executive 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 (57)**

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 (Touche Ross). He held a number of senior financial positions throughout his career at ICI PLC between 1984 and 1995, then Henkel Ltd from 1995 to 2000 and Amersham plc from 2000 to 2004. Robin was the Deputy Chief Financial Officer and then later the Chief Financial Officer of Pearson PLC between 2006 and August 2015, where he was heavily involved with the transformation and diversification of Pearson. His other Non-Executive Directorships include Moneysupermarket.com Group PLC and Cable and Wireless Communications plc, where he is also Senior Independent Director and Chairman of the Audit Committee. Robin sits on the Board of ICAEW as an Advisory Group Member, Financial Reporting Faculty and is a member of the CBI Economic Growth Board. He was previously Non-Executive Director at eChem Ltd from 2000 to 2014 and Deputy Chairman of the 100 Group until 2015, having been Chair from 2012 to 2014.

### **Skills and Competencies**

Robin has been a well-regarded FTSE 100 Chief Financial Officer 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 (72)**

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 Chief Executive Officer of City of Hope, the prestigious cancer research and treatment institution in California. He 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 Vice President of research, medical and public policy for Pharmacia Corporation and also Deputy Commissioner and Acting Commissioner at the US Food and Drug Administration. He has served on a number of Boards in a non-executive capacity, including Rite Aid Corporation. Currently, Michael is a Non-Executive Director of Celgene Corporation, Non-Executive Director 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

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**Brian Larcombe (62)****Joseph Papa (60)****Susan Swabey (54)**

Independent Non-Executive Director

Independent Non-Executive Director

Company Secretary

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.

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.

Appointed Company Secretary in May 2009.

**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. After leading the UK investment business for a number of years, he became Finance Director and then Chief Executive of the Group following its flotation. He has held a number of Non-Executive

**Career and Experience**

Joe graduated with a Bachelor of Science degree in Pharmacy from the University of Connecticut and Master of Business Administration 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 commercial

**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, risk, 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

Directorships. He is currently Non-Executive Director of Kodak Alaris Holdings Limited and Cape plc.

career at Novartis International AG as an Assistant Product Manager and eventually rose to Vice President, Marketing, having held senior positions in both Switzerland and the US. He moved on to hold senior positions at Searle Pharmaceuticals and was later President & Chief Operating Officer of DuPont Pharmaceuticals and later Watson Pharma, Inc. Between 2004 and 2006, he was Chairman and Chief Executive Officer of Cardinal Health Inc. Joe is currently Chairman and Chief Executive of Perrigo Company plc, one of the largest over-the-counter pharmaceutical companies in the US.

is also a Trustee of ShareGift, the share donation charity.

**Skills and Competencies**

Brian's experience in private equity is particularly useful to Smith & Nephew when evaluating acquisitions and new business opportunities. His long service as a Non-Executive Director has provided continuity throughout a period of change and his corporate memory and wise counsel continues to support our Chairman. As Senior Independent Director and member of the Nomination & Governance Committee, he plays an active role in succession planning and assisted with the search for new Non-Executive Directors in 2014 and 2015.

**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**

British

**Nationality**

British

**Nationality**

American

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Supported by a strong leadership team

**Julie Brown (53)**

Chief Financial Officer

Joined Smith & Nephew in February 2013 as Chief Financial Officer. Julie is a graduate, Fellow of the Institute of Chartered Accountancy and Fellow of the Institute of Taxation. She is based in London.

**Skills and Experience**

Julie’s experience in the healthcare sector includes 25 years with AstraZeneca plc in progressively senior roles and four years with KPMG. Most recently, she served as Interim Chief Financial Officer of AstraZeneca. She has international experience and a deep understanding of the healthcare sector gained through her previously held Vice President Finance positions in all areas of the healthcare value chain including Commercial, Operations, R&D and Business Development. Julie has also led commercial organisations, being Country President and Regional Vice President in AstraZeneca.

**Nationality**



British

### Rodrigo Bianchi (56)

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

### Jack Campo (61)

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

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**Michael Frazzette (54)**

Chief Commercial Officer

Joined Smith & Nephew in July 2006 as President of the Endoscopy Global Business Unit. In July 2011, he was appointed President of the Advanced Surgical Devices Division, with responsibility for the Orthopaedic Reconstructive, Trauma and Endoscopy businesses in the Established Markets. Since 2014, he has had responsibility for our commercial business in Latin America. With effect from 1 January 2016, Mike became the

Chief Commercial Officer with responsibility for oversight of all commercial activities (sales, marketing, market access, and commercial strategy) across the Company for our full line of business. He is currently based in Andover, Massachusetts.

**Skills and Experience**

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

**Nationality**

American

**Elga Lohler (48)**

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, and Corporate Functions and Group. Elga has more than 25 years Human Resources experience.

**Nationality**

American/South African

**Diogo Moreira-Rato (55)**

President, Europe and Canada

Joined Smith & Nephew in May 2014 with responsibility for leading all of our commercial business in Europe and Canada. He is based in Baar, Switzerland.

**Skills and Experience**

Diogo's experience in the healthcare industry includes 31 years with Johnson & Johnson in progressively senior roles. Most recently, Diogo was President, DePuy Synthes, EMEA, where he led the merger and integration of DePuy and Synthes in EMEA. Prior roles included International Vice President for the Medical Devices and Diagnostics business, President DePuy Orthopaedics and Managing Director of Portugal.

**Nationality**

Portuguese



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**Cyrille Petit (45)**

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

**Matthew Stober (48)**

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. He is based in Memphis.

**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

**Glenn Warner (53)**

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



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**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
<p>The Board sets the tone at the top of the Company through:</p> <p>A clear definition of the roles of the individual members of the Board</p> <p>A comprehensive corporate governance framework</p>	<p>The Board carries out its duties through:</p> <p>Regular meetings focusing on the oversight of strategy, risk, including viability and succession planning</p> <p>An annual review into the effectiveness of the Board</p>	<p>The Board delegates some of its detailed work to the Board Committees:</p> <p>Each Committee meets regularly and reports back to the Board on its activities</p> <p>The terms of reference of each Committee may be found on the Company website at <a href="http://www.smith-nephew.com">www.smith-nephew.com</a></p>

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

A comprehensive programme of development activities throughout the year

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

[READ MORE ABOUT OUR BOARD S](#)

[READ MORE ABOUT OUR BOARD S](#)

[READ MORE ABOUT OUR BOARD S](#)

[LEADERSHIP ON PAGE 60](#)

[EFFECTIVENESS ON PAGE 62](#)

[ACCOUNTABILITY ON PAGE 68](#)

## 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 approved by shareholders in 2014 and how we implemented it in 2015 and plan to implement it in 2016.

[READ MORE ABOUT OUR BOARD S](#)

[REMUNERATION ON PAGE 78](#)

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.

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The Directors Report comprises pages 36 to 39, 49 to 77, 104, 113, 115, 117 and pages 171 to 194 of the Annual Report.

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**Leadership**

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**

BOARD NATIONALITY

45%	19%	9%	9%	9%	9%
BRITISH	AMERICAN	FRENCH	INDIAN	ITALIAN/ AMERICAN	SWEDISH

EXECUTIVE/NON-EXECUTIVE

GENDER SPLIT

A EXECUTIVE	2	A MALE	8
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B NON-EXECUTIVE 8 B FEMALE 3

C CHAIRMAN 1

Changes to the Board

INDEPENDENT NON-EXECUTIVE DIRECTORS

**Joined the Board during 2015**

Erik Engstrom (appointed 1 January 2015)

Robin Freestone (appointed 1 September 2015)

Experience

NON-EXECUTIVE TENURE

A LESS THAN ONE YEAR 1

B ONE TO THREE YEARS 3

C THREE TO SIX YEARS 2

D SIX TO NINE YEARS	1
E OVER NINE YEARS	1

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**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.

**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.

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

#### 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.

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## Leadership continued

## 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 day-to-day running of the business is delegated to Olivier Bohuon, the Chief Executive Officer, and his executive team comprising the Executive Officers who are shown on pages 54 to 56.

During 2015, the Executive Officers formed the Commercial and Operations Committee which advised the Chief Executive Officer in decisions relating to the commercial and operational aspects of the business.

The Chief Executive Officer in turn delegates the day-to-day management of the Group functions and regional commercial operations divisions to the Executive Officers, who are assisted in their decision making by their own leadership teams and other committees and councils.

In 2016, the Governance structure below Board level is being revised to reflect the new organisational structure.

## BOARD

<p><b>AUDIT COMMITTEE</b></p> <p>Provides independent assessment of the financial affairs of the Company, reviews financial statements and controls, and the risk management process. Manages use of internal and external auditors.</p>	<p><b>REMUNERATION COMMITTEE</b></p> <p>Determines remuneration policy and packages for Executive Directors and Executive Officers.</p>	<p><b>NOMINATION &amp; GOVERNANCE COMMITTEE</b></p> <p>Reviews size and composition of the Board, succession planning, diversity and governance matters.</p>	<p><b>ETHICS &amp; COMPLIANCE COMMITTEE</b></p> <p>Reviews and monitors ethics and compliance matters across the Group. Reviews and oversees quality and regulatory matters.</p>	<p><b>AD HOC COMMITTEES</b></p> <p><b>Ad hoc committees may be established to review and approve specific matters or projects.</b></p>
<p><b>Read more</b></p> <p><a href="#">See page 72</a></p>	<p><b>Read more</b></p> <p><a href="#">See page 78</a></p>	<p><b>Read more</b></p> <p><a href="#">See page 68</a></p>	<p><b>Read more</b></p> <p><a href="#">See page 70</a></p>	

**CHIEF EXECUTIVE OFFICER**

**Supporting the Business**

Various committees and groups relating to the running of the business report to the Chief Executive Officer. These groups have a dual role both advising the Chief Executive Officer and also implementing the strategy throughout the business. A number of these committees also report regularly to the Board or one of its Committees.

**Investment in the Strategic Priorities**

Investment in our Strategic Priorities, important for our future success, is governed through a number of committees and groups. These groups report either to the Chief Executive Officer or to one of the Executive Officers and are focused on allocating resources to and overseeing investment in the strategic priorities. Regular reports from these groups are submitted to the Board or one of its Committees.

**Commercial & Operations Committee** Committee of the Executive Officers, advising the Chief Executive Officer on commercial and operational matters

**Regional Leadership Teams** Implement work of regional presidents

**Functional Leadership Teams** Implement work of functional presidents

**Disclosure Committee** Approves all announcements (except routine regulatory matters) released to investors and to UKLA, London and New York Stock Exchanges, SEC and SOx compliance

**Finance & Banking Committee** Approves banking and treasury matters, corporate structure changes, acquisition details

**Group Risk Committee** Reviews risk registers and mitigation plans, reports to Board and Audit Committee

**Health, Safety and Environment Leadership Team** Oversees health, safety and environment matters across Group, reports to Board on sustainability

**Diversity & Inclusion Council** Implements strategies to promote diversity and inclusion across the Group

**Group Benefits Committee** Oversees policies and processes relating to pension and employee benefit plans

**Research & Development Council** Reviews and evaluates R&D projects, determining the allocation of resources, ensuring alignment with corporate strategy, reports regularly to the Board

**Mergers & Acquisitions Council** Oversees corporate development strategy, monitors status of transactions and approves various stages of acquisition prior to presentation to Board

**Capital Governance Board** Sets group level targets for capital expenditure priorities and monitors capital expenditure within the parameters set by the Board

**IT Governance Board** Oversees the IT strategy and investment allocation throughout the Group, monitors IT systems and cyber security, reports regularly to the Audit Committee

**Group Optimisation Steering Group** Oversees the implementation of the Group Optimisation project, reports regularly to the Board

**Group Ethics & Compliance (including Quality)**

**Committee** Monitors developments in compliance and quality matters, approves enhanced compliance programme, reports to Board Ethics & Compliance Committee

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**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 question. 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 served as an independent Non-Executive Director for a period of 13 years, a period of time that some might regard as likely to impact his independence. We do not believe this to have been the case as throughout 2015, 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 have asked Brian Larcombe to remain on the Board for another year to support the Chairman during the time he will be providing additional Executive oversight whilst the Chief Executive Officer is undergoing medical treatment.

**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 23 February 2016.

Each of us as a 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 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 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, four 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 one external company. 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 and Julie Brown is nominated for election as a Non-Executive Director of Roche Holding Limited at its Annual

General Meeting on 1 March 2016. Each Director discussed their external roles with the Chairman, prior to accepting these appointments and the Chairman was satisfied that each Executive Director 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. Robin Freestone who was appointed to the Board on 1 September 2015, will offer himself for election at the Annual General Meeting. Each Director may be removed at any time by the Board or the shareholders.

### 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 2015, the Executive Directors held meetings with institutional investors, including investors representing approximately 43.5% of the share capital as at December 2015.

During 2015, Roberto Quarta met with investors to hear their views of the Company. He held four meetings with investors holding approximately 7.2% of the share capital.



Joseph Papa, the Chairman of the Remuneration Committee also met with key institutional investors towards the end of 2015. He held meetings with 14 investors holding around 18.4% of the share capital. These were useful discussions giving insight into current investor thinking.

Ian Barlow, the Chairman of the Audit Committee also offered to meet with institutional investors to discuss audit related matters. The meetings held with six investors holding around 5.6% of the issued share capital were interesting and useful and we welcomed some insightful comments on possible improvements to the Audit Committee Report.

Michael Friedman, the Chairman of the Ethics & Compliance Committee met with one investor during the year who was interested in understanding more about our global compliance programme and the challenges we face in this area.

Members of the Board are always happy to engage with investors, if they have matters they wish to raise with the Non-Executive team.

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 and Julie Brown routinely report on any concerns or issues that shareholders have raised with them in their meetings. Copies of 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 155.

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**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 corporate social responsibility, health and safety, Code of Conduct and Code of Share Dealing and other matters.

Approving the appointment and removal of key professional advisers.

## RISK

Overseeing the Group's risk management programme.

Regularly reviewing the risk register.

Overseeing risk management processes (see pages 42 to 48 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.

## 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.

#### 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](http://www.smith-nephew.com)

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Board timetable 2015

FEBRUARY

MARCH

APRIL

MAY

JUNE

JULY

AUGUST

SEPTEMBER

OCTOBER

NOVEMBER

D

What we did

EARLY FEBRUARY

**Approval of Preliminary Announcement**

Reviewed the results for the full year 2014 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 the Group Optimisation Plan and tracked its progress.

Approved the Budget for 2015 and the five-year Plan for 2015 to 2020.

Reviewed the results of the review into the effectiveness of the Board in 2014 and agreed action points for 2015.

Reviewed and approved the acquisitions of Eurociencia, the Colombian distributor and DeOst, the Russian distributor.

## LATE FEBRUARY

### Approval of Financial Statements (by telephone)

Reviewed and approved the Annual Report and Accounts for 2014, having determined that they were fair, balanced and understandable.

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

## EARLY APRIL

Prepared for the Strategic Review in September.

Reviewed progress of past transactions and acquisitions by management.

Approved the Sustainability Report.

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

## LATE APRIL

### Approval of Q1 Trading Statement (by telephone)

Reviewed the results for the first quarter 2015 and approved the Q1 trading statement announcement.

## JULY

### Approval of H1 results

Reviewed the results for the first half 2015 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.

Received an update regarding the new UK site at Croxley Green Business Park in Watford, North London.

Received a report from Group Operations on Manufacturing.

Approved the appointment of Robin Freestone as a Non- Executive Director with effect from 1 September 2015.

## SEPTEMBER

### Strategy Review, Geneva

Approved the Strategic Plan for 2015 to 2020 over a two-day Strategy Review with the executive team.

Approved the renewal of the Directors and Officers Liability insurance.

## OCTOBER

### Approval of Q3 Trading Statement, Durban, South Africa

Reviewed the results for the third quarter 2015 and approved the Q3 trading statement announcement.

Received and considered the annual report from the executive team on executive Succession Planning.

Received an update on the business in China.

Received an update on our strategy in Emerging Markets.

Received a report on investor perceptions.

## DECEMBER

### Approval of Budget

Approved the Budget for 2016.

Received a report on the Capital Structure.

Conducted Deep Dive into Cyber Security Risk.

Received reports on Europe region with particular focus on Iberia.





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**Effectiveness continued**

We also agreed to approve the 2015 final budget and dispose of certain trademarks to Smith & Nephew (Overseas) Ltd, a subsidiary entity of Smith & Nephew plc by written resolution.

Since the year end, we have also approved the Annual Report and Accounts for 2015 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 2015.

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

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 Business 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 Meetings	Audit	Remuneration	Nomination & Governance	Ethics & C
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	(8 meetings)	Committee Meetings (7 meetings)	Committee Meetings (5 meetings)	Committee Meetings (2 meetings)	Committee Meetings (4 meetings)
Roberto Quarta <sup>1</sup>	7/8		5/5	2/2	
Olivier Bohuon	8/8			2/2	
Julie Brown	8/8				
Vinita Bali <sup>2</sup>	7/8		3/3		
Ian Barlow	8/8	7/7			
Virginia Bottomley <sup>3</sup>	7/8		5/5	2/2	
Erik Engstrom <sup>4</sup>	7/8	6/7			
Robin Freestone <sup>5</sup>	3/3	2/2	2/2		
Michael Friedman	8/8				
Brian Larcombe	8/8	7/7	5/5	2/2	
Joseph Papa <sup>6</sup>	6/8	6/7	5/5		

1 Roberto Quarta was unable to attend one Board call due to a prior appointment.

2 Vinita joined the Ethics & Compliance and the Remuneration Committees from 1 April 2015. She was unable to attend one Board meeting due to a meeting arranged prior to being appointed.

3 Virginia Bottomley was unable to attend one Board meeting due to a prior appointment.

4 Erik Engstrom was appointed to the Board and Audit Committee on 1 January 2015. He was unable to attend one Board and one Audit Committee meeting due to a meeting arranged prior to being appointed.

5 Robin Freestone was appointed to the Board and Audit and Remuneration Committees on 1 September 2015.

6 Joseph Papa was unable to attend the April Board and October Board, Audit and Ethics & Compliance Committee meetings due to his company holding emergency meetings.

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**Board Effectiveness Review**

The Board Effectiveness Review in 2015 was externally facilitated by Belinda Hudson of Independent Audit, who had undertaken the previous external review in 2012. Independent Audit has no other business relationship with the Company or any member of the Board. Following an initial planning meeting with the Chairman and Company Secretary, she reviewed the minutes and papers of the Board and Committee meetings over the previous year. She then interviewed each member of the Board, the Company Secretary, the External Auditor and a number of other Senior Executives, who regularly interacted with the Board and its Committees. She also attended and observed the Board meeting in December 2015.

In January 2016, she prepared a report, detailing her findings. This report was shared with the Chairman and the rest of the Board. The Chairman then discussed the findings with each member of the Board and collectively at a meeting with the Non-Executive Directors and the Company Secretary.

She concluded that the Board appears to have a much better understanding of all the issues and challenges that Smith & Nephew faces than in the past. It has remained supportive throughout while providing a good degree of challenge to the thinking of the executives and commented that the Board was on a good trajectory and becoming increasingly effective. She highlighted the benefits of the refreshing of the Board that had taken place over the previous 18 months, noting that this had led to a new level of energy and dynamism as well as fresh thinking and input, a better balanced Board, a better focus on strategy and a stronger focus on exercising oversight of risk, better relationships and better informed discussion on succession planning.

**Suggested Improvements**

She did however recommend some key ways in which the Board could become more effective. The Board has discussed these recommendations and have agreed the following actions for 2016:

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.

The development of a programme for Non-Executive Directors to get to know the business better outside the scheduled Board visits.

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.

The areas for attention identified in the 2014 review have been addressed as follows:

ACTIONS IDENTIFIED	ACTION TAKEN
<p>Make more effective use of the annual Board Planner to ensure that all key strategic issues were timetabled appropriately throughout the year.</p>	<p>The annual Board planner and the format of the Board agendas were redesigned during the year. This has resulted in a more logical flow of matters being discussed at each Board meeting with more time spent on matters of greater strategic importance and less on routine matters.</p>
<p>Encourage the executive team to access the diverse competencies of the Non-Executive Directors more between Board meetings.</p>	<p>Opportunities have been taken by the executives to access the specialist skills of some of the Non-Executive Directors during the year, particularly in the areas of risk management, cyber security and in-country knowledge of certain territories. However, the Board and the executive team recognised that this is an area which could be developed further in 2016.</p>
<p>Continue the practice of inviting members of the executive team to present regularly to the Board.</p>	<p>At each Board meeting during the year, there was a presentation by members of the executive team on relevant topics. This has enabled the Non-Executive Directors to meet and get to know key members of the executive team, which is helping with succession planning.</p>

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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 2015, we particularly focused on the new reporting requirement to include a Viability Statement and the consequent changes we would make to the way we monitored risks throughout the Group.

New Directors receive tailored induction programmes when they join the Board. In 2015, Vinita Bali continued her induction programme with a series of meetings with key Senior Executives, a visit to our site in Hull and attendance at some orthopaedic operations in India. Erik Engstrom and Robin Freestone also commenced their induction programmes during the year, meeting with key Senior Executives. 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.

### Development activities

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

#### APRIL

Presentation from WPP on innovation trends in the Global Healthcare market.

#### JULY

Presentation from our Auditor, KPMG on MegaTrends which were likely to impact business in coming years.

#### SEPTEMBER

Presentation from Boston Consulting Group on trends in healthcare.  
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.

#### OCTOBER

Visit to the Company's site in Durban, South Africa and meetings with the South African executive team.  
Series of presentations from our South African management team on the challenges faced by the business in South Africa, our strategy and initiatives to meet these challenges and an update on progress made since the previous year.

DECEMBER

Internally facilitated workshop on Risk Management programme focusing on Group's principal risks, the Board's risk appetite and tolerance for each risk, mitigation actions and resultant net risks post mitigation.



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**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 68 to 69 explains the process the Board and the Nomination & Governance Committee followed in 2015 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 October 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.

By order of the Board, on 24 February 2016

**Roberto Quarta**

Chairman

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Accountability

NOMINATION & GOVERNANCE  
COMMITTEE

CURRENT MEMBERS IN 2015

**Roberto Quarta**  
Committee Chairman

**Brian Larcombe**  
Senior Independent Non-Executive Director

**Virginia Bottomley**  
Independent Non-Executive Director

**Olivier Bohuon<sup>1</sup>**  
Chief Executive Officer

<sup>1</sup> Olivier Bohuon has ceased to be a member of this committee with effect from 4 February 2016.

## KEY ACTIVITIES

Reviewed the composition of the Board and made recommendations to the Board regarding the appointment of Directors.

Oversaw governance aspects of the Board and its Committees.

Recommended the appointment of Robin Freestone to the Board, Remuneration and Audit Committees.

Recommended the appointment of Independent Audit to conduct external Board evaluation.

## 2016 FOCUS

Recommend to the Board ways of addressing any issues raised in the external Board evaluation.

Dear Shareholder,

I am pleased to present the 2015 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.

**FIND IT ON OUR WEBSITE**

**[WWW.SMITH-NEPHEW.COM](http://WWW.SMITH-NEPHEW.COM)**

**Activities of the Nomination & Governance Committee in 2015 and since the year end**

In 2015, we held two physical meetings. 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 2015 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 and approved the appointment of Vinita Bali to the Remuneration and Ethics & Compliance Committees.

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

Considered and discussed the results of the annual review into the effectiveness of the Board.

Approved the appointment of The Zygus Partnership recruitment consultant.



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**JULY****Appointment of Robin Freestone**

Reviewed the short list of candidates for the position of Non-Executive Director and discussed the outcome of meetings already held with potential candidates.

Agreed to recommend to the Board that Robin Freestone be appointed Non-Executive Director with effect from 1 September 2015.

Commenced the appointment for the external Board Evaluation process.

Since the year end, we have also discussed the future structure of the Board. In particular, we recommended to the Board that Brian Larcombe remains in place as Senior Independent Director in order to support me as Chairman, should I be required to provide additional executive oversight during the Chief Executive Officer's period of illness.

We also agreed that Olivier Bohuon would cease to be a member of this committee, recognising that some shareholders believe that the Chief Executive Officer should not sit on the Nomination & Governance Committee. He will continue to attend and contribute to discussions at our meetings, as we value his input particularly when discussing succession planning.

**Non-Executive Directors**

During 2015, Erik Engstrom and Robin Freestone joined the Board on 1 January 2015 and 1 September respectively. In selecting these new Board members, we continued the process we started in 2014, which had identified the skills and experiences we needed on the Board to implement our Strategy over the next five years. The process we followed in 2015 was as follows:

The analysis in 2014 had identified that we needed one more Board member with financial expertise gained as Chief Financial Officer of a FTSE 100 company.

The Nomination & Governance Committee selected Zygos to undertake the search for a new Non-Executive Director with financial expertise.

Zygos prepared a long list of candidates satisfying one or more of the above criteria and Brian Larcombe and I met with them to discuss the long list and select a short list of suitable candidates.

Members of the Nomination & Governance Committee and Ian Barlow, Chairman of the Audit Committee then met individually with a number of candidates.

The Nomination & Governance Committee agreed to recommend that the Board appoint Robin Freestone as Non-Executive Director because of his experience as Chief Financial Officer of Pearson plc and previous experience of the Healthcare industry at Amersham plc.

Zygos does not perform any other services for the Company and we are satisfied that the advice is objective and independent.

### 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 characteristic. 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, 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. 27% of our Board is female. We do not regard this as a fixed percentage as the number of Board members will fluctuate from time to time and we would not necessarily expect to replace any retiring Director with a new Director of the same gender. We will still continue to appoint Directors on merit, valuing the unique contribution that they will bring to the Board, regardless of gender.

### 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

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Accountability continued

ETHICS & COMPLIANCE  
COMMITTEE

CURRENT MEMBERS IN 2015

**Michael A. Friedman**  
Committee Chairman

**Ian Barlow**

Independent Non-Executive Director

**Joseph Papa**

Independent Non-Executive Director

**Vinita Bali (from 1 April 2015)**

Independent Non-Executive Director

## KEY ACTIVITIES

Reviewed ethics and compliance processes and practices across the Group.

Oversaw quality and regulatory matters.

Monitored significant compliance, quality and regulatory issues or failures as they arise.

## 2016 FOCUS

Enhance oversight of quality and regulatory matters, including review of data for trends and patterns and proactively working to minimise associated risks.

Continue to focus on compliance issues within the context of our growth in Emerging Markets organically and through acquisitions.

Continue to enhance the compliance processes and practices of our third party distributors.

Dear Shareholder,

I am pleased to present the 2015 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.

Overseeing the Group's internal and external communications relating to ethics and compliance matters.

Reviewing external developments and compliance activities.

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 Assurance ( 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.

[FIND IT ON OUR WEBSITE](#)

[WWW.SMITH-NEPHEW.COM](http://WWW.SMITH-NEPHEW.COM)

[Activities of the Ethics & Compliance Committee in 2015 and since the year end](#)

In 2015, 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 and the QARA Officers also attended by invitation. Our programme of work in 2015 included the following:

## FEBRUARY

Noted that the final self-monitoring report had been filed with the SEC and DOJ together with a certification of compliance.

Received an update regarding the newly-structured Quality Assurance and Regulatory Assurance function. This function now provided a quarterly update to the Committee.

Noted the Culture of Quality survey had been undertaken across all employees to measure employee ownership, peer involvement, message credibility and leadership emphasis.

Noted the implementation of detailed Additional Compliance Standards for distributors and sales agents.

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**APRIL**

Successful completion of performance under the three-year FCPA settlement agreements and closure of matter.  
Noted expansion of monitoring programme whereby regional compliance officers conducted periodic compliance checks.  
Noted the US Food and Drug Administration ( FDA ) inspections undertaken in St Petersburg, Curaçao, Aarau, Tuttlingen and Andover.

**JULY**

Noted management review of updated compliance risk register.  
  
Monitoring of compliance in China and other developing markets and key actions undertaken.  
Noted the data published under the US Sunshine Act regarding the Company and its competitors.

**OCTOBER**

Noted the results of annual manager training.

Monitored the compliance integration plan for the Russian acquisition.

Received a report from the SVP Quality Assurance and Regulatory Assurance on the activities of the QARA function, reviewing the quality and regulatory challenges faced across the Company and initiatives to address them.

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 2015, considered the compliance implications of recent acquisitions and continued our oversight of the Quality Assurance and Regulatory Assurance function.

### Employee Compliance Programme

New employees are trained on our Code of Conduct, which sets out the basic legal and ethical principles for conducting business. A copy of the Code of Conduct can be found on our website at [www.smith-nephew.com](http://www.smith-nephew.com)

Further support is provided through a comprehensive set of tools and resources located on our global intranet platform. These tools and resources are regularly updated.

The Code of Conduct includes our whistle-blower policy, which enables employees and members of the public to contact us anonymously through an independent provider (where allowed by local law). Individuals can also report any concern to their direct manager or a manager in Compliance, Legal or Human Resources. All calls and contacts are investigated and the appropriate action taken, including reports for senior management or the Board, where warranted. As stated in the Code of Conduct, we also enforce our non-retaliation policy with respect to anyone who makes a report in good faith. The Ethics & Compliance Committee is advised of potentially significant improprieties from time to time, and the Company's response.

In 2015, we continued to work to enhance the employee compliance training programme. New employees receive training on our Code of Conduct ( Code ), and we assign annual compliance training to

employees. In 2015, we also introduced, developed and piloted a face to face course for new managers, supplementing the on-line manager certification training.

### Compliance Programme for Third Parties

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 and compliance training. To increase oversight, we have augmented compliance standards and monitoring programmes in 2015.

Our oversight of third party sellers included site assessments to check compliance controls and monitoring visits to review books and records.

We also have controls over other third parties engaged by us to provide services other than selling our products, such as customs, registration and travel agents. We have established a policy and process requiring that managers prioritise

our oversight of third parties and take appropriate steps, including performing a risk assessment, conducting due diligence and assigning training, based on third party type and risk profile.

### Compliance implications around acquisitions

In support of strategic acquisition activity across the Group, we undertake comprehensive due diligence evaluation prior to acquisition and implement compliance integration plans from the point of executing the acquisition. This is to ensure that new businesses are integrated into the Smith & Nephew compliance culture as soon and consistently as possible and that all new employees are immediately made aware of how we do things at Smith & Nephew.

### Oversight of Quality Assurance and Regulatory Assurance Function

In 2014, the Committee assumed responsibility for oversight of the Quality Assurance and Regulatory Affairs Function ( QARA ). Product safety is at the heart of our business and 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. The QARA function carries out work in the area of Quality Management systems in our manufacturing activities.

The Committee approved the QARA Three Year Plan and the QARA Audit Plans for 2015 and 2016. During the year, we reviewed the results of the QARA audits undertaken during the year, approved follow up actions and monitored progress made to address these actions.

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

We also reviewed the results of a Culture of Quality survey undertaken across all employees measuring the culture of quality against four key drivers – employee ownership, peer involvement, message credibility and leadership emphasis.

### **Michael A. Friedman**

Chairman of the Ethics & Compliance Committee



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## Accountability continued

## Dear Shareholder,

It's been a year of positive change for the Audit Committee during 2015. We have welcomed Erik Engstrom and Robin Freestone to the Committee. They both have strong FTSE 100 backgrounds. Robin Freestone was previously a Chief Financial Officer and they provide a fresh perspective to the Committee.

Following the audit tender during 2014 and the appointment of KPMG LLP in April 2015, the Committee oversaw a smooth transition from the former auditor. This process included KPMG LLP shadowing EY LLP through the 31 December 2014 year end audit process, along with attendance at Group Audit Committee meetings before their formal appointment.

We undertook a number of non-routine items during the year, which have provided debate and progression for the Company, including:

Discussion of the risk framework as part of the 2015 Strategy Review. This led to further work, which enabled the completion of the first 2015 Viability Statement. This process was also reviewed by the Audit Committee.

A deeper review of SOx work, in particular in our Emerging Markets, and following the implementation of COSO 2013, which was first applicable in 2014.

The Minimum Acceptable Practices ( MAPs ) were launched in December 2014 and are our minimum control procedures and best practices. They have

This was supplemented by KPMG LLP performing detailed audit planning activities at all the Group's material operating locations throughout the summer and a review of EY LLP audit files at major locations.

This is the first time in Smith & Nephew's history as a listed company that we have changed our audit firm. Bringing in a new firm to conduct our audit has brought fresh energy to the role; risk areas have been reassessed and new questions asked. This has not been without challenge, and has required the Group to invest significantly more resources and time, especially in this first year. However, we are pleased with the way in which the change has been managed and the output of a robust audit.

At our half-year meeting we received a detailed audit plan for the 2015 financial year from KPMG LLP identifying their audit scope, planning materiality and their assessment of key risks. The audit plan for the 2015 financial year provided a different style, with further depth and coverage including 78% of Group's revenue and 95% of adjusted Group profit before tax.

become a standardised process across the Group and additional support has been provided to the team to ensure completion of these by year end.

Monitoring of the Finance Transformation project throughout 2015 to ensure its risks were mitigated and timeline remained on track.

Following the appointment of a new Head of Internal Audit in 2014, the scope and depth of the reviews across the business increased during 2015. This has led to increased oversight by the Audit Committee on issues such as the consequences on the China business and its governance framework of the slow down of the Chinese economy, and internal controls in newly acquired distributors.

Reviewed the development of the process for monitoring the results and performance of acquisitions.

We received a regulatory enquiry during the year. Following explanation from Julie Brown, our Chief Financial Officer and her team, this matter was dealt with to our satisfaction.

**Ian Barlow**

Chairman of the Audit Committee

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AUDIT  
COMMITTEE

CURRENT MEMBERS IN 2015

**Ian Barlow**

Committee Chairman and designated financial expert

**Erik Engstrom (from 1 January 2015)**

Independent Non-Executive Director

**Robin Freestone (from 1 September 2015)**

Independent Non-Executive Director and financial expert.

**Brian Larcombe**

Senior Independent Non-Executive Director

**Joseph Papa**

Independent Non-Executive Director

KEY ACTIVITIES

Undertook independent assessment of the financial affairs of the Company.

Oversaw system of control and risk management throughout the Group.

Undertook detailed work to support the Board's approval of the financial results.

2016 FOCUS

Monitor the roll-out of enhanced SOx controls and MAPs to ensure consistently applied financial controls across the Group, particularly in Emerging Markets.

Continue to develop the process to monitor the results and performance of acquisitions.



### Role of the Audit Committee

Our work falls into the following five 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 2014 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 report any issues arising out of such reviews to the Board.

Reviewing the process undertaken and deep-dive work required to complete the Viability Statement.  
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, where further information can be found for permitted non-audit services.

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**Accountability continued****Activities of the Audit Committee****in 2015 and since the year end**

In 2015, we held five physical meetings and two meeting by telephone. Each meeting was attended by all appointed members of the Committee. The Chairman, the Chief Executive Officer, the Chief Financial Officer, the Head of Internal Audit, the external auditor (both the incumbent and also KPMG from the December 2014 meeting, until formal appointment at the Annual General Meeting on 9 April 2015), 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 2015 was as follows:

**EARLY FEBRUARY****Approval of Preliminary Announcement**

Reviewed the results for the full year 2014 and the preliminary announcement and recommended them for adoption by the Board.

Approved the decision to submit Quarterly Trading Reports instead of full Quarterly Reporting.



Reviewed the effectiveness of financial controls and of the risk management process and concluded they were operating effectively.

Reviewed compliance with UK Corporate Governance and US Corporate Governance.

Received the Internal Audit Report and approved the Internal Audit progress report for 2015.

Received the Quality Assurance Report and approved the Quality Assurance work programme for 2015.

Received the fraud report and reviewed whistle-blowing procedures.

Confirmed the independence of KPMG as external auditor before its formal appointment within professional and regulatory standards, following a rigorous review during the tender process.

Approved EY 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

### **Approval of Financial Statements (by telephone)**

Reviewed and approved the Annual Report and Accounts for 2014, 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 progress for Minimum Acceptable Practices for the Finance function and other control initiatives.

## EARLY APRIL

Private meeting held with the external auditor.

Reviewed the control themes and observations of the external auditor and concluded there was nothing of significance.

Approved the Sustainability Report and its verification process.

Received a corporate governance update for 2015 corporate reporting.

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

Reviewed the Progress Report from Internal Audit which included an update on the status of the 2015 Internal Audit Plan.

## LATE APRIL

### **Approval of Q1 Trading Statement (by telephone)**

Reviewed the Q1 2015 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**

Private meeting with the internal auditor.

Reviewed the results for the first half 2015 and approved the H1 announcement.

Reviewed the Progress Report from Internal Audit which included an update on the status of the 2015 Internal Audit plan.

