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GROUP FINANCIAL STATEMENTS

STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE ANNUAL REPORT AND THE FINANCIAL STATEMENTS

The Directors are responsible for preparing the Annual Report and Form 20-F and the Group and Parent Company financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare Group and Parent Company financial statements for each financial year. Under that law they are required to prepare the Group financial statements in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board (IASB) and as adopted by the European Union (IFRSs as adopted by the EU) and applicable law and have elected to prepare the Parent Company financial statements in accordance with UK accounting standards, including FRS 101 Reduced Disclosure Framework.

Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and Parent Company and of their profit or loss for that period. In preparing each of the Group and Parent Company financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable, relevant, reliable and prudent;
- for the Group financial statements, state whether they have been prepared in accordance with IFRSs, as issued by the IASB and adopted by the EU;
- for the Parent Company financial statements, state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the Parent Company financial statements;
- assess the Group and Parent Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and
- use the going concern basis of accounting unless they either intend to liquidate the Group or the Parent Company or to cease operations, or have no realistic alternative but to do so.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Parent Company's transactions and disclose with reasonable accuracy at any time the financial position of the Parent Company and enable them to ensure that its financial statements comply with the Companies Act 2006. They are responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the Directors are also responsible for preparing a Strategic Report, Directors' Report, Directors' Remuneration Report and Corporate Governance Statement that complies with that law and those regulations.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

RESPONSIBILITY STATEMENT OF THE DIRECTORS IN RESPECT OF THE ANNUAL REPORT

We confirm that to the best of our knowledge:

- the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole; and
- the Strategic Report and Directors' Report include a fair review of the development and performance of the business and the position of the issuer and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

The Strategic Report, which has been prepared in accordance with the requirements of the Companies Act 2006, comprises the following sections:

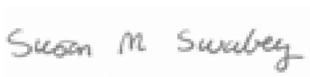
- Overview (pages 2–7);
- Our Business and Marketplace (pages 8–17);
- Operational Review (pages 18–35);
- Financial Review (pages 38–39);
- Risk (pages 40–49).

The Directors' Report has also been prepared in accordance with the Companies Act 2006 and The Small Companies and Groups (Accounts and Directors' Report) Regulations 2008 comprising of pages 6, 16–17, 25–28, 33–39, 42–78, 107, 140–142, 158 and pages 171–192 of the Annual Report.

And has been approved and signed on behalf of the Board.

We consider the Annual Report and financial statements, taken as a whole, are fair, balanced and understandable and provide the information necessary for shareholders to assess the Group's position and performance, business model and strategy.

By order of the Board, on 22 February 2018



Susan Swabey
Company Secretary

GROUP FINANCIAL STATEMENTS

INDEPENDENT AUDITOR'S UK REPORT

AUDITOR'S REPORTS ON THE FINANCIAL STATEMENTS AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING (SARBANES-OXLEY ACT SECTION 404)

The report set out below is provided in compliance with International Standards on Auditing (UK and Ireland). KPMG LLP has also issued reports in accordance with standards of the Public Company Accounting Oversight Board in the US, which will be included in the Annual Report on Form 20-F to be filed with the US Securities and Exchange Commission. Those reports are unqualified and include opinions on the Group Financial Statements and on the effectiveness of internal control over financial reporting as at 31 December 2017 (Sarbanes-Oxley Act Section 404).

The Directors' statement on internal control over financial reporting is set out on pages 77–78.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF SMITH & NEPHEW PLC ONLY

OPINIONS AND CONCLUSIONS ARISING FROM OUR AUDIT

1. Our opinion is unmodified

We have audited the financial statements of Smith & Nephew Plc ("the Company") for the year ended 31 December 2017 which comprise the Group Income Statement, Group Statement of Comprehensive Income, Group Balance Sheet, Group Cash Flow Statement, Group Statement of Changes in Equity, Company Balance Sheet, Company Statement of Changes in Equity, and the related notes which include the accounting policies.

In our opinion:

– The financial statements give a true and fair view of the state of the Group's and of the parent Company's affairs as at 31 December 2017 and of the Group's profit for the year then ended;
– The Group financial statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union;
– The parent Company financial statements have been properly prepared in accordance with UK accounting standards, including FRS 101 Reduced Disclosure Framework; and
– The financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

Additional opinion in relation to IFRSs as issued by the IASB

As explained in the accounting policies set out in the Group financial statements, the Group, in addition to complying with its legal obligation to apply IFRS as adopted by the EU, has also applied IFRS as issued by the IASB. In our opinion, the Group financial statements have been properly prepared in accordance with IFRS as issued by the IASB.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities are described below. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion. Our audit opinion is consistent with our report to the audit committee.

We were appointed as auditor by the shareholders on 9 April 2015. The period of total uninterrupted engagement is for the 3 financial years ended 31 December 2017. We have fulfilled our ethical responsibilities under, and we remain independent of the Group in accordance with, UK ethical requirements including the FRC Ethical Standard as applied to listed public interest entities. No non-audit services prohibited by that standard were provided.

OVERVIEW

Materiality: Group financial statements as a whole	$42m (2016: $44m) 4.8% (2016: 5.3%) of group normalised profit before tax	
Coverage	87% (2016: 91%) of group profit before tax	
Risks of material misstatement	**Recurring risks**	vs 2016
	Recognition and measurement of provisions for uncertain tax provisions	◀▶
	Liability provisioning for metal-on-metal hip products	◀▶
	Advanced Wound Care, Bioactives and Devices revenue related rebates	◀▶
	Excess and obsolescence (E&O) provision for Orthopaedics Inventory	◀▶

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2. Key audit matters: our assessment of risks of material misstatement

Key audit matters are those matters that, in our professional judgment, were of most significance in the audit of the financial statements and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by us, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team.

We summarise below the key audit matters in decreasing order of audit significance, in arriving at our audit opinion above, together with our key audit procedures to address those matters and, as required for public interest entities, our results from those procedures. These matters were addressed, and our results are based on procedures undertaken, in the context of, and solely for the purpose of, our audit of the financial statements as a whole, and in forming our opinion thereon, and consequently are incidental to that opinion, and we do not provide a separate opinion on these matters.

Recognition and measurement of provisions for uncertain tax provisions

Included in current tax payable ($233 million; 2016: $231 million)

Risk vs 2016:

The risk	Our response
Uncertain outcome The Group has extensive international operations and is subject to complex local and international tax legislation in the normal course of business. As a result of the complexities of tax rules on transfer pricing and other tax legislation, the provisioning for uncertain direct tax positions is judgemental and requires the Directors to make estimates in relation to these uncertainties.	**Our procedures included:** – **Control operation:** Testing the controls that Group has in place to identify and quantify its uncertain tax exposures. – **Our taxation expertise:** Using our international and local tax specialists to assess the Group's direct tax positions and to analyse and challenge the assumptions used to determine provisions based on our knowledge and experience of the application of the international and local legislation by the relevant authorities and courts. – **Test of detail:** Examining the calculations prepared by the Directors and agreeing assumptions used to underlying data where possible. – With the help of our tax specialists, considering the judgements applied to each significant provision including the maximum potential exposure and the likelihood of a payment being required. – Inspecting correspondence with relevant tax authorities and assessing third party tax advice received to evaluate the conclusions drawn from the advice where relevant to the significant exposures faced by the Group. **Our results:** From the evidence we obtained we found the level of provisioning in respect of uncertain direct tax positions to be acceptable.

Refer to page 75 (Audit Committee Report) and pages 114 and 127–129 (accounting policy and financial disclosures).

Liability provisioning for metal-on-metal hip products

($157 million; 2016: $163 million)

Risk vs 2016:

The risk	Our response
Subjective estimate As disclosed in note 17 the Group holds a provision of $157 million in respect of potential liabilities arising from the ongoing exposure for metal-on-metal hip products. The estimate for this provision requires the Directors to use a statistical model and make a number of key assumptions which include the expected number of claimants, projected value of each settlement and the likely time period expected for the settlements.	**Our procedures included:** – **Control operation:** Testing the controls that Group has in place to identify and quantify its uncertain legal provisions. – **Enquiry of lawyers:** Inspection of correspondence with external counsel and formal confirmations from counsel of open cases. – **Test of detail:** Examining the calculations prepared by the Directors and agreeing assumptions used to underlying data where possible. – For the cases identified in external counsel confirmations that all these have been adequately considered by the Directors in making their judgement on any provisioning that may be required. – **Our actuary expertise:** Using our actuarial specialists to challenge the critical assumptions used in statistical projections in determining the estimated liability by reference to historical data including settlement amounts. – **Assessing transparency:** Assessing the adequacy of the Group's disclosures in respect of the metal-on-metal hip provision. **Our results:** The results of our testing were satisfactory and we considered the liability recognised to be acceptable.

Refer to page 74 (Audit Committee Report) and pages 114 and 148–150 (accounting policy and financial disclosures)

GROUP FINANCIAL STATEMENTS

INDEPENDENT AUDITOR'S UK REPORT continued

Advanced Wound Care, Bioactives and Devices revenue related rebates

Risk vs 2016

The risk	Our response
Subjective estimate The Group has a variety of agreements with wholesalers and distributors whereby contractual rebates are due to customers based on the actual quantity of goods purchased over a defined period of time. The contractual arrangement for rebates can vary by customer, product type and jurisdiction. The amount of revenue recognised for products sold through these channels (wholesale customers and distributors) require the Directors to calculate estimates for these contractual rebates which are deducted in arriving at revenue recorded in the period. Due to the variations in complexity of these arrangements, we consider that there is a risk of error in calculating the estimates of rebates that have yet to be agreed with the customer.	**Our procedures included:** – **Control operation:** Evaluating controls that the Group has in place over the identification, estimation and settlement of rebates. – **Inspection of customer contracts:** Inspecting underlying contractual terms and correspondence with customers for a selection of arrangements in place and considering whether the accounting policy had been applied appropriately to the terms of the rebate, discount and/or returns. – **Test of detail:** Performing detailed testing on a sample basis of the largest rebates with particular attention to whether these adjustments were recognised in the correct period and the completeness and appropriateness of any rebates accrued at the year-end. – **Historical comparisons:** Comparing provisions held in prior years to actual outcomes to assess the accuracy by which the Directors were able to estimate these provisions. **Our results:** The results of our testing were satisfactory and we considered the rebates estimated to be acceptable.

Refer to page 122 (accounting policy and financial disclosures).

Excess and Obsolescence (E&O) provision for Orthopaedics Inventory

Risk vs 2016:

The risk	Our response
Forecast-based valuation In line with industry practice, the Group has high levels of Orthopaedics Inventory located at customer premises to be available for immediate use by surgeons. Complete product sets include outsizes which are used less frequently. Towards the end of a product's life cycle, finished goods inventory levels may exceed requirements, in particular as it relates to inventory used less frequently. Historical sales of this inventory is often indicative of future usage, adjusted for changes in market demand, technological advancements or other factors. In calculating the provision for excess and obsolete inventory (E&O provision) the Directors have to estimate the utilisation of inventory on hand based on forecast production and sales.	**Our procedures included:** – **Control operation:** Evaluating controls the Group has in place over the preparation, review and approval of E&O provision, as well as over the review of the Group wide inventory provisioning policy. – **Methodology implementation:** Comparing the calculation of E&O provision to the principles outlined in the Group accounting policy. – **Test of detail:** Testing the accuracy of E&O provision calculation and assessing key underlying assumptions. These include expected usage of inventory based on historical sales and other internal or external factors which may impact the demand for the product. Corroborating key assumptions against source documents such as prior year audited information. – **Inquiry of management:** Performing inquiry of management to corroborate the Directors' plans for launching new or discontinuing product lines. – **Historical comparisons:** Comparing provisions held in prior years to actual inventory write-offs to assess the accuracy by which the Directors were able to forecast this E&O provision. – **Assessing transparency:** Assessing the adequacy of the Group's disclosures in respect of E&O provision. **Our results:** The results of our testing were satisfactory and we considered the E&O provisions made to be acceptable.

Refer to page 74 (Audit Committee Report) and pages 114 and 137 (accounting policy and financial disclosures).

Parent company financial statements: Recoverability of parent company's investment in subsidiaries
Investments ($7,092 million; 2016: $5,322 million)

Risk vs 2016:

The risk	Our response
Low risk, high value The carrying amount of the Company's investments in subsidiaries held at cost less impairment represents 94% (2016: 86%) of the Company's total assets. We do not consider the valuation of these investments to be at a high risk of significant misstatement, or to be subject to a significant level of judgement. However, due to their materiality in the context of the Company financial statements as a whole, this is considered to be the area which had the greatest effect on our overall audit strategy and allocation of resources in planning and completing our parent company audit.	Our procedures included: – **Test of details:** Comparing a sample of the highest value investments representing 98% (2016: 97%) of the total investment balance with the relevant subsidiaries' draft balance sheets to identify whether their net assets, being an approximation of their minimum recoverable amount, were in excess of their carrying amount and assessing whether those subsidiaries have historically been profit-making. – **Assessing subsidiary audits:** Assessing the work performed by the subsidiary audit team on that sample of those subsidiaries and considering the results of that work, on those subsidiaries' profits and net assets. Our results: We found the Directors' assessment of the carrying value of investments to be acceptable.

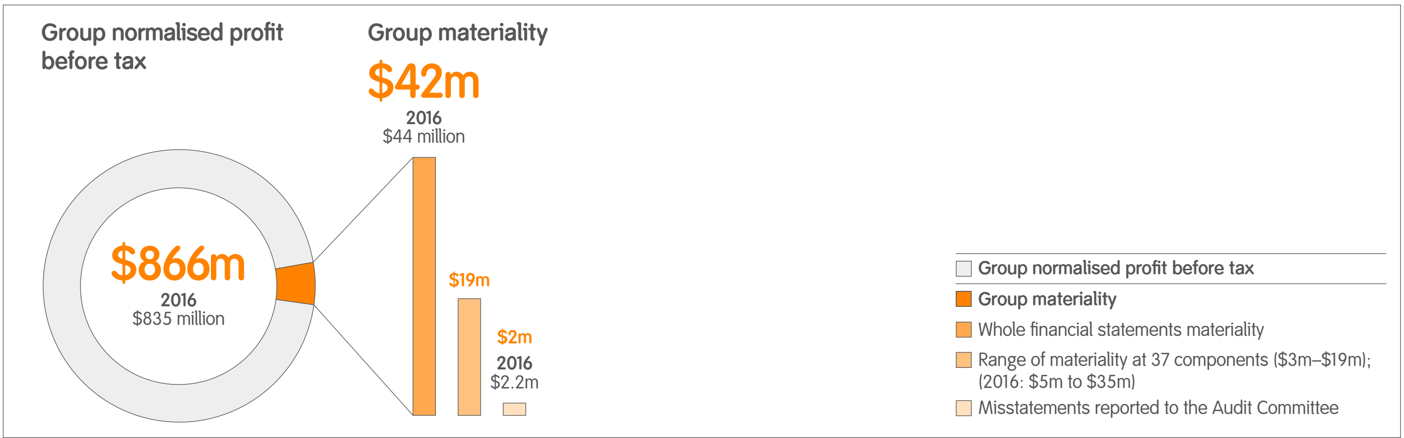
Acquisition intangible assets

Oasis, the main asset at risk of impairment in the acquisition intangibles portfolio, was impaired in previous years. Whilst we continue to perform audit procedures over the valuation of remaining acquisition intangibles, these assets have continued to perform in line with expectations. Therefore, we no longer consider the valuation of acquisition intangible assets as a key audit matter and, consequently, is not separately identified in our audit report this year.

3. Our application of materiality and an overview of the scope of our audit

Materiality for the Group financial statements as a whole was set at $42 million (2016: $44 million), determined with reference to a benchmark of Group profit before tax, normalised to exclude acquisition related credit of $10 million, impairment charges of $10 million and a net credit for legal and other items of $13 million as disclosed in Note 2 of which it represents 4.8% (2016: 5.3%). In addition to a net charge for legal and other items of $20 million, the normalisation adjustments in 2016 also included a gain on disposal of a business of $326 million, acquisition related costs of $9 million, impairment charges of $48 million and restructuring and rationalisation expenses of $62 million. There was no disposal of business in 2017 and the restructuring programme was completed at the end of 2016.

We believe that pre-tax profit excluding these items provides us with a consistent year-on-year basis for determining materiality and is the most relevant performance measure to the users of the financial statements. Materiality for the parent company financial statements as a whole was set at $31 million (2016: $31 million), determined with reference to a benchmark of company total assets, of which it represents 0.4% (2016: 1%).



