SMITH & NEPHEW PLC
Form 20-F
March 05, 2015
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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

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

For the fiscal year ended December 31, 2014

or

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

or

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

Commission file number 1-14978

Smith & Nephew plc

(Exact name of Registrant as specified in its charter)

England and Wales

(Jurisdiction of incorporation or organization)

15 Adam Street, London WC2N 6LA

(Address of principal executive offices)

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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What s in this report

Strategic Report

Supporting Healthcare professionals

Corporate Governance

Financial statements
and other information

* These sections and pages 111, 113 and 115 form the Directors Report.

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Our mission

Delivering advanced medical technologies that help healthcare professionals, our customers, improve the quality of life for their patients

and this will drive our performance

$4.6bn Revenue[1] up 2%	**$1,055m** Trading profit[1,2] up 3%	**$749m** Operating profit[1] down 8%
83.2¢ Adjusted earnings per share[2] up 8%	**56.1¢** Earnings per share down 9%	**29.6¢** Dividends per share up 8%

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.
2 Explanations of these non-GAAP financial measures are provided on pages 176 to 179.

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STRATEGIC REPORT

Financial highlights

Continuing to improve

our performance

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 measures and exclude restructuring/rationalisation costs, acquisition and disposal-related costs, amortisation of acquisition intangibles and other transactions which affect short-term profitability. An explanation of these measures is provided on pages 176 to 179.

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Chairman s statement

Dear Shareholder,

I joined Smith & Nephew in December 2013, and succeeded Sir John Buchanan as Chairman in April 2014. In my first letter to you I am pleased to report that Smith & Nephew made good progress last year, delivering strong earnings growth and enhanced value for shareholders. We did this whilst making major investments to reshape the Group for future success such as the acquisition of ArthroCare Corporation for $1.5 billion net.

Revenue was $4,617 million, up 2% on an underlying basis or 6% on a reported basis. Trading profit was $1,055 million, up 3% on an underlying basis or 7% on a reported basis. The trading profit margin of 22.9% was 20bps up on the previous year. The Board is pleased to propose a Final Dividend for the year just gone of 18.6¢ per share, giving a total dividend for 2014 of 29.6¢, up 8% year-on-year.

Board changes

Sir John Buchanan retired as Chairman in April at the 2014 Annual General Meeting, after nine years of outstanding service. On behalf of the Board and the whole of Smith & Nephew I thank him for his leadership.

Richard (Dick) de Shutter also retired at the Annual General Meeting. In his role as Senior Independent Director, Dick provided wise counsel through a period of significant growth and change. Ajay Piramal retired in March, having provided valuable insight into the emerging markets as we built our presence there. Pamela Kirby retired from the Board in July. She also made a major contribution particularly as Chairman of the Ethics & Compliance Committee. I thank Dick, Ajay and Pamela for their service.

It is a credit to the growing strength and reputation of the Company that we have attracted top global talent to succeed these individuals. Vinita Bali joined the Board in December following an impressive career at blue-chip global corporations such as The Coca-Cola Company in multiple

First impressions

My first impression of Smith & Nephew was of a Company with strong leadership, a clear strategy and sound financial platform. The open communication between the Board and the executive team is a real strength of the business. I was particularly impressed with the execution of the ArthroCare acquisition, especially the thoroughness of our due diligence and how well the team is managing the integration.

I have also been able to spend time visiting our sites and meeting employees, including attending a Sports Medicine procedure to witness how our highly-skilled reps assist surgeons in improving outcomes. I have consistently found a business with a strong culture, particularly in areas of ethics and compliance, and people who are proud of their work supporting healthcare professionals.

Looking ahead I see many exciting opportunities in the Established Markets where we are challenging the status quo through new commercial models, in the Emerging & International Markets geographies including India, Africa, South America, the US and UK. Her strong appreciation of customer service and marketing will bring deep insight to Smith & Nephew as we continue to develop innovative ways to serve our markets. Erik Engstrom, the CEO of Reed Elsevier, joined the Board in January 2015. His understanding of how technology can be used to transform a business will be invaluable.

where we have a leadership platform and from recent acquisitions. In 2015, I believe we will begin to see more clearly the benefits of the transformational work that has been undertaken at Smith & Nephew, and I look forward to sharing more news of these achievements next year.

Yours sincerely,

Roberto Quarta

Chairman

Smith & Nephew made good progress last year, delivering strong earnings growth and enhanced value to shareholders.

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STRATEGIC REPORT

Chief Executive Officer s review

A good financial performance while strengthening the business

The journey to reshape Smith & Nephew continues and I am excited by our prospects for accelerating growth in 2015 and beyond.

Dear Shareholder

Smith & Nephew proudly supports healthcare professionals in their daily efforts to improve the lives of their patients. We do this by taking a pioneering approach to the design of our products and services, by striving to ensure wider access to our advanced technologies, and by enabling better outcomes for patients and healthcare systems. In doing so, we drive growth and create value for our stakeholders.

In 2014, we made great progress. We drove a much improved performance in US Hip and Knee Implants and maintained our momentum in Sports Medicine Joint Repair and Trauma & Extremities. Advanced Wound Bioactives, acquired at the end of 2012, again produced double-digit growth. Our continued investment in Emerging & International Markets drove revenues up 17%.

Performance in Europe was weaker and Advanced Wound Management was held back by a distribution hold on RENASYSà in the US, and I am confident that we have taken actions that will deliver a better 2015 across these areas. Additionally, the Phase 3 trial results for HP802 were a disappointment, but we remain committed to developing pioneering Advanced Wound Bioactives treatments.

The Group generated a good increase in revenues and trading profit, and an 8% uplift in EPSA. I am pleased by the changing mix of the business, as we successfully rebalance by strengthening our higher growth platforms. These now represent more than half of our revenue, up from just 35% three years ago.

Pioneering design

Smith & Nephew has a long history of pioneering design, dating back to our foundations in the 19th century. In 2014, we launched many exciting products, including a cruciate retaining version of our JOURNEYàII natural-motion knee, a first-of-its-kind DYONICSà PLAN surgical planning tool for hip arthroscopy, and the HAT-TRICK Lesser Toe Repair System. We continued to invest more in R&D, over 5% of revenue, and have a strong pipeline for 2015 and beyond.

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For us, innovation is not just about products. It is also about how we do business. We seek new ways to serve our customers. In 2014, we pioneered a new commercial solution for Orthopaedic Reconstruction that fulfils the unmet needs of customers searching for a different value proposition. Called Syncera[à], this offers clinically proven primary hip and knee implants combined with cutting-edge technology to streamline the extensive support process. Syncera has the potential to generate significant savings for the customer. We are encouraged by the contracts signed and prospective customers.

Widening access

In the Emerging & International Markets we have built an entrepreneurial business resourced to maximise the significant opportunities we see. In 2014, it generated more than $600 million revenue, with China, our largest market, growing revenue at over 30%. 15% of Group revenue came from these markets in 2014, up from 8% in 2010.

In 2014, we established a new commercial structure to market and expand our mid-tier value product ranges. This will provide wider access to our advanced technologies, helping ArthroCare, completed in May 2014, has strengthened our Sports Medicine business. Its technology and products significantly enhance our portfolio, and we will use our global presence to drive substantial new growth. The integration is progressing well.

Enhanced efficiency

By simplifying and improving our operating model we are increasing our agility and efficiency. In 2011, we announced a programme to generate annual savings of $150 million. By 31 December 2014, we had achieved annualised savings of $146 million, enabling investment in the Emerging & International Markets, R&D and other growth opportunities.

In 2014, we announced a further programme to realise at least another $120 million of annual savings. This work is progressing well. For instance, we are rationalising our global property portfolio and found major savings through better procurement processes. These savings will more directly benefit the bottom line.

Our results

22.9%

Trading margin[1] up 20bps

83.2¢

EPSA[1] up 8%

1 Explanations of these non-GAAP financial measures are provided on pages 176 to 179.

us support an ever greater number of customers in delivering affordable healthcare.

Enabling better outcomes

We provide high quality products and medical education to help drive better clinical outcomes. During 2014, we saw strong and rising demand for unique products such as our hard-wearing VERILASTª Hips and Knees, VISIONAIREª patient-matched instrumentation and the PICOª portable disposable Negative Pressure Wound Therapy system. These, and many other advanced Smith & Nephew products, also enable healthcare professionals to treat more patients faster, improving the economic outcome for the healthcare system payers.

Strengthening our platform

In recent years, we have successfully supplemented our organic growth through acquisitions. Healthpoint Biotherapeutics gave us a leading position in Advanced Wound Bioactives, the fastest growing segment of Advanced Wound Management. We have also completed a number of acquisitions in the Emerging & International Markets, strengthening our platform by adding products, manufacturing, distribution and sales teams.

Great Place to Work

Achieving recognition as a Great Place to Work is important to me. It means having a workplace where employees are proud and excited to come each day because they are doing work that makes a difference for customers and patients. During 2014, I was proud to congratulate our colleagues in Spain for being the first country to achieve this distinction from the Great Place to Work Institute and it will not be the last. Also, our sustainability performance was recognised again as we retained our rankings in both the FTSE4Good and Dow Jones Sustainability indices. Acting sustainably and responsibly to deliver long-term benefits to society is important. It is our employees who earn these awards, and I thank them for their efforts.

I am pleased with our momentum in 2014 as we delivered a good financial performance while strengthening the business, and you will find more details on our successful actions on pages 42 to 53. Whilst the journey to reshape Smith & Nephew continues, we enter 2015 stronger and more efficient and I am excited by our prospects for accelerating growth in 2015 and beyond.

Sincerely,

Olivier Bohuon

Chief Executive Officer

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STRATEGIC REPORT

Smith & Nephew today

Our marketplace is growing

Demand for healthcare continues to increase worldwide. This is driven by increased longevity, more prevalence of obesity and associated disease states, greater expectation of an active lifestyle, improved awareness of treatment options and the increasing affluence of the emerging markets.

Advanced Surgical Devices	Advanced Wound Management
Total segment value	Total segment value
$24bn	**$7bn**
+5%	+4%

Our products are used by surgeons and nurses to help repair and heal the human body throughout a person s life

Global population

Source: United Nations World Population Prospects, The 2012 Revision.

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Served by our global businesses

Our global franchises design, develop and deliver our advanced medical technologies to customers in more than 100 countries globally.

Advanced Surgical Devices global

1. Orthopaedic Reconstruction

Specialist hip and knee implant systems.

Revenue[1]

$1,527m **+2%**

2013 $1,518m

2. Trauma & Extremities

Internal and external devices used in the stabilisation of severe fractures and deformity correction procedures.

Revenue[1]

$506m **+4%**

2013 $486m

3. Sports Medicine Joint Repair

Instruments, technologies and implants necessary to perform minimally invasive surgery of joints.

Revenue[1]

$576m **+8%**

2013 $496m

4. Arthroscopic Enabling Technologies

Cutting, visualisation and fluid management technologies necessary for Sports Medicine Joint Repair.

Revenue[1]

$542m **+1%**

2013 $441m

5. Other ASD

ENT and gynaecology instrumentation.

Revenue[1]

$147m **+10%**

2013 $74m

Advanced Wound Management global

1. Advanced Wound Care

Products for the treatment of acute and chronic wounds, including leg, diabetic and pressure ulcers, burns and post-operative wounds.

Revenue[1]

$805m **4%**

2013 $843m

2. Advanced Wound Devices

Traditional and single-use Negative Pressure Wound Therapy (NPWT) and hydrosurgery systems.

Revenue[1]

$192m **9%**

2013 $213m

3. Advanced Wound Bioactives

Bioactive technologies that provide unique approaches to debridement and dermal repair and regeneration.

Revenue[1]

$322m **+15%**

2013 $280m

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.

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STRATEGIC REPORT

Smith & Nephew today *continued*

Our business model

delivers value

Our Capital Allocation Framework

Maintain a strong balance sheet to ensure solid investment grade credit metrics

Resource utilised

$7.3bn	**$235m**	**13,468**	**15**	**$245m**
Total Assets	Investment in R&D	Employees	Manufacturing plants worldwide	Corporation tax paid

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With a strategy to

drive our performance

Our strategic priorities

Established Markets

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

Emerging & International Markets

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

Innovate for value

Accelerate our rate of innovation by investing more in research & development to support projects that will move clinical and cost boundaries and deliver maximum value.

Simplify and improve our operating model

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

Supplement organic growth with acquisitions

Build our platform by acquiring complementary technologies, manufacturing and distribution in the emerging markets and complementary products or businesses in our higher growth segments.

u Read more about our strategy in action on pages 42 53

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STRATEGIC REPORT

Strategic performance

How we performed

Established Markets

Performance

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

Our combined businesses in the Established Markets delivered flat growth for the year. Headwinds in Europe impacted our performance and offset the positive growth we achieved across the US, Japan, Australia & New Zealand.

In Advanced Wound Management, our performance was slightly below estimated global segment growth, despite a 15% growth in Advanced Wound Bioactives. While Trauma & Extremities, Hip Implants and Knee Implants

Emerging & International Markets

Performance

Emerging & International Markets represent those outside of the Established Markets including the fast growing BRIC group of Brazil, China, India and Russia.

Our Emerging & International Markets grew at 17%, building further on the double-digit growth of 2013. These geographies now represent 15% of the Group s overall revenue, up from 11% in 2011.

During 2014:

Our success in China continued with growth of over 30%, for a

Innovate for value

Performance

For Smith & Nephew Innovate for value means having a pioneering approach to creating both products and new commercial models to bring products and services to our customers.

Consistent with 2013, R&D investment represented over 5% of revenue, bringing a wide range of products to market across all our franchises. More detail on individual products is set out on pages 21 to 22 and on pages 27 and 31.

In addition we have made investments in two venture funds as part of our search for future disruptive technologies.

growth were also slightly below the market, these franchises performed better than last year and demonstrated an improving trend in the second half of the year as a result of our investments in marketing, medical education and new products. In the higher growth Sports Medicine Joint Repair segment we delivered growth at around market rate and saw the first benefits of the ArthroCare acquisition.

Global Outlook

While there are some signs of improvement in economic conditions, overall the Established Markets continue to experience a challenging environment. We have responded by realigning our business models and made focused investments to enhance our performance and efficiency in these markets.

second year in a row, as our investment in training and infrastructure continue to show results.

Our Latin American markets, which include Brazil and Mexico, are set for improvement going forward as we spent the year integrating acquisitions and making organisational and strategic changes.

The execution of our mid-tier market strategy continues with the establishment of an independent commercial structure and increased investment in building a suitable product portfolio.

Global Outlook

The healthcare environment in our regions continues to rapidly expand and with the right investments combined with strategic execution will provide sustained growth opportunities for the Group.

We have also been investing in an innovative commercial solution for Orthopaedic Reconstruction that fulfils the unmet needs of customers searching for a different value proposition. Called Syncera, it offers customers clinically proven primary hip and knee implants combined with cutting-edge technology that streamlines the supply chain and logistics and enables technical support in the operating room. This new model has the potential to generate significant savings for the customer.

A pioneering approach to products and services provides competitive advantages. Smarter, easier to use, cost-efficient products and services can offset pricing pressures, disrupt markets and challenge the status quo, which will be required to meet the new and expanding demands for healthcare customers globally.

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Simplify and improve

our operating model

Performance

Trading profit grew by 3% and trading profit margin increased by 20bps while investing in our commercial operations and meeting market and pricing pressures.

Key initiatives included:

Continuing to deliver our $150 million per annum efficiency savings programme, of which we have achieved annualised savings of $146 million as at 31 December 2014.

Commencing a further $120 million annualised Group Optimisation plan through a one-off investment of $150

Supplement organic

growth with acquisitions

Performance

In 2014, we completed five acquisitions and investments, including our largest deal to date, the $1.7 billion acquisition of ArthroCare Corporation. This brings the total over the last 4 years to 15 transactions for a combined consideration of $2.8 billion, including the $782 million acquisition of Healthpoint Therapeutics in late 2012.

ArthroCare was a compelling opportunity to add unique technology and highly complementary products to further strengthen our sports medicine business. We will be able to generate significant additional revenue from the more comprehensive portfolio. We will use our global presence to drive substantial new growth. The transaction accelerates our strategy million, which is progressing well.

Moving to a single Managing Director model in markets outside of the US, combining the commercial organisations to leverage scale and better serve customers.

By simplifying and improving our operating model we have been able to liberate resources to invest in growth opportunities, meet the persistent price pressure and improve our financial returns. A simpler and more efficient organisation allows us to make faster and better decisions.

to rebalance Smith & Nephew towards higher growth opportunities.

We regularly review acquisitions to ensure they are meeting our expectations, and use IRRs and ROCE to confirm performance is on track to deliver the required return. During 2014 we continued to integrate our recent emerging markets acquisitions, whilst Healthpoint performed strongly in its second full year in Smith & Nephew.

Acquisitions and partnerships are important elements which supplement organic investment and provide increased opportunity for high growth and value creation.

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.

2 Explanations of these non-GAAP financial measures are provided on pages 176 to 179.

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STRATEGIC REPORT

Chief Financial Officer s overview

We made significant

progress in 2014...

Our results

$4,617m

Revenue[1] up 2%

$1,055m

Trading profit[1,2] up 3%

Dear Shareholder,

Smith & Nephew made significant progress in 2014 and continued to deliver good revenue and earnings growth. Our growth trajectory is being enhanced by the integration of our acquisitions, greater Group efficiency, and tax improvement combining with strong cash generation and disciplined capital allocation to accelerate value creation for shareholders.

Strong earnings growth

In the full year 2014, we generated revenue of $4,617 million (2013: $4,351 million), an increase of 2% on an underlying basis and 6% on a reported basis. Acquisitions added 5% to the reported growth rate, while currency was a -1% headwind.

Reinvestment & Group optimisation

During 2014, we launched a programme to target further efficiencies. We have identified four main areas of activity:

1 Globalising 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 Rationalising our footprint to simplify the way we work.

4 Further simplifying our operating model, including establishing a single operating

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.

2 Explanations of these non-GAAP financial measures are provided on pages 176 to 179.

Trading profit was $1,055 million (2013: $987 million), up 3% underlying and 7% on a reported basis. The trading profit margin was 22.9% (2013: 22.7%), a 20bps increase despite the headwind from the US RENASYS distribution hold announced in June.

Operating profit for 2014 was $749 million (2013: $810 million), reflecting acquisition costs largely relating to ArthroCare, as well as restructuring and rationalisation costs, amortisation of acquisition intangibles and legal and other items incurred. The net interest charge and other financing costs for 2014 were $33 million (2013: $7 million). Profit before tax was therefore $714 million (2013: $802 million).

The tax charge of $213 million reflects an effective tax rate of 27.7% for the full year (2013: 29.2%) on Trading results.

EPSA was 83.2¢ (166.4¢ per ADS) (2013: 76.9¢). Reported basic earnings per share was 56.1¢ (112.2¢ per ADS) (2013: 61.7¢).

Trading cash flow was $781 million (2013: $877 million), reflecting a trading profit to cash conversion ratio of 74% (2013: 89%).

Net debt at the year-end was $1,613 million reflecting our acquisitions of ArthroCare and in the emerging markets. This represents a reported

structure under a single managing director in all markets outside the US so that we can make decisions more quickly and effectively.

All areas of the programme are progressing well. Overall, we are on target to deliver benefits of over $120 million over a four-year period, with the majority of this expected to benefit margin over time.

Acquisitions

We acquired ArthroCare Corporation in 2014 for a net $1.5 billion. This has strengthened our Sports Medicine business. Its technology and products will significantly enhance our portfolio, and we will use our global presence to drive substantial new growth. The integration is progressing well.

The financial rationale for this transaction was strong, and we expect to realise cost and revenue synergies of around $85 million of additional annual trading profit in 2017.

Our other recent acquisitions continue to perform well. The Advanced Wound Bioactives business acquired at the end of 2012 delivered strong 15% growth in 2014. Our emerging markets acquisitions in Brazil, Turkey and India are now bedded in and net debt/EBITDA ratio of 1.2x.

delivering increasing benefits. And Bioventus, our orthobiologic therapies development vehicle, completed a successful external refinancing and repaid a $160 million loan-note, plus $28 million of accrued interest, to us in October.

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...and continued to deliver good

revenue and earnings growth.

Segment reporting

As we simplify our operating model and move to one commercial organisation in all countries barring the US, we are updating our segmental reporting to reflect this, providing disclosure consistent with the financial information used by senior management to run the business. This means that from 1 January 2015 we will continue to disclose revenue performance by franchise, but other financial data, such as trading margin and assets, will no longer be split between two divisions Advanced Surgical Devices (ASD) and Advanced Wound Management (AWM), since they are now part of one operating unit.

Outlook

We have made material progress in reshaping Smith & Nephew for higher growth since 2011. Whilst the journey to transform Smith & Nephew continues, increasingly we expect to benefit from the actions and investments we have made.

We expect the Group to deliver higher underlying revenue growth in 2015 than in 2014. We also expect to deliver a further improvement in trading profit margin.

We expect the Group to deliver higher underlying revenue growth in 2015 than in 2014. We also expect to deliver a further improvement in trading profit margin.

Additionally, we expect the effective corporate tax rate on trading results to reduce to slightly above 27% in 2015, absent any changes to tax legislation. This is incremental to the 220bps reduction achieved in the last two years.

We believe the Group is at the start of a new and exciting phase in its 158-year history.

Sincerely,

Julie Brown

Chief Financial Officer

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STRATEGIC REPORT

Our marketplace

Changing demands

Market trends

The combination of ageing populations and increasing prevalence of obesity and associated chronic illness is expanding the gap between the demand for healthcare and ability of governments to supply it. The changing balance in ageing populations also means that there is a potential decrease in funds available for healthcare raised through taxes on the working population. Consequentially, governments and healthcare providers are looking for various ways to constrain their healthcare expenditure.

Cost and Outcomes

Healthcare providers, in an effort to reduce spending, are increasingly focusing on the cost of the whole treatment, rather than the individual components. This is leading governments and hospitals to seek greater transparency of product pricing.

In the US, healthcare-acquired infections cost almost $10 billion annually, with surgical site infections being the largest contribution to overall cost.

Product innovation has been the primary response by some suppliers in meeting patient and healthcare provider demands to improve outcomes, simplify procedures and reduce cost.

New commercial models, together with product innovation, are being adopted by health systems as a solution to improving resource allocation. There is a recent trend by health systems to shift towards payment for performance schemes in an effort to promote high quality care and increase the effectiveness of treatments. Additionally, suppliers of healthcare products and devices are providing lower cost or reduced service offerings to those segments of the market more sensitive to price.

Self-Care and Prevention

Self-care and prevention is regarded as an important element of healthcare in that it will help protect society from potential health threats by minimising the risk factors that cause them. Governments have been investing in programmes and providing tools to encourage and support healthier behaviour to reduce the strain on healthcare systems from lifestyle diseases. Additionally, pressure is gradually being applied on the food industry to reduce saturated fats, sugar and salt in products and increase nutritional labelling in an effort to tackle rising rates of obesity and diabetes.

Regulatory standards and compliance in the healthcare industry

The international medical device industry is highly regulated.

As a result, health economic data is being used to obtain reimbursement or justify product pricing. Health economic data currently forms an integral part in shaping the recommendations from the National Institute for Health and Care Excellence (NICE) in the UK and in the US, the Affordable Care Act has committed budget spend to carry out comparative effectiveness research on treatments.

As well as the focus on suppliers of healthcare products, some providers are also implementing incentives for better health outcomes to reduce the costs associated with repeated patient treatments or reduced hospital stay.

Governments are beginning to impose penalties on healthcare facilities for acute patient re-admissions or for infections acquired within the health system which present an additional economic burden on health care systems.

The healthcare industry is also seeing protectionism/localisation playing a part in the product selection process as some jurisdictions are implementing laws to show bias towards locally manufactured products. This already exists in Brazil for major tender offers and China is considering incentives to encourage hospitals to use locally made medical devices.

The increased demand for healthcare products and the limitation of available resources is widening the funding gap. Providing technologies that deliver value by improving clinical outcomes while reducing the consumption of overall healthcare resources is vital for the success and sustainability of medical device businesses.

Regulatory requirements are important in determining whether substances and materials can be developed into safe and effective products and done so 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 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 business also apply to all our global operations.

We are committed to assuring a high level of regulatory compliance and to doing business with integrity and welcome the trend to 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 and will continue to require significant financial and resource investment. See Legal proceedings on page 146.

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 as a result of government policy. We are therefore largely dependent on future governments providing increased funds commensurate with the increased demand arising from demographic trends.

Pricing of our products is largely influenced in most developed 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 we operate. This control may be exercised by or for an entire procedure. We are exposed to changes in reimbursement policy, tax policy and pricing which may have an adverse impact on revenue and operating profit. There may be an increased risk of adverse changes to government funding policies arising from the deterioration in macro-economic conditions in some of our markets.

Competitors

Competition exists among healthcare providers to gain patients on the basis of quality, service and price. Providers are under pressure to reduce the total cost of healthcare delivery. In order to achieve this there has been some consolidation in our customer base, as well as amongst our competitors, and these trends are expected to continue in the long term. We compete against both local and multinational corporations, including some with greater financial, marketing and other resources.

determining prices for an individual
product

Manufacturing facility in Suzhou, China.

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STRATEGIC REPORT

Our marketplace *continued*

Smith & Nephew estimates that the global orthopaedic reconstruction segment is worth approximately $14 billion and increased by approximately 3% in 2014. Competitors in the orthopaedic reconstruction segment include Biomet, DePuy Synthes (a division of Johnson & Johnson), Stryker and Zimmer.

Smith & Nephew estimates that the global orthopaedic trauma segment is worth approximately $5 billion and grew by approximately 6% in 2014. Competitors in the orthopaedic trauma segment include Biomet, DePuy Synthes, Stryker and Zimmer.

Smith & Nephew estimates that the global sports medicine segment (representing access, resection and repair products) is worth approximately $5 billion and grew by approximately 8% in 2014. Competitors in the sports medicine segment include Arthrex, Conmed, DePuy Mitek (a division of Johnson & Johnson) and Stryker.

Smith & Nephew estimates that the global wound management segment is worth approximately $7 billion and grew by 4% in 2014. Global competitors vary across our product areas and geographies and include Acelity, Coloplast, ConvaTec, 3M and Molnlycke.

Customers

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

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 the Advanced Wound Management business.

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STRATEGIC REPORT

Our business

Delivering advanced medical technologies

Smith & Nephew s business model, set out on page 12, supports our mission to deliver advanced medical technologies to help healthcare professionals, our customers, improve the quality of life for their patients.