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

Received the fraud report and reviewed whistle-blowing procedures.

Considered the Company's response to the changing reporting requirements on risk following the implementation of the UK Corporate Governance Code 2014.

Reviewed and approved the external auditor's Integrated Audit Plan for 2015.

Received governance updates on the going concern and viability statements for 2015.

Private meeting with the external auditor.

## OCTOBER

### **Approval of Q3 Trading Statement**

Reviewed the results for Q3 2015 and approved the Q3 Trading Statement.

Reviewed the Progress Reports from the external auditor on Q3 2015 and from Internal Audit on their work.

Approved the process for ensuring the Board could coordinate the risk management programme and conclude that it was effective.

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

DECEMBER

**Review of Functional Reports**

Received and discussed a report on the Finance Transformation project and reports from the Group Treasurer and the Chief Information Officer on IT security risk.

Received an update on SOx testing and Minimum Acceptable Practices.

Received a report from the Internal Audit function focusing on China.

Reviewed the Internal Audit Plan for 2016.

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

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 2015 year end.

Received an update from KPMG on the external audit and preliminary SOx findings.

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Since the year end, we have also reviewed the Annual Report and Accounts for 2015 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 10 to 11, risks and the key performance indicators and their link to the strategy.

**Significant matters related to the financial statements**

We considered the following key areas of judgement in relation to the 2015 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 21% at 31 December 2015 (21% as at 31 December 2014). 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. As disclosed in Note 3 a charge of \$203 million has been recorded in respect of potential liabilities. This arises from the Group's portfolio of modular metal-on-metal hip products. This has resulted in a provision being carried forward of \$185 million as of 31 December 2015. 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. Aside from the developments in relation to metal-on-metal, the other 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 \$74 million included within legal and other provisions in Note 17.1 in 2015 (\$74 million in 2014) 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 \$51m that has been recorded in 2015 the principal component of which related to the Oasis brand. Based on our challenge of the key assumptions we concurred with management that the amount of impairment is appropriate. We have also considered the disclosure surrounding these reviews, and concluded that the review and disclosure were appropriate.

## TAXATION

Provisioning for potential current tax liabilities and the level of deferred tax asset recognition in relation to accumulated tax losses are underpinned by a range of judgements about the future statutory profitability of constituent entities of the Group.

### **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 thereof 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 Colombia and Russia. During 2015 we also considered and concurred with management that there had been no changes to the provisional fair values recognised in the 2014 acquisition of ArthroCare.

## OPERATING SEGMENTS

Following completion of the Group's transition to a new commercial organisational structure on 1 January 2015 the Group is now engaged in a single business activity, being the development, manufacture and sales of medical technology products and services. As the allocation of the Group's resources are determined on a project by project basis by the Chief Operating Decision Maker (being the Commercial Operations team) the Group now has one operating segment.

**Our action**

In applying the requirements of the relevant accounting standard, we have reviewed management's analysis on determining that the Group has one operating segment and agreed with the interpretation. Given the level of judgement involved we have determined that it is appropriate to include this as a significant area of judgement in our report.

We note that within the External Audit report there is a principal risk associated with the timing of revenue recognition and measurement of related reserves as required by auditing standards. We have considered this and have concluded that we have appropriate procedures and controls in place not to include this as a significant area of judgement.

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**Accountability continued****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 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. During 2015, fees paid to KPMG LLP, our external auditor, for non-audit work totalled \$1 million, representing 25% of total audit fees. Full details are shown in Note 3.2 of the Notes to the Group accounts.

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 2015 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 2015 effectively.

#### Appointment of External Auditors at Annual General Meeting

Resolutions will be put to the Annual General Meeting to be held on 14 April 2016 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.

#### Audit and Professional Fees paid to the Auditor

Fees for professional services provided by Ernst & Young LLP and KPMG LLP (appointed from 9 April 2015), the Group's independent auditors in each of the last two fiscal years, in each of the following categories were:

	2015	2014
	\$ million	\$ million
Audit	4	3
Audit-related fees		
Tax		2
Other	1	
Total	5	5

Any pre-approved aggregate, individual amounts up to \$50,000 may be authorised by the Tax Director/Group Financial Controller respectively and amounts up to \$100,000 by the Chief Financial Officer. Any individual amount over \$100,000 must be pre-approved by myself as Chairman of the Audit Committee. If we require additional permitted tax services or any which exceed the amounts approved, again pre-approval by the Chairman of the Audit Committee is required.

#### Internal Audit

Our Internal Audit function reports directly to the Audit Committee and is headed by Jenny Morgan, Senior Vice President Internal Audit. 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

2015 being Emerging Markets, finance transformation, inventory and core financial controls systems.

During the year, they completed 33 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 unremediated and overdue control recommendations and oversee the effective and timely remediation of any recommendations.

Of particular note in 2015 were the Internal Audit reviews conducted in China following the slowdown of the Chinese economy. 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, India, South Korea, Malaysia and Thailand. Internal Audit also performed independent validation reviews of the implementation of the Group's MAPs and programme assurance reviews over the Group's SAP implementation as part of the Finance Transformation.

In 2016, 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

During the year, we reviewed the Financial Reporting Council changes to the UK Corporate Governance Code and considered how these changes would impact our risk management processes and the work that we would need to undertake to enable the Board to make the Viability Statement.

We reviewed our risk management processes at our meetings in February, July and October. These reviews included a report from Deloitte, which recommended a number of suggestions for improving our risk management framework, which we shall be implementing over the next six to 12 months. One of these recommendations is the development of Key Risk Indicators to enable us to track progress in the future. We also considered reviews undertaken by our Internal Audit function into specific risks, such as IT Security and Cyber Risk and received regular reports from the Group Finance function on their findings from reviews with regard to compliance with the Sarbanes

Oxley Act.

Since the year end, we 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 manage those risks and the Board risk appetite in respect of each risk.

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We concluded that the risk management process during 2015 and up to the date of approval of this Annual Report was effective. Work will continue in 2016 and beyond to continue to enhance the process.

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 2015 and up to the date of approval of this Annual Report. No concerns were raised with us in 2015 regarding possible improprieties in matters of financial reporting.

See pages 42 to 48 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 49.

**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 Divisions. The main elements of the internal control framework are:

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

The Group Finance manual sets out, amongst other things, financial and accounting policies and MAPS.

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 managements 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 2015 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 process of internal controls similar to that of the Company.

This process complies with the Financial Reporting Council's Internal Control: Revised Guidance for Directors on the UK corporate governance code and additionally contributes to our compliance with the obligations under the Sarbanes-Oxley Act 2002 and other internal assurance activities.

There has been no change 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 2015 and included the period up to the approval of this Annual Report.

The main elements of this annual review are as follows:

The Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of the design and operation of the Group's disclosure controls and procedures as at 31 December 2015. Based upon this evaluation, the Chief Executive Officer and Chief Financial Officer concluded on 23 February 2016 that the disclosure controls were effective as at 31 December 2015.

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 2015 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 2015, 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 2015. This report appears on pages 106 to 110.

#### 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 2015 or up until 23 February 2016. A copy of the Code of Ethics for Senior Financial Officers can be found on our website at [www.smith-nephew.com](http://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 2015.

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.

#### **Ian Barlow**

Chairman of the Audit Committee

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Remuneration

Dear Shareholder,

2015 was a successful year for the Company where we made both financial and strategic progress. The increase in underlying revenue growth, trading profit margin and adjusted earnings year-on-year reflect management's actions to improve both our commercial performance and operational efficiency. Our performance on the measures we use in our variable pay plans was as follows:

Revenue at \$4,634 million showed underlying growth of 4%, twice that achieved in 2014;

The other change that you will notice, in direct response to feedback from our shareholders, is the retrospective disclosure of financial targets under the Annual Incentive Plan.

In respect of performance during the year, Executive Directors received cash incentive payments ranging from 104% to 112% of target and Equity Incentive Awards ranging from 55% to 65% of salary. The 2013 Performance Share Awards vested slightly above threshold at 33.5% of maximum.

[2013](#) [2015 PSP Awards](#)

Strong trading profit led to an increase of 80bps in trading profit margin;

Trading cash flow was \$936 million with the year trading profit to cash ratio of 85% reflecting a return to stronger cash performance levels;

Revenues from Emerging Markets at \$715 million showed underlying growth of 11% in spite of the significant slow down in China;

Share price improved from 1060p to 1212p during the year.

On these five financial measures, which are reflected in our Annual Incentive Plan and in our Performance Share Plan, the Company performed well in 2015. It is against this backdrop that I should like to present our Remuneration Report for 2015.

### Continued Alignment

Throughout 2015, the Remuneration Committee focused on ensuring continued alignment of our remuneration arrangements with the corporate strategy and performance of the Company. The table overleaf summarises how the measures in our incentive arrangements link to our corporate objectives, which remain unchanged from last year.

### Changes in 2015

During 2015, changes to the remuneration of the Executive Directors were limited to base salary increases of 3% taking effect in April 2015. These were

For over 10 years the Smith & Nephew incentive plans have included a relative Total Shareholder Return (TSR) measure, reflecting investor preferences, UK market practice and the perceived alignment of shareholder and executive interests. Over this time, the level of vesting has ranged from 0% to 88%.

As noted in my introductory comments, the Company delivered excellent TSR to our shareholders over the last three years, with an investment of £100 at the end of 2012 being worth £180 at the end of 2015. This was significantly ahead of broad market indices, both in the UK and the US, against which many of our investors compare the Company. However, against the small select group of medical devices companies in our peer group, the Company's TSR performance was just below median.

A number of factors have contributed to this result including volatility within the peer group, which reduced to just 14 peer companies over the performance period due to acquisitions; exchange rate movements, which can have a significant impact given all but two of the peer companies are US listed; and a reduced correlation between the peer companies and Smith & Nephew in terms of size and geographic exposure.

The Remuneration Committee is of the view that this outcome does not reflect either the corporate performance delivered over the three-year performance period or the strong absolute returns experienced by shareholders. We have therefore taken the highly unusual step of exercising our discretion to permit the TSR element of the 2013 Performance Share Awards to vest at threshold (25% of the shares granted). When combined with the Free Cash Flow achievement, this gives a combined vesting of 33.5% for all participants. Further details of this decision are set out on page 86.

in line with average increases awarded across the rest of the Group. There were no changes to Annual Incentive or Performance Share Plan award levels or measures, although performance targets were updated to reflect expectations going into 2015.



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I wish to assure shareholders that this decision was not taken lightly and the Committee was unanimous in reaching it. We considered many factors and also took the opportunity to seek the views of some of our largest shareholders towards the end of 2015, which was most helpful. Ultimately we have made a decision that we believe to be in the best interests of shareholders, reflecting the corporate performance delivered, while continuing to engage and incentivise the Company's senior management over the longer term.

On page 86 you will see that we have revised and expanded the TSR peer group for the awards to be made in 2016 in an attempt to reduce the risk of this situation arising again in 2019. With the continued consolidation that is expected within our industry over the coming years, this is something that we will consider as part of our review during 2016 which I discuss overleaf.

**Other Matters****Measures in our Variable Pay Plans****FINANCIAL MEASURES IN ANNUAL INCENTIVE PLANS**

Revenue, trading profit, trading cash

**Link to Strategic Priorities**

We need to generate cash in our Established Markets to be able to invest in Emerging Markets, innovation, organic growth and acquisitions in order to continue to grow in the future. Cash flow is therefore important and this in turn is derived from increased revenues and healthy trading profits.

**BUSINESS OBJECTIVES IN ANNUAL INCENTIVE PLANS**

Business process

Other matters we considered in 2015 included the remuneration arrangements for our new Executive Officers Elga Lohler and Matt Stober. We also looked at benchmarking analyses of the remuneration arrangements for our Executive Directors and Executive Officers comparing them against the arrangements in place at other companies for executives undertaking similar roles in comparable organisations.

### Looking Forward

During 2016, we shall be undertaking a thorough review of our remuneration arrangements ahead of the shareholder vote in 2017 on our Remuneration Policy. This review will cover all aspects of our remuneration, including the structure of our incentive arrangements and the measures we use within our incentive plans, the length of vesting and holding periods applicable to our long-term share plan and the competitiveness of our remuneration arrangements in attracting global talent.

The Remuneration Committee remains committed to considering and approving remuneration arrangements which link executive reward to the shareholder experience as far as possible. Thank you for your continued support.

### Joseph Papa

Chairman of the Remuneration Committee

### Link to Strategic Priorities

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 & International Markets, innovation, organic growth and acquisitions.

People

### Link to Strategic Priorities

We need to attract and retain the right people to achieve our strategy through improving our operating model.

Customer

### Link to Strategic Priorities

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

Free cumulative cash flow

### Link to Strategic Priorities

Cash flow from our Established Markets is necessary in order to fund growth in Emerging Markets, innovation, organic growth and acquisitions.

Revenue in Emerging Markets

**Link to Strategic Priorities**

Our long-term strategy depends on our ability to grow in Emerging Markets.

TSR

**Link to Strategic Priorities**

If we execute our strategy successfully, this will lead to an increased return for our shareholders.

**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 80 to 93) 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 14 April 2016. The Implementation Report explains how the remuneration policy was implemented during 2015 and also how it is currently being implemented in 2016. Pages 82 to 86 and 93 have been audited by KPMG LLP, including the tables on pages 87 to 90.

The second part of the Report (pages 94 to 102) is the Directors Remuneration Policy Report (the Policy Report ) which was approved by shareholders at the Annual General Meeting held in 2014. 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 year and will next be put to shareholder vote at the Annual General Meeting to be held in 2017. The level of base salary and benefits paid and performance measures shown in the Policy Report are as at 2014, when the Policy Report was approved by shareholders. Full details of any changes to these details since then, in accordance with the Policy Report are given in the Implementation Report.

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REMUNERATION  
COMMITTEE

CURRENT MEMBERS IN 2015

**Joseph Papa**

Committee Chairman

**Vinita Bali (from 1 April 2015)**

Independent Non-Executive Director

**Virginia Bottomley**

Independent Non-Executive Director

**Robin Freestone (from 1 September 2015)**

Independent Non-Executive Director

**Brian Larcombe**

Senior Independent Non-Executive Director

**Roberto Quarta**

Chairman of the Board

**KEY ACTIVITIES**

Setting the remuneration policy and packages for Executive Directors and Executive Officers.

Approval of all share plans operating throughout the Group.

## 2016 FOCUS

Determination of payouts under cash incentive and long-term incentive plans vesting in 2016.

Determine targets to apply to cash incentive and share plan awards in 2016.

Review the overall structure of our remuneration policies to ensure they still support our business strategy in preparation for putting a new remuneration policy to shareholders at the 2017 AGM.

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 as an advisory vote at the Annual General Meeting to be held on 14 April 2016.

**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.

**FIND IT ON OUR WEBSITE**

**[WWW.SMITH-NEPHEW.COM](http://WWW.SMITH-NEPHEW.COM)**

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**Activities of the Remuneration Committee in 2015 and since the year end**

In 2015, we held five physical meetings and determined three matters by written resolution. Each meeting was attended by all members of the Committee. 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 2015 was as follows:

**EARLY FEBRUARY****Approval of salaries, awards and payouts in 2015**

Noted the financial results for 2014 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 2015.

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 options and share awards granted in 2012 and reviewed the performance of long-term awards granted in 2013 and 2014.

Reviewed benchmark data increases to salaries across the Group and approved salary increases for Executive Directors and Executive Officers with effect from 1 April 2015.

Approved the text of the Remuneration Report.

**LATE FEBRUARY****Final approval of the Remuneration Report (by telephone)**

Approved the final targets for the short-term and long-term incentive plans for 2015.



Approved the final text of the Remuneration Report.

## LATE 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 2013, 2014 and 2015.

Agreed to review the basis for calculation of TSR performance given that a number of companies in the peer group had delisted.

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.

Reviewed and approved the business plan for the Remuneration Committee for 2015.

Approved the termination arrangements for two departing Executive Officers and the remuneration arrangements for a new Executive Officer.

## OCTOBER

Planned the programme of engagement with shareholders on remuneration matters.

Considered the methodology to be used for the benchmarking of base salaries for Executive Directors and Executive Officers.

Reviewed options for addressing the loss of companies from the TSR peer group.

Drafted the Remuneration Report for 2015.

## DECEMBER

### Review of Remuneration Strategy

Reviewed and considered the principles for determining payouts under the long-term plans due to vest in 2016.

Received a report from the Chairman of the Remuneration Committee on recent engagement with shareholders.

Approved the Remuneration Strategy for 2016.

Considered the timetable for the remuneration review to be conducted in 2016.

Reviewed market data for the Executive Directors and Executive Officers prepared in accordance with the agreed methodology.

Further considered the TSR peer group.

Passed written resolutions approving the shareplan treatment for a deceased Senior Executive and the remuneration packages for one new and three promoted Executive Officers.

Since the year end, we have also reviewed the financial results for 2015 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 2016. 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 2013. 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, undertook calculations relating to the PSP performance conditions and supported a review of the TSR peer group. The fees paid to Willis Towers Watson for Remuneration Committee advice during 2015, charged on a time and expense basis was £186,683.31 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.

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Single total figure on remuneration

Executive Directors

Director	Base salary	Payment in lieu of pension	Fixed pay Taxable benefits	Annual variable pay		Hybrid Annual Incentive Plan equity	Long-term variable pay		Total
				Incentive Plan cash	Annual Incentive Plan equity		Performance Share Plan	Share Option Plan	
<b>Olivier Bohuon</b> Appointed 1 April 2011									
2015	\$1,260,594	\$378,178	\$228,698	\$1,419,192	\$825,396	\$1,387,128	\$0	\$5,499,186	
2014	\$1,464,515	\$439,354	\$286,341	\$952,318	\$811,006	\$2,831,587		\$6,785,121	
<b>Julie Brown</b> Appointed 4 February 2013									
2015	\$803,116	\$240,936	\$29,862	\$843,482	\$444,954	\$764,967	\$0	\$3,127,317	
2014	\$840,487	\$252,146	\$38,494	\$470,373	\$465,437			\$2,066,938	

The amounts for 2015 have been converted into US\$ for ease of comparability using the exchange rates of £ to US\$1.5281 and to US\$1.1089, and for the prior years, using exchange rates disclosed in previous years' accounts.

**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 83 to 85 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 1124.69p per share, which was the average price of a share over the last quarter of 2015. The value of the 2012 share awards that vested in 2015 have now been restated with the share price on the date of actual vesting being 1128.7948p per share on 9 March 2015. The value of the 2013 Share Awards that will vest in March 2016 are calculated in the table by using the Q4 average share price of 1124.69 pence per share.

**Other Items in the Nature of Remuneration:** could also include All-Employee Share Plans and One-Off Awards.

**Total:** the sum of the above elements.

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**Base salary**

With effect from 1 April in each year, Executive Directors were paid the following base salaries, reflecting an increase of 3%:

	2014	2015
Olivier Bohuon	1,111,782	1,145,135
Julie Brown	£514,000	£529,420

In February 2016, 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%. The Remuneration Committee has therefore agreed that the Executive Directors' base salaries will increase by 3% with effect from 1 April 2016 to the following:

Olivier Bohuon	1,179,490
Julie Brown	£545,303

**Payment in lieu of pension**

In 2015, 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 2016.

**Benefits**

In 2015, 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 2016. The following table summarises the value of benefits on an element-by-element basis in respect of 2014 and 2015.

Olivier Bohuon

Julie Brown

	2014	2015	2014	2015
Health Cover	£20,642	£15,040	£1,144	£1,144
Car and fuel allowance	18,751	21,344	£14,640	£14,640
Financial consultancy advice	£24,053	£95,052	£7,597	£3,758
Travel costs	101,926			
Subscriptions	£28,537	£20,961	£0	£0
	£3,473	£3,120	£0	£0

#### Annual Incentive Plan 2015

During 2015, 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 2015 were revenue, trading profit and trading cash. For each of these measures, the Committee determined threshold, target and maximum performance in February 2015. In February 2016, 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 <sup>1</sup>
Revenue	\$4,572m	\$4,713m	\$4,854m	\$4,686m
Trading profit	\$1,071m	\$1,104m	\$1,137m	\$1,102m
Trading cash	\$815m	\$906m	\$997m	\$915m

<sup>1</sup> At constant exchange rates. See page 177.

This resulted in an achievement level of 67 out of a target of 70 in respect of the financial objectives.

	Weight	Award % of target	Award % of salary
Revenue <sup>1</sup>	30%	90%	27%
Trading profit <sup>1</sup>	30%	97%	29%
Trading cash <sup>1</sup>	10%	110%	11%
		Total	67%

<sup>1</sup> At constant exchange rates. See page 177.

Accordingly, the following amounts have been earned by the Executive Directors in respect of their financial objectives.

Olivier Bohuon	764,510
Julie Brown	£ 353,449

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**The Implementation Report continued****Business Objectives**

The business objectives on which performance was assessed in 2015 were business process, people and customer. For each of these measures, the Committee determined the level of expected performance in February 2015. In February 2016, the Committee reviewed performance against each of these objectives as explained in the table below. As a result of this review, the Committee determined that 45% of the target award made to Oliver Bohuon would vest in respect of these business objectives and 37.5% of the target award made to Julie Brown would vest.

BUSINESS PROCESS	
Olivier Bohuon	Julie Brown
Strengthened leadership team to deliver strong commercial performance including turnaround in AWM and Europe.	Delivered Group Optimisation programme ahead of plan, with \$100 million of annualised benefits at year end contributing to trading profit margin improvement.
Improved efficiency and agility through Group Optimisation programme, including establishing Global Business Services.	Further tax improvement, with a 90bps reduction year-on-year in the tax rate on trading results.

<p>Centralised commercial execution under Chief Commercial Officer to drive commercial excellence.</p>	<p>Improved trading profit to cash conversion ratio.</p>
<p>Strengthened platform through distributor acquisitions in Russia and Colombia.</p>	<p>Shielded Group from transactional currency impact through hedging strategy.</p>
<p><b>PEOPLE</b></p>	
<p>Olivier Bohuon</p>	<p>Julie Brown</p>
<p>Continued to drive significant change across the Company to focus on new business, growth and efficiency with strong results.</p>	<p>Embedded finance transformation programme through the continued simplification of financial processes, system and tools.</p>
<p>Strong leadership and communication to all employees to drive strategic alignment and performance focus.</p>	<p>Standardised and improved financial controls and processes across operating entities Group-wide through introduction of minimum acceptable practices (MAPs).</p>
<p>Refined leadership structure, including centralising commercial execution under Chief Commercial Officer to drive excellence.</p>	<p>Improved employee development and engagement across Finance with significant moves made to develop top talent, leading training and capability development for Finance business partners and across the finance function, with finance training across the business overall.</p>
<p>Extended Single Managing Director model to the US, completing global roll-out.</p>	
<p>Established leadership forum for new managing directors.</p>	
<p>Invested directly in talent development across the Company through CEO Forum and CEO Awards.</p>	
<p>Contributed to the roll-out of Great Place to Work accreditation, now achieved in Spain and Italy.</p>	
<p><b>CUSTOMER</b></p>	
<p>Olivier Bohuon</p>	<p>Julie Brown</p>



<p>Integrated ArthroCare acquisition to strengthen Sports Medicine portfolio, on-track to deliver expected synergies.</p>	<p>Represented the Group with investors and financial analysts at one-to-one meetings and industry conferences in the UK and abroad, receiving strong positive feedback.</p>
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<p>Widened access to products through continued strong Emerging Markets growth despite China slow-down.</p>	<p>Delivered improved insight into the profitability by market and customer, facilitating improved resource allocation and margin improvement.</p>
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Continued to build innovative ways to anticipate customers changing need (e.g. Syncera).

Developed mid-tier product portfolio including acquiring trauma manufacturing in Russia.

Maintained R&D investment, strong product pipeline for 2016, improved focus through creation of R&D global function.

Acquired Blue Belt Technologies establishing strong position in robotics.

Olivier Bohuon level of award

Julie Brown level of award

515,310 representing 45% out of the 30% target award subject to business objectives.

£198,532 representing 37.5% out of the 30% target award subject to business objectives.

The Remuneration Committee also considered whether to apply the +/- 10 multiplier to the annual incentive assessment of Olivier Bohuon and Julie Brown and agreed that no multiplier was appropriate in respect of 2015.

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In summary, as a result of the financial performance described on page 83 and the performance described in the table on page 84, the Remuneration Committee determined that the following awards be made under the Annual Incentive Plan in respect of performance in 2015:

Executive Director	Cash Component		Equity Component	
	% of salary	Amount	% of salary	Amount
Olivier Bohuon	112	1,279,820	65	744,388
Julie Brown	104	£551,981	55	£291,181

These figures are converted into dollars and included under Annual Incentive Plan (cash) and (equity) in the single figure table on page 82.

As a result of the 2015 performance assessment for both Olivier Bohuon and Julie Brown, the first tranche of the Equity Incentive Award made in 2015, the second tranche of the Equity Incentive Award made in 2014 and the third tranche of the Equity Incentive Award made in 2013 (to Olivier Bohuon only) will vest.

**Annual Incentive Plan 2016**

The Remuneration Committee has also reviewed the Annual Incentive Plan arrangements for 2016 and has determined that the following performance measures and weightings will apply to the financial and business objectives in 2016:

Financial Objectives	70%
Revenue	30%
Trading profit	30%
Trading cash	10%
	30%

## Business Objectives

Business process 10%

People 10%

Customer 10%

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 however will 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 2016. Threshold and Maximum are set at +/- 3% from the target for revenue, at +/- 5% for the trading profit measure and at +/- 10% for the cash flow measure.

### Details of awards made under the Equity Incentive Programme during 2015

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 2014 performance (awarded in 2015) 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 9 March 2015	38,545	1/3 on 9 March 2016 1/3 on 9 March 2017 1/3 on 9 March 2018
Julie Brown 9 March 2015	24,711	1/3 on 9 March 2016 1/3 on 9 March 2017 1/3 on 9 March 2018

The precise awards granted in 2016 in respect of service in 2015 will be announced when the awards are made and will be disclosed in the 2016 Annual Report.

### Performance Share Programme 2015 grants

Performance share awards in 2015 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 2015 and will vest subject to performance and continued employment in 2018. 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. 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 \$1.578bn	Nil
\$1.578bn	23.75%
\$1.814bn	47.5%
\$2.050bn or more	95%

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

Revenue in Emerging Markets is defined as cumulative revenue over a three-year period opening 1 January 2015 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 2015 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 2015 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, Medtronic, NuVasive,

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Orthofix, Stryker, St Jude Medical, Wright Medical and Zimmer. Nobel Biocare and Covidien were also part of this peer group when the awards were made, but have since delisted following acquisitions.

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 2016**

Performance share awards will be made in 2016 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 commencing 1 January 2016 and will vest subject to performance and continued employment in 2019. Vesting will be subject to the same three performance measures as applies to the awards made in 2015.

50% of the award will vest subject to cumulative free cash flow performance, 25% to revenue in Emerging Markets and 25% to relative TSR.

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%

25% of the award will vest subject to revenue in Emerging Markets.

As was the case with the awards in 2015, the precise targets for revenue growth in the Emerging Markets are commercially sensitive and will be disclosed on vesting in the 2019 Annual Report.

Target is set at target cumulative revenues from Emerging Markets in the corporate plan approved by the Board for the three years commencing 1 January 2016. Threshold and Maximum are set at +/- 15% from target.

In response to the industry dynamics, the Committee undertook a review of the peer group to be used for the 25% of the awards subject to TSR, having used the same group for a number of years. The Committee considered a combination of factors focused on comparability to Smith & Nephew, in particular absolute size, industry and geographic presence. As a result, six new companies (Essilor International SA, Getinge AB, GN Store Nord A/S, Shire plc, Sonova Holding AG and William Demant) will be added to the peer group for awards made in 2016, with three companies removed (NuVasive, Orthofix and Wright Medical). These changes seek to ensure the peer group remains more robust over the next three years in the face of inevitable consolidation, while focusing on those companies more similar to Smith & Nephew. As part of the broader policy review for 2017, the Committee will undertake a holistic review of the remuneration programmes more generally.

The peer group for the purpose of calculating relative TSR performance will consist of 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.

### Vesting of Awards made in 2013

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 2013. Vesting of the conditional awards made in 2012 was subject to performance conditions based on TSR and cumulative free cash flow measured over a three-year period commencing 1 January 2013.

50% of the award was based on the Company's TSR relative to a bespoke group of 18 medical devices companies. Our industry is one that is fast-paced and highly-evolving, and this was reflected in further consolidation during the performance period with three of the peer companies delisting due to merger and acquisition activity. This resulted in the peer group reducing to just 15 companies, meaning that relatively small differences in TSR have a significant impact on the level of vesting.

Over the three years ending 31 December 2015, the Company delivered a return of 80%, meaning an investment of £100 would now be worth £180, outperforming both the FTSE 100 (£120) and S&P 500 (\$154 on an investment of

\$100). Against the peer group however, the Company ranked 10th, just below median.

In light of the strong absolute performance and returns delivered to shareholders coupled with the industry context, the Committee was concerned about the outcome and resolved to undertake a comprehensive review. The Committee is aware of shareholder sensitivity around the use of discretion. At the same time, the Committee recognises the importance of discretion in seeking to ensure any payments, or lack thereof, under our incentive plans align with business performance and the shareholder experience. Having spoken with some of our larger shareholders in December to obtain their views on this matter, the following points were considered:

TSR was clustered around median, and the Company's TSR was just 8.5 percentage points below median, the threshold requirement for vesting.

The majority of companies in the 2013 peer group are listed in the US. By calculating TSR in common currency, the outcome is distorted both by the relative performance of the US Dollar and Sterling, but also the relative performance of the markets more generally, as evidenced by the FTSE 100 and S&P 500 data illustrated on the next page. Neither of these items are within the control of management. On a local (also referred to as constant) currency basis, the Company ranked at median.

The Company significantly out-performed broader market indices. Against the FTSE 100, an index of particular interest to many of our investors, the Company ranked above the upper quartile.

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In addition, the Committee took account of the Plan Rules which provide for the replacement of delisted companies with substitutes as the alternative to automatic exclusion. While the use of substitutes is uncommon in the market and some of our shareholders interpreted this to be a retrospective change, concerned by industry consolidation and reduction of the peer group from 18 to 15, the Committee resolved to consider the outcome under this approach. While the Company remained below median, the gap in TSR between the Company and the peer group median reduced to 1.7%.

On balance, the Committee determined that the default outcome under the plan did not reflect the corporate performance delivered over the three-year performance period, nor the shareholder experience of absolute returns exceeding 70%. Applying the discretion permitted to the Committee under the Plan Rules and Remuneration Policy, it was concluded that the element of the awards subject to TSR performance would be deemed to vest at threshold (25%). The Committee recognised that the use of discretion was not something to be taken lightly, but after much debate felt that this was appropriate and fair in the circumstances.

This part of the award therefore vested at 25%.

50% of the award was based on cumulative free cash flow performance. The target set in 2013 was \$1,780 billion. Over the three-year period, the adjusted cumulative cash free cash flow was \$1,703 billion. 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 hold, the Capex plan and metal-on-metal settlements. This part of the award therefore vested at 42%.

Overall therefore, the conditional awards made in 2013 will vest at 33.5% of maximum on 7 March 2016 as follows:

Director	Date of grant	Number of shares under award at maximum	Number vesting
Olivier Bohuon	7 March 2013	240,928	80,710
Julie Brown	7 March 2013	132,866	44,510

### Summary of scheme interests awarded during the financial year

Basis on which award is made	Number of shares	Olivier Bohuon		Julie Brown	
		Face value	Number of shares	Face value	Number of shares



Annual Equity Incentive Award (see page 85)	38,545	611,480	24,711	£282,700
Performance Share Award at maximum (see page 85)	133,156	2,112,386	85,366	£976,600
190% base salary at maximum				

Please see Policy Table on pages 96 to 97 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 9 March 2015 was 1144p.

Details of awards made under the Performance Share Programme

Details of conditional awards over shares granted to Executive Directors subject to performance conditions are shown on the next page. These awards were granted under the Global Share Plan 2010. The performance conditions and performance periods applying to these awards are detailed on page 85.

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	Number of ordinary shares		
	Date granted	under award at maximum	Date of vesting
Olivier Bohuon	7 March 2013 <sup>1</sup>	240,928	7 March 2016
	7 March 2014	180,304	7 March 2017
	9 March 2015	133,156	9 March 2018
Julie Brown	7 March 2013 <sup>1</sup>	132,866	7 March 2016

7 March 2014 100,688 7 March 2017

9 March 2015 85,366 9 March 2018

1 On 2 February 2016, 67% of the award granted at maximum to Olivier Bohuon and Julie Brown lapsed following completion of the performance period.

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.

Director	Date granted	Number of shares under option	Date of vesting	Exercise period	Option price
Brown	17 September 2013	2,400 ordinary shares	1 November 2018	1 November 2018 to 30 April 2019	£

### Single total figure on remuneration

### Chairman and Non-Executive Directors

#### Senior Independent Director/

Director	Basic annual fee <sup>1</sup>		Committee fee		Intercontinental travel fee		Total	
	2014	2015	2014	2015	2014	2015	2014	2015
Roberto Quarta	£334,673	£400,000	N/A	N/A	£7,000	£3,500	£341,673	£403,500
Vinita Bali	£5,250	£63,000	N/A	N/A	£3,500	£17,500	£8,750	£80,500
		\$6000						\$6000
Ian Barlow	£66,150	£66,150	£15,000	£15,000	£7,000	£3,500	£88,150	£84,650
Virginia Bottomley	£66,150	£66,150	N/A	N/A	£7,000	£3,500	£73,150	£69,650
Erik Engstrom <sup>2</sup>	N/A	£66,150	N/A	N/A	N/A	£3,500	N/A	£69,650
Robin Freestone <sup>3</sup>	N/A	£21,000	N/A	N/A	N/A	£3,500	N/A	£24,500
Michael Friedman	\$126,000	\$126,000	\$11,250	\$27,000	\$35,000	\$42,000	\$172,250	\$195,000

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Brian Larcombe	£66,150	£66,150	£10,865	£15,000	£7,000	£3,500	£84,015	£84,650
Joseph Papa	\$126,000	\$126,000	\$27,000	\$27,000	\$35,000	\$35,000	\$188,000	\$188,000

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 101.

2 Appointed to the Board on 1 January 2015.

3 Appointed to the Board on 1 September 2015.

**Chairman and Non-Executive Director Fees**

The fees paid to the Chairman and the Non-Executive Directors remained unchanged in 2015. 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, 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.

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**Chief Executive Officer's remuneration compared to employees generally**

The percentage change in the remuneration of the Chief Executive Officer between 2014 and 2015 compared to that of employees generally is as follows:

	Base salary	Benefits	Annual cash bonus
	% change 2015	% change 2015	% change 2015
Chief Executive Officer	3	4.5	78
Average for all employees	5	N/A	N/A

The average cost of wages and salaries for employees generally decreased by 11.6% in 2015 (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 2015.

**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 99 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 in 2015. He is also a Non-Executive Director of Shire Plc and received £66,491 in respect of this appointment in 2015. Julie Brown is nominated for election as a new member of the Board of Directors of Roche Holding Ltd at the Annual General Meeting on 1 March 2016, for which she will receive a fee.

Directors' interests in ordinary shares

Beneficial interests of the Executive Directors in the ordinary shares of the Company are as follows:

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	1 January 2015	31 December 2015	Olivier Bohuon 23 February 2016 <sup>1</sup>	1 January 2015	31 December 2015	23
Ordinary shares	210,974	338,183	338,183 <sup>3</sup>	25,000	42,945	
Share options	0	0	0	2,400	2,400	
Performance share awards <sup>2</sup>	688,536	554,388	474,880	233,554	318,920	
Equity Incentive awards	147,114	107,142	107,142	26,497	42,377	
Other awards	0	0	0	50,000	25,000	

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 83 to 84.

3 The ordinary shares held by Olivier Bohuon on 23 February 2016 represent 435.2% of his base annual salary.

4 The ordinary shares held by Julie Brown on 23 February 2016 represent 122.2% of her base annual salary.

5 This option was granted under the Smith & Nephew ShareSave Plan (2012).

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.