We agreed to report to the Audit Committee any corrected or uncorrected identified misstatements exceeding $2.0 million (2016: $2.2 million), in addition to other identified misstatements that warranted reporting on qualitative grounds.

Of the Group's 110 (2016: 145) reporting components, we subjected 24 (2016: 46) to full scope audits for Group purposes and 13 (2016: 13) to audits of specific account balances including revenue, receivables, inventory and taxation. The latter were not individually financially significant enough to require a full scope audit for Group purposes, but did present specific individual risks that needed to be addressed or were included in the scope of our Group reporting work in order to provide further coverage over the Group's results.

The components within the scope of our work accounted for the percentages illustrated.

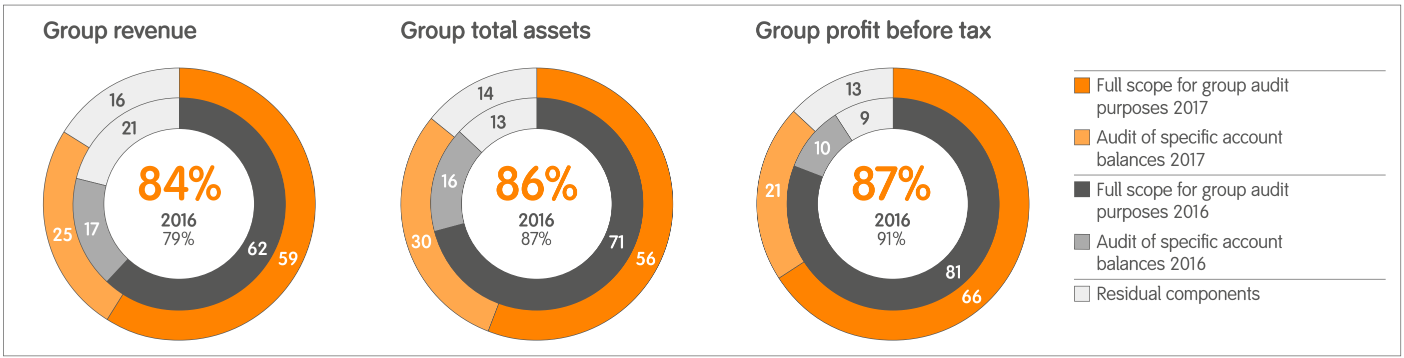
The remaining 16% (2016: 21%) of total Group revenue, 13% (2016: 9%) of group profit before tax and 14% (2016: 13%) of total Group assets is represented by 73 (2016: 86) reporting components, none of which individually represented more than 2% (2016: 4%) of any of total Group revenue, Group profit before tax or total Group assets. For these residual components, we performed analysis at an aggregated Group level to re-examine our assessment that there were no significant risks of material misstatement within these.

GROUP FINANCIAL STATEMENTS

INDEPENDENT AUDITOR'S UK REPORT continued

The Group team instructed component auditors as to the significant areas to be covered, including the relevant risks detailed above and the information to be reported back. The Group team approved component materialities, which ranged from $3 million to $19 million (2016: $5 million to $35 million), having regard to the mix of size and risk profile of the Group across the components. The work on 19 of the 37 components (2016: 40 of the 59 components) was performed by component auditors and the rest, including the audit of the parent company, was performed by the Group team. The Group team performed procedures on the items excluded from normalised Group profit before tax.

The Group team visited 10 (2016: 5) component locations in USA, China, France, Italy, Spain, UK, South Africa, Costa Rica, Switzerland and Germany (2016: USA, UK, Brazil, Germany and Switzerland) to assess the audit risk and strategy. Video and telephone conference meetings were also held with these component auditors and others that were not physically visited. At these visits and meetings, the findings reported to the Group team were discussed in more detail, and any further work required by the Group team was then performed by the component auditor.



4. We have nothing to report on going concern

We are required to report to you if:

- we have anything material to add or draw attention to in relation to the Directors' statement in note 1 to the financial statements on the use of the going concern basis of accounting with no material uncertainties that may cast significant doubt over the Group and Company's use of that basis for a period of at least twelve months from the date of approval of the financial statements; or
- the related statement under the Listing Rules set out on page 77 is materially inconsistent with our audit knowledge.

We have nothing to report in these respects.

5. We have nothing to report on the other information in the Annual Report

The Directors are responsible for the other information presented in the Annual Report together with the financial statements. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except as explicitly stated below, any form of assurance conclusion thereon.

Our responsibility is to read the other information and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work we have not identified material misstatements in the other information.

Strategic report and directors' report

Based solely on our work on the other information:

- we have not identified material misstatements in the strategic report and the directors' report;
- in our opinion the information given in those reports for the financial year is consistent with the financial statements; and
- in our opinion those reports have been prepared in accordance with the Companies Act 2006.

Directors' remuneration report

In our opinion the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006.

Disclosures of principal risks and longer-term viability

Based on the knowledge we acquired during our financial statements audit, we have nothing material to add or draw attention to in relation to:

- the Directors' confirmation within the viability statement on page 48–49 that they have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency and liquidity;
- the Principal Risks disclosures describing these risks and explaining how they are being managed and mitigated; and
- the Directors' explanation in the viability statement of how they have assessed the prospects of the Group, over what period they have done so and why they considered that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

Under the Listing Rules we are required to review the viability statement. We have nothing to report in this respect.

Corporate governance disclosures

We are required to report to you if:

- we have identified material inconsistencies between the knowledge we acquired during our financial statements audit and the Directors' statement that they consider that the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy; or

– the section of the annual report describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.

We are required to report to you if the Corporate Governance Statement does not properly disclose a departure from the eleven provisions of the UK Corporate Governance Code specified by the Listing Rules for our review.

We have nothing to report in these respects.

6. We have nothing to report on the other matters on which we are required to report by exception

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

– adequate accounting records have not been kept by the parent Company, or returns adequate for our audit have not been received from branches not visited by us; or
– the parent Company financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns; or
– certain disclosures of directors' remuneration specified by law are not made; or
– we have not received all the information and explanations we require for our audit.

We have nothing to report in these respects.

7. Respective responsibilities

Directors' responsibilities

As explained more fully in their statement set out on page 107, the directors are responsible for: the preparation of the financial statements including being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the Group and parent Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the Group or the parent Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud, other irregularities (see below), or error, and to issue our opinion in an auditor's report. Reasonable assurance is a high level of assurance, but does not guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud, other irregularities or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

A fuller description of our responsibilities is provided on the FRC's website at www.frc.org.uk/auditorsresponsibilities.

Irregularities – ability to detect

We identified areas of laws and regulations that could reasonably be expected to have a material effect on the financial statements from our sector experience, through discussion with the directors and other management (as required by auditing standards), and from inspection of the Group's regulatory and legal correspondence as necessary. We had regard to laws and regulations in areas that directly affect the financial statements including financial reporting (including related company legislation) and taxation legislation. We considered the extent of compliance with those laws and regulations as part of our procedures on the related financial statements items.

In addition we considered the impact of laws and regulations in the specific areas of compliance with the Food and Drug Administration in the USA and the compliance of business practices with the UK Bribery Act and the US Foreign Corrupt Practices Act recognising the regulated nature of the Group's activities. With the exception of any known or possible non-compliance, and as required by auditing standards, our work in respect of these was limited to enquiry of the directors and other management, testing the effectiveness of relevant entity level controls and inspection of relevant regulatory and legal correspondence. We considered the effect of any known or possible non-compliance in these areas as part of our procedures on the related financial statements items.

We communicated identified laws and regulations throughout our team and remained alert to any indications of non-compliance throughout the audit. This included communication from the Group to component audit teams of relevant laws and regulations identified at Group level, with a request to report on any indications of potential existence of non-compliance with relevant laws and regulations (irregularities) in these areas, or other areas directly identified by the component team.

As with any audit, there remained a higher risk of non-detection of non-compliance with relevant laws and regulations irregularities, as these may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls.

8. The purpose of our audit work and to whom we owe our responsibilities

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.

Stephen Oxley (Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor

Chartered Accountants
15 Canada Square, London E14 5GL
22 February 2018

GROUP FINANCIAL STATEMENTS

CRITICAL JUDGEMENTS AND ESTIMATES

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 and estimates 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.

The Group's accounting policies do not include any critical judgements. The Group's accounting policies are set out in Notes 1–23 of the Notes to the Group accounts. Of those, the policies which require the most use of management's estimation are as follows:

VALUATION OF INVENTORIES

A feature of the Orthopaedic Reconstruction and Trauma & Extremities franchises (whose finished goods inventory make up approximately 79% of the Group's total finished goods inventory) is the high level of product inventory required, some of which is located at customer premises and is available for customers' immediate use. Complete sets of products, including large and small sizes, have to be made available in this way. These sizes are used less frequently than standard sizes and towards the end of the product life cycle are inevitably in excess of requirements. Adjustments to carrying value are therefore required to be made to orthopaedic inventory to anticipate this situation. These adjustments are calculated in accordance with a formula based on levels of inventory compared with historical usage. This formula is applied on an individual product line basis and is first applied when a product group has been on the market for two years. This method of calculation is considered appropriate based on experience, but it does require management estimate in respect of 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 intangible assets, a number of significant assumptions have to be made when preparing cash flow projections. These include the future rate of market growth, discount rates, the market demand for the products acquired, the future profitability of acquired businesses or products, levels of reimbursement and success in obtaining regulatory approvals. If actual results should differ or changes in expectations 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 and it is Group policy to submit its tax returns to the relevant tax authorities as promptly as possible. At any given time, the Group is involved in disputes and tax audits and will have a number of tax returns potentially subject to audit. 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 tax 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.

GROUP INCOME STATEMENT

	Notes	Year ended 31 December 2017 $ million	Year ended 31 December 2016 $ million	Year ended 31 December 2015 $ million
Revenue	2	4,765	4,669	4,634
Cost of goods sold		(1,248)	(1,272)	(1,143)
Gross profit		3,517	3,397	3,491
Selling, general and administrative expenses	3	(2,360)	(2,366)	(2,641)
Research and development expenses	3	(223)	(230)	(222)
Operating profit	2 & 3	934	801	628
Interest income	4	6	6	11
Interest expense	4	(57)	(52)	(49)
Other finance costs	4	(10)	(16)	(15)
Share of results of associates	11	6	(3)	(16)
Profit on disposal of business	21	–	326	–
Profit before taxation		879	1,062	559
Taxation	5	(112)	(278)	(149)
Attributable profit for the year[1]		767	784	410
Earnings per ordinary share[1]	6			
Basic		87.8¢	88.1¢	45.9¢
Diluted		87.7¢	87.8¢	45.6¢

GROUP STATEMENT OF COMPREHENSIVE INCOME

	Notes	Year ended 31 December 2017 $ million	Year ended 31 December 2016 $ million	Year ended 31 December 2015 $ million
Attributable profit for the year[1]		767	784	410
Other comprehensive income:				
Items that will not be reclassified to income statement				
Re-measurement of net retirement benefit obligations	18	64	(81)	(8)
Taxation on other comprehensive income	5	(9)	10	10
Total items that will not be reclassified to income statement		55	(71)	2
Items that may be reclassified subsequently to income statement				
Cash flow hedges – forward foreign exchange contracts				
– (losses)/gains arising in the year		(45)	(15)	34
– losses/(gains) transferred to inventories for the year		21	20	(50)
Fair value remeasurement of available for sale asset		(10)	10	–
Exchange differences on translation of foreign operations		181	(134)	(176)
Total items that may be reclassified subsequently to income statement		147	(119)	(192)
Other comprehensive income/(loss) for the year, net of taxation		202	(190)	(190)
Total comprehensive income for the year[1]		969	594	220

1 Attributable to equity holders of the Company and wholly derived from continuing operations.

The Notes on pages 119–162 are an integral part of these accounts.

GROUP FINANCIAL STATEMENTS

GROUP BALANCE SHEET

	Notes	At 31 December 2017 $ million	At 31 December 2016 $ million
Assets			
Non-current assets			
Property, plant and equipment	7	1,049	982
Goodwill	8	2,371	2,188
Intangible assets	9	1,371	1,411
Investments	10	21	25
Investments in associates	11	118	112
Other non-current assets	13	16	–
Retirement benefit assets	18	62	–
Deferred tax assets	5	127	97
		5,135	4,815
Current assets			
Inventories	12	1,304	1,244
Trade and other receivables	13	1,258	1,185
Cash at bank	15	169	100
		2,731	2,529
Total assets		7,866	7,344
Equity and liabilities			
Equity attributable to owners of the Company			
Share capital	19	178	180
Share premium		605	600
Capital redemption reserve		17	15
Treasury shares	19	(257)	(432)
Other reserves		(228)	(375)
Retained earnings		4,329	3,970
Total equity		4,644	3,958
Non-current liabilities			
Long-term borrowings	15	1,423	1,564
Retirement benefit obligations	18	131	164
Other payables	14	128	82
Provisions	17	97	134
Deferred tax liabilities	5	97	94
		1,876	2,038
Current liabilities			
Bank overdrafts and loans	15	27	86
Trade and other payables	14	957	884
Provisions	17	129	147
Current tax payable	5	233	231
		1,346	1,348
Total liabilities		3,222	3,386
Total equity and liabilities		7,866	7,344

The accounts were approved by the Board and authorised for issue on 22 February 2018 and are signed on its behalf by:

Roberto Quarta
Chairman

Olivier Bohuon
Chief Executive Officer

Graham Baker
Chief Financial Officer

The Notes on pages 119–162 are an integral part of these accounts.

GROUP CASH FLOW STATEMENT

	Notes	Year ended 31 December 2017 $ million	Year ended 31 December 2016 $ million	Year ended 31 December 2015 $ million
Cash flows from operating activities				
Profit before taxation		879	1,062	559
Net interest expense	4	51	46	38
Depreciation, amortisation and impairment		447	463	493
Loss on disposal of property, plant and equipment and software		13	15	15
Distribution from trade investments		–	–	3
Share-based payments expense (equity settled)	23	31	27	29
Share of results of associates	11	(6)	3	16
Profit on disposal of business	21	–	(326)	–
Net movement in post-retirement benefit obligations		(40)	(85)	(57)
Increase in inventories		(17)	(47)	(83)
Increase in trade and other receivables		(40)	(74)	(26)
(Decrease)/increase in trade and other payables and provisions		(45)	(49)	216
Cash generated from operations[1]		1,273	1,035	1,203
Interest received		2	3	8
Interest paid		(50)	(48)	(44)
Income taxes paid		(135)	(141)	(137)
Net cash inflow from operating activities		1,090	849	1,030
Cash flows from investing activities				
Acquisitions, net of cash acquired	21	(159)	(214)	(44)
Capital expenditure	2	(376)	(392)	(358)
Investment in associate	11	–	–	(25)
Purchase of investments	10	(8)	(2)	(2)
Proceeds on disposal of business	21	–	343	–
Tax on disposal of business		–	(118)	–
Net cash used in investing activities		(543)	(383)	(429)
Cash flows from financing activities				
Proceeds from issue of ordinary share capital		5	10	16
Purchase of own shares		(52)	(368)	(77)
Proceeds from borrowings due within one year	20	53	34	42
Settlement of borrowings due within one year	20	(64)	(38)	(26)
Proceeds from borrowings due after one year	20	570	890	831
Settlement of borrowings due after one year	20	(706)	(759)	(1,062)
Proceeds from own shares		5	6	5
Settlement of currency swaps	20	24	(25)	(15)
Equity dividends paid	19	(269)	(279)	(272)
Net cash used in financing activities		(434)	(529)	(558)
Net increase/(decrease) in cash and cash equivalents		113	(63)	43
Cash and cash equivalents at beginning of year	20	38	102	65
Exchange adjustments	20	4	(1)	(6)
Cash and cash equivalents at end of year[2]		155	38	102

1 Includes $15m (2016: $62m, 2015: $52m) of outgoings on restructuring and rationalisation expenses, $3m (2016: $24m, 2015: $36m) of acquisition-related costs and $25m (2016: $36m, 2015: $3m) of legal and other costs.

2 Cash and cash equivalents is net of bank overdrafts of $14m (2016: $62m, 2015: $18m).

The Notes on pages 119–162 are an integral part of these accounts.