Through it we create value. This value creation process is actioned through five streams of activity.

Research & Development

Ethics & Compliance

Manufacturing

Medical Education

Sales & Marketing

Research and Development

We have a deep knowledge of the needs of surgeons, physicians and nurses, we understand the economic pressures healthcare payers work under, and we recognise that patients are demanding better treatment options to restore quality of life.

These factors inform our Research and Development (R&D) strategy, which is at the heart of our business model.

In 2014, we launched many exciting products, including a cruciate retaining version of our JOURNEY II natural-motion knee, a first-of-its-kind DYONICS PLAN surgical planning tool for hip arthroscopy, and the HAT-TRICK Lesser Toe Repair System. We have a strong new product pipeline for 2015, with many innovations scheduled.

Strict criteria are applied to ensure new products fulfil an unmet clinical need, have a strong commercial case, and are technologically feasible. Our R&D teams also work closely with manufacturing and supply chain management to ensure we can produce new products to clinical, cost and time specification. Our products undergo clinical and health economic assessment both during their development and post launch.

Open innovation

As part of our R&D strategy, Smith & Nephew supports and works with numerous small companies looking for help with developing and commercialising new technologies. We scout globally for new technologies and services to meet the needs of our customers.

We are a primary sponsor of the Massachusetts Medical Device Development Center (M2D2) New Venture Competition, supporting

Our business model is underpinned by our Capital Allocation Framework. This enables us to invest for the future, both in organic growth and through acquisitions, whilst also generating value for shareholders today through a progressive dividend policy and commitment to return any excess capital.

These new products, and many more currently in development, are a result of our focus on R&D. We invested $235 million in this area in 2014, in-line with our commitment, stated in 2011, to increase our investment level to around 5% of revenue.

We are 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.

entrepreneurial product development by early-stage medical device companies. We also work with MassChallenge, a global start-up competition and accelerator programme, to support emerging companies that fit with our strategic areas of interest.

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STRATEGIC REPORT

Our business *continued*

We continued in 2014 as the commercial partner in SWAN-iCare, an EU-funded initiative to bring multidisciplinary European research teams together to deliver a next generation integrated autonomous solution for monitoring and adapting personalised therapy of foot and leg ulcers.

Smith & Nephew also welcomes new product concepts from surgeons. Through our InVentures programme we collaborate to bring ideas to reality. InVentures evaluates surgeon concepts for technical and market viability and our development team works hand-in-hand with surgeons to deliver new products that advance healing. Commercialised products benefit from the global selling power of Smith & Nephew.

In addition, Smith & Nephew invests in early stage technologies relevant to our business. Recent examples include UK-based Michelson Diagnostics that is developing a point-of-care tissue-imaging system that for the first time allows users to see below the surface of the skin; and an incubator fund investing in orthopaedic technologies close to commercial launch.

Ethics and 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 Smith & Nephew operates. We are committed to upholding our promise in our Code that we will not retaliate against anyone who makes a report in good faith.

Managing Directors complete an annual certification to the CEO to confirm implementation of required programmes. Managers and employees make an annual compliance certification, and executive management, managers and employees have a compliance performance objective customised to their level in the organisation.

In 2014, we developed and piloted a face-to-face course for new managers, which supplements the on-line manager certification training. In 2015, all new managers will be required to complete both the on-line and the face-to-face course.

New distributors and other higher risk third parties are subject to screening and are contractually obligated to comply with applicable laws and our Code. Their management is required to take compliance training and certify that they will ensure their employees and agents comply with the law and our Code. They also receive a CD-ROM with tools to assist them with their own compliance programmes. We have expanded our oversight of independent agents and distributors with on-site assessments to check

We continue to scout for further opportunities where we can access new disruptive technologies in our areas of specialism. These investments are typically in technologies that are not yet ready for acquisition but that we believe hold great promise. As well as funding, we may bring R&D, management and manufacturing expertise, and gain privileged access to or rights to the technology. We aim to accelerate the journey to market and may ultimately acquire the business.

Intellectual property

We protect the results of our research and development through patents and other forms of intellectual property. The Group s patent portfolio currently includes in excess of 5,000 patents and patent applications. Patent protection for our products is sought routinely in our principal markets.

We also have a policy of protecting our products by registering trademarks under the local laws of markets in which such products are sold. We vigorously protect our trademarks against infringement.

In addition to protecting our market position by filing and enforcing patents and trademarks, we may oppose third party patents and trademark filings where appropriate in those areas that might conflict with our business interests.

New employees receive training on our Code, and we assign annual compliance training to employees. In 2014, we updated our Code training. The new module is more interactive, role-based and allows individuals to apply the Code in different scenarios. Individuals can earn trust points and achievement badges if they make the right choices in the scenarios. Individuals who show an understanding of the Code by selecting the right behaviour in a scenario can move through the module more quickly than individuals who choose the incorrect behaviour and are then subject to remediation.

Global compliance programme

Smith & Nephew has implemented what we believe is 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; and reporting channels.

Through a global intranet website, we provide resources and tools to guide employees to make decisions that comply with the law and our Code and earn trust. We conduct advance review and approval for significant interactions with healthcare professionals or government officials. We regularly assess existing and emerging risks compliance controls and monitoring visits to review a sample of transactions from their books and records.

In 2014, Smith & Nephew filed its first report in compliance with the US Physician Payments Sunshine Act, which comprised over 22,000 transactions with nearly $18 million in payments and expenses to reportable individuals and entities.

In early 2015, Smith & Nephew submitted the final report to the US Department of Justice (DoJ) and the US Securities and Exchange Commission (SEC) required under the Company s Foreign Corrupt Practices Act settlement agreement. We also filed our first report under the deferred prosecution agreement we inherited with the ArthroCare acquisition (see Note 17.3 of the Notes to the Group accounts).

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

in the countries in which we operate.

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High quality manufacturing

An employee at our manufacturing plant in

Tuttlingen, Germany, working on a polished

cementless hip stem.

Manufacturing

We operate manufacturing facilities in a number of countries across the globe, and a number of central distribution facilities in key geographical areas in which we operate. 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 we review 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;

We outsource certain parts of our manufacturing processes where necessary to obtain specialised expertise or gain 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.

Our largest manufacturing operation for Advanced Surgical Devices is based in Memphis (Tennessee, US), with additional production and assembly plants based in Mansfield (Massachusetts, US), Oklahoma City (Oklahoma, US), Austin (Texas, US), Aarau (Switzerland), Tuttlingen (Germany), Beijing (China), Calgary (Canada),

The Aarau, Tuttlingen, Beijing and Warwick facilities produce a large number of products including key trauma products, the PLUSà knee and hip range and the BIRMINGHAMà Hip Resurfacing System. The facility in Oklahoma City deals mainly with the assembly of surgical digital equipment, such as HD560à Camera.

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.

The Advanced Wound Management manufacturing is primarily managed from our factory and offices in Hull (UK). Wound Management products are also made at our facilities in precision machining, high volume and automated manufacturing for both our Advanced Surgical Devices and Advanced Wound Management products.

We procure raw materials, components, finished products and packaging materials from key suppliers. These purchases include metal forgings and stampings for orthopaedic products, optical and electronic subcomponents 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 ensure value for money based on the total spend across the Group.

Warwick (UK), Heredia (Costa Rica) and Sangameshwar (India).

The Memphis facilities produce key products and instrumentation in our Knee Implants, Hip Implant and Trauma franchises. These include the JOURNEY II and LEGIONà knees, the ANTHOLOGYà Primary Hip System and key Trauma products such as the PERI-LOCà Ankle Fusion Plating System and TRIGENà Intramedullary Nails. In addition to this, Memphis is the home to the design and manufacturing process of the VISIONAIRE patient matched instrumentation sets.

The Mansfield facility focuses on sports medicine related products for minimally invasive surgery including the FAST FIXà 360 Meniscal Repair System, FOOTPRINTà PK Suture Anchor, DYONICS Platinum Shaver Blades, ENDOBUTTONà CL Ultra and the HEALICOILà PK suture anchor.

Suzhou (China), Curaçao (Dutch Caribbean), Alberta (Canada) and Oklahoma City (Oklahoma, US).

The products made at the Hull site cover the therapies of Exudate management (Foam products principally ALLEVYNà), Burns treatment (ACTICOATà) and Wound Closure (OPSITEà film products). Several products produced in Hull, such as JELONETà and BACTIGRASà, transitioned to Suzhou in 2014, as part of our global footprint optimisation programme.

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STRATEGIC REPORT

Our business *continued*

OPSITE Post-Op Visible

A waterproof, bacteria-proof dressing with

see-through absorbant pad. Unique design allows

continual monitoring of the incision site without the

need to disrupt the healing process.

A key base material used in the production of a large number of dressings is the intermediate bulk rolls of film which are manufactured in the Gilberdyke (UK) facility. The facility in Alberta (Canada) provides specific expertise in the addition of silver coatings onto the ACTICOAT burns range prior to shipping to Hull for the final conversion process into finished dressings. The facility in Gilberdyke (UK) was sold in 2014, and will continue to supply sub components to other facilities until 2016. The processes at the Alberta facility are being transferred to the Hull site during 2015.

The Suzhou facility opened in 2009 initially to manufacture some Foam products within Exudate management. It has since expanded to take on production of some Film Wound

Advanced Wound Management distribution hubs are located in Neunkirchen (Germany) and Derby (UK) for international distribution, Bedford (UK) for UK domestic distribution and Lawrenceville (Georgia, US) for US distribution.

Medical 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.

Sales and marketing

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

The largest single customer worldwide is a purchasing group based in the UK that represented less than 5% of our worldwide revenue in 2014.

In our Established Markets, our Advanced Surgical Devices are principally shipped and invoiced directly to healthcare providers, hospitals and other healthcare facilities. Certain Advanced Wound

Closure products.

The majority of the NPWT components are bought in from third parties and assembled in the Advanced Surgical Devices Oklahoma City facility, with the exception of the dressings used for the PICO product which are manufactured in Hull.

Manufacturing for Advanced Wound Bioactives 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). Advanced Wound Bioactives has facilities for the development and possible production of cell based therapies in Fort Worth (Texas, US).

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 2014, we provided training to more than 25,000 surgeons. Working under expert guidance, attendees refine techniques and learn new skills, whilst experiencing the safe and effective use of our products. We also support healthcare professionals through our on-line resources such as the Global Wound Academy, The Wound Institute and, for surgeons, our Education and Evidence website.

Management products are shipped and invoiced to wholesale distributors and others are consigned to distributors that lease the devices to healthcare providers, hospitals and other healthcare facilities and end-users.

Our US sales forces 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 other Established Markets country-specific commercial organisations manage employee sales forces directly.

In our Emerging & International Markets we operate through direct selling and marketing operations, and through distributors. In these markets, our Advanced Surgical Devices franchises frequently share sales resources. The Advanced Wound Management sales force may be separate where it calls on different customers.

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Our people

Smith & Nephew is committed to attracting, engaging, developing and retaining employees. In 2014, we had more than 14,000 employees dedicated to our core values of Innovation, Trust and Performance. These values represent the foundation of our culture, and underpin our commitment to be an employer of choice as well as a responsible corporate citizen.

Investing in our people and communities helps ensure the long-term sustainability of our business. Smith & Nephew strives to create a more engaged and productive workforce and focuses on measures to drive employee engagement. These include an understanding of the Group s mission and direction, sense of employee involvement, focus and adaptability to customers and market place. We continue to listen to our employees, via regular surveys and focus groups, and we value their opinions. In 2014, we conducted a Global Employee survey to measure progress against our actions and were named Great Place to Work in Spain.

Attracting the best talent and developing and engaging our employees are critical to achieving and sustaining our business objectives and

Smith & Nephew strives to create a highly engaged and productive workforce. We foster this goal with targeted initiatives to ensure understanding of the Company s mission and direction, encourage employee involvement, and ensure focus and adaptability to our customers and market place. We seek employee feedback via regular surveys and focus groups, and we act on this feedback in the spirit of continuous improvement.

Diversity at Smith & Nephew

Smith & Nephew believes 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.

We aim to provide an open, challenging, productive and participative environment based on constructive relationships.

We maintain open and transparent communication with employees through regular and timely information and consultation. We clearly communicate our business goals and performance standards, and provide the training, information and authority needed to achieve them. We provide fair recognition and reward based on performance. Our annual CEO Award, open to all employees worldwide, recognises employees who deliver exceptional results in line with our core values, encouraging innovation and a spirit of continuous improvement at all levels. We are committed to working with employees to develop each individual s talents, skills and abilities. We provide encouragement to learn and continuously improve. We recruit, employ and promote employees on the sole basis of the qualifications and abilities needed for the work to be performed. We do not tolerate discrimination on any grounds and provide equal opportunity based on merit.

We are committed to building diversity in a working overall performance. Employee advancement is merit-based, based on performance as well as demonstration of core competencies which include our core 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. Talented employees are provided with opportunities to develop their skills and career through new assignments and on the job experiences. Current programmes include our Chief Executive Officer (CEO) Forum where small groups of high potential and emerging talent are given the opportunity to learn more about the business from the Company s most senior leaders and to benefit from peer mentorship and the annual Managing Director s Meeting where country and regional commercial leaders begin the year in alignment with the Group s strategy and goals. In addition, the Board reviews succession plans for key executive roles and succession plans are in place for critical positions across our business.

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

The Board and Executive officers continue to recognise the importance of diversity and over the last two years have expanded their own diversity profile: three of our ten Board members are female.

On 31 December 2014, Smith & Nephew had the following breakdown of employees:

Number of Employees [1]	
Board of Directors	
Male	7
Female	3
Total	**10**
Senior Managers and above[2]	

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.

and certify their adherence to this Code.

Male	562
Female	168
Total	**730**
Total employees	
Male	8,485
Female	5,757
Total	**14,242**

1 Number of employees as at 31 December 2014 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 of our subsidiary companies.

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Overview

In Advanced Surgical Devices (ASD) we develop, manufacture and sell products in the areas of Orthopaedic Reconstruction, Trauma & Extremities, Sports Medicine Joint Repair, Arthroscopic Enabling Technologies, and others such as Gynaecology and Ear, Nose and Throat.

Orthopaedic Reconstruction

Smith & Nephew offers a range of specialist products for orthopaedic reconstruction in its Knee Implants and Hip Implants franchises.

Implant bearing surfaces such as the proprietary OXINIUMª Oxidized Zirconium continue to be a point of differentiation for Smith & Nephew. OXINIUM Technology combines the enhanced wear resistance of a ceramic bearing with the superior toughness of a metallic bearing. When combined with highly cross-linked polyethylene (XLPE) it results in our proprietary VERILAST Technology. In Hip Implants, the combination of a ceramicised metal head and a highly cross-linked polyethylene lined cup have been shown in various national joint replacement registries to have displayed best in class survivorship rates when compared to implants made from any other materials. In Knee Implants, the LEGION Primary Knee with VERILAST Technology is the only knee implant that has been laboratory-tested to 30-years of simulated wear. While lab testing is not the same as clinical performance, the tests showed significant reduction in wear compared to conventional technologies.

These systems also feature VERILAST Technology, our advanced bearing surface and also utilise VISIONAIRE Patient-Matched Instrumentation.

With VISIONAIRE Instrumentation, a patient s MRI and X-rays are used to create customised cutting blocks that allow the surgeon to achieve optimal mechanical axis alignment of the new implant. In addition, VISIONAIRE also helps save time by reducing the number of procedural steps and instruments used in the operating room.

In 2014, Smith & Nephew entered into a commercial agreement with Blue Belt Technologies (BBT), makers of the Navio® Orthopaedic Surgical System, the next generation of orthopaedic robotic surgical navigation. Under this agreement, surgeons using the Navio system will be able to implant Smith & Nephew s JOURNEY UNI partial knee.

We also announced an agreement with OrthoSensor, the leader in intelligent orthopaedics, that will enable surgeons to benefit from OrthoSensor s VERASENSE™ Sensor Assisted Surgery Technology for soft tissue balancing when implanting our

Knee Implants

Smith & Nephew offers a range of products for specialised knee procedures. In 2014, Smith & Nephew launched the JOURNEY II Cruciate Retaining (CR) knee implant extending the JOURNEY II Active Knee System to procedures that preserve the posterior cruciate ligament (PCL) which account for approximately half of all knee replacement procedures.

The LEGION/GENESISà II Total Knee System is a comprehensive system designed to allow surgeons to address a wide range of knee procedures from primary to revision.

JOURNEY II and LEGION Total Knee Systems. VERASENSE utilises advanced sensor technologies to enable evidence-based surgical decisions regarding component position, limb alignment and soft tissue balance to optimise outcomes in total knee replacement.

Hip Implants

For Hip Implants, core systems include the ANTHOLOGY Hip System, SYNERGYà Hip System, the SMFà Short Modular Femoral Hip System, the R3à Acetabular System, the POLARCUPà Dual Mobility Hip System and the SL-PLUSà Hip Family System.

In 2014, we introduced the POLARSTEMà HA Cementless Stem System in the US for state-of-the-art minimally invasive surgical techniques that preserve bone and soft tissue, with good functionality and reproducible results.

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STRATEGIC REPORT

Segment performance: Advanced Surgical Devices ***continued***

For US patients, our successful VERILAST knee consumer campaign was expanded to include hips in 2014. Thanks to the combination of a well-established brand, a compelling call-to-action and our position as the first company to advertise differentiating technology to this audience, we were able to mirror the successes of our earlier knee campaigns by driving potential patients to our consumer-facing RediscoverYourGo website and its surgeon locator.

Trauma & Extremities

Our Trauma & Extremities franchises offer 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.

For extremities and limb restoration, the franchise offers the TAYLOR SPATIAL FRAMEà 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, hand and wrist, and trauma surgeons. For Trauma, the principal internal fixation products are the TRIGENà family of IM nails (TRIGEN

In hip repair, we introduced INTERTANà Gold instrumentation that is designed to streamline the surgical steps and improve clinical outcomes by offering a more efficiently designed set. In addition, the INTERTAN 10S was launched to meet the unique needs of smaller-stature patients by offering a more appropriate size for this population.

We launched the EVOSà MINI Plating System for use in complex fractures of the long bones of the arms and legs. Designed specifically for traumatologists, this long-bone-specific system includes the variety of mini, flat plates and screw sizes necessary to address both fracture reduction and short-term fixation while the final, load-bearing repair is being completed.

Sports Medicine Joint Repair

The 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 knee, hip and shoulder repair.

Key AET products include DYONICS shaver blades, ACUFEXà handheld instruments, and a wide range of RF probes. The ArthroCare acquisition brought us the latest generation of RF technology the internationally patented COBLATION technology which offers ablation, resection, and coagulation of soft tissue and hemostasis of blood vessels. The DYONICS Platinum Series Shaver Blades are single-use blades that provide superior resection due to their sharpness and virtually eliminate clogging through their improved debris evacuation capabilities. The DYONICS PLAN Hip Impingement Planning System was launched in 2014. This interactive, 3D software system uses data from low-dose[1] CT scans to help surgeons visualise, assess and plan each patient s unique Femoroacetabular Impingement (FAI) surgery before they enter the operating room.

Other ASD

The Other ASD franchise includes smaller businesses such as Gynaecology and our newly acquired Ear, Nose and Throat (ENT) business.

META-NAIL System, TRIGEN Humeral Nail System, TRIGEN SURESHOTà, and TRIGEN INTERTANà) and the PERI-LOCà Plating System.

2014 saw the introduction of the D-RADà SMART PACK System for treating distal radius fractures. The new system which includes complete, sterile, single-use instrument kits with implants, and a tray of sterile packaged fasteners and templates allows hospital operating room staff to reduce the typical time and expense involved with reprocessing traditional plate and screw systems.

In wrist repair, we introduced a new solution for triangular fibrocartilage (TFCC), a complex repair that leverages our FAST-FIXà 360 technology and provides an all arthroscopic repair which eliminates knot stack.

Smith & Nephew also announced its entry into the forefoot market in 2014, with the launch of the HAT-TRICK Lesser Toe Repair System. Comprised of three separate repair options, the HAT-TRICK System includes products for metatarsophalangeal (MTP) ligament repair and reconstruction, a metatarsal osteotomy guide, and a revisable, all-PEEK implant for Proximal Inter-Phalanges (PIP) fusion, also known as hammer-toe correction.

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

In 2014, Smith & Nephew launched its SUTUREFIXà Ultra soft suture anchor for hip and shoulder labral repair to surgeons in the US. The new anchor s small, soft construct, and superior pull-out strength, allow surgeons to more precisely place fixation points around the joint to more accurately re-approximate the patient s native anatomy.

2014 also saw the launch of the N8TIVEà ACL (anterior cruciate ligament) System which helps surgeons create highly anatomic ACL Reconstructions. N8TIVE allows surgeons to restore the size, shape, and location of the native femoral and tibial ACL insertion points.

Arthroscopic Enabling

Technologies (AET)

Our Arthroscopic Enabling technologies franchise now includes the latest generation COBLATIONà radio frequency (RF) technology acquired from ArthroCare, as well as electromechanical and mechanical blades and hand instruments for the

The main Gynaecology product is the TRUCLEARà System, a first-of-its-kind hysteroscopic tissue removal system, providing safe and efficient removal of endometrial polyps and submucosal fibroids. The business also sells a hysteroscopic fluid management system, which provides uterine distension and clear visualisation during hysteroscopic procedures.

Our ENT business develops, manufactures, and markets products for the ENT market space. We offer a wide variety of products in this area including our COBLATION technology and our RAPIDRHINOà carboxymethylcellulose (CMC) technology which is featured in dissolvable nasal and sinus dressings, removable nasal and sinus dressings, and epistaxis treatment products.

removal of damaged tissue. Additionally, the franchise offers fluid management equipment for surgical access and high definition cameras, digital image capture, scopes, light sources and monitors to assist with visualisation inside the joint.

1 Low-dose scan protocol reduces radiation by approximately 50% compared to standard CT protocol. CT Protocol Report, HIPS. Document number 15001984, 2013. Data on file at Smith & Nephew.

VERILAST Technology for Hip Replacement

The proprietary technology combines innovation with long-term performance.

Regulatory approvals

In 2014, regulatory clearances/approvals were obtained for several key products and instrumentations.

In the US, 510(k) clearances were given to the D-RADà SMART PACK, VLPà MINI-MOD Plates and Screws, EVOS Mini-Fragment Plating System, JOURNEY II BCS Constrained Articular Inserts, BIOSURE HEALICOILà PK screw, Cannulated Captured Screw, N8TIVE ACL Anatomic Reconstruction System and NasaStentà CMC Nasal Dressing. Additional 510(k) clearances were also granted for our VISIONAIRE software revisions as well as the Q-Fixà Suture Anchor, the Multi-Fixà S Knotless Fixations System and the Topazà EZ Microdebrider COBLATION Wand.

In Canada, approvals were granted for our LEGION Narrow OXINIUM and CoCr Femoral Components, HEALICOIL REGENESORBà Suture Anchor, the SUTUREFIXà ULTRA Suture Anchor, TFCC FAST-FIX Kit, TRUEPASSà Suture Passer, DYONICS PLAN, ULTRATAPEà, N8TIVE ACL Reconstruction System, BIOSURE HEALICOIL PK screw, KVacà and Ambient KVac COBLATION Wands, Q-Fix Suture Anchor System and MediENTà Turbinate

In Australia, LEGION Narrow OXINIUM, HEALICOIL REGENESORB, LEGION Hinge Knee System, KVac COBLATION Wand, N8TIVE ACL Reconstruction System, SpeedLockà Hip Knotless Fixation System, Multi-Fix S Knotless Fixation Device, Q-Fix Suture Anchor System, Venteraà Sinus Dilation System and Serpentà Articulating ENT Instrument were approved.

In Latin America, the Quantumà 2 COBLATION System and the Magnumà 2 Knotless Fixation Device were approved in Argentina; the Speedfixà Suture System and the Titanà Suture Anchor were approved in Brazil; and the RAPIDRHINO System was approved in Mexico.

In Europe, the following products obtained regulatory clearance: HEALICOIL REGENSORB Suture Anchor, VLP MINI-MOD Plates and Screws, the EVOS Mini-Fragments Plates and Screws, the LEGION Hinge Knee System and the JOURNEY II CR Knee System.

In Japan, the ANTHOLOGY HA Coated Hip stem, SMFà Hip Stem, Osteoraptorà OS Suture Anchor, HEALICOIL REGENESORB Suture Anchor, SUTUREFIX ULTRA Suture Anchor, Implant.

TFCCà FAST-FIX Kit, OSTEORAPTORà HA curved, TRUEPASS Suture Passer, DYONICS PLAN, and ULTRATAPE were all approved.

Other approvals include the Speedlock Hip Knotless Fixation System in Singapore and the ENT Irrigation Pumpà in Korea.

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Overview

In Advanced Wound Management (AWM) we offer products from initial wound bed preparation through to full wound closure. These products are targeted at chronic wounds associated with the elderly population, such as pressure sores and venous leg ulcers. There are also products for the treatment of acute wounds such as burns and invasive surgery that impact the wider population.

The main products within the AWM business are for management of wound exudate, treatment and prevention of wound infections, negative pressure wound therapy (NPWT) and bioactive therapies. The portfolio is grouped into disposable wound care products (Advanced Wound Care), electrical equipment for wound therapy (Advanced Wound Devices) and bioactives (Advanced Wound Bioactives).

Advanced Wound Care

Exudate management

Exudate management products focus on effectively and efficiently managing wound fluid and creating an optimal healing environment to promote improved healing outcomes. Our key brands in this space are ALLEVYN foam dressings and DURAFIBERª gelling fibre dressings.

In 2014, we continued to invest in the development and commercialisation of our flagship ALLEVYN brand, with significant sales and marketing efforts in key countries. The ALLEVYN brand is evolving towards ALLEVYN Life, our latest innovation in foam dressings, which was designed to provide a better patient experience, and greater wear time. This leads to

We have also experienced a significant increase in the utilisation of ALLEVYN Life as a prophylactic measure to help prevent pressure ulcers, driven by the dressing s unique multi-layer design which gives it superior pressure redistribution properties.

Throughout 2014, we have continued to invest in customer insights and the generation of meaningful clinical and health economic evidence to ensure that our ALLEVYN portfolio is in a sustainable, category leading position and delivers to our customers expectations.