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Beneficial interests of the Chairman and Non-Executive Directors in the ordinary shares of the Company are as follows:

Director	1 January 2015 (or date of appointment) if later	31 December 2015 (or date of retirement if earlier)	23 February 2016 <sup>1</sup>	Shareholding as % of annual fee <sup>2</sup>
Roberto Quarta	15,136	19,765	19,765	56.9%
Vinita Bali <sup>3</sup>	0	6,186	6,186	108.2%
Ian Barlow	18,403	18,556	18,556	323.2%
Virginia Bottomley	18,056	18,219	18,219	317.3%
Erik Engstrom	15,000	15,140	15,140	263.7%
Robin Freestone	0	15,000	15,000	261.2%
Michael Friedman <sup>3</sup>	8,822	9,014	9,014	116.5%
Brian Larcombe	40,368	40,508	40,508	705.4%
Joseph Papa <sup>3</sup>	12,997	13,197	13,197	170.5%

- 1 The latest practicable date for this Annual Report.
- 2 Calculated using the closing share price of 1152p per ordinary share and \$32.57 per ADS on 23 February 2016, and an exchange rate of £1/\$1.4078.
- 3 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 2015 and 2014 on remuneration, the attributable profit for each year and the dividends declared and paid in each year.

	For the year to 31 December 2015	For the year to 31 December 2014	% change
Attributable profit for the year	\$410m	\$501m	-18.2%
Dividends paid during the year	\$272m	\$250m	8.8%
Share buyback <sup>1</sup>	\$77m	\$75m	2.7%
Total Group spend on remuneration	\$1,193m	\$1,237m	3.6%

- 1 Share buy-back programme ceased during 2014 following the acquisition of Arthrocare. Shares are bought in the market in respect of shares issued as part of the executive and employee share plans. See Note 19.2 for further information.



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**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.

**Seven-year Total Shareholder Return**

(measured in UK Sterling, based on monthly spot values)

However, as we compare the Company's performance to a tailored sector peer group of medical devices companies (see page 88), 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.

**Seven-year Total Shareholder Return**

(measured in US Dollars, based on monthly spot values)

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Table of historic data

The following table details information about the pay of the Chief Executive Officer in the previous seven years:

Year	Chief Executive Officer	Single figure of total remuneration \$	Annual Cash Incentive payout against maximum %	Long-term incentive vesting rates against maximum opportunity	
				Performance shares %	Options %
2015	Olivier Bohuon	\$5,499,186	75 <sup>5</sup>	33.5	N/A
2014	Olivier Bohuon	\$6,785,121 <sup>4</sup>	43 <sup>6</sup>	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 <sup>1,3</sup>	\$7,442,191	68	N/A	N/A
2011	David Illingworth <sup>2</sup>	\$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 Resigned as Chief Executive Officer on 1 April 2011.

- 3 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.
- 4 Prior years are restated to reflect amounts not known at the date of signing the previous Annual Report.
- 5 Calculated as 112% (actual payout) disclosed on page 85 divided by the maximum potential payout of 150%.
- 6 This has been restated such that it is calculated consistently to the amounts disclosed in the current year.

#### Implementation of remuneration policy in 2016

The Remuneration Committee proposes to make no changes to the way that the remuneration policy is implemented in 2016 from how it was implemented in 2015, other than increasing base salaries in line with salary increases across the Group, as explained on pages 83 and 88 and setting new targets for the Annual Incentive Plan and the Performance Share Programme, as explained on page 86.

#### Statement of voting at Annual General Meeting held in 2015

At the Annual General Meeting held on 9 April 2015, 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	533,724,308	92.09	45,839,876	7.91	579,564,184	18,275,546

Joseph Papa, Chairman of the Remuneration Committee has met with a number of shareholders in previous years to discuss remuneration matters. In December 2015, he met with shareholders holding around 18.4% of the Company's shares to discuss the following issues:

Previously, the Board felt that the disclosure of the financial targets used in our Annual Incentive Plan would be commercially sensitive. However, following discussions with shareholders, we agreed to look at ways of disclosing these targets retrospectively without causing us commercial concerns. The financial targets we used in our Annual Incentive Plan for 2015 are therefore disclosed on page 83.

We also discussed with shareholders whether the vesting period relating to our long-term share plans should be extended from three to five years, by requiring Directors to retain and hold vested shares for a two-year period after vesting. Whilst this is exactly what our Executive Directors do, out of choice, this is not something that is currently a condition of the Performance Share Awards. The Committee has considered this further and have agreed that this is a matter, which we would prefer to address in the context of a full review of our remuneration policy, which we shall be undertaking during 2016 ahead of putting the remuneration policy to shareholders for approval in 2017.

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**Other remuneration matters**

## Senior Management remuneration

The Group's administrative, supervisory and management body (the 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 54 to 56.

Compensation paid to Senior Management in respect of 2015, 2014 and 2013 was as follows:

	2013	2014	2015
Total compensation (excluding pension emoluments, but including cash payments under the performance-related incentive plans)	\$14,186,000	\$12,725,000	\$13,971,000
Total compensation for loss of office	\$0	\$2,664,000	0
Aggregate increase in accrued pension scheme benefits	\$257,000	\$16,000	0

Aggregate amounts provided for under supplementary schemes \$414,000 \$507,000 \$698,000  
 As at 23 February 2016, the Senior Management owned 528,367 shares and 56,970 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 23 February 2016 by members of Senior Management are as follows:

	Share awards granted during the year	Total share awards held as at 23 February 2016
--	--------------------------------------	--

Equity Incentive awards	198,497	332,925
Performance Share awards	508,650	1,271,834
Conditional share awards under the Global Share Plan 2010	9,115	38,514
Options under Employee ShareSave plans	2,675	8,940
Options under the Global Share Plan 2010 Dilution headroom	0	110,193

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 (2006 to 2015), the number of new shares issued under our share plans has been as follows:

All-employee share plans	7,530,287 (0.84% of issued share capital as at 23 February 2016)
Discretionary share plans	36,408,270(4.07% of issued share capital as at 23 February 2016)

By order of the Board, on 24 February 2016

**Joseph Papa**

Chairman of the Remuneration Committee

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**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:

**How the component supports the short- and long-term strategy of the Company**

**How the component operates**

<b>BASE SALARY AND BENEFITS</b>
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 Emerging Markets 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.

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 market in which the Executive is based.

#### 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.

Current Executive Directors receive an allowance in lieu of membership of a Company-run pension scheme.

Base salary is the only component of remuneration that is pensionable.

#### 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.



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 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.

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.

## 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.

ShareSave Plans are operated in the UK and 27 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.

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**Maximum levels of payment****Framework in which performance is assessed**

The base salary of the Executive Directors with effect from 1 April 2014 will be as follows:

Olivier Bohuon 1,111,782

Julie Brown £514,000

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 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 should higher increases be approved in exceptional cases.

Up to 30% of base salary.

The level of payment in lieu of a pension paid to Executive Directors is not dependent on

performance.

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 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.

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.

As an indication, the cost of such benefits provided in 2013 was as follows:

Olivier Bohuon 80,705

Julie Brown £14,400

The maximum amount payable in benefits to an Executive Director, in normal circumstances, will not be significantly more than amounts paid in 2013 (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.

Executive Directors may currently invest up to £250 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.



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**Future policy table**

Executive Directors continued

**How the component supports the short- and long-term strategy of the Company**

**How the component operates**

<b>ANNUAL INCENTIVES</b>
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 and cash flow underlie our strategy for growth and the need to generate cash to fund future 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.

For example, a Reinvestment objective links to the priority of improving the efficiency of the business model and investment in higher growth segments and geographies and Processes and People objectives link to developing the right organisation.

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 cash component is paid in full after the end of the performance year.

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.

#### 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.

The equity award component comprises conditional share awards (made at the time of the cash award), with vesting phased over the following three years.

The equity component vests 1/3, 1/3, 1/3 on successive award anniversaries, only if performance remains satisfactory over each of these three years; otherwise the award will lapse.

Participants will receive an additional number of shares equivalent to the amount of dividend payable per vested share during the relevant performance period.

#### 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.

Our strategy requires the generation of cash in order to invest for growth. Cash flow is therefore a key performance measure in our performance share plan.

Growth in our Emerging & International Markets is a key part of our strategy. Revenue in our Emerging & International Markets is therefore included as one of our performance share plan measures.

If our strategy succeeds, the total return to our shareholders will also increase and therefore we include a relative TSR measure in our long-term share plan.

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.

Awards may be subject to clawback in the event of material financial misstatement or misconduct.

Participants will receive an additional number of shares equivalent to the amount of dividend payable per vested share during the relevant performance period.

## ONE-OFF SHARE AWARDS

In order to implement our Group strategy, we recognise that it is not always possible to promote from within the Company. In the event that we recruit an Executive Director who is currently employed by another company, we recognise that we might be required to compensate that Executive Director for cash or share awards, they may forfeit on leaving their former employer. Our policy regarding such awards is detailed in the notes.

One-off share awards may be made under the provisions of Listing Rule 9.4.2 to facilitate the appointment of a new Executive Director. Such awards will be made on a case-by-case basis depending on the circumstances at the time to take account of amounts forfeited elsewhere on accepting appointment.

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**Maximum levels of payment****Framework in which performance is assessed**

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.

50% salary awarded for threshold performance.

70% of the cash component is based on financial performance measures, which currently include revenue, trading profit and trading cash. The Remuneration Committee retains the discretion to adopt any financial performance measure that is relevant to the Company.

100% salary awarded for target performance.

150% salary awarded for maximum performance.

30% of the cash component is based on other business goals linked to the Company's strategy, which could include financial and non-financial measures.

Performance assessed against individual objectives and Group financial targets.

The Remuneration Committee has the discretion to apply a multiplier, adjusting the outcome up or down by 10% to reward or penalise conduct in respect of leadership, corporate reputation, ethics, organisational behaviours and representing the Company both internally and externally.



The maximum opportunity shown to the left cannot be exceeded through the application of the multiplier.

0% of salary awarded for performance below target.

The Remuneration Committee will use their judgement of the individual's performance in determining the level of equity award that may be awarded within the range of 50% to 65% of salary.

50% of salary awarded for target performance.

65% of salary awarded for maximum performance.

The equity component will vest in three equal tranches over a three-year period, provided that the annual performance conditions set at the beginning of each year continue to be met.

Performance assessed against individual performance which includes an element of Group financial targets.

Annual awards:

Currently:

47.5% of salary for threshold performance.

50% of the award vests on achievement of a three-year cumulative free cash flow target.

95% of salary for target performance.

25% of the award vests subject to three-year Total Shareholder Return (TSR) at median performance relative to industry peers.

190% of salary for maximum performance.

25% of the award vests subject to the achievement of revenue targets in Emerging & International Markets.

These measures are described in more detail in the notes and the targets and performance against them will be disclosed in the Implementation Report if appropriate.

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 2014 were subject to TSR and cash flow targets.

Each award will be determined on a case-by-case basis. In normal circumstances such awards will be no more beneficial than the value of amounts forfeited by the Executive Director on leaving a previous company to join the Board.

The Remuneration Committee has the discretion to apply performance conditions to one-off awards if appropriate. However, if it is impossible to replicate the vesting conditions applicable to awards granted by other companies, awards may be made without performance conditions.

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**The Policy Report continued****Notes to Future policy table****Executive Directors****Changes to remuneration policy**

The remuneration policy described in the future policy table – Executive Directors is the same remuneration policy in respect of Executive Directors that has been in force since the beginning of 2012. It is anticipated that this policy will apply at least until the Annual General Meeting in 2017. The only changes made have been to introduce a third performance measure to our Performance Share Programme and to increase the maximum monthly contribution under the UK ShareSave Plan to £500 in line with the maximum permitted by HM Customs & Excise.

**Performance measures – Annual Incentive Plan**

The performance measures which apply to the Annual Incentive Plan for Executive Directors comprise 70% financial measures and 30% business goals linked to the Company's strategy, which could include financial and non-financial measures.

The financial measures may differ from year to year to provide continued alignment with the Company strategy. Measures to be used in 2014 are detailed in the Implementation Report. Each year the measures are chosen in order to relate to our Strategic Priorities and in turn to our key performance indicators, which are set out in this Annual Report. The performance targets are set by taking into account the strategy of the Company and are designed to be realistic yet stretching.

The business measures will differ from year to year as the evolving corporate strategy means that we will wish to set Executive Directors different business objectives in order to meet the current corporate needs. The business objectives are personal to each Executive Director, and are tailored to reflect their role and responsibilities during the year. These are set at the start of the year and reflect the most important areas of strategic focus for the Company. The Remuneration Committee sets annual measurement criteria (performance targets) that are appropriate to motivate and measure an Executive Director's performance in any one year. The factors taken into consideration include the three-year strategic plan, prior years' delivered performance and budgeted performance. In the past, measures have included R&D investment, succession planning, employee engagement, compliance, development of product portfolio, M&A activity and shared services implementation.

Performance measures – Performance Share Programme

The performance measures which apply to the Performance Share Programme awards made in 2014 relate to cumulative free cash flow, revenue in Emerging & International Markets and Total Shareholder Return. We have chosen three measures which are relevant for the long-term success of the Company.

The free cash flow measure is important for us in a period of growth, when we need to generate cash to fund both organic and inorganic investment.

Revenue in Emerging & International Markets is important for us when we are seeking to generate profitable revenue in new markets and from new products.

The Total Shareholder Return measure, which compares our long-term performance against that of our peers, seeks to align the payout of the Performance Share Programme with the experience of our shareholders. This helps Executive Directors relate to the shareholder experience and ensure that vesting is aligned to the out-performance of our sector.

The Remuneration Committee will keep these performance measures under review and retains the discretion to alter the measures or their respective weightings to ensure continuing alignment to the corporate strategy.

#### 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 division 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.



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**Illustrations of the application of the remuneration policy**

The following charts show the potential split between the different elements of the Executive Directors' remuneration under three different performance scenarios:

Figures as at salary levels in 2014, when the Policy Report was approved by shareholders

**TOTAL REMUNERATION BY PERFORMANCE SCENARIO FOR 2014 FINANCIAL YEAR**

Data for the Chief Executive Officer assumes an exchange rate of 1 = £0.8494.

**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, 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 discretion in setting 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 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.

### 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 and 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.

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**The Policy Report continued****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.

#### 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. Executive Directors are therefore expected to build up a holding of Smith & Nephew shares worth two times their base salary. In order to reinforce this expectation, we require them to retain 50% of all shares vesting under the Company share plans (after tax) 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 and the intrinsic value of any vested but unexercised options.

#### Statement of consideration of employment conditions elsewhere in the Company and differences to the Executive Director Policy

All employees across the Group including the Executive Directors are incentivised in a similar manner. Although the salary levels and maximum opportunities under bonus and share plans differ, generally speaking the same targets and performance conditions relating to the Company's strategy apply throughout the organisation.

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 divisional 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 (72 as at 2014) 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 2014, over 4,500 employees in 32 countries participate in one or more of our global share plans.

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**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.

**How the component supports the short-****and long-term strategy of the Company****How the component operates****Maximum levels of payment****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.

Fees will be reviewed periodically. In future, any increase will be paid in shares until 25% of the total fee is paid in shares.

Annual fees are currently as follows:

£63,000 in cash plus £3,150 in shares; or

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 interest of shareholders.

Fees are set in line with market practice for fees paid by similarly sized UK listed companies.

\$120,000 in cash plus \$6,000 in shares.

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.

Chairman fee:

£400,000 plus £20,000 in shares (to April 2014).

£300,000 plus £100,000 in shares (from April 2014).

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.

A fixed fee is paid, which is reviewed periodically.

£15,000 in cash; or

\$27,000 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.	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.

Figures as at fee levels in 2014, when the Policy Report was approved by shareholders.

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[Non-Executive Directors](#)

Changes to remuneration policy

The Board has altered the policy regarding the payment of Non-Executive Directors and to the Chairman in one respect in 2013, by introducing the payment of a proportion of the fees in the form of shares. The fees paid to the Non-Executive Directors and to the Chairman were reviewed in July 2013 and it was agreed that the basic fee should be increased by 5% (there having been no increase to these fees since August 2011) and that the increase be paid in the form of shares. The amount of the increase less applicable taxes was used to purchase shares in the market on 15 August 2013. Going forward, any increase in the level of fees paid to a Non-Executive Director will be paid in the form of shares until 25% of the Non-Executive Director's fee is paid in the form of shares. We have made this change in order to align the fees paid to Non-Executive Directors with the experience of our shareholders. With the appointment of Roberto Quarta as Chairman of the Company with effect from the Annual General Meeting, we have taken the opportunity to pay 25% of his fees in the form of shares immediately.

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

This Policy Report sets out the remuneration policy in relation to Executive Directors, which has been in place since 2012. As this policy evolved at the end of 2011 and during 2012, we engaged actively with shareholders to explain our remuneration arrangements and to discuss their views on our proposals. At the time, Joseph Papa, the Chairman of the Remuneration Committee and members of the Senior Executive Team met with the holders of around 30% of our shares, including collectively with a number of smaller engaged investors, as well as shareholder advisory bodies. We discussed the structure of our remuneration package, our policies on termination, recruitment, shareholding requirements and the operation of Annual Incentive Plan. The Directors' Remuneration Report was approved by 96% of shareholders who voted at the Annual General Meeting in 2013 and we received feedback from shareholders around the time of this meeting that they understood and approved of our remuneration arrangements. Although the remuneration policy has remained essentially unchanged as in previous years, given the changes in remuneration reporting, we also conducted an engagement programme with our larger shareholders in 2013. Joseph Papa met with the holders of around 20% of our shares, and with a number of shareholder advisory bodies. He has also been available to discuss any aspect of our remuneration programme with shareholders throughout the year. The shareholders who have engaged with us have all been supportive of our approach to remuneration, recognising the link between the corporate strategy and executive reward.

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## 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.

By order of the Board, 24 February 2016

**Susan Swabey**

Company Secretary

#### [Directors' Responsibilities for, and Report on, Internal Control over Financial Reporting](#)

The Directors are responsible for establishing and maintaining adequate internal control over financial reporting. Smith & Nephew's internal control over financial reporting is designed to provide reasonable assurance over the reliability of financial reporting and the preparation of consolidated Financial Statements in accordance with generally accepted accounting principles.

Due to its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risks that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

The Directors assessed the effectiveness of Smith & Nephew's internal control over financial reporting as at 31 December 2015 based on the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control-Integrated Framework (2013). Based on this assessment, the Directors believe that, as at 31 December 2015, the internal control over financial reporting is effective based on those criteria.

KPMG LLP, an independent registered public accounting firm, has audited the effectiveness of internal control over financial reporting as at 31 December 2015 and, as explained on page 105, has issued an unqualified report thereon.

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Independent auditor's US report

**Report of Independent Registered Public Accounting firms**

The Board of Directors and Shareholders Smith &amp; Nephew plc:

We have audited the accompanying Group balance sheet of Smith & Nephew plc and subsidiaries as of 31 December 2015 and the related Group income statement, Group statement of comprehensive income, Group cash flow statement and Group statement of changes in equity, for the year then ended. We also have audited Smith & Nephew plc's internal control over financial reporting as of 31 December 2015, 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 authorisations 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 2015, and the results of their operations and their cash flows for the year 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 2015, 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 and 2013 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 or 2013 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 or 2013 Group financial statements taken as a whole.

**KPMG LLP**

London, United Kingdom

24 February 2016

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Independent auditor's UK report

[Independent auditor's report to the members of Smith & Nephew plc only](#)

[Opinions and conclusions arising from our audit](#)

1 Our opinion on the financial statements is unmodified

We have audited the financial statements of Smith & Nephew plc for the year ended 31 December 2015 set out on pages 111 to 170.

In our opinion:

The financial statements give a true and fair view of the state of the Group's and of the parent company's affairs as at 31 December 2015 and of the Group's profit for the year then ended:

The Group financial statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union;

The parent company financial statements have been properly prepared in accordance with UK Accounting Standards, including FRS 101 Reduced Disclosure Framework; and

The financial statements have been prepared in accordance with the requirements of the Companies Act 2006; and, as regards the Group financial statements, Article 4 of the IAS Regulation.

[Separate opinion in relation to IFRS as issued by the International Accounting Standards Board \(IASB\)](#)

As explained in the accounting policies set out in the Group Financial Statements, the Group, in addition to complying with its legal obligation to apply IFRS as adopted by the EU, has also applied IFRS as issued by the IASB. In our opinion, the Consolidated Financial Statements comply with IFRS as issued by the IASB.

## 2 Our assessment of risks of material misstatement

In light of this being the first year of our audit we familiarised ourselves with the business by spending a significant amount of time both at the Company's head office in London and key operating locations around the world. Our primary objective during this phase was to understand the business model of the Group, the risks inherent in that business model and how these are mitigated.

We also met with key functional leaders including: legal; IT; compliance; human resources; and business development to understand the priorities, challenges and risks inherent in the changes arising from the ongoing simplification programme of the Group.

We considered the strength of the Group's control environment, the relative maturity and sophistication of the IT infrastructure and the impact of the simplification programme on financial controls over key processes and transactions.

These assessments highlighted the key areas of financial statement risk that our audit was focused on. Those that had the greatest effect on our audit are set out below, together with our procedures to address these areas. Any comments that we make on the results of our procedures should be read in the context of our opinion on the financial statements as a whole.

Inventory valuation: \$1,217 million

THE RISK	OUR RESPONSE AND CONCLUSIONS
<p>The Group has high levels of finished goods some of which are located at customer premises to be available for immediate use. Complete sets of products, including outsizes, have to be made available in this way, with these sizes used less frequently. Towards the end of a product's life cycle, these inventory levels are more than is required and therefore excess to requirements.</p> <p>In estimating the net realisable value for inventory, management has to apply judgement on how much of the inventory on hand will ultimately be used.</p>	<p>The key inputs used in estimating the Excess and Obsolescence (E&amp;O) provision include historic sales for significant product lines and expected future usage of inventory.</p> <p>On a sample basis we corroborated historic sales back to underlying source data. We also corroborated on a sample basis the expected usage of inventory with the Director's plans for launching new product lines or discontinuing product lines.</p>



We considered the historical accuracy of the provision against actual inventory write-offs.

We also considered the adequacy of the Group's disclosures in respect of inventory valuation.

As a result, we satisfied ourselves that inventory provisions have been prepared in line with policy and are supportable on the basis of historical trends as well as management's expectations for future sales and inventory management plans.

REFER TO PAGE 75 (AUDIT COMMITTEE REPORT), PAGE 111

(ACCOUNTING POLICY) AND PAGE 136 (FINANCIAL DISCLOSURES)

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Revenue: \$4,634 million

THE RISK	OUR RESPONSE AND CONCLUSIONS
<p>Revenue is recognised when the risks and rewards are passed to the customer.</p> <p>Revenue recognition is one of the key judgemental areas for our audit, particularly in respect of estimates made for contractual rebates, chargebacks and returns which are deducted in arriving at revenue from wholesale customers and distributors.</p>	<p>Our principal audit procedures included: testing the Group's controls surrounding revenue recognition and key controls in the order-to-cash transaction cycle. This included reconciliations between sales systems and the general ledger; assessing whether appropriate revenue recognition policies are applied through comparison with accounting standards; and performing testing over revenue at significant components, which included analysis of product sales year-on-year, corroborating movements compared with expectations and inspection of contracts with customers.</p> <p>Our audit work in respect of the accrual rebates, chargebacks and returns involved testing key controls including the Group's review of chargebacks, returns and rebates.</p> <p>We also assessed the accuracy of the accrual calculation, corroborated inputs and key assumptions, both to source documents, and considered the historical accuracy of the accrual.</p> <p>We also assessed the adequacy of the Group's disclosures of its revenue recognition policy, the judgment involved and other related disclosures.</p>

The results of our testing were satisfactory and we concur that revenue recognition is appropriate.

REFER TO PAGE 75 (AUDIT COMMITTEE REPORT) AND PAGE 121

(ACCOUNTING POLICY AND FINANCIAL DISCLOSURES)

Litigation reserves and contingent liabilities (\$303 million included in provisions)

THE RISK	OUR RESPONSE AND CONCLUSIONS
<p>The development, manufacture and sale of medical devices entails risk of product liability claims and patent infringement issues due to the technological nature of the products and the competitive nature of the industry. Determining the impact and likely outcome of any litigation matters is inherently subjective and the amounts involved are potentially material.</p>	<p>We tested the Group's controls surrounding litigation and contingent liabilities, inspected legal invoices and corresponded directly with external legal advisers to understand the fact patterns and ensure that all significant cases had been adequately considered.</p>
<p>As disclosed in Note 17 a provision of \$185 million has been recognised in the year in respect of potential liabilities arising from the ongoing exposure for Metal on Metal implants.</p>	<p>We tested the estimates of provisions, including their assessment of potential royalties payable for past sales, and expected settlement of product liability cases. We challenged the assumptions made based on the fact pattern of similar historic cases.</p>
	<p>For the liability recognised in respect of the expected payouts for Metal on Metal cases we involved our actuarial specialists to review the critical assumptions used in statistical projections in determining the estimate. The key assumptions included: expected number of claimants; projected value of each settlement; and the likely time period expected for settlement.</p>
	<p>We also considered the adequacy of the Group's disclosures in respect of litigation reserves and contingent liabilities.</p>
	<p>The results of our testing were satisfactory and we concur that the costs in respect of litigation and contingent liabilities is appropriate.</p>

REFER TO PAGE 75 (AUDIT COMMITTEE REPORT), PAGE  
111

(ACCOUNTING POLICY) AND PAGE 146 (FINANCIAL  
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Independent auditor's UK report continued

Valuation of acquired intangible assets (included in intangible assets of \$1,502 million)

THE RISK	OUR RESPONSE AND CONCLUSIONS
<p>The Group has capitalised acquired intangibles of which the most significant relate to recent acquisitions in respect of ArthroCare (acquired in 2014) and Healthpoint (acquired in 2012).</p>	<p>Our audit procedures included testing the principles and integrity of the Group's discounted cash flow models and corroborating the assumptions made on revenue and profitability projections.</p>
<p>There is a risk that due to changes in the competitive landscape, regulatory or other external factors the acquired assets underperform in comparison to their original investment case and that the carrying value may be impaired.</p>	<p>We tested the sensitivity of key assumptions to the value in use calculated. We also assessed whether the Group's disclosures about the sensitivity of the outcome of the impairment assessment to changes in key assumptions reflected the key risks inherent in the valuation of acquired intangibles.</p>
<p>An impairment charge of \$40 million has been recognised in the current year in relation to an acquired brand, Oasis, from the Healthpoint acquisition which has underperformed against the original investment case.</p>	<p>As a result of our work, we determined that the quantum of impairment recognised in 2015 was appropriate. For those intangible assets, where management determined no impairment was required, we found that these judgements were supported by reasonable assumptions.</p>

REFER TO PAGE 75 (AUDIT COMMITTEE REPORT), PAGE 111

(ACCOUNTING POLICY) AND PAGES 133 TO 134 (FINANCIAL DISCLOSURES)

Tax provisioning (included in current tax payable of \$ 263 million)

THE RISK	OUR RESPONSE AND CONCLUSIONS
<p>Accruals for tax contingencies require the Directors to make judgements and estimates in relation to tax issues and exposures given that the Group operates in a number of tax jurisdictions, the complexities of transfer pricing and other international tax legislation and the time taken for tax matters to be agreed with the tax authorities.</p>	<p>In this area our audit procedures included the use of our own international and local tax specialists to assess the Group's tax positions, its correspondence with the relevant tax authorities, and to analyse and challenge the assumptions used to determine tax provisions based on our knowledge and experiences of the application of the international and local legislation by the relevant authorities and courts.</p> <p>We also considered the adequacy of the Group's disclosures in respect of tax and uncertain tax positions.</p> <p>From the evidence obtained, we considered the level of provisioning to be acceptable in the context of the Group financial statements taken as a whole.</p>

REFER TO PAGE 75 (AUDIT COMMITTEE REPORT), PAGE 111

(ACCOUNTING POLICY) AND PAGE 126 (FINANCIAL DISCLOSURES)

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### 3 Our application of materiality and an overview of the scope of our audit

The materiality for the Group financial statements as a whole was set at \$44 million, determined with reference to a benchmark of 5% of Group profit before tax normalised to exclude acquisition related costs of \$12 million, impairment charges of \$51 million, restructuring and rationalisation expenses of \$65 million and legal and other charges of \$190 million as disclosed in Note 3. We believe that pre-tax profit excluding these items provides us with a consistent year-on-year basis for determining materiality and is the most relevant performance measure to the shareholders of the entity.

#### MATERIALITY FOR THE GROUP FINANCIAL STATEMENTS

Of the Group's 143 reporting components, we subjected 60 to full scope audits for Group reporting purposes, nine to audits of specific account balances. The latter were not individually financially significant to require an audit for Group reporting purposes, but were included in the scope of our Group reporting work in order to provide further coverage over the identified risks and the Group's results.

The remaining 22% of total Group revenue, 5% of Group profit before tax and 13% of total Group assets is represented by 74 reporting components, none of which individually represented more than 5% of any of total Group revenue, Group profit before tax or total Group assets. For these remaining components, we performed analysis at an aggregated Group level to re-examine our assessment that there were no significant risks of material misstatement within these.

The Group audit team instructed component auditors as to the significant areas to be covered, including the relevant risks detailed above and the information to be reported back. The Group audit team approved the component materialities which ranged from \$5 million to \$35 million, having regard to the mix of size and risk profile of the Group across the components. The work on 32 of the 69 components was performed by component auditors and the rest by the Group audit team.

The Group audit team visited 24 components in USA, China, UK, Brazil, Australia, Italy, Germany and Switzerland. Telephone conference meetings were also held with these component auditors and the majority of the others that were not physically visited. At these visits and meetings, the findings reported to the Group audit team were discussed in more detail, and any further work required by the Group audit team was then performed by the component auditor.

4 Our opinion on other matters prescribed by the Companies Act 2006 is unmodified

In our opinion:

The part of the Directors Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006; and

The information given in the Strategic Report and the Directors Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

The components within the scope of our work accounted for the following percentages of the Group's results:

GROUP REVENUE  
%

GROUP PROFIT BEFORE TAX  
%

TOTAL ASSETS  
%

- A Audits for group reporting purposes (145 components)
- B Audits of account balances (revenue, receivables and inventory) (9 components)
- C Out of scope



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Independent auditor's UK report continued

5 We have nothing to report on the disclosures of principal risks

Based on the knowledge we acquired during our audit, we have nothing material to add or draw attention to in relation to:

The Directors' statement of viability statement on page 49, concerning the principal risks, their management, and, based on that, the Directors' assessment and expectations of the Group's continuing in operation over the three years to December 2018; or

The disclosures in Note 1 of the financial statements concerning the use of the going concern basis of accounting.

6 We have nothing to report in respect of the matters on which we are required to report by exception

Under ISAs (UK and Ireland) we are required to report to you if, based on the knowledge we acquired during our audit, we have identified other information in the Annual Report that contains a material inconsistency with either that knowledge or the financial statements, a material misstatement of fact, or that is otherwise misleading.

In particular, we are required to report to you if:

We have identified material inconsistencies between the knowledge we acquired during our audit and the Directors statement that they consider that the Annual Report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy; or

The Audit Committee report does not appropriately address matters communicated by us to the Audit Committee. Under the Companies Act 2006 we are required to report to you if, in our opinion:

Adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or

The parent company financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns; or

Certain disclosures of Directors' remuneration specified by law are not made; or

We have not received all the information and explanations we require for our audit.

Under the Listing Rules we are required to review:

The Directors' statements, set out on pages 104 and 49, in relation to going concern and longer-term viability; and

The part of the Corporate Governance Statement on page 57 in the Corporate Governance report relating to the Company's compliance with the 11 provisions of the 2014 UK Corporate Governance Code specified for our review. We have nothing to report in respect of the above responsibilities.

#### Scope and responsibilities

As explained more fully in the Directors' Responsibilities Statement set out on page 104, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at [www.frc.org.uk/auditscopeukprivate](http://www.frc.org.uk/auditscopeukprivate). This report is made solely to the Company's members as a body and is subject to important explanations and disclaimers regarding our responsibilities, published on our website at [www.kpmg.com/uk/auditscopeukco2014b](http://www.kpmg.com/uk/auditscopeukco2014b), which are incorporated into this report as if set out in full and should be read to provide an understanding of the purpose of this report, the work we have undertaken and the basis of our opinions.

#### **Stephen Oxley (Senior Statutory Auditor)**

For and on behalf of KPMG LLP, Statutory Auditor

Chartered Accountants

15 Canada Square

London

E14 5GL

24 February 2016

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**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 franchise (whose finished goods inventory make up approximately 79% 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 brings 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 2014, we acquired ArthroCare Corporation; 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.

## Operating segments

In making decisions about the prioritisation and allocation of the Group's resources, the Commercial Operations team (CommOps, the body considered to be the Chief Operating Decision Maker) review financial information on an integrated basis for the Group as a whole and determines the best allocation of resources to group-wide projects. In assessing performance, CommOps 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.

In applying the requirements of IFRS 8 Operating Segments, the Group considers the fact that the prioritisation and allocation of resources by CommOps being determined at Group level on a project by basis results in the Group having one operating segment.

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## Group income statement

	Notes	Year ended 31 December 2015 \$ million	Year ended 31 December 2014 \$ million	Year ended 31 December 2013 \$ million
<b>Revenue</b>	2	4,634	4,617	4,351
Cost of goods sold		(1,143)	(1,162)	(1,100)
<b>Gross profit</b>		3,491	3,455	3,251
Selling, general and administrative expenses	3	(2,641)	(2,471)	(2,210)
Research and development expenses	3	(222)	(235)	(231)
<b>Operating profit</b>	2 & 3	628	749	810
Interest income	4	11	13	14
Interest expense	4	(49)	(35)	(10)
	4	(15)	(11)	(11)

Other finance costs				
Share of results of associates	11	(16)	(2)	(1)
<b>Profit before taxation</b>		<b>559</b>	<b>714</b>	<b>802</b>
Taxation	5	(149)	(213)	(246)
<b>Attributable profit for the year<sup>1</sup></b>		<b>410</b>	<b>501</b>	<b>556</b>
<b>Earnings per ordinary share<sup>1</sup></b>	6			
Basic		45.9¢	56.1¢	61.7¢
Diluted		45.6¢	55.7¢	61.4¢
Group statement of comprehensive income				

	Notes	Year ended 31 December 2015 \$ million	Year ended 31 December 2014 \$ million	Year ended 31 December 2013 \$ million
<b>Attributable profit for the year<sup>1</sup></b>		<b>410</b>	<b>501</b>	<b>556</b>
Other comprehensive income:				
<i>Items that will not be reclassified to income statement</i>				
Re-measurement of net retirement benefit obligations	18	(8)	(94)	12
Taxation on other comprehensive income	5	10	19	(16)
Total items that will not be reclassified to income statement		2	(75)	(4)
<i>Items that may be reclassified subsequently to income statement</i>				
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	34	31	8
gains transferred to inventories for the year	(50)	(14)	(3)
Exchange differences on translation of foreign operations	(176)	(196)	(6)
Total items that may be reclassified subsequently to income statement	(192)	(184)	(1)
<b>Other comprehensive (expense)/income for the year, net of taxation</b>	<b>(190)</b>	<b>(259)</b>	<b>(5)</b>
<b>Total comprehensive income for the year<sup>1</sup></b>	<b>220</b>	<b>242</b>	<b>551</b>

1 Attributable to equity holders of the Company and wholly derived from continuing operations.

THE NOTES ON PAGES 119 TO 166 ARE AN INTEGRAL PART OF THESE ACCOUNTS.



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Commentary on the Group income statement  
and Group statement of comprehensive income

**Revenue**

Group revenue increased by \$17m, 0% on a reported basis, from \$4,617m in 2014 to \$4,634m in 2015.

The underlying increase is 4%, after adjusting for the 4% impact of acquisitions and the 8% attributable to the unfavourable impact of currency movements.

Established Markets had an underlying growth of 3% and Emerging Markets had an underlying growth of 11%, both of which contributed to the Group increase of 4%.

**Cost of goods sold**

Cost of goods sold decreased by \$19m, 2% on a reported basis, from \$1,162m in 2014 to \$1,143m in 2015. The movement is primarily due to the strengthening of the US Dollar which more than offsets the increase in volume from acquisitions and underlying trading.

During 2015, no restructuring and rationalisation expenses (2014 \$12m) and acquisition related costs (2014 \$23m) were charged to cost of goods sold.

**Selling, general and administrative expenses**

Selling, general and administrative expenses increased by \$170m (7% on a reported basis) from \$2,471m in 2014 to \$2,641m in 2015. The underlying movement is 7% after adjusting for net impact of 7% from acquisitions and unfavourable currency movements of 7%.

In 2015, administrative expenses included amortisation of software and other intangible assets of \$66m (2014 \$62m), \$65m of restructuring and rationalisation expenses (2014 \$49m), an amount of \$204m relating to amortisation and impairment of acquired intangibles (2014 \$129m), \$12m of acquisition related costs (2014 \$95m) and \$203m relating to anticipated and settled metal-on-metal hip claims and additional expenses primarily relating to the RENASYS distribution hold in the US. These expenses were offset by a net gain of \$33m relating to a patent litigation and past service and curtailment gains of \$19m (2014 \$46m) arising on US and UK post-retirement benefits.