GROUP FINANCIAL STATEMENTS

GROUP STATEMENT OF CHANGES IN EQUITY

	Share capital $ million	Share premium $ million	Capital redemption reserve $ million	Treasury shares[2] $ million	Other reserves[3] $ million	Retained earnings $ million	Total equity $ million
At 31 December 2014	184	574	11	(315)	(64)	3,650	4,040
Attributable profit for the year[1]	–	–	–	–	–	410	410
Other comprehensive (expense)/income	–	–	–	–	(192)	2	(190)
Equity dividends declared and paid	–	–	–	–	–	(272)	(272)
Share-based payments recognised	–	–	–	–	–	29	29
Taxation on share-based payments	–	–	–	–	–	5	5
Purchase of own shares	–	–	–	(77)	–	–	(77)
Cost of shares transferred to beneficiaries	–	–	–	38	–	(33)	5
Cancellation of treasury shares	(1)	–	1	60	–	(60)	–
Issue of ordinary share capital[4]	–	16	–	–	–	–	16
At 31 December 2015	183	590	12	(294)	(256)	3,731	3,966
Attributable profit for the year[1]	–	–	–	–	–	784	784
Other comprehensive expense	–	–	–	–	(119)	(71)	(190)
Equity dividends declared and paid	–	–	–	–	–	(279)	(279)
Share-based payments recognised	–	–	–	–	–	27	27
Taxation on share-based payments	–	–	–	–	–	2	2
Purchase of own shares	–	–	–	(368)	–	–	(368)
Cost of shares transferred to beneficiaries	–	–	–	40	–	(34)	6
Cancellation of treasury shares	(3)	–	3	190	–	(190)	–
Issue of ordinary share capital[4]	–	10	–	–	–	–	10
At 31 December 2016	180	600	15	(432)	(375)	3,970	3,958
Attributable profit for the year[1]	–	–	–	–	–	767	767
Other comprehensive income	–	–	–	–	147	55	202
Equity dividends declared and paid	–	–	–	–	–	(269)	(269)
Share-based payments recognised	–	–	–	–	–	31	31
Taxation on share-based payments	–	–	–	–	–	(3)	(3)
Purchase of own shares	–	–	–	(52)	–	–	(52)
Cost of shares transferred to beneficiaries	–	–	–	26	–	(21)	5
Cancellation of treasury shares	(2)	–	2	201	–	(201)	–
Issue of ordinary share capital[4]	–	5	–	–	–	–	5
At 31 December 2017	178	605	17	(257)	(228)	4,329	4,644

1 Attributable to equity holders of the Company and wholly derived from continuing operations.

2 Refer to Note 19.2 for further information.

3 Other reserves comprises gains and losses on cash flow hedges, foreign exchange differences on translation of foreign operations and net changes on fair value of trading investments. The cumulative translation loss within other reserves at 31 December 2017 was $207m (2016: $388m loss, 2015: $254m loss).

4 Issue of ordinary share capital as a result of options being exercised.

The Notes on pages 119–162 are an integral part of these accounts.

NOTES TO THE GROUP ACCOUNTS

1 BASIS OF PREPARATION

Smith & Nephew plc (the Company) is a public limited company incorporated in England and Wales. In these accounts, the 'Group' means the Company and all its subsidiaries. The principal activities of the Group are to develop, manufacture, market and sell medical devices and services.

As required by the European Union's IAS Regulation and the Companies Act 2006, the Group has prepared its accounts in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU) effective as at 31 December 2017. 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 2017. IFRSs as adopted by the EU differs in certain respects from IFRS as issued by the IASB. However, the differences have no impact for the periods presented.

The preparation of accounts in conformity with IFRS requires management to use estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the accounts and the reported amounts of revenues and expenses during the year. The accounting policies requiring management to use significant estimates and assumptions are: inventories, impairment, taxation and liability provisions. These are discussed on page 114. 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. Further information regarding the Group's business activities, together with the factors likely to affect its future development, performance and position, are set out in Our Business & Marketplace on pages 8–17.

As described in Note 15, the Group meets its funding requirements through a mixture of shareholders' funds, bank borrowings and private placement notes. At 31 December 2017, the Group had committed borrowing facilities of $2.4bn and total liquidity of $1.2bn, including net cash and cash equivalents of $155m and undrawn committed borrowing facilities of $1bn. The earliest expiry date of the Group's committed borrowing facilities is in respect of a $300m bilateral term loan facility due to expire in April 2020. In addition, Note 16 includes the Group's objectives, policies and processes for managing its capital; our financial risk management objectives; details of our financial instruments and hedging activities; and our exposures to foreign exchange, interest rates and credit risk.

The Group's forecasts and projections, taking into account reasonably possible changes in trading performance, show that the Group has sufficient financial resources. The Directors have reasonable expectation that the Company and the Group are well placed to manage their business risks and to continue in operational existence for a period of at least three years from the date of the approval of the financial statements. Accordingly, the Directors continue to adopt the going concern basis (in accordance with the guidance 'Guidance on Risk Management, Internal Control and Related Financial and Business Reporting' issued by the FRC) in preparing the consolidated financial statements.

There have been no new accounting pronouncements impacting the Group in 2017.

New accounting standards effective 2018

A number of new standards, amendments to standards and interpretations are effective for the Group's annual periods beginning on or after 1 January 2018, and have not been applied in preparing these consolidated accounts. These include IFRS 15 *Revenue from contracts with customers* and IFRS 9 *Financial Instruments* which will be adopted from 1 January 2018.

IFRS 15

The Group has undertaken a detailed impact assessment applying IFRS 15 to all the current ways in which the Group delivers products or services to customers to identify divergence with current practice and has concluded that IFRS 15 will not have a significant impact on the timing and recognition of revenue. The performance obligations involved in the sale of an orthopaedic implant are all considered to occur at the time of procedure giving rise to no difference in the timing of revenue recognition. The instrument set and implant used in an orthopaedic procedure are considered to be part of a single performance obligation. In line with past practice we will continue to measure and recognise revenue based on invoiced amounts at the time of the procedure. Revenue recognised on the sale of products in our other surgical and wound businesses have also been considered with reference to IFRS 15 with no impact identified in relation to the timing and measurement of revenue. The Group has also considered the impact on provisions for returns, trade discounts and rebates and has determined that the current policy is aligned with IFRS 15.

The Group intends to apply the practical expedients in IFRS 15 to not disclose the amount of the transaction price allocated to the remaining performance obligations and an explanation of when the Group expects to recognise that amount as revenue for all reporting periods presented before 1 January 2018. The Group also intends to apply the practical expedients in relation to contracts with variable consideration and contracts that were completed at the beginning of the earliest period presented and/or modified before the beginning of the earliest period presented. The Group has concluded that applying these practical expedients will not have a significant impact on the timing, measurement and recognition of revenue.

The Group has assessed the disclosure requirements of IFRS 15 and has preliminarily determined that the majority of the disclosures are either currently included in the financial statements or can be prepared using data currently available. The Group continues to assess the disclosure requirements in relation to unsatisfied performance obligations and the disaggregation of revenue.

NOTES TO THE GROUP ACCOUNTS continued

1 BASIS OF PREPARATION continued

IFRS 9

The amendments to IFRS 9 mainly relate to the classification and measurement of financial instruments, and will not have a significant impact to the Group financial statements. When initially applying IFRS 9, the Group may choose as its accounting policy to continue to apply the hedge accounting requirements of IAS 39 instead of the requirements in IFRS 9. The Group will continue to apply the hedge requirements of IAS 39 on transition. The Group has considered the expected credit loss model and has determined that it will not have a significant impact on the provision for bad and doubtful debts. The Group has elected, from 1 January 2018, to present changes in the fair value of trade investments in the income statement.

New accounting standards effective 2019

IFRS 16

IFRS 16 *Leases* will be adopted retrospectively with the cumulative effect of initially applying the standard recognised at 1 January 2019 and the Group is currently assessing the application and impact of the standard.

1.1 Consolidation

The Group accounts include the accounts of Smith & Nephew plc and its subsidiaries for the periods during which they were members of the Group.

Subsidiaries are entities controlled by the Group. The Group controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Subsidiaries are consolidated in the Group accounts from the date that the Group obtains control, and continue to be consolidated until the date that such control ceases. Intra-group balances and transactions, and any unrealised income and expenses arising from intra-group transactions, are eliminated on consolidation. All subsidiaries have year ends which are co-terminus with the Group's, with the exception of jurisdictions whereby a different year end is required by local legislation.

When the Group loses control over a subsidiary, it derecognises the assets and liabilities of the subsidiary and any related components of equity. Any resulting gain or loss is recognised in profit or loss. Any retained interest in the former subsidiary is measured at fair value.

1.2 Foreign currencies

Functional and presentation currency

The Group accounts are presented in US Dollars. The Company's functional currency is US Dollars.

Foreign currency transactions

Transactions in foreign currencies are translated to the respective functional currencies of Group companies at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are retranslated to the functional currency as at the exchange rate at the reporting date. Non-monetary items are not retranslated.

Foreign operations

Balance sheet items of foreign operations, including goodwill and fair value adjustments arising on acquisition are translated into US Dollars on consolidation at the exchange rates at the reporting date. Income statement items and the cash flows of foreign operations are translated at average rates as an approximation to actual transaction rates, with actual transaction rates used for large one off transactions.

Foreign currency differences are recognised in 'Other comprehensive income' and accumulated in 'Other reserves' within equity. These include: exchange differences on the translation at closing rates of exchange of non-US Dollar opening net assets; the differences arising between the translation of profits into US Dollars at actual (or average, as an approximation) and closing exchange rates; to the extent that the hedging relationship is effective, the difference on translation of foreign currency borrowings or swaps that are used to finance or hedge the Group's net investments in foreign operations; and the movement in the fair value of forward foreign exchange contracts used to hedge forecast foreign exchange cash flows.

The exchange rates used for the translation of currencies into US Dollars that have the most significant impact on the Group results were:

	2017	2016	2015
Average rates			
Sterling	1.29	1.35	1.53
Euro	1.13	1.11	1.11
Swiss Franc	1.02	1.02	1.04
Year end rates			
Sterling	1.35	1.23	1.48
Euro	1.20	1.05	1.09
Swiss Franc	1.02	0.98	1.00

2 BUSINESS SEGMENT INFORMATION

The Group is engaged in a single business activity, being the development, manufacture and sale of medical technology products and services.

Development, manufacturing, supply chain and central functions are managed globally for the Group as a whole. Sales are managed through two geographical selling regions: US and International; with a president for each who is responsible for the commercial review of that region. The Executive Committee ('ExCo'), comprises geographical presidents and certain heads of function and is chaired by the Chief Executive Officer ('CEO'). ExCo is the body through which the CEO uses the authority delegated to him by the Board of Directors to manage the operations and performance of the Group. All significant operating decisions regarding the allocation and prioritisation of the Group's resources and assessment of the Group's performance are made by ExCo, and whilst the members have individual responsibility for the implementation of decisions within their respective areas, it is at the ExCo level that these decisions are made. Accordingly, ExCo is considered to be the Group's chief operating decision maker as defined by IFRS 8 *Operating Segments*.

In making decisions about the prioritisation and allocation of the Group's resources, ExCo reviews financial information on an integrated basis for the Group as a whole and determines the best allocation of resources to Group-wide projects. This information is prepared substantially on the same basis as the Group's IFRS financial statements aside from the adjustments described in Note 2.2. In assessing performance, ExCo also considers financial information presented on a geographical selling region and product franchise basis for revenue. Financial information for corporate and functional costs is presented on a Group-wide basis.

The types of products and services offered by the Group's global business segment are as follows:

- Sports Medicine Joint Repair, which offers surgeons a broad array of instruments, technologies and implants necessary to perform minimally invasive surgery of the joints;
- Arthroscopic Enabling Technologies, which offers healthcare providers a variety of technologies such as fluid management equipment for surgical access, high definition cameras, digital image capture, scopes, light sources and monitors to assist with visualisation inside the joints, radio frequency, electromechanical and mechanical tissue resection devices, and hand instruments for removing damaged tissue;
- Trauma & Extremities, consisting of internal and external devices used in the stabilisation of severe fractures and deformity correction procedures;
- Other Surgical Businesses, which includes robotics-assisted surgery, various products and technologies to assist in surgical treatment of the ear, nose and throat, and gynaecological instrumentation, until the Gynaecology business disposal in August 2016;
- Knee Implants, which offers an innovative range of products for specialised knee replacement procedures;
- Hip Implants, which offers a range of specialist products for reconstruction of the hip joint;
- Advanced Wound Care, which includes products for the treatment and prevention of acute and chronic wounds, including leg, diabetic and pressure ulcers, burns and post-operative wounds;
- Advanced Wound Bioactives, which includes biologics and other bioactive technologies that provide unique approaches to debridement and dermal repair/regeneration; and
- Advanced Wound Devices, which consists of traditional and single-use Negative Pressure Wound Therapy and hydrosurgery systems.

The segment information is prepared in conformity with the accounting policies of the Group and the accounting standard IFRS 8 *Operating Segments*.

The segment profit measure reported to the Chief Executive Officer and the ExCo for the purposes of resource allocation and assessment is trading profit and excludes the effects of non-recurring, infrequent, non-cash and other items that management does not otherwise believe are indicative of the underlying performance of the consolidated Group as discussed in Note 2.2. Group financing (including interest receivable and payable) is managed on a net basis outside the business segment.

NOTES TO THE GROUP ACCOUNTS continued

2.1 Revenue by business segment and geography

Accounting policy

Revenue comprises sales of products and services to third parties at amounts invoiced net of trade discounts and rebates, excluding taxes on revenue. Revenue from the sale of products is recognised upon transfer to the customer of the significant risks and rewards of ownership. This is generally when goods are delivered to customers. There is no significant revenue associated with the provision of discrete services. In Established Markets we typically sell direct to healthcare institutions while in our Emerging Markets we typically sell to distributors and intermediaries. In general our surgical business is more direct to hospitals and ambulatory service centres whereas in our wound business, and in particular products used in community and homecare facilities, it is through wholesalers. Sales of inventory located at customer premises and available for customers' immediate use are recognised when notification is received that the product has been implanted or used. Appropriate provisions for returns, trade discounts and rebates are deducted from revenue. Rebates comprise retrospective volume discounts granted to certain customers on attainment of certain levels of purchases from the Group. These are accrued over the course of the arrangement based on estimates of the level of business expected and adjusted at the end of the arrangement to reflect actual volumes.

Segment revenue reconciles to statutory revenues from continuing operations as follows:

	2017 $ million	2016 $ million	2015 $ million
Reportable segment revenue			
Revenue from external customers	4,765	4,669	4,634

In presenting information on the basis of geographical segments, segment revenue is based on location of Smith & Nephew businesses:

	2017 $ million	2016 $ million	2015 $ million
Geographical segment revenue			
United Kingdom	244	266	301
United States of America	2,332	2,299	2,217
Other[1]	2,189	2,104	2,116
Consolidated revenue from continuing operations	4,765	4,669	4,634

1 No other country represents more than 6% of consolidated sales revenue from continuing operations.

The table below shows revenue by product type from continuing operations. Included within the 2015 analysis is a reclassification of $58m of product sales formerly included in the Sports Medicine Joint Repair franchise which has now been included in the Arthroscopic Enabling Technologies franchise in order to present analysis in line with 2017 management reporting on a consistent basis.

	2017 $ million	2016 $ million	2015 $ million
Revenue by product from continuing operations			
Knee Implants	984	932	883
Hip Implants	599	597	604
Trauma & Extremities	495	475	497
Sports Medicine Joint Repair	627	587	548
Arthroscopic Enabling Technologies	615	631	631
Other Surgical Businesses	189	214	205
Advanced Wound Care	720	719	755
Advanced Wound Bioactives	342	342	344
Advanced Wound Devices	194	172	167
Consolidated revenue from continuing operations	4,765	4,669	4,634

Major customers

No single customer generates revenue greater than 10% of the consolidated revenue.

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; amortisation and impairment of acquisition intangibles; significant restructuring programmes; gains and losses arising from legal disputes; and other significant items. Further detail is provided in Notes 2.3, 2.4 and 2.5. Operating profit reconciles to trading profit as follows:

	2017 $ million	2016 $ million	2015 $ million
Operating profit of the business segment	934	801	628
Acquisition-related costs	(10)	9	12
Restructuring and rationalisation expenses	–	62	65
Amortisation and impairment of acquisition intangibles	140	178	204
Legal and other	(16)	(30)	190
Trading profit of the business segment	1,048	1,020	1,099

2.3 Acquisition-related costs

Acquisition-related costs credit of $10m (2016: $9m charge, 2015: $12m charge) relates to a remeasurement of contingent consideration for a prior year acquisition partially offset by costs associated with the acquisition of Rotation Medical, Inc.