Infection management

AWM has two significant technologies in its infection management portfolio, silver (ACTICOAT, DURAFIBER Ag and ALLEVYN Ag) and iodine (IODOSORBª). The iodine-based IODOSORB product has continued to gain interest due to the unique properties of the cadexomer iodine molecule and their impact on biofilms, which have become a well-recognised barrier to healing in wound care. IODOSORB benefits from one of the most comprehensive evidence bases in wound care.

improved patient outcomes and economic savings for payers, which has now been demonstrated in several studies.

We are also experiencing strong interest in ACTICOAT, particularly in post-surgical wounds to prevent the complications associated with surgical site infection and in delayed healing chronic wounds.

Other

AWM offers a wide range of other wound care products, resulting in Smith & Nephew having 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.

IV3000à: AWM s specialist breathable premium IV dressing, utilising REALTICà film technology and unique patterned adhesive, continues to perform well, particularly driven by emerging markets. In 2014, the IV3000 range benefited from several product upgrades reinforcing its differentiation as a premium offering. Success in the emerging markets has created an opportunity for a mid-tier offering, which will be introduced in 2015.

ALLEVYN Life

An innovative multi-layered dressing designed for people living their everyday lives.

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STRATEGIC REPORT

Segment performance: Advanced Wound Management ***continued***

OPSITE Post-Op Visible: This is our innovative dressing that combines the qualities of a premium dressing with the ability to see and monitor the incision. This unique product continues to deliver strong growth in both our Established Markets and Emerging & International Markets, supported by investment in clinical evidence.

Advanced Wound Devices

Advanced Wound Devices consists of two categories of products: NPWT and VERSAJETà.

NPWT

Our NPWT solutions include traditional NPWT products (RENASYS products) and the single-use portfolio (PICO and KALYPTOà products).

We are also progressing with launch plans for our next-generation traditional NPWT product.

VERSAJET

The VERSAJET II Hydrosurgery system is a mechanical debridement device used by surgeons to excise and evacuate non-viable tissue, bacteria and contaminants from wounds, burns and soft tissue injuries.

Advanced Wound Bioactives

Smith & Nephew is the global market share leader in the bioactives segment, which is the fastest growing category of wound therapeutics. Our diversified biotherapeutic portfolio offers differentiated, cost-effective solutions for tissue repair and healing, addressing the full spectrum of hard-to-heal wounds.

Currently, our leading bioactive brand is Collagenase SANTYLà Ointment, the only FDA-approved biologic enzymatic debriding agent for chronic dermal ulcers and severe burns. In 2014, Smith & Nephew launched a new 90g

During 2014, we were required to initiate a distribution hold in the US on RENASYS products as the FDA indicated new regulatory clearances were required in respect of certain design enhancements. We are working to obtain these and RENASYS remains available outside of the US.

The PICO system, our single-use, canister-free solution, is revolutionising NPWT. As familiar and easy to use as an advanced wound dressing, PICO provides an active intervention to help promote optimal healing for early discharge and enhanced outcomes in complex cases. PICO simplifies the delivery of negative pressure, which benefits patients and caregivers alike.

Collagenase SANTYL Ointment

The only enzymatic debrider approved by the FDA for use in the US. It selectively removes necrotic tissue without harming surrounding healthy tissue.

package size to bring convenience and economy to providers and patients treating large dermal ulcers and burns with SANTYL. In addition, consistent with Smith & Nephew s scientific leadership strategy, new clinical data highlighting the benefits of using SANTYL adjunctively with sharp debridement was released early in the year and was closely followed by initiation of a larger, follow-on study of similar design to corroborate the initial findings.

REGRANEXª Gel is the first and only FDA approved recombinant platelet-derived growth factor indicated for use as an adjunct to good ulcer care in the treatment of lower extremity diabetic neuropathic ulcers. Physicians increased their prescribing of REGRANEX throughout the year, in part due to REGRANEX 360, a novel programme launched by Smith & Nephew to help patients maximise the benefits of the brand by informing about insurance coverage, shipping the medication directly to the patient s home or office and providing expert consultation on how to use the brand appropriately.

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OASIS[à], a family of naturally-derived, extracellular matrix replacement products indicated for the management of both chronic and traumatic wounds completes Smith & Nephew s bioactive portfolio.

In October 2014, we announced the top-line results of the Phase 3 study of HP802-247, a living cell spray-on therapy designed to stimulate healing of venous leg ulcers. HP802-247 did not meet the primary endpoint in this trial and we have taken the decision to stop the Phase 3 programme. We remain committed to investing in developing pioneering Advanced Wound Bioactive treatments.

Regulatory approvals

In 2014, regulatory clearance was obtained for both ALLEVYN Life and DURAFIBER in Japan making the latest absorbent dressing technologies available to this important market.

PICO, our single use NPWT system was approved for the first time in Japan. In addition, a significant enhancement to the PICO product, in the form of the new Soft Port dressing and tubing set, was approved in the EU and Australia.

Other registration activities during the year include expanding the geographic footprint of established products within the emerging markets and the ongoing expansion of Smith & Nephew Medical (Suzhou) as a new supply site for multiple wound care products.

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Financial review and principal risks

The Group finished 2014 set to

benefit from the actions and

investments we have made

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 execution of disposals.
2 Explanation of these non-GAAP financial measures are provided on pages 176 to 179.

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Revenue by market

The underlying increase in each division s revenues, by market, reconciles to reported growth, the most directly comparable financial measure calculated in accordance with IFRS, as follows:

	2014 $ million	2013 $ million	Reported growth in revenue %	Constant currency exchange effect %	Acquisition/ Disposal effect %	Underlying growth in revenue %
Advanced Surgical Devices						
US	**1,558**	1,391	12		(10)	2
Other Established Markets	**1,229**	1,204	2	2	(4)	
Established Markets	**2,787**	2,595	7	1	(7)	1
Emerging & International Markets	**511**	420	22	3	(8)	17
Advanced Surgical Devices	**3,298**	3,015	9	1	(7)	3
Advanced Wound Management						
US	**454**	471	(4)			(4)
Other Established Markets	**699**	722	(3)	(1)		(2)
Established Markets	**1,153**	1,193	(3)			(3)
Emerging & International Markets	**166**	143	16	3	(5)	14
Advanced Wound Management	**1,319**	1,336	(1)	1	(1)	(1)

Advanced Surgical Devices

1% unfavourable foreign currency translation. Sales in our VERILAST Hip and direct anterior approach

Revenue

ASD revenue increased by $283 million (9% on a reported basis) from $3,015 million in 2013 to $3,298 million in 2014. The underlying increase of 3% is after adjusting for a 7% impact from the acquisition of ArthroCare Corp in May 2014 and a 1% unfavourable foreign currency translation.

In the US, revenue increased by $167 million to $1,558 million in 2014 from $1,391 million in 2013 (12% on a reported basis). The underlying increase of 2% is after adjusting 10% for the impact of the ArthroCare Corp acquisition in May 2014. In Other Established Markets, revenue was $1,229 million in 2014, an increase of $25 million from $1,204 million in 2013 (2% on a reported basis). The underlying increase was flat after adjusting for 2% from favourable foreign currency translation and the impact of 4% from acquisitions. Our Emerging & International Markets revenue increased by $91 million to $511 million in 2014 from $420 million in 2013 (22% increase on a reported basis). The underlying increase was 17% after adjusting for 3% for unfavourable foreign currency translation and the impact of 8% from acquisitions.

In the global Knee Implant franchise, revenue increased by $8 million from $865 million in 2013 to $873 million in 2014 (1% on a reported basis), representing a 2% underlying revenue increase after 1% of unfavourable currency translation. Growth has been impacted by exposure to a weakening European market with conditions continuing to deteriorate in Germany, our largest European market, and our position in the product life cycle versus our peers. Growth improved driven by sales of the JOURNEY II BCS Knee System.

Global revenue from the Hip Implant franchise increased by $1 million from $653 million in 2013 to $654 million in 2014 (flat on a reported basis), which represented an underlying revenue increase of 1% after

portfolio contributed to the increase.

Trauma & Extremities revenue increased by $20 million from $486 million in 2013 to $506 million in 2014 (4% on a reported basis), representing underlying revenue growth of 4% after adjusting for a 1% impact from the acquisition of a Brazilian distributor and 1% of unfavourable foreign currency translation.

Sports Medicine Joint Repair revenue increased by $80 million from $496 million in 2013 to $576 million in 2014 (16% on reported basis), representing underlying revenue growth of 8% after adjusting for a 8% impact from the acquisition of ArthroCare Corp, 1% from the acquisition of a Brazilian distributor and 1% of unfavourable foreign currency translation.

Global revenue from Arthroscopic Enabling technologies increased by $101 million from $441 million in 2013 to $542 million in 2014 (23% on a reported basis). This increase represents an underlying revenue increase of 1% after adjusting for the 22% impact from the acquisition of ArthroCare Corp, 1% from the acquisition of a Brazilian distributor and 1% of unfavourable foreign currency translation.

The revenue in the Other ASD (including Gynaecology and ENT) franchise increased by $73 million from $74 million in 2013 to $147 million in 2014 following the acquisition of ArthroCare Corp in 2014. Excluding the impact of this acquisition, underlying revenue in the Other ASD franchise, which includes gynaecology, grew by 10%.

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STRATEGIC REPORT

Financial review and principal risks ***continued***

Trading and operating profit

Operating profit, the most directly comparable financial measure under IFRS, reconciles to trading profit as follows:

	2014 $ million	2013 $ million
Operating profit	**626**	620
Acquisition-related costs	**107**	7
Restructuring and rationalisation costs	**33**	44
Amortisation of acquisition intangibles and impairments	**78**	41
Legal and other	**(34)**	
Trading profit	**810**	712

Trading profit margin increased from 23.6% to 24.6%. Trading profit increased by $98 million to $810 million from $712 million in 2013. This increase reflects the benefits from our structural efficiency programme.

Trading and operating profit

Operating profit, the most directly comparable financial measure under IFRS, reconciles to trading profit as follows:

	2014 $ million	2013 $ million
Operating profit	**123**	190
Acquisition-related costs	**11**	24
Restructuring and rationalisation costs	**28**	14
Amortisation of acquisition intangibles and impairments	**51**	47
Legal and other	**32**	
Trading profit	**245**	275

Trading profit margin decreased from 20.6% to 18.6%. Trading profit decreased by $30 million to $245 million from $275 million in 2013. The decrease in the year is primarily attributable to the RENASYS hold.

Operating profit increased by $6 million from $620 million in 2013 to $626 million in 2014. This comprises the increase in trading profit of $98 million discussed above offset by increases in acquisition-related costs of $100 million and amortisation of acquisition intangibles of $37 million and partially offset by a decrease in restructuring and rationalisation costs of $11 million and credit relating to the US pension settlement and closure.

Advanced Wound Management

Revenue

AWM revenue decreased by $17 million (-1% on a reported basis), from $1,336 million in 2013 to $1,319 million in 2014. The underlying decrease of 1% is after adjusting for an increase of 1% for acquisitions completed in the year and a 1% unfavourable foreign currency translation.

In the US, revenue decreased by $17 million to $454 million in 2014 from $471 million in 2013 (-4% on a reported basis). The underlying decrease was also 4%. In Other Established Markets, revenue was $699 million in 2014, a decrease of $23 million from $722 million in 2013 (-3% on a reported basis). The underlying revenue decrease was 2% with 1% of unfavourable foreign currency translation. Our Emerging & International Markets revenue increased by $23 million in 2014 (16% on a reported basis). The underlying increase was 14% after adjusting 2% for unfavourable foreign currency translation.

Advanced Wound Care revenue decreased by $38 million (-5% on a reported basis) to $805 million in 2014 from $849 million in 2013. The underlying

Operating profit decreased by $67 million from $190 million in 2013 to $123 million in 2014. This comprises of the decrease in trading profit of $30 million discussed above, costs relating to the hold on RENASYS and cessation of the HP802 trials amounting $52 million, offset by a decrease in acquisition-related costs of $13 million, due to the integration of the Healthpoint acquisition which completed in December 2012, an increase in restructuring and rationalisation costs of $14 million and an increase of $4 million in amortisation of acquisition intangibles.

Principal risks and risk management

As an integral part of planning and review Group, business area and functional management seek to identify the significant risks involved in the business, and to review the risk management action plans for those risks. The Group Risk Committee, which is comprised of the Chief Executive Officer and senior executives, meets twice a year to review the risks identified by the businesses and corporate functions and any risk management actions being taken. As appropriate, the Risk Committee may re-categorise risks or require further information on the risk management action plans. The Risk Committee reports to the Board on an annual basis detailing all principal risks. In addition, the Board considers risk as part of the development of strategy. Internal audit reviews and the Audit Committee reports on the effectiveness of the operation of the risk management process.

There are known and unknown risks and uncertainties relating to Smith & Nephew s business. The following pages provide an overview of what the Board considers the most significant risks that could cause the Group s business, financial position and results of operations to differ materially and adversely from expected and historical levels, and how these risks relate to the Group s strategic priorities. Additional detail is set decline of 4% is after adjusting for foreign currency translation. Conditions across many European markets remain challenging but the introduction of the ALLEVYN Life range continues to make good progress across Europe following product introductions and investment in marketing.

Advance Wound Devices revenue decreased from $213 million in 2013 to $192 million in 2014, a reported decrease of $21 million and 10%. The underlying decrease of 9% is after adjusting for unfavourable foreign currency translations of 1%. This decline was due to the hold of RENASYS in the US due to regulatory issues and competitive pressures in traditional canister-based NPWT in Europe.

Advanced Wound Bioactives revenue increase to $322 million in 2014 from $280 million in 2013 (15% reported growth). The underlying increase was also 15%.

forth under Risk Factors in the Group information section of this report. 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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Product Portfolio Development

The medical devices industry has a rapid rate of new product introduction. The Group must be adept at monitoring the landscape for technological advances, have an efficient and valuable product development pipeline and secure protection for its intellectual property. The Group may also seek to acquire businesses as part our business strategy to augment the product portfolio or business scale in a certain geography.

Specific risks we face	Risk management actions	Possible impacts
Competitors may introduce a disruptive technology, or obtain patents or other intellectual property rights, that affect the Group s competitive position	Processes focused on identifying new products and potential disruptive technologies (internal and external)	Loss of market share, profit and long-term growth
Claims by third parties regarding infringement of their intellectual property rights	Improved productivity, prioritisation and allocation of R&D funds	**Link to Strategic Priority**
Lack of innovation due to low R&D investment, R&D skills gap or poor product development execution for Established and Emerging & International markets	Increasing R&D investment to enhance clinical capability and invest in biomaterials	**Innovate for value**
	Strengthen intellectual property rights and monitor and defend against infringement	**Established Markets**

Failure to receive regulatory approval to successfully commercialise a pipeline product	Global strategic marketing programmes Support an Emerging & International Market product portfolio	**Emerging & International Markets** **Supplement organic growth** **through acquisitions**

Acquisitions and Business Development

The Group may seek to acquire businesses or products as part of our strategy to augment the product portfolio or generate business scale in certain geographies. These acquisitions must deliver the expected returns and not create significant liability exposures or the Group may not meet its financial targets.

Specific risks we may face	Risk management actions	Possible impacts
Ineffective acquisition due diligence Inflated forecasts or projections may cause over-valuation of transaction	Strong resources and processes to ensure rigorous review and integration of acquisitions or product related investments Mergers & Acquisitions Council consisting of senior executives that reviews acquisitions and business	Loss of market share, profit and long-term growth **Link to Strategic Priority**

Lack of timely adoption of Group standards policies and financial controls during integration could create additional liabilities Acquisitions in emerging markets may identify practices that must be ceased to meet Group standards	development transactions Board of Directors review of all significant transactions Detailed compliance due diligence and integration reporting processes Robust Internal Audit and Group Finance Controls Post acquisition review programme	**Emerging & International Markets** **Supplement organic growth** **through acquisitions** **Established Markets**

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STRATEGIC REPORT

Financial review and principal risks ***continued***

Government Action, Pricing and Reimbursement Pressure

In most markets throughout the world, expenditure on medical devices is controlled to a large extent by governments, many of which are facing increasingly intense budgetary constraints. The Group is therefore largely dependent on governments providing increased funds commensurate with the increased demand arising from demographic trends. Reimbursement rates may be set in response to perceived economic value of the devices, based on clinical and other data relating to cost, patient outcomes and comparative effectiveness. Political upheaval in the countries where the Group operates or surrounding regions could adversely affect Group operations or turnover.

Group operations are affected by transactional exchange rate movements. The Group s manufacturing cost base is situated in the US, UK, Costa Rica, China and Switzerland and finished products are exported worldwide.

Specific risks we face	Risk management actions	Possible impacts
Reduced reimbursement levels and increasing pricing pressures Reduced demand for elective surgery	Develop innovative economic product and service solutions for both Established and Emerging & International markets (Syncera) Incorporate health economic component into design and development of new products	Loss of revenue, profit and cash flows

Lack of compelling health economics data to support reimbursement requests

Enhanced expertise supporting reimbursement strategy and guidance

Link to Strategic Priority

Government policies favouring lower priced and locally sourced products

Optimise cost to serve to protect margins and liberate funds for investment

Simplify and improve

our operating model

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

Streamline Cost of Goods Sold, Stock Keeping Units and inventory management

Established Markets

The Group is exposed to fluctuations in exchange rates. If the manufacturing country currencies strengthen against the selling currencies, the trading margin may be affected

The Group transacts forward foreign currency commitments when firm purchase orders are placed to reduce exposure to currency fluctuations

Emerging & International Markets

Economic downturn impacts demand and collections

Business Operations and Business Continuity

Unexpected events could disrupt the business by affecting either a key facility or system or a large number of employees. The business is also reliant on certain key suppliers of raw materials, components, finished products and packaging materials.

The Group manages a large product portfolio and a large product inventory. Sales and operation planning and supply chain management must ensure the products needed are available at the right place and time.

In a fast changing, complex, global business, high performing talent in key positions is a business critical requirement.

Specific risks we face	**Risk management actions**	**Possible impacts**
Catastrophe could render one of the Group s production facilities out of action	Crisis response/business continuity plans at major facilities and for key products and key suppliers	Loss of revenue, profit and cash flows
A significant event could impact key leadership or a large number of employees	Audit programme for critical suppliers and second sources or increased inventories for critical components	
Issues with a single source supplier of a key component and failure to secure critical supply	Enhanced travel security and protection programme	**Link to Strategic Priority**
A severe IT fault or cyber crime could disable critical systems and cause loss of sensitive data	IT disaster and data recovery plans in place to support overall business continuity plans	**Simplify and improve our operating model**
Over-production of product inventory and instrument sets may occur due to inadequate portfolio planning	Mobile device and cyber security protection plan	**Established Markets**
Poor retention of high performing and high potential staff could jeopardise achieving objectives	Improved sales and operations processes and inventory management with dedicated teams and key performance indicators	**Emerging & International Markets**
	Robust talent systems and processes with focus on identifying key roles and successors	

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Product Safety, Regulation, and Litigation

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 (QMS) or Good Manufacturing Practice (GMP) regulations. Design or manufacturing defects in products could result in product recalls and liability claims and impact revenues, profits and reputation.

Specific risks we face	Risk management actions	Possible impacts
Defective products supplied to Smith & Nephew or failure in design or manufacturing process New technology, product or processes changed by Smith & Nephew or supplier result in product deficiencies Failure to implement programmes and supporting resources to ensure product quality and regulatory compliance	Global QARA organisation to create a single Quality Management System Standardised Group quality management and practice Monitoring and auditing programmes to assure compliance Group-wide product complaint and registration systems	Loss of revenue, profit and reduction in share price Negative impact on brand/ reputation **Link to Strategic Priority** **Simplify and improve**

Failure to manage, process and analyse customer complaints and adverse event data	Group-wide practices to drive design, and production line performance and dependability Design for manufacture in product development Post launch review of product safety and complaint data	**our operating model** **Established Markets** **Emerging & International Markets**

Compliance with Laws and Ethical Behaviour

Business practices in the healthcare industry are subject to increasing scrutiny by government authorities. The trend in many countries is towards increased enforcement activity for bribery and corruption. The Group is also subject to increased scrutiny under US healthcare laws (e.g. False Claims Act) and in the EU for data protection. Acquisitions and expansion into emerging markets may require additional compliance controls.

Specific risks we face	Risk management actions	Possible impacts
Violation of anti-corruption, healthcare, or data privacy laws could result in fines, loss of reimbursement and harm reputation Cultures in certain geographies and in acquired businesses may not fully support the Group value to Earn Trust	Strong Board and Executive oversight bodies supported by a global Office of Ethics & Compliance Code of Conduct/Global Policies and Procedures (GPPs) providing guidelines for ethical behaviour and controls for significant compliance risks	Loss of profit and reduction in share price Negative impact on brand/ reputation

Rapid growth in Emerging & International Markets with increasing numbers of distributors Third parties retained by the Group may be involved in improper activities which result in penalties or loss of reputation. Failure to conduct adequate due diligence or to integrate appropriate internal controls into acquired businesses could result in fines and impact return on investment	Training and e-resources to guide employees and third parties with ethical and compliance responsibilities Monitoring and auditing programmes to verify implementation Minimum acceptable financial procedures adopted by all businesses wholly owned by the Group Independent reporting channels for employees and third parties to report concerns with confidentiality Robust investigation procedures to ensure adequate reviews and documentation with significant issues escalated to and monitored by legal and compliance heads Controls for significant interactions with Health Care Professionals and Government Officials Higher risk third parties including distributors and agents subject to screening, compliance requirements, training and oversight processes Due diligence reviews and integration plans and reporting for acquisitions Risk assessments to determine resources and controls for higher risk	**Link to Strategic Priority** **Simplify and improve** **our operating model** **Emerging & International Markets** **Established Markets**

markets

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STRATEGIC REPORT

Sustainability

Protecting the future

We care about our customers and helping improve people s lives. We also care about the people who work for us, the environment in which we operate and the societies in which we do business. Addressing unmet social need with more affordable products gathered pace in 2014 with the introduction of our Syncera range and further growth and consolidation of our mid-tier products. As part of our commitment to build trust we increased our engagement with suppliers to increase assurance around compliance and ethics.

This is a summary of our sustainability activities and progress in 2014. Our Sustainability Report will be published in April 2015.

In 2014, there were no employee or contractor fatalities and our Lost Time Injury Frequency Rate (LTIFR) fell again for the fourth successive year, this time by 20%. Compared to the previous year, total waste increased by 13%, however waste disposed to landfill fell by 19% as we found new ways to recycle.

Energy consumption has increased by 9% since 2011. However, after adjusting for the transient effect of transferring some production to China and the impact of newly acquired businesses, there was a net fall in energy consumption of 2%.

Safety

The continuous improvement in safety performance is underpinned by committed leadership and a sharp focus on managing risks. Making health and safety a priority for all of our employees and contractors was an imperative in 2014. This was supported by the progressive rollout of our integrated management system and the wide introduction of behavioural based safety programmes.

After three consecutive years of increases, water consumption reduced by 7% in 2014 compared to the previous year.

As part of the Great Place to Work strategy, substantially more of our employees enjoyed the benefits of wellness programmes.

We donated approximately $9 million in philanthropic activities, of which $2 million was in product donations and charitable gifts. Volunteering programmes were active in most of the territories where we work and the benefits to society and the level of employee involvement continued to increase.

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Water

Reducing water consumption continued to be a challenge in 2014, however there was a reduction of 7% achieved as a result of a breakthrough in water consumption at our Memphis manufacturing facility where 66% of Smith & Nephew s water is consumed.

Waste

The annual increase of 13% in total waste was offset by moving landfill waste to recycling or energy recovery. A transient increase created by commissioning new capacity in China and the one-off event of disposing of waste arising from the Hull flood increased the total waste by 8%. In 2014, we carried out a thorough waste audit in order to implement more initiatives to manage and reduce our waste.

Energy and CO_2

The energy increase of 15.2 GWh (9%) since 2011 has been dominated by the transient impact of commissioning new manufacturing capacity in China accounting for 10 GWh whilst continuing production in the UK. The effect of recently acquired businesses accounted for 8.7GWh of the increase.

The underlying reduction of 3.5 GWh (2%) reflects the implementation of efficiency improvements in our manufacturing facilities.

Transferring manufacturing to China from the UK and acquiring capacity in India has resulted in higher emissions factors and increased CO_2 emissions.

Greenhouse gases

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 2014 are included in the data.

All emissions fall within the scope of our consolidated financial statement and we have used the Greenhouse Gas Protocol: A Corporate Accounting and Reporting Standard (Revised Edition) as guidance for this process. Primary data from energy suppliers has been used wherever possible. The Biotherapeutics and the Sushrut Adler acquisitions are included in the data for 2014 for the first time. Data from the ArthroCare acquisition is excluded and 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 US and regional factors within the US. We have used the US EPA Emissions & Generation Resource Integrated Database (eGRID) for US regions and the UK Government DEFRA Conversion Factors for Greenhouse Gas Reporting for elsewhere. The emissions from all years have been recalculated using the most up-to-date factors available in 2014. Fugitive emissions are included from the manufacturing and research locations and arise from the losses of refrigerant gases.

	2014	2013
CO_2e Emissions (tonnes) from:		
Direct emissions	**11,213**	10,152
Indirect emissions	**74,797**	68,795
Total	**86,010**	78,947
Intensity ratio		
CO_2e (t) per $m revenue*	**19.5**	19.4
CO_2e (t) per full-time employee*	**6.9**	7.5

Revenue data: 2014 $4.4 billion, 2013 $4.1 billion

Full-time employee data: 2014 12,437, 2013 10,520

* Notes: 2013 data adjusted to exclude Healthpoint (Biotherapeutics) and 2014 data adjusted to exclude ArthroCare.
By order of the Board, 25 February 2015

Susan Swabey

Company Secretary

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At the top of their game

Sports Medicine is the treatment of injuries to the soft tissues through keyhole surgery typically ligaments, tendons and cartilage in the joints. These injuries can affect anyone, not just athletes. Sports Medicine helps patients recover function as well as minimise disability and recovery time.

Smith & Nephew is a global leader in Sports Medicine. In 2014, nearly a quarter of our revenue came from this area, and our Joint Repair business delivered revenue growth of 8%.

It is a $4.6 billion global market, and a strong area of focus and opportunity for Smith & Nephew.

We expect to see long-term global growth driven by delivering both clinical benefits and strong health economics. Repairing injuries today prevents them becoming more debilitating as patients get older, which reduces future demands on healthcare systems. In the emerging markets we are helping to widen access to these advanced treatments through delivering medical education.

Sports Medicine is a great place to innovate. We are investing more in R&D to improve existing treatments, and to develop new instrumentation to enable surgeons to better treat their patients.