**Research and development expenses**

Research and development expenditure as a percentage of revenue remained broadly consistent at 4.8% in 2015 (2014 5.1%). Actual expenditure was \$222m in 2015 compared to \$235m in 2014. The Group continues to invest in innovative technologies and products to differentiate it from competitors.

#### Operating profit

Operating profit decreased by \$121m from \$749m in 2014 to \$628m in 2015.

This movement was primarily driven by the benefits of the Group Optimisation programme and synergies from the ArthroCare acquisition in 2014, offset by the costs relating to anticipated and settled metal-on-metal hip claims.

#### Interest income/(expense)

Net interest expense increased by \$16m from a net \$22m expense in 2014 to a net \$38m expense in 2015. This movement is primarily due to an increase in interest expense due to the financing of the ArthroCare acquisition in 2014.

#### Other finance costs

Other finance costs in 2015 increased by \$4m and principally relates to costs associated with the Group's retirement benefit schemes.

#### Taxation

The taxation charge decreased by \$64m to \$149m from \$213m in 2014.

After adjusting for specific transactions that management considers affect the Group's short-term profitability (restructuring and rationalisation expenses, amortisation of acquisition intangibles, acquisition related costs and legal and other items) the tax rate on trading profit was 26.8% (2014 27.7%).

**THE FINANCIAL COMMENTARY ON THIS PAGE FORMS PART OF THE BUSINESS REVIEW AND IS UNAUDITED.**

**SEE PAGES 181 TO 182 FOR COMMENTARY ON THE 2014 FINANCIAL YEAR.**

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## Group balance sheet

	Notes	At 31 December 2015 \$ million	At 31 December 2014 \$ million
<b>Assets</b>			
<b>Non-current assets</b>			
Property, plant and equipment	7	932	891
Goodwill	8	2,012	2,027
Intangible assets	9	1,502	1,747
Investments	10	13	5
Investments in associates	11	115	112
Retirement benefit asset	18	13	7
Deferred tax assets	5	105	77
		4,692	4,866
<b>Current assets</b>			
Inventories	12	1,217	1,181
Trade and other receivables	13	1,138	1,166
Cash at bank	15	120	93
		2,475	2,440
<b>Total assets</b>		<b>7,167</b>	<b>7,306</b>

**Equity and liabilities****Equity attributable to owners of the Company**

Share capital	19	183	184
Share premium		590	574
Capital redemption reserve		12	11
Treasury shares	19	(294)	(315)
Other reserves		(256)	(64)
Retained earnings		3,731	3,650
<b>Total equity</b>		<b>3,966</b>	<b>4,040</b>
<b>Non-current liabilities</b>			
Long-term borrowings	15	1,434	1,666
Retirement benefit obligations	18	184	233
Other payables	14	29	44
Provisions	17	133	63
Deferred tax liabilities	5	77	98
		<b>1,857</b>	<b>2,104</b>
<b>Current liabilities</b>			
Bank overdrafts and loans	15	46	39
Trade and other payables	14	842	838
Provisions	17	193	67
Current tax payable		263	218
		<b>1,344</b>	<b>1,162</b>
<b>Total liabilities</b>		<b>3,201</b>	<b>3,266</b>
<b>Total equity and liabilities</b>		<b>7,167</b>	<b>7,306</b>

The accounts were approved by the Board and authorised for issue on 24 February 2016 and are signed on its behalf by:

**Roberto Quarta**  
Chairman

**Olivier Bohuon**  
Chief Executive Officer

**Julie Brown**  
Chief Financial Officer

THE NOTES ON PAGES 119 TO 166 ARE

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Commentary on the Group balance sheet

**Non-current assets**

Non-current assets decreased by \$174m to \$4,692m in 2015 from \$4,866m in 2014. This is principally attributable to the following:

Property, plant and equipment increased by \$41m from \$891m in 2014 to \$932m in 2015. There were \$303m of additions together with \$6m acquired with the Colombia and Russia acquisitions which were offset by \$11m of assets disposed. Depreciation of \$226m was charged during 2015 and there were unfavourable currency movements of \$31m.

Goodwill decreased by \$15m from \$2,027m in 2014 to \$2,012 in 2015. This movement relates to additions of \$10m from the acquisition in Colombia and \$24m from the acquisition in Russia. This was offset by unfavourable currency movements of \$49m which decreased the overall goodwill balance.

Intangible assets decreased by \$245m from \$1,747m in 2014 to \$1,502 in 2015. There were additions of \$55m in 2015 relating to intellectual property, distribution rights and software acquired together with \$19m acquired with the Colombia and Russia acquisitions. Amortisation and impairment during 2015 was \$270m and there were unfavourable currency movements of \$45m.

Investments in associates increased to \$115m from \$112m in 2014. The increase was attributable to a capital contribution to Bioventus of \$25m and other investment gains of \$2m, offset by an investment loss in Bioventus of \$18m and a reclassification of an associate to investments of \$6m due to a change in shareholding.

Deferred tax assets increased by \$28m in the year from \$77m in 2014 to \$105m in 2015. The net deferred tax position has changed from a liability of \$21m in 2014 to an asset of \$28m in 2015. The net movement of \$49m is mainly due to the creation of the metal-on-metal hip claim provision and amortisation of certain acquired intangibles, offset by a reduction in retirement benefit obligations.

**Current assets**

Current assets increased by \$35m to \$2,475m from \$2,440m in 2014. The movement relates to the following:

Inventories rose by \$36m to \$1,217m in 2015 from \$1,181 in 2014. This movement is driven by inventory acquired with the Colombia and Russia acquisitions and a general increase across the Emerging Markets. This was offset by unfavourable currency movements of \$63m.

The level of trade and other receivables decreased by \$28m to \$1,138m in 2015 from \$1,166m in 2014. The movement primarily relates to the \$17m increase in the bad debt provision as well as unfavourable currency movements.

Cash at bank has increased by \$27m from \$93m in 2014 to \$120m in 2015. Refer to the Group cash flow statement and related commentary on pages 116 and 117 for further detail.

#### Non-current liabilities

Non-current liabilities decreased by \$247m from \$2,104m in 2014 to \$1,857m in 2015. This movement principally relates to:

Long-term borrowing decreased from \$1,666m in 2014 to \$1,434m in 2015 principally due to repayments of bank debt.

The retirement benefit obligation decreased from \$233m in 2014 to \$184m in 2015 due to past cost adjustments arising from plan amendments in the UK and US, increases in discount rates and supplementary cash contributions.

Deferred tax liabilities decreased by \$21m from \$98m in 2014 to \$77m in 2015. Refer to commentary within non-current assets for explanation of the net deferred tax position movement.

The impact of the above was partly offset by an increase in non-current provisions, primarily relating to the estimated costs to resolve all future known and anticipated metal-on-metal hip claims.

#### Current liabilities

Current liabilities increased by \$182m from \$1,162m in 2014 and \$1,344m in 2015. This movement is attributable to:

Bank overdrafts and loans increased by \$7m from \$39m in 2014 to \$46m in 2015.

Provisions increased by \$126m from \$67m in 2014 to \$193m in 2015 primarily due to an increase in legal provision for known and anticipated metal-on-metal hip claims.

Current tax payables increased by \$45m from \$218m in 2014 to \$263m, mainly attributable to differences in the timing of cash tax payments year-on-year.

Total equity

Total equity decreased by \$74m from \$4,040m in 2014 to \$3,966m in 2015. The principal movements were:

	Total equity \$ million
1 January 2015	4,040
Attributable profit	410
Currency translation losses	(176)
Hedging reserves	(16)
Actuarial losses on retirement benefit obligations	(8)
Dividends paid during the year	(272)
Purchase of own shares	(77)
Taxation on other comprehensive income and equity items	15
Net share-based transactions	50
31 December 2015	3,966

THE FINANCIAL COMMENTARY ON THIS PAGE FORMS PART OF THE BUSINESS REVIEW AND IS UNAUDITED.

SEE PAGES 181 TO 182 FOR COMMENTARY ON THE 2014 FINANCIAL YEAR.

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## Group cash flow statement

	Notes	Year ended 31 December 2015 \$ million	Year ended 31 December 2014 \$ million	Year ended 31 December 2013 \$ million
<b>Cash flows from operating activities</b>				
Profit before taxation		559	714	802
Net interest expense/(income)	4	38	22	(4)
Depreciation, amortisation and impairment		493	427	361
Loss on disposal of property, plant and equipment and software		15	11	23
Distribution from trade investments		3	1	
Share-based payments expense (equity settled)	23	29	32	28
Share of results of associates	11	16	2	1
Dividends received from associates	11			1
Profit on disposal of manufacturing facility	21		(9)	
Net movement in post-retirement benefit obligations		(57)	(81)	(27)
Increase in inventories		(83)	(168)	(99)
Increase in trade and other receivables		(26)	(76)	(70)
		216	86	122



Increase in trade and other payables and provisions				
Cash generated from operations <sup>1</sup>		1,203	961	1,138
Interest received		8	3	4
Interest paid		(44)	(36)	(10)
Income taxes paid		(137)	(245)	(265)
<b>Net cash inflow from operating activities</b>		<b>1,030</b>	<b>683</b>	<b>867</b>
<b>Cash flows from investing activities</b>				
Acquisitions, net of cash acquired	21	(44)	(1,572)	(74)
Capital expenditure	2	(358)	(375)	(340)
Investment in associate	11	(25)	(2)	
Purchase of investments	10	(2)	(4)	
Proceeds from associate loan redemption			188	
Proceeds on disposal of manufacturing facility	21		20	
Cash received on disposal of associate				7
<b>Net cash used in investing activities</b>		<b>(429)</b>	<b>(1,745)</b>	<b>(407)</b>
<b>Cash flows from financing activities</b>				
Proceeds from issue of ordinary share capital		16	40	48
Purchase of own shares		(77)	(75)	(231)
Proceeds from borrowings due within one year	20	42	30	12
Settlement of borrowings due within one year	20	(26)	(52)	(6)
Proceeds from borrowings due after one year	20	831	3,390	695
Settlement of borrowings due after one year	20	(1,062)	(2,068)	(779)
Proceeds from own shares		5	4	3
Settlement of currency swaps	20	(15)	(11)	(1)
Equity dividends paid	19	(272)	(250)	(239)
<b>Net cash (used in)/from financing activities</b>		<b>(558)</b>	<b>1,008</b>	<b>(498)</b>
Net increase/(decrease) in cash and cash equivalents		43	(54)	(38)
Cash and cash equivalents at beginning of year	20	65	126	167
Exchange adjustments	20	(6)	(7)	(3)
<b>Cash and cash equivalents at end of year<sup>2</sup></b>		<b>102</b>	<b>65</b>	<b>126</b>

1 Includes \$52m (2014 \$60m, 2013 \$54m) of outgoings on restructuring and rationalisation expenses, \$36m (2014 \$112m, 2013 \$25m) of acquisition-related costs and \$3m (2014 \$23m, 2013 \$nil) of legal and other costs.

2 Cash and cash equivalents is net of bank overdrafts of \$18m (2014 \$28m).

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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 2015 of \$1,203m (2014 \$961m, 2013 \$1,138m) is after paying out \$36m (2014 \$112m, 2013 \$25m) of acquisition-related costs, \$52m (2014 \$60m, 2013 \$54m) of restructuring and rationalisation expenses and \$3m (2014 \$23m, 2013 \$nil) relating to legal and other costs.

#### 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 2015, capital expenditure on tangible and intangible fixed assets represented approximately 8% of continuing Group revenue (2014 8%, 2013 8%).

In 2015, capital expenditure amounted to \$358m (2014 \$375m, 2013 \$340m). 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 2015, \$24m (2014 \$34m, 2013 \$41m) of capital expenditure had been contracted but not provided for which will be funded from cash inflows.

#### Acquisitions and disposals

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.

During 2014, the Group received repayment of the \$160m loan note to Bioventus and \$28m of accrued interest. Proceeds of \$20m were received on the disposal of the Group's manufacturing plant in Gilberdyke, UK.

#### Dividends

The 2014 final dividend of 18.6 US cents per ordinary share totalling \$166m was paid on 6 May 2015. The 2015 interim dividend of 11.8 US cents per ordinary share totalling \$106m was paid on 27 October 2015.

### Share buy-backs

During the year ended 31 December 2015, the Group purchased a total of 4.4m (2014 4.6m) ordinary shares at a cost of \$77m (2014 \$75m).

### 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 2015, the Group held \$102m (2014 \$65m, 2013 \$126m) in cash net of bank overdrafts. The Group had committed facilities available of \$2,425m at 31 December 2015 of which \$1,425m 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 \$10m.

During the year ended 31 December 2014, the Group refinanced its principal banking facilities. The Group signed a new five-year committed \$1bn multi-currency revolving credit facility with a maturity date of March 2019. This maturity date has since been extended to March 2020. In April 2015, the Group signed a new three-year, \$300m bilateral term loan with one of its relationship banks. The new term loan has a maturity date of April 2018. The proceeds of this new loan were used to repay the remaining outstanding amount on the committed term loan used to fund the acquisition of ArthroCare.

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 decreased from \$1,613m at the beginning of 2015 to \$1,361m at the end of 2015, representing an overall decrease of \$252m.

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 181 TO 182 FOR COMMENTARY ON THE 2014 FINANCIAL YEAR.

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## Group statement of changes in equity

	Share capital \$ million	Share premium \$ million	Capital redemption reserve \$ million	Treasury shares <sup>2</sup> \$ million	Other reserves <sup>3</sup> \$ million	Retained earnings \$ million	Total equity \$ million
At 31 December 2012	193	488		(735)	121	3,817	3,884
Attributable profit for the year <sup>1</sup>						556	556
Other comprehensive income					(1)	(4)	(5)
Equity dividends declared and paid						(239) 28	(239) 28
Share-based payments							

recognised

Taxation on  
share-based  
payments

3

3

Purchase of own  
shares

(231)

(231)

Cost of shares  
transferred to  
beneficiaries

21

(18)

3

Cancellation of  
treasury shares

(10)

10

623

(623)

Issue of ordinary  
share capital<sup>4</sup>  
At 31 December  
2013

1

47

184

535

10

(322)

120

3,520

48

4,047

Attributable profit  
for the year<sup>1</sup>

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)

25

(21)

(75)

4

Cost of shares  
transferred to

beneficiaries

Cancellation of  
treasury shares

(1) 1 57 (57)

Issue of ordinary  
share capital<sup>4</sup>  
At 31 December  
20141 39 40  
184 574 11 (315) (64) 3,650 4,040Attributable profit  
for the year<sup>1</sup>

410 410

Other  
comprehensive  
income/(expense)

(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<sup>4</sup>

16 16

**At 31 December  
2015**

183	590	12	(294)	(256)	3,731	3,966
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- 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 the difference arising as a result of translating share capital and share premium at the rate ruling on the date of redenomination instead of the rate at the balance sheet date. The cumulative translation loss within other reserves at 31 December 2015 of \$254m (2014 \$78m loss, 2013 \$118m gain).
- 4 Issue of ordinary share capital as a result of options being exercised.

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**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 2015. 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 2015. 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 reporting period. The accounting policies requiring management to use significant estimates and assumptions are: inventories, impairment, taxation, liability provisions, business combinations and disclosures in segmental reporting. These are discussed under Critical accounting policies on page 111. 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 2015, the Group had committed borrowing facilities of \$2.4bn and total liquidity of \$1.1bn, including net cash and cash equivalents of \$102m and undrawn committed borrowing facilities of \$1bn. 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 2018.

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 2015.

A number of new standards, amendments to standards and interpretations are effective for the Group's annual periods beginning on or after 1 January 2016, and have not been applied in preparing these consolidated accounts. With the exception of the new leasing standard IFRS 16 *Leases*, which was issued on 13 January 2016 and will become effective from 1 January 2019, for which the extent of the impact is still being determined, none of these are expected to have a significant effect on the consolidated accounts of the Group.

### 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.

The exchange rates used for the translation of currencies into US Dollars that have the most significant impact on the Group results were:

	2015	2014	2013
<b>Average rates</b>			
Sterling	1.53	1.65	1.56
Euro	1.11	1.33	1.33
Swiss Franc	1.04	1.09	1.08
Renminbi	0.16	0.16	0.16
<b>Year end rates</b>			
Sterling	1.48	1.56	1.66
Euro	1.09	1.21	1.38
Swiss Franc	1.00	1.01	1.12
Renminbi	0.15	0.16	0.17

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**2 Business segment information**

The Group has historically reported two operating segments, Advanced Surgical Devices ( ASD ) and Advanced Wound Management ( AWM ). On 1 January 2015, the Group completed its transition to a new commercial organisational structure as part of the Group Optimisation programme. The resultant effect of these restructuring activities is that the Group is now engaged in a single business activity, being the development, manufacture and sales of medical technology products and services.

Development, manufacturing, supply chain and central functions are managed globally for the Group as a whole. Sales are managed through six geographical selling regions, with each having a president who is responsible for the commercial review of that region. The Commercial Operations team ( CommOps ), comprises geographical presidents and certain heads of function and is chaired by the Chief Executive Officer ( CEO ). CommOps 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 and prioritisation of the Group's resources and assessment of the Group's performance are made by CommOps, and whilst the members have individual responsibility for the implementation of decisions within their respective areas, it is at the CommOps level that these decisions are made. Accordingly, CommOps is considered to be the Group's Chief Operating Decision Maker ( CODM ) as defined by IFRS 8 Operating Segments.

In making decisions about the prioritisation and allocation of the Group's resources, CommOps 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, CommOps 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.

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;

Arthroscopy 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 gynaecological instrumentation as well as various products and technologies to assist in surgical treatment of the ear, nose and throat;

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 Devices, which consists of traditional and single-use Negative Pressure Wound Therapy and hydrosurgery systems; and

Advanced Wound Bioactives, which includes biologics and other bioactive technologies that provide unique approaches to debridement and dermal repair/regeneration.

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 CommOps 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 below. Group financing (including interest receivable and payable) is managed on a net basis outside of the business segment.

The results and other information as required of the single segment are shown below. Segment information from the prior year has been restated to conform to the one global segment view, in order to provide more meaningful comparison.

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## 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:

	2015	2014	2013
	\$ million	\$ million	\$ million
<b>Reportable segment revenue</b>			
<b>Revenue from external customers</b>	4,634	4,617	4,351

The table below shows sales revenue by product type from continuing operations:

	2015	2014	2013
	\$ million	\$ million	\$ million
<b>Sales revenue by product from continuing operations</b>			
Sports Medicine Joint Repair	606	576	496

Arthroscopic Enabling Technologies	573	542	441
Trauma & Extremities	497	506	486
Other Surgical Businesses	205	147	74
Knee Implants	883	873	865
Hip Implants	604	654	653
Advanced Wound Care	755	805	843
Advanced Wound Bioactives	344	322	280
Advanced Wound Devices	167	192	213
<b>Consolidated sales revenue from continuing operations</b>	<b>4,634</b>	<b>4,617</b>	<b>4,351</b>

In presenting information on the basis of geographical segments, segment revenue is based on location of Smith & Nephew businesses:

	2015	2014	2013
	\$ million	\$ million	\$ million
<b>Geographical segment revenue</b>			
United Kingdom	301	299	293
United States of America	2,217	2,012	1,862
Other	2,116	2,306	2,196
<b>Consolidated sales revenue from continuing operations</b>	<b>4,634</b>	<b>4,617</b>	<b>4,351</b>

Major customers

No single customer generates revenue greater than 10% of the consolidated entity's total revenues.

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**2 Business segment information *continued*****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 of acquisition intangibles and impairments; significant restructuring events; gains and losses arising from legal disputes; and significant uninsured losses. Further detail is provided in Notes 3.3, 3.4 and 3.5. Operating profit reconciles to trading profit as follows:

	2015	2014	2013
	\$ million	\$ million	\$ million
<b>Trading profit of the business segment</b>	1,099	1,055	987
Acquisition-related costs	(12)	(118)	(31)
Restructuring and rationalisation expenses	(65)	(61)	(58)
Amortisation of acquisition intangibles and impairments	(204)	(129)	(88)
	(190)	2	



Legal and other			
<b>Operating profit of the business segment</b>	628	749	810
Net interest expense/(revenue)	(38)	(22)	4
Other finance costs	(15)	(11)	(11)
Share of results of associates	(16)	(2)	(1)
Taxation	(149)	(213)	(246)
<b>Attributable profit for the year of the business segment</b>	410	501	556

## 2.3 Assets and liabilities by business segment and geography

	2015	2014	2013
	\$ million	\$ million	\$ million
<b>Reconciliation of assets of the business segment to the consolidated group</b>			
Assets of the business segment	6,929	7,129	5,532
Unallocated corporate assets:			
Deferred tax assets	105	77	145
Retirement benefit assets	13	7	5
Cash at bank	120	93	137
<b>Total assets of the consolidated group</b>	7,167	7,306	5,819

Segment assets are based on the location of the assets:

	2015	2014	2013
	\$ million	\$ million	\$ million
United Kingdom	366	379	255
United States of America	2,982	3,104	2,086
	1,226	1,299	1,072

Other			
<b>Non-current assets by geographical location<sup>1</sup></b>	4,574	4,782	3,413

1 Non-current assets excludes retirement benefit assets and deferred tax assets.

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	2015	2014	2013
	\$ million	\$ million	\$ million
<b>Reconciliation of liabilities of the business segment to the consolidated group</b>			
Liabilities of the business segment	1,197	1,012	917
Unallocated corporate liabilities:			
Long-term borrowings	1,434	1,666	347
Retirement benefit obligations	184	233	230
Deferred tax liabilities	77	98	50
Bank overdrafts and loans due within one year	46	39	44
Current tax payable	263	218	184
<b>Total liabilities of the consolidated group</b>	<b>3,201</b>	<b>3,266</b>	<b>1,772</b>
<b>Depreciation, amortisation and impairment of the business segment</b>			
Depreciation of property, plant and equipment	226	222	209
Amortisation of acquired intangibles	153	129	88
	66	62	64
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Amortisation of other intangible assets			
<b>Total depreciation and amortisation</b>	445	413	361
Impairment losses on property, plant and equipment		14	
Impairment losses acquired intangibles	51		
Impairment reversal on trade investments	(3)		
<b>Total non-cash items<sup>1</sup></b>	493	427	361

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:

	2015	2014	2013
	\$ million	\$ million	\$ million
Additions to property, plant and equipment	303	298	242
Additions to intangibles	55	77	98
<b>Capital expenditure (excluding business combinations)</b>	358	375	340
Trade investments	2	4	
Acquisitions Goodwill	34	844	53
Acquisitions Intangible assets	19	833	53
Acquisitions Property, plant and equipment	6	62	5
<b>Capital expenditure</b>	419	2,118	451

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**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.

	2015	2014	2013
	\$ million	\$ million	\$ million
Revenue	4,634	4,617	4,351
Cost of goods sold <sup>1,2</sup>	(1,143)	(1,162)	(1,100)
Gross profit	3,491	3,455	3,251
Research and development expenses	(222)	(235)	(231)
Selling, general and administrative expenses:			
Marketing, selling and distribution expenses	(1,735)	(1,670)	(1,535)
Administrative expenses <sup>3,4,5,6</sup>	(906)	(801)	(675)
	(2,641)	(2,471)	(2,210)
<b>Operating profit</b>	<b>628</b>	<b>749</b>	<b>810</b>

1 2015 includes \$nil of restructuring and rationalisation expenses (2014 \$12m, 2013 \$12m).

2 2015 includes \$nil of acquisition-related costs (2014 \$23m, 2013 \$5m).

3 2015 includes \$66m of amortisation of software and other intangible assets (2014 \$62m, 2013 \$64m).

4 2015 includes \$65m of restructuring and rationalisation expenses and \$204m of amortisation and impairment of acquisition intangibles (2014 \$49m of restructuring and rationalisation expenses and \$129m of amortisation of acquisition intangibles, 2013 \$46m of restructuring and rationalisation expenses and \$88m of amortisation of acquisition intangibles).

5 2015 includes \$190m relating to legal and other exceptionals (2014 \$2m, 2013 \$nil).

6 2015 includes \$12m of acquisition-related costs (2014 \$95m, 2013 \$26m).

Note that items detailed in 1, 2, 4, 5 and 6 are excluded from the calculation of trading profit.

Operating profit is stated after charging/(crediting) the following items:

	2015	2014	2013
	\$ million	\$ million	\$ million
Other operating income	(41)	(9)	
Amortisation of intangibles	219	191	152
Impairment of intangible assets	51		
Depreciation of property, plant and equipment	226	222	209
Loss on disposal of property, plant and equipment and intangible assets	15	25	23
Operating lease payments for land and buildings	37	38	32
Operating lease payments for other assets	20	18	19
Advertising costs	91	96	91

Other operating income primarily relates to a net gain relating to patent litigation as discussed in Note 3.5.

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## 3.1 Staff costs and employee numbers

Staff costs during the year amounted to:

	Notes	2015 \$ million	2014 \$ million	2013 \$ million
Wages and salaries		1,193	1,237	998
Social security costs		135	127	106
Pension costs (including retirement healthcare)	18	58	17	72
Share-based payments	23	30	32	28
		1,416	1,413	1,204

During the year ended 31 December 2015, the average number of employees was 14,686 (2014 13,469, 2013 11,036).

## 3.2 Audit Fees information about the nature and cost of services provided by auditors

	2015 \$ million	2014 \$ million	2013 \$ million
Audit services:			
Group accounts	2	2	1
Local statutory audit pursuant to legislation	2	1	2



Other services:			
Non-audit services	1		
Taxation services:			
Compliance services		1	2
Advisory services		1	1
<b>Total auditors remuneration</b>	<b>5</b>	<b>5</b>	<b>6</b>
Arising:			
In the UK	2	3	3
Outside the UK	3	2	3
	5	5	6

Audit fees for the current year are those relating to KPMG LLP, the Group's auditors. In 2014 and 2013, fees relate to EY LLP, the Group's former auditors.

### 3.3 Acquisition-related costs

Acquisition-related costs of \$12m (2014 \$118m, 2013 \$31m) were incurred within operating profit in the 12-month period to 31 December 2015. These costs relate to ongoing ArthroCare integration.

### 3.4 Restructuring and rationalisation expenses

Restructuring and rationalisation costs of \$65m (2014 \$61m, 2013 \$58m) were incurred in the 12-month period to 31 December 2015. These costs primarily relate to the ongoing implementation of the Group Optimisation plan that was announced in May 2014.

### 3.5 Legal and other

The legal and other costs within operating profit of \$190m (2014 \$2m credit, 2013 \$nil). The net charge primarily relates to \$203m for known, anticipated and settled metal-on-metal hip claims and \$21m for associated legal expenses. This was offset by a net gain of \$33m relating to patent litigation with Arthrex and past service and curtailment gains of \$19m arising on US and UK post-retirement benefits. In addition, a total of \$18m charge primarily relates to final costs relating to the RENASYS distribution hold and redundancies from the decision to cease development of HP802.

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**4 Interest and other finance costs****4.1 Interest income/(expense)**

	2015	2014	2013
	\$ million	\$ million	\$ million
Interest income	11	13	14
Interest expense:			
Bank borrowings	(9)	(19)	(8)
Private placement notes	(37)	(14)	
Other	(3)	(2)	(2)
<b>Net interest (expense)/income</b>	<b>(49)</b>	<b>(35)</b>	<b>(10)</b>
	<b>(38)</b>	<b>(22)</b>	<b>4</b>

**4.2 Other finance costs**

Notes	2015	2014	2013
-------	------	------	------

		\$ million	\$ million	\$ million
Retirement benefit net interest expense	18	(11)	(10)	(11)
Unwinding of purchase discount		(3)		
Other		(1)	(1)	
<b>Other finance costs</b>		<b>(15)</b>	<b>(11)</b>	<b>(11)</b>

The retirement benefit net interest expense includes \$2m of fees paid directly by the Group relating to de-risking exercises carried out in the UK.

Foreign exchange gains or losses arose primarily on the translation of intercompany and third party borrowings and amounted to a net \$11m gain in 2015 (2014 net \$21m gain, 2013 net \$1m gain). These amounts were fully 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.

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## 5.1 Taxation charge attributable to the Group

	2015	2014	2013
	\$ million	\$ million	\$ million
Current taxation:			
UK corporation tax at 20.3% (2014 21.5%, 2013 23.3%)	31	39	50
Overseas tax	219	235	229
Current income tax charge	250	274	279
Adjustments in respect of prior periods	(56)	(6)	(5)
<b>Total current taxation</b>	<b>194</b>	<b>268</b>	<b>274</b>
Deferred taxation:			
Origination and reversal of temporary differences	(73)	(52)	(23)
Changes in tax rates	(3)		(4)
Adjustments to estimated amounts arising in prior periods	31	(3)	(1)
<b>Total deferred taxation</b>	<b>(45)</b>	<b>(55)</b>	<b>(28)</b>
Total taxation as per the income statement	149	213	246
Taxation in other comprehensive income	(10)	(19)	16
Taxation in equity	(5)		(3)
<b>Taxation attributable to the Group</b>	<b>134</b>	<b>194</b>	<b>259</b>

The 2015 prior period current taxation adjustments mainly relate to a reclassification from current to deferred taxation

together with releases of provisions after settlement with tax authorities or the expiry of statute of limitations and tax accrual to tax return adjustments. The 2015 prior period deferred taxation adjustments mainly relate to a reclassification from current to deferred taxation and tax accrual to tax return adjustments.

The tax charge was reduced by \$130m (2014 \$71m reduction and 2013 \$40m reduction) as a consequence of acquisition-related costs, restructuring and rationalisation costs, amortisation and impairment of acquisition intangibles, and legal and other.

#### 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 tax rate changes, tax legislation changes and resolution of tax audits and disputes. At any given time the Group has 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.

In 2015, the UK Government enacted legislation to reduce the main rate of UK statutory corporation tax to 19.0% from 1 April 2017 and 18.0% from 1 April 2020.

The UK standard rate of corporation tax for 2015 is 20.3% (2014 21.5%, 2013 23.3%). Overseas taxation is calculated at the rates prevailing in the respective jurisdictions. The reported tax rate differs from the UK standard rate as follows:

	2015	2014	2013
	%	%	%
UK standard rate	20.3	21.5	23.3
Non-deductible/non-taxable items	1.1	0.5	(1.0)
Prior year items	(4.5)	(1.2)	(0.5)
Tax losses incurred not relieved	2.0	1.6	0.9
Overseas income taxed at other than UK standard rate	7.8	7.5	7.8
<b>Reported tax rate</b>	<b>26.7</b>	<b>29.9</b>	<b>30.5</b>

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**5 Taxation *continued*****5.2 Deferred taxation**

Movements in the main components of deferred tax assets and liabilities were as follows:

	Accelerated tax depreciation	Intangibles	Retirement benefit obligation	Macrotexture	Inventory, provisions and other differences	Total
	\$ million	\$ million	\$ million	\$ million	\$ million	\$ million
At 1 January 2014	(91)	(22)	68	52	88	95
Exchange adjustment	2	1	(2)		(10)	(9)
Movement in income statement current year	18	16	(18)		36	52
Movement in income statement prior years	1	(1)	22		3 (3)	3 19

## Movement in other comprehensive income

Acquisitions		(220)			39	(181)
At 31 December 2014	(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 UK tax rate		2			1	3
Acquisitions		(3)				(3)
<b>At 31 December 2015</b>	<b>(62)</b>	<b>(223)</b>	<b>39</b>	<b>52</b>	<b>222</b>	<b>28</b>
Represented by:						

	2015	2014
	\$ million	\$ million
Deferred tax assets	105	77
Deferred tax liabilities	(77)	(98)
<b>Net position at 31 December</b>	<b>28</b>	<b>(21)</b>

During the year, the classification of deferred tax balances were revisited resulting in some reclassifications. There was no change in the deferred tax asset or liability balance.

The Group has unused gross tax losses of \$125m (2014 \$92m) available for offset against future profits. A deferred tax asset has been recognised in respect of \$29m (2014 \$47m) of these 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 \$467m (2014 \$449m).

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## 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 of acquisition intangible assets and impairments; significant restructuring events; significant gains and losses arising from legal

disputes and significant uninsured losses; 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:

	2015	2014	2013
	\$ million	\$ million	\$ million
<b>Earnings</b>			
Attributable profit for the year	410	501	556
Adjusted attributable profit (see below)	761	743	693

Attributable profit is reconciled to adjusted attributable profit as follows:

	Notes	2015	2014	2013
		\$ million	\$ million	\$ million
Attributable profit for the year		410	501	556
Acquisition-related costs <sup>1</sup>		25	125	31
Restructuring and rationalisation expenses	3	65	61	58
Amortisation of acquisition intangibles and impairments	9	204	129	88
Legal and other <sup>2</sup>		187	(2)	
Taxation on excluded items	5	(130)	(71)	(40)
<b>Adjusted attributable profit</b>		<b>761</b>	<b>743</b>	<b>693</b>

1 Acquisition-related costs include \$12m within operating profits (refer to Note 3.3), a \$2m interest charge relating to ArthroCare financing and an \$11m share of deferred consideration fair value adjustments in associates.

2 Legal and other costs include \$190m within operating profits (refer to Note 3.5) and a \$3m net interest credit.

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:

	2015	2014	2013
<b>Number of shares (millions)</b>			
Basic weighted number of shares	894	893	901
Dilutive impact of share options outstanding	5	6	5
Diluted weighted average number of shares	899	899	906
<b>Earnings per ordinary share</b>			
Basic	45.9¢	56.1¢	61.7¢
Diluted	45.6¢	55.7¢	61.4¢
Adjusted: Basic	85.1¢	83.2¢	76.9¢
Adjusted: Diluted	84.6¢	82.6¢	76.5¢

There were nil share options which were not included in the diluted EPS calculation because they were non-dilutive in the period (2014 nil, 2013 0.5m).

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## 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.

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	Notes	Land and buildings		Plant and equipment		Assets in	\$ m
		Freehold \$ million	Leasehold \$ million	Instruments \$ million	Other \$ million	course of construction \$ million	
<b>Cost</b>							
At 1 January 2014		143	53	1,065	938	80	
Exchange adjustment		(4)	(1)	(68)	(35)	(2)	
Acquisitions	21	11	4	9	17	21	
Additions				158	57	83	
Disposal of business					(12)		
Disposals		(2)	(3)	(108)	(40)	(4)	
Transfers		1	1	4	38	(44)	
At 31 December 2014		149	54	1,060	963	134	
Exchange adjustment		(3)	(1)	(63)	(26)	(1)	
Acquisitions	21			6			

Additions	4	1	152	78	68
Disposals	(1)	(1)	(113)	(47)	
Transfers	5	5		35	(45)
<b>At 31 December 2015</b>	154	58	1,042	1,003	156
<b>Depreciation and impairment</b>					
At 1 January 2014	43	31	764	625	
Exchange adjustment	(2)		(50)	(24)	
Charge for the year	5	4	137	76	
Impairment				3	11
Disposal of business				(7)	
Disposals	(1)	(3)	(107)	(36)	
<b>At 31 December 2014</b>	45	32	744	637	11
Exchange adjustment	(1)		(43)	(19)	
Charge for the year	5	4	137	80	
Disposals	(1)	(1)	(106)	(43)	
<b>At 31 December</b>	48	35	732	655	11



**2015****Net book  
amounts****At  
31 December**

<b>2015</b>	106	23	310	348	145
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At 31 December					
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2014	104	22	316	326	123
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Land and buildings includes land with a cost of \$19m (2014 \$20m) that is not subject to depreciation. Assets held under finance leases with a net book value of \$6m (2014 \$8m) are included within land and buildings.

The impairment charge in the prior year relates to certain assets which related to the production of HP802, which the Group decided not to continue.

Historically, capital expenditure represents the Group's expected annual investment in property, plant and equipment and other intangible assets. This varies between 6% and 8% (2014 6% and 8%) of annual revenue.

Group capital expenditure relating to property, plant and equipment contracted but not provided for amounted to \$20m (2014 \$27m).

The amount of borrowing costs capitalised in 2015 and 2014 was minimal.

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## 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 business is managed and the way the core assets are used to generate cash flows.

If the recoverable amount of the cash-generating unit 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	2015 \$ million	2014 \$ million
<b>Cost</b>			
At 1 January		2,027	1,256
Exchange adjustment		(49)	(73)
Acquisitions	21	34	844
At 31 December		2,012	2,027
<b>Impairment</b>			
At 1 January and 31 December			
<b>Net book amounts</b>		2,012	2,027

The Group has historically identified two CGUs, being Advanced Surgical Devices and Advanced Wound Management, and tested the goodwill balance for impairment at this level. Following the completion of the Group's business reorganisation in 2015, 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:

	2015 \$ million
Reconstruction	557
Other Surgical Devices	1,140
Advanced Wound Management	315
	2,012

Impairment reviews were performed in September 2015 and 2014 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 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 2.1% to 8.6% 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 5.6%. The pre-tax discount rate used in the Reconstruction CGU value-in-use calculation is 10.3%.