2.4 Restructuring and rationalisation expenses

No restructuring and rationalisation costs were incurred in 2017 (2016: $62m, 2015: $65m). In 2016 and 2015, these costs primarily related to the ongoing implementation of the Group Optimisation Plan which was completed in 2016.

2.5 Legal and other

The legal and other credit within operating profit of $16m (2016: $30m credit, 2015: $190m charge) primarily related to a $54m credit recognised following a settlement payment received from Arthrex relating to patent litigation, partially offset by legal expenses for patent litigation with Arthrex and ongoing metal-on-metal hip claims. In 2017 there was a $10m increase in the provision that reflects the present value of the estimated costs to reduce all other known and anticipated metal-on-metal hip claims.

2.6 Assets and liabilities by business segment and geography

	2017 $ million	2016 $ million	2015 $ million
Reconciliation of assets of the business segment to the consolidated group			
Assets of the business segment	7,508	7,147	6,929
Unallocated corporate assets:			
– Deferred tax assets	127	97	105
– Retirement benefit assets	62	–	13
– Cash at bank	169	100	120
Total assets of the consolidated group	7,866	7,344	7,167

In presenting information on the basis of geographical segments, non-current segment assets are based on their location:

	2017 $ million	2016 $ million	2015 $ million
Geographical segment assets			
United Kingdom	364	335	366
United States of America	3,295	3,145	2,982
Other	1,287	1,238	1,226
Total non-current assets of the consolidated group[1]	4,946	4,718	4,574

1 Non-current assets excludes retirement benefit assets and deferred tax assets.

NOTES TO THE GROUP ACCOUNTS continued

2 BUSINESS SEGMENT INFORMATION continued

	2017 $ million	2016 $ million	2015 $ million
Reconciliation of liabilities of the business segment to the consolidated group			
Liabilities of the business segment	1,311	1,247	1,197
Unallocated corporate liabilities:			
– Long-term borrowings	1,423	1,564	1,434
– Retirement benefit obligations	131	164	184
– Deferred tax liabilities	97	94	77
– Bank overdrafts and loans – current	27	86	46
– Current tax payable	233	231	263
Total liabilities of the consolidated group	3,222	3,386	3,201
Depreciation, amortisation and impairment of the business segment			
Depreciation of property, plant and equipment	243	224	226
Amortisation of acquisition intangibles	130	130	153
Amortisation of other intangible assets	62	61	66
Total depreciation and amortisation	435	415	445
Impairment losses on acquisition intangibles[1]	10	48	51
Impairment loss/(reversal) on trade investments[1]	2	–	(3)
Total depreciation, amortisation and impairment	447	463	493

1 Impairments recognised in operating profit, within the administrative expenses line.

Segment acquisition of property, plant and equipment and intangibles reconciles to that of the consolidated group, and comprises the following:

	2017 $ million	2016 $ million	2015 $ million
Additions to property, plant and equipment	308	320	303
Additions to intangibles	68	72	55
Capital expenditure (excluding business combinations)	376	392	358
Trade investments	8	2	2
Acquisitions – Goodwill	132	211	34
Acquisitions – Intangible assets	61	85	19
Acquisitions – Property, plant and equipment	1	2	6
Capital and acquisition expenditure	578	692	419

3 OPERATING PROFIT

Accounting policies

Research and development

Research expenditure is expensed as incurred. Internal development expenditure is only capitalised if the recognition criteria in IAS 38 *Intangible Assets* have been satisfied. The Group considers that the regulatory, technical and market uncertainties inherent in the development of new products mean that in most cases development costs should not be capitalised as intangible assets until products receive approval from the appropriate regulatory body.

Payments to third parties for research and development projects are accounted for based on the substance of the arrangement. If the arrangement represents outsourced research and development activities the payments are generally expensed except in limited circumstances where the respective development expenditure would be capitalised under the principles established in IAS 38. By contrast, the payments are capitalised if the arrangement represents consideration for the acquisition of intellectual property developed at the risk of the third party.

Capitalised development expenditures are amortised on a straight-line basis over their useful economic lives from product launch.

Advertising costs

Advertising costs are expensed as incurred.

	2017 $ million	2016 $ million	2015 $ million
Revenue	4,765	4,669	4,634
Cost of goods sold	(1,248)	(1,272)	(1,143)
Gross profit	3,517	3,397	3,491
Research and development expenses	(223)	(230)	(222)
Selling, general and administrative expenses:			
Marketing, selling and distribution expenses	(1,781)	(1,712)	(1,735)
Administrative expenses[1,2,3,4]	(579)	(654)	(906)
	(2,360)	(2,366)	(2,641)
Operating profit	934	801	628

1 2017 includes $62m of amortisation of software and other intangible assets (2016: $61m, 2015: $66m).

2 2017 includes $140m of amortisation and impairment of acquisition intangibles (2016: $62m of restructuring and rationalisation expenses and $178m of amortisation and impairment of acquisition intangibles, 2015: $65m of restructuring and rationalisation expenses and $204m of amortisation and impairment of acquisition intangibles).

3 2017 includes $16m credit relating to legal and other items (2016: $30m credit, 2015: $190m charge).

4 2017 includes $10m credit of acquisition-related costs (2016: $9m charge, 2015: $12m charge).

Note that items detailed in 2, 3, 4 are excluded from the calculation of trading profit, the segment profit measure.

Operating profit is stated after charging/(crediting) the following items:

	2017 $ million	2016 $ million	2015 $ million
Other operating income	(66)	(25)	(41)
Amortisation of intangibles	192	191	219
Impairment of intangible assets	10	48	51
Depreciation of property, plant and equipment	243	224	226
Loss on disposal of property, plant and equipment and intangible assets	13	15	15
Operating lease payments for land and buildings	36	39	37
Operating lease payments for other assets	21	19	20
Advertising costs	102	88	91

In 2017 other operating income primarily relates to a gain relating to patent litigation (2016: insurance recovery relating to metal-on-metal claims, 2015: net gain relating to patent litigation).

NOTES TO THE GROUP ACCOUNTS continued

3 OPERATING PROFIT continued

3.1 Staff costs and employee numbers

Staff costs during the year amounted to:

	Notes	2017 $ million	2016 $ million	2015 $ million
Wages and salaries		1,157	1,227	1,193
Social security costs		178	129	135
Pension costs (including retirement healthcare)[1]	18	64	23	58
Share-based payments	23	31	27	30
		1,430	1,406	1,416

1 In 2016, pension costs include the past service cost credit of $49m arising primarily from the closure of the UK defined benefit scheme to future accrual.

During the year ended 31 December 2017, the average number of employees was 16,333 (2016: 15,584, 2015: 14,686).

3.2 Audit Fees – information about the nature and cost of services provided by the auditor

	2017 $ million	2016 $ million	2015 $ million
Audit services:			
Group accounts	2.4	2.0	2.1
Local statutory audit pursuant to legislation	2.0	2.0	2.0
Other services:			
Non-audit services	0.1	0.5	0.5
Taxation services:			
Compliance services	–	0.1	0.5
Advisory services	–	–	–
Total auditor's remuneration	4.5	4.6	5.1
Arising:			
In the UK	2.5	2.5	2.5
Outside the UK	2.0	2.1	2.6
	4.5	4.6	5.1

4 INTEREST AND OTHER FINANCE COSTS

4.1 Interest income/(expense)

	2017 $ million	2016 $ million	2015 $ million
Interest income	6	6	11
Interest expense:			
Bank borrowings	(11)	(9)	(9)
Private placement notes	(38)	(37)	(37)
Other	(8)	(6)	(3)
	(57)	(52)	(49)
Net interest expense	(51)	(46)	(38)

4.2 Other finance costs

	Notes	2017 $ million	2016 $ million	2015 $ million
Retirement benefit net interest expense	18	(5)	(7)	(11)
Unwinding of discount		(5)	(9)	(3)
Other		–	–	(1)
Other finance costs		(10)	(16)	(15)

Foreign exchange gains or losses arose primarily on the translation of intercompany and third party borrowings and amounted to a net $25m loss in 2017 (2016: net $22m gain, 2015: net $11m gain). These amounts were matched by the fair value gains or losses on currency swaps held to manage this currency risk.

5 TAXATION

Accounting policy

The charge for current taxation is based on the results for the year as adjusted for items which are non-assessable or disallowed. It is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

The Group operates in numerous tax jurisdictions around the world and it is Group policy to submit its tax returns to the relevant tax authorities as promptly as possible. At any given time, the Group is involved in disputes and tax audits and will have a number of tax returns potentially subject to audit. 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 tax provision whenever necessary. The ultimate tax liability may differ from the amount provided depending on interpretations of tax law, settlement negotiations or changes in legislation.

Deferred tax is recognised in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.

Deferred tax is not recognised: for temporary differences related to investments in subsidiaries and associates where the Group is able to control the timing of the reversal of the temporary difference and it is probable that this will not reverse in the foreseeable future; on the initial recognition of non-deductible goodwill; and on the initial recognition of an asset or liability in a transaction that is not a business combination and that, at the time of the transaction, does not affect the accounting or taxable profit.

Deferred tax assets are recognised to the extent that it is probable that future taxable profits will be available against which they can be used. Deferred tax assets are reviewed at each reporting date.

Deferred tax is measured on an undiscounted basis, and at the tax rates that have been enacted or substantively enacted by the reporting date that are expected to apply in the periods in which the asset or liability is settled. It is recognised in the income statement except when it relates to items credited or charged directly to other comprehensive income or equity, in which case the deferred tax is also recognised within other comprehensive income or equity respectively.

Deferred tax assets and liabilities are offset when they relate to income taxes levied by the same taxation authority, when the Group intends to settle its current tax assets and liabilities on a net basis and that authority permits the Group to make a single net payment.

5.1 Taxation charge attributable to the Group

	2017 $ million	2016 $ million	2015 $ million
Current taxation:			
UK corporation tax	23	23	31
Overseas tax	177	261	219
Current income tax charge	200	284	250
Adjustments in respect of prior periods	(60)	(53)	(56)
Total current taxation	140	231	194
Deferred taxation:			
Origination and reversal of temporary differences	32	24	(73)
Changes in tax rates	(49)	–	(3)
Adjustments to estimated amounts arising in prior periods	(11)	23	31
Total deferred taxation	(28)	47	(45)
Total taxation as per the income statement	112	278	149
Taxation in other comprehensive income	9	(10)	(10)
Taxation in equity	3	(2)	(5)
Taxation attributable to the Group	124	266	134

The 2017 and 2016 net prior period adjustment benefits of $71m and $30m respectively mainly relate to provision releases following agreement reached with the IRS on US tax matters after the conclusion of US tax audits in 2017 and 2016, provision releases on the expiry of statute of limitations and tax accrual to tax return adjustments, partially offset by an increase in certain other tax provisions. The 2015 net prior period adjustment benefit of $25m mainly relates to provision releases after settlement with tax authorities or the expiry of statute of limitations and tax accrual to tax return adjustments.

Included in the total tax charge is a $32m net benefit as a result of the new US tax reform legislation enacted in December 2017, which comprises a benefit from a revaluation of deferred tax balances included within changes in tax rates, partially offset by a current tax charge relating to the deemed repatriation of foreign profits not previously taxed in the US.

Total taxation as per the income statement of $112m includes a $58m net credit (2016: $48m net charge, 2015: $130m net credit) as a consequence of the net benefit from US tax reform, acquisitions and disposals, amortisation and impairment of acquisition intangibles and legal and other.

NOTES TO THE GROUP ACCOUNTS continued

5 TAXATION continued

Factors affecting future tax charges

The Group operates in numerous tax jurisdictions around the world and is subject to factors that may affect future tax charges including the recently enacted US tax reform, the review by the European Commission into whether the UK CFC financing exemption rules constitute illegal State Aid, implementation of the OECD's BEPS actions, tax rate changes, tax legislation changes, expiry of the statute of limitations and resolution of tax audits and disputes.

At any given time the Group has unagreed years outstanding in various countries and is involved in tax audits and disputes, some of which may take several years to resolve. Current tax payable of $233m includes $201m of provisions for uncertain tax positions in respect of various countries. The Group believes that it has made adequate provision in respect of additional tax liabilities that may arise from these unagreed years, tax audits and disputes, the majority of which relate to transfer pricing matters as would be expected for a Group operating internationally. However, the actual liability for any particular issue may be higher or lower than the amount provided resulting in a negative or positive effect on the tax charge in any given year, including a reduction in the tax charge because of an expiry of the relevant statute of limitations. Whilst the impact can vary from year to year, the negative or positive effect on the tax charge for 2018 is not expected to result in a net prior period adjustment for 2018 which is greater than that realised in 2017.

The Group has completed its review of the new US tax reform legislation, as enacted, including the reduction of the US federal tax rate from 35% to 21%, which came into effect on 1 January 2018. As a result, the Group expects a positive impact on its tax charge for future years in addition to the one-off net tax benefit of $32m in 2017. However, it should be noted that parts of the new legislation are subject to questions of interpretation, and further regulations may be issued in the future to clarify or change certain elements, which may affect future tax charges.

In December 2016, the Group appealed to the First Tier Tribunal in the UK against a decision by HM Revenue and Customs (HMRC) relating to the tax deductibility of certain historical foreign exchange losses. The decision of the Tribunal was released on 8 February 2017 and it upheld the Group's appeal. HMRC appealed against this decision and their appeal will be heard by the Upper Tribunal in June 2018. No tax benefit has been recognised to date in respect of these foreign exchange losses. In the event that the Group is ultimately successful in the Courts, then the Group's tax charge would be reduced, in the year of success, as a result.

In 2016, the UK Government enacted legislation to reduce the main rate of UK statutory corporation tax to 19.0% from 1 April 2017 and 17.0% from 1 April 2020.

The UK standard rate of corporation tax for 2017 is 19.3% (2016: 20.0%, 2015: 20.3%). Overseas taxation is calculated at the rates prevailing in the respective jurisdictions. The table below reconciles the expected tax charge at the UK statutory rate with the actual tax charge:

	2017 $ million	2016 $ million	2015 $ million
Profit before taxation	879	1,062	559
Expected taxation at UK statutory rate of 19.3% (2016: 20.0%, 2015: 20.3%)	169	212	113
Differences in overseas taxation rates[1]	48	34	52
Disposal of the Gynaecology business (mainly at the US tax rate)	–	56	–
Benefit of US Manufacturing deduction	(9)	(7)	(7)
R&D credits	(3)	(3)	(6)
Tax losses not recognised	10	1	11
Utilisation of previously unrecognised tax losses	(6)	(9)	–
Impact of US tax reform	(32)	–	–
Expenses not deductible for tax purposes	11	23	14
Changes in tax rates	(5)	1	(3)
Adjustments in respect of prior years[2]	(71)	(30)	(25)
Total taxation as per the income statement	112	278	149

1 Mainly relates to profits taxed in the US at a rate higher than the UK statutory rate and includes the impact of intra-group loans provided to finance US acquisitions and business operations.

2 The adjustments in respect of prior years are explained on the previous page.

5.2 Deferred taxation

Movements in the main components of deferred tax assets and liabilities were as follows:

	Accelerated tax depreciation $ million	Intangibles $ million	Retirement benefit obligation $ million	Macrotexture $ million	Inventory, provisions, losses and other differences $ million	Total $ million
At 31 December 2015	(62)	(223)	39	52	222	28
Exchange adjustment	–	2	–	–	(3)	(1)
Movement in income statement – current year	–	34	(16)	–	(42)	(24)
Movement in income statement – prior years	(11)	6	(2)	–	(16)	(23)
Movement in other comprehensive income	–	–	7	–	(1)	6
Movement in equity	–	–	–	–	2	2
Changes in tax rate	–	1	–	–	(1)	–
Acquisitions	–	(29)	–	–	44	15
At 31 December 2016	(73)	(209)	28	52	205	3
Exchange adjustment	1	(2)	2	–	13	14
Movement in income statement – current year	(9)	15	(6)	(1)	(31)	(32)
Movement in income statement – prior years	2	4	–	–	5	11
Movement in other comprehensive income	–	–	(17)	–	4	(13)
Movement in equity	–	–	–	–	(3)	(3)
Changes in tax rate	29	71	–	(18)	(33)	49
Acquisitions	–	(22)	–	–	23	1
At 31 December 2017	(50)	(143)	7	33	183	30

Represented by:

	2017 $ million	2016 $ million
Deferred tax assets	127	97
Deferred tax liabilities	(97)	(94)
Net position at 31 December	30	3

The Group has gross unused trading and non-trading tax losses of $271m (2016: $230m) and gross unused capital losses of $113m (2016: $122m) available for offset against future profits of which $32m of trading losses will expire within 3-8 years from the balance sheet date if not utilised. A deferred tax asset of $38m (2016: $45m) has been recognised in respect of $132m (2016: $109m) of the trading and non-trading tax losses. No deferred tax asset has been recognised on the remaining unused tax losses as they are not expected to be realised in the foreseeable future. There are no temporary differences in respect of investments in subsidiaries and associates for which deferred tax liabilities have not been recognised (2016: temporary differences of approximately $483m).