24%
Nearly a quarter of Smith & Nephew revenue
came from Sports Medicine in 2014

$5bn
Global Sports Medicine market with Smith & Nephew
having 24% market share in 2014 (see page 20)

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Better by

design

We have a deep knowledge of the needs of surgeons and nurses, we understand the economic pressures healthcare payers work under, and we recognise that patients are demanding better treatment options to restore quality of life. These factors drive our new product development programmes. In 2014, we launched a number of exciting new products, expanding our portfolios in our Established Markets and Emerging & International Markets.

We also invested $235 million in R&D in 2014, over 5% of revenue, and have a strong pipeline of innovation to come. Our experts in Europe, US, China and India keep us close to our customers and ensure our programmes target unmet clinical needs, have strong financials and are technologically feasible. They also work closely with manufacturing to ensure we can produce new products to clinical, cost and time specifications.

JOURNEY II

The JOURNEY II Cruciate Retaining (CR) knee replacement extends the JOURNEY II Total Knee System to procedures that preserve the posterior cruciate ligament (PCL), which accounts for approximately half of all knee replacement procedures. The JOURNEY II CR knee, like the JOURNEY II Bi-cruciate Stabilized (BCS) knee that was launched last year, sets a new standard in knee implant performance by restoring more normal motion for patients.

HAT-TRICK

The HAT-TRICK Lesser Toe Repair System is our entry into the high-growth forefoot market, where we believe there are significant opportunities for

us to enhance the surgeon experience, simplify the procedures and, most importantly, improve patient outcomes.

EVOS

EVOS MINI Plating System for use in complex fractures of the long bones of the arms and legs. Designed specifically for traumatologists, this long-bone-specific system includes the variety of mini, flat plates and screw sizes necessary to address both fracture reduction and short-term fixation while the final, load-bearing repair is being completed.

PICO

PICO, Smith & Nephew s disposable, canister-free Negative Pressure Wound Therapy system has been named Most Innovative Product 2014 at The Irish Medical and Surgical Trade Association Awards. The award was judged by a panel of top clinicians, health service executives and medical companies.

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Realising

potential

The ability to attract and retain talented employees is essential to achieving our business goals. This is why one of our strategic imperatives is to be recognised as, a great place to work.

For Smith & Nephew, being a great place to work means having a workplace where employees are proud and excited to come each day because they are doing work that makes a difference for customers and patients.

It is a place where employees are valued for their performance and achievements, and a place that values trust above all else.

To qualify as a Great Place to Work, a company must complete the Great Place to Work Trust Index survey and its management must participate in a Culture Audit. Both evaluate the company s performance on key dimensions of engagement: Credibility, Respect, Fairness, Pride and Camaraderie.

We aim to provide an open, challenging, productive, diverse, healthy, safe and participative environment based on constructive relationships.

Diverse

Smith & Nephew believes 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. Diversity & Inclusion continues to be a key focus for us and we have a Global Steering team sponsored by the CEO with local councils established across the business. 30% of our Board of Directors and 23% of senior managers are female.

Healthy

We strongly believe we perform better when our employees are healthy, motivated and focused. The support we provide our employees when they experience a health concern is a critical factor in how well and how quickly they are able to get back to peak. During 2014, Smith & Nephew signed up to the UK s Time to Change programme, showing our employees being open about mental health concerns will lead to support, not discrimination, and embarked on a global wellness initiative to

support all employees.

Safe

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. During 2014, we reduced the lost time injury frequency by 20%, reflecting a sharp focus of leadership on identifying and managing workplace risk.

14,000
Our employees support healthcare

professionals in more than 100 countries

23%
of our senior managers are female

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CORPORATE GOVERNANCE

Our Board of Directors

Roberto Quarta (65)
Chairman

Joined the Board in December 2013 and appointed Chairman following election by shareholders on 10 April 2014. 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

Olivier Bohuon (56)
Chief Executive Officer

Joined the Board and was appointed Chief

Executive Officer in April 2011. He is a Member of the Nomination & Governance Committee.

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 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

Julie Brown (52)
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 trained with KPMG before working at AstraZeneca PLC, where she served as Vice President Group Finance, and ultimately, as Interim

Chief Financial Officer. Prior to that she was

Regional Vice President Latin America, Marketing Company President AstraZeneca Portugal, and Vice President Corporate

Strategy and R&D Chief

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 Group S.p.A. and Rexel S.A. He is currently Chairman Designate of WPP plc, and will shortly retire as Chairman of IMI plc, the global engineering group as soon as a suitable replacement is appointed. He is a partner at Clayton, Dubilier & Rice and he is a member of the Investment Committee of Fondo Strategico Italiano Spa.

Skills and Competencies

Roberto s career in private equity brings valuable experience to the Board, 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 conducted the search for new Non-executive Directors resulting in the appointment of Vinita Bali and Erik Engstrom.

Nationality

American/Italian

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 FTSE100 company with a deep heritage and provide inspiring leadership. He is a Non-executive Director of Virbac group.

Nationality

French

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 so far in her career, fulfilled two Non-executive

Directorships with the NHS in the UK and the Board of the British Embassy.

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 (59)

Independent Non-executive Director

Appointed Independent Non-executive Director on 1 December 2014. She will join the Remuneration and Ethics & Compliance Committees 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

Ian Barlow (63)

Independent Non-executive Director

Appointed Independent Non-executive Director in March 2010 and Chairman of the Audit Committee in May 2010. He was appointed a Member of the Ethics & Compliance Committee on 2 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

The Rt. Hon Baroness Virginia Bottomley of Nettlestone DL (66)

Independent Non-executive Director

Appointed Independent Non-executive Director in April 2012. She is a Member of the Remuneration Committee and joined the Nomination & Governance Committee on 10 April 2014.

Career and Experience

Virginia gained her MSc in Social Administration from the London School of Economics and Political Science 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., Strategy in 2001. In 2003, she joined the consultancy, Zyman Group as Managing Principal, again based in the US. Until recently, Vinita was Managing Director and Chief Executive Officer of Britannia Industries Ltd, a leading Indian publicly listed food company. Currently, Vinita is a Non-executive Director of Syngenta AG, Titan Company Ltd and CRISIL (Credit Rating Information Services of India) Ltd. She is also a board member of GAIN (Global Alliance for Improved Nutrition).

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 the Company as we continue to develop innovative ways to serve our markets and grow our business.

Nationality

Indian

Group plc and of Think London, the inward investment agency. 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; Board Member of the China-Britain Business Council and Chairman of The Racecourse Association.

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. It was of particular benefit when leading the selection process for the new external auditor in 2014. His appointment as an additional member of the Ethics & Compliance Committee recognises the close links between the activities and oversight role of both committees. His work for a number of international companies gives added insight when reviewing our global businesses.

Nationality

British

Chancellor of University of Hull and Sheriff of Hull, Pro Chancellor of the University of Surrey, Governor of the London School of Economics and Trustee of The Economist Newspaper.

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 long association with Hull, the home of many of our UK employees also brings an added perspective.

Nationality

British

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CORPORATE GOVERNANCE

Our Board of Directors ***continued***

Erik Engstrom (51)
Independent Non-executive Director
Appointed Independent 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 & Co. and then worked in publishing, latterly as President and Chief Operating Officer of

Random House, Inc. and as President and

Chief Executive Officer at Bantam Doubleday

Dell, North America. In 2001, he moved on to be a partner at General

Michael Friedman (71)
Independent Non-executive Director
Appointed Independent Non-executive Director in April 2013. He was appointed Chairman of the Ethics & Compliance Committee on 1 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. 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

Brian Larcombe (61)
Independent Non-executive Director
Appointed Independent Non-executive Director in March 2002, Member of the Audit Committee, Nomination & Governance Committee and Remuneration Committee, and appointed Senior Independent Director on 10 April 2014.

Career and Experience

Brian graduated with a Bachelor of Commerce degree from Birmingham University. He spent most of his career in private equity with 3i Group. After leading the UK investment business for a number of years, he became Finance Director and then Chief Executive of the Group following its flotation. He has held a number of Non-executive Directorships. He is currently Non-executive Director of gategroup Holding AG and Non-executive Director of Kodak Alaris Holdings Limited.

Skills and Competencies

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 Reed Elsevier.

Skills and Competencies

Erik has successfully reshaped Reed Elsevier 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.

Nationality

Swedish

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 (FDA). 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 and Non-executive Director of MannKind Corporation.

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 and resulted in a smooth handover during 2014.

Nationality

American

Brian s experience in private equity is particularly useful to us 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 new Chairman. As Senior Independent Director and member of the Nomination & Governance Committee, he plays an active role in succession planning and the search for new Non-executive Directors. In 2014, he led an insightful review into the effectiveness of the Board.

Nationality

British

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Joseph Papa (59)

Independent Non-executive Director

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

Career and Experience

Joe graduated with a Bachelor of Science degree in Pharmacy from the University of Connecticut and Master of Business Administration from Northwestern University s Kellogg 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 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 then Watson Pharma Inc. Between 2004 and 2006,

Susan Swabey (53)

Company Secretary

Appointed Company Secretary in May 2009.

Skills and Experience

Susan has 30 years experience as a company secretary in a wide range of companies including Prudential plc, Amersham plc and RMC Group plc. Her work has covered board support, corporate governance, corporate transactions, share registration, listing obligations, corporate social responsibility, pensions, insurance and employee and executive share plans. Susan is joint Vice-Chair of the GC100 Group, a member of the CBI Companies Committee and is a frequent speaker on corporate governance and related matters. She is also a trustee of ShareGift, the share donation charity.

Nationality

he was Chairman and Chief Executive Officer of the Pharmaceutical Technologies Services Segment 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.

British

Skills and Competencies

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

Nationality

American

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CORPORATE GOVERNANCE

Our Executive Officers

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

Julie Brown (52)

Chief Financial Officer

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

Skills and Competencies

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.

Rodrigo Bianchi (55)

President, IRAMEA

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.

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

Nationality

British

Helen Maye (55)
Chief Human Resources Officer

Joined Smith & Nephew in July 2011 and leads the Global Human Resources and Internal Communications functions. Since 2013, she has also led the Sustainability, Health, Safety & Environment functions. She is based in London.

Skills and Experience

Helen has more than 35 years experience across a variety of international and global roles in medical devices and pharmaceuticals, including manufacturing, supply chain and human resources. Previously, she was Divisional Vice President of Human Resources at Abbott Laboratories.

Nationality

Irish

Diogo Moreira-Rato (53)
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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Jack Campo (60)
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.

Nationality

American

Michael Frazzette (53)
President, Advanced Surgical Devices

Joined Smith & Nephew in July 2006 as President of the Endoscopy business. Since July 2011, he has headed up the Advanced Surgical Devices Division and is responsible for the Orthopaedic Reconstruction, Trauma and Endoscopy business units. Since 2014 he is also responsible for all of our commercial business in Latin America. He is based in Andover, Massachusetts.

Skills and Experience

Mike has held a number of senior positions within the US medical devices industry. He was Chief Executive Officer of Micro Group, a privately held manufacturer of medical devices. Prior to that, he spent 15 years at Tyco Healthcare in various leadership roles including President of the Patient Care Division, Health Systems, and Tyco Healthcare Group Canada.

Gordon Howe (52)
President, Global Operations

Joined Smith & Nephew in 1998 and, since 2013, is responsible for manufacturing, supply chain and procurement, IT systems and Regulatory and Quality Affairs. Prior to that, he headed up the Global Planning and Business Development teams. He is based in Memphis, Tennessee.

Skills and Experience

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

Nationality

American

Nationality

American

Cyrille Petit (44)
Chief Corporate Development Officer

Joined Smith & Nephew in 2012 and leads the Corporate Development function. 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

Glenn Warner (52)
President, Advanced Wound Management

Joined Smith & Nephew in June 2014 with responsibility for Advanced Wound Management s global franchise strategy, marketing and produce development, as well as its US commercial business.

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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CORPORATE GOVERNANCE

Chairman s letter

Good Governance lies at the heart of a well-run Company

Dear Shareholder,

I am delighted to present my first Corporate Governance Statement as your Chairman following my appointment at the Annual General Meeting in April 2014. I feel very 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 should pervade throughout the rest of the organisation.

Later in this statement, as well as all 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 those committees throughout the year. These reports will explain to you where we have focused our work in 2014. Firstly, however I should like to explain the key issues that we, as a Board, have been handling:

Board succession planning

As mentioned in my letter on page 5, Sir John Buchanan, Richard De Schutter, Ajay Piramal and Pamela Kirby all retired from the Board during 2014. One of my first tasks in assuming the role of Chairman therefore was to refresh the Board to take the Company into our next stage of development. The report from the Nomination & Governance Committee on page 70 discusses the process we followed to identify the gaps in Board skills and experiences left by the departing directors and to commence the search for our new Non-executive Directors, Vinita Bali, who joined the Board on 1 December 2014, and Erik Engstrom, who joined us on 1 January 2015. I believe that we have a well-balanced Board with the skills we need for the future and I welcome our new Board members. This, however, is an ongoing process and we shall keep the Board composition under constant review in the years ahead, making changes where necessary to adapt to the changing needs of the Company.

Mergers and acquisitions

Following the successful acquisition of our Biotherapeutics business in 2012, we continued to make further acquisitions throughout 2013 of the Adler business in India, two distributorships in Brazil and one in Turkey. In January 2014, we announced the acquisition of ArthroCare Corporation and this deal completed in May. You will read elsewhere in this Annual Report about the successful integration of ArthroCare into our Company. We also undertook post acquisition reviews of the transaction and earlier acquisitions to monitor actual performance against expected performance at the time of acquisition and we continued to review and evaluate other potential acquisitions for the future to support our Strategic Priorities.

Succession planning below Board level

We believe that succession planning below Board level is crucially important for the long-term future of the Company. In October, the Board therefore reviewed management succession plans both for the Executive Board members and also for their direct reports. We recognised that whilst there were some gaps, there were also plans in place to address these gaps and develop the next tier of management to become Board-ready in the medium-term. The Board also takes the opportunity to meet with local management teams when undertaking site visits and senior executives below Board level frequently present to the Board and its Committees. This helps us to get to know executives who could well become Board members in the future.

Understanding the business more deeply

Corporate governance does not exist in isolation and cannot be reduced to compliance with checklists and codes. In order for the Board to be able to review strategy, to determine our approach to risk and to respond to events, we need to have a thorough understanding of the business in which we operate.

During the year, the Board received a number of presentations from the businesses covering corporate development activity, the ArthroCare integration progress and our investment in Bioventus LLP. In October, we visited our Biotherapeutics facility in Fort Worth, Texas, where we met with management and toured the R&D facility.

In September, we held our annual Strategy Review in Singapore and met with members of our ASEAN management team and discussed their opportunities and challenges.

The Board is committed to the highest standards of corporate governance and we comply with all of the provisions of the UK Corporate Governance Code 2012 (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 except that the Nomination & Governance Committee is not comprised wholly of Independent Directors as required by the NYSE, but consists of a majority of Independent Directors in accordance with the Code. We shall explain in this Corporate Governance Statement and in the reports on the Audit Committee, the Nomination & Governance Committee, the Ethics & Compliance Committee and the Remuneration Committee, how we have applied the provisions and principles of the Financial Conduct Authority s (FCA) Listing Rules, Disclosure & Transparency Rules (DTRs) and the Code throughout the year.

The Directors report comprises pages 54 to 80, 103, 111, 113, 115 and pages 170 to 193 of the Annual Report.

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Working together as a Board

Given the number of changes at Board level in 2014, we decided that our review into the Board s effectiveness would focus on how we worked together as a Board and how we worked with the Executive Team. This review was led by Brian Larcombe, our Senior Independent Director. He asked the Directors and key members of the Executive team a series of open-ended questions about their views on the role of the Board and its Committees and how we worked together. The results of his review have proved to be very interesting and we are now working on ways to work together even more effectively. This is explained in greater detail on page 68.

Yours sincerely,

Roberto Quarta

Chairman

Overview

The Board is 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.

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CORPORATE GOVERNANCE

Corporate Governance Statement

Leadership

Diversity and experience

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.

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Role of Directors *continued*

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.

Changes to the Board

Chairman

Roberto Quarta replaced Sir John Buchanan on 10 April 2014

Independent Non-executive Directors

Left the Board during 2014

Ajay Piramal (resigned 24 March 2014)
Richard De Shutter (retired 10 April 2014)
Pamela Kirby (retired 31 July 2014)

Joined the Board during 2014

Vinita Bali (appointed 1 December 2014)
Erik Engstrom (appointed 1 January 2015, since year-end)

Role changed during 2014

Brian Larcombe replaced Richard De Schutter as Senior Independent Director on 10 April 2014
Michael Friedman replaced Pamela Kirby as Chairman of the Ethics & Compliance Committee on 31 July 2014

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Corporate Governance Statement *continued*

Leadership

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 58 to 59.

The Executive Officers form the Commercial and Operations Committee which advises 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.

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.

We acknowledge that Brian Larcombe has served as an independent Non-executive Director for a period of 13 years, which is a period of time that some might regard as likely to impact his independence. We do not believe this to be the case as Brian Larcombe continues to maintain an independent view within Board discussions. Furthermore, his experience on the Board, wise counsel and corporate memory has been most useful to Roberto Quarta in his first year as Chairman of the Company, particularly in a year when a number of other long-serving directors have left the Board and new

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. Vinita Bali and Erik Engstrom, who were appointed to the Board on 1 December 2014 and 1 January 2015 respectively, will offer themselves 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 judgment 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.

Non-executive Directors have been appointed.

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 2015.

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, six situations have been identified which could potentially give rise to a conflict of interest and these have been duly authorised by the Board and are reviewed on an annual basis.

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 2014, the Executive Directors held meetings with institutional investors, including investors representing approximately 46% of the share capital as at December 2014.

Since joining the Company, Roberto Quarta, the new Chairman has taken the opportunity to meet with investors to hear from them their views of the Company and also to talk about his first impressions of the Company and management. He held 12 meetings with investors holding approximately 22% of the share capital. These meetings have been a useful part of his induction process in understanding the Company from the investor perspective.

Joseph Papa, the Chairman of the Remuneration Committee also offered to meet with key institutional investors towards the end of 2014. Most investors were overwhelmingly supportive of our remuneration arrangements and we have made no changes to these arrangements over the year. He therefore met with four investors holding around 2% 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 and in particular, the tender process we had followed to select new auditors. The meetings held with five investors holding around 5.45% of the issued share capital were interesting and useful and we welcomed some insightful comments on possible improvements to the Audit Committee Report.

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

Outside Directorships

We encourage our Executive Directors to serve as a Non-executive Director of a maximum of one external company. Olivier Bohuon is a Non-executive Director of Virbac group and Julie Brown does not hold such a position.

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.

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CORPORATE GOVERNANCE

Corporate Governance Statement *continued*

Effectiveness

Board timetable

Responsibility of the Board

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

Strategy	Risk
Approving the Group strategy including major changes to corporate and management structure	Overseeing the Group s risk management programme
Approving acquisitions, mergers, disposals, capital transactions in excess of $50 million	Regularly reviewing the risk register
Setting priorities for capital investment across the Group	Overseeing risk management processes (see pages 36 to 39 for further details).
Approving annual budget, financial plan, five-year business plan	**Shareholder Communications**

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.

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

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

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.

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What we did

Month	
January (acquisition of ArthroCare)	Considered and approved acquisition of ArthroCare Corporation
Early February (Approval of Preliminary Announcement)	Reviewed the results for the full year 2013 and the preliminary announcement and approved the final dividend to be recommended to shareholders for approval Reviewed and approved the annual risk management report Approved the Budget for 2014 and the five-year Plan for 2014 to 2018 Approved the continuation of the share buy-back programme to repurchase shares issued in connection with share plans on a quarterly basis Reviewed the results of the review into the effectiveness of the Board in 2013 and agreed action points for 2014
Late February (by telephone) (Approval of Financial Statements)	Reviewed and approved the Annual Report and Accounts for 2013, having determined that they were fair, balanced and understandable Reviewed and approved the Notice of Annual General Meeting and related documentation
Early April	Noted, considered and approved the new Commercial organisation structure Received a presentation on SYNCERA, the new value range for our ASD division Approved the Sustainability Report Prepared for the Annual General Meeting to be held later that day
Late April (by telephone)	Reviewed the results for the first quarter 2014 and approved the Q1 announcement

(Approval of Q1 results)	
July (Approval of H1 results)	Reviewed the results for the first half 2014 and approved the H1 announcement, having considered management s judgement in a number of areas and approved payment of interim dividend Received and considered a report analysing the progress of recent acquisitions against expectations at the time of acquisition Received and discussed annual review of defence planning Received update reports from Group Taxation and Group Treasury Approved the appointment of Deutsche Bank as ADR Depositary Bank and the change of the ratio of ADR to ordinary shares Updated and approved the Schedule of Matters Reserved to the Board
Early October (Strategy Review) Singapore	Approved the Strategic Plan for 2015 to 2019 over a two-day Strategy Review with the executive team Approved the renewal of the Directors and Officers Liability insurance Authorised the executive team to arrange the private placement of debt
Late October (Approval of Q3 Results) Fort Worth, Texas	Reviewed the results for the third quarter 2014 and approved the Q3 announcement Received and considered the annual report from the executive team on executive Succession Planning Received an update on the progress of the integration of ArthroCare Approved the appointment of Vinita Bali as a Non-executive Director
December (Approval of Budget)	Approved the Budget for 2015 Authorised the executive team to conduct a selection process for new corporate brokers Received a report on the progress of our investment in Bioventus LLP Received an update on the HR transformation project Received an update on the Commercial structure within Europe

We also agreed to appoint Erik Engstrom as Non-executive Director by written resolution.

Since the year end, we have also approved the Annual Report and Accounts for 2014 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 2014.

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.

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CORPORATE GOVERNANCE

Corporate Governance Statement ***continued***

Effectiveness

Board and Committee Attendance

Director	Board Meetings **(9 meetings)**	Audit Committee Meetings **(8 meetings)**	Remuneration Committee Meetings **(4 meetings)**	Nomination & Governance Committee Meetings **(3 meetings)**	Ethics & Compliance Committee Meetings **(4 meetings)**
Roberto Quarta	9 / 9		2 / 2[7]	3 / 3	
Olivier Bohuon	9 / 9			3 / 3	
Julie Brown	9 / 9				
Vinita Bali[1]	1 / 1				
Ian Barlow	9 / 9	8 / 8			1 / 1[9]
Virginia Bottomley	9 / 9		4 / 4	2 / 2[8]	
Sir John Buchanan[2]	3 / 4			1 / 1	
Michael Friedman[3]	8 / 9				4 / 4
Pamela Kirby[4]	6 / 6		3 / 3		3 / 3
Brian Larcombe	9 / 9	8 / 8	4 / 4	3 / 3	

Joseph Papa	9 / 9	8 / 8	4 / 4		4 / 4
Ajay Piramal[5]	1 / 3				
Richard De Schutter[6]	4 / 4	3 / 3	2 / 2	1 / 1	2 / 2

1 Vinita Bali was appointed to the Board on 1 December 2014

2 Sir John Buchanan retired from the Board on 10 April 2014

3 Michael Friedman was unable to attend one Board telephone update due to a flight delay

4 Pamela Kirby retired from the Board on 31 July 2014

5 Ajay Piramal retired from the Board on 24 March 2014

6 Richard De Schutter retired from the Board on 10 April 2014

7 Roberto Quarta joined the Remuneration Committee on 10 April 2014

8 Virginia Bottomley joined the Nomination & Governance Committee on 10 April 2014

9 Ian Barlow joined the Ethics & Compliance Committee on 2 October 2014

In the event that a Director is unable to attend a Board or Board Committee meeting, they ensure that they are familiar with the matters to be discussed and make their views known to the Chairman of the Board or Board Committee prior to the meeting.

Dear Shareholder,

The Chairman asked me as Senior Independent Director to conduct the review into the effectiveness of the Board in 2014. I interviewed all the members of the Board, the Company Secretary and the Head of Human Resources towards the end of 2014, basing our discussions around a short questionnaire prepared by the Company Secretary.

The Board scores highly on all the key assessments of our responsibilities for approving strategy, monitoring performance, determining risk, diligence of members developing an excellent working relationship with Olivier. He has invested the time to understand the business, getting to know the senior executives and the major shareholders and has made excellent progress in strengthening the Board with appointment of new Non-executive Directors. The Committees of the Board were also found to be operating effectively.

There has been some healthy discussion around the role played by the Board, with the Non-executives eager to play a more active role in agenda planning, setting the strategy, organisational change and management succession and the appointment of attendance and quality of discussion. Roberto Quarta, Chairman of the Board is universally respected for his professionalism, chairmanship skills and for advisers.

The Board discussed the results of my findings at our Board meeting in February 2015 and agreed the following actions for 2015:

Action identified
Make more effective use of the annual Board Planner to ensure that all key strategic issues were timetabled appropriately throughout the year
Encourage the executive team to access the diverse competencies of the Non-executive Directors more between Board meetings
Continue the practice of inviting members of the executive team to present regularly to the Board

The review into the Board s effectiveness in 2015 will be facilitated externally as although we undertake an annual review, the last externally facilitated review was in 2012. The areas for attention identified in the 2013 review have been addressed as follows:

Progress made in 2014 against the Areas for Attention identified in the 2013 review

Succession Planning at Non-executive Director level would be a key priority following the retirement of a number of long serving Non-executive Directors during the year.	Nomination & Governance Committee undertook a comprehensive search for new Non-executive Directors leading to the appointment of Vinita Bali on 1 December 2014 and of Erik Engstrom on 1 January 2015. This process is ongoing. Details of the full search process are given in the Nomination & Governance Committee Report on page 70.
Timing and length of the Board and Committee meetings could be reviewed to consider whether the current pattern of meetings was most effective.	The timing and frequency of Board meetings has been reviewed by the Chairman and the Chief Executive Officer, who have concluded that the current pattern of meetings is appropriate for the Company and fits in well with the programme of executive activities throughout the year. The reporting schedule inhibits changing the Board timetable.