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## 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 1.2% to 13.5% 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 5.6%. The pre-tax discount rate used in the Other Surgical Devices CGU value-in-use calculation is 10.3%.

## 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 3.8% to 20.5% 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 6.7%. The pre-tax discount rate used in the Advanced Wound Management CGU value-in-use calculation is 10.3%.

## 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 23.2% for the Reconstruction CGU, 28.1% for the Other Surgical Devices CGU and 28.5% 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.

#### 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 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 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.

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**9 Intangible assets** *continued*

	Technology \$ million	Product- related \$ million	Customer and Distribution related \$ million	Software \$ million	Total \$ million
<b>Cost</b>					
At 1 January 2014	7	1,319	103	229	1,658
Exchange adjustment		(42)	(4)	(11)	(57)
Acquisitions	237	584	9	3	833
Additions		23	5	49	77
Disposals				(3)	(3)
At 31 December 2014	244	1,884	113	267	2,508
Exchange adjustment	(9)	(31)	(13)	(8)	(61)
Acquisitions <sup>1</sup>			19		19
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Additions		17		38	55
Disposals		(6)		(8)	(14)
<b>At 31 December 2015</b>	235	1,864	119	289	2,507
<b>Amortisation and impairment</b>					
At 1 January 2014	3	455	42	104	604
Exchange adjustment		(29)		(3)	(32)
Charge for the year	7	138	15	31	191
Disposals				(2)	(2)
At 31 December 2014	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)
<b>At 31 December 2015</b>	21	759	69	156	1,005
<b>Net book amounts</b>					
<b>At 31 December 2015</b>	214	1,105	50	133	1,502
At 31 December 2014	234	1,320	56	137	1,747

1 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:

	2015	2014
	\$ million	\$ million
Technology	11	7
	188	117
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Product-related		
Customer and Distribution related		5
<b>Total</b>	204	129

Group capital expenditure relating to software contracted but not provided for amounted to \$4m (2014 \$7m).

The carrying values of intangible assets are considered for indicators of impairment and where an indicator, such as declining revenues, is present a full impairment review comparing value in use to carrying value is performed.

Two product-related intangible assets were determined to have value in use below carrying value, resulting in an impairment charge being recognised. The impairment charge primarily relates to \$40m from Oasis, calculated using a discount rate of 11.2% (2014 10.2%), 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 \$45m is supported by the present value of anticipated future cash flows.

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## 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 an 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.

	2015 \$ million	2014 \$ million
At 1 January	5	2
Additions	2	4
Changes in value <sup>1</sup>	3	
Transfer from investments in associates	6	
Distributions	(3)	(1)
At 31 December	13	5

1 Change in value in 2015 relates to the reversal of impairment recognised in prior years.

## 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 2015 and 31 December 2014, 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 stimulation devices and is a provider of osteoarthritis injection therapies. The loss after taxation recognised in the income statement relating to Bioventus was \$18m (2014 loss after taxation \$2m). Of this loss, \$11m relates to a change in the acquisition fair value of the OsteoAMP liability.

In November 2015, the Group contributed \$25m of capital to Bioventus as part of a rights issue, following which the Group's shareholding in Bioventus remained at 49%. The rights issue was to fund the acquisition of Biostructures LLC, a leading medical device company focused on developing bioresorbable bone graft products for a broad range of spinal and orthopaedic fusion procedures.

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 fair value measurement was categorised as a level 3 fair value based on the inputs and valuation technique used.

The amounts recognised in the balance sheet and income statement for associates are as follows:

	2015	2014
	\$ million	\$ million
Balance sheet	115	112
Income statement loss	(16)	(2)

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**11 Investments in associates *continued***

Summarised financial information for significant associates

Set out below is the summarised financial information for Bioventus, adjusted for differences with Group accounting policies:

	2015	2014
	\$ million	\$ million
<b>Summarised balance sheet</b>		
Non-current assets	389	339
Current assets	93	90
Non-current liabilities	(235)	(220)
Current liabilities	(80)	(48)
Net assets	167	161
Group's share of net assets at 49%	82	79
Group adjustments <sup>1</sup>	30	26
Group's carrying amount of investment at 49%	112	105

	2015	2014
	\$ million	\$ million
<b>Summarised statement of comprehensive income</b>		
Revenue	256	242
Attributable loss for the year	(41)	(11)
Group adjustments <sup>1</sup>	5	6
Total comprehensive loss	(36)	(5)
Group share of loss for the year at 49%	(18)	(2)

<sup>1</sup> Group adjustments primarily relate to an adjustment to align the useful life of intangible assets with Group policy. At December 2015, the Group held an equity investment in one other associate (2014 two) with a carrying value of \$3m (2014 \$7m). The Group's other associate was re-classified to an investment during the year.

## 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 of disposal 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 five 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.

	2015	2014	2013
	\$ million	\$ million	\$ million
Raw materials and consumables	205	214	151
Work-in-progress	84	82	72
Finished goods and goods for resale	928	885	783
	1,217	1,181	1,006

Reserves for excess and obsolete inventories were \$322m (2014 \$317m, 2013 \$354m). The increase in reserves of \$5m in the year comprised \$17m charged to the reserve on the write-down of inventory and \$3m attributable to business combinations during the year, partially offset by foreign exchange movements of \$15m.

The cost of inventories recognised as an expense and included in cost of goods sold amounted to \$961m (2014 \$1,013m, 2013 \$958m). In addition, \$73m was recognised as an expense within cost of goods sold resulting from inventory write-offs (2014 \$55m, 2013 \$73m).

Notwithstanding inventory acquired within acquisitions, no inventory is carried at fair value less costs to sell in any year.

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## 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.

	2015	2014	2013
	\$ million	\$ million	\$ million
Trade receivables	1,003	1,015	992
Less: provision for bad and doubtful debts	(64)	(47)	(57)
Trade receivables net (loans and receivables)	939	968	935
Derivatives forward foreign exchange & interest rate contracts	33	49	28
Other receivables	83	51	60
Prepayments and accrued income	83	98	90
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1,138

1,166

1,113

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 \$25m (2014 \$4m credit, 2013 \$15m expense). Amounts due from insurers in respect of the macro textured claim of \$144m (2014 \$143m, 2013 \$138m) are included within other receivables and have been provided in full.

The amount of trade receivables that were past due was as follows:

	2015	2014	2013
	\$ million	\$ million	\$ million
Past due not more than three months	154	181	206
Past due more than three months and not more than six months	45	49	52
Past due more than six months and not more than one year	57	51	61
Past due more than one year	53	42	70
	309	323	389
Neither past due nor impaired	694	692	603
Provision for bad and doubtful debts	(64)	(47)	(57)
Trade receivables net (loans and receivables)	939	968	935

Movements in the provision for bad and doubtful debts were as follows:

	2015	2014	2013
	\$ million	\$ million	\$ million
At 1 January	47	57	49
Exchange adjustment	(3)	(4)	1
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Net receivables (provision released)/provided for during the year	25	(4)	15
Utilisation of provision	(5)	(2)	(8)
At 31 December	64	47	57

Trade receivables include amounts denominated in the following major currencies:

	2015	2014	2013
	\$ million	\$ million	\$ million
US Dollar	362	353	293
Sterling	58	92	103
Euro	192	225	271
Other	327	298	268
Trade receivables net (loans and receivables)	939	968	935

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**14 Trade and other payables**

	2015	2014
	\$ million	\$ million
<b>Trade and other payables due within one year</b>		
Trade and other payables	808	807
Derivatives – forward foreign exchange and currency swaps	26	21
Acquisition consideration	8	10
	842	838
<b>Other payables due after one year</b>		
Acquisition consideration	19	23
Other payables	10	21
	29	44

The acquisition consideration due after more than one year is expected to be payable as follows: \$7m in 2017, \$7m in 2018 and \$5m in 2019 (2014 – \$5m in 2016, \$8m in 2017 and \$10m in 2018).

## 15 Cash and borrowings

## 15.1 Net debt

Net debt comprises borrowings and credit balances on currency swaps less cash at bank.

	2015	2014
	\$ million	\$ million
Bank overdrafts and loans due within one year	46	39
Long-term bank borrowings and finance leases	308	541
Private placement notes	1,126	1,125
Borrowings	1,480	1,705
Cash at bank	(120)	(93)
Credit/(debit) balance on derivatives currency & interest rate swaps	1	1
Net debt	1,361	1,613

Borrowings are repayable as follows:

	Within one year or on demand	Between one and two years	Between two and three years	Between three and four years	Between four and five years	Between five years and After five years	Total
	\$ million	\$ million	\$ million	\$ million	\$ million	\$ million	\$ million
<b>At 31 December 2015:</b>							
Bank loans	26		300				326
Bank overdrafts	18	2	3	3			18
	2	2	3	3			10

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Finance lease liabilities							
Private placement notes				125		1,001	1,126
	46	2	303	128		1,001	1,480
At 31 December 2014:							
Bank loans	9	400			131		540
Bank overdrafts	28						28
Finance lease liabilities	2	2	2	3	3		12
Private placement notes					125	1,000	1,125
	39	402	2	3	259	1,000	1,705

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## 15.2 Assets pledged as security

Assets are pledged as security under normal market conditions. Secured borrowings and pledged assets are as follows:

	2015	2014
	\$ million	\$ million
Finance lease liabilities due within one year	2	2
Finance lease liabilities due after one year	8	10
Total amount of secured borrowings	10	12
Total net book value of assets pledged as security:		
Property, plant and equipment	6	8
	6	8

## 15.3 Liquidity risk exposures 2015

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 (2014 \$2.5bn). 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 2015, 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 principal facilities are:

Facility	Date due
\$300 million bilateral, term loan facility	April 2018
\$1.0 billion syndicated, revolving credit facility	March 2020
\$80 million 2.47% Senior Notes	November 2019
\$45 million Floating Rate Senior Notes	November 2019
\$75 million 3.23% Senior Notes	January 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
\$100 million 3.89% Senior Notes	January 2024
\$305 million 3.36% Senior Notes	November 2024
\$25 million Floating Rate Senior Notes	November 2024
\$75 million 3.99% Senior Notes	January 2026

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**15 Cash and borrowings *continued*****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 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
<b>At 31 December 2015</b>					
Non-derivative financial liabilities:					
Bank overdrafts and loans	44		300		344
Trade and other payables	808	10			818
Finance lease liabilities	3	3	6		12
Private placement notes			125	1,001	1,126



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)
At 31 December 2014	865	20	443	1,001	2,329
Non-derivative financial liabilities:					
Bank overdrafts and loans	37	400	131		568
Trade and other payables	807	21			828
Finance lease liabilities	3	3	9		15
Private placement notes			125	1,000	1,125
Acquisition consideration	10	13	10		33
Derivative financial liabilities:					
Currency swaps/forward foreign exchange contracts outflow	1,811				1,811
Currency swaps/forward foreign exchange contracts inflow	(1,810)				(1,810)
	858	437	275	1,000	2,570

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.

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Future minimum lease payments under finance leases together with the present value of the minimum lease payments are as follows:

	2015	2014
	\$ million	\$ 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	3
After four and within five years		3
After five years		
Total minimum lease payments	12	15
Discounted by imputed interest	(2)	(3)
Present value of minimum lease payments	10	12

Present value of minimum lease payments can be split out as: \$2m (2014 \$2m) due within one year, \$8m (2014 \$10m) due between one to five years and \$nil (2014 \$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 2015, the Group held \$102m (2014 \$65m, 2013 \$126m) in cash net of bank overdrafts. The Group had committed facilities available of \$2,425m at 31 December 2015 of which \$1,425m 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 \$10m.

During the year ended 31 December 2014, the Group refinanced its principal banking facilities. The Group signed a new five-year committed \$1bn multi-currency revolving credit facility with a maturity date of March 2019. This maturity date has since been extended to March 2020. In April 2015, the Group signed a new three year, \$300m bilateral term loan with one of its relationship banks. The new term loan has a maturity date of April 2018. The proceeds of this new loan were used to repay the remaining outstanding amount on the committed term loan used to fund the ArthroCare acquisition.

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 decreased from \$1,613m at the beginning of 2015 to \$1,361m at the end of 2015, representing an overall decrease of \$252m.

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 income/(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.

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**16 Financial instruments and risk management *continued*****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 2015, the Group had contracted to exchange within one year the equivalent of \$1.9bn (2014 \$1.5bn). Based on the Group's net borrowings as at 31 December 2015, if the US Dollar were to weaken against all currencies by 10%, the Group's net borrowings would decrease by \$1m (2014 decrease by \$6m) 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 2015 would have been \$42m lower (2014 \$37m). Similarly, if the Euro was to

weaken by 10% against all other currencies, then the fair value of the forward foreign exchange contracts as at 31 December 2015 would have been \$16m higher (2014 \$26m). 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 2015 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 2015, if interest rates were to increase by 100 basis points in all currencies then the annual net interest charge would increase by \$6m (2014 \$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 2015 was \$33m (2014 \$49m), 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 2015 was \$120m (2014 \$93m). 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.

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## 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:

	Gross borrowings \$ million	Currency swaps \$ million	Total liabilities \$ million	Floating rate liabilities \$ million	Fixed rate liabilities \$ million	Weighted average interest rate %	Fixed rate liabilities Weighted average time for which rate is fixed Years
<b>At 31 December 2015</b>							
US Dollar	1,439	310	1,749	884	865	3.5	7.8
Other	41	60	101	101			
<b>Total interest bearing liabilities</b>	<b>1,480</b>	<b>370</b>	<b>1,850</b>	<b>985</b>	<b>865</b>		
At 31 December 2014							
US Dollar	1,685	208	1,893	826	1,067	3.4	8.3
Euro	10	35	45	45			
Other	10	37	47	47			
<b>Total interest bearing liabilities</b>	<b>1,705</b>	<b>280</b>	<b>1,985</b>	<b>918</b>	<b>1,067</b>		
At 31 December 2015, \$10m (2014 \$12m) of fixed rate liabilities related to finance leases. In 2015, the Group also							



had liabilities due for deferred acquisition consideration (denominated in US Dollars and Brazilian Real) totalling \$27m (2014 \$33m, 2013 \$21m) 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 2015 was 2% (2014 1%).

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
<b>At 31 December 2015</b>						
US Dollars	1	72	55	128	127	1
Other		48	313	361	361	
<b>Total interest bearing assets</b>	<b>1</b>	<b>120</b>	<b>368</b>	<b>489</b>	<b>488</b>	<b>1</b>

At 31 December 2014

US Dollars		13	79	92	92	
Other		80	200	280	280	
<b>Total interest bearing assets</b>		<b>93</b>	<b>279</b>	<b>372</b>	<b>372</b>	

Floating rates on assets are typically based on the short-term deposit rates relevant to the currency concerned. There were \$1m fixed rate assets at 31 December 2015 (2014 \$nil).

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16 Financial instruments and risk management *continued*

## 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.

	Designated at fair value	Fair value hedging instruments	Loans and receivables	Available for sale	Other financial liabilities	Carrying	Fair value		
						amount Total	Level 2	Level 3	Total
At 31 December 2015	\$ million	\$ million	\$ million	\$ million	\$ million	\$ million	\$ million	\$ million	\$ million
<b>Financial assets measured at fair value</b>									
Forward foreign exchange contracts		31				31	31		31
Investments				13		13		13	13
Currency swaps	1					1	1		1
Interest rate swaps		1				1	1		1
	1	32		13		46	33	13	46
<b>Financial liabilities measured at fair value</b>									
	(27)					(27)		(27)	(27)

Acquisition consideration									
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)		(227)	(254)
<b>Financial assets not measured at fair value</b>									
Trade and other receivables			1,022			1,022			
Cash at bank			120			120			
			1,142			1,142			
<b>Financial liabilities not measured at fair value</b>									
Bank overdrafts						(18)		(18)	
Bank loans						(326)		(326)	
Private placement debt						(925)		(949)	(949)

Finance lease liabilities	(10)	(10)			
Trade and other payables	(818)	(818)			
	(2,097)	(2,097)			

The fair value of the private placement notes is determined using a discounted cash flow model based on prevailing market rates.

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	Designated at fair value	Fair value hedging instruments	Loans and receivables	Available for sale	Other financial liabilities	Carrying			Fair value
						amount Total	Level 2	Level 3	Total
At 31 December 2014	\$ million	\$ million	\$ million	\$ million	\$ million	\$ million	\$ million	\$ million	\$ million
<b>Financial assets measured at fair value</b>									
Forward foreign exchange contracts		48				48	48		48
Investments				5		5		5	5
Currency swaps	1 1	48		5		1 54	1 49	5	1 54

**Financial  
liabilities  
measured at**

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**fair value**

Acquisition consideration	(33)		(33)		(33)	(33)
Forward foreign exchange contracts		(19)	(19)	(19)		(19)
Currency swaps	(2)		(2)	(2)		(2)
	(35)	(19)	(54)	(21)	(33)	(54)

**Financial assets not measured at fair value**

Trade and other receivables		1,019		1,019		
Cash at bank		93		93		
		1,112		1,112		

**Financial liabilities not measured at fair value**

Bank overdrafts			(28)	(28)		
Bank loans			(540)	(540)		
Private placement debt			(1,125)	(1,125)	(1,144)	(1,144)
			(12)	(12)		

Finance lease  
liabilities

Trade and  
other  
payables

(828)	(828)
(2,533)	(2,533)

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 2014, other than the representation of \$98m of prepayments and accrued income which is no longer presented as a financial asset.

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.

There were no transfers between Levels 1, 2 and 3 during 2015 and 2014.

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.



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## 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	Metal-on-metal	Legal and other provisions	Total
	\$ million	\$ million	\$ million	\$ million
At 1 January 2014	18		107	125
Acquisitions			24	24
Charge to income statement	17		15	32
Utilised	(22)		(28)	(50)
Exchange adjustment	(1)			(1)
At 31 December 2014	12		118	130
Charge to income statement	23	185	18	226
Utilised	(11)		(31)	(42)
Transfers			15	15
Exchange adjustment	(1)		(2)	(3)
<b>At 31 December 2015</b>	<b>23</b>	<b>185</b>	<b>118</b>	<b>326</b>
Provisions due within one year	23	63	107	193
Provisions due after one year		122	11	133
<b>At 31 December 2015</b>	<b>23</b>	<b>185</b>	<b>118</b>	<b>326</b>
Provisions due within one year	12		55	67
			63	63

Provisions due after one year			
At 31 December 2014	12	118	130

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 \$185m (2014: \$nil) relating to the present value at 31 December 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.

Furthermore, for the year to 31 December 2015, included within legal and other provisions are:

A provision of \$5m (2014: \$10m) relating to the RENASYS distribution hold.

A provision of \$4m (2014: \$7m) relating to the HP802 programme which was stopped during the fourth quarter of 2014.

The remaining balance largely represents provisions for various other litigation matters.

All provisions are expected to be substantially utilised within five years of 31 December 2015 and none are treated as financial instruments.

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**17.2 Contingencies**

The Company and its subsidiaries are parties to various legal proceedings, some of which include claims for substantial damages. The outcome of these proceedings cannot readily be foreseen, but management believes none of them 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 almost all have been resolved. The aggregate cost at 31 December 2015 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 2016, and giving effect to the US settlement described below, approximately 718 such claims were pending with the Group around the world, of which 388 had given rise to pending legal proceedings. The Group has requested indemnity from its product liability insurers for most of these metal-on-metal hip implant claims. 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. These represent the vast majority of current patients.

In 2015 the Group's US subsidiary settled the majority of its US metal-on-metal hip lawsuits, without admitting liability. Insurance receipts covered more than half of the gross settlement, with the net cash cost being \$25 million. 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. 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.

#### Business practice investigations

Business practices in the healthcare industry are subject to regulation and review by various government authorities. From time to time authorities undertake investigations of the Group's activities to verify compliance.

In January 2014, before agreeing to be acquired by the Group, ArthroCare announced a settlement of charges by the US Department of Justice relating to securities fraud in which certain members of prior management were implicated. ArthroCare paid a \$30m fine and signed a deferred prosecution agreement that imposed reporting, compliance and other requirements on ArthroCare for a two-year term. That agreement expired in January 2016, and the related complaint against ArthroCare was dismissed.

#### 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 won a jury verdict in the US district court for Oregon against Arthrex Inc. in 2011 for infringement of the Group's patent relating to suture anchors. A number of issues have been disputed and appealed since the case was first filed in 2003; Arthrex paid \$99m in June 2015, and most of that award (net of various expenses) was recognised in the Group's trading profit at that time. A follow-up trial asserting the same patent against additional Arthrex products is in progress in the Oregon court. Arthrex asserted other patents against the Group in 2014 and 2015 in the US district court for the Eastern District of Texas.

#### Other matters

In April 2009, the Group was served with a subpoena by the US Department of Justice in Massachusetts requiring the production of documents from 1995 to 2009 associated with the marketing and sale of a bone growth stimulation product that the Group has since divested. Similar subpoenas had been served on a number of competitors in the bone growth stimulator market, and a qui tam or 'whistle-blower' complaint had been filed in federal court in Boston, Massachusetts. The Group cooperated with the government inquiry, defended the qui tam action, and agreed in principle to settle the latter in 2015 without admitting any liability.

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## 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, 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 and finance income/costs. 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:

	2015	2014
	\$ million	\$ million
Funded plans:		
UK Plan	(7)	16
US Plan	56	74
Other plans	48	42
	97	132
Unfunded plans:		
Other plans	44	48
Retirement healthcare	30	46
Amount recognised on the balance sheet liability	171	226
Amount recognised on the balance sheet asset	184	233
	(13)	(7)

The Group sponsors 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 Plan was closed to future accrual in March 2014.

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. The main uncertainties affecting the level of benefits payable under the UK Plan are future inflation levels (including the impact of inflation on future salary increase) and the actual longevity of the membership. 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. As a result the Group has recognised a surplus for the UK Plan of \$7m in 2015.

The US Plan is governed by a US Pension Committee which is composed 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.



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## 18.2 Reconciliation of benefit obligations and pension assets

The movement in the Group's pension benefit obligation and pension assets is as follows:

	Obligation	Asset	2015 Total	Obligation	Asset	2014 Total
	\$ million	\$ million	\$ million	\$ million	\$ million	\$ million
Amounts recognised on the balance sheet at beginning of the period	(1,637)	1,411	(226)	(1,581)	1,356	(225)
Income statement expense:						
Current service cost	(20)		(20)	(22)		(22)
Past service cost	22		22	36		36
Settlements	30	(32)	(2)	71	(60)	11
Interest (expense)/income	(56)	50	(6)	(67)	60	(7)
Administration costs and taxes	(3)		(3)	(3)		(3)
Costs recognised in Income statement	(27)	18	(9)	15		15
Re-measurements:						
Actuarial gain due to liability experience	17		17	5		5
Actuarial (loss)/gain due to financial assumptions change	20		20	(179)		(179)

Actuarial loss due to demographic assumptions				(30)		(30)
Return on plan assets (less than)/greater than discount rate		(45)	(45)		110	110
Re-measurements recognised in OCI	37	(45)	(8)	(204)	110	(94)
Cash:						
Employer contributions		66	66		65	65
Employee contributions	(5)	5		(5)	5	
Benefits paid directly by the Group, taxes and administration costs paid from scheme assets	3		3	3		3
Benefits paid	52	(55)	(3)	51	(54)	(3)
Net cash	50	16	66	49	16	65
Exchange rates	56	(50)	6	84	(71)	13
Amount recognised on the balance sheet	(1,521)	1,350	(171)	(1,637)	1,411	(226)
Amount recognised on the balance sheet liability	(691)	507	(184)	(1,611)	1,378	(233)
Amount recognised on the balance sheet asset	(830)	843	13	(26)	33	7
Represented by:						

	Obligation	Asset	2015 Total	Obligation	Asset	2014 Total
	\$ million	\$ million	\$ million	\$ million	\$ million	\$ million
UK Plan	(804)	811	7	(879)	863	(16)
US Plan	(460)	404	(56)	(482)	408	(74)
Other Plans	(257)	135	(122)	(276)	140	(136)
<b>Total</b>	<b>(1,521)</b>	<b>1,350</b>	<b>(171)</b>	<b>(1,637)</b>	<b>1,411</b>	<b>(226)</b>

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 19 years and 14 years for the UK and US Plans respectively.

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**18 Retirement benefit obligations *continued*****18.3 Plan assets**

The market value of the US, UK and Other Plans assets are as follows:

	2015	2014	2013
	\$ million	\$ million	\$ million
<b>UK Plan:</b>			
Assets with a quoted market price:			
Cash and cash equivalents	5	6	8
Equity securities	234	237	220
Government bonds			61
fixed interest index linked			109
Other Bonds	43		
	171	227	
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Liability driven investments			
Diversified growth funds	144	155	159
	597	625	557
Other assets:			
Insurance contract	214	238	248
Market value of assets	811	863	805
<b>US Plan:</b>			
Assets with a quoted market price:			
Cash and cash equivalents			6
Equity securities	166	167	181
Government bonds fixed interest	119	121	64
Corporate bonds	119	120	151
Hedge funds			15
Market value of assets	404	408	417
<b>Other Plans:</b>			
Assets with a quoted market price:			
Cash and cash equivalents	9	6	6
Equity securities	35	33	32
Government bonds fixed interest	5	7	9
index linked	9	13	11
Corporate bonds	13	12	13
Insurance contracts	28	31	24
	8	6	6
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Property			
Other quoted securities	1	3	3
	108	111	104
Other assets:			
Insurance contracts	27	29	29
Investment property			1
Market value of assets	135	140	134
Total market value of assets	1,350	1,411	1,356
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 ) in order to maintain the same level of hedging against interest rate and inflation risks.

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.

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## 18.4 Expenses recognised in the income statement

The total expense relating to retirement benefits recognised for the year is \$58m (2014 \$17m, 2013 \$72m). Of this cost recognised for the year, \$49m (2014 \$32m, 2013 \$32m) relates to defined contributions and \$9m net expense (2014 \$15m net credit, 2013 \$40m expense) 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 2015 due to be paid over to the plans (2014 \$nil, 2013 \$nil).

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, which is detailed under Inflation risk in Note 18.7.

In 2014, the \$15m net credit for defined benefits plans includes a \$35m past service cost credit which arose on the closure of the US Plan to future accrual and a \$11m gain on settlement of benefits as a result of a member buyout.

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 \$3m net interest cost, administration and taxes recognised for the UK Plan includes \$2m fees paid directly by the Group relating to the de-risking options offered to members in 2015.

The defined benefit pension costs charged for the UK and US Plans are:

	2015		2014		2013	
	UK Plan	US Plan	UK Plan	US Plan	UK Plan	US Plan
	\$ million	\$ million	\$ million	\$ million	\$ million	\$ million
Service cost	9		10	2	7	10
Past service cost	(7)			(35)		
Settlement gain	2			(11)		
	3	4	3	3	1	7

Net interest cost, administration and taxes	7	4	13	(41)	8	17
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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.

	2015	2014	2013
	% per annum	% per annum	% per annum
<b>UK Plan:</b>			
Discount rate	3.8	3.7	4.4
Future salary increases	3.6	3.5	3.9
Future pension increases	3.1	3.0	3.4
Inflation (RPI)	3.1	3.0	3.4
Inflation (CPI)	2.1	2.0	2.4
<b>US Plan:</b>			
Discount rate	4.3	4.0	4.9
Future salary increases	n/a	n/a	3.0
Inflation	n/a	n/a	2.5

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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 MP2014 scale. The current longevities underlying the values of the obligations in the defined benefit plans are as follows:

	2015 years	2014 years	2013 years
<b>Life expectancy at age 60</b>			
<b>UK Plan:</b>			
Males	29.6	29.4	29.3
Females	31.3	31.2	31.1
<b>US Plan:</b>			
Males	25.8 28.2	26.0 28.5	23.8 25.5



Females		Life expectancy at age 60 in 20 years time		
<b>UK Plan:</b>				
Males	32.6	32.4	32.2	
Females	33.4	33.3	33.2	
<b>US Plan:</b>				
Males	27.6	27.8	23.8	
Females	29.9	30.2	25.5	

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 affect on the US Pension Plan as it was closed to future accrual in 2014.

\$ million	Increase in pension obligation		Increase in pension cost	
	+50bps/+1yr	-50bps/ 1yr	+50bps/+1yr	-50bps/ 1yr
<b>UK Plan:</b>				
Discount rate	72	+83	4	+4
Inflation	+80	70	+4	3
Mortality	+29	29	+1	1
<b>US Plan:</b>				
Discount rate	29	+33	1	+1
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Inflation		n/a	n/a	n/a	n/a
Mortality		+11	11		

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## 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.

During 2015, the Trustees of the UK Plan offered eligible retired and deferred members three benefit options which would provide them with greater flexibility to manage their final benefit. The three options further minimised the exposure of the UK Plan to inflation risk and were:

an option to exchange future increases on pension benefits for a higher level of pension with no increases;

an option to take a transfer and draw their pension in a more flexible form; and

an option to take a transfer in excess of a standard cash equivalent transfer which could be taken to another pension arrangement.

The US Plan has 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.

The three options offered to members in the UK during 2015 further minimised the exposure to longevity risk (see Inflation risk above).

**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 US has been eliminated with the closure of the US Plan 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 is being undertaken as at 30 September 2015. Contributions to the UK Plan in 2015 were \$37m (2014 \$33m, 2013 \$37m). This included supplementary payments of \$29m (2014 \$23m, 2013 \$31m).

The Group has currently agreed to pay supplementary payments until 2017 and the agreed supplementary contribution for 2016 is \$29m. A new schedule of contributions will be agreed in 2016.

### **US Plan**

Full actuarial valuations were performed annually for the US Plan with the last undertaken as at 20 September 2013 before the closure of the Plan to future accrual. Contributions to the US Plan were \$20m (2014 \$22m, 2013 \$20m) which included supplementary payments of \$20m. The planned contribution for 2016 is \$20m.

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## 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
<b>Authorised</b>			

At 31 December 2013	1,223,591	245	50	245
At 31 December 2014	1,223,591	245	50	245
At 31 December 2015	1,223,591	245	50	245

**Allotted, issued and fully paid**

At 1 January 2013	963,580	193	50	193
Share options	5,587	1		1
Shares cancelled	(51,000)	(10)		(10)
At 31 December 2013	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)
<b>At 31 December 2015</b>	<b>915,447</b>	<b>183</b>	<b>50</b>	<b>183</b>

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 by him) 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:

	2015	2014	2013
	\$ million	\$ million	\$ million
Share capital	183	184	184
Share premium	590	574	535
Capital redemption reserve	12	11	10
Treasury shares	(294)	(315)	(322)
Retained earnings and other reserves	3,475	3,586	3,640
	3,966	4,040	4,047



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## 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 2 May 2013, as part of the new Capital Allocation Framework, the Group announced the start of a new share buy-back programme to return \$300m of surplus capital to its shareholders. The programme was suspended in February 2014 following the announcement of the ArthroCare acquisition. Shares issued in connection with the Group's share incentive plans are bought back on a quarterly basis. 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. During 2014, a total of 4.4m ordinary shares (0.5%) had been purchased at a cost of \$72m and 4.4m ordinary shares (0.5%) had been cancelled. The maximum number of ordinary shares held in treasury during 2015 was 25.0m (2.7%) with a nominal value of \$5.0m.

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 partial 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 2014	318	4	322
Shares purchased	72	3	75
Shares transferred from treasury	(11) (8)	11 (17)	(25)

## Shares transferred to Group beneficiaries

Shares cancelled	(57)		(57)
At 31 December 2014	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

	Number of shares million	Number of shares million	Number of shares million
At 1 January 2014	25.5	0.3	25.8
Shares purchased	4.4	0.2	4.6
Shares transferred from treasury	(0.9)	0.9	
Shares transferred to Group beneficiaries	(0.6)	(1.3)	(1.9)
Shares cancelled	(4.4)		(4.4)
At 31 December 2014	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)
	(4.4)		(4.4)

Shares cancelled At 31 December 2015	18.9	2.3	21.2
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## 19.3 Dividends

	2015	2014	2013
	\$ million	\$ million	\$ million
The following dividends were declared and paid in the year:			
Ordinary final of 18.6¢ for 2014 (2013 17.0¢, 2012 16.20¢) paid 6 May 2015	166	152	146
Ordinary interim of 11.8¢ for 2015 (2014 11.0¢, 2013 10.40¢) paid 27 October 2015	106	98	93
	272	250	239

A final dividend for 2015 of 19.0 US cents per ordinary share was proposed by the Board on 3 February 2016 and will be paid, subject to shareholder approval, on 11 May 2016 to shareholders on the Register of Members on 22 April 2016. The estimated amount of this dividend is \$170m.

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## 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

	Cash	Overdrafts	Due within one year	Due after one year	Net currency swaps	Net interest swaps	Borrowings Net	Total
	\$ million	\$ million	\$ million	\$ million	\$ million	\$ million	\$ million	\$ million
At 1 January 2013	178	(11)	(27)	(430)	2			(288)
	(38)		(6)	84	1			41

## Net cash flow

Exchange adjustment At 31 December 2013	(3)		(1)	(2)	(6)		
	137	(11)	(33)	(347)	1		(253)
Net cash flow	(35)	(19)	22	(1,322)	11		(1,343)
Exchange adjustment At 31 December 2014	(9)	2	3	(13)	(17)		
	93	(28)	(11)	(1,666)	(1)		(1,613)
Net cash flow	34	9	(17)	231	15	1	273
Exchange adjustment <b>At 31 December 2015</b>	(7)	1	1	(16)	(21)		
	120	(18)	(28)	(1,434)	(2)	1	(1,361)

Reconciliation of net cash flow to movement in net debt

	2015	2014	2013
	\$ million	\$ million	\$ million
Net cash flow from cash net of overdrafts	43	(54)	(38)
Settlement of currency swaps	15	11	1
Net cash flow from borrowings	215	(1,300)	78
Change in net debt from net cash flow	273	(1,343)	41
Exchange adjustment	(21)	(17)	(6)
Change in net debt in the year	252	(1,360)	35
Opening net debt	(1,613)	(253)	(288)
<b>Closing net debt</b>	<b>(1,361)</b>	<b>(1,613)</b>	<b>(253)</b>
Cash and cash equivalents			

For the purposes of the Group cash flow statement cash and cash equivalents at 31 December 2015 comprise cash at bank net of bank overdrafts.

	2015	2014	2013
	\$ million	\$ million	\$ million
Cash at bank	120	93	137
Bank overdrafts	(18)	(28)	(11)
<b>Cash and cash equivalents</b>	<b>102</b>	<b>65</b>	<b>126</b>

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.

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## 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 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 estimated fair value of the consideration is \$68m and included \$23m of contingent consideration and \$13m through the settlement of working capital commitments. The fair values shown below have been determined on a provisional basis. If new information is obtained within the measurement period about facts and circumstances that existed at the acquisition date, the acquisition accounting will be revised.

The following table summarises the aggregate consideration transferred and the aggregate amounts of assets acquired and liabilities assumed at the acquisition date:

	\$ million
<b>Aggregate identifiable assets acquired and liabilities assumed</b>	
Intangible assets	19
Other assets <sup>1</sup>	29
Liabilities	(14)
Net assets	34
Goodwill	34
<b>Cost of acquisition</b>	<b>68</b>

<sup>1</sup> Including net cash of \$1m.

The provisional 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.



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**21 Acquisitions and disposals *continued***

The following table summarises the consideration transferred, and the recognised amounts of assets acquired and liabilities assumed at the acquisition date.

	\$ million
<b>Identifiable assets acquired and liabilities assumed</b>	
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)
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Current tax payable	(18)
Deferred tax liabilities	(173)
Net assets	717
Goodwill	829
<b>Consideration (net of \$169m of cash acquired)</b>	<b>1,546</b>

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.

### 21.2 Disposal of business

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.

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## 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:

	2015	2014
	\$ million	\$ million
Land and buildings:		
Within one year	29	34
After one and within two years	20	25
After two and within three years	14	18
After three and within four years	11	12
	8	8
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After four and within five years		
After five years	9	8
Other assets:	91	105
Within one year	16	15
After one and within two years	9	9
After two and within three years	5	4
After three and within four years	2	3
	32	31

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[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, Denmark, Finland, France, Germany, Hong Kong, India, Ireland, Italy, Japan, South Korea, Mexico, the Netherlands, New Zealand, Norway, Poland, Portugal, Singapore, South Africa, Spain, Sweden, Switzerland and the United Arab Emirates. Employees in Malaysia and Costa Rica became eligible to join the plan in 2015. 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.