NOTES TO THE GROUP ACCOUNTS continued

6 EARNINGS PER ORDINARY SHARE

Accounting policies

Earnings per share

Basic earnings per share is calculated by dividing the profit attributable to equity holders by the weighted average number of ordinary shares in issue during the year, excluding shares held by the Company in the Employees' Share Trust or as treasury shares.

Diluted earnings per share

Diluted earnings per share is calculated by adjusting the basic earnings per share for the effect of conversion to ordinary shares associated with dilutive potential ordinary shares, which comprise share options and awards granted to employees.

Adjusted earnings per share

Adjusted earnings per share is a trend measure, which presents the long-term profitability of the Group excluding the impact of specific transactions that management considers affects the Group's short-term profitability. The Group presents this measure to assist investors in their understanding of trends. Adjusted attributable profit is the numerator used for this measure. The Group has identified the following items as those to be excluded when arriving at adjusted attributable profit: acquisitions and disposals related items including amortisation and impairment of acquisition intangible assets; significant restructuring programmes; significant gains and losses arising from legal disputes and other significant items (including US tax reform) and taxation thereon.

The calculations of the basic, diluted and adjusted earnings per ordinary share are based on the following attributable profit and numbers of shares:

	2017 $ million	2016 $ million	2015 $ million
Earnings			
Attributable profit for the year	767	784	410
Adjusted attributable profit (see below)	826	735	761

Attributable profit is reconciled to adjusted attributable profit as follows:

	Notes	2017 $ million	2016 $ million	2015 $ million
Attributable profit for the year		767	784	410
Acquisition-related costs		(10)	9	25
Restructuring and rationalisation expenses	3	–	62	65
Amortisation and impairment of acquisition intangibles	9	140	178	204
Legal and other[1]		(13)	(20)	187
Profit on disposal of business	21	–	(326)	–
US tax reform	5	(32)	–	–
Taxation on excluded items	5	(26)	48	(130)
Adjusted attributable profit		826	735	761

1 Legal and other credit in 2017 includes $16m within operating profits (refer to Note 2.5), and a $3m charge within other finance costs for unwinding of the discount on the provision for known, anticipated and settled metal-on-metal hip claims. In 2016 the legal and other credit includes $30m within operating profits (refer to Note 2.5), a $5m charge within other finance costs for unwinding of the discount on the provision for known, anticipated and settled metal-on-metal hip claims, and a $5m charge within share of results of associates for expenses incurred by Bioventus for an aborted initial public offering of shares. In 2015 legal and other costs include $190m within operating profit (refer to Note 2.5) and a $3m net interest credit.

The numerators used for basic and diluted earnings per ordinary share are the same. The denominators used for all categories of earnings for basic and diluted earnings per ordinary share are as follows:

	2017	2016	2015
Number of shares (millions)			
Basic weighted number of shares	874	890	894
Dilutive impact of share options outstanding	1	3	5
Diluted weighted average number of shares	875	893	899
Earnings per ordinary share			
Basic	87.8¢	88.1¢	45.9¢
Diluted	87.7¢	87.8¢	45.6¢
Adjusted[2]	94.5¢	82.6¢	85.1¢

2 Adjusted earnings per share is calculated using the basic weighted number of shares.

7 PROPERTY, PLANT AND EQUIPMENT

Accounting policies

Property, plant and equipment

Items of property, plant and equipment are stated at cost less accumulated depreciation and any accumulated impairment losses.

Depreciation is calculated to write off the cost of items of property, plant and equipment less their estimated residual values using the straight-line method over their estimated useful lives, and is ultimately recognised in profit or loss. Leased assets are depreciated over the shorter of the lease term and their useful lives unless it is reasonably certain that the Group will obtain ownership by the end of the lease term. Freehold land is not depreciated. The estimated useful lives of items of property, plant and equipment is 3–20 years and for buildings is 20–50 years.

Assets in course of construction are not depreciated until they are available for use.

Depreciation methods, useful lives and residual values are reviewed at each reporting date and adjusted if appropriate.

Finance costs relating to the purchase or construction of property, plant and equipment and intangible assets that take longer than one year to complete are capitalised based on the Group weighted average borrowing costs. All other finance costs are expensed as incurred.

Impairment of assets

The carrying values of property, plant and equipment are reviewed for impairment when events or changes in circumstances indicate the carrying value may be impaired. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of impairment loss. Where it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash-generating unit to which it belongs.

An asset's recoverable amount is the higher of an asset's or cash-generating unit's fair value less costs to sell and its value-in-use. In assessing value-in-use, its estimated future cash flow is discounted to its present value using a pre-tax discount rate that reflects the current market assessment of the time value of money and the risks specific to the asset.

NOTES TO THE GROUP ACCOUNTS continued

7 PROPERTY, PLANT AND EQUIPMENT continued

	Notes	Land and buildings Freehold $ million	Land and buildings Leasehold $ million	Plant and equipment Instruments $ million	Plant and equipment Other $ million	Assets in course of construction $ million	Total $ million
Cost							
At 1 January 2016		154	58	1,042	1,003	156	2,413
Exchange adjustment		(6)	–	(22)	(46)	(5)	(79)
Acquisitions	21	–	–	2	–	–	2
Additions		1	1	166	72	80	320
Disposals	21	–	–	(76)	(39)	(3)	(118)
Transfers		16	60	4	33	(113)	–
At 31 December 2016		165	119	1,116	1,023	115	2,538
Exchange adjustment		6	1	63	33	3	106
Acquisitions	21	–	–	–	1	–	1
Additions		1	–	176	28	103	308
Disposals		–	(27)	(73)	(79)	(12)	(191)
Transfers		56	(20)	2	56	(115)	(21)
At 31 December 2017		228	73	1,284	1,062	94	2,741
Depreciation and impairment							
At 1 January 2016		48	35	732	655	11	1,481
Exchange adjustment		(3)	–	(15)	(34)	–	(52)
Charge for the year		5	7	131	81	–	224
Disposals		–	–	(67)	(30)	–	(97)
At 31 December 2016		50	42	781	672	11	1,556
Exchange adjustment		3	–	45	24	–	72
Charge for the year		6	7	146	84	–	243
Disposals		–	(22)	(67)	(74)	(11)	(174)
Transfers		2	3	(1)	(9)	–	(5)
At 31 December 2017		61	30	904	697	–	1,692
Net book amounts							
At 31 December 2017		167	43	380	365	94	1,049
At 31 December 2016		115	77	335	351	104	982

Land and buildings includes land with a cost of $21m (2016: $19m) that is not subject to depreciation. There were no assets held under finance leases at 31 December 2017 (2016: assets held under finance leases with a net book value of $5m were included within land and buildings).

Transfers from assets in course of construction includes $4m (2016: $nil) of software and $12m (2016: $nil) net book value of other non-current assets.

Group capital expenditure relating to property, plant and equipment contracted but not provided for amounted to $26m (2016: $55m).

The amount of borrowing costs capitalised in 2017 and 2016 was minimal.

8 GOODWILL

Accounting policy

Goodwill is not amortised but is reviewed for impairment annually. Goodwill is allocated to the cash-generating unit (CGU) that is expected to benefit from the acquisition. The goodwill is tested annually for impairment by comparing the recoverable amount to the carrying value of the CGUs. The CGUs identified by management are at the aggregated product franchise levels of Orthopaedics, Other Surgical Devices and Advanced Wound Management, in the way the core assets are used to generate cash flows.

If the recoverable amount of the CGU is less than its carrying amount then an impairment loss is determined to have occurred. Any impairment losses that arise are recognised immediately in the income statement and are allocated first to reduce the carrying amount of goodwill and then to the carrying amounts of the other assets of the CGU.

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

	Notes	2017 $ million	2016 $ million
Cost			
At 1 January		2,188	2,012
Exchange adjustment		51	(35)
Acquisitions	21	132	211
At 31 December		2,371	2,188
Impairment			
At 1 January and 31 December		–	–
Net book amounts		2,371	2,188

Management has identified four CGUs in applying the provisions of IAS 36 Impairment of Assets: Orthopaedics (Reconstruction and Trauma), Other Surgical Devices, Advanced Wound Care & Devices and Bioactives.

For the purpose of goodwill impairment testing, the Advanced Wound Care & Devices and Bioactives CGUs have been aggregated (Advanced Wound Management), as this is the level at which goodwill is monitored and level at which the economic benefits relating to the goodwill within these CGUs is realised.

Goodwill is allocated to the Group's CGUs as follows:

	2017 $ million	2016 $ million
Orthopaedics	566	551
Other Surgical Devices	1,501	1,351
Advanced Wound Management	304	286
	2,371	2,188

Impairment reviews were performed in September 2017 and September 2016 by comparing the recoverable amount of each CGU with its carrying amount, including goodwill. These were updated during December, taking into account any significant events that occurred between September and December.

For each CGU, the recoverable amounts are based on value-in-use which is calculated from pre-tax cash flow projections for five years using data from the Group's budget and strategic planning process, the results of which are reviewed and approved by the Board. These projections exclude any estimated future cash inflows or outflows expected to arise from future restructurings. The five-year period is in line with the Group's strategic planning process. In determining the growth rates used in the calculations of the value-in-use, management considered annual revenue growth. Projections are based on anticipated volume and value growth in the markets served by the Group and assumptions as to market share movements. Each year the projections for the previous year are compared to actual results and variances are factored into the assumptions used in the current year.

The discount rates used in the value-in-use calculations reflect management's assessment of risks specific to the assets of each CGU.

8.1 Orthopaedics CGU

The sales growth and trading profit margin used in the value-in-use calculation for the Orthopaedics CGU, which includes the Reconstruction and Trauma businesses, reflects management's distinctive orthopaedic reconstruction strategy, which combines cutting edge innovation, disruptive business models and a strong Emerging Markets platform to drive outperformance.

Revenue growth rates for the five-year period ranged from 1.0% to 10.6% for the various components of the Orthopaedics CGU. The average growth rate used to extrapolate the cash flows beyond the five-year period in calculating the terminal value is 2.0%. The pre-tax discount rate used in the Orthopaedics CGU value-in-use calculation reflects the geographical mix and is 10.0%.

NOTES TO THE GROUP ACCOUNTS continued

8 GOODWILL continued

8.2 Other Surgical Devices CGU

The value-in-use calculation for the Other Surgical Devices CGU reflects growth rates and trading profit margins consistent with management's strategy to rebalance Smith & Nephew towards higher growth areas such as, for example, Sports Medicine.

Revenue growth rates for the five-year period ranged from 1.0% to 9.0% for the various components of the Other Surgical Devices CGU. The weighted average growth rate used to extrapolate the cash flows beyond the five-year period in calculating the terminal value is 2.0%. The pre-tax discount rate used in the Other Surgical Devices CGU value-in-use calculation reflects the geographical mix of the revenues and is 10.0%.

8.3 Advanced Wound Management CGU

The aggregated Advanced Wound Management CGU comprises the Advanced Wound Care & Devices and Bioactives CGUs.

In performing the value-in-use calculation for this combined CGU, management considered the Group's focus across the wound product franchises, focusing on widening access to the customer, the higher added value sectors of healing chronic wounds and tissue repair using bioactives, and by continuing to improve efficiency.

Revenue growth rates for the five-year period ranged from 2.0% to 17.3% for the various components of the Advanced Wound Management CGU. The weighted average growth rate used to extrapolate the cash flows beyond the five-year period in calculating the terminal value is 2.0%. The pre-tax discount rate used in the Advanced Wound Management CGU value-in-use calculation reflects the geographical mix and industry sector and is 10.0%.

8.4 Sensitivity to changes in assumptions used in value-in-use calculations

The calculations of value-in-use for the identified CGUs are most sensitive to changes in discount and growth rates. Management's consideration of these sensitivities is set out below:

- Growth of market and market share – management has considered the impact of a variance in market growth and market share. The value-in-use calculations shows that if the assumed long-term growth rates were reduced to nil, the recoverable amount of each CGU would still be greater than its carrying value.
- Discount rate – management has considered the impact of an increase in the discount rate applied to the value-in-use calculations. This sensitivity analysis shows that for the recoverable amount of each CGU to be less than its carrying value, the discount rate would have to be increased to 29.5% for the Orthopaedics CGU, 16.6% for the Other Surgical Devices CGU and 26.3% for the Advanced Wound Management CGU.

9 INTANGIBLE ASSETS

Accounting policies

Intangible assets

Intangible assets acquired separately from a business combination (including purchased patents, know-how, trademarks, licences and distribution rights) are initially measured at cost. The cost of intangible assets acquired in a material business combination (referred to as acquisition intangibles) is the fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. All intangible assets are amortised on a straight-line basis over their estimated useful economic lives. The estimated useful economic life of an intangible asset ranges between three and 20 years depending on its nature. Internally-generated intangible assets are expensed in the income statement as incurred. Purchased computer software and certain costs of information technology projects are capitalised as intangible assets. Software that is integral to computer hardware is capitalised as plant and equipment.

Contingent consideration

Contingent consideration receivable associated with the sale of product rights and other assets outside a business combination is recognised at the time of purchase to the extent that the future event upon which the contingent consideration is conditional is within the Group's control, or to the extent that it is considered to be virtually certain that the contingent consideration will become due. If the contingent consideration is outside the Group's control or it cannot be considered virtually certain that it will become due, an asset and corresponding entry in profit and loss is recognised only once it becomes virtually certain that the contingent consideration will become due.

Contingent consideration payable associated with the purchase of product rights and other assets outside a business combination is recognised at the time of sale to the extent that the future event upon which the contingent consideration is conditional is under the control of the seller and it is considered probable that the contingent consideration will become due. Contingent consideration associated within a contingent condition that is within the Group's control is recognised at the point when the contingent condition is met.

Impairment of intangible assets

The carrying values of intangible assets are reviewed for impairment when events or changes in circumstances indicate the carrying value may be impaired. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of impairment loss. Where it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the CGU to which it belongs. An asset's recoverable amount is the higher of an asset's or CGU's fair value less costs to sell and its value-in-use. In assessing value-in-use, its estimated future cash flow is discounted to its present value using a pre-tax discount rate that reflects the current market assessments of the time value of money and the risks specific to the asset.

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

	Technology $ million	Product-related $ million	Customer and distribution related $ million	Software $ million	Total $ million
Cost					
At 1 January 2016	235	1,864	119	289	2,507
Exchange adjustment	(2)	(20)	2	(8)	(28)
Acquisitions[1]	68	17	–	–	85
Additions	–	24	–	48	72
Disposals	–	(36)	–	–	(36)
At 31 December 2016	301	1,849	121	329	2,600
Exchange adjustment	10	38	1	12	61
Acquisitions[1]	59	2	–	–	61
Additions	–	2	3	63	68
Disposals	(6)	(43)	(5)	(5)	(59)
Transfers	(6)	6	–	4	4
At 31 December 2017	358	1,854	120	403	2,735
Amortisation and impairment					
At 1 January 2016	21	759	69	156	1,005
Exchange adjustment	–	(16)	1	(4)	(19)
Charge for the year – amortisation[2]	15	131	10	35	191
Charge for the year – impairment	–	48	–	–	48
Disposals	–	(36)	–	–	(36)
At 31 December 2016	36	886	80	187	1,189
Exchange adjustment	2	21	1	6	30
Charge for the year – amortisation	6	133	15	38	192
Charge for the year – impairment	–	10	–	–	10
Disposals	11	(61)	(3)	(4)	(57)
Transfers	(4)	4	–	–	–
At 31 December 2017	51	993	93	227	1,364
Net book amounts					
At 31 December 2017	307	861	27	176	1,371
At 31 December 2016	265	963	41	142	1,411

1 In 2017 this relates to technology and product-related intangibles acquired with the purchase of Rotation Medical, Inc. In 2016 this relates to technology and product related intangibles acquired with the purchase of Blue Belt Technologies Inc. and BST-CarGel.

2 The amortisation charge between technology and product-related intangibles has been restated by $33m with no impact on the total net book value of intangible assets.