Yours sincerely,

Brian Larcombe

Senior Independent Director

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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 2014, we particularly focused on the changes to Narrative Reporting and reporting on Remuneration as well as the changes incorporated in the UK Corporate Governance Code 2014 and the Financial Reporting Council s Audit Quality Thematic Review into fraud risks and laws and regulations. New Directors receive tailored induction programmes when they join the Board. In 2014, Vinita Bali commenced her induction programme with a series of meetings with key senior executives and a briefing on UK Company Law and Corporate Governance delivered jointly by our corporate lawyers, Freshfields and our Company Secretary, Susan Swabey. Since the year end, Vinita Bali and Erik Engstrom have continued meeting with key senior executives and a series of visits to our major facilities is planned for them both over the next few months. 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:

Month	Activity
February	Individual cyber profiling sessions with each Director Presentation from external consultants on the current state of the Medical Devices industry across Europe
April	Presentation on new SYNCERA range

July	Joint presentation from our corporate brokers on equity markets and investor perceptions of Smith & Nephew
September	Meetings with our ASEAN management team in Singapore with presentations from the local Managing Directors in Singapore, Malaysia and Thailand Presentation from a leading Indian hip surgeon on the challenges in the Indian market 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 Biotherapeutics facility in Fort Worth, Texas and meetings with the Biotherapeutics research and development teams Series of presentations from our Advanced Wound Management US Commercial team on the challenges faced by the business, our strategy and initiatives to meet these challenges and an update on progress made since the previous year

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 70 to 71 explains the process the Board and the Nomination & Governance Committee followed in 2014 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 25 February 2015

Roberto Quarta

Chairman

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CORPORATE GOVERNANCE

Accountability

Accountability

Nomination & Governance

Committee Report

Dear Shareholder

I am pleased to present our Report on the role and activities of the Nomination & Governance Committee in 2014.

Current Members in 2014

Roberto Quarta	Committee Chairman
Brian Larcombe	Senior Independent Non-executive Director
Virginia Bottomley (from 10 April 2014)	Independent Non-executive Director

Olivier Bohuon	Chief Executive Officer

1 Sir John Buchanan and Richard De Schutter left the Committee on 10 April 2014 on their retirement from the Board.

Key activities

Review the composition of the Board and make recommendations to the Board regarding the appointment of Directors.

Oversee governance aspects of the Board and its Committees.

2015 focus

Continue to search for one more Non-executive Director with financial expertise.

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 at www.smith-nephew.com

Activities of the Nomination & Governance Committee in 2014 and since the year end

In 2014, we held four physical meetings. Each meeting was attended by all members of the Committee. The Company Secretary, the Head of Human Resources and external search agents also attended by invitation. In between each meeting, various discussions were held between members of the Nominations & Governance Committee and the external search agent. Our programme of work in 2014 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 and updated 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

- Noted an update on corporate governance matters relating to reporting and disclosure requirements.

Early September (Appointment of Vinita Bali)

- Reviewed the long list of candidates for the position of Non-executive Director and discussed the outcome of meetings already held with candidates who had been shortlisted

- Agreed to recommend to the Board that Vinita Bali be appointed Non-executive Director.

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End October (Appointment of Erik Engstrom)

Further reviewed the longlist and shortlist of Non-executive Director candidates and discussed the outcome of meetings held with candidates

Agreed to recommend to the Board that Erik Engstrom be appointed Non-executive Director

Agreed to hold further meetings with other candidates.

Early December (Appointment of Non-executive Directors)

Further reviewed the longlist and shortlist of Non-executive Director candidates and discussed the outcome of meetings held with candidates.

The Nomination & Governance Committee agreed to recommend that the Board appoint Vinita Bali and Erik Engstrom as Non-executive Directors.

The Nomination & Governance Committee selected Vinita Bali to be a Non-executive Director because of her experience as a very senior commercial executive in a wide range of Emerging Markets across India, Africa and South America.

We selected Erik Engstrom because of his experience in his role as Chief Executive Officer leading his company Reed Elsevier through significant technological change and his ability to add value to our Audit Committee.

Russell Reynolds also undertook succession planning assessments on behalf of management. The Committee is satisfied that their 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

Since the year end, we have also considered the outcomes of the Board Effectiveness review and discussed the future structure of the Board.

Non-executive Directors

During 2014, there were a number of changes to the composition of the Board. Sir John Buchanan retired as Chairman of the Board at the Annual General Meeting after nine years service to the Company. Richard De Schutter also retired at the Annual General Meeting following 13 years service and Pamela Kirby retired after 12 years service in July. Earlier in the year, Ajay Piramal also retired from the Board in March due to the pressure of other commitments. These departures left a number of positions on the Board to be filled. We therefore undertook a search programme to identify suitable new Board members, which resulted in the appointment of Vinita Bali as Non-executive Director with effect from 1 December 2014 and of Erik Engstrom with effect from 1 January 2015. The process we followed was as follows:

I worked with Olivier Bohuon, Chief Executive Officer, the Company Secretary and the Head of Human Resources to analyse the skills and experiences we felt that we needed on the Board to implement our Strategy over the next five years. We also analysed the skills and experiences of those Directors who would be remaining on the Board

From this review, we identified that we would wish to search for up to three new Non-executive Directors, each with a combination of one or more of the following skills, experiences or backgrounds:

Experience of one or more of the Emerging Markets in which we operate;

gender or ethnicity but is equally important. A Board needs a range of skills from technical adherence to governance or regulatory matters for an understanding of 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. 30% 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.

Yours sincerely,

Digital experience we later modified this to leading a company through a period of considerable technological change;

Experience as a Chief Executive Officer in another listed company;

At least one new female Non-executive Director;

The Board reviewed this analysis and endorsed the skills and experiences against which we would be searching

The Nomination & Governance Committee selected Russell Reynolds to undertake the search for new Non-executive directors, having reviewed three firms suggested by the Head of Human Resources and the Company Secretary

Russell Reynolds 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 longlist and select a shortlist of suitable candidates

Members of the Nomination & Governance Committee then met individually with a number of candidates. Additional Board members were also asked to meet certain candidates where there were particular interests or experiences

Roberto Quarta

Chairman of the Nomination & Governance Committee

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CORPORATE GOVERNANCE

Accountability ***continued***

Ethics & Compliance

Committee Report

Dear Shareholder

I am pleased to present our Report on the role and activities of the Ethics & Compliance Committee in 2014.

Current Members in 2014

Michael A. Friedman (from 31 July 2014)	Committee Chairman
Ian Barlow (from 2 October 2014)	Independent Non-executive Director
Joseph Papa	Independent Non-executive Director

1 Richard De Schutter left the Committee on 10 April 2014 on their retirement from the Board.
2 Pamela Kirby left the Committee on 31 July 2014 on her retirement from the Board.
3 Vinita Bali will join the Committee on 1 April 2015.

Key activities

Reviews ethics and compliance processes and practices across the Group.

Oversees quality and regulatory matters.

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

2015 focus

Develop a deeper oversight of quality and regulatory matters.

Continue to focus on compliance issues within the context of our acquisition programme.

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

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 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

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

Receiving and considering regular functional reports and presentations from the SVP Quality Assurance and Regulatory Assurance (QARA).

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

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Activities of the Ethics & Compliance Committee in 2014 and since the year end

In 2014, 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 SVP Quality Assurance and Regulatory Assurance also attended by invitation. Our programme of work in 2014 included the following:

February

- Noted that the SEC and DOJ had confirmed the termination of the independent monitorship in January 2014 and that the Company was now subject to self-reporting. Discussed and noted the requirements of self-reporting
- Noted the ethics and compliance due diligence and integration work being undertaken in respect of recent transactions in India, Turkey and Brazil and the Biotherapeutics business
- Noted the preparations being made in capturing data to be filed under the US Sunshine Act and considered the Sunshine legislation in other territories.

April

- Reviewed the processes in place to ensure oversight over third party sellers
- Noted the ethics and compliance due diligence and integration work being undertaken in respect of recent transactions in India, Turkey and Brazil and ArthroCare
- Noted that the first aggregate payment report under the US Sunshine Act had been filed in March 2014 and considered the Sunshine legislation in other territories.

July

- Noted that the Company s first self-reporting report would be filed with the SEC and DOJ in July 2014.

October

Reviewed the results of 2014 ethics survey

Noted the data recently published under the US Sunshine Act in respect of both the Company and its competitors

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 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 2014, 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

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 any potentially significant improprieties from time to time, and the Company s response.

In 2014, 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 2014, we updated our Code training. The new module is more interactive, role-based and allows individuals to apply the Code in different scenarios.

We also developed and piloted a face-to-face course for new managers, supplementing the on-line manager certification training. In 2015, all new managers will be required to complete both the on-line and the face-to-face course.

Accountability ***continued***

Compliance Programme for Third Parties

We continually review our compliance programme with 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 monitoring and auditing programmes in 2014.

We expanded our oversight of third party sellers with site assessments to check compliance controls and monitoring visits to review books and records.

We have continued to strengthen controls over other third parties engaged by us to provide services other than selling our products, such as customs, registration and travel agents. In 2014, we focused on potentially higher risk third parties. 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 both 2013 and 2014, there has been increased strategic acquisition activity across the Group. In all cases, we

Oversight of Quality Assurance and Regulatory Assurance Function

During the course of 2014, it was agreed that primary oversight of the Quality Assurance and Regulatory Assurance Function (QARA) would move from the Audit Committee to the Ethics & Compliance Committee. Product safety is at the heart of our business and regulatory authorities enforce a complex series of laws and regulations that govern the design, development, approval, manufacture, labelling, marketing and sale of healthcare products, including review of the safety and efficacy of such products. Jerry Porreca, SVP Quality Assurance and Regulatory Assurance presented to the Ethics & Compliance Committee in October 2014, explaining the new structure of the QARA function and the current focuses and initiatives being addressed by the function. The QARA function is built on four pillars quality assurance, regulatory affairs, customer complaints and quality systems and regulatory compliance.

Going forward, the Ethics & Compliance Committee will monitor the work of the QARA function on a quarterly basis, approve the QARA annual programme of work, as outlined in their 3-Year QARA Plan, consider any quality or regulatory issues that arise during the year, and approve any appropriate remedial action.

Yours sincerely,

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.

Michael A. Friedman

Chairman of the Ethics & Compliance Committee

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Audit Committee Report

Dear Shareholder

I am pleased to present our Report on the role and activities of the Audit Committee in 2014.

Current Members in 2014

Ian Barlow	Committee Chairman and designated financial expert
Erik Engstrom (from 1 January 2015)	Independent Non-executive Director
Brian Larcombe	Senior Independent Non-executive Director
Joseph Papa	Independent Non-executive Director

1 Richard De Schutter left the Committee on 10 April 2014 on his retirement from the Board.

Key activities

Undertake independent assessment of the financial affairs of the Company.

Role of the Audit Committee

Our work falls into the following five areas:

Financial Reporting

Reviewing significant financial reporting judgments 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

Oversee system of control and risk management throughout the Group.

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

2015 focus

Consideration of how to address the requirement to publish a Viability Statement in the 2015 Annual Report and more detailed risk management reporting.

Monitor the roll-out of enhanced consistently applied financial controls across the Group.

Monitoring announcements relating to the Group s financial performance.

Internal Controls and Risk Management

Monitoring the effectiveness of internal controls and compliance with the UK Corporate Governance Code 2012 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.

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.

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 re-appointment 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 at www.smith-nephew.com

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CORPORATE GOVERNANCE

Accountability ***continued***

Activities of the Audit Committee in 2014 and since the year end

In 2014, we held five physical meetings and three meetings by telephone. Each meeting was attended by all members of the Committee. The Chief Executive Officer, the Chief Financial Officer, the Head of Internal Audit (following her appointment in May 2014), the external auditor and key members of the finance function, the Company Secretary and Deputy Company Secretary also attended by invitation. We also met regularly with the external auditor without management present. Our programme of work in 2014 was as follows:

Month	Activity
Early February (Approval of Preliminary Announcement)	Reviewed the results for the full year 2013 and the preliminary announcement and recommend them for adoption by the Board Reviewed the effectiveness of financial controls and of the risk management process and concluded they were operating effectively Received the Internal Audit Report and approved the Internal Audit work programme for 2014 Received the Quality Assurance Report and approved the Quality Assurance work programme for 2014 Received the fraud report and reviewed whistle-blowing procedures Approved external audit fees and the policy for pre-approval of EY non-audit tax fees and noted consulting fees paid to other major audit firms
Late February (by telephone) (Approval of Financial Statements)	Reviewed and approved the Annual Report and Accounts for 2013, having considered whether 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 Agreed to put the audit out to tender for the financial year 2015
Early April (Presentations from prospective audit firms)	Confirmed the detailed plan for the audit tender and appointed the Audit Tender Steering Committee Received a presentation from the three audit firms planning to participate in our audit tender process
Late April	Reviewed the results for the first quarter 2014 and approved the Q1 announcement

(by telephone) (Approval of Q1 results)	
Early July (by telephone) (Appointment of new Auditors)	Considered and approved the recommendation of the Audit Tender Steering Committee to appoint KPMG LLP as the Company auditors for the year ending 31 December 2015
Late July (Approval of H1 results)	Reviewed the results for the first half 2014 and approved the H1 announcement Reviewed the Progress Report from Internal Audit which included an update on the status of the 2014 Internal Audit plan Received the fraud report and reviewed whistle-blowing procedures Reviewed and discussed the due diligence process for acquisitions, noting improvements made to this process in the past year
	Reviewed and approved the external Auditor s Audit Plan for 2014
October (Approval of Q3 Results)	Reviewed the results for the third quarter 2014 and approved the Q3 announcement Approved the terms of the engagement letter of EY as Auditors for the financial year 2014 Reviewed the Progress Report from Internal Audit, the status of the 2014 Internal Audit plan and two internal audit reports. Approved the Group Risk management programme conducted in 2014 Considered and discussed the updated UK Corporate Governance Code issued by the Financial Reporting Council Considered and discussed the Financial Reporting Council s Audit Quality Thematic Review - Fraud risks and laws and regulations. Received the fraud report and reviewed whistle-blowing processes Noted the progress of the European IT SAP implementation project Reviewed the inspection reports on EY from the Financial Reporting Council (UK) and the Public Company Accounting Oversight Board (US) Reviewed and discussed the roll-out of the Minimum Acceptable Practices for Finance and other control focussed initiatives
December (Review of Functional	Reviewed and updated the terms of reference of the Audit Committee Considered and approved critical accounting policies and judgments in advance of the 2014 year end
Reports)	Considered and approved the external audit plan for 2015 Reviewed and approved the layout and design of the Annual Report 2014 Received and discussed a report on the Finance transformation project and reports from the Head of Taxation, the Group Treasurer and the Chief Information Officer on Disaster Recovery and IT risk. These reports focused on the respective controls and risks within each function

During the year, we also approved our Policy on the use of Conflict Minerals by written resolution.

Since the year end, we have also reviewed the Annual Report and Accounts for 2014 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 page 12, 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 2014 accounts and at each reporting quarter end, which we discussed in all cases with management and the external auditor:

Area of judgement	**Our action**
Valuation of inventories	
A feature of the orthopaedic business model (whose finished goods inventory makes up 81% 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.	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 21.5% at 31 December 2014 (26.0% as at 31 December 2013). We concluded that the proposed levels were appropriate.
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 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.	As members of the Board, we receive regular updates from the Chief Legal Officer. These updates form the basis for the level of provisioning. These judgements have not moved materially during the year, with some cases having been resolved, and we have determined that the proposed levels at year end of $74 million in 2014 ($86 million in 2013) were appropriate in the circumstances.
Impairment	
In carrying out impairment reviews of goodwill, intangible assets and property, plant and equipment, a	We reviewed management s reports on the key assumptions with respect to goodwill, acquisition

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.	intangible assets and investments in associates particularly the forecast future cash flows and discount rates used to make these calculations. 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 judgments about the future statutory profitability of constituent entities of the Group.	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, concluding that the levels of provisions was appropriate.
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 understanding the circumstances at acquisition and estimates of the future results of the acquired business and management judgement is a factor in making these determinations.	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 and approved these reports.

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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External Auditor

Independence of External Auditors

The independence of our external auditors is critical for the integrity of the audit. 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 our non-audit services, and all such services are strictly governed by this policy. During 2014, fees paid to Ernst & Young LLP, our external auditor, for non-audit work totalled $1.8 million, representing 35% of total audit fees. Full details are shown in Note 3.2 of the Notes to the Group accounts. During 2014, fees paid to KPMG LLP, who will be appointed as our external auditors at the Annual General Meeting, amounted to $3.9 million. The provision of non-audit services by KPMG will be subject to our Auditor Independence Policy and the level of these services will be monitored closely. It is not expected that the level of non-audit services provided by KPMG will be as high in 2015.

The Auditor Independence Policy also governs the policy regarding audit partner rotation. In 2014, Les Clifford who had been our audit partner for five years was replaced by Michael Rudberg.

Effectiveness of External Auditors

Although EY will cease to be the Company s external auditors at the Annual General Meeting, we felt that it would still be useful to carry out a review of the effectiveness of the external audit process and the quality of the audit, as the findings could be of use to KPMG, the incoming external auditor. We therefore conducted a review into the effectiveness of the external audit as part of the 2014 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, EY and KPMG.

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 EY.

The Audit Quality Review Team of the Financial Reporting Council in the UK reviewed the 2013 audit EY performed of the Company. We have discussed the results of this inspection with EY and are satisfied that the points raised by the review have been appropriately addressed in the 2014 audit.

Overall therefore, we concluded that EY had carried out their audit for 2014 effectively.

Appointment of External Auditors at Annual General Meeting

Ernst & Young LLP will be retiring as the Company s external auditor at the Annual General Meeting. The reports of Ernst & Young LLP on the Company s financial statements for the past two fiscal years did not contain an adverse opinion or a disclaimer of opinion and were not qualified or modified as to uncertainty, audit scope, or accounting principles. In connection with the audits of the Company s financial statements for each of the two fiscal years ended 2013 and 2014, and in the subsequent interim period to 23 February 2015, there were no disagreements with Ernst & Young LLP on any matters of accounting principles or practices, financial statement disclosure, or auditing scope and procedures which, if not resolved to the satisfaction of Ernst & Young LLP would have caused Ernst & Young LLP to make reference to the matter in their report.

Resolutions will be put to the Annual General Meeting to be held on 9 April 2015 proposing the appointment of KPMG LLP as the Company s Auditors and authorising the Board to determine their remuneration, on the recommendation of the Audit Committee.

Disclosure of Information to the Auditors

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

information of which the Auditor, Ernst & Young LLP, are unaware and the Directors also confirm that they have taken reasonable steps to be aware of any relevant audit information and, accordingly, to establish that the Auditor is aware of such information.

Audit and Professional Fees paid to the Auditor

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

	2014 $ million	2013 $ million
Audit	**3**	3
Audit-related fees		
Tax	**2**	3
Other		
Total	**5**	6

Internal Audit

Our Internal Audit function reports directly to the Audit Committee and is headed by Jenny Morgan, Senior Vice President Internal Audit, whom we appointed in May 2014. She has subsequently restructured her team to meet the requirements of the evolving nature of our business, particularly in Emerging Markets and new acquisitions.

The internal Audit function carries out work in the following three areas:

- Financial systems and processes;
- Systems that ensure compliance with our Code of Conduct, regulation and laws; and
- Quality management systems in our manufacturing activities.

In all three areas, they act as a third line of defence behind operational management s front line and the Company s internal assurance activities within Group Finance Compliance and Quality Assurance. During the year, they completed 26 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.

Specific activities of the Internal Audit function in 2014 were the review of the design of the post-deal acquisition review process and the calculation of the benefits and costs associated with the Group Optimisation programme. In addition site specific audits were conducted of the China commercial business and the new acquisitions in Turkey and India to ensure that integration efforts were in line with approved plans.

In 2015, 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.

During 2014, KPMG carried out an external review into the effectiveness of the Internal Audit function. The review made a number of recommendations regarding the role and remit of internal audit, the resourcing of the function and the development of integrated working with other functions to provide a more holisitc approach to risk and assurance across the Group. These recommendations were accepted and are being implemented.

Since this review, the Internal Audit function has been strengthened by the appointment of Jenny Morgan, the new Senior Vice President Internal Audit who has in turn restructured the function as detailed above.

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Tender of External Audit Services

EY and their predecessor firms have been the Company s auditors since the Company listed in 1937. We have been very satisfied with the effectiveness of the external audit process and the quality of the audit and have undertaken a number of measures to ensure that the external auditor has continued to maintain its independence. However, in common with a number of other companies, as we explained in our Audit Committee Report last year, we recognised in 2014, that it was the right time to put the external audit out to tender.

During the early summer of 2014, I led a process to select a new external auditor for the year ending 31 December 2015. I worked with the Group s procurement function and established a Steering Committee comprising myself, Brian Larcombe, member of the Audit Committee and Senior Independent Director, Julie Brown, the Chief Financial Officer, Susan Swabey, the Company Secretary and Dan Baker, Senior Vice President Group Finance. Given the size, complexity and geographical scope of the business, we invited Deloitte, KPMG and PwC to take part in the tender for carrying out our external audit. In addition, in light of the emerging rules from Europe, we reached mutual agreement with EY that they would not take part in the tender process.

Prior to the commencement of the tender process, each firm was invited to make a presentation to the early April Audit Committee meeting on a project on which they had recently been working with the Company. This was to ensure that each firm had sufficient exposure to the Audit Committee prior to the financial tender.

identification, audit approach to risks audit scope. These written tenders also included the proposed audit fee, as we believed that as well as ensuring the quality of the audit, we also needed to have regard to the sensible containment of costs.

5. Early July In the week leading up to the presentation, each audit firm was asked to prepare a response to an audit query, the same query for each firm, to simulate real life working and allow the Steering Committee to assess how well they responded to a request at short notice and how they interacted with the Committee on a technical issue.

6. Early July Each firm was asked to make a presentation to the Steering Committee explaining why we should select them as our external auditors.

7. Early July Following the presentations and further discussions, the Audit Committee met and considered the recommendation of the Steering Committee and agreed to appoint KPMG LLP as our external auditors for the 2015 financial year. A resolution to this effect will be submitted to shareholders for approval at the Annual General Meeting.

Throughout the process, we were mindful of the need to preserve the independence of the external audit. As part of the tender, each firm was required to disclose all existing relationships with the Company and explain their proposals for ensuring that these relationships would not cause any conflict of interest after 1 January 2015. Given that up until 2008, I was Senior Partner in London with KPMG, We were conscious that the audit tender process is time and resource consuming, both for the firms involved and for the Company, and were therefore determined to have a concise yet thorough process, ensuring equivalent access to management for each firm. We undertook the following process over just six weeks:

1. Late May Issued the request for tender.
2. Late May Participating firms attended a joint workshop over a period of two days. This included a group meeting with all firms with a series of presentations from key members of management, explaining their key expectations from the external audit process, as well as a series of individual meetings with management.
3. Late May Each firm was granted access to key senior members of management in a structured programme following the workshop, and then given access to senior managers and finance staff throughout the Group to help them understand the business further.
4. End June Each firm submitted their written tender document covering predetermined areas of focus, including risk

we were aware that there might be some concerns about my independence. In order to address this, our Chairman Roberto Quarta joined the Steering Committee for the final stage of presentations to ensure impartiality was maintained. We also noted that other senior members of the finance team had recently joined the Company from other tendering firms.

We chose KPMG to be our external auditors as we felt that they had demonstrated that they understood our business and risks well and could work both constructively and in a challenging manner with our management and provide the Audit Committee with the assurances we would need to fulfil our role.

The audit of the 2014 Annual Report and Accounts will therefore be the last external audit to be conducted by EY. I should therefore like to record my thanks to EY and their partners and staff for their many years of excellent service to the shareholders of Smith & Nephew. As Chairman of the Audit Committee for the past five years, I have enjoyed working with them and have valued the insights and professionalism they have brought to the Audit Committee meetings.

Risk Management and Internal Control

On behalf of the Board, we reviewed the system of internal financial control and satisfied ourselves that we are meeting required standards both for the year ended 31 December 2014 and up to the date of approval of this Annual Report. No concerns were raised with us in 2014 about possible improprieties in matters of financial reporting.

In coming to this conclusion:

We received regular reports from the Internal Audit and Group Finance functions on their findings from the reviews undertaken throughout the year, both from an internal audit perspective and also with regard to compliance with the Sarbanes-Oxley Act.

We requested and reviewed a report mapping Group level risks and related control assurance.

We requested various reports from management relating to specific risks identified through the risk management process. Our Risk Management Framework is underpinned by Business and Functional Risk Registers that highlight the risks identified and the probability and impact of risk to the Group, as well as mitigation plans. The most significant of these risks are considered by the Group Risk Committee for inclusion on a Group Risk Register. The effectiveness of the framework is reviewed annually by Internal Audit and by the Audit Committee. In 2014, the Audit Committee concluded that the framework was effective.

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CORPORATE GOVERNANCE

Accountability ***continued***

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 minimum internal financial control standards.

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

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

The Audit Committee reviews the Group whistle-blower procedures.

The Audit Committee reviews regular reports from the Senior Vice President, Group Finance and the heads of the Financial Controls and Compliance, Taxation and Treasury functions.

This system of internal control has been designed to manage rather than eliminate material risks to the achievement of our strategic and business objectives and can provide only reasonable, and not absolute, assurance against material misstatement or loss. Because of inherent 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. The system of internal control is not applied to the entities in which the Group does not hold a controlling interest. This process complies with the Financial Reporting Council s Internal Control: Revised Guidance for Directors on the Combined Code and additionally contributes to our compliance with the obligations under the Sarbanes-Oxley Act 2002 and other internal assurance activities. Other than the integration of ArthroCare there has been no change in the Group s internal control over financial reporting during the period covered by this Annual Report that has materially affected, or is reasonably likely to materially affect, the Group s internal control over financial reporting.

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 2014 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 2014. Based upon this evaluation, the Chief Executive Officer and Chief Financial Officer concluded on 23 February 2015 that the disclosure controls were effective as at 31 December 2014.

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 2014 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 2014, the Group s internal control over financial reporting is effective based on those criteria.

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

Ernst & Young LLP. An independent registered public accounting firm issued an audit report on the Group s internal control over financial reporting as at 31 December 2014. This report appears on page 105.

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 2013 or up until 23 February 2015. A copy of the Code of Ethics for Senior Financial Officers can be found on our website at www.smith-nephew.com.

In addition every individual in the finance function certifies to the Chief Financial Officer that they have complied with the Finance Code of Conduct.

Evaluation of Effectiveness of the Audit Committee

The effectiveness of the Audit Committee was evaluated as part of the review into the effectiveness of the Board conducted at the end of 2014. The results of this review are described on pages 66 to 67 of this Annual Report.