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At 31 December 2015, 7,235,070 (2014 8,708,000, 2013 13,601,000) options were outstanding under share option plans as follows:

	Number of shares thousand	Range of option exercise prices pence	Weighted average exercise price pence
<b>Employee Plans:</b>			
Outstanding at 1 January 2013	3,162	380.0 609.0	473.1
Granted	1,178	625.0	625.0
Forfeited	(174)	380.0 625.0	488.2
Exercised	(751)	380.0 609.0	453.8
Expired	(128)	380.0 625.0	490.0
Outstanding at 31 December 2013	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
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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
<b>Outstanding at 31 December 2015</b>	<b>3,594</b>	<b>452.0</b>	<b>949.0</b>	<b>797.3</b>
<b>Options exercisable at 31 December 2015</b>	<b>82</b>	<b>461.0</b>	<b>556.0</b>	<b>521.4</b>
Options exercisable at 31 December 2014	94	380.0	585.0	439.6
Options exercisable at 31 December 2013	71	461.0	556.0	467.8
<b>Executive Plans:</b>				
Outstanding at 1 January 2013	16,528	409.5	680.5	583.3
Forfeited	(118)	514.0	650.0	618.8
Exercised	(5,540)	435.5	671.0	568.0
Expired	(556)	435.5	650.0	582.3
Outstanding at 31 December 2013	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
	(1,841)	479.0	680.5	602.2



Exercised				
Expired	(182)	479.0	650.0	604.2
<b>Outstanding at 31 December 2015</b>	<b>3641</b>	<b>470.0</b>	<b>650.0</b>	<b>592.7</b>
<b>Options exercisable at 31 December 2015</b>	<b>3641</b>	<b>470.0</b>	<b>650.0</b>	<b>592.7</b>
Options exercisable at 31 December 2014	4,713	470.0	680.5	585.3
Options exercisable at 31 December 2013	6,631	409.5	680.5	571.1

The weighted average remaining contractual life of options outstanding at 31 December 2015 was 5.1 years (2014 5.8 years, 2013 6.2 years) for Executive Plans and 2.7 years (2014 2.5 years, 2013 2.5 years) for Employee Plans.

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	2015	2014	2013
	pence	pence	pence
Weighted average share price	1,144.4	994.4	764.7

Options granted during the year were as follows:

	Weighted average fair value per option at grant date	Weighted average share price at grant date	Weighted average exercise price	Weighted average option life
Employee Plans	thousand pence 1,622 293.9	pence 1,155.0	pence 949.0	years 3.8

The weighted average fair value of options granted under Employee Plans during 2014 was 255.8p (2013 203.9p) and those under Executive Plans during 2014 was nil (2013 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:

	2015	2014	Employee Plans 2013
Dividend yield %	2.0	2.0	2.0
Expected volatility % <sup>1</sup>	25.0	20.0	25.0
Risk free interest rate % <sup>2</sup>	1.3	1.3	1.3
Expected life in years	3.8	3.9	3.8

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% (2014 40%, 2013 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.

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At 31 December 2015, the maximum number of shares that could be awarded under the Group's long-term incentive plans was:

	Other Awards	EIA	Number of shares in thousands Deferred		Total
			PSP	Bonus Plan	
Outstanding at January 2013	718	929	5,242	164	7,053
Awarded	1,179	785	1,963		3,927
Vested	(437)	(379)	(411)	(115)	(1,342)
Forfeited	(11)	(51)	(1,597)	(5)	(1,664)
Outstanding at 31 December 2013	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)
Outstanding at 31 December 2014	1,521	1,151	4,519		7,191
Awarded	661	592	1,393		2,646
Vested	(678)	(648)	(1,794)		(3,120)
Forfeited	(93)	(84)	(138)		(315)

<b>Outstanding at 31 December 2015</b>	1,411	1,011	3,980	6,402
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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 2015 was 1.1 years (2014 1.1 years, 2013 1.4 years) for the PSP, nil years (2014 nil years, 2013 0.2 years) for the Deferred Bonus Plan, 1.6 years (2014 1.5 years, 2013 1.8 years) for the EIA and 1.9 years (2014 2.0 years, 2013 2.1 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:

	2015	2014	2013
	\$ million	\$ million	\$ million
Granted in current year	11	9	10
Granted in prior years	19	23	18
<b>Total share-based payments expense for the year<sup>1</sup></b>	<b>30</b>	<b>32</b>	<b>28</b>

1 The total share-based payments expense comprises \$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 summarised below:

	2015	2014	2013
	\$ million	\$ million	\$ million
Sales to the associates			5
Purchases from the associates		1	2

All sale and purchase transactions occur on an arm's length basis.

#### Key management personnel

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The remuneration of executive officers (including Non-Executive Directors) during the year is summarised below:

	2015	2014	2013
	\$ million	\$ million	\$ million
Short-term employee benefits	16	14	15
Share-based payments expense	8	8	11
Pension and post-employment benefit entitlements	1	1	1
Other benefits	25	3	27
		26	

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## 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 <sup>1</sup>	Country of operation and incorporation
<b>UK:</b>	
The Albion Soap Company Limited <sup>4</sup>	England & Wales
ArthroCare UK Limited <sup>3</sup>	England & Wales
Michelson Diagnostics Ltd <sup>5</sup> (12.5%)	England & Wales
Smith & Nephew Orthopaedics Limited <sup>4</sup>	England & Wales
Neotherix Limited <sup>5</sup> (24.9%)	England & Wales
Smith & Nephew China Holdings UK Limited <sup>3</sup>	England & Wales
Smith & Nephew UK Executive Pension Scheme Trustee Limited <sup>4</sup>	England & Wales
Smith & Nephew UK Pension Fund Trustee Limited <sup>4</sup>	England & Wales
T.J.Smith and Nephew, Limited <sup>3</sup>	England & Wales
TP Limited <sup>3</sup>	England & Wales
Smith & Nephew ESN Limited <sup>4</sup>	England & Wales
Smith & Nephew Finance <sup>4</sup>	England & Wales
Smith & Nephew Pharmaceuticals Limited <sup>4</sup>	England & Wales



Smith & Nephew USD Limited <sup>3</sup>	England & Wales
Smith & Nephew ARTC Limited <sup>3</sup>	England & Wales
Smith & Nephew Pensions Nominees Limited <sup>4</sup>	England & Wales
Smith & Nephew Trading Group Limited <sup>3</sup>	England & Wales
Smith & Nephew Collagenase Limited	England & Wales
Smith & Nephew Finance Oratec <sup>4</sup>	England & Wales
Smith & Nephew Medical Limited <sup>4</sup>	England & Wales
Smith & Nephew (Overseas) Limited <sup>2, 3</sup>	England & Wales
Smith & Nephew Extruded Films Limited <sup>4</sup>	England & Wales
Smith & Nephew Healthcare Limited <sup>4</sup>	England & Wales
Smith & Nephew Investment Holdings Limited <sup>3</sup>	England & Wales
Smith & Nephew Medical Fabrics Limited <sup>4</sup>	England & Wales
Smith & Nephew Nominee Company Limited <sup>4</sup>	England & Wales
Smith & Nephew Nominee Services Limited <sup>3,4</sup>	England & Wales
Smith & Nephew Employees Trustees Limited <sup>4</sup>	England & Wales
Smith & Nephew UK Limited <sup>2,3</sup>	England & Wales
Plus Orthopedics (UK) Limited <sup>4</sup>	England & Wales
Smith & Nephew Raisegrade Limited <sup>3, 4</sup>	England & Wales
Smith & Nephew Rareletter Limited <sup>4</sup>	England & Wales
Smith & Nephew Beta Limited <sup>4</sup>	England & Wales

Country of

operation and

incorporation

Company name<sup>1</sup>

**Continental Europe:**

Smith & Nephew GmbH	Austria
ArthroCare Belgium SPRL <sup>4</sup>	Belgium
Smith & Nephew S.A.-N.V	Belgium
Smith & Nephew A/S	Denmark
Smith & Nephew Oy	Finland
A2 Surgical	France
Smith & Nephew France SAS <sup>3</sup>	France
Smith & Nephew S.A.S.	France
Joimax GmbH <sup>5</sup> (0.46%)	Germany
Smith & Nephew GmbH	Germany
Smith & Nephew Business Services GmbH & Co. KG <sup>3</sup>	Germany
Smith & Nephew Orthopaedics GmbH	Germany
Smith & Nephew Business Services Verwaltungs GmbH <sup>3</sup>	Germany
Smith & Nephew Deutschland (Holding) GmbH <sup>3</sup>	Germany
Plus Orthopedics Hellas SA	Greece
Smith & Nephew Hellas S.A.	Greece
Smith & Nephew Limited	Ireland
Smith & Nephew Finance Ireland Limited	Ireland
Plus Orthopedics Italy S.r.l	Italy
Smith & Nephew S.r.l. <sup>3</sup>	Italy
ArthroCare Luxembourg Sarl <sup>3, 4</sup>	Luxembourg
Smith & Nephew Finance S.a.r.l. <sup>3</sup>	Luxembourg
Smith & Nephew International S.A. <sup>3</sup>	Luxembourg
Smith & Nephew (Europe) B.V. <sup>3</sup>	Netherlands
Smith & Nephew Nederland CV	Netherlands

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Smith & Nephew Management B.V. <sup>3</sup>	Netherlands
Smith & Nephew Optics B.V. <sup>4</sup>	Netherlands
Smith & Nephew B.V. <sup>3</sup>	Netherlands
Smith & Nephew A/S	Norway
Smith & Nephew sp. z.o.o.	Poland
Smith & Nephew Lda	Portugal
Smith & Nephew S.A.U	Spain
Lumina Adhesives AB <sup>5</sup> (11%)	Sweden
Smith & Nephew AB <sup>3</sup>	Sweden
Smith & Nephew Orthopaedics AG <sup>3</sup>	Switzerland
Plus Orthopedics Holding AG <sup>3</sup>	Switzerland
Smith & Nephew Schweiz AG	Switzerland
Smith & Nephew Manufacturing AG	Switzerland

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Company name <sup>1</sup>	Country of operation and incorporation
<b>US:</b>	
ArthroCare Corporation <sup>3</sup>	United States
Bioventus LLC <sup>5</sup> (49%)	United States
Blue Sky Medical Group, Inc.	United States
Delphi Ventures V, L.P. <sup>5</sup> (6.9%)	United States
Smith & Nephew TE II, L.L.C <sup>3</sup>	United States
Surgical Frontiers Series I, LLC <sup>5</sup> (32%)	United States
Smith & Nephew AHP, Inc. <sup>4</sup>	United States
Smith & Nephew Holdings, Inc. <sup>3</sup>	United States
Smith & Nephew Consolidated, Inc. <sup>3</sup>	United States
Smith & Nephew TE I, LLC <sup>3, 4</sup>	United States
Smith & Nephew, Inc.	United States
Smith & Nephew Wound Management (La Jolla)	United States
OsteoBiologics, Inc.	United States
Oratec Interventions, Inc.	United States
Orthopaedic Biosystems Ltd., Inc.	United States
Plus Orthopedics LLC	United States
Sinopsys Surgical, Inc. <sup>5</sup> (11.5%)	United States
Smith & Nephew OUS, Inc. <sup>3</sup>	United States
Healicoil, Inc.	United States
Hipco, Inc.	United States
Kalypto Medical, Inc.	United States
LifeModeler, Inc.	United States
Memphis Biomed Ventures I, L.P. <sup>5</sup> (4.6%)	United States
Norseman Acquisition Corp.	United States
<b>Africa, Asia, Australasia and Other America:</b>	
Smith & Nephew Argentina S.R.L. <sup>4</sup>	Argentina
ArthroCare (Australasia) Pty Ltd <sup>4</sup>	Australia
Smith & Nephew Surgical Pty Limited <sup>3</sup>	Australia
Smith & Nephew Pty Limited	Australia
Smith & Nephew Surgical Holdings Pty Limited <sup>3</sup>	Australia
Smith & Nephew do Brasil Participacoes S.A. <sup>3</sup>	Brazil
Smith & Nephew Comercio de Produtos Medicos LTDA	Brazil

Smith & Nephew Inc.	Canada
Smith & Nephew (Alberta) Inc. <sup>4</sup>	Canada
Tenet Medical Engineering, Inc.	Canada
ArthroCare Corporation Cayman Islands <sup>3</sup>	Cayman Islands
Smith & Nephew Finance Holdings Limited <sup>3</sup>	Cayman Islands
ArthroCare Medical Devices (Beijing) Co. Limited	China
Smith & Nephew Medical (Shanghai) Limited <sup>4</sup>	China
Smith & Nephew Medical (Suzhou) Limited	China
Smith & Nephew Orthopaedics (Beijing) Co., Ltd	China
	Country of
	operation and
Company name <sup>1</sup>	incorporation
<b>Africa, Asia, Australasia and Other America: continued</b>	
Smith & Nephew Colombia S.A.S	Colombia
S&N Holdings SAS <sup>3</sup>	Colombia
ArthroCare Costa Rica Srl	Costa Rica
Smith & Nephew Curacao N.V.	Curaçao
ArthroCare (Hong Kong) Limited	Hong Kong
Smith & Nephew Limited <sup>3</sup>	Hong Kong
Smith & Nephew Beijing Holdings Limited <sup>3</sup>	Hong Kong
Smith & Nephew Suzhou Holdings Limited <sup>3</sup>	Hong Kong
Adler Mediequip Private Limited	India
ArthroCare India Medical Device Private Limited <sup>3</sup>	India
Smith & Nephew Healthcare Private Limited	India
Ortho-Space Ltd. <sup>5</sup> (14.3%)	Israel
Smith & Nephew Endoscopy KK	Japan
Smith & Nephew KK <sup>3</sup>	Japan
Smith & Nephew Orthopaedics KK	Japan
Smith & Nephew Wound Management KK	Japan
Smith & Nephew Chusik Hoesia	Korea, Republic of
Smith & Nephew Healthcare Sdn Berhad	Malaysia
Smith & Nephew S.A. de C.V.	Mexico
Smith & Nephew Limited	New Zealand
Smith & Nephew Surgical Limited	New Zealand
Smith & Nephew Inc.	Puerto Rico
D-Orthopaedics LLC	Russian Federation
LLC DC	Russian Federation
LLC Smith & Nephew	Russian Federation
Smith & Nephew Pte Limited	Singapore
Smith & Nephew Pharmaceuticals (Proprietary) Limited	South Africa
ICEMBE Medical (pty) Ltd <sup>5</sup> (10%)	South Africa
Smith & Nephew (pty) Limited <sup>3</sup>	South Africa
Smith & Nephew Limited	Thailand
Sri Siam Medical Limited <sup>3, 5</sup> (48.9%)	Thailand
Smith ve Nephew Medikal Cihazlar Ticaret Limited Sirketi	Turkey
Smith & Nephew FZE	United Arab
	Emirates

- 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.

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**24 Post balance sheet events**

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. This acquisition will be treated as a business combination under IFRS 3. The maximum consideration is \$279m and a provisional fair value consideration is \$265m cash. Acquired net assets have a provisional value of \$1m which is not expected to have material fair value adjustments. The remaining \$264m will be allocated between identifiable intangible assets including technology, research and development in-progress and goodwill, with the majority expected to be goodwill (representing know-how and workforce), and is not expected to be deductible for tax purposes.

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**COMPANY  
FINANCIAL STATEMENTS**

Company balance sheet

	Notes	At 31 December 2015 \$ million	At 31 December 2014 \$ million
<b>Fixed assets:</b>			
Investments	3	5,322	5,322
<b>Current assets:</b>			
Debtors	4	2,234	2,143
Cash and bank	6	47	1
		2,281	2,144
<b>Creditors: amounts falling due within one year:</b>			
Borrowings	6	(3)	(40)
Other creditors	5	(1,881)	(1,287)
		(1,884)	(1,327)
		397	817
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<b>Net current assets</b>			
<b>Total assets less current liabilities</b>		5,719	6,139
<b>Creditors: amounts falling due after one year:</b>			
Borrowings	6	(1,425)	(1,655)
<b>Total assets less total liabilities</b>		4,294	4,484
Equity shareholders' funds:			
Called up equity share capital	7	183	184
Share premium account	7	590	574
Capital redemption reserve	7	12	11
Capital reserve	7	2,266	2,266
Treasury shares	7	(294)	(315)
Exchange reserve	7	(52)	(52)
Profit and loss account	7	1,589	1,816
<b>Shareholders' funds</b>		4,294	4,484

The accounts were approved by the Board and authorised for issue on 24 February 2016 and signed on its behalf by:

<b>Roberto Quarta</b>	<b>Olivier Bohuon</b>	<b>Julie Brown</b>
Chairman	Chief Executive Officer	Chief Financial Officer

THE PARENT COMPANY FINANCIAL STATEMENTS OF SMITH & NEPHEW PLC ON PAGES 167 TO 170 DO NOT FORM PART OF THE SMITH & NEPHEW'S ANNUAL REPORT ON FORM 20-F AS FILED WITH THE SEC.



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**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.

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 \$107m (2014 \$922m).

## 3 Investments

### ACCOUNTING POLICY

Investments in subsidiaries are stated at cost less provision for impairment.

	2015	2014
	\$ million	\$ million
At 1 January	5,322	3,597
Additions		1,725
At 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 this section.

THE PARENT COMPANY FINANCIAL STATEMENTS OF SMITH & NEPHEW PLC ON PAGES 167 TO 170 DO NOT FORM PART OF THE SMITH & NEPHEW S ANNUAL REPORT ON FORM 20-F AS FILED WITH THE SEC.

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**4 Debtors**

	2015	2014
	\$ million	\$ million
Amounts falling due within one year:		
Amounts owed by subsidiary undertakings	2,169	2,074
Prepayments and accrued income	5	3
Current asset derivatives forward foreign exchange contracts	30	46
Current asset derivatives forward foreign exchange contracts subsidiary undertakings	21	19
Current taxation	9	1
	2,234	2,143

**5 Other creditors**

	2015	2014
	\$ million	\$ million
Amounts falling due within one year:		
Amounts owed to subsidiary undertakings	1,813	1,212
Other creditors	15	9
	21	19

Current liability derivatives	forward foreign exchange contracts		
Current liability derivatives	forward foreign exchange contracts	subsidiary undertakings	30
Current liability derivatives	currency swaps		2
			1,881
			1,287

## 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.

	2015	2014
	\$ million	\$ million
Bank loans and overdrafts due within one year or on demand	3	40
Bank loans due after one year	1,425	1,655
Borrowings	1,428	1,695
Cash and bank	(47)	(1)
Credit balance on derivatives	2	1
Net debt	1,383	1,695

All currency swaps are stated at fair value. Gross US Dollar equivalents of \$368m (2014 \$261m) receivable and \$370m (2014 \$262m) payable have been netted. Currency swaps comprise foreign exchange swaps and were used in 2015 and 2014 to hedge intragroup loans.

THE PARENT COMPANY FINANCIAL STATEMENTS OF SMITH & NEPHEW PLC ON PAGES 167 TO 170 DO NOT FORM PART OF THE SMITH & NEPHEW S ANNUAL REPORT ON FORM 20-F AS FILED WITH THE SEC.

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## 7 Equity and reserves

	Share capital	Share premium	Capital redemption reserve	Capital reserves	Treasury shares	Exchange reserves	Profit and loss account
	\$ million	\$ million	\$ million	\$ million	\$ million	\$ million	\$ million
At 1 January	184	574	11	2,266	(315)	(52)	1,810
Attributable profit for the year							100
Net losses on cash flow hedges							
Exchange adjustments							(272)

Equity dividends paid in the year								
Share-based payments recognised								29
Cost of shares transferred to beneficiaries						38		(38)
New shares issued on exercise of share options		16						
Cancellation of treasury shares	(1)		1			60		(60)
Treasury shares purchased						(77)		
At 31 December	183	590	12	2,266	(294)	(52)		1,585

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 \$1,243m (2014 \$1,449m). 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 \$107m (2014 \$922m).

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.

## 8 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.

## 9 Contingencies

	2015	2014
	\$ million	\$ million
Guarantees in respect of subsidiary undertakings		11
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 167 to 170 do not form part of the Smith & Nephew s

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**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 over 150 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.

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	21
Group research facility in York, UK	84
Regional headquarters in Andover, Massachusetts, US	144
Manufacturing and distribution facility in Hull, UK	473
Manufacturing 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 and warehouse facility in Tuttlingen, Germany	64
Distribution facility and European headquarters in Baar, Switzerland	67
Manufacturing facility in Mansfield, Massachusetts, US	98
Manufacturing facility in Oklahoma City, Oklahoma, US	155
Manufacturing facility in Austin, Texas, US	198
Manufacturing facility in La Aurora and Alayuela, Costa Rica	292
Research facility in Irvine, California, US	23
Manufacturing facility in Sangameshwar, India	39
Manufacturing facility in Suzhou, China	288
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Manufacturing facility in Puschino, Russia

Bioactives headquarters and laboratory space in Fort Worth, Texas, US

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Manufacturing facility in Curaçao, Dutch Caribbean

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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 172 to 174 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.

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**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 2015, 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 certain parts of southern Europe. These factors tempered the overall growth of the Group's global markets and could have an increased impact on growth in the future.

Political uncertainties

The Group operates on a worldwide basis and has distribution channels, purchasing agents and buying entities in over 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.

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**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 117.

**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, Sangameshwar in India, Suzhou and Beijing in China, La Aurora in Costa Rica, Puschino in Russia and Curaçao. 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.

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## 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 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 Global Market](#) on pages 14 to 15, [Financial review](#) on pages 40 to

41 and Taxation information for shareholders on pages 191 to 192.

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Selected financial data

	2015	2014	2013	2012	2011
	\$ million	\$ million	\$ million	\$ million	\$ million
<b>Income statement</b>					
Revenue	4,634	4,617	4,351	4,137	4,270
Cost of goods sold	(1,143)	(1,162)	(1,100)	(1,070)	(1,140)
Gross Profit	3,491	3,455	3,251	3,067	3,130
Selling, general and administrative expenses	(2,641)	(2,471)	(2,210)	(2,050)	(2,101)
Research and development expenses	(222)	(235)	(231)	(171)	(167)
Operating profit	628	749	810	846	862
Net interest (payable)/receivable	(38)	(22)	4	2	(8)
Other finance (costs)/income	(15)	(11)	(11)	(11)	(13)
Share of results of associates	(16)	(2)	(1)	4	
Profit on disposal of net assets held for sale				251	

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Profit before taxation	559	714	802	1,092	841
Taxation	(149)	(213)	(246)	(371)	(266)
Attributable profit for the year	410	501	556	721	575
<b>Earnings per ordinary share</b>					
Basic	45.9¢	56.1¢	61.7¢	80.4¢	64.5¢
Diluted	45.6¢	55.7¢	61.4¢	80.0¢	64.2¢
<b>Adjusted attributable profit</b>					
Attributable profit for the year	410	501	556	721	575
Acquisition related costs	25	125	31	11	
Restructuring and rationalisation expenses	65	61	58	65	40
Legal and other	187	(2)			23
Amortisation of acquisition intangibles and impairments	204	129	88	43	36
Profit on disposal of net assets held for sale				(251)	
Taxation on excluded items	(130)	(71)	(40)	82	(17)
Adjusted attributable profit	761	743	693	671	657
Adjusted basic earnings per ordinary share ( EPSA <sup>1</sup> )	85.1¢	83.2¢	76.9¢	74.8¢	73.7¢
Adjusted diluted earnings per ordinary share <sup>2</sup>	84.6¢	82.6¢	76.5¢	74.5¢	73.4¢

1 Adjusted basic earnings per ordinary share is calculated by dividing adjusted attributable profit by the average number of shares.

2 Adjusted diluted earnings per ordinary share is calculated by dividing adjusted attributable profit by the diluted number of shares.

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	2015	2014	2013	2012	2011
	\$ million	\$ million	\$ million	\$ million	\$ million
<b>Group balance sheet</b>					
Non-current assets	4,692	4,866	3,563	3,498	2,542
Current assets	2,475	2,440	2,256	2,144	2,080
Assets held for sale					125
<b>Total assets</b>	<b>7,167</b>	<b>7,306</b>	<b>5,819</b>	<b>5,642</b>	<b>4,747</b>
Share capital	183	184	184	193	191
Share premium	590	574	535	488	413
Capital redemption reserve	12	11	10		
Treasury shares	(294)	(315)	(322)	(735)	(766)
Retained earnings and other reserves	3,475	3,586	3,640	3,938	3,349
<b>Total equity</b>	<b>3,966</b>	<b>4,040</b>	<b>4,047</b>	<b>3,884</b>	<b>3,187</b>



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Non-current liabilities	1,857	2,104	699	828	422
Current liabilities	1,344	1,162	1,073	930	1,119
Liabilities directly associated with assets held for sale					19
<b>Total liabilities</b>	3,201	3,266	1,772	1,758	1,560
<b>Total equity and liabilities</b>	7,167	7,306	5,819	5,642	4,747
<b>Group cash flow statement</b>					
Cash generated from operations	1,203	961	1,138	1,184	1,135
Net interest paid	(36)	(33)	(6)	(4)	(8)
Income taxes paid	(137)	(245)	(265)	(278)	(285)
Net cash inflow from operating activities	1,030	683	867	902	842
Capital expenditure (including trade investments and net of disposals of property, plant and equipment)	(358)	(375)	(340)	(265)	(321)
Acquisitions and disposals	(46)	(1,556)	(67)	(782)	(33)
Proceeds on disposal of net assets held for sale				103	
Investment in associate	(25)	(2)		(10)	
Proceeds from associate loan redemption		188			
Proceeds from own shares	5	4	3	6	7
Equity dividends paid	(272)	(250)	(239)	(186)	(146)
Issue of ordinary capital and treasury shares purchased	(61)	(35)	(183)	77	11
Net cash flow from financing and investing activities	273	(1,343)	41	(155)	360
Exchange adjustments	(21)	(17)	(6)	5	(6)
Opening net debt	(1,613)	(253)	(288)	(138)	(492)

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Closing net debt	(1,361)	(1,613)	(253)	(288)	(138)
<b>Selected financial ratios</b>					
Gearing (closing net debt as a percentage of total equity)	34%	40%	6%	7%	4%
Dividends per ordinary share <sup>1</sup>	30.8¢	29.60¢	27.40¢	26.10¢	17.40¢
Research and development costs to revenue	4.8%	5.1%	5.3%	4.1%	3.9%
Capital expenditure (including intangibles but excluding goodwill) to revenue	7.7%	8.1%	7.8%	6.4%	7.5%

<sup>1</sup> The Board has proposed a final dividend of 19.0 US cents per share which together with the first interim dividend of 11.8 US cents makes a total for 2015 of 30.8 US cents.

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**Non-GAAP financial information**

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, 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.

**Revenue**

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

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

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

The Group considers that revenue from sales of products acquired in material business combinations results in a step-up in growth in revenue in the year of acquisition that cannot be wholly attributed to local management's efforts with respect to the business in the year of acquisition. Depending on the timing of the acquisition, there will usually be

a further step change in the following year. A measure of growth excluding the effects of business combinations also allows senior management to evaluate the performance and relative impact of growth from the existing business and growth from acquisitions. The process of making business acquisitions is directed, approved and funded from the Group corporate centre in line with strategic objectives.

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

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

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

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

	2015	2014	2013
	%	%	%
Reported revenue growth	0	6	5
Constant currency exchange effect	8	1	1
Acquisitions/Disposals effect	(4)	(5)	(2)
Underlying revenue	4	2	4

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## 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.

Underlying growth in trading profit and trading profit margin (trading profit expressed as a percentage of revenue and trading cash flow) are measures, which present the growth trend in the long-term profitability of the Group.

Underlying growth in trading profit is used to compare the period-on-period growth in trading profit on a like-for-like basis. This is achieved by adjusting for the impact of material business combinations and disposals and for movements in exchange rates in the same manner as underlying revenue growth is determined, as described above.

## Adjusted earnings per ordinary share ( EPISA )

EPISA 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 ).

		Restructuring				
	Trading	Acquisition	and	Amortisation	Legal	Capital
	results	related	rationalisation	of acquisition	and	expenditure
	2015	costs	costs	intangibles	other	
For the year ended 31 December 2015	\$ million	\$ million	\$ million	\$ million	\$ million	\$ million
<b>Revenue</b>	4,634					
Cost of goods sold	(1,143)					
<b>Gross profit</b>	3,491					
Selling, general and administration expenses	(2,170)	(12)	(65)	(204)	(190)	
Research and development expenses	(222)					
<b>Trading/operating profit</b>	1,099	(12)	(65)	(204)	(190)	
<i>Trading/operating profit margin</i>	23.7%					
Interest receivable	6				5	
Interest payable	(47)	(2)				
Other finance costs	(13)				(2)	
Share of loss from associates	(5)	(11)				
<b>Profit before taxation</b>	1,040	(25)	(65)	(204)	(187)	
Taxation	(279)	9	18	66	37	
<b>Adjusted attributable/attributable profit</b>	761	(16)	(47)	(138)	(150)	
<b>EPSA/EPS</b>	85.1	(1.8)	(5.3)	(15.4)	(16.7)	
	894					

Weighted average number of shares (million)

**Diluted EPSA/EPS**

84.6 (1.8) (5.2) (15.4) (16.6)

Diluted weighted average number of shares (million)

899

**Trading cash flow/cash generated from operating activities**

936 (36) (52) (3)

35

*Trading profit to cash conversion ratio (%)*

85%

**Acquisition related costs and cash flows:** For the year to 31 December 2015, these costs primarily relate to ongoing ArthroCare integration and deferred consideration for an acquisition made by an associate.

**Restructuring and rationalisation costs:** For the year to 31 December 2015, these costs primarily relate to the ongoing implementation of the Group Optimisation plan that was announced in May 2014.

**Amortisation and impairment of acquisition intangibles:** For the year ended 31 December 2015, these charges relate to the amortisation of intangible assets acquired in material business combinations and a total impairment of \$51m including \$40m relating to Oasis, a product acquired with the Healthpoint acquisition in 2013.

**Legal and other:** For the year to 31 December 2015, the net charge primarily relates to \$203m for known, anticipated and settled metal on metal hip claims and associated legal expenses of \$21m. This was offset by a net gain of \$33m relating to patent litigation with Arthrex and past service and curtailment gains of \$19m arising on US and UK post-retirement benefits.

In addition, a total of \$18m charge primarily relates to final costs relating to RENASYS distribution hold and redundancies from the decision to cease development of HP802.

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	Trading results 2014	Acquisition related costs \$ million	Restructuring and rationalisation costs \$ million	Amortisation of acquisition intangibles \$ million	Legal and other \$ million	Capital expenditure \$ million
For the year ended 31 December 2014	\$ million	\$ million	\$ million	\$ million	\$ million	\$ million
<b>Revenue</b>	4,617					
Cost of goods sold	(1,127)	(23)	(12)			
<b>Gross profit</b>	3,490	(23)	(12)			
Selling, general and administration expenses	(2,200)	(95)	(49)	(129)	2	
Research and development expenses	(235)					
<b>Trading/operating profit</b>	1,055	(118)	(61)	(129)	2	
<i>Trading/operating profit margin</i>	22.9%					
Interest receivable	13					
Interest payable	(28)	(7)				
Other finance costs	(11) (2)					



Share of loss from associates					
<b>Profit before taxation</b>	1,027	(125)	(61)	(129)	2
Taxation	(284)	30	15	35	(9)
<b>Adjusted attributable/attributable profit</b>	743	(95)	(46)	(94)	(7)
<b>EPSA/EPS</b>	83.2¢	(10.6¢)	(5.2¢)	(10.5¢)	(0.8¢)
Weighted average number of shares (million)	893				
<b>Diluted EPSA/EPS</b>	82.6¢	(10.5¢)	(5.1¢)	(10.5¢)	(0.8¢)
Diluted weighted average number of shares (million)	899				
<b>Trading cash flow/cash generated from operating activities</b>	781	(112)	(60)	(23)	375

*Trading profit to cash conversion ratio (%)*

74%

**Acquisition related costs:** For the year ended 31 December 2014, these costs primarily relate to transaction and integration costs associated with the ArthroCare acquisition with a small portion of costs relating to the continued integration of Healthpoint and the recent acquisitions in the Emerging & International Markets. In addition, trading results eliminate the short-term increase in cost of goods sold from recognising acquired inventory at fair value rather than standard cost. For the year ended 31 December 2013, these costs primarily relate to the integration of the Healthpoint business.

**Restructuring and rationalisation costs:** For the year ended 31 December 2014, these costs relate to the Group Optimisation programme that was announced in May 2014 and the structural and efficiency programme announced in August 2011.

**Amortisation of acquisition intangibles:** This charge relates to the amortisation of intangible assets acquired in material business combinations.

**Legal and other:** For the year ended 31 December 2014, this net credit relates to a past service gain and a settlement credit on the closure of US Pension Plan of \$46m and a gain on disposal of a UK manufacturing facility of \$9m, offset by a charge of \$25m relating to the likely costs of a distribution hold on RENASYS in the US pending new regulatory approvals and a charge of \$28m relating to the HP802 programme which was stopped in the fourth quarter.

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	Trading Results 2013 \$ million	Acquisition related costs \$ million	Restructuring and rationalisation costs \$ million	Amortisation of acquisition intangibles \$ million	Legal and other \$ million	Capital expenditure \$ million
For the year ended 31 December 2013						
<b>Revenue</b>	4,351					
Cost of goods sold	(1,083)	(5)	(12)			
<b>Gross profit</b>	3,268	(5)	(12)			
Selling, general and administration expenses	(2,050)	(26)	(46)	(88)		
Research and development expenses	(231)					
<b>Trading/operating profit</b>	987 22.7%	(31)	(58)	(88)		

*Trading/operating profit margin*

Interest receivable	14			
Interest payable	(10)			
Other finance costs	(11)			
Share of loss from associates	(1)			
<b>Profit before taxation</b>	979	(31)	(58)	(88)
Taxation	(286)	6	11	23
<b>Adjusted attributable/attributable profit</b>	693	(25)	(47)	(65)
<b>EPSA/EPS</b>	76.9¢	(2.8¢)	(5.2¢)	(7.2¢)
Weighted average number of shares (million)	901			
<b>Diluted EPSA/EPS</b>	76.5¢	(2.8¢)	(5.2¢)	(7.1¢)
Diluted weighted average number of shares (million)	906			
<b>Trading cash flow/cash generated from operating activities</b>	877	(25)	(54)	340

*Trading profit to cash conversion ratio (%)*

89%

**Acquisition related costs:** For the year ended 31 December 2013, these costs primarily relate to the integration of the Healthpoint business.

**Restructuring and rationalisation costs:** For the year ended 31 December 2013, these costs primarily relate to the structural and efficiency programme announced in August 2011.

**Amortisation of acquisition intangibles:** This charge relates to the amortisation of intangible assets acquired in material business combinations.

Transactional and translational exchange

The Group's principal markets outside the US are, in order of significance, Continental Europe, UK, Australia and Japan. Revenues in these markets fluctuate when translated into US Dollars on consolidation. During the year, the average rates of exchange against the US Dollar used to translate revenues and profits arising in these markets changed compared to the previous year as follows: the Euro weakened from 1.33 to 1.09 ( - 18%), Sterling weakened from 1.65 to 1.48 ( - 10%), the Swiss Franc weakened from 1.09 to 1.00 ( - 8%), the Australian Dollar weakened from 0.90 to 0.73 ( - 18%) and the Japanese Yen weakened from 105.84 to 120.38 (14%).

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

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**Contractual obligations**

Contractual obligations at 31 December 2015 were as follows:

	Payments due by period			
	Less than 1 year \$ million	1 3 years \$ million	3 5 years \$ million	More than 5 years \$ million
Debt obligations	44	300		
Finance lease obligations	2	5	3	
Operating lease obligations	45	48	21	9
Retirement benefit obligation	49			
Purchase obligations	19	19	15	3
Capital expenditure	24			
Other	31	19		
	214	391	39	12

Other contractual obligations represent \$23m of foreign exchange contracts and \$27m of acquisition consideration. Provisions that do not relate to contractual obligations are not included in the above table.

The agreed contributions for 2016 in respect of the Group's defined benefits plans are: \$36m for the UK (including \$29m of supplementary payments), \$20m for the US Plan and \$6m for other funded defined benefit plans. The table above does not include amounts payable in respect of 2016 and beyond as these are subject to future agreement and amounts cannot be reasonably estimated.