Amortisation and impairment of acquisition intangibles is set out below:

	2017 $ million	2016 $ million
Technology	6	48
Product-related	124	126
Customer and distribution related	10	4
Total	140	178

Group capital expenditure relating to software contracted but not provided for amounted to $nil (2016: $9m). In 2017, a product-related intangible asset was determined to have a value in use below its carrying value, resulting in an impairment charge of $10m being recognised.

In determining the recoverable amount of the Coblation technology asset acquired with the purchase of ArthoCare in 2014, revenue from products utilising this technology was assumed to have a growth rate of 4-5% in the medium term. This supported the carrying value of the Coblation technology asset but a reduction of 4% would give rise to there being no headroom.

In 2016, two product-related intangible assets were determined to have a value in use below their carrying value, resulting in an impairment charge being recognised. The impairment charge primarily relates to $32m from Oasis, calculated using a discount rate of 10.3%, a product right acquired with the Healthpoint acquisition in 2012. The continued reimbursement pressure in 2016 resulted in revenues not increasing at the previously expected rate. The second product-related intangible asset has no residual carrying value.

NOTES TO THE GROUP ACCOUNTS continued

10 INVESTMENTS

Accounting policy

Investments, other than those related to associates, are initially recorded at fair value plus any directly attributable transaction costs on the trade date. The Group has investments in unquoted entities and an entity that holds mainly unquoted equity securities, which by their nature have no fixed maturity date or coupon rate. These investments are classed as 'available-for-sale' carried at fair value. The fair value of these investments are based on the underlying fair value of the equity securities: marketable securities are valued by reference to closing prices in the market; and non-marketable securities are estimated considering factors including the purchase price; prices of recent significant private placements of securities of the same issuer and estimates of liquidation value. Changes in fair value are recognised in other comprehensive income except where management considers that there is objective evidence of an impairment of the underlying equity securities. Objective evidence would include a significant or prolonged decline in the fair value of the investment below its cost less any impairment loss previously recognised. Impairment losses are recognised by reclassifying the losses accumulated in other reserves to profit or loss.

	2017 $ million	2016 $ million
At 1 January	25	13
Additions	8	2
Fair value remeasurement	(10)	10
Impairment	(2)	–
At 31 December	21	25

11 INVESTMENTS IN ASSOCIATES

Accounting policy

Investments in associates, being those entities over which the Group has a significant influence and which is neither a subsidiary nor a joint venture, are accounted for using the equity method, with the Group recording its share of the associates' profit and loss and other comprehensive income. The Group's share of associates' profit or loss is included in one separate income statement line and is calculated after deduction of their respective taxes.

At 31 December 2017 and 31 December 2016, the Group holds 49% of Bioventus LLC (Bioventus). Bioventus is a limited liability company operating as a partnership. The company's headquarters is located in Durham, North Carolina, US. Bioventus focuses its medical product development around its core competencies of orthobiologic therapies and orthopaedic diagnostics from which it develops and markets clinically proven orthopaedic therapies and diagnostic tools, including osteoarthritis pain treatments, bone growth stimulators and ultrasound devices. Bioventus sells bone healing stimulation devices and is a provider of osteoarthritis injection therapies. The Group's ability to recover the value of its investment is dependent upon the ongoing clinical and commercial success of these products. The profit after taxation recognised in the income statement relating to Bioventus was $6m (2016: loss after taxation $3m).

The carrying amount of this investment was reviewed for impairment as at the balance sheet date. For the purposes of impairment testing the recoverable amount of this investment was based on its fair value less cost to sell, estimated using discounted cash flows.

The amounts recognised in the balance sheet and income statement for associates are as follows:

	2017 $ million	2016 $ million
Balance sheet	118	112
Income statement profit/(loss)	6	(3)

Summarised financial information for significant associates

Set out below is the summarised financial information for Bioventus, adjusted for differences with Group accounting policies:

	2017 $ million	2016 $ million
Summarised statement of comprehensive income		
Revenue	301	282
Attributable profit/(loss) for the year	1	(21)
Group adjustments[1]	11	15
Total comprehensive profit/(loss)	12	(6)
Group share of profit/(loss) for the year at 49%	6	(3)

	2017 $ million	2016 $ million
Summarised balance sheet		
Non-current assets	332	364
Current assets	122	105
Non-current liabilities	(246)	(258)
Current liabilities	(47)	(53)
Net assets	161	158
Group's share of net assets at 49%	79	77
Group adjustments[1]	35	32
Group's carrying amount of investment at 49%	114	109

1 Group adjustments include an adjustment to align the useful life of intangible assets with Group policy.

At December 2017, the Group held an equity investment in one other associate (2016: one) with a carrying value of $3m (2016: $3m).

12 INVENTORIES

Accounting policy

Finished goods and work-in-progress are valued at factory cost, including appropriate overheads, on a first-in first-out basis. Raw materials and bought-in finished goods are valued at purchase price. All inventories are reduced to net realisable value where lower than cost. Inventory acquired as part of a business acquisition is valued at selling price less costs to sell and a profit allowance for selling efforts.

Orthopaedic instruments are generally not sold but provided to customers and distributors for use in surgery. They are recorded as inventory until they are deployed at which point they are transferred to plant and equipment and depreciated over their useful economic lives of between three and seven years.

A feature of the orthopaedic business is the high level of product inventory required, some of which is located at customer premises and is available for customers' immediate use (referred to as consignment inventory). Complete sets of product, including large and small sizes, have to be made available in this way. These outer sizes are used less frequently than standard sizes and towards the end of the product life cycle are inevitably in excess of requirements. Adjustments to carrying value are therefore required to be made to orthopaedic inventory to anticipate this situation. These adjustments are calculated in accordance with a formula based on levels of inventory compared with historical or forecast usage. This formula is applied on an individual product line basis and is first applied when a product group has been on the market for two years. This method of calculation is considered appropriate based on experience but it involves management judgements on effectiveness of inventory deployment, length of product lives, phase-out of old products and efficiency of manufacturing planning systems.

	2017 $ million	2016 $ million	2015 $ million
Raw materials and consumables	207	213	205
Work-in-progress	69	55	84
Finished goods and goods for resale	1,028	976	928
	1,304	1,244	1,217

Reserves for excess and obsolete inventories were $296m (2016: $303m, 2015: $322m). The decrease in reserves of $7m in the year comprised a $20m reduction in the reserve relating to the write-off of inventory which was partially offset by foreign exchange movements of $13m. The determination of the estimate of excess and obsolete inventory is a critical accounting estimate and includes assumptions on the future usage of all different items of finished goods. This estimate is not considered to have a range of potential outcomes that is significantly different to the $296m held at 31 December 2017.

The cost of inventories recognised as an expense and included in cost of goods sold amounted to $1,013m (2016: $1,131m, 2015: $961m). In addition, $68m was recognised as an expense within cost of goods sold resulting from inventory write-offs (2016: $85m, 2015: $73m).

Notwithstanding inventory acquired within acquisitions, no inventory is carried at fair value less costs to sell in any year.

NOTES TO THE GROUP ACCOUNTS continued

13 TRADE AND OTHER RECEIVABLES

Accounting policy

Trade and other receivables are carried at amortised cost, less any allowances for uncollectible amounts. They are included in current assets, except for maturities greater than 12 months after the balance sheet date. These are classified as non-current assets.

The Group manages credit risk through credit limits which require authorisation commensurate with the size of the limit and which are regularly reviewed. Credit limit decisions are made based on available financial information and the business case. Significant receivables are regularly reviewed and monitored at Group level. The Group has no significant concentration of credit risk, with exposure spread over a large number of customers and geographies. Furthermore, the Group's principal customers are backed by government and public or private medical insurance funding, which historically represent a lower risk of default. The maximum exposure to credit risk at the reporting date is the fair value of each class of receivable. The Group does not hold any collateral as security.

	2017 $ million	2016 $ million	2015 $ million
Trade and other receivables due within one year			
Trade receivables	1,125	1,042	1,003
Less: provision for bad and doubtful debts	(69)	(54)	(64)
Trade receivables – net	1,056	988	939
Derivatives – forward foreign exchange, currency swaps and interest rate contracts	28	48	33
Other receivables	92	76	83
Prepayments	82	73	83
	1,258	1,185	1,138
Due after more than one year			
Other non-current assets	16	–	–
	1,274	1,185	1,138

Trade receivables are classified as loans and receivables. Management considers that the carrying amount of trade and other receivables approximates to the fair value.

The provision for bad and doubtful debts is based on specific assessments of risk and reference to past default experience. The bad debt expense for the year was $17m (2016: $7m expense, 2015: $25m expense).

Other non-current assets primarily relate to long-term prepayments.

The amount of trade receivables that were past due was as follows:

	2017 $ million	2016 $ million	2015 $ million
Past due not more than three months	225	142	154
Past due more than three months and not more than six months	65	51	45
Past due more than six months and not more than one year	66	70	57
Past due more than one year	105	54	53
	461	317	309
Neither past due nor impaired	664	725	694
Provision for bad and doubtful debts	(69)	(54)	(64)
Trade receivables – net	1,056	988	939

Movements in the provision for bad and doubtful debts were as follows:

	2017 $ million	2016 $ million	2015 $ million
At 1 January	54	64	47
Exchange adjustment	3	(3)	(3)
Acquisitions	1	–	–
Net receivables provided during the year	17	7	25
Utilisation of provision	(6)	(14)	(5)
At 31 December	69	54	64

Trade receivables include amounts denominated in the following major currencies:

	2017 $ million	2016 $ million	2015 $ million
US Dollar	418	416	362
Sterling	54	57	58
Euro	212	193	192
Other	372	322	327
Trade receivables – net	1,056	988	939

14 TRADE AND OTHER PAYABLES

	2017 $ million	2016 $ million
Trade and other payables due within one year		
Trade and other payables	873	807
Derivatives – forward foreign exchange, currency swaps and interest rate contracts	48	39
Acquisition consideration	36	38
	957	884
Other payables due after one year		
Acquisition consideration	124	82
Other payables	4	–
	128	82

The acquisition consideration includes $104m (2016: $56m) contingent upon future events.

The acquisition consideration due after more than one year is expected to be payable as follows: $50m in 2019, $24m in 2020, $43m in 2021, $2m in 2022, and $5m due in over five years (2016: $29m in 2018, $8m in 2019, $20m in 2020, $11m in 2021, and $14m due in over five years).

NOTES TO THE GROUP ACCOUNTS continued

15 CASH AND BORROWINGS

15.1 Net debt

Net debt comprises borrowings and credit balances on currency swaps less cash at bank.

	2017 $ million	2016 $ million
Bank overdrafts and loans due within one year	27	86
Long-term bank borrowings and finance leases	300	440
Private placement notes	1,123	1,124
Borrowings	1,450	1,650
Cash at bank	(169)	(100)
(Debit)/credit balance on derivatives – currency swaps	(2)	1
Credit/(debit) balance on derivatives – interest rate swaps	2	(1)
Net debt	1,281	1,550

Borrowings are repayable as follows:

	Within one year or on demand $ million	Between one and two years $ million	Between two and three years $ million	Between three and four years $ million	Between four and five years $ million	After five years $ million	Total $ million
At 31 December 2017:							
Bank loans	13	–	300	–	–	–	313
Bank overdrafts	14	–	–	–	–	–	14
Private placement notes	–	124	–	264	125	610	1,123
	27	124	300	264	125	610	1,450
At 31 December 2016:							
Bank loans	22	–	300	–	135	–	457
Bank overdrafts	62	–	–	–	–	–	62
Finance lease liabilities	2	2	3	–	–	–	7
Private placement notes	–	–	125	–	264	735	1,124
	86	2	428	–	399	735	1,650

15.2 Assets pledged as security

Assets are pledged as security under normal market conditions. Secured borrowings and pledged assets are as follows:

	2017 $ million	2016 $ million
Finance lease liabilities – due within one year	–	2
Finance lease liabilities – due after one year	–	5
Total amount of secured borrowings	–	7
Total net book value of assets pledged as security:		
Property, plant and equipment	–	5
	–	5

15.3 Liquidity risk exposures

The Board has established a set of policies to manage funding and currency risks. The Group uses derivative financial instruments only to manage the financial risks associated with underlying business activities and their financing.

Liquidity risk is the risk that the Group is not able to settle or meet its obligations on time or at a reasonable price. The Group's policy is to ensure that there is sufficient funding and facilities in place to meet foreseeable borrowing requirements. The Group manages and monitors liquidity risk through regular reporting of current cash and borrowing balances and periodic preparation and review of short and medium-term cash forecasts, having regard to the maturities of investments and borrowing facilities.

The Group has available committed facilities of $2.4bn (2016: $2.4bn). The interest payable on borrowings under committed facilities is either at fixed or floating rates. Floating rates are typically based on the LIBOR (or other reference rate) relevant to the term and currency concerned.

The Company is subject to restrictive covenants under its principal facility agreements. These financial covenants are tested at the end of each half year for the 12 months ending on the last day of the testing period. As of 31 December 2017, the Company was in compliance with these covenants. The facilities are also subject to customary events of default, none of which are currently anticipated to occur.

The Group's committed facilities are:

Facility	Date due
$80 million 2.47% Senior Notes	November 2019
$45 million Floating Rate Senior Notes	November 2019
$300 million bilateral, term loan facility	April 2020
$75 million 3.23% Senior Notes	January 2021
$1.0 billion syndicated, revolving credit facility	March 2021
$190 million 2.97% Senior Notes	November 2021
$75 million 3.46% Senior Notes	January 2022
$50 million 3.15% Senior Notes	November 2022
$105 million 3.26% Senior Notes	November 2023
$100 million 3.89% Senior Notes	January 2024
$305 million 3.36% Senior Notes	November 2024
$25 million Floating Rate Senior Notes	November 2024
$75 million 3.99% Senior Notes	January 2026

15.4 Year end financial liabilities by contractual maturity

The table below analyses the Group's year end financial liabilities by contractual maturity date, including contractual interest payments and excluding the impact of netting arrangements:

	Within one year or on demand $ million	Between one and two years $ million	Between two and five years $ million	After five years $ million	Total $ million
At 31 December 2017					
Non-derivative financial liabilities:					
Bank overdrafts and loans	27	–	300	–	327
Trade and other payables	873	1	1	2	877
Private placement notes	36	161	476	647	1,320
Acquisition consideration	36	50	69	5	160
Derivative financial liabilities:					
Currency swaps/forward foreign exchange contracts – outflow	2,737	–	–	–	2,737
Currency swaps/forward foreign exchange contracts – inflow	(2,739)	–	–	–	(2,739)
	970	212	846	654	2,682
At 31 December 2016					
Non-derivative financial liabilities:					
Bank overdrafts and loans	86	–	435	–	521
Trade and other payables	807	–	–	–	807
Finance lease liabilities	3	3	3	–	9
Private placement notes	36	36	491	800	1,363
Acquisition consideration	38	30	46	16	130
Derivative financial liabilities:					
Currency swaps/forward foreign exchange contracts – outflow	2,284	–	–	–	2,284
Currency swaps/forward foreign exchange contracts – inflow	(2,285)	–	–	–	(2,285)
	969	69	975	816	2,829

The amounts in the tables above are undiscounted cash flows, which differ from the amounts included in the balance sheet where the underlying cash flows have been discounted.

NOTES TO THE GROUP ACCOUNTS continued

15 CASH AND BORROWINGS continued

15.5 Finance leases

Accounting policy

Leases are classified as finance leases when the terms of the lease transfer substantially all the risks and rewards of ownership to the Group. All other leases are classified as operating leases.

The leased assets are measured initially at an amount equal to the lower of their fair value and the present value of the minimum lease payments. Assets held under finance leases are capitalised as property, plant or equipment and depreciated accordingly. Minimum lease payments are apportioned between the finance expense and the reduction in the outstanding liability. The finance expense is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

Future minimum lease payments under finance leases together with the present value of the minimum lease payments are as follows:

	2017 $ million	2016 $ million
Within one year	–	3
After one and within two years	–	3
After two and within three years	–	3
After three and within four years	–	–
After four and within five years	–	–
After five years	–	–
Total minimum lease payments	–	9
Discounted by imputed interest	–	(2)
Present value of minimum lease payments	–	7

In 2017, the Group terminated its finance lease. Present value of minimum lease payments can be split out as: $nil (2016: $2m) due within one year, $nil (2016: $5m) due between one to five years and $nil (2016: $nil) due after five years.

Liquidity and capital resources

The Group's policy is to ensure that it has sufficient funding and facilities to meet foreseeable borrowing requirements.