Yours sincerely,

Ian Barlow

Chairman of the Audit Committee

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CORPORATE GOVERNANCE

Remuneration report

Remuneration

Dear Shareholder,

The Board focuses on the long-term future of the Company. We are delivering on our strategy to rebalance Smith & Nephew by strengthening our higher growth platforms, which now represent more than half the business, up from just 35% in 2011. In 2014, we undertook a number of important actions to accelerate this transformation:

- We drove a much improved performance in US Hip and Knee Implants, and maintained our momentum in Sports Medicine Joint Repair and Trauma & Extremities.
- We strengthened our higher growth platforms, acquiring ArthroCare to give us a broader sports medicine portfolio.
- We created new growth platforms, the mid-tier portfolio for Emerging markets, and Syncera, as well as delivering double-digit growth from our recent acquisition Advanced Wound Bioactives.

The role of the Remuneration Committee is to design a remuneration strategy that drives performance aligned to the strategic priorities.

Our performance in 2014 reflected the choices we made to continue investing to transform Smith & Nephew and, as a result, the Group enters 2015 stronger, more efficient, and set for higher growth. However, these choices did impact profit and cash performance in 2014 and consequently performance against the financial measures in the Annual Incentive Plan and the resulting payouts under this plan are accordingly lower than in previous years. The Remuneration Committee recognises that the Executive Directors made the right decisions for the long-term future of the Company and for the benefit of shareholders, and performed well against their business objectives.

In devising our remuneration arrangements, we aim to have a clear line of sight between the performance of the Company and how our Directors and senior executives are paid. We do this by setting the fixed elements of pay, notably base salary and benefits, in line with what our Executive Directors would be paid at another company of a comparable size, complexity and geographical spread. For the variable elements of pay, we select performance measures that are linked to one or more of our Strategic Priorities as detailed on page 13 of the Annual Report. These performance measures are summarised on the following page.

Our remuneration arrangements have essentially remained unchanged from last year and we will therefore not be asking shareholders to vote on a new remuneration policy. We have however chosen to replicate the policy you approved last year following the annual report on remuneration for ease of reference.

During the year, Richard De Schutter and Pamela Kirby ceased to be members of the Remuneration Committee on their retirement from the Board. We value the contribution they each made to the work of the Committee during the years they served and thank them both for their work.

We welcome the opportunity we have had during the year to meet with our investors to discuss our remuneration arrangements and we thank the shareholders who met with us for their valuable contributions and insights into the way we think about remuneration. We were delighted to have received the ICSA Excellence in Governance Award for Best Remuneration Report in FTSE 100 in 2014.

Yours sincerely,

Joseph Papa

Chairman of the Remuneration Committee

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CORPORATE GOVERNANCE

Remuneration report ***continued***

Measure in our Variable Pay Plans	Link to Strategic Priorities
Financial measures in Annual Incentive Plans	
Revenue, Trading profit, Cash	We need to generate cash in our Established Markets to be able to invest in Emerging & International 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	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	We need to attract and retain the right people to achieve our strategy through improving our operating model.

Customer	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 Cash flow	Cash flow from our Established Markets is necessary in order to fund growth in Emerging & International Markets, innovation, organic growth and acquisitions.
Revenue in Emerging & International markets	Our long-term strategy depends on our ability to grow in Emerging & International Markets.
TSR	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 83 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 9 April 2015. The Implementation Report explains how the remuneration policy was implemented during 2014 and also how it is currently being implemented in 2015. Pages 85, and 88 to 90 have been audited by Ernst & Young LLP.

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 at least the next two years and will next be put to shareholder vote at the Annual General Meeting to be held in 2017. We will bring the policy report back to shareholders earlier in the event that we make any material change to the remuneration policy or shareholders do not approve the annual report on remuneration. 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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The Implementation Report

Remuneration Committee

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 9 April 2015.

Current Members in 2014

Joseph Papa	Committee Chairman
Virginia Bottomley	Independent Non-executive Director
Brian Larcombe	Senior Independent Non-executive Director
Roberto Quarta (from 10 April 2014)	Chairman of the Board

1. Richard De Schutter left the Committee on 10 April 2014 on his retirement from the Board.
2. Pamela Kirby left the Committee on 31 July 2014 on her retirement from the Board.

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

3. Vinita Bali will join the Committee on 1 April 2015.

Key activities

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

Approval of all share plans operating throughout the Group.

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

2015 focus

Determination of payouts under cash incentive and long-term incentive plans vesting in 2015.

Determine targets to apply to cash incentive and share plan awards in 2015.

Review the overall structure of our remuneration policies to ensure they still support our business strategy.

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 oversees the use of shares in all executive and all-employee plans.

Reporting and Engagement with shareholders on

Remuneration Matters

Approval of Directors remuneration report ensuring compliance with related governance provisions

Continuance of constructive engagement on remuneration issues with shareholders.

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

CORPORATE GOVERNANCE

Remuneration report ***continued***

Activities of the Remuneration Committee in 2014 and since the year end

In 2014, we held four physical meetings and determined four 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, Towers Watson without management present. Our programme of work in 2014 was as follows:

Month	Activity
Early February (Approval of salaries, awards and payouts in 2014)	Noted the financial results for 2013 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 2014, approving the third performance measure for the Performance Share Plan 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 2011 and reviewed the performance of long-term awards granted in 2012 and 2013 Reviewed benchmark data increases to salaries across the Group and approved salary increases for Executive Directors and Executive Officers with effect from 1 April 2014 Approved the text of the Remuneration report Reviewed and approved the business plan for the Remuneration Committee for 2014.
Late February (by telephone) (Final approval of	Approved the final targets for the short-term and long-term incentive plans for 2014 Approved the final text of the Remuneration report.

Remuneration report)

Late July (Mid-year Review of Remuneration Arrangements)	Reviewed the shareholder response and support for the Remuneration Policy and Report at the Annual General Meeting 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 Approved the schedule of share awards made since the previous meeting Approved minor changes to the rules of various share plans in line with local legislative changes Reviewed the performance of long-term awards granted in 2012, 2013 and 2014.
December (Review of Remuneration Strategy)	Received a report from the Chairman of the Remuneration Committee on recent engagement with shareholders Approved the Remuneration Strategy for 2015 Considered the first draft of the Remuneration report for 2014 Reviewed and considered the principles for determining payouts under the short-term and long-term plans due to vest in 2015 Approved the schedule of share awards made since the previous meeting.

Four written resolutions were approved during the year relating to the approval of two leaver and two recruitment arrangements for Executive Officers.

Since the year end, we have also reviewed the financial results for 2014 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 2015. 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 2012. Finally, we approved the wording of this Directors remuneration report.

During the year, the Remuneration Committee received information and advice from 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 and in determining the third performance measure for the Performance Share Programme. The fees paid to Towers Watson for Remuneration Committee advice during 2014, charged on a time and expense basis was £39,745 in total. Towers Watson also provided other human resources and compensation advice to the Company for the level below the Board. 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

	Fixed pay			Annual variable pay	Hybrid	Long-term variable pay		Other items in the natur of remuneration	
Director	Base salary	Payment in lieu of pension	Taxable benefits	Annual Incentive Plan cash	Annual Incentive Plan equity	Performance Share Plan	Share Option Plan	All-Employee Share Plans	One-Off Awards
Olivier Bohuon Appointed 1 April 2011									
2014	$1,464,515	$439,354	$286,341	$952,318	$811,006	$2,641,455			
2013	$1,425,559	$427,668	$112,637	$1,793,584	$933,410	0	0		
Julie Brown Appointed 4 February 2013									
2014	$840,487	$252,146	$38,494	$470,373	$465,437				
2013	$708,450	$212,536	$22,510	$858,978	$390,800			$5,684	$838,266

These figures have been calculated as follows:

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. Prior years are restated to reflect amounts not known at the date of signing the previous annual report.

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 87 and 88 of this report.

Performance Share Plan: the value of shares vesting that were subject to performance over the three-year period ending on 31 December in the relevant financial year, based on an estimated share price of 1,053 pence per share, which was the average price of a share over the last quarter of 2014.

Share Option Plan: the embedded gain of options vesting that were subject to performance over the three-year period ending on 31 December in the relevant financial year.

All-Employee Share Plans: the gain on the date of grant for SAYE awards (these are only subject to an employment condition and therefore the total value is captured in the year of grant), reflecting the 20% discount at which options are granted in the relevant financial year.

One-off awards: the total face value of shares awarded to Julie Brown on appointment in 2013 as described on page 89 of this report (these awards are only subject to an employment condition and therefore the total value is captured in the year of award).

Total: the sum of the above elements.

The amounts for 2014 have been converted into US$ for ease of comparability using the exchange rates of £ to US$1.6464 and to US$1.3263, and for the prior years using exchange rates disclosed in previous years accounts.

Base salary

With effect from 1 April in each year, Executive Directors were paid the following base salaries:

	2013	**2014**
Olivier Bohuon	1,081,500	**1,111,782**
Julie Brown	£500,000	**£514,000**

In February 2015, 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 2015 to the following:

Olivier Bohuon	1,145,135
Julie Brown	£529,420

Payment in lieu of pension

In 2014, 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 2015.

Benefits

In 2014, 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. Oliver Bohuon also received assistance with travel costs between London and Paris. The same arrangements will apply in 2015. The following table summarises the value of benefits on an element-by-element basis in respect of 2013 and 2014.

	Olivier Bohuon		Julie Brown	
	2013	**2014**	2013	**2014**
Health Cover	£12,088	£20,642	£1,130	£1,144
Car and fuel allowance	18,050	18,751	£13,270	£14,640
Financial	£4,893	£24,053		
consultancy advice (ii)	19,816	101,926	£0	£7,597
Travel costs	£19,407	£28,537	£0	£0
Subscriptions	£3,504 (i)	£3,473	£0	£0

(i) Previous years are restated to reflect amounts not known at the date of signing of the previous Annual Report.
(ii) The level of financial consultancy advice fees for Olivier Bohuon in 2014 reflects that he is a French national working in a global role of a company headquartered in the UK.

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CORPORATE GOVERNANCE

Remuneration report ***continued***

Annual Incentive Plan

During 2014, the Annual Incentive Plan for Executive Directors was based on the achievement of specific financial and business objectives as follows:

Financial objectives		70%
Revenue 30%		
Trading profit 30%		
Trading cash 10%		
Business objectives		30%
Re-investment and		
	Olivier Bohuon	Julie Brown
Group Optimisation	5%	10%
	Olivier Bohuon	Julie Brown
Business		
People		
Customer	25%	20%

The Board have considered whether it would be in the best interests of the Company and its shareholders to disclose the precise targets agreed for each of the performance measures in 2014. The targets for each year are set within the context of the Group s five-year plan, which is updated at least annually. If we were to disclose the precise targets for one year of the plan, this would give information to our competitors about our long-term plans, which they could use to compete against us, for example by re-timing the launch of new products or extension into new growth areas. This could be detrimental to our commercial performance both in 2015 and going forward. The Board has concluded that even though the actual results for 2014 are known and published, it would be commercially sensitive to disclose what the precise targets determined at the beginning of 2014 were. At present, the Board would not be in a position to declare these targets at a later date, but will keep this under review.

In early 2015, the Remuneration Committee conducted an assessment of the Executive Directors against their 2014 financial and business objectives. In doing so the Remuneration Committee focused on the need to balance short-term growth whilst building the platform to deliver sustainable strong performance and greater shareholder value over the medium-term.

In summary, the performance of the Executive Directors against the targets set for 2014 was as follows:

Below

	threshold	Between target and threshold	Between target and maximum	Above maximum
Revenue (30%)		X		
Trading profit (30%)	X			
Trading cash (10%)	X			
Business objectives (30%) Olivier Bohuon			X	
Business objectives (30%) Julie Brown			X	
Multiplier (+/- 10%) Olivier Bohuon	The Remuneration Committee agreed not to apply the multiplier to the annual incentive assessment in respect of 2014.			
Multiplier (+/- 10%) Julie Brown				

Financial Objectives

Over the period, revenue was $4,617 million, trading profit was $1,055 million and trading cash flow $781 million. When set against the financial objectives for 2014, revenue performance was between target

and threshold, while trading profit and trading cash performance was below threshold.

The Committee believes, whilst some of the underperformance on trading profit and cash is attributable to the RENASYS hold in the US, the financial outturn partly reflects the impact of important strategic decisions to invest more in the business during 2014 to deliver longer-term, sustainable value. Decisions to invest in R&D, Emerging & International Markets, the sales force, particularly in wound, and new, disruptive business models in 2014 all impacted profitability for the year, but strengthened the platform for future growth. Trading cash flow was impacted as we made significant investment in instrument sets to support growth rebuilt our wound safety stock following flooding in our Hull, UK factory and increased the holdings of Advanced Wound Bioactives products to meet anticipated demand.

Business Objectives

Under Olivier s strong leadership, and consistent with the strategic plan he initiated in 2011, the Group made significant progress in 2014.

Olivier is delivering on his strategy to rebalance Smith & Nephew by strengthening our higher growth platforms, which currently represent more than half the business, up from just 35% three years ago. Advanced Wound Bioactives delivered strong double-digit growth, Sports Medicine Joint Repair performed well, Trauma & Extremities made good progress, and the Emerging & International Markets business increased underlying revenue by 17%. He also oversaw a successful turnaround in US Orthopeadic Reconstruction and addressed issues in Europe and AWM where we faced headwinds.

In addition to maintaining an increased level of investment in R&D and supporting new products, he introduced new, disruptive commercial models in orthopaedic reconstruction and the Emerging & International Markets to position Smith & Nephew to fulfil the unmet needs of customers.

Finally, he continues to deliver on our strategic priority to supplement organic growth through acquisition. He led the acquisition of ArthroCare Corporation for $1.7 billion, Smith & Nephew s largest deal to date. This has strengthened our Sports Medicine business and we will use our global presence to drive substantial new growth. He also oversaw the integration of our recent Emerging & International Markets acquisitions.

The Remuneration Committee has therefore determined that Olivier performed between target and maximum in 2014 with regard to his business objectives.

Under Julie s stewardship we continued our disciplined approach to finance, applying our cash allocation framework, managing trading cash effectively to support investments and initiating a major Group optimisation programme. Led by Julie, this will realise at least $120 million of annual savings. This is progressing as planned, with early results including rationalising our global property portfolio and making major savings through better procurement processes. She led a successful private placement and has overseen an improvement in our corporate tax rate with further progress expected.

She is leading a finance transformation project, establishing new transactional systems across Europe and new Business Information tools, which is improving visibility and consistency of financial information in the business.

The Remuneration Committee has therefore determined that Julie performed between target and maximum in 2014 with regard to her business objectives.

It is not appropriate to disclose the precise personal targets set as a number of the measurements continue to apply into 2015 and would be commercially sensitive if known by our competitors. At present, the Board would not be in a position to declare these targets at a later date, but will keep this under review. The Remuneration Committee did highlight a number of their achievements as follows:

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Commentary on 2014 performance

Reinvestment and Group Optimisation

Olivier Bohuon

Increased business agility and efficiency, he has delivered annualised savings of $146 million for reinvestment in higher-growth platforms, including Emerging & International Markets. Ensured higher investment levels maintained in R&D and strong pipeline of new products including expanding JOURNEY II knee system and new Sports Medicine and Trauma & Extremities systems. Initiated Group optimisation programme to achieve further savings, including optimising locations.

Julie Brown

Leading implementation of new Group optimisation programme to achieve $120 million of annual savings, with programme on plan at year-end. Oversaw tax improvement with 220bps reduction in full-year effective rate achieved since the end of 2012 and further progress expected.

Business objectives

Olivier Bohuon

Completed $1.7 billion acquisition of ArthroCare Corporation, strengthening our Sports Medicine business with technology and products and strategy to drive substantial new growth through our global platform. Implemented leaner corporate structure, including one managing director across markets outside of the US, to enable better focus on the customer.

Julie Brown

Maintained rigorous oversight of investment performance across recent acquisitions including Advanced Wound Bioactives business acquired at the end of 2012, which delivered 15% growth in 2014 and Emerging & International Markets acquisitions in Brazil, Turkey and India, and the acquisition of ArthroCare.

People

Olivier Bohuon

Employee engagement surveys demonstrated significant improvements in Strategic Direction, Empowerment, Cross-business Coordination and Customer Focus across the Group. Achieved first Great Place to Work accreditation.

Julie Brown

Delivered structural and cultural transformation programme across finance function, and improved quality of management information to support decision making across the Group.

Customer

Olivier Bohuon

Julie Brown

Delivered new business models to meet the unmet needs of the customer including Syncera, a new commercial solution for Orthopaedic Reconstruction, and a mid-tier organisation for the Emerging & International Markets. These challenge the status quo, widening access to market and giving customers new economic options as they seek to improve the quality of life for their patients. Set the tone from the top and ensured strong ethics and compliance performance across the Group.

Represented the Group with investors and financial analysts, gaining strongly positive feedback. Hosted CFO roundtable events in New York City, and presented at investor and other high-profile conferences. Introduced new financial disciplines with the development of group-wide Minimum Acceptable Practices. Refinanced the Company through US Private Placement, term loans and revolving credit facility.

The Remuneration Committee also considered whether to apply the multiplier to the annual incentive assessment of Olivier Bohuon and Julie Brown and agreed that no multiplier was appropriate in respect of 2014.

In summary, as a result of the performance described above, the Remuneration Committee determined that the following awards be made under the Annual Incentive Plan in respect of performance in 2014:

Executive Director	Cash Component		Equity Component	
	% of salary	Amount	% of salary	Amount
Olivier Bohuon	65	718,026	55	611,480
Julie Brown	56	£285,698	55	£282,700

As a result of the 2014 performance assessment for both Olivier Bohuon and Julie Brown, the first tranche of the Equity Incentive Award made in 2014, the second tranche of the Equity Incentive Award made in 2013 and the third tranche of the Equity Incentive Award made in 2012 (to Olivier Bohuon only) will vest.

Annual Incentive Plan 2015

The Remuneration Committee has also reviewed the Annual Incentive Plan arrangements for 2015 and has determined that the following performance measures and weightings will apply to the financial and business objectives in 2015:

Financial objectives	70%
Revenue 30%	
Trading profit 30%	
Trading cash 10%	
Business objectives	30%
Business process	
People	
Customer	

The Board has determined that the disclosure of performance targets at this time is commercially sensitive. As explained on page 96, 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. At present, the Board would not be in a position to declare these targets at a later date, but will keep this under review.

For the financial performance measures, Target is set at target performance as approved by the Board in the Budget for 2015. Threshold and Maximum are set at +/ 3% from the target for revenue and trading profit measures and at +/ 10% for the cash flow measure.

Details of awards made under the Equity incentive Programme

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 in 2014 are shown below. The performance conditions and performance periods applying to these awards are detailed above.

Date granted	Number of shares under award	Date vesting
Olivier Bohuon		
7 March 2014	61,683 ordinary shares	1/3 on 7 March 2015 1/3 on 7 March 2016 1/3 on 7 March 2017
Julie Brown		
7 March 2014	26,497 ordinary shares	1/3 on 7 March 2015 1/3 on 7 March 2016 1/3 on 7 March 2017

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CORPORATE GOVERNANCE

Remuneration report *continued*

The precise awards granted in 2015 in respect of service in 2014 will be announced when the awards are made and will be disclosed in the 2015 Annual Report.

Performance Share Programme grants

Performance share awards in 2014 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 2014 and will vest subject to performance and continued employment in 2017. 50% of the award will vest subject to free cash flow performance, 25% to revenue in Emerging & International Markets and 25% to TSR.

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 free cash flow performance will vest as follows:

Cumulative free cash flow	Award vesting as % of salary
Below $1.64bn	Nil
$1.64bn	23.75%
$1.88bn	47.5%
$2.12bn or more	95%

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

Revenue in Emerging & International Markets is defined as cumulative revenue over a three-year period opening 1 January 2014 from our Emerging & International Markets. The 25% of the award that will be subject to revenue in Emerging & International Market performance will vest as follows:

Revenue in Emerging & International 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 & International Markets as this will give commercially sensitive information to our competitors concerning our growth plans in Emerging & International Markets, which they could use against us to launch new products and enter new markets. This would be detrimental to our business in Emerging & International Markets, which are key to our success overall. Target is set at target cumulative revenues from Emerging & International Markets in the corporate plan approved by the Board for the three years commencing 1 January 2014. Threshold and Maximum are set at +/ 15% from target. At present, the Board would not be in a position to declare these targets at a later date, but will keep this under review.

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 2014 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 2014 awards comprises of the following companies: Baxter, Becton Dickinson, Boston Scientific, CR Bard, Coloplast, Conmed, Covidien, Edwards life Sciences, Medtronic, Nobel Biocare, Nuvasive, Orthofix, Stryker, St Jude Medical, Wright Medical and Zimmer.

The Group s TSR performance and its performance relative to the comparator group is independently monitored and reported to the remuneration Committee by Towers Watson. TSR is calculated in common currency using a three-month averaging period at the start and end of the performance period. The Company has established protocols for dealing with companies that cease to be listed or merger and acquisition activity within the peer group.

Performance Share Programme 2015

Performance share awards will be made in 2015 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 2015 and will vest subject to performance and continued employment in 2018. Vesting will be subject to the same three performance measures as applies to the awards made in 2014 using the same definitions and same comparator group. 50% of the award will vest subject to free cash flow performance, 25% to revenue in Emerging & International Markets and 25% to TSR.

The 50% of the award that will be subject to free cash flow performance will vest as follows:

Cumulative free cash flow	Award vesting as % of salary
Below $1.58bn	Nil
$1.58bn	23.75%
$1.81bn	47.5%
$2.05bn or more	95%

The free cash flow performance measure target for 2015 is lower than the same target in 2014, primarily due to exchange rate movement, as well as the continued impact of the RENASYS hold in the US and restructuring charges associated with the Group Optimisation Plan, both of which were not factored in when setting the prior year target.

Vesting of Awards made in 2012

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 2012. 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 2012.

50% of the award was based on the Company s TSR performance relative to a bespoke peer group of companies in the medical devices sector. Over the three-year period ending 31 December 2014, the Company was ranked 7th out of 17 companies in the comparator group. This part of the award therefore vested at 58.5%.

50% of the award was based on free cash-flow performance. Over the same three-year period, the adjusted cumulative cash free cash-flow was $1.642 billion. These adjustments include items such as Board approved M&A including the acquisition of Healthpoint and ArthroCare but do not include items such as the proceeds of the sale of the Gilberdyke business or the repayment of the Bioventus loan which are excluded from free cash. This part of the award therefore vested at 55.5%.

Overall therefore, the conditional awards made in 2012 will vest at 57% on 8 March 2015 as follows:

Director	Date of grant	Number of shares under award	Number vesting
Olivier Bohuon	8 March 2012	267,304	152,363

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Summary of scheme interests awarded during the financial year

	Olivier Bohuon		Julie Brown	
Basis on which award is made	Number of shares	Face value	Number of shares	Face value
Annual Equity Incentive Award (see page 86)	61,683	702,975	26,497	£250,000
Performance Share Award (see page 88)				
190% base salary at maximum	180,304	2,054,850	100,688	£950,000
95% base salary at target	90,152	1,027,425	50,344	£475,000

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 7 March 2014 was 943.5 pence.

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 below. These awards were granted under the Global Share Plan 2010. The performance conditions and performance periods applying to these awards are detailed on pages 96 to 97.

	Date granted	Number of ordinary shares under award	Date of vesting
Olivier Bohuon	8 March 2012[(i)]	267,304	8 March 2015
	7 March 2013	240,928	7 March 2016
	7 March 2014	180,304	7 March 2017
Julie Brown	7 March 2013	132,866	7 March 2016
	7 March 2014	100,688	7 March 2017

(i) On 3 February 2015, 43% of the award granted to Olivier Bohuon 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
Julie Brown	17 September 2013	2,400 ordinary shares	1 November 2018	1 November 2018 to 30 April 2019	£6.25

Details of one-off awards

Details of the award granted to Julie Brown on joining the Company to compensate her for shares forfeited on leaving her former company are shown below. This award was made under Listing Rule 9. There are no performance conditions attaching to these shares other than continued service.

Director	Date granted	Number of shares under award	Date of vesting
Julie Brown	7 March 2013	25,000 ordinary shares	4 February 2016

Single total figure on remuneration Chairman and Non-executive Directors

Director	Basic annual fee[i]		Senior Independent Director/ Committee fee		Intercontinental travel fee		**Total**	
	2013	**2014**	2013	**2014**	2013	**2014**	2013	**2014**
Roberto Quarta[ii]	£4,846	**£334,673**	N/A	**N/A**	£0	**£7,000**	£4,846	**£341,673**
Vinita Bali[iii]	N/A	**£5,250**	N/A	**N/A**	N/A	**£3,500**	N/A	**£8,750**
Ian Barlow	£66,150	**£66,150**	£15,000	**£15,000**	£7,000	**£7,000**	£88,150	**£88,150**
Virginia Bottomley	£66,150	**£66,150**	N/A	**N/A**	£7,000	**£7,000**	£73,150	**£73,150**
Sir John Buchanan[iv]	£420,000	**£112,307**	N/A	**N/A**	N/A	**N/A**	£420,000	**£112,307**
Michael Friedman	$126,000	**$126,000**	N/A	**$11,250**	$28,000	**$35,000**	$154,000	**$172,250**
Pamela Kirby[v]	£66,150	**£36,750**	£15,000	**£8,750**	£7,000	**N/A**	£88,150	**£45,500**

Brian Larcombe	£66,150	**£66,150**	N/A	**£10,865**	£7,000	**£7,000**	£73,150	**£84,015**
Joseph Papa	$126,000	**$126,000**	$27,000	**$27,000**	$28,000	**$35,000**	$181,000	**$188,000**
Ajay Piramal(vi)	£66,150	**£10,500**	N/A	**N/A**	£10,500	**N/A**	£76,650	**£10,500**
Richard De Schutter(vii)	$126,000	**$33,692**	$27,000	**$7,580**	$35,000	**$14,000**	$188,000	**$55,273**

(i) 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.

(ii) Appointed to the Board on 4 December 2013 and as Chairman of the Company on 10 April 2014. (iii) Appointed to the Board on 1 December 2014. (iv) Retired from the Board on 10 April 2014.

(v) Retired from the Board on 31 July 2014 (vi) Retired from the Board on 24 March 2014 (vii) Retired from the Board on 10 April 2014 (vi) Erik Engstrom is not included in the table because he joined the Board on 1 January 2015.