There are a number of agreements that take effect, alter or terminate upon a change in control of the Company or the

Group following a takeover, such as bank loan agreements and Company share plans. None of these are deemed to be significant in terms of their potential impact on the business of the Group as a whole. In addition, there are service contracts between the Company and its Executive Directors which provide for the automatic payment of a bonus following loss of office or employment occurring because of a successful takeover bid. Further details are set out on page 100.

The Company does not have contracts or other arrangements which individually are essential to the business.

## 2014 Financial highlights

### Revenue

Group revenue increased by \$266m (6% on a reported basis), from \$4,351m in 2013 to \$4,617m in 2014.

The underlying increase is 2%, after adjusting for the 5% impact of the acquisitions of ArthroCare and a Brazilian distributor and 1% attributable to the unfavourable impact of currency movements. Despite flat growth in the Established Markets, growth of 17% in the Emerging & International Markets contributed to this underlying increase of 2%.

### Cost of goods sold

Cost of goods sold increased by \$62m (6% on a reported basis) from \$1,100m in 2013 to \$1,162m in 2014. The underlying movement is 5% after adjusting for the net impact of 4% from the ArthroCare acquisition and 3% attributable to the unfavourable impact of currency movements. The movement in underlying costs of goods sold of 5% is largely attributable to the increase in underlying trading.

During 2014, \$12m of restructuring and rationalisation expenses (2013 \$12m) and \$23m of acquisition related costs (2013 \$5m) were charged to cost of goods sold.

### Selling, general and administration expenses

Selling, general and administrative expenses increased by \$261m (12% on a reported basis) from \$2,210m in 2013 to \$2,471m in 2014. The underlying movement is 5% after adjusting for the net impact of 7% from the ArthroCare acquisition. Currency movements had no impact.

The underlying increase of 5% is due to the promotion of new product and costs associated with the RENASYS distribution hold and HP802 termination and the underlying increase in trading.

In 2014, administrative expenses included \$62m of amortisation of other intangible assets (2013 \$64m), \$49m of restructuring and rationalisation expenses (2013 \$46m), an amount of \$129m relating to amortisation of acquisition intangibles (2013 \$88m) and \$95m of acquisition related costs (2013 \$26m).

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## Research and development expenses

Research and development expenditure as a percentage of revenue remained broadly consistent at 5.1% in 2014 (2013 5.3%). Actual expenditure was \$235m in 2014 compared to \$231m in 2013. The Group continues to invest in innovative technologies and products to differentiate it from competitors.

## Operating profit

Operating profit decreased by \$61m to \$749m from \$810m in 2013. This comprised an increase of \$6m in Advanced Surgical Devices and a decrease of \$67m in Advanced Wound Management.

The movement in Advanced Surgical Devices is attributable to the continuing pressure on margins and its investment in the Emerging & International Markets. Advanced Wound Management has been adversely impacted by the costs associated with the RENASYS distribution hold and the impairment and costs associated with the termination of the HP802 programme.

## Net interest receivable/(payable)

Net interest receivable increased by \$26m from net \$4m receivable in 2013 to a net receivable of \$22m in 2014. This movement is primarily due to an increase in interest payable as a result of financing the ArthroCare acquisition. Interest receivable also decreased following the repayment by Bioventus LLC of their loan note in October 2014.

## Other finance cost

Other finance costs in 2014 remained at \$11m and principally relate to costs associated with the Group's retirement benefit schemes.

## Taxation

The taxation charge decreased by \$33m to \$213m from \$246m in 2013. The reported rate of tax was 29.9%, compared with 30.5% in 2013.

After adjusting for specific transactions that management considers affect the Group's short-term profitability, restructuring and rationalisation expenses, amortisation of acquisition intangibles, acquisition related costs and legal and other items, the tax rate on trading profit was 27.7% (2013 29.2%).

Commentary on the Group balance sheet

### **Non-current assets**

Non-current assets increased by \$1,303m to \$4,866m in 2014 from \$3,563m in 2013. This is principally attributable to the following:

Property, plant and equipment increased by \$75m from \$816m in 2013 to \$891m in 2014. Depreciation of \$222m was charged during 2014, assets with a net book value of \$15m were disposed of and \$14m was impaired relating to HP802. These movements were offset by \$298m of additions relating primarily to instruments and other plant & machinery and \$62m of additions arising on acquisitions of ArthroCare. The balance relates to unfavourable currency movements totalling \$34m.

Goodwill increased by \$771m from \$1,256m in 2013 to \$2,027m in 2014. Of this movement, \$829m arose on the acquisition of ArthroCare and \$15m on the acquisition in Brazil. The remaining balance relates to favourable currency movements totalling \$73m.

Intangible assets decreased by \$693m from \$1,054m in 2013 to \$1,747m in 2014. Intangible assets totalling \$817m and \$16m arose on the acquisition of ArthroCare and Brazil respectively. Amortisation of \$191m was charged during the year and assets with a net book value of \$1m were disposed of. A total of \$77m relates to the cost of intellectual property, distribution rights and software acquired. The balance relates to unfavourable currency movements totalling \$25m.

Investment in associates of \$112m in 2014 has increased from \$107m in 2013. The loan to the associate was fully repaid in the year.

Deferred tax assets decreased by \$68m in the year from \$145m in 2013 to \$77m in 2014.

### **Current assets**

Current assets increased by \$184m to \$2,440m from \$2,256m in 2013. The movement relates to the following:

Inventories rose by \$175m to \$1,181m in 2014 from \$1,006m in 2013. This movement is principally attributable to the acquisitions of ArthroCare and distributor in Brazil which increased inventory by \$70m and \$36m relating to the purchase of an advanced quantity of an ingredient to ensure continued supply of REGRANEX.



The level of trade and other receivables increased by \$53m to \$1,166m in 2014 from \$1,113m in 2013. The movement primarily relates to the increase in underlying revenues and \$54m from the ArthroCare acquisition offset by \$75m of unfavourable currency movements.

Cash at bank has fallen by \$44m to \$93m from \$137m in 2013.

**Non-current liabilities**

Non-current liabilities increased by \$1,405m from \$699m in 2013 to \$2,104m in 2014. This movement relates to the following items:

Long-term borrowings have increased from \$347m in 2013 to \$1,666m in 2014 as a result of the \$1.1bn private placements and \$400m additional long-term facility use to fund the acquisition of ArthroCare.

The Retirement benefit obligation increased by \$3m to \$233m in 2014 from \$230m in 2013.

Deferred tax liabilities increased by \$48m in the year from \$50m in 2013 to \$98m in 2014.

**Current liabilities**

Current liabilities increased by \$89m from \$1,073m in 2013 to \$1,162m in 2014. This movement is attributable to:

Bank overdrafts and current borrowings have decreased by \$5m from \$44m in 2013 to \$39m in 2014.

Trade and other payables have increased by \$53m to \$838m in 2014 from \$785m in 2013. This increase includes \$75m of trade and other payables arising on the acquisition of ArthroCare and distributor in Brazil offset by \$34m of favourable currency movements.

Current tax payable is \$218m at the end of 2014 compared to \$184m in 2013.

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Total equity

Total equity decreased by \$7m from \$4,047m in 2013 to \$4,040m in 2014. The principal movements were:

	Total equity
	\$ million
1 January 2014	4,047
Attributable profit	501
Currency translation gains	(196)
Hedging reserves	12
Actuarial losses on retirement benefit obligations	(94)
Dividends paid during the year	(250)
Purchase of own shares	(75)
Taxation on other comprehensive income and equity items	19
Net share-based transactions	76
31 December 2014	4,040

[2013 Financial performance by business segment](#)[2013 Financial highlights](#)

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## Revenue

Group revenue increased by \$214m (5% on a reported basis), from \$4,137m in 2012 to \$4,351 in 2013. The underlying increase is 4% after adjusting for the net impact of 2% on the Healthpoint acquisition and Clinical Therapies disposal and 1% attributable to the unfavourable impact of currency movements.

## Costs of goods sold

Costs of goods sold increased by \$30m (3% on a reported basis) from \$1,070m in 2012 to \$1,100m in 2013. The underlying movement is 2% after adjusting for the net impact of 2% on the Healthpoint acquisition and Clinical Therapies disposal and 1% attributable to the favourable impact of currency movements. The movement in underlying costs of goods sold of 2% is largely attributable to the increase in underlying trading.

During 2013, \$12m of restructuring and rationalisation expenses (2012 \$3m) and \$5m of acquisition related costs (2012 \$nil) were charged to costs of goods sold.

## Selling, general and administration expenses

Selling, general and administrative expenses increased by \$160m (8% on a reported basis) from \$2,050m in 2012 to \$2,210m in 2013. The underlying movement is 6% after adjusting for the net impact of 3% on the Healthpoint acquisition and Clinical Therapies disposal and 1% attributable to the favourable impact of currency movements.

The underlying increase of 6% is due to the continuing investment in Emerging & International Markets, promotion of new products in ASD and AWM and the underlying increase in trading.

In 2013, administrative expenses included \$64m of amortisation of other intangible assets (2012 \$51m), \$46m of restructuring and rationalisation expenses (2012 \$62m), an amount of \$88m relating to amortisation of acquisition intangibles (2012 \$43m) and \$26m of acquisition related costs (2012 \$11m).

## Research and development expenses

Research and development expenditure as a percentage of revenue increased by 1.2% to 5.3% in 2013 (2012 4.1%). Actual expenditure was \$231m in 2013 compared to \$171m in 2012. The Group continues to invest in innovative technologies and products to differentiate it from competitors.

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## Operating profit

Operating profit decreased by \$36m to \$810m from \$846m in 2012. This comprised a decrease of \$12m in Advanced Surgical Devices and a decrease of £24m in Advanced Wound Management.

The movement in Advanced Surgical Devices is attributable to the continuing pressure on margins and its investment in the Emerging & International Markets. Advanced Wound Management has continued to invest in new products and new geographic markets throughout the year.

## Net interest receivable/(payable)

Net interest receivable increased by \$2m from net \$2m receivable in 2012 to a net receivable of \$4m in 2013. This increase is principally a consequence of the interest receivable on the Bioventus LLC ( Bioventus ) loan note issued following the disposal of the Clinical Therapies business which has been in place for a full year in 2013 compared to eight months in 2012. This loan note was repaid in full in 2014.

## Other finance cost

Other finance costs in 2013 remained at \$11m and principally relate to costs associated with the Group's retirement benefit schemes.

## Taxation

The taxation charge decreased by \$125m to \$246m from \$371m in 2012. The reported rate of tax was 30.5%, compared with 33.7% in 2012.

After adjusting for specific transactions that management considers affect the Group's short-term profitability (profit on disposal of the Clinical Therapies business, restructuring and rationalisation expenses, amortisation of acquisition

intangibles and acquisition related costs) the tax rate on trading profit was 29.2% (2012 29.9%).

#### Group balance sheet

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


	2013	2012
	\$ million	\$ million
Non-current assets	3,563	3,498
Current assets	2,256	2,144
Total assets	5,819	5,642
Non-current liabilities	699	828
Current liabilities	1,073	930
Total liabilities	1,772	1,758
Total equity	4,047	3,884
Total equity and liabilities	5,819	5,642

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Annual General Meeting	14 April 2016
First quarter trading report	5 May 2016
Payment of 2015 final dividend	11 May 2016
Half year results announced	28 July 2016 <sup>1</sup>
Third quarter trading report	3 November 2016
Payment of 2016 interim dividend	November 2016
Full year results announced	February 2017 <sup>1</sup>
Annual Report available	February/March 2017
Annual General Meeting	April 2017

<sup>1</sup> Dividend declaration dates.  
Annual General Meeting

The Company's Annual General Meeting ( AGM ) will be held on 14 April 2016 at 2:00pm at No. 11 Cavendish Square, London W1G 0AN. Registered shareholders have been sent either a Notice of Annual General Meeting or notification of availability of the Notice of Annual General Meeting.

Corporate headquarters and registered office

The corporate headquarters is in the UK and the registered office address is: Smith & Nephew plc, 15 Adam Street, London W2N 6LA, UK. Registered in England and Wales No. 324357. Tel. +44 (0)20 7401 7646 website: www.smith-nephew.com

[Ordinary shareholders](#)

Registrar

All general enquiries concerning shareholdings, dividends, changes to shareholders' personal details and the AGM should be addressed to:

Equiniti, Aspect House, Spencer Road, Lancing, West Sussex BN99 6DA

Tel: 0371 384 2081\*

Tel: +44 (0) 121 415 7072 from outside the UK

Website: [www.shareview.co.uk](http://www.shareview.co.uk)

\* Lines are open from 8:30am to 5:30pm Monday to Friday, excluding public holidays in England and Wales.  
Shareholder facilities

### **Shareview**

Equiniti's on-line enquiry and portfolio management service for shareholders. To view information about your shareholdings online, register at [www.shareview.co.uk](http://www.shareview.co.uk). Once registered for Shareview, you will also be able to elect to receive future shareholder communications via the Company's website ([www.smith-nephew.com](http://www.smith-nephew.com)), update your address details or dividend payment instructions and register your proxy instructions on-line.

### **E-communications**

We encourage you to elect to receive communications via e-mail as this has significant environmental and cost benefits. You may register for this service through Equiniti, at [www.shareview.co.uk](http://www.shareview.co.uk). You will receive a confirmation letter from Equiniti at your registered address, containing an Activation Code for future use.

### **Payment of dividends direct to your bank or building society account**

If you wish to avoid the risk of your dividend awards getting lost or mislaid you can arrange to have your cash dividends paid directly to a bank or building society account. This facility is available to UK resident shareholders who receive Sterling dividends. If you do not live in the UK you may be able to register for the overseas payment service. Further information is available at [www.shareview.co.uk](http://www.shareview.co.uk) or by contacting Equiniti (UK and overseas helpline numbers as above).

### **Dividend Re-Investment plan ( DRIP )**

The Company offers shareholders (except those in North America) the opportunity to participate in a DRIP. This enables you to reinvest your cash dividends in further ordinary shares of Smith & Nephew plc. These are purchased in the market at competitive dealing costs. For further details plus an application form to reinvest future dividends, contact Equiniti.

### **Duplicate accounts**

If you have more than one account due to inconsistency in account details, you may avoid duplicate mailings by contacting Equiniti and requesting an amalgamation of your share accounts.

### **Keep your personal details up to date**

## Edgar Filing: SMITH & NEPHEW PLC - Form 20-F

Please remember to tell Equiniti if you move house or change bank details or there is any other change in your account information. You can update your information on-line via the Shareview portfolio if you are a Smith & Nephew Shareview member. If you do not have a portfolio you will need to write to Equiniti or complete a change of address form which can be downloaded from Shareview. If you hold 2,500 shares or fewer, you can also change your address or update your bank details quickly and easily over the phone using the contact details provided.



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**Individual savings account ( ISA )**

Shareholders who are UK resident may hold Smith & Nephew plc shares in an ISA, which is administered by the Company's registrar. For information about this service please contact Equiniti.

**Shareholder communications**

We make quarterly financial announcements which are made available through Stock Exchange announcements and on the Group's website ([www.smith-nephew.com](http://www.smith-nephew.com)). Copies of recent Annual Reports, press releases, institutional presentations and audio webcasts are also available on the website.

We send paper copies of the Notice of Annual General Meeting and Annual Report only to those shareholders and ADS holders who have elected to receive shareholder documentation by post. Electronic copies of the Annual Report and Notice of Annual General Meeting are available on the Group's website at [www.smith-nephew.com](http://www.smith-nephew.com). Both ordinary shareholders and ADS holders can request paper copies of the Annual Report, which the Company provides free of charge. The Company will continue to send to ordinary shareholders by post the Form of Proxy notifying them of the availability of the Annual Report and Notice of Annual General Meeting on the Group's website. If you elect to receive the Annual Report and Notice of Annual General Meeting electronically you are informed by e-mail of the documents' availability on the Group's website. ADS holders receive the Form of Proxy by post, but will not receive a paper copy of the Notice of Annual General Meeting.

**Investor communications**

The Company maintains regular dialogue with individual institutional shareholders, together with results presentations. To ensure that all members of the Board develop an understanding of the views of major investors, the Executive Directors review significant issues raised by investors with the Board. Non-Executive Directors are sent copies of analysts' and brokers' briefings. There is an opportunity for individual shareholders to question the Directors

at the Annual General Meeting and the Company regularly responds to letters from shareholders on a range of issues.

### UK capital gains tax

For the purposes of UK capital gains tax, the price of the Company's ordinary shares on 31 March 1982 was 35.04p.

### Smith & Nephew share price

The Company's ordinary shares are quoted on the London Stock Exchange under the symbol SN. The Company's share price is available on the Smith & Nephew website [www.smith-nephew.com](http://www.smith-nephew.com) and at [www.londonstockexchange.com](http://www.londonstockexchange.com) where the live financial data is updated with a 15-minute delay.

### ShareGift

If you hold a small number of shares, which would cost more to sell than they are worth, you may wish to consider donating them to the charity ShareGift (Registered Charity no. 1052686) which specialises in accepting such shares as donations. There are no implications for Capital Gains Tax purposes (no gain or loss) and it may also be possible to obtain income tax relief. The relevant stock transfer form may be obtained from Equiniti at the address given on page 185.

Further information about ShareGift is available at [www.sharegift.org](http://www.sharegift.org) or by contacting ShareGift at:

ShareGift, PO Box 72253, London SW1P 9LQ

Tel: (+44) (0) 20 7930 3737

### Unauthorised brokers (boiler room scams)

You are advised to be very wary of any unsolicited advice, offers to buy shares at a discount or offers of free company reports. These are typically from overseas-based brokers who target UK shareholders offering to sell them what often turn out to be worthless or high-risk shares in US or UK investments. These operations are commonly known as boiler rooms.

If you deal with an unauthorised firm, you will not be eligible to receive payment under the Financial Services Compensation Scheme if things go wrong. If you receive any unsolicited investment advice, obtain the correct name of the person and organisation and check that they are properly authorised by the FCA by visiting [www.fca.org.uk/register/](http://www.fca.org.uk/register/).

If you think you have been approached by an unauthorised firm you should contact the FCA consumer helpline on 0800 111 6768 or e-mail [consumer.queries@fca.org.uk](mailto:consumer.queries@fca.org.uk).

More detailed information can be found on the FCA website at [www.fca.org.uk/consumers/protect-yourself/unauthorised-firms](http://www.fca.org.uk/consumers/protect-yourself/unauthorised-firms).

### Social media

Smith & Nephew has a presence across a range of social media channels, including Twitter, Facebook and LinkedIn, which are linked below. Information provided by Smith & Nephew through social media channels is not incorporated by reference herein and does not form part of our Annual Report or Form 20-F.

[twitter.com/SmithNephewPLC](https://twitter.com/SmithNephewPLC)

[facebook.com/SmithNephewPlc](https://facebook.com/SmithNephewPlc)

[linkedin.com/company/smith-&-nephew](https://linkedin.com/company/smith-&-nephew)

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[American Depositary Shares \(ADSs\) and American Depositary Receipts \(ADRs\)](#)

In the USA, the Company's ordinary shares are traded in the form of ADSs, evidenced by ADRs, on the New York Stock Exchange under the symbol SNN. Each American Depositary Share represents two ordinary shares. Deutsche Bank is the authorised depositary bank for the Company's ADR programme.

[ADS enquiries](#)

All enquiries regarding ADS holder accounts and payment of dividends should be addressed to:

Deutsche Bank Shareholder Services

American Stock Transfer and Trust Company

Operations Centre 6201 15th Avenue

Brooklyn, New York

NY 11219

Tel: +1 866 249 2593 (toll free)

E-mail: [DB@amstock.com](mailto:DB@amstock.com)

Website: [www.adr.db.com](http://www.adr.db.com)

The Deutsche Bank Global Direct Investor Services Program is available for US residents, enabling investment directly in ADSs with reduced brokerage commissions and service costs. For further information on Global Direct contact Deutsche Bank Shareholder Services (as above) or visit [www.adr.db.com](http://www.adr.db.com).

The Company provides Deutsche Bank, as depositary, with copies of Annual Reports containing Consolidated Financial Statements and the opinion expressed thereon by its independent auditor. Such financial statements are prepared under IFRS. Deutsche Bank will send these reports to recorded ADS holders who have elected to receive paper copies. The Company also provides to Deutsche Bank all notices of shareholders' meetings and other reports and communications that are made generally available to shareholders of the Company. Deutsche Bank makes such notices, reports and communications available for inspection by recorded holders of ADSs and sends voting instruction forms by post to all recorded holders of ADSs.

[Smith & Nephew ADS price](#)

The Company's ADS price can be obtained from the official New York Stock Exchange website at [www.nyse.com](http://www.nyse.com), the Smith & Nephew website [www.smith-nephew.com](http://www.smith-nephew.com), and is quoted daily in the Wall Street Journal where the live financial data is updated with a 15-minute delay.

### ADS payment information

The Company hereby discloses ADS payment information for the year ended 31 December 2015 in accordance with the Securities and Exchange Commission rules 12.D.3 and 12.D.4 relating to Form 20-F filings by foreign private issuers. The depositary collects its fees for delivery and surrender of ADSs directly from investors depositing shares or surrendering ADSs for the purpose of withdrawal or from intermediaries acting for them. The depositary collects fees for making distributions to investors, including payment of dividends by the Company by deducting those fees from the amounts distributed or by selling a portion of distributable property to pay the fees. The depositary may collect its annual fee for depositary services by deductions from cash distributions or by directly billing investors or by charging the book-entry system accounts of participants acting for them. The depositary may generally refuse to provide fee-attracting services until its fee for those services are paid.

Persons depositing or withdrawing shares must pay  
\$5.00 (or less) per 100 ADSs (or portion of 100 ADSs)

\$0.05 (or less) per ADS

\$0.05 (or less) per ADS per calendar year  
Registration or transfer fees

Taxes and other governmental charges the depositary or the custodian have to pay on any ADS or share underlying an ADS, for example, stock transfer taxes, stamp duty or withholding taxes

Any charges incurred by the depositary or its agents for servicing the deposited securities

During 2015, a fee of one US cent per ADS was collected on the 2014 final dividend paid in May and a fee of one US cent per ADS was collected on the 2015 interim dividend paid in October. In the period 1 January 2015 to 23 February 2016, the total program payments made by Deutsche Bank Trust Company Americas were \$517,700.19.

For  
Issuance of ADSs, including issuances resulting from a distribution of shares or rights or other property

Cancellation of ADSs for the purpose of withdrawal, including if the deposit agreement terminates

Any cash distribution to ADS registered holders, including payment of dividend

Depositary services

Transfer and registration of shares on our share register to or from the name of the depositary or its agent when shares are deposited or withdrawn

As necessary

As necessary

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**Dividend history**

Smith & Nephew has paid dividends on its ordinary shares in every year since 1937. Following the capital restructuring and dividend reduction in 2000, the Group adopted a policy of increasing its dividend cover (the ratio of EPSA, as set out in the Selected financial data , to ordinary dividends declared for the year). This was intended to increase the financing capability of the Group for acquisitions and other investments. From 2000 to 2004, the dividend increased in line with inflation and, in 2004, dividend cover stood at 4.1 times. Having achieved this level of dividend cover the Board changed its policy, from that of increasing dividends in line with inflation, to that of increasing dividends for 2005 and after by 10%. Following the redenomination of the Company's share capital into US Dollars, the Board re-affirmed its policy of increasing the dividend by 10% a year in US Dollar terms.

On 2 August 2012, the Board announced its intention to pursue a progressive dividend policy, with the aim of increasing the US Dollar value of ordinary dividends over time broadly based on the Group's underlying growth in earnings, while taking into account capital requirements and cash flows.

At the time of the full year results, the Board reviews the appropriate level of total annual dividend each year. The Board intends that the interim dividend will be set by a formula and will be equivalent to 40% of the total dividend for the previous year. Dividends will continue to be declared in US Dollars with an equivalent amount in Sterling payable to those shareholders whose registered address is in the UK, or who have validly elected to receive Sterling dividends.

An interim dividend in respect of each fiscal year is normally declared in August and paid in November. A final dividend will be recommended by the Board of Directors and paid subject to approval by shareholders at the Company's Annual General Meeting.

Future dividends of Smith & Nephew will be dependent upon: future earnings; the future financial condition of the Group; the Board's dividend policy; and the additional factors that might affect the business of the Group set out in Special note regarding forward-looking statements and Risk Factors .

## Dividends per share

The table below sets out the dividends per ordinary share in the last five years.

		Years ended 31 December				
	2015	2014	2013	2012	2011	
Pence per share:						
Interim	8.533	7.578	7.211	6.811	4.639	
Final <sup>1,2</sup>	13.496	13.711	11.233	11.778	7.444	
Total	22.029	21.289	18.444	18.589	12.083	
US cents per share:						
Interim	13.111	12.222	11.556	11.000	7.333	
Final <sup>2</sup>	19.000	20.667	18.889	18.000	12.000	
Total	32.111	32.889	30.445	29.000	19.333	

1 Translated at the Bank of England rate on 23 February 2016.

2 2015 final dividend does not include a UK tax credit. See below.

Dividends above include the associated UK tax credit of 10%, but exclude the deduction of withholding taxes, up to and including the interim dividend for 2015. From 6 April 2016, please note that dividends below £5,000 per tax year will be tax free and dividends above £5,000 per tax year will be subject to personal income tax at the rate of 7.5% for basic rate taxpayers, 32.5% for higher rate taxpayers and 38.1% for additional rate taxpayers. A self-assessment form will therefore be required. This will apply to both cash and DRIP dividends, although dividends paid on shares held within pensions and ISAs will be unaffected, remaining tax free.

Since the second interim dividend for 2005, all dividends have been declared in US cents per ordinary share.

The 2015 final dividend will be payable on 11 May 2016, subject to shareholder approval.

In respect of the proposed final dividend for the year ended 31 December 2015 of 19.0 US cents per ordinary share, the record date will be 22 April 2016 and the payment date will be 11 May 2016. The Sterling equivalent per ordinary share will be set following the record date. Shareholders may elect to receive their dividend in either Sterling or US Dollars and the last day for election will be 22 April 2016. The ordinary shares will trade ex-dividend on both the London and New York Stock Exchanges from 21 April 2016.

The proposed final dividend of 19.0 US cents per ordinary share, which together with the interim dividend of 11.8 US cents, makes a total for 2015 of 30.8 US cents.

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**Share prices**

The table below sets out, for the periods indicated, the highest and lowest middle market quotations for the Company's ordinary shares (as derived from the Daily Official List of the UK Listing Authority) and the highest and lowest sales prices of its ADSs (as reported on the New York Stock Exchange composite tape).

	Ordinary shares		High	ADSs Low
	High	Low		
	£	£		
<b>Year ended 31 December:</b>				
2011	7.42	5.21	60.19	42.17
2012	6.93	5.80	56.13	45.13
2013	8.68	6.80	71.85	52.90
2014 <sup>1</sup>	11.93	8.57	97.27	29.39
2015	12.12	10.60	37.78	32.48
<b>Quarters in the year ended 31 December:</b>				
2014:				
1st Quarter	9.60	8.57	80.18	70.84
2nd Quarter	11.00	8.61	97.27	73.17
3rd Quarter	10.80	9.86	90.45	82.91
	11.93	9.06	83.14	29.39



4th Quarter<sup>1</sup>  
2015:

1st Quarter	12.00	11.13	36.85	33.44
2nd Quarter	11.95	10.72	35.80	33.68
3rd Quarter	12.03	10.68	37.78	33.24
4th Quarter 2016:	12.12	10.60	35.88	32.48
1st Quarter (to 23 February 2016)	11.79	10.51	34.80	30.55
<b>Last six months:</b>				
August 2015	12.03	10.71	37.78	33.62
September 2015	11.81	11.22	36.32	34.13
October 2015	11.69	10.96	35.81	33.57
November 2015	11.33	10.70	34.38	32.74
December 2015	12.12	10.60	35.88	32.48
January 2016	11.79	10.82	34.80	31.47
February 2016 (to 23 February 2016)	11.61	10.51	33.66	30.55

1 On 14 October 2014, the ratio of ordinary shares per ADS changed from five ordinary shares per ADS to two ordinary shares per ADS.

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**Share Capital**

The principal trading market for the ordinary shares is the London Stock Exchange. The ordinary shares were listed on the New York Stock Exchange on 16 November 1999, trading in the form of ADSs evidenced by ADRs. Each ADS represents two ordinary shares from 14 October 2014, before which time one ADS represented five ordinary shares. The ADS facility is sponsored by Deutsche Bank acting as depositary.

All the ordinary shares, including those held by Directors and Executive Officers, rank pari passu with each other. On 23 January 2006, the ordinary shares of 12 2/4p were redenominated as ordinary shares of US 20 cents (following approval by shareholders at the Extraordinary General Meeting in December 2005). The new US Dollar ordinary shares carry the same rights as the previous ordinary shares. The share price continues to be quoted in Sterling. In 2006, the Company issued £50,000 of shares in Sterling in order to comply with English law. These were issued as deferred shares, which are not listed on any stock exchange. They have extremely limited rights and therefore effectively have no value. These shares were allotted to the Chief Executive Officer, although the Board reserves the right to transfer them to another member of the Board should it so wish.

**Shareholdings**

As at 23 February 2016, to the knowledge of the Group, there were 17,487 registered holders of ordinary shares, of whom 91 had registered addresses in the USA and held a total of 187,058 ordinary shares (0.02% of the total issued). Because certain ordinary shares are registered in the names of nominees, the number of shareholders with registered addresses in the USA is not representative of the number of beneficial owners of ordinary shares resident in the USA.

As at 23 February 2016, 28,257,095 ADSs equivalent to 56,514,190 ordinary shares or approximately 6.31% of the total ordinary shares in issue, were outstanding and were held by 87 registered ADS holders.

**Major shareholders**

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As far as is known to Smith & Nephew, the Group is not directly or indirectly owned or controlled by another corporation or by any government and the Group has not entered into arrangements, the operation of which may at a subsequent date result in a change in control of the Group.

As at 23 February 2016, no persons are known to Smith & Nephew to have any interest (as defined in the Disclosure and Transparency Rules of the FCA) in 3% or more of the ordinary shares, other than as shown below. The following tables show changes over the last three years in the percentage and numbers of the issued share capital owned by shareholders holding 3% or more of ordinary shares, as notified to the Company under the Disclosure and Transparency Rules:

	23 February 2016	2015	2014	As at 31 December 2013
	%	%	%	%
BlackRock, Inc.	5.2	5.2	5.5	4.7
Invesco	6.0	5.7	5.3	12.1

	23 February 2016	2015	2014	As at 31 December 2013
	000	000	000	000
BlackRock, Inc.	46,427	46,427	49,008	41,870
Invesco	53,693	51,539	47,508	107,823

The Company is not aware of any person who has a significant direct or indirect holding of securities in the Company, and is not aware of any persons holding securities which may control the Company. There are no securities in issue which have special rights as to the control of the Company.

### Purchase of ordinary shares on behalf of the Company

At the AGM, the Company will be seeking a renewal of its current permission from shareholders to purchase up to 10% of its own 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 by the Company. From 1 January 2015 to 23 February 2016, in the months listed below, the Company has purchased 4,564,065 ordinary shares at a cost of US\$77,532,429.17.

Total shares purchased (000s)	Average price paid per share (pence)	Approximate US\$ value of shares

			purchased under the plan
6	20 May 2015	1,830	1,129.1436 32,007,094
7	8 September 2015	505	1,164.3216 9,105,910
18	24 November 2015	965	1,112.5264 16,403,478
9	19 February 2016	1,264	1,099.4366 20,015,947

The shares were purchased in the open market by JP Morgan Cazenove Limited and Merrill Lynch International on behalf of the Company.

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**Exchange controls and other limitations affecting security holders**

There are no UK governmental laws, decrees or regulations that restrict the export or import of capital or that affect the payment of dividends, interest or other payments to non-resident holders of Smith & Nephew's securities, except for certain restrictions imposed from time to time by Her Majesty's Treasury of the United Kingdom pursuant to legislation, such as the United Nations Act 1946 and the Emergency Laws Act 1964, against the government or residents of certain countries.

There are no limitations, either under the laws of the UK or under the Articles of Association of Smith & Nephew, restricting the right of non-UK residents to hold or to exercise voting rights in respect of ordinary shares, except that where any overseas shareholder has not provided to the Company a UK address for the service of notices, the Company is under no obligation to send any notice or other document to an overseas address. It is, however, the current practice of the Company to send every notice or other document to all shareholders regardless of the country recorded in the register of members, with the exception of details of the Company's dividend reinvestment plan, which are not sent to shareholders with recorded addresses in the USA and Canada.

**Taxation information for shareholders**

The comments below are of a general and summary nature and are based on the Group's understanding of certain aspects of current UK and US federal income tax law and practice relevant to the ADSs and ordinary shares not in ADS form. The comments address the material US and UK tax consequences generally applicable to a person who is the beneficial owner of ADSs or ordinary shares and who, for US federal income tax purposes, is a citizen or resident of the USA, a corporation (or other entity taxable as a corporation) created or organised in or under the laws of the USA (or any State therein), or an estate or trust the income of which is included in gross income for US federal income tax purposes regardless of its source (each a "US Holder"). The comments set out below do not purport to address all tax consequences of the ownership of ADSs or ordinary shares that may be material to a particular holder and in particular do not deal with the position of shareholders who directly or indirectly own 10% or more of the Company's issued ordinary shares. This discussion does not apply to (i) persons whose holding of ADSs or ordinary shares is effectively connected with or pertains to either a permanent establishment in the UK through which a US Holder carries on a business in the UK or a fixed base from which a US Holder performs independent personal services in the UK, or (ii) persons whose registered address is inside the UK. This discussion does not apply to certain investors subject to special rules, such as certain financial institutions, tax-exempt entities, insurance companies, broker-dealers and traders in securities that elect to use the mark-to-market method of tax accounting, partnerships or other entities treated as partnerships for US federal income tax purposes, US Holders holding ADSs or ordinary shares as part of a hedging, conversion or other integrated transaction or whose functional currency for US federal income tax purposes is other than the US Dollar and US Holders liable for alternative minimum tax. In addition, the comments below do not address the potential application of the provisions of the United States Internal Revenue Code, known as the Medicare contribution tax, or any US state, local or non-US (other than UK) taxes. The summary deals only with US Holders who hold ADSs or ordinary shares as capital assets. The summary is based on current UK

and US law and practice which is subject to change, possibly with retroactive effect. US Holders are recommended to consult their own tax advisers as to the particular tax consequences to them of the ownership of ADSs or ordinary shares. The Company believes, and this discussion assumes, that the Company was not a passive foreign investment company for its taxable year ended 31 December 2015.

This discussion is based in part on representations by the depositary and assumes that each obligation under the deposit agreement and any related agreement will be performed in accordance with its terms. For purposes of US federal income tax law, US Holders of ADSs will generally be treated as owners of the ordinary shares represented by the ADSs. However, the US Treasury has expressed concerns that parties to whom depositary shares are released before shares are delivered to the depositary ( pre-released ) may be taking actions that are inconsistent with the claiming of foreign tax credits by owners of depositary shares. Such actions would also be inconsistent with the claiming of the reduced rate of tax, described below, applicable to dividends received by certain non-corporate US Holders. Accordingly, the availability of the reduced tax rate for dividends received by certain non-corporate US Holders of ADSs could be affected by actions that may be taken by parties to whom ADSs are pre-released.

#### Taxation of dividends in the UK and the USA

The UK does not currently impose a withholding tax on dividends paid by a UK corporation, such as the Company.

Distributions paid by the Company will be treated for US federal income tax purposes as foreign source ordinary dividend income to a US Holder to the extent paid out of the Company's current or accumulated earnings and profits as determined for US federal income tax purposes. Because the Company does not maintain calculations of its earnings and profits under US federal income tax principles, it is expected that distributions generally will be reported to US Holders as dividends. Such dividends will not be eligible for the dividends-received deduction generally allowed to corporate US Holders.

Dividends paid to certain non-corporate US Holders of ordinary shares or ADSs may be subject to US federal income tax at lower rates than those applicable to other types of ordinary income if certain conditions are met. Non-corporate US Holders should consult their own tax advisers to determine whether they are subject to any special rules that limit their ability to be taxed at these favourable rates.

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## Taxation of capital gains

US Holders, who are not resident or ordinarily resident for tax purposes in the UK, will not generally be liable for UK capital gains tax on any capital gain realised upon the sale or other disposition of ADSs or ordinary shares unless the ADSs or ordinary shares are held in connection with a trade carried on in the UK through a permanent establishment (or in the case of individuals, through a branch or agency). Furthermore, UK resident individuals who acquire ADSs or ordinary shares before becoming temporarily non-UK residents may remain subject to UK taxation of capital gains on gains realised while non-resident.