At 31 December 2017, the Group held $155m (2016: $38m, 2015: $102m) in cash net of bank overdrafts. The Group had committed facilities available of $2,425m at 31 December 2017 of which $1,425m was drawn. Smith & Nephew intends to repay the amounts due within one year using available cash and drawing down on the longer-term facilities.

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 2018, as well as its other known or expected commitments or liabilities, can be met from its existing resources and facilities. The Group's net debt decreased from $1,550m at the beginning of 2017 to $1,281m at the end of 2017, representing an overall decrease of $269m.

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

16 FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Accounting policy

Derivative financial instruments

Derivative financial instruments are initially recognised at fair value on the date a derivative contract is entered into and are subsequently remeasured at their fair value at subsequent balance sheet dates.

Changes in the fair value of derivative financial instruments that are designated and effective as cash flow hedges of forecast third party and intercompany transactions are recognised in other comprehensive income until the associated asset or liability is recognised. Amounts taken to other comprehensive income are transferred to the income statement in the period in which the hedged transaction affects profit and loss. Where the hedged item is the cost of a non-financial asset, the amounts taken to other comprehensive income are transferred to the initial carrying value of the asset.

Currency swaps to match foreign currency net assets with foreign currency liabilities are fair valued at the balance sheet date. Changes in the fair values of currency swaps that are designated and effective as net investment hedges are matched in other comprehensive income against changes in value of the related net assets.

Interest rate derivatives transacted to fix interest rates on floating rate borrowings are accounted for as cash flow hedges and changes in the fair values resulting from changes in market interest rates are recognised in other comprehensive income. Amounts taken to other comprehensive income are transferred to the income statement when the hedged transaction affects profit and loss.

Interest rate derivatives transacted to convert fixed rate borrowings into floating rate borrowings are accounted for as fair value hedges and changes in the fair values resulting from changes in market interest rates are recognised in the income statement.

Any ineffectiveness on hedging instruments and changes in the fair value of derivative financial instruments that do not qualify for hedge accounting are recognised in the income statement within other finance costs as they arise.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. At that point in time, any cumulative gain or loss on the hedging instrument recognised in other comprehensive income is retained there until the forecast transaction occurs. If a hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in other comprehensive income is transferred.

16.1 Foreign exchange exposures

The Group operates in many countries and as a consequence has transactional and translational foreign exchange exposure. It is Group policy for operating units not to hold material unhedged monetary assets or liabilities other than in their functional currencies.

Foreign exchange variations affect trading results in two ways. Firstly, on translation of overseas sales and profits into US Dollars and secondly, transactional exposures arising where some, or all of the costs of sale are incurred in a different currency from the sale. The principal transactional exposures arise as the proportion of costs in US Dollars, Sterling and Swiss Francs exceed the proportion of sales in each of these currencies and correspondingly the proportion of sales in Euros exceeds the proportion of costs in Euros.

The impact of currency movements on the cost of purchases is partly mitigated by the use of forward foreign exchange contracts. The Group uses forward foreign exchange contracts, designated as cash flow hedges, to hedge forecast third party and intercompany trading cash flows up to one year. When a commitment is entered into, forward foreign exchange contracts are normally used to increase the hedge to 100% of the exposure. Cash flows relating to cash flow hedges are expected to occur within 12 months of inception and profits and losses on hedges are expected to enter into the determination of profit (within cost of goods sold) within a further 12-month period. The principal currencies hedged by forward foreign exchange contracts are US Dollars, Euros, Sterling and Singapore Dollars. At 31 December 2017, the Group had contracted to exchange within one year the equivalent of $2.3bn (2016: $1.8bn). Based on the Group's net borrowings as at 31 December 2017, if the US Dollar were to weaken against all currencies by 10%, the Group's net borrowings would decrease by $3m (2016: decrease by $1m) as the Group held a higher amount of foreign denominated cash than foreign denominated borrowings.

If the US Dollar were to weaken by 10% against all other currencies, then the fair value of the forward foreign exchange contracts as at 31 December 2017 would have been $53m lower (2016: $51m lower). Similarly, if the Euro were to weaken by 10% against all other currencies, then the fair value of the forward foreign exchange contracts as at 31 December 2017 would have been $12m higher (2016: $17m higher). Movements in the fair value of forward foreign exchange contracts would be recognised in other comprehensive income and accumulated in the hedging reserve.

A 10% strengthening of the US Dollar or Euro against all other currencies at 31 December 2017 would have had the equal but opposite effect to the amounts shown above, on the basis that all other variables remain constant.

The Group's policy is to hedge all actual foreign exchange exposures and the Group's forward foreign exchange contracts are designated as cash flow hedges. The net impact of transaction related foreign exchange on the income statement from a movement in exchange rates on the value of forward foreign exchange contracts is not significant. In addition, the movements in the fair value of other financial instruments used for hedging such as currency swaps for which hedge accounting is not applied, offset movements in the values of assets and liabilities and are recognised through the income statement.

NOTES TO THE GROUP ACCOUNTS continued

16 FINANCIAL INSTRUMENTS AND RISK MANAGEMENT continued

16.2 Interest rate exposures

The Group is exposed to interest rate risk on cash, borrowings and certain currency and interest rate swaps which are at floating rates. When required the Group uses interest rate derivatives to meet its objective of protecting borrowing costs within parameters set by the Board. These interest rate derivatives are accounted for as cash flow hedges and, as such, changes in fair value resulting from changes in market interest rates are recognised in other comprehensive income and accumulated in the hedging reserve, with the fair value of the interest rate derivatives recorded in the balance sheet.

Additionally, the Group uses interest rate swaps to reduce the overall level of fixed rate debt, within parameters set by the Board. When used in this way, interest rate derivatives are accounted for as fair value hedges. The fair value movement of the derivative is offset in the income statement against the fair value movement in the underlying fixed rate debt.

Based on the Group's gross borrowings as at 31 December 2017, if interest rates were to increase by 100 basis points in all currencies then the annual net interest charge would increase by $6m (2016: $7m). A decrease in interest rates by 100 basis points in all currencies would have an equal but opposite effect to the amounts shown above.

16.3 Credit risk exposures

The Group limits exposure to credit risk on counterparties used for financial instruments through a system of internal credit limits. The financial exposure of a counterparty is determined as the total of cash and deposits, plus the risk on derivative instruments, assessed as the fair value of the instrument plus a risk element based on the nominal value and the historic volatility of the market value of the instrument. The Group does not anticipate non-performance of counterparties and believes it is not subject to material concentration of credit risk as the Group operates within a policy of counterparty limits designed to reduce exposure to any single counterparty.

The maximum credit risk exposure on derivatives at 31 December 2017 was $28m (2016: $48m), being the total debit fair values on forward foreign exchange contracts and currency swaps. The maximum credit risk exposure on cash at bank at 31 December 2017 was $169m (2016: $100m). The Group's exposure to credit risk is not material as the amounts are held in a wide number of banks in a number of different countries.

Credit risk on trade receivables is detailed in Note 13.

16.4 Currency and interest rate profile of interest bearing liabilities and assets

Short-term debtors and creditors are excluded from the following disclosures.

Currency and interest rate profile of interest bearing liabilities:

							Fixed rate liabilities	
	Gross borrowings $ million	Currency swaps $ million	Interest rate swaps $million	Total liabilities $ million	Floating rate liabilities $ million	Fixed rate liabilities $ million	Weighted average interest rate %	Weighted average time for which rate is fixed Years
At 31 December 2017								
US Dollar	(1,428)	(291)	(2)	(1,721)	(866)	(855)	3.4	5.8
Other	(22)	(95)	–	(117)	(117)	–	–	–
Total interest bearing liabilities	(1,450)	(386)	(2)	(1,838)	(983)	(855)		
At 31 December 2016								
US Dollar	(1,588)	(367)	(1)	(1,956)	(1,108)	(862)	3.5	6.8
Other	(62)	(81)	–	(143)	(129)	–	–	–
Total interest bearing liabilities	(1,650)	(448)	(1)	(2,099)	(1,237)	(862)		

At 31 December 2017, $nil (2016: $7m) of fixed rate liabilities related to finance leases. In 2017, the Group also had liabilities due for deferred and contingent acquisition consideration (denominated in US Dollars, Euros, Turkish Lira and Russian Rubles) totalling $160m (2016: $120m, 2015: $27m) on which no interest was payable (see Note 14). There were no other significant interest bearing financial liabilities.

Floating rates on liabilities are typically based on the one, three or six-month LIBOR (or other reference rate) relevant to the currency concerned. The weighted average interest rate on floating rate borrowings as at 31 December 2017 was 3% (2016: 2%).

Currency and interest rate profile of interest bearing assets:

	Interest rate swaps $ million	Cash at bank $ million	Currency swaps $ million	Total assets $ million	Floating rate assets $ million	Fixed rate assets $ million
At 31 December 2017						
US Dollars	–	110	94	204	204	–
Other	–	59	294	353	353	–
Total interest bearing assets	–	169	388	557	557	–
At 31 December 2016						
US Dollars	–	29	83	112	112	–
Other	–	71	366	437	437	–
Total interest bearing assets	–	100	449	549	549	–

Floating rates on assets are typically based on the short-term deposit rates relevant to the currency concerned.

16.5 Fair value of financial assets and liabilities

Accounting policy

Measurement of fair values

A number of the Group's accounting policies and disclosures require the measurement of fair values, for both financial assets and liabilities and non-financial assets acquired in a business combination (see Note 21).

When measuring the fair value of an asset or liability, the Group uses market observable data as far as possible. Fair values are categorised into different levels in the fair value hierarchy based on the inputs used in the valuation techniques as follows: Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities; Level 2: inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and Level 3: inputs for the asset or liability that are not based on observable data (unobservable inputs).

The Group recognises transfers between the levels of the fair value hierarchy at the end of the reporting period during which the change has occurred.

There has been no change in the classification of financial assets and liabilities, the method and assumptions used in determining fair value and the categorisation of financial assets and liabilities within the fair value hierarchy from those disclosed in the Annual Report for the year ended 31 December 2016.

The Group enters into derivative financial instruments with financial institutions with investment grade credit ratings. The fair value of forward foreign exchange contracts is calculated by reference to quoted market forward exchange rates for contracts with similar maturity profiles. The fair value of currency swaps is determined by reference to quoted market spot rates. As a result, foreign forward exchange contracts and currency swaps are classified as Level 2 within the fair value hierarchy. The changes in counterparty credit risk had no material effect on the hedge effectiveness for derivatives designated in hedge relationships and other financial instruments recognised at fair value.

The fair value of investments is based upon third party pricing models for share issues. As a result, investments are considered Level 3 in the fair value hierarchy. There were no transfers between Levels 1, 2 and 3 during 2017 and 2016. For cash and cash equivalents, short-term loans and receivables, overdrafts and other short-term liabilities which have a maturity of less than three months, the book values approximate the fair values because of their short-term nature.

Long-term borrowings are measured in the balance sheet at amortised cost. As the Group's long-term borrowings are not quoted publicly and as market prices are not available, their fair values are estimated by discounting future contractual cash flows to net present values at the current market interest rates available to the Group for similar financial instruments as at the year end.

The fair value of the private placement notes is determined using a discounted cash flow model based on prevailing market rates.

NOTES TO THE GROUP ACCOUNTS continued

16 FINANCIAL INSTRUMENTS AND RISK MANAGEMENT continued

The following table shows the carrying amounts and fair values of financial assets and financial liabilities, including their levels in the fair value hierarchy. It does not include fair value information for financial assets and financial liabilities not measured at fair value if the carrying amount is a reasonable approximation of fair value.

	Carrying amount						Fair value		
At 31 December 2017	Designated at fair value $ million	Fair value – hedging instruments $ million	Loans and receivables $ million	Available for sale $ million	Other financial liabilities $ million	Total $ million	Level 2 $ million	Level 3 $ million	Total $ million
Financial assets measured at fair value									
Forward foreign exchange contracts	–	25	–	–	–	25	25	–	25
Investments	–	–	–	21	–	21	–	21	21
Currency swaps	3	–	–	–	–	3	3	–	3
	3	25	–	21	–	49			
Financial liabilities measured at fair value									
Acquisition consideration	(104)	–	–	–	–	(104)	–	(104)	(104)
Forward foreign exchange contracts	–	(45)	–	–	–	(45)	(45)	–	(45)
Currency swaps	(1)	–	–	–	–	(1)	(1)	–	(1)
Interest rate swaps	–	(2)	–	–	–	(2)	(2)	–	(2)
Private placement debt	–	–	(198)	–	–	(198)	(198)	–	(198)
	(105)	(47)	(198)	–	–	(350)			
Financial assets not measured at fair value									
Trade and other receivables	–	–	1,148	–	–	1,148			
Cash at bank	–	–	169	–	–	169			
	–	–	1,317	–	–	1,317			
Financial liabilities not measured at fair value									
Acquisition consideration	(56)	–	–	–	–	(56)			
Bank overdrafts	–	–	–	–	(14)	(14)			
Bank loans	–	–	–	–	(313)	(313)			
Private placement debt	–	–	–	–	(925)	(925)	(931)	–	(931)
Trade and other payables	–	–	–	–	(877)	(877)			
	(56)	–	–	–	(2,129)	(2,185)			

Total acquisition consideration measured at fair value increased from $56m at 31 December 2016 to $104m at 31 December 2017 due to the addition of $72m relating to the Rotation Medical, Inc. acquisition which was partially offset by $14m of acquisition payments and a remeasurement reduction of $10m. The fair value of contingent consideration is estimated using a discounted cash flow model. The valuation model considers the present value of expected payment, discounted using a risk-adjusted discount rate. The expected payment is determined by considering the possible scenarios, which relate to the achievement of established milestones and targets, the amount to be paid under each scenario and the probability of each scenario. As a result, contingent consideration is classified as Level 3 within the fair value hierarchy.

At 31 December 2016	Designated at fair value $ million	Fair value – hedging instruments $ million	Loans and receivables $ million	Available for sale $ million	Other financial liabilities $ million	Carrying amount Total $ million	Fair value Level 2 $ million	Fair value Level 3 $ million	Fair value Total $ million
Financial assets measured at fair value									
Forward foreign exchange contracts	–	45	–	–	–	45	45	–	45
Investments	–	–	–	25	–	25	–	25	25
Currency swaps	3	–	–	–	–	3	3	–	3
Interest rate swaps	–	–	–	–	–	–	–	–	–
	3	45	–	25	–	73			
Financial liabilities measured at fair value									
Acquisition consideration	(56)	–	–	–	–	(56)	–	(56)	(56)
Forward foreign exchange contracts	–	(36)	–	–	–	(36)	(36)	–	(36)
Currency swaps	(2)	–	–	–	–	(2)	(2)	–	(2)
Interest rate swaps	–	(1)	–	–	–	(1)	(1)	–	(1)
Private placement debt	–	–	(199)	–	–	(199)	(199)	–	(199)
	(58)	(37)	(199)	–	–	(294)			
Financial assets not measured at fair value									
Trade and other receivables	–	–	1,064	–	–	1,064			
Cash at bank	–	–	100	–	–	100			
	–	–	1,164	–	–	1,164			
Financial liabilities not measured at fair value									
Acquisition consideration	(64)	–	–	–	–	(64)			
Bank overdrafts	–	–	–	–	(62)	(62)			
Bank loans	–	–	–	–	(457)	(457)			
Private placement debt	–	–	–	–	(925)	(925)	(935)	–	(935)
Finance lease liabilities	–	–	–	–	(7)	(7)			
Trade and other payables	–	–	–	–	(807)	(807)			
	(64)	–	–	–	(2,258)	(2,322)			

NOTES TO THE GROUP ACCOUNTS continued

17 PROVISIONS AND CONTINGENCIES

Accounting policy

In the normal course of business the Group is involved in various legal disputes. Provisions are made for loss contingencies when it is deemed probable that an adverse outcome will occur and the amount of the losses can be reasonably estimated. Where the Group is the plaintiff in pursuing claims against third parties, legal and associated expenses are charged to the income statement as incurred.

The recognition of provisions for legal disputes is subject to a significant degree of estimation. In making its estimates management takes into account the advice of internal and external legal counsel. Provisions are reviewed regularly and amounts updated where necessary to reflect developments in the disputes. The ultimate liability may differ from the amount provided depending on the outcome of court proceedings or settlement negotiations or as new facts emerge.

A provision for onerous contracts is recognised when the expected benefits to be derived by the Group from a contract are lower than the unavoidable cost of meeting its obligations under the contract. For the purpose of calculating any onerous lease provision, the Group takes the discounted future lease payments (if any), net of expected rental income. Before a provision is established, the Group recognises any impairment loss on the assets associated with that contract.

A provision for rationalisation is recognised when the Group has approved a detailed and formal restructuring plan, and the restructuring either has commenced or has been announced publicly. Future operating losses are not provided for.

17.1 Provisions

	Rationalisation provisions $ million	Metal-on-metal $ million	Legal and other provisions $ million	Total $ million
At 1 January 2016	23	185	118	326
Net charge to income statement	12	–	(1)	11
Acquisitions	–	–	10	10
Unwinding of discount	–	5	–	5
Utilised	(14)	(27)	(30)	(71)
Exchange adjustment	(1)	–	1	–
At 31 December 2016	20	163	98	281
Net charge to income statement	–	10	2	12
Unwinding of discount	–	3	–	3
Utilised	(15)	(19)	(28)	(62)
Transfers	–	–	(9)	(9)
Exchange adjustment	1	–	–	1
At 31 December 2017	6	157	63	226
Provisions – due within one year	6	73	50	129
Provisions – due after one year	–	84	13	97
At 31 December 2017	6	157	63	226
Provisions – due within one year	20	43	84	147
Provisions – due after one year	–	120	14	134
At 31 December 2016	20	163	98	281

The principal elements within rationalisation provisions relate to the Group Optimisation programme (mainly severance) announced in May 2014.

Following the settlement of a large part of the US metal-on-metal hip claims (discussed below) the Group has estimated a provision of $157m (2016: $163m) relating to the present value at 31 December 2017 of the estimated costs to resolve all other known and anticipated metal-on-metal hip claims. The estimated value of the provision has been determined using an actuarial model. Given the inherent uncertainty in assumptions relating to factors such as the number of claims and outcome the actual costs may differ significantly from this estimate. A range of expected outcomes between the 25th and 75th percentile generated by the actuarial model would not give rise to a significantly different outcome in 2018. The provision does not include any possible insurance recoveries on these claims or legal fees associated with defending claims. The Group carries considerable product liability insurance, and will continue to defend claims vigorously.

The legal and other provisions mainly relate to various other product liability and intellectual property litigation matters.

All provisions are expected to be substantially utilised within five years of 31 December 2017 and none are treated as financial instruments.

17.2 Contingencies

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

In August 2003, the Group withdrew voluntarily from all markets the macrotextured versions of its OXINIUM femoral knee components. A charge of $154m was recorded in 2004 for anticipated expenses in connection with macrotexture claims. Most of that amount has since been applied to settlements of such claims, and all claims have now been resolved. The aggregate cost at 31 December 2017 related to this matter is approximately $205m. The Group has sought recovery from its primary and excess insurers for costs of resolving the claims. The primary insurance carrier has paid $60m in full settlement of its policy liability. However, the excess carriers have denied coverage, citing defences relating to the wording of the insurance policies and other matters. In December 2004, the Group brought suit against them in the US district court for the Western District of Tennessee, for which a trial has not yet begun. An additional $22m was received during 2007 from a successful settlement with a third party.

17.3 Legal proceedings

Product liability claims

The Group faces claims from time to time for alleged defects in its products and has on occasion recalled or withdrawn products from the market. Such claims are endemic to the medical device industry. The Group maintains product liability insurance subject to limits and deductibles that management believes are reasonable. All policies contain exclusions and limitations, however, and there can be no assurance that insurance will be available or adequate to cover all claims.

In recent years, there has been heightened concern about possible adverse effects of hip implant products with metal-on-metal bearing surfaces, and the Group has incurred, and will continue to incur expenses to defend claims in this area. As of February 2018, and giving effect to the US settlements described below, approximately 740 such claims were pending with the Group around the world, of which approximately 430 had given rise to pending legal proceedings. Most claims relate to the Group's Birmingham Hip Resurfacing (BHR) product and its two modular metal-on-metal components: the Birmingham Hip Modular Head (BHMH) and the optional metal liner component of the R3 Acetabular System (R3ML). The BHMH and R3ML are no longer on the market: the R3ML was withdrawn in 2012 and the BHMH was phased out in 2014. In 2015, the Group ceased offering smaller sizes of the BHR and restricted instructions for BHR use in female patients. These actions were taken to ensure that the BHR is only used in those patient groups where it continues to demonstrate strong performance.

In 2015 and 2016, the Group's US subsidiary settled a large part of the majority of its US metal-on-metal hip lawsuits in two group settlements, without admitting liability. Insurance receipts covered most of the amounts paid, with the net cash cost being $25m. In November 2017, the Group's US subsidiary entered into a memorandum of understanding to settle a third group of claims, without admitting liability. The third settlement is expected to be finalised in 2018. These cases principally related to the Group's modular metal-on-metal hip components, which are no longer on the market. On 5 April 2017, the Judicial Panel on Multidistrict Litigation (MDL) ordered Smith & Nephew BHR cases pending or later filed in US federal court to be consolidated for pre-trial proceedings and transferred to the federal court in Baltimore, Maryland. There are currently 253 cases pending in the MDL in the United States. In England and Wales, the Group's UK subsidiary entered into a group settlement in 2017 to settle 150 claims principally related to the Group's modular metal-on-metal hip component, which are no longer on the market. Metal-on-metal hip implant claims against various companies in England and Wales have been consolidated for trials under group litigation orders in the High Court in London. The BHR and other claims pending against the Group have been stayed and will not be reactivated until the outcome of those trials is known.

The Group has requested indemnity from its product liability insurers for most of these metal-on-metal hip implant claims. Each insurer makes its own decision as to coverage issues, and the liability of some insurers depends on exhaustion of lower levels of coverage. Insurers of the lower layers of the Group's insurances have indemnified the Group in respect of these claims up to the limits of those insurances. The Group has commenced arbitration proceedings against another insurer in respect of that insurer's share of the claims and associated defence costs in the amount of $50m.

Litigation outcomes are difficult to predict and defence costs can be significant. The Group takes care to monitor the clinical evidence relating to its metal hip implant products and ensure that its product offerings are designed to serve patients' interests.

Intellectual property disputes

The Group is engaged, as both plaintiff and defendant, in litigation with various competitors and others over claims of patent infringement and other intellectual property matters. These disputes are being heard in courts in the US and other jurisdictions and also before agencies that examine patents. Outcomes are rarely certain and costs are often significant.

The Group prosecuted and defended a series of patent infringement suits against Arthrex in US federal courts in Oregon and Texas starting in 2004, principally relating to suture anchors for use in shoulder surgery. Arthrex paid $99m in June 2015 in connection with the Oregon litigation, and most of that award (net of various expenses) was recognised in the Group's operating profit at that time. The Group asserted the same patent against additional Arthrex products in a follow-up suit that was scheduled for trial in February 2017 in the Oregon court. Arthrex asserted its own suture anchor patents against Smith & Nephew in 2014 and 2015 in the US District Court for the Eastern District of Texas. In December 2016, the jury in that case decided that two of the Group's US subsidiaries infringed two asserted Arthrex patents and awarded Arthrex $17.4m. In February 2017, the parties reached a settlement resulting in the dismissal of all patent litigation in Oregon and Texas. Smith & Nephew agreed to pay Arthrex $8m, and each party agreed to additional payments contingent on the outcome of patent validity proceedings currently pending at the US Patent & Trademark Office relating to the asserted patents. In November 2017, the US Patent & Trademark Office issued a Reexamination Certificate confirming validity of certain claims of US Patent No. 5,601,557 asserted by Smith & Nephew against Arthrex in the Oregon litigation. The issuing of the Reexamination Certificate triggered a payment of $80m which was received by Smith & Nephew in December 2017, and $54m (net of various expenses) is recognised in the Group's 2017 operating profit. The Group has fully provided for any possible additional payment relating to its historical sales.

NOTES TO THE GROUP ACCOUNTS continued

17 PROVISIONS AND CONTINGENCIES continued

In February 2016, ConforMIS, Inc. filed suit against the Group's US subsidiary in the Eastern Division of the US District Court for the District of Massachusetts, alleging that a number of its patents (generally directed to patient specific instrumentation associated with knee arthroplasty) are infringed by Smith & Nephew's VISIONAIRE cutting guides and associated knee implants. The suit requests damages and an injunction. Smith & Nephew seeks to invalidate the asserted patents at the US Patent & Trademark Office and has also filed counterclaims for infringement by ConforMIS of the Group's US patents.

17.4 Tax Matters

At any given time the Group has unagreed years outstanding in various countries and is involved in tax audits and disputes, some of which may take several years to resolve. The Group believes that it has made adequate provision in respect of related additional tax liabilities that may arise. See Note 5 for further details.

18 RETIREMENT BENEFIT OBLIGATIONS

Accounting policy

The Group sponsors defined benefit plans in a number of countries. A defined benefit pension plan defines an amount of pension benefit that an employee will receive on retirement or a minimum guaranteed return on contributions, which is dependent on various factors such as age, years of service and final salary. The Group's obligation is calculated separately for each plan by discounting the estimated future benefit that employees have earned in return for their service in the current and prior periods. The fair value of any plan assets is deducted to arrive at the net liability.

The calculation of the defined benefit obligation is performed annually by external actuaries using the projected unit credit method. Re-measurements arising from defined benefit plans comprise actuarial gains and losses and the return on the plan assets net of the costs of managing the plan assets. The Group recognises these immediately in other comprehensive income (OCI) and all other expenses, such as service cost, net interest cost, administration costs and taxes, are recognised in the income statement.

A number of key assumptions are made when calculating the fair value of the Group's defined benefit pension plans. These assumptions impact the balance sheet asset and liabilities, operating profit, finance income/costs and other comprehensive income. The most critical assumptions are the discount rate, the rate of inflation and mortality assumptions to be applied to future pension plan liabilities. The discount rate is based on the yield at the reporting date on bonds that have a credit rating of AA, denominated in the currency in which the benefits are expected to be paid and have a maturity profile approximately the same as the Group's obligations. In determining these assumptions management take into account the advice of professional external actuaries and benchmarks its assumptions against external data.

The Group determines the net interest expense/income on the net defined benefit liability/asset for the period by applying the discount rate used to measure the defined benefit obligation at the beginning of the annual period to the net defined benefit liability/asset.

The Group also operates a number of defined contribution plans. A defined contribution plan is a pension plan under which the Group and employees pay fixed contributions to a third party financial provider. The Group has no further payment obligations once the contributions have been paid. Contributions are recognised as an employee benefit expense when they are due.

18.1 Retirement benefit net obligations/(assets)

The Group's retirement benefit obligations/(assets) comprise:

	2017 $ million	2016 $ million
Funded plans:		
UK Plan	(53)	4
US Plan	(9)	27
Other plans	46	52
	(16)	83
Unfunded plans:		
Other plans	60	55
Retirement healthcare	25	26
	69	164
Amount recognised on the balance sheet – liability	131	164
Amount recognised on the balance sheet – asset	(62)	–

The Group sponsors defined benefit pension plans for its employees or former employees in 16 countries and these are established under the laws of the relevant country. Funded plans are funded by the payment of contributions and the assets are held by separate trust funds or insurance companies. The provision of retirement and related benefits across the Group is kept under regular review. Employees' retirement benefits are the subject of regular management review. The Group's defined benefit plans provide employees with an entitlement to retirement benefits varying between 1.3% and 66.7% of final salary on attainment of retirement age. The level of entitlement is dependent on the years of service of the employee.

The Group's two major defined benefit pension plans are in the UK and US. Both these plans were closed to new employees in 2003 and defined contribution plans are offered to new joiners. The US and UK Plans were closed to future accrual in March 2014 and December 2016 respectively.

The UK Plan operates under trust law and responsibility for its governance lies with a Board of Trustees. This Board is composed of representatives of the Group, plan participants and an independent trustee, who act on behalf of members in accordance with the terms of the Trust Deed and Rules and relevant legislation. The UK Plan's assets are held by the trust. Annual increases on benefits in payment are dependent on inflation.

There is no legislative minimum funding requirement in the UK, however the Group has agreed with the Board of Trustees to pay a schedule of supplementary payments (see Note 18.8). The Trust Deed of the UK Plan and the Plan Document of the US Plan provide the Group with a right to a refund of surplus assets assuming the full settlement of plan liabilities in the event of a plan wind-up. Furthermore, in the ordinary course of business the UK trustee and US committee have no rights to unilaterally wind up, or otherwise augment the benefits due to members of the plans. Based on these rights, any net surplus in the UK and US Plans is recognised in full.

The US Plan is governed by a US Pension Committee which is comprised of both plan participants and representatives of the Group. In the US, the Pension Protection Act (2006) established both a minimum required contribution and a maximum deductible contribution. Failure to contribute at least the minimum required amount will subject the Company to significant penalties, and contributions in excess of the maximum deductible have negative tax consequences. The minimum funding requirement is intended to fully fund the present value of accrued benefits over seven years.

18.2 Reconciliation of benefit obligations and pension assets

The movement in the Group's pension benefit obligation and pension assets is as follows:

			2017			2016
	Obligation $ million	Asset $ million	Total $ million	Obligation $ million	Asset $ million	Total $ million
Amounts recognised on the balance sheet at beginning of the period	(1,577)	1,413	(164)	(1,521)	1,350	(171)
Income statement expense:						
Current service cost	(12)	–	(12)	(19)	–	(19)
Past service credit	4	–	4	51	–	51
Settlements	–	–	–	7	(7)	–
Interest (expense)/income	(44)	42	(2)	(52)	48	(4)
Administration costs and taxes	(3)	–	(3)	(3)	–	(3)
Costs recognised in income statement	(55)	42	(13)	(16)	41	25
Re-measurements:						
Actuarial gain due to liability experience	1	–	1	7	–	7
Actuarial loss due to financial assumptions change	(38)	–	(38)	(301)	–	(301)
Actuarial gain due to demographic assumptions	42	–	42	33	–	33
Return on plan assets greater than discount rate	–	59	59	–	180	180
Re-measurements recognised in OCI	5	59	64	(261)	180	(81)
Cash:						
Employer contributions	–	53	53	–	60	60
Employee contributions	(4)	4	–	(4)	4	–
Benefits paid directly by the Group	2	(2)	–	3	(3)	–
Benefits paid, taxes and administration costs paid from scheme assets	102	(102)	–	61	(61)	–
Net cash	100	(47)	53	60	–	60
Exchange rate movements	(98)	89	(9)	161	(158)	3
Amount recognised on the balance sheet	(1,625)	1,556	(69)	(1,577)	1,413	(164)
Amount recognised on the balance sheet – liability	(290)	159	(131)	(1,577)	1,413	(164)
Amount recognised on the balance sheet – asset	(1,335)	1,397	62	–	–	–

NOTES TO THE GROUP ACCOUNTS continued

18 RETIREMENT BENEFIT OBLIGATIONS continued

Represented by:

	2017			2016		
	Obligation $ million	Asset $ million	Total $ million	Obligation $ million	Asset $ million	Total $ million
UK Plan	(854)	907	53	(844)	840	(4)
US Plan	(481)	490	9	(461)	434	(27)
Other Plans	(290)	159	(131)	(272)	139	(133)
Total	(1,625)	1,556	(69)	(1,577)	1,413	(164)

All benefits are vested at the end of each reporting period. The weighted average duration of the defined benefit obligation at the end of the reporting period is 20 years and 11 years for the UK and US Plans respectively.

18.3 Plan assets

The market value of the US, UK and Other Plans assets are as follows:

	2017 $ million	2016 $ million	2015 $ million
UK Plan:			
Assets with a quoted market price:			
Cash and cash equivalents	8	6	5
Equity securities	235	213	234
Other bonds	43	38	43
Liability driven investments	192	239	171
Diversified growth funds	152	130	144
	630	626	597
Other assets:			
Insurance contract	277	214	214
Market value of assets	907	840	811
US Plan:			
Assets with a quoted market price:			
Cash and cash equivalents	–	–	–
Equity securities	88	178	166
Government bonds – fixed interest	201	128	119
Corporate bonds	201	128	119
Market value of assets	490	434	404
Other Plans:			
Assets with a quoted market price:			
Cash and cash equivalents	4	4	9
Equity securities	43	35	35
Government bonds – fixed interest	4	3	5
– index linked	3	3	9
Corporate and other bonds	11	11	13
Insurance contracts	36	34	28
Property	19	12	8
Other quoted securities	2	2	1
	122	104	108
Other assets:			
Insurance contracts	37	35	27
Market value