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CORPORATE GOVERNANCE

Remuneration report ***continued***

Chief Executive Officer s remuneration compared to employees generally

The percentage change in the remuneration of the Chief Executive Officer between 2013 and 2014 compared to that of employees generally is as follows:

	Base salary % change 2014	Benefits % change 2014	Annual cash bonus % change 2014
Chief Executive Officer	3.0	154.0	-46.9
Average for all employees	3.0	N/A	

(i) The average cost of wages and salaries for employees generally increased by 1.57% in 2014 (see Notes 2.4 and 3.1 of the Notes 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 2014.

Outside Directorships

Olivier Bohuon is a Non-executive Director of Virbac SA and received 21,000 in respect of this appointment in 2014.

Directors interests in ordinary shares

Beneficial interests of the Executive Directors in the ordinary shares of the Company are as follows:

	Olivier Bohuon			Julie Brown	
	1 January 2014	**31 December 2014**	23 February 2015(i)	1 January 2014	**31 December 2014**
Ordinary shares	111,238	**210,974**	210,974(iii)	0	**25,000**
	151,698	**0**	0	2,400	**2,400**

Share options					
Performance share awards[ii]	735,779	**688,536**	573,595	132,886	**233,554**
Equity Incentive awards	143,387	**147,114**	147,114	0	**26,497**
Other awards	66,666	**0**	0	75,000	**50,000**

(i) The latest practicable date for this Annual Report.
(ii) These share awards are subject to further performance conditions before they may vest, as detailed on pages 96 to 97.
(iii) The ordinary shares held by Olivier Bohuon on 23 February 2015 represent 304.9% of his base annual salary.
(iv) The ordinary shares held by Julie Brown on 23 February 2015 represent 87.8% of her base annual salary.
(v) This option was granted under the Smith & Nephew ShareSave Plan (2012).

The beneficial interest of each Executive Director is less that 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.

Beneficial interests of the Chairman and Non-executive Directors in the ordinary shares of the Company are as follows:

Director	1 January 2014 (or date of appointment) if later	**31 December (or date of retirement if earlier)**	23 February 2015[i]	Shareholding as % of annual fee[ii]
Roberto Quarta	0	**15,136**	15,136	44.7%
Vinita Bali	0	**0**	0	0%
Ian Barlow	18,232	**18,403**	18,403	328.6%
Virginia Bottomley	17,820	**18,056**	18,056	322.4%
Sir John Buchanan	166,337	**166,337**		
Erik Engstrom	N/A	**15,000**	15,000	267.8%
Michael Friedman[iii]	8,624	**8,822**	8,822	127.7%
Pamela Kirby	15,232	**15,232**		
Brian Larcombe	40,212	**40,368**	40,368	720.7%
Joseph Papa[iii]	12,799	**12,997**	12,997	188.2%
Ajay Piramal	240	**240**		
Richard De Schutter	220,299	**220,299**		

(i) The latest practicable date for this Annual Report.
(ii) Calculated using the closing share price of 1,181p per ordinary share and $36.49 per ADS on 23 February 2015, and an exchange rate of £1/$1.5449.
(iii) 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 that 1% of the ordinary share capital of the Company.

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Relative importance of spend on pay

The following table sets out the total amounts spent in 2014 and 2013 on remuneration, the attributable profit for each year and the dividends declared and paid in each year.

	For the year to 31 December 2014	For the year to 31 December 2013	% change
Attributable profit for the year	$501m	$556m	-9.89%
Dividends paid during the year	$250m	$239m	4.60%
Share buyback(i)	$75m	$226m	-66.81%
Total Group spend on remuneration	$1,237m	$998m	23.95%

(i) 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 on page 154 for further information.

Total Shareholder Return

A graph of the Company s TSR performance compared to that of the FTSE 100 index is shown below in accordance with Schedule 8 to the Regulations.

Six 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.

Six Year Total Shareholder Return

(measured in US dollars, based on monthly spot values)

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CORPORATE GOVERNANCE

Remuneration report *continued*

Table of historic data

The following table details information about the pay of the Chief Executive Officer in the previous five years:

				Long-term rates against maxi
Year	Chief Executive Officer	Single figure of total remuneration	Annual Cash Incentive payout against maximum %	Performance shares %
2014	Olivier Bohuon	$6,594,989	65	57
2013	Olivier Bohuon	$4,692,858[(iv)]	84	N/A
2012	Olivier Bohuon	$4,956,771	84	N/A
2011	Olivier Bohuon[(i),(iii)]	$7,442,191	68	N/A
2011	David Illingworth[(ii)]	$3,595,787	37	27
2010	David Illingworth	$4,060,707	57	70
2009	David Illingworth	$4,406,485	59	46

(i) Appointed Chief Executive Officer on 1 April 2011
(ii) Resigned as Chief Executive Officer on 1 April 2011
(iii) 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
(iv) Prior years are restated to reflect amounts not known at the date of signing the previous annual report.

Implementation of remuneration policy in 2015

The Remuneration Committee proposes to make no changes to the way that the remuneration policy is implemented in 2015 from how it was implemented in 2014, other than increasing base salaries in line with salary increases across the Group, as explained on page 85 and setting new targets for the Annual Incentive Plan and the Performance Share Programme, as explained on page 88.

Statement of voting at Annual General Meeting held in 2014

At the Annual General Meeting held on 10 April 2014, votes cast by proxy and at the meeting and votes with-held in respect of the two votes on the Directors Remuneration Policy and the Directors remuneration report were as follows:

Resolution	Votes for	% for	Votes against	% against	Total votes validly cast	Votes withheld
Approval of Directors Remuneration Policy	586,941,104	93.50%	40,818,512	6.50%	627,759,616	1,990,842
Approval of Directors remuneration report	615,870,158	97.97%	12,774,146	2.03%	628,644,304	1,106,154

Joseph Papa, Chairman of the Remuneration Committee has met with a number of shareholders in previous years to discuss remuneration matters and met and held calls with the holders of around 28% of the shares in 2013. In 2014, he offered again to meet with shareholders to discuss remuneration matters. Very few shareholders accepted his invitation to meet, acknowledging that shareholders were broadly happy with our remuneration arrangements and had no concerns that they wished to discuss. He did however meet with shareholders holding around 2% of the share capital, who also indicated their broad support for our remuneration arrangements. Joseph Papa is always happy to meet and talk to shareholders who wish to discuss remuneration matters with him.

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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 59.

Compensation paid to Senior Management in respect of 2014, 2013 and 2012 was as follows:

	2012	2013	2014
Total compensation (excluding pension emoluments, but including cash payments under the performance-related incentive plans)	$15,249,000	$14,186,000	$12,725,000
Total compensation for loss of office	$0	$0	$2,664,000
Aggregate increase in accrued pension scheme benefits	$229,000	$257,000	$16,000
Aggregate amounts provided for under supplementary schemes	$537,000	$414,000	$507,000

As at 23 February 2015, the Senior Management owned 376,202 shares and 100,855 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 2015 by members of Senior Management are as follows:

	Share awards granted during the year	Total share awards held as at 23 February 2015
Equity Incentive awards	209,623	400,695
Performance Share awards	582,474	1,397,597
Conditional share awards under the Global Share Plan 2010	11,596	87,830
Options under Employee ShareSave plans and under the Global Share Plan 2010	2,042	4,442

Dilution headroom

The Remuneration Committee ensures that at all times the number of new shares which may be issued under any share-based plans, including all-employee plans, does not exceed 10% of the Company s issued share capital over any rolling ten-year period (of which up to 5% may be issued to satisfy awards under the Company s discretionary plans). The Company monitors headroom closely when granting awards over shares taking into account the number of options or shares that might be expected to lapse or be forfeited before vesting or exercise. In the event that insufficient new shares are available, there are processes in place to purchase shares in the market to satisfy vesting awards and to net-settle option exercises.

Over the previous 10 years (2005 to 2014), the number of new shares issued under our share plans has been as follows:

All-employee share plans	7,991,875 (0.89% of issued share capital as at 23 February 2015)
Discretionary share plans	37,853,815 (4.23% of issued share capital as at 23 February 2015)

By order of the Board, on 25 February 2015

Joseph Papa

Chairman of the Remuneration Committee

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CORPORATE GOVERNANCE

Remuneration report ***continued***

The Policy Report

The Remuneration Committee presents the Directors remuneration policy report, which was approved by shareholders at the Annual General Meeting held on 10 April 2014.

Future policy table

Executive Directors

The following table and accompanying notes explain the different elements of remuneration we pay to our Executive Directors:

All figures in this policy table are as at 2014 when the Policy Report was approved by shareholders

How the component supports the short- and long-term strategy of the Company	How the component operates
Base salary and benefits	
Base salary	
We are a FTSE 50 listed company, operating in over 100 countries around the world. Our strategy to generate cash from Established Markets in order to invest for growth in 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.

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.

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.

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:	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.
Olivier Bohuon 1,111,782	
Julie Brown £514,000	
The factors noted in the previous column will be taken into consideration when making increases to base salary and when appointing a new Director.	
In normal circumstances, base salary increases for Executive Directors will relate to the geographic market and peer group. In addition, the average increases for employees across the Group will be taken into account. The Remuneration Committee retains the right to approve higher increases when there is a substantial change in the scope of the Executive Director s role. A full explanation will be provided in the Implementation Report 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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CORPORATE GOVERNANCE

Directors remuneration report ***continued***

Future policy table

Executive Directors *continued*

How the component supports the short- and long-term strategy of the Company	How the component operates
Annual incentives	
Annual Incentive Plan Cash Incentive	
To motivate and reward the achievement of specific annual financial and business objectives related to the Company s strategy and sustained through a clawback mechanism explained more fully in the notes.	The 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 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 cash component is paid in full after the end of the performance year.
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.	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.

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.

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 $\frac{1}{3}$, $\frac{1}{3}$, $\frac{1}{3}$ 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 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.
The performance measures which determine the level of vesting of the Performance Share Awards are linked to our corporate strategy.	Awards may be subject to clawback in the event of material financial misstatement or misconduct.
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.	Participants will receive an additional number of shares equivalent to the amount of dividend payable per vested share during the relevant performance period.
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.	

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. 100% salary awarded for target 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.
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. 50% of salary awarded for target performance. 65% of salary awarded for maximum performance. Performance assessed against individual performance which includes an element of Group financial targets.	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. 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.
Annual awards: 47.5% of salary for threshold performance. 95% of salary for target performance. 190% of salary for maximum performance.	Currently: 50% of the award vests on achievement of a three-year cumulative free cash-flow target 25% of the award vests subject to three-year Total Shareholder Return (TSR) at median performance relative to industry peers 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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CORPORATE GOVERNANCE

Remuneration 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 change made has been to introduce a third performance measure to our Performance Share Programme.

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

Chief Executive Officer

Chief Financial Officer

Total Remuneration by Performance Scenario for 2014 Financial Year

Chief Executive Officer Chief Financial Officer

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-exisiting 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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CORPORATE GOVERNANCE

Remuneration 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 £1.5m 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 Chairman 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 salary levels in 2014, when the Policy report was approved by shareholders

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CORPORATE GOVERNANCE

Remuneration report ***continued***

Notes to Future policy table 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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Directors responsibilities for the accounts

The Directors are responsible for preparing the Group and Company accounts in accordance with applicable UK law and regulations. As a consequence of the Company s ordinary shares being traded on the New York Stock Exchange (in the form of American Depositary Shares) the Directors are responsible for the preparation and filing of an annual report on Form 20-F with the US Securities and Exchange Commission.

The Directors are required to prepare Group accounts for each financial year, in accordance with the International Financial Reporting Standards (IFRS) as adopted by the European Union which present fairly the financial position of the Group and the financial performance and cash flows of the Group for that period. In preparing those Group accounts, the Directors are required to:

- select suitable accounting policies in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* and then apply them consistently;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Group s financial position and financial performance; and
- state that the Group has complied with IFRS, subject to any material departures disclosed and explained in the accounts.

Under UK law the Directors have elected to prepare the Company accounts in accordance with UK Generally Accepted Accounting Practice (UK Accounting Standards and applicable law), which are required by law to give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing the Company accounts, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;

- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the accounts; and

- prepare the accounts on a going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors confirm that they have complied with the above requirements in preparing the accounts.

The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Group and the Company and enable them to ensure that the accounts comply with the Companies Act 2006 and, in the case of the Group accounts, Article 4 of the IAS Regulation. They are also responsible for safeguarding the assets of the Group and the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Group s website. It should be noted that information published on the internet is accessible in many countries with different legal requirements. Legislation in the UK governing the preparation and dissemination of accounts may differ from legislation in other jurisdictions.

Fair, Balanced and Understandable

As required by the UK Corporate Governance Code, the Directors confirm that they consider that the Annual Report, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company s performance, business model and strategy. When arriving at this conclusion the Board was assisted by a number of processes including:

- The Annual Report is drafted and comprehensively reviewed by appropriate senior management with overall co-ordination by the Head of Financial Reporting;

- An extensive verification process is undertaken to ensure factual accuracy, with third party review by legal advisers; and

- The final draft is reviewed by the Audit Committee prior to consideration by the Board.

Directors responsibility statement pursuant to disclosure and transparency Rule 4

The Directors confirm that, to the best of each person s knowledge:

- the Group accounts in this report, which have been prepared in accordance with IFRS as adopted by the European Union and those parts of the Companies Act 2006 applicable to companies reporting under IFRS, give a true and fair view of the assets, liabilities, financial position and profit of the Group taken as a whole;

- the Company accounts in this report, which have been prepared in accordance with UK Generally Accepted Accounting Practice and the Companies Act 2006, give a true and fair view of the assets, liabilities, financial position and profit of the Company; and the Financial review and principal risks section and commentary on pages 34 to 39 contained in the accounts includes a fair review of the development and performance of the business and the financial position of the Company and the Group taken as a whole, together with a description of the principal risks and uncertainties that they face.

Going concern

The Group s business activities, together with the factors likely to affect its future development, performance and position are set out in the Financial review and principal risks section on pages 34 to 39. The financial position of the Group, its cash flows, liquidity position and borrowing facilities are described under Commentary on the Group cash flow statement section set out on page 115.

In addition, the Notes to the Group accounts include the Group s objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments and hedging activities; and its exposure to credit risk and liquidity risk.

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

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

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

Directors Report

The Directors Report has been prepared in accordance with the requirements of the Companies Act 2006.

By order of the Board, 25 February 2015

Susan Swabey

Company Secretary

FINANCIAL STATEMENTS

Critical accounting policies

The Group prepares its consolidated financial statements in accordance with IFRS as issued by the IASB and IFRS as adopted by the EU, the application of which often requires judgements to be made by management when formulating the Group s financial position and results. Under IFRS, the Directors are required to adopt those accounting policies most appropriate to the Group s circumstances for the purpose of presenting fairly the Group s financial position, financial performance and cash flows.

In determining and applying accounting policies, judgement is often required in respect of items where the choice of specific policy, accounting estimate or assumption to be followed could materially affect the reported results or net asset position of the Group; it may later be determined that a different choice would have been more appropriate.

The Group s significant accounting policies are set out in Notes 1 to 23 of the Notes to the Group accounts. Of those, the policies which require the most use of management s judgement are as follows:

Valuation of inventories

A feature of the Orthopaedic Reconstruction and Trauma & Extremities franchises (whose finished goods inventory makes up approximately 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 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 judgements on customer demand, effectiveness of inventory deployment, length of product lives, phase-out of old products and efficiency of manufacturing planning systems.

Impairment

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

Liability provisioning

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

Taxation

The Group operates in numerous tax jurisdictions around the world. Although it is Group policy to submit its tax returns to the relevant tax authorities as promptly as possible, at any given time the Group has unagreed years outstanding and is involved in disputes and tax audits. Significant issues may take several years to resolve. In estimating the probability and amount of any tax charge, management takes into account the views of internal and external 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.

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Independent auditor s US reports

Report of Independent Registered Public Accounting Firm to the Board of Directors and shareholders of Smith & Nephew plc

We have audited the accompanying group balance sheets of Smith & Nephew plc as of 31 December 2014 and 2013, and the related group income statements, group statements of comprehensive income, group cash flow statements and group statements of changes in shareholder s equity for each of the three years in the period ended 31 December 2014. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

Auditor s responsibility

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 audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Smith & Nephew plc at 31 December 2014 and 2013, and the consolidated results of its operations and its cash flows for each of the three years in the period ended 31 December 2014, in conformity with International Financial Reporting Standards as issued by the International Accounting Standards Board and International Financial Reporting Standards as adopted by the European Union.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Smith & Nephew plc s internal control over financial reporting as of 31 December 2014, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organisations of the Treadway Commission (2013 framework) and our report dated 25 February 2015 expressed an unqualified opinion thereon.

Ernst & Young LLP

London, England

25 February 2015

Report of Independent Registered Public Accounting Firm to the Board of Directors and shareholders of Smith & Nephew plc

We have audited Smith & Nephew plc s internal control over financial reporting as of 31 December 2014, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework), (the COSO criteria). Smith & Nephew plc s management is responsible 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 the company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

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 (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized 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, Smith & Nephew plc maintained, in all material respects, effective internal control over financial reporting as of 31 December 2014, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the group balance sheets of Smith & Nephew plc as of 31 December 2014 and 2013, and the related group income statements, group statements of comprehensive income, group cash flow statements and group statements of changes in equity for each of the three years in the period ended 31 December 2014 of Smith & Nephew plc and our report dated 25 February 2015 expressed an unqualified opinion thereon.

Ernst & Young LLP

London, England

25 February 2015

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FINANCIAL STATEMENTS

Independent auditor s UK report

Independent auditor s report to the members

of Smith & Nephew plc

Opinion on financial statements

In our opinion:

- the financial statements give a true and fair view of the state of the group and of the parent company s affairs as at 31 December 2014;
- the group financial statements give a true and fair view of the profit for the year ended 31 December 2014;
- the group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and IFRSs as adopted by the International Accounting Standards Board (IASB);
- the parent company financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice;
- the group and the parent company financial statements have been prepared in accordance with the requirements of the Companies Act 2006; and
- the group financial statements have been prepared in accordance with Article 4 of the IAS Regulation.

What we have audited

We have audited the financial statements of Smith & Nephew plc for the year ended 31 December 2014 which comprise:

Group	Company

The Group income statement

The Company balance sheet

The Group statement of comprehensive income

The related notes 1 to 9.

The Group balance sheet

The Group cash flow statement

The Group statement of changes in equity

The related notes 1 to 23.

As explained in Note 1 to the consolidated financial statements, the group in addition to applying IFRS as adopted by the European Union has also applied IFRS as issued by the International Accounting Standards Board (IASB). The financial reporting framework that has been applied in the preparation of the Company financial statements is the provisions of the Companies Act 2006 and United Kingdom Generally Accepted Accounting Practice.

Overview

Materiality	Overall Group materiality of $45 million which represents 5% of adjusted profit before tax
Audit scope	We performed an audit of the complete financial information of two components and audit procedures on specific balances for a further ten components.
	The 12 reporting components where we performed audit procedures accounted for 81% of the group s total assets, 64% group revenue and 85% of

	the group s profit before tax and 86% of the group s adjusted profit before tax.
Areas of focus	Recognition and measurement of provisions for litigation reserves and contingent liabilities
	Recognition and measurement of provisions for taxation
	Existence and valuation of inventory
	Timing of revenue recognition and measurement of related reserves
	Judgements determining purchase price allocation on acquisitions

Our application of materiality

We determined materiality for the group to be $45 million (2013: $45 million), which is calculated as 5% of adjusted profit before tax. We believe that profit before tax, adjusted for the items, as described below, provides us with a consistent year on year basis for determining materiality and is the most relevant performance measure to the stakeholders of the entity. Adjustments are made to profit before tax for acquisition related costs of $118m and restructuring and rationalisation expenses of $61m as highlighted in note 2.2 of the financial statements, as well as acquisition-related finance costs of $7m. This provided a basis for identifying and assessing the risk of material misstatement and determining the nature, timing and extent of further audit procedures.

On the basis of our risk assessments, together with our assessment of the group s overall control environment and other qualitative considerations, our judgement was that overall performance materiality (i.e. our tolerance for misstatement in an individual account or balance) for the group should be 75% (2013: 75%) of planning materiality, namely $33.75 million (2013: $33.75 million). Our objective in adopting this approach was to reduce to an appropriately low level the probability that the aggregate of total undetected and uncorrected misstatements for the accounts as a whole did not exceed our planning materiality.

Audit work at individual components is undertaken based on a percentage of our total performance materiality. The performance materiality set for each component is based on the relative size of the component and our view of the risk of misstatement at that component. In the current year the range of performance materiality allocated to components was $3.32m to $21.58m.

We agreed with the Audit Committee that we would report to the

Committee all audit differences in excess of $2.25 million (2013: $2.25 million), as well as differences below that threshold that, in our view warranted reporting on qualitative grounds.

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in the light of other relevant qualitative considerations.

This page does not form part of Smith & Nephew s Annual Report and Form 20-F as filed with the SEC.

Scope of our audit

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the group s circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Following our assessment of the risk of material misstatement to the group financial statements, we selected 12 components which represent the principal business units within the group s two reportable segments. Two of these components were subject to a full audit and ten were subject to a partial scope audit where the extent of audit work was based on our assessment of the risks of material misstatement outlined below and the materiality of the location s business operations relative to the group. The scope of these components may not have included testing of all significant accounts of the location but will have contributed to the coverage of significant accounts tested for the group. Partial scope component testing of significant risks is primarily focused on the inventory and revenue recognition risks as tax, litigation

and purchase price allocation risks are audited centrally. For the remaining components, we performed other procedures to test or assess that there were no significant risks of material misstatement in these components in relation to the group financial statements. The components subject to full audit or partial scope audit procedures make up 81% of the group s total assets, 64% of the group s revenue, 85% of the group s profit before tax and 86% of the group s adjusted profit before tax, although for countries where a partial scope audit was performed, not all balances that comprise these coverage percentages have been audited.

The group audit team continued to follow a programme of planned visits that has been designed to ensure that the Senior Statutory Auditor or his designate visits each of the locations where the Group audit scope was focused at least once every two years and the most significant of them at least once a year. For all full scope entities, in addition to the location visit, the group audit team participated in the component team s planning, including the component team s discussion of fraud and error. The group audit team have also reviewed key working papers and challenged conclusions on significant risk areas, as identified at the scoping stage, primarily inventory and revenue recognition. The group audit team visited nine locations in total over the course of the current year audit.

Our assessment of risks of material misstatement

We consider that the following areas present the greatest risk of material misstatement in the financial statements and consequently have had the greatest impact on our audit strategy, the allocation of resources and the efforts of the engagement team, including the more senior members of the team:

Principal risk area and rationale	Audit response
Recognition and measurement of provisions for litigation reserves and contingent liabilities	
The development, manufacture and sale of medical devices entails risk of product liability claims and patent infringement issues due to the surgical nature of the products and the competitive nature of the industry. Determining the impact and likely outcome of any litigation matters requires significant judgement due to the uncertainty of the litigation process and the level of royalty that may be payable for infringed products and raises the risk that those legal provisions may be incorrect.	The litigation reserve at 31 December 2014, included in legal and other provisions of $118m in note 17.1 to the financial statements, covers a number of open legal matters as described in detail in note 17.3 to the financial statements. We held discussions with in-house legal counsel to understand the status of litigation cases. We read legal invoices and corresponded directly with external legal advisors to understand the fact patterns of the cases. We reviewed management s calculations of provisions, including their assessment of potential royalties payable for past sales and challenged and corroborated key assumptions.
Recognition and measurement of provisions for taxation	
The tax charge of profits is determined according to complex tax laws and regulations. Where the effect of these tax laws and regulations is unclear, judgements are used in determining the liability for the tax to be paid. As a multinational Company, tax audits can be ongoing in a number of jurisdictions at any point in time and tax returns are subject to possible challenge in most locations in which the Company operates. There can be significant judgement involved in determining the provision for tax liabilities.	The details of the tax charge are included in note 5.1 to the financial statements. We involved tax specialists in the US and the UK to assist us in assessing and challenging the assumptions and judgements made by the company in their recognition and measurement of provisions for taxation. We tested tax calculations and challenged the company s transfer pricing arrangements, tax planning activities and status and findings from ongoing tax audits to assess the reasonableness of the provisions recorded. This included an assessment of the likelihood that known uncertain tax positions would result in a tax liability to the company.

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FINANCIAL STATEMENTS

Independent auditor s UK report *continued*

Principal risk area and rationale	Audit response
Existence and valuation of inventory	
The Company has high levels of finished goods inventory, as detailed in note 12 to the financial statements, some of which are located at customer premises to be available for immediate use.	We carried out tests of controls over routine inventory processes, including cycle counts and period end counts.
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.	We independently counted or confirmed inventory levels at key component locations and also reviewed the results of management s testing results for a sample of counts that we did not attend.
In estimating the appropriate value for inventory, management has to apply judgement on how much of the inventory on hand will ultimately be used, considering the length of product lives predicted, product usage and how quickly products will be phased out.	We challenged management s judgements and assumptions used in determining the inventory excess and obsolescence provision in order to assess that their calculation represents excess and obsolete inventory. We understood their plans for launching new product lines or discontinuing product lines to assess the adequacy of the provision, as well as reflecting on the adequacy of prior year provisions.
	We tested management s calculation to eliminate intercompany profit held in inventory as goods are sold between group companies, including the recalculation and vouching of margins on a sample basis.
Timing of revenue recognition and measurement of related reserves	

Revenue recognition is one of the key areas of audit focus, particularly in respect of the risk of management override and the risk of cut-off of revenue for sales to distributors with the need for the risks and rewards of ownership to have passed before revenue is recognised.	We carried out tests of controls over revenue recognition, including the timing of revenue recognition, as well as substantive testing, analytical procedures and assessing whether the revenue recognition policies adopted complied with IFRS as detailed in note 2.1 to the financial statements. Procedures included independent confirmation with distributors, reviewing shipping terms for items despatched to test that the risk and reward of ownership had passed, cut off testing of items despatched close to the year end date and a review of returns and credit notes issued subsequent to the year end. We also performed detailed trend analysis by period and by major customer to identify unusual fluctuations.
Judgements determining purchase price allocation on acquisitions	
On 27 May 2014, the Group acquired ArthroCare Corporation for $1.7bn. The acquisition accounting includes the need to determine the fair value of the acquired assets and liabilities at the acquisition date. This included complex valuation considerations and required the use of specialists. The most significant judgements relate to the valuation of intangible assets acquired, the uplift to the value of inventory and property, plant and equipment and the value of any provisions recorded.	We focused on this area given the significant judgements involves in assessing the fair values of assets and liabilities acquired as this directly impacts the amount of goodwill recognised on acquisition. The fair values are based on valuation techniques built, in part, on assumptions around the future performance of the business. We challenged the assumptions underpinning the valuations, assessed the fair value of the identified assets and liabilities, audited the accounting differences upon IFRS conversion and evaluated the adequacy of the disclosures. We also discussed the specialist valuations with the specialists and read their reports, with involvement of our own specialists to conclude on the appropriateness of the valuation.