For US federal income tax purposes, gains or losses realised upon a taxable sale or other disposition of ADSs or ordinary shares by US Holders generally will be US source capital gains or losses and will be long-term capital gains or losses if the ADSs or ordinary shares were held for more than one year. The amount of a US Holder's gain or loss will be equal to the difference between the amount realised on the sale or other disposition and such holder's tax basis in the ADSs, or ordinary shares, each determined in US Dollars.

## Inheritance and estate taxes

The HM Revenue & Customs imposes inheritance tax on capital transfers which occur on death, and in the seven years preceding death. The HM Revenue & Customs considers that the US/UK Double Taxation Convention on Estate and Gift Tax applies to inheritance tax. Consequently, a US citizen who is domiciled in the USA and is not a UK national or domiciled in the UK will not be subject to UK inheritance tax in respect of ADSs and ordinary shares. A UK national who is domiciled in the USA will be subject to both UK inheritance tax and US federal estate tax but will be entitled to a credit for US federal estate tax charged in respect of ADSs and ordinary shares in computing the liability to UK inheritance tax. Conversely, a US citizen who is domiciled or deemed domiciled in the UK will be entitled to a credit for UK inheritance tax charged in respect of ADSs and ordinary shares in computing the liability for US federal estate tax. Special rules apply where ADSs and ordinary shares are business property of a permanent establishment of an enterprise situated in the UK.

## US information reporting and backup withholding

Payments of dividends on, or proceeds from the sale of, ADSs or ordinary shares that are made within the USA or through certain US-related financial intermediaries generally will be subject to US information reporting, and may be subject to backup withholding, unless a US Holder is an exempt recipient or, in the case of backup withholding, provides a correct US taxpayer identification number and certain other conditions are met. US backup withholding may apply if there has been a notification from the US Internal Revenue Service of a failure to report all interest or dividends.

Any backup withholding deducted may be credited against the US Holder's US federal income tax liability, and, where the backup withholding exceeds the actual liability, the US Holder may obtain a refund by timely filing the appropriate refund claim with the US Internal Revenue Service.

Certain US Holders who are individuals (and under proposed Treasury regulations, certain entities) may be required to report information relating to securities issued by a non-US person (or foreign accounts through which the securities are held), subject to certain exceptions (including an exception for securities held in accounts maintained by US financial institutions). US Holders should consult their tax advisers regarding their reporting obligations with respect to the ordinary shares or ADSs.

#### UK stamp duty and stamp duty reserve tax

UK stamp duty is charged on documents and in particular instruments for the transfer of registered ownership of ordinary shares. Transfers of ordinary shares in certificated form will generally be subject to UK stamp duty at the rate of  $\frac{1}{2}\%$  of the consideration given for the transfer with the duty rounded up to the nearest £5.

UK stamp duty reserve tax (SDRT) arises when there is an agreement to transfer shares in UK companies for consideration in money or money's worth, and so an agreement to transfer ordinary shares for money or other consideration may give rise to a charge to SDRT at the rate of  $\frac{1}{2}\%$  (rounded up to the nearest penny). The charge of SDRT will be cancelled, and any SDRT already paid will be refunded, if within six years of the agreement an instrument of transfer is produced to HM Revenue & Customs and the appropriate stamp duty paid.

Transfers of ordinary shares into CREST (an electronic transfer system) are exempt from stamp duty so long as the transferee is a member of CREST who will hold the ordinary shares as a nominee for the transferor and the transfer is in a form that will ensure that the securities become held in uncertificated form within CREST. Paperless transfers of ordinary shares within CREST for consideration in money or money's worth are liable to SDRT rather than stamp duty. SDRT on relevant transactions will be collected by CREST at  $\frac{1}{2}\%$ , and this will apply whether or not the transfer is effected in the UK and whether or not the parties to it are resident or situated in the UK.

A charge of stamp duty or SDRT at the rate of  $1\frac{1}{2}\%$  of the consideration (or, in some circumstances, the value of the shares concerned) will arise on a transfer or issue of ordinary shares to the depositary or to certain persons providing a clearance service (or their nominees or agents) for the conversion into ADRs and will generally be payable by the depositary or person providing clearance service. In accordance with the terms of the Deposit Agreement, any tax or duty payable by the depositary on deposits of ordinary shares will be charged by the depositary to the party to whom ADRs are delivered against such deposits.

No liability for stamp duty or SDRT will arise on any transfer of, or agreement to transfer, an ADS or beneficial ownership of an ADS, provided that the ADS and any instrument of transfer or written agreement to transfer remains at all times outside the UK, and provided further that any instrument of transfer or written agreement to transfer is not executed in the UK and the transfer does not relate to any matter or thing done or to be done in the UK (the location of the custodian as a holder of ordinary shares not being relevant in this context). In any other case, any transfer of, or agreement to transfer, an ADS or beneficial ownership of an ADS could, depending on all the circumstances of the transfer, give rise to a charge to stamp duty or SDRT.



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**Articles of Association**

The following summarises certain material rights of holders of the Company's ordinary shares under the material provisions of the Company's Articles of Association and English law. This summary is qualified in its entirety by reference to the Companies Act and the Company's Articles of Association. In the following description, a shareholder is the person registered in the Company's register of members as the holder of an ordinary share.

The Company is incorporated under the name Smith & Nephew plc and is registered in England and Wales with registered number 324357.

The Company's ordinary shares may be held in certificated or uncertificated form. No holder of the Company's shares will be required to make additional contributions of capital in respect of the Company's shares in the future. In accordance with English law, the Company's ordinary shares rank equally.

**Directors**

Under the Company's Articles of Association, a Director may not vote in respect of any contract, arrangement, transaction or proposal in which he, or any person connected with him, has any material interest other than by virtue of his interests in securities of, or otherwise in or through, the Company. This is subject to certain exceptions relating to proposals (a) indemnifying him in respect of obligations incurred on behalf of the Company, (b) indemnifying a third party in respect of obligations of the Company for which the Director has assumed responsibility under an indemnity or guarantee, (c) relating to an offer of securities in which he will be interested as an underwriter, (d) concerning another body corporate in which the Director is beneficially interested in less than 1% of the issued shares of any class of shares of such a body corporate, (e) relating to an employee benefit in which the Director will share equally with other employees and (f) relating to any insurance that the Company is empowered to purchase for the benefit of Directors of the Company in respect of actions undertaken as Directors (and/or officers) of the Company.

A Director shall not vote or be counted in any quorum present at a meeting in relation to a resolution on which he is not entitled to vote.

The Directors are empowered to exercise all the powers of the Company to borrow money, subject to the limitation that the aggregate amount of all monies borrowed after deducting cash and current asset investments by the Company and its subsidiaries shall not exceed the sum of \$6,500,000,000.

Any Director who has been appointed by the Directors since the previous Annual General Meeting of shareholders, either to fill a casual vacancy or as an additional Director holds office only until the conclusion of the next Annual General Meeting and then shall be eligible for re-election by the shareholders. The other Directors retire and are eligible for re-appointment at the third Annual General Meeting after the meeting at which they were last re-appointed. If not re-appointed, a Director retiring at a meeting shall retain office until the meeting appoints

someone in his place, or if it does not do so, until the conclusion of the meeting. The Directors are subject to removal with or without cause by the Board or the shareholders. Directors are not required to hold any shares of the Company by way of qualification.

Under the Company's Articles of Association and English law, a Director may be indemnified out of the assets of the Company against liabilities he may sustain or incur in the execution of his duties.

#### Rights attaching to ordinary shares

Under English law, dividends are payable on the Company's ordinary shares only out of profits available for distribution, as determined in accordance with accounting principles generally accepted in the UK and by the Companies Act 2006. Holders of the Company's ordinary shares are entitled to receive final dividends as may be declared by the Directors and approved by the shareholders in general meeting, rateable according to the amounts paid up on such shares, provided that the dividend cannot exceed the amount recommended by the Directors.

The Company's Board of Directors may declare such interim dividends as appear to them to be justified by the Company's financial position. If authorised by an ordinary resolution of the shareholders, the Board may also direct payment of a dividend in whole or in part by the distribution of specific assets (and in particular of paid up shares or debentures of the Company).

Any dividend unclaimed after 12 years from the date the dividend was declared, or became due for payment, will be forfeited and will revert to the Company.

There were no material modifications to the rights of shareholders under the Articles during 2016.

#### Voting rights of ordinary shares

Voting at any general meeting of shareholders is by a show of hands unless a poll, which is a written vote, is duly demanded and held. On a show of hands, every shareholder who is present in person at a general meeting has one vote regardless of the number of shares held. On a poll, every shareholder who is present in person or by proxy has one vote for each ordinary share held by that shareholder. A poll may be demanded by any of the following:

the chairman of the meeting;

at least five shareholders present or by proxy entitled to vote on the resolution;

any shareholder or shareholders representing in the aggregate not less than one-tenth of the total voting rights of all shareholders entitled to vote on the resolution; or

any shareholder or shareholders holding shares conferring a right to vote on the resolution on which there have been paid-up sums in aggregate equal to not less than one-tenth of the total sum paid up on all the shares conferring that right.

A form of proxy will be treated as giving the proxy the authority to demand a poll, or to join others in demanding one, as above.

The necessary quorum for a general meeting is two shareholders present in person or by proxy carrying the right to vote upon the business to be transacted.

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Matters are transacted at general meetings of the Company by the processing and passing of resolutions of which there are two kinds; ordinary or special resolutions:

Ordinary resolutions include resolutions for the re-election of Directors, the approval of financial statements, the declaration of dividends (other than interim dividends), the appointment and re-appointment of auditors or the grant of authority to allot shares. An ordinary resolution requires the affirmative vote of a majority of the votes of those persons voting at the meetings at which there is a quorum.

Special resolutions include resolutions amending the Company's Articles of Association, dis-applying statutory pre-emption rights or changing the Company's name; modifying the rights of any class of the Company's shares at a meeting of the holders of such class or relating to certain matters concerning the Company's winding up. A special resolution requires the affirmative vote of not less than three-quarters of the votes of the persons voting at the meeting at which there is a quorum.

Annual General Meetings must be convened upon advance written notice of 21 days. Other general meetings must be convened upon advance written notice of at least 14 clear days. The days of delivery or receipt of notice are not included. The notice must specify the nature of the business to be transacted. Meetings are convened by the Board of Directors. Members with 5% of the ordinary share capital of the Company may requisition the Board to convene a meeting.

#### Variation of rights

If, at any time, the Company's share capital is divided into different classes of shares, the rights attached to any class may be varied, subject to the provisions of the Companies Act, with the consent in writing of holders of three-quarters in nominal value of the issued shares of that class or upon the adoption of a special resolution passed at a separate

meeting of the holders of the shares of that class. At every such separate meeting, all the provisions of the articles of association relating to proceedings at a general meeting apply, except that the quorum is to be the number of persons (which must be two or more) who hold or represent by proxy not less than one-third in nominal value of the issued shares of the class and at any such meeting a poll may be demanded in writing by any person or their proxy who hold shares of that class. Where a person is present by proxy or proxies, he is treated as holding only the shares in respect of which the proxies are authorised to exercise voting rights.

#### Rights in a winding up

Except as the Company's shareholders have agreed or may otherwise agree, upon the Company's winding up, the balance of assets available for distribution:

after the payment of all creditors including certain preferential creditors, whether statutorily preferred creditors or normal creditors; and

subject to any special rights attaching to any other class of shares;

is to be distributed among the holders of ordinary shares according to the amounts paid-up on the shares held by them. This distribution is generally to be made in US Dollars. A liquidator may, however, upon the adoption of any extraordinary resolution of the shareholders and any other sanction required by law, divide among the shareholders the whole or any part of the Company's assets in kind.

#### Limitations on voting and shareholding

There are no limitations imposed by English law or the Company's Articles of Association on the right of non-residents or foreign persons to hold or vote the Company's ordinary shares or ADSs, other than the limitations that would generally apply to all of the Company's shareholders.

#### Transfers of shares

The Board may refuse to register the transfer of shares held in certificated form which:

are not fully paid (provided that it shall not exercise this discretion in such a way as to prevent stock market dealings in the shares of that class from taking place on an open and proper basis);

are not duly stamped or duly certified or otherwise shown to the satisfaction of the Board to be exempt from stamp duty, lodged at the Transfer Office or at such other place as the Board may appoint and (save in the case of a transfer by a person to whom no certificate was issued in respect of the shares in question) accompanied by the certificate for the shares to which it relates, and such other evidence as the Board may reasonably require to show the right of the transferor to make the transfer and, if the instrument of transfer is executed by some other person on his behalf, the authority of that person so to do;

are in respect of more than one class of shares; or

are in favour of more than four transferees.

#### Deferred shares

Following the re-denomination of share capital on 23 January 2006, the ordinary shares nominal value became 20 US cents each. There were no changes to the rights or obligations of the ordinary shares. In order to comply with the Companies Act 2006, a new class of Sterling shares was created, deferred shares, of which £50,000 were issued and allotted in 2006 as fully paid to the Chief Executive Officer though the Board reserves the right to transfer them to another member of the Board should it so wish. These deferred shares have no voting or dividend rights and on winding up only are entitled to repayment at nominal value only if all ordinary shareholders have received the nominal value of their shares plus an additional \$1,000 each.

#### Amendments

The Company does not have any special rules about amendments to its Articles of Association beyond those imposed by law.

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This table provides a cross reference from the information included in this Annual Report to the requirements of Form 20-F.

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**Glossary of terms**

Unless the context indicates otherwise, the following terms have the meanings shown below:

Term	Meaning
<b>ACL</b>	The anterior cruciate ligament (ACL) is one of the four major ligaments in the human knee.
<b>ADR</b>	In the US, the Company's ordinary shares are traded in the form of ADSs evidenced by American Depository Receipts ( ADRs ).
<b>ADS</b>	In the US, the Company's ordinary shares are traded in the form of American Depository Shares ( ADSs ).
<b>Advanced Surgical Devices</b>	A product group comprising products for orthopaedic replacement and reconstruction, endoscopy devices and trauma devices. Products for orthopaedic replacement include systems for knees, hips, and shoulders. Endoscopy devices comprise of support products for orthopaedic surgery such as computer assisted surgery and minimally invasive surgery techniques using specialised viewing and access devices, surgical instruments and powered equipment. Orthopaedics trauma devices are used in the treatment of bone fractures including rods, pins, screws, plates and external frames.
<b>Advanced Wound Management</b>	A product group comprising products associated with the treatment of skin wounds, ranging from products that provide moist wound healing using breathable films and polymers to products providing active wound healing by biochemical or cellular action.
<b>AGM</b>	Annual General Meeting of the Company.
<b>Arthroscopy</b>	Endoscopy of the joints is termed arthroscopy , with the principal applications being the knee and shoulder.
<b>ASD</b>	Advanced Surgical Devices division.
<b>AWM</b>	Advanced Wound Management division.
<b>Basis Point</b>	One hundredth of one percentage point.
<b>Chronic wounds</b>	Chronic wounds are those with long or unknown healing times including leg ulcers, pressure sores and diabetic foot ulcers.
<b>Company</b>	Smith & Nephew plc or, where appropriate, the Company's Board of Directors, unless the context otherwise requires.
<b>Companies Act</b>	Companies Act 2006, as amended, of England and Wales.
<b>EBITA</b>	Earnings before interest, tax and amortisation.
<b>EBITDA</b>	Earnings before interest, tax, depreciation and amortisation.
<b>Emerging Markets</b>	Emerging Markets include Greater China, India, Brazil and Russia.

<b>EPSA</b>	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.
<b>Endoscopy</b>	Through a small incision, surgeons are able to see inside the body using a monitor and identify and repair defects.
<b>ERP</b>	Enterprise Resource Planning: a software system which integrates internal and external management information, facilitating the flow of information across an organisation.
<b>Established Markets</b>	Established Markets include United States of America, Europe, Australia, New Zealand, Canada and Japan.
<b>Euro or</b>	References to the common currency used in the majority of the countries of the European Union.
<b>External fixation</b>	The use of wires or pins transfixed through bone to hold a frame to the position of a fracture.
<b>FDA</b>	US Food and Drug Administration.
<b>Financial statements</b>	Refers to the consolidated Group Accounts of Smith & Nephew plc.
<b>FTSE 100</b>	Index of the largest 100 listed companies on the London Stock Exchange by market capitalisation.
<b>GMP</b>	Good manufacturing practice or GMP is the guidance that outlines the aspects of production and testing that can impact the quality of a product.
<b>Group or Smith &amp; Nephew</b>	Used for convenience to refer to the Company and its consolidated subsidiaries, unless the context otherwise requires.

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Term	Meaning
<b>Health economics</b>	A branch of economics concerned with issues related to efficiency, effectiveness, value and behaviour in the production and consumption of health and healthcare.
<b>IFRIC</b>	International Financial Reporting Interpretations as adopted by the EU and as issued by the International Accounting Standards Board.
<b>IFRS</b>	International Financial Reporting Standards as adopted by the EU and as issued by the International Accounting Standards Board.
<b>International Markets</b>	International Markets include Middle East, North Africa, Southern Africa, Latin America, ASEAN, South Korea and Eastern Europe.
<b>LSE</b>	London Stock Exchange.
<b>Metal-on-metal hip resurfacing</b>	A less invasive surgical approach to treating arthritis in certain patients whereby only the surfaces of the hip joint are replaced leaving the hip head substantially preserved.
<b>Negative Pressure Wound Therapy</b>	A technology used to treat chronic wounds such as diabetic ulcers, pressure sores and post-operative wounds through the application of sub-atmospheric pressure to an open wound.
<b>NYSE</b>	New York Stock Exchange.
<b>Orthobiologics products</b>	Any product that is primarily intended to act as a scaffold and/or actively stimulates bone growth.
<b>Orthopaedic products</b>	Orthopaedic reconstruction products include joint replacement systems for knees, hips and shoulders and support products such as computer-assisted surgery and minimally invasive surgery techniques. Orthopaedic trauma devices are used in the treatment of bone fractures including rods, pins, screws, plates and external frames. Clinical therapies products include joint fluid therapy for pain reduction of the knee and an ultrasound treatment to accelerate the healing of bone

	fractures.
<b>OXINIUM</b>	OXINIUM material is an advanced load bearing technology. It is created through a proprietary manufacturing process that enables zirconium to absorb oxygen and transform to a ceramic on the surface, resulting in a material that incorporates the features of ceramic and metal. Management believes that OXINIUM material used in the production of components of knee and hip implants exhibits unique performance characteristics due to its hardness, low-friction and resistance to roughening and abrasion.
<b>Parent Company</b>	Smith & Nephew plc.
<b>Pound Sterling, Sterling, £, pence or p</b>	References to UK currency. 1p is equivalent to one hundredth of £1.
<b>Repair</b>	A product group within ASD comprising specialised devices, fixation systems and bio-absorbable materials to repair joints and associated tissue.
<b>Resection</b>	Products that cut or ablate tissue within ASD comprising mechanical blades, radio frequency wands, electromechanical and hand instruments for resecting tissue.
<b>SEC</b>	US Securities and Exchange Commission.
<b>Trading results</b>	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.
<b>UK</b>	United Kingdom of Great Britain and Northern Ireland.
<b>UK GAAP</b>	Accounting principles generally accepted in the United Kingdom.
<b>Underlying growth</b>	Growth after adjusting for the effects of currency translation and the inclusion of the comparative impact of acquisitions and exclusion of disposals.
<b>US</b>	United States of America.
<b>US Dollars, US \$ or cents</b>	References to US currency. 1 cent is equivalent to one hundredth of US\$1.
<b>US GAAP</b>	Accounting principles generally accepted in the United States of America.
<b>Visualisation</b>	Products within ASD comprising digital cameras, light sources, monitors, scopes, image capture, central control and multimedia broadcasting systems for use in endoscopic surgery with visualisation.
<b>Wound bed</b>	An area of healthy dermal and epidermal tissue of a wound.

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**About Smith & Nephew**

The Smith & Nephew Group (the Group) is a global medical devices business operating in the markets for advanced surgical devices comprising orthopaedic reconstruction, trauma and sports medicine and advanced wound management, with revenue of approximately \$4.6bn in 2015. Smith & Nephew plc (the Company) is the parent company of the Group. It is an English public limited company with its shares listed on the premium list of the UK Listing Authority and traded on the London Stock Exchange. Shares are also traded on the New York Stock Exchange in the form of American Depositary

Shares ( ADSs ).

This is the Annual Report of Smith & Nephew plc for the year ended 31 December 2015. It comprises, in a single document, the Annual Report and Accounts of the Company in accordance with UK requirements and the Annual Report on Form 20-F in accordance with the regulations of the United States Securities and Exchange Commission ( SEC ).

Smith & Nephew operates on a worldwide basis and has distribution channels in over 100 countries. In the more established countries by revenue, the Group's business operations are organised by divisions. In the majority of the remaining markets, operations are managed by country managers who are responsible for sales and distribution of the Group's entire product range. These comprise the Emerging Markets & International Markets.

Smith & Nephew's corporate website, www.smith-nephew.com, gives additional information on the Group, including an electronic version of this Annual Report. Information made available on this website, or other websites mentioned in this Annual Report, are not and should not be regarded as being part of, or incorporated into, this Annual Report.

For the convenience of the reader, a Glossary of technical and financial terms used in this document is included on pages 197 to 198.

The product names referred to in this document are identified by use of capital letters and the  symbol (on first occurrence) and are trademarks owned by or licensed to members of the Group.

## Presentation

The Groups fiscal year end is 31 December. References to a particular year in this Annual Report are to the fiscal year, unless otherwise indicated. Except as the context otherwise requires, Ordinary Share or share refer to the ordinary shares of Smith & Nephew plc of 20 US cents each.

The Group Accounts of Smith & Nephew in this Annual Report are presented in US Dollars. Solely for the convenience of the reader, certain parts of this Annual Report contain translations of amounts in US Dollars into Sterling at specified rates. These translations should not be construed as representations that the US Dollar amounts actually represent such Sterling amounts or could be converted into Sterling at the rate indicated.

Unless stated otherwise, the translation of US Dollars and cents to Sterling and pence in this Annual Report has been made at the Bank of England exchange rate on the date indicated. On 23 February 2016, the Bank of England rate was US\$1.4078 per £1.

The results of the Group, as reported in US Dollars, are affected by movements in exchange rates between US Dollars and other currencies. The Group applied the average exchange rates prevailing during the year to translate the results of companies with functional currency other than US Dollars. The currencies which most influenced these translations in the years covered by this report were Sterling, Swiss Franc and the Euro.

The Accounts of the Group in this Annual Report are presented in millions ( m ) unless otherwise indicated.

## Special note regarding forward-looking statements

The Groups reports filed with, or furnished to, the US Securities and Exchange Commission ( SEC ), including this document and written information released, or oral statements made, to the public in the future by or on behalf of the Group, contain forward-looking statements within the meaning of the US Private Securities Litigation Reform Act of 1995, that may or may not prove accurate. For example, statements regarding expected revenue growth and trading profit margins discussed under Outlook, Global Outlook and Strategic performance, market trends and our product pipeline are forward-looking statements. Phrases such as aim, plan, intend, anticipate, well-placed, believe, expect, target, consider and similar expressions are generally intended to identify forward-looking statements. Forward-looking statements involve known and unknown risks, uncertainties and other important factors that could cause actual results, to differ materially from what is expressed or implied by the statements.

For Smith & Nephew, these factors include: economic and financial conditions in the markets we serve, especially those affecting health care providers, payers and customers; price levels for established and innovative medical devices; developments in medical technology; regulatory approvals, reimbursement decisions or other government actions; product defects or recalls; litigation relating to patent or other claims; legal compliance risks and related investigative, remedial or enforcement actions; strategic actions, including acquisitions and dispositions and our success in performing due diligence, valuing and integrating acquired businesses; disruption that may result from transactions or other changes we make in our business plans or organisation to adapt to market developments and numerous other matters that affect us or our markets, including those of a political, economic, business, competitive or reputational nature; relationships with healthcare professionals; reliance on information technology. Specific risks faced by the Group are described under Risk factors on pages 171 to 174 of this Annual Report. Any forward-looking statement is based on information available to Smith & Nephew as of the date of the statement. All written or oral forward-looking statements attributable to Smith & Nephew are qualified by this caution. Smith & Nephew does not undertake any obligation to update or revise any forward-looking statement to reflect any change in circumstances or in Smith & Nephews expectations.

### Division data

Division data and division share estimates throughout this report are derived from a variety of sources including publicly available competitors' information, internal management information and independent market research reports.

### Documents on display

It is possible to read and copy documents referred to in this Annual Report at the Registered Office of the Company. Documents referred to in this Annual Report that have been filed with the Securities and Exchange Commission in the US may be read and copied at the SEC's public reference room located at 450 Fifth Street, NW, Washington DC 20549. Please call the SEC at 1-800-SEC-0330 for further information on the public reference rooms and their copy charges. The SEC also maintains a website at [www.sec.gov](http://www.sec.gov) that contains reports and other information regarding registrants that file electronically with the SEC. This Annual Report and some of the other information submitted by the Group to the SEC may be accessed through the SEC website.

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The inks used are renewable, biodegradable and emit fewer Volatile Organic Compounds (VOCs) than mineral-oil inks.

They are based on high levels of renewable raw materials such as vegetable oils and naturally occurring resin.

The inks do not contain any toxic heavy metals and therefore, do not pose a problem if placed in landfill.

Designed by Radley Yeldar.

Printed by RR Donnelley 472599.

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Smith & Nephew plc

15 Adam Street

London WC2N 6LA

United Kingdom

T +44 (0) 20 7401 7646

[enquiries@smith-nephew.com](mailto:enquiries@smith-nephew.com)

[www.smith-nephew.com](http://www.smith-nephew.com)

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**SIGNATURE**

The Registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and has duly caused and authorized the undersigned to sign this Annual Report on its behalf.

Smith & Nephew plc

(Registrant)

By: /s/ Susan Swabey  
Susan Swabey  
Company Secretary

London, England

March 4, 2016

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<b>Exhibit No.</b>	<b>Description of Document</b>	<b>Incorporated Herein by Reference To</b>	<b>Filed Herewith</b>
1	Articles of Association	Form 20-F for the year ended December 31, 2011 filed on March 1, 2012 (File No. 1-14978)	
2	Smith & Nephew plc is not party to any single instrument relating to long-term debt pursuant to which a total amount of securities exceeding 10% of Smith & Nephew plc's total assets (on a consolidated basis) is authorized to be issued. Smith & Nephew plc hereby agrees to furnish to the SEC, upon its request, a copy of any instrument defining the rights of holders of its long-term debt or the rights of holders of the long-term debt of any of its subsidiaries for which consolidated or unconsolidated financial statements are required to be filed with the SEC.		
4	(a) (i) Material contract: Agreement and Appendices dated 3 February 2014 by and among Smith & Nephew plc, Barclays Bank Plc, The Financial Institutions in Schedule 1, Barclays Bank Plc and J.P. Morgan Chase Bank, N.A. and J.P. Morgan Europe Limited.	Form 20-F for the year ended December 31, 2013 filed on March 6, 2014 (File No.1-14978)	
	(ii) Material contract: Agreement and Plan Merger dated 2 February 2014 by and among ArthroCare Corporation Smith & Nephew, Inc. and Smith & Nephew plc.	Form 20-F for the year ended December 31, 2013 filed on March 6, 2014 (File No.1-14978)	
	(iii) Material contract: Agreement and Appendices dated 24 March 2014 by and among Smith & Nephew plc, Barclays Bank Plc; J.P. Morgan Limited; Bank Of America Merrill Lynch International Limited; Bank Of China Limited, London Branch; The Bank Of Tokyo-Mitsubishi Ufj, Ltd.; HSBC Bank Plc; Mizuho Bank, Ltd.; National Australia Bank Limited; The Royal Bank Of Scotland Plc; Societe Generale; Sumitomo Mitsui Banking Corporation;	Form 20-F for the year ended December 31, 2014 filed on March 5, 2015 (File No.1-14978)	



Wells Fargo Bank International and  
Deutsche Bank Ag, London Branch.

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<b>Exhibit No.</b>	<b>Description of Document</b>	<b>Incorporated Herein by Reference To</b>	<b>Filed Herewith</b>
4 (a) (iv)	Material contract: Agreement and Appendices dated 19 November 2014 by and among Smith & Nephew plc and the purchasers listed in Schedule A.	Form 20-F for the year ended December 31, 2014 filed on March 5, 2015 (File No.1-14978)	
4 (c) (i)	Service Agreement of Olivier Bohuon	Form 20-F for the year ended December 31, 2010 filed on March 3, 2011 (File No. 1-14978)	
	(ii) Retirement provisions for David J Illingworth	Form 20-F for the year ended December 31, 2010 filed on March 3, 2011 (File No. 1-14978)	
	(iii) Service Agreement of Julie Brown	Form 20-F for the year ended December 31, 2012 filed on February 28, 2013 (File No. 1-14978)	
	(iv) Side Letter to the Service Agreement of Julie Brown	Form 20-F for the year ended December 31, 2012 filed on February 28, 2013 (File No. 1-14978)	
	(v) Letter of Appointment of Ian Barlow	Form 20-F for the year ended December 31, 2009 filed on March 26, 2010 (File No. 1-14978)	
	(vi) Letter of Appointment of The Rt. Hon Baroness Virginia Bottomley	Form 20-F for the year ended December 31, 2012 filed on February 28, 2013 (File No.1-14978)	
	(vii) Letter of Appointment of Michael Friedman	Form 20-F for the year ended December 31, 2012 filed on February 28, 2013 (File No.1-14978)	
	(viii) Letter of Appointment of Ajay Piralal	Form 20-F for the year ended December 31, 2011 filed on March 1, 2012 (File No. 1-14978)	
	(ix) Letter of Re-Appointment of Rolf Stomberg	Form 20-F for the year ended December 31, 2012 filed on February 28, 2013 (File No.1-14978)	
	(x) Letter of Re-Appointment of Richard De Schutter	Form 20-F for the year ended December 31, 2013 filed on March 6, 2014 (File No.1-14978)	
	(xi) Letter of Re-Appointment of Pamela Kirby	Form 20-F for the year ended December 31, 2013 filed on March 6, 2014 (File No.1-14978)	

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<b>Exhibit No.</b>	<b>Description of Document</b>	<b>Incorporated Herein by Reference To</b>	<b>Filed Herewith</b>
4 (c) (xii)	Letter of Re-Appointment of Brian Larcombe	Form 20-F for the year ended December 31, 2013 filed on March 6, 2014 (File No.1-14978)	
(xiii)	Letter of Re-Appointment of Joseph Papa	Form 20-F for the year ended December 31, 2013 filed on March 6, 2014 (File No.1-14978)	
(xiv)	Letter of Appointment of Roberto Quarta	Form 20-F for the year ended December 31, 2013 filed on March 6, 2014 (File No.1-14978)	
(xv)	Letter of Appointment of Vinita Bali	Form 20-F for the year ended December 31, 2014 filed on March 5, 2015 (File No.1-14978)	
(xvi)	Letter of Appointment of Erik Engstrom	Form 20-F for the year ended December 31, 2014 filed on March 5, 2015 (File No.1-14978)	
(xvii)	Letter of Re-Appointment of Brian Larcombe	Form 20-F for the year ended December 31, 2014 filed on March 5, 2015 (File No.1-14978)	
(xviii)	Letter of Re-Appointment of The Rt. Hon Baroness Virginia Bottomley DL	Form 20-F for the year ended December 31, 2014 filed on March 5, 2015 (File No.1-14978)	
(xix)	Letter of Appointment of Robin Freestone		X
(xx)	Letter of Re-Appointment of Ian Barlow		X
(xxi)	Letter of Re-Appointment of Michael Friedman		X
(xxii)	Letter of Re-Appointment of Brian Larcombe		X
(xxiii)	The Smith & Nephew 2001 UK Approved Share Option Plan	Form 20-F for the year ended December 31, 2004 filed on March 16, 2005 (File No. 1-14978)	
(xxiv)	The Smith & Nephew 2001 UK Unapproved Share Option Plan	Form 20-F for the year ended December 31, 2004 filed on March 16, 2005 (File No. 1-14978)	
(xxv)	The Smith & Nephew 2001 US Share Plan	Registration Statement on Form S-8 No. 333-13694 filed on July 9, 2001 (File No. 1-14978)	
(xxvi)	The Smith & Nephew Sharesave Plan (2002)	Form 20-F for the year ended December 31, 2002 filed on April 25, 2003 (File No. 1-14978)	

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<b>Exhibit No.</b>	<b>Description of Document</b>	<b>Incorporated Herein by Reference To</b>	<b>Filed Herewith</b>
4 (c) (xxvii)	The Smith & Nephew International Sharesave Plan (2002)	Form 20-F for the year ended December 31, 2004 filed on March 16, 2005 (File No. 1-14978)	
(xxviii)	The Smith & Nephew Italian Sharesave Plan (2002)	Form 20-F for the year ended December 31, 2002 filed on April 25, 2003 (File No. 1-14978)	
(xxix)	The Smith & Nephew Dutch Sharesave Plan (2002)	Form 20-F for the year ended December 31, 2002 filed in April 25, 2003 (File No. 1-14978)	
(xxx)	The Smith & Nephew Belgian Sharesave Plan (2002)	Form 20-F for the year ended December 31, 2002 filed on April 25, 2003 (File No. 1-14978)	
(xxxii)	The Smith & Nephew French Sharesave Plan (2002)	Form 20-F for the year ended December 31, 2002 filed on April 25, 2003 (File No. 1-14978)	
(xxxiii)	Smith & Nephew Irish Employee Share Option Scheme	Form 20-F for the year ended December 31, 2003 filed on March 26, 2004 (File No. 1-14978)	
(xxxiv)	Smith & Nephew 2004 Executive Share Option Scheme	Registration statement on Form S-8 No. 333-122801 filed on February 14, 2005 (File No. 1-14978)	
(xxxv)	Smith & Nephew 2004 Performance Share Plan	Registration statement on Form S-8 No. 333-122801 filed on February 14, 2005 (File No. 1-14978)	
(xxxvi)	Smith & Nephew 2004 Co-investment Plan	Registration statement on Form S-8 No. 333-122801 filed on February 14, 2005 (File No. 1-14978)	
(xxxvii)	Smith & Nephew U.S. Employee Stock Purchase Plan	Registration statement on Form S-8 No. 333-12052 filed on May 30, 2000 (File No. 1-14978)	
(xxxviii)	Smith & Nephew Long Service Award Scheme	Registration Statement on Form S-8 No. 33-39814 filed on April 5, 1991 (File No. 1-14978)	
(xxxviii)	Smith & Nephew 2004 Performance Share Plan	Registration statement on Form S-8 No. 333-155172 filed on November 7, 2008 (File No. 1-14978)	

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<b>Exhibit No.</b>	<b>Description of Document</b>	<b>Incorporated Herein by Reference To</b>	<b>Filed Herewith</b>
4	(c) (xxxix) Smith & Nephew 2001 US Share Plan	Registration statement on Form S-8 No. 333-155173 filed on November 7, 2008 (File No. 1-14978)	
	(xxxx) Smith & Nephew plc Deferred Bonus Plan	Registration statement on Form S-8 No. 333-158239 filed on March 27, 2009 (File No. 1-14978)	
	(xxxxxi) Smith & Nephew plc Global Share Plan 2010	Registration statement on Form S-8 No. 333-168544 filed on August 5, 2010 (File No. 1-14978)	
	(xxxixii) Smith & Nephew ShareSave Plan (2012)	Form 20-F for the year ended December 31, 2012 filed on February 28, 2013 (File No.1-14978)	
	(xxxixiii) Smith & Nephew International ShareSave Plan (2012)	Form 20-F for the year ended December 31, 2012 filed on February 28, 2013 (File No.1-14978)	
	(xxxixiv) Smith & Nephew plc Global Share Plan 2010	Registration statement on Form S-8 No. 333-199117 filed on October 2, 2014 (File No.1-14978)	
8	Principal Subsidiaries		X
12	(a) Certification of Olivier Bohuon, filed pursuant to Exchange Act Rule 13a-14(a)		X
	(b) Certification of Julie Brown filed pursuant to Exchange Act Rule 13a-14(a)		X
13	(a) Certification of Olivier Bohuon and Julie Brown furnished pursuant to Exchange Act Rule 13a-14(b)		X
15.1	Consent of KPMG LLP, Independent Registered Public Accounting Firm		X
15.2	Consent of Ernst & Young LLP, Independent Registered Public Accounting Firm		X
15.3	Report of Independent Registered Public Accounting Firm by Ernst & Young LLP in respect of the financial statements as of and for the years ending December 31, 2013 and 2014		X
15.4			X

Ernst & Young LLP's letter to the SEC  
confirming their agreement with the  
statements pursuant to the disclosure  
requirements of Item 16 of the Form  
20-F