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Opinion on other matter prescribed by

the Companies Act 2006

In our opinion the information given in the Strategic Report and the Directors Report for the financial year for which the group financial statements are prepared is consistent with the group financial statements.

Respective responsibilities of directors and auditor

As explained more fully in the Directors Responsibilities Statement set out on page 103, the directors are responsible for the preparation of the group financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the group financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board s Ethical Standards for Auditors.

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

Matters on which we are required to report

by exception

We have nothing to report in respect of the following:

Under the ISAs (UK and Ireland), we are required to report to you if, in our opinion, information in the annual report is:

- materially inconsistent with the information in the audited financial statements; or

- apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Group acquired in the course of performing our audit; or

- is otherwise misleading.

In particular, we are required to consider whether we have identified any inconsistencies between our knowledge acquired during the audit and the directors statement that they consider the annual report is fair, balanced and understandable and whether the annual report appropriately discloses those matters that we communicated to the audit committee which we consider should have been disclosed.

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- 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 statement, set out on page 103, in relation to going concern.
- the part of the Corporate Governance Statement relating to the company s compliance with the nine provisions of the UK Corporate Governance Code specified for our review.

Michael Rudberg (Senior statutory auditor)

for and on behalf of Ernst & Young LLP, Statutory Auditor

London

25 February 2015

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Group income statement

	Notes	Year ended 31 December 2014 $ million	Year ended 31 December 2013 $ million	Year ended 31 December 2012 $ million
Revenue	2	**4,617**	4,351	4,137
Cost of goods sold		**(1,162)**	(1,100)	(1,070)
Gross profit		**3,455**	3,251	3,067
Selling, general and administrative expenses	3	**(2,471)**	(2,210)	(2,050)
Research and development expenses	3	**(235)**	(231)	(171)
Operating profit	2 & 3	**749**	810	846
Interest receivable	4	**13**	14	11
Interest payable	4	**(35)**	(10)	(9)
Other finance costs	4	**(11)**	(11)	(11)
Share of results of associates	11	**(2)**	(1)	4
Profit on disposal of net assets held for sale	3			251
Profit before taxation		**714**	802	1,092
Taxation	5	**(213)**	(246)	(371)
Attributable profit for the year (i)		**501**	556	721
Earnings per ordinary share (i)	6			
Basic		**56.1¢**	61.7¢	80.4¢
Diluted		**55.7¢**	61.4¢	80.0¢

Group statement of comprehensive income

	Notes	Year ended 31 December 2014 $ million	Year ended 31 December 2013 $ million	Year ended 31 December 2012 $ million
Attributable profit for the year (i)		**501**	556	721
Other comprehensive income:				
Items that will not be reclassified to income statement				
Actuarial (losses)/gains on retirement benefit obligations	18	**(94)**	12	(5)
Taxation on other comprehensive income	5	**19**	(16)	20
Total items that will not be reclassified to income statement		**(75)**	(4)	15

Items that may be reclassified subsequently to income statement			
Cash flow hedges interest rate derivatives			
losses arising in the year	**(5)**		
Cash flow hedges forward foreign exchange contracts			
gains/(losses) arising in the year	**31**	8	(1)
gains transferred to inventories for the year	**(14)**	(3)	(6)
Exchange differences on translation of foreign operations	**(196)**	(6)	36
Exchange on borrowings classified as net investment hedges			1
Total items that may be reclassified subsequently to income statement	**(184)**	(1)	30
Other comprehensive (expense)/income for the year, net of taxation	**(259)**	(5)	45
Total comprehensive income for the year (i)	**242**	551	766

(i) Attributable to equity holders of the Company and wholly derived from continuing operations.
The Notes on pages 117 to 165 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 $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 administrative 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).

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 assocaited with the RENASYS distribution hold and the impairment and costs associated with the termination of the HP802 programme.

Net interest receivable/(payable)

Net interest payable increased by $26m, from a net $4m receivable in 2013 to a net payable 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 costs

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 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 was 27.7% (2013 29.2%).

The financial commentary on this page forms part of the business review and is unaudited.

See pages 180 to 183 for commentary on the 2013 financial year.

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FINANCIAL STATEMENTS

Group balance sheet

	Notes	At 31 December 2014 $ million	At 31 December 2013 $ million
Assets			
Non-current assets:			
Property, plant and equipment	7	891	816
Goodwill	8	2,027	1,256
Intangible assets	9	1,747	1,054
Investments	10	5	2
Investments in associates	11	112	107
Loans to associates	11		178
Retirement benefit asset	18	7	5
Deferred tax assets	5	77	145
		4,866	3,563
Current assets:			
Inventories	12	1,181	1,006
Trade and other receivables	13	1,166	1,113
Cash at bank	15	93	137
		2,440	2,256
Total assets		7,306	5,819
Equity and liabilities			
Equity attributable to owners of the Company:			
Share capital	19	184	184
Share premium		574	535
Capital redemption reserve		11	10
Treasury shares	19	(315)	(322)
Other reserves		(64)	120
Retained earnings		3,650	3,520
Total equity		4,040	4,047
Non-current liabilities:			
Long-term borrowings	15	1,666	347
Retirement benefit obligations	18	233	230
Other payables	14	44	7
Provisions	17	63	65
Deferred tax liabilities	5	98	50
		2,104	699
Current liabilities:			
Bank overdrafts and loans	15	39	44
Trade and other payables	14	838	785

Provisions	17	**67**	60
Current tax payable		**218**	184
		1,162	1,073
Total liabilities		**3,266**	1,772
Total equity and liabilities		**7,306**	5,819

The accounts were approved by the Board and authorised for issue on 25 February 2015 and are signed on its behalf by:

Roberto Quarta	**Olivier Bohuon**	**Julie Brown**
Chairman	Chief Executive Officer	Chief Financial Officer

The Notes on pages 117 to 165 are an integral part of these accounts.

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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 the 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 unfavourable currency movements totalling $73m.

Intangible assets increased 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.

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 losses	(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

The financial commentary on this page forms part of the business review and is unaudited.

See pages 180 to 183 for commentary on the 2013 financial year.

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FINANCIAL STATEMENTS

Group cash flow statement

	Notes	Year ended 31 December 2014 $ million	Year ended 31 December 2013 $ million	Year ended 31 December 2012 $ million
Cash flows from operating activities				
Profit before taxation		714	802	1,092
Net interest payable/(receivable)	4	22	(4)	(2)
Depreciation, amortisation and impairment		427	361	312
Loss on disposal of property, plant and equipment and software		11	23	12
Distribution from investment		1		
Share-based payments expense	23	32	28	34
Share of results of associates	11	2	1	(4)
Dividends received from associates	11		1	7
Profit on disposal of manufacturing facility	21	(9)		
Profit on disposal of net assets held for sale	3			(251)
Net movement in post retirement benefit obligations		(81)	(27)	(28)
(Increase)/Decrease in inventories		(168)	(99)	12
Increase in trade and other receivables		(76)	(70)	(5)
Increase in trade and other payables and provisions		86	122	5
Cash generated from operations (i) (ii)		961	1,138	1,184
Interest received		3	4	4
Interest paid		(36)	(10)	(8)
Income taxes paid		(245)	(265)	(278)
Net cash inflow from operating activities		683	867	902
Cash flows from investing activities				
Acquisitions, net of cash acquired	21	(1,572)	(74)	(782)
Proceeds on disposal of net assets held for sale				103
Capital expenditure	2	(375)	(340)	(265)
Investment in associate	11	(2)		(10)
Purchase of investments	10	(4)		
Proceeds from associate loan redemption	11	188		
Proceeds on disposal of manufacturing facility	21	20		
Cash received on disposal of associate			7	
Net cash used in investing activities		(1,745)	(407)	(954)
Cash flows from financing activities				
Proceeds from issue of ordinary share capital		40	48	77
Purchase of own shares		(75)	(231)	

Proceeds of borrowings due within one year	20	**30**	12	40
Settlement of borrowings due within one year	20	**(52)**	(6)	(296)
Proceeds on borrowings due after one year	20	**3,390**	695	415
Settlement of borrowings due after one year	20	**(2,068)**	(779)	(1)
Proceeds from own shares		**4**	3	6
Settlement of currency swaps	20	**(11)**	(1)	(1)
Equity dividends paid	19	**(250)**	(239)	(186)
Net cash from/(used in) financing activities		**1,008**	(498)	54
Net (decrease)/increase in cash and cash equivalents		**(54)**	(38)	2
Cash and cash equivalents at beginning of year	20	**126**	167	161
Exchange adjustments	20	**(7)**	(3)	4
Cash and cash equivalents at end of year		**65**	126	167

(i) Includes $60m (2013 $54m, 2012 $55m) of outgoings on restructuring and rationalisation expenses.

(ii) Includes $112m (2013 $25m, 2012 $3m) of acquisition-related costs and $23m (2013 $nil, 2012 $22m) of legal and other costs

The Notes on pages 117 to 165 are an integral part of these accounts.

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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 2014 of $961m (2013 $1,138m, 2012 $1,184m) is after paying out $112m (2013 $25m, 2012 $3m) of acquisition-related costs, $60m (2013 $54m, 2012 $55m) of restructuring and rationalisation expenses and $23m (2013 $nil, 2012 $22m) relating to legal and other exceptional 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 2014, capital expenditure on tangible and intangible fixed assets represented approximately 8% of continuing Group revenue (2013 8%, 2012 6%).

In 2014, capital expenditure amounted to $375m (2013 $340m, 2012 $265m). 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 2014, $34m (2013 $41m, 2012 $4m) of capital expenditure had been contracted but not provided for which will be funded from cash inflows.

Acquisitions and disposals

In the three-year period ended 31 December 2014, $2,428m was spent on acquisitions, funded from net debt and cash inflows. This comprised, $782m for Healthpoint acquired in December 2012, $74m relating to acquisitions in Turkey, Brazil and India completed in quarter four of 2013, $1,546m for ArthroCare acquired in May 2014 and $26m for the acquisition in Brazil completed in quarter one 2014.

During 2012, the Group completed the transfer of its Biologics and Clinical Therapies business (CT) to Bioventus for total consideration of $367m. As part of this transaction the Group received a 49% interest in Bioventus with a value of $104m and subsequently invested a further $10m.

During 2014, the Group received repayment of the $160m loan note to Bioventus and $28m of accrued interest.

Proceeds of $20m have been received on the disposal of the Group s manufacturing plant in Gilberdyke, UK.

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 2014, the Group held $65m (2013 $126m, 2012 $167m) in cash net of bank overdrafts. The group had committed facilities available of $2,525m at 31 December 2014 of which $1,655m 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 $12m.

During the year ended 31 December 2014, the Group refinanced its principal banking facilities. The Group has signed a new five-year committed $1 billion multi-currency revolving credit facility with a maturity date of March 2019. In addition, the Group signed a $1.4 billion committed term loan facility with a maturity date of February 2016. The Group drew down its $1.4 billion committed term loan facility to fund the acquisition of ArthroCare. $1 billion of this loan was repaid during the year partly from private placement proceeds.

During the year ended 31 December 2014, the Group received the entire proceeds of the $325 million private placement debt agreement signed in December 2013. The funds have a weighted average fixed rate of 3.7% and mature between 2021 and 2026. The Group also received $800 million of proceeds from a second private placement agreement signed in November 2014. The funds have a weighted average fixed rate of 3.1% and mature between 2019 and 2024.

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 2015, as well as its other known or expected commitments or liabilities, can be met from its existing resources and facilities. The Group s net debt increased from $288m at the beginning of 2013 to $1,613m at the end of 2014, representing an overall increase of $1,325m.

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 180 to 183 for commentary on the 2013 financial year.

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FINANCIAL STATEMENTS

Group statement of changes in equity

	Share capital $ million	Share premium $ million	Capital redemption reserve $ million	Treasury shares (ii) $ million	Other reserves (iii) $ million	Retained earnings $ million	Total equity $ million
At 31 December 2011	191	413		(766)	91	3,258	3,187
Total comprehensive income (i)					30	736	766
Equity dividends declared and paid						(186)	(186)
Share-based payments recognised						34	34
Cost of shares transferred to beneficiaries				31		(25)	6
Issue of ordinary share capital (iv)	2	75					77
At 31 December 2012	193	488		(735)	121	3,817	3,884
Total comprehensive income (i)					(1)	552	551
Equity dividends declared and paid						(239)	(239)
Share-based payments recognised						28	28
Deferred 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 (iv)	1	47					48
At 31 December 2013	184	535	10	(322)	120	3,520	4,047
Total comprehensive income (i)					**(184)**	**426**	**242**
Equity dividends declared and paid						**(250)**	**(250)**
Share-based payments recognised						**32**	**32**
Purchase of own shares				**(75)**			**(75)**
Cost of shares transferred to beneficiaries				**25**		**(21)**	**4**
Cancellation of treasury shares	**(1)**		**1**	**57**		**(57)**	
Issue of ordinary share capital (iv)	**1**	**39**					**40**
At 31 December 2014	**184**	**574**	**11**	**(315)**	**(64)**	**3,650**	**4,040**

(i) Attributable to equity holders of the Company and wholly derived from continuing operations.

(ii) Refer to Note 19.2 for further information.

(iii) 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 adjustments within Other Reserves at 31 December 2014 were $(78)m (2013 $118m, 2012 $124m).

(iv) Issue of ordinary share capital as a result of options being exercised.

The Notes on pages 117 to 165 are an integral part of these accounts.

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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 in the sectors of Advanced Surgical Devices and Advanced Wound Management.

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 2014. 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 2014. 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 and business combinations. These are discussed under Critical accounting policies on page 104. 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.

There have been no new accounting pronouncements impacting the Group in 2014.

A number of new standards, amendments to standards and interpretations are effective for the Group s annual periods beginning on or after 1 January 2015, and have not been applied in preparing these consolidated accounts. With the exception of IFRS 9 *Financial Instruments* and IFRS 15 *Revenue*, which the Group does not intend to early adopt and for which the extent of the impact is still being determined, none of these is expected to have a significant effect on the consolidated accounts of the Group.

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 Group s.

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.

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 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:

	2014	2013	2012
Average rates			
Sterling	**1.65**	1.56	1.58
Euro	**1.33**	1.33	1.28
Swiss Franc	**1.09**	1.08	1.07
Year-end rates			
Sterling	**1.56**	1.66	1.63
Euro	**1.21**	1.38	1.32
Swiss Franc	**1.01**	1.12	1.09

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Notes to the Group accounts *continued*

2 Business segment information

During 2014 for management purposes the Group was organised into two global divisions according to the nature of its products which represented two reportable business segments   Advanced Surgical Devices and Advanced Wound Management.

As part of the Reinvestment & Group Optimisation programme management have created a single unified operating structure with a single cost base, led by a managing director in each major country (outside the US). The change in structure took effect on 1 January 2015 and as such the Group will report as a single segment from this date.

The types of products and services offered by each business segment in 2014 are:

Smith & Nephew   s Advanced Surgical Devices (ASD   ) business offers the following products and technologies:

Orthopaedic Reconstruction which includes Hip Implants, Knee Implants and ancillary products such as bone cement and mixing systems used in cemented reconstruction joint surgery

Trauma & Extremities consisting of internal and external devices used in the stabilisation of severe fractures and deformity correction procedures

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 offer 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

Other ASD which includes gynaecological instrumentation and the remaining Clinical Therapies geographies which are in the process of being transferred to Bioventus.

Smith & Nephew   s Advanced Wound Management (AWM   ) business offers a range of products:

Advanced Wound Care includes products for the treatment of acute and chronic wounds, including leg, diabetic and pressure ulcers, burns and post-operative wounds

Advanced Wound Devices consists of traditional and single-use Negative Pressure Wound Therapy and hydrosurgery systems

Advanced Wound Bioactives includes biologics and other bioactive technologies that provide unique approaches to debridement and dermal repair/regeneration.

Management monitors the operating results of its business segments separately for the purposes of making decisions about resource allocation and performance assessment. Group financing (including interest receivable and payable) and income taxes are managed on a Group basis and are not allocated to business segments.

The following tables present revenue, profit, asset and liability information regarding the Group s operating segments as they existed during the year. Investments in associates and loans to associates are segmentally allocated to Advanced Surgical Devices.

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. 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.

	2014 $ million	2013 $ million	2012 $ million
Revenue by business segment			
Advanced Surgical Devices	**3,298**	3,015	3,108
Advanced Wound Management	**1,319**	1,336	1,029
	4,617	4,351	4,137

There are no material sales between business segments.

	2014 $ million	2013 $ million	2012 $ million
Revenue by geographic market			
United States	**2,012**	1,862	1,651
United Kingdom	**299**	293	297
Other Established Markets	**1,629**	1,633	1,706
Emerging & International Markets	**677**	563	483
	4,617	4,351	4,137

Revenue has been allocated by basis of destination. No revenue from a single customer is in excess of 10% of the Group s revenue.

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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. Operating profit reconciles to trading profit as follows:

	Notes	2014 $ million	2013 $ million	2012 $ million
Operating profit		749	810	846
Acquisition-related costs	3	118	31	11
Restructuring and rationalisation expenses	3	61	58	65
Amortisation of acquisition intangibles and impairments	9	129	88	43
Legal and other	3	(2)		
Trading profit		1,055	987	965
Trading profit by business segment				
Advanced Surgical Devices		810	712	728
Advanced Wound Management		245	275	237
		1,055	987	965
Operating profit by business segment reconciled to				
attributable profit for the year				
Advanced Surgical Devices		626	620	632
Advanced Wound Management		123	190	214
Operating profit		749	810	846
Net interest (payable)/receivable		(22)	4	2
Other finance costs		(11)	(11)	(11)
Share of results of associates		(2)	(1)	4
Profit on disposal on net assets held for sale				251
Taxation		(213)	(246)	(371)
Attributable profit for the year		501	556	721

2.3 Assets and liabilities by business segment and geography

	2014 $ million	2013	2012

		$ million	$ million
Balance sheet			
Assets:			
Advanced Surgical Devices	**5,368**	3,684	3,518
Advanced Wound Management	**1,761**	1,848	1,776
Operating assets by business segment	**7,129**	5,532	5,294
Unallocated corporate assets	**177**	287	348
Total assets	**7,306**	5,819	5,642
Liabilities:			
Advanced Surgical Devices	**697**	609	530
Advanced Wound Management	**315**	308	256
Operating liabilities by business segment	**1,012**	917	786
Unallocated corporate liabilities	**2,254**	855	972
Total liabilities	**3,266**	1,772	1,758

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Notes to the Group accounts *continued*

2 Business segment information *continued*

Unallocated corporate assets and liabilities comprise the following:

	2014	2013	2012
	$ million	$ million	$ million
Deferred tax assets	77	145	164
Retirement benefit asset	7	5	6
Cash at bank	93	137	178
Unallocated corporate assets	177	287	348
Long-term borrowings	1,666	347	430
Retirement benefit obligations	233	230	266
Deferred tax liabilities	98	50	61
Bank overdrafts and loans due within one year	39	44	38
Current tax payable	218	184	177
Unallocated corporate liabilities	2,254	855	972

	2014	2013	2012
	$ million	$ million	$ million
Capital expenditure (including acquisitions)			
Advanced Surgical Devices	2,045	327	188
Advanced Wound Management	73	124	839
	2,118	451	1,027

Capital expenditure segmentally allocated above comprises:

	2014	2013	2012
	$ million	$ million	$ million
Additions to property, plant and equipment	298	242	197
Additions to intangible assets	77	98	68
Capital expenditure (excluding business combinations)	375	340	265
Trade investments	4		
Acquisitions Goodwill	844	53	73

Acquisitions	Intangible assets	**833**	53	662
Acquisitions	Property, plant and equipment	**62**	5	27
Capital expenditure		**2,118**	451	1,027

	2014	2013	2012
	$ million	$ million	$ million
Depreciation, amortisation and impairment			
Advanced Surgical Devices	**320**	268	274
Advanced Wound Management	**107**	93	38
	427	361	312

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Amounts comprise depreciation of property, plant and equipment, amortisation of other intangible assets, impairment of investments and amortisation of acquisition intangibles and impairments as follows:

	2014 $ million	2013 $ million	2012 $ million
Amortisation of acquisition intangibles	129	88	43
Depreciation of property, plant and equipment	222	209	212
Impairment of property, plant and equipment	14		
Impairment of goodwill and investments			6
Amortisation of other intangible assets	62	64	51
	427	361	312

$14m impairments were recognised within operating profit in 2014 (2013 $nil, 2012 $6m, recognised within the administrative expenses line). In 2014, the impairment was segmentally allocated to Advanced Wound Management (2012: Advanced Surgical Devices).

Geographic

	2014 $ million	2013 $ million
Assets by geographic location		
United States	3,104	2,086
United Kingdom	379	255
Other Established Markets	1,101	902
Emerging & International Markets	198	170
Non-current operating assets by geographic location	4,782	3,413
United States	1,104	1,121
United Kingdom	234	288
Other Established Markets	706	486
Emerging & International Markets	303	224
Current operating assets by geographic location	2,347	2,119
Unallocated corporate assets (see page 120)	177	287
Total assets	7,306	5,819

2.4 Other business segment information

	2014 $ million	2013 $ million	2012 $ million
Other significant expenses recognised within operating profit			
Advanced Surgical Devices	106	51	57
Advanced Wound Management	71	38	19

	177	89	76

The $177m incurred in 2014 relates to $61m restructuring and rationalisation expenses and $118m acquisition related costs and a net $2m credit related to legal and other (2013 $58m relates to restructuring and rationalisation expenses and $31m acquisition related costs, 2012 $65m relates to restructuring and rationalisation expenses and $11m acquisition related costs).

	2014 numbers	2013 numbers	2012 numbers
Average number of employees			
Advanced Surgical Devices	**9,273**	7,066	7,194
Advanced Wound Management	**4,195**	3,970	3,283
	13,468	11,036	10,477

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FINANCIAL STATEMENTS

Notes to the Group accounts *continued*

3 Operating profit

ACCOUNTING POLICIES

Research and development

Research expenditure is expensed as occurred. 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

Expenditure on advertising costs is expensed as incurred.

	2014 $ million	2013 $ million	2012 $ million
Revenue	4,617	4,351	4,137
Cost of goods sold (i)(ii)	(1,162)	(1,100)	(1,070)
Gross profit	3,455	3,251	3,067
Research and development expenses	(235)	(231)	(171)
Selling, general and administrative expenses:			
Marketing, selling and distribution expenses	(1,670)	(1,535)	(1,440)
Administrative expenses (iii) (iv) (v) (vi)	(801)	(675)	(610)
	(2,471)	(2,210)	(2,050)
Operating profit	749	810	846

(i) 2014 includes $12m of restructuring and rationalisation expenses (2013 $12m, 2012 $3m).

(ii) 2014 includes $23m of acquisition-related costs (2013 $5m, 2012 $nil).

(iii) 2014 includes $62m of amortisation of other intangible assets (2013 $64m, 2012 $51m).

(iv) 2014 includes $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, 2012 $62m of restructuring and rationalisation expenses and $43m of amortisation of acquisition intangibles).

(v) 2014 includes $2m credit relating to legal and other exceptionals (2013 $nil, 2012 $nil).

(vi) 2014 includes $95m of acquisition-related costs (2013 $26m, 2012 $11m).

Note that items detailed in (i), (ii), (iv), (v) and (vi) are excluded from the calculation of trading profit.

Operating profit is stated after charging the following items:

	2014 $ million	2013 $ million	2012 $ million
Amortisation of acquisition intangibles	129	88	43
Amortisation of other intangible assets	62	64	51
Impairment of goodwill and investments			6
Depreciation of property, plant and equipment	222	209	212
Loss on disposal of property, plant and equipment and software	25	23	12
Minimum operating lease payments for land and buildings	38	32	29
Minimum operating lease payments for other assets	18	19	21
Advertising costs	96	91	74

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3.1 Staff costs

Staff costs during the year amounted to:

	Notes	2014 $ million	2013 $ million	2012 $ million
Wages and salaries		**1,237**	998	886
Social security costs		**127**	106	97
Pension costs (including retirement healthcare)	18	**17**	72	72
Share-based payments	23	**32**	28	34
		1,413	1,204	1,089

3.2 Audit Fees information about the nature and cost of services provided by auditors

	2014 $ million	2013 $ million	2012 $ million
Audit services: Group accounts	**2**	1	1
Other services:			
Local statutory audit pursuant to legislation	1	2	2
Taxation services:			
Compliance services	**1**	2	1
Advisory services	**1**	1	1
Total auditors remuneration	**5**	6	5
Arising:			
In the UK	**3**	3	2
Outside the UK	**2**	3	3
	5	6	5

3.3 Acquisition related costs

Acquisition related costs of $118m (2013 $31m, 2012 $11m) were incurred within operating profit in the twelve month period to 31 December 2014. These costs relate to professional and adviser fees and integration costs in connection with the acquisitions of ArthroCare and the distributor in Brazil completed in 2014, the acquisitions in Turkey, Brazil and India during 2013 and the acquisition of Healthpoint Biotherapeutics completed in 2012. In addition, $7m of debt-related acquisition costs were incurred in the year.

3.4 Restructuring and rationalisation expenses

Restructuring and rationalisation costs of $61m (2013 $58m, 2012 $65m) were incurred in the twelve month period to 31 December 2014. These related mainly to charges of $49m (2013 $nil, 2012 $nil) incurred in relation to the Group Optimisation programme announced in May 2014. Charges of $12m (2013 $58m, 2012 $65m) were also incurred relating to people costs and contract termination costs associated with the structural and process changes announced in August 2011.

3.5 Legal and other

The legal and other net credit within operating profit of $2m (2013 $nil, 2012 $251m) relates to a settlement credit and past service gain on the closure of the US Pension Plan of $46m and a gain on the 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.

In 2012, a profit on disposal of $251m was recorded relating to the disposal of our Clinical Therapies business.

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Notes to the Group accounts *continued*

4 Interest and other finance costs

4.1 Interest receivable/(payable)

	2014 $ million	2013 $ million	2012 $ million
Interest receivable	**13**	14	11
Interest payable:			
Bank borrowings	**(19)**	(8)	(7)
Private placement notes	**(14)**		
Other	**(2)**	(2)	(2)
	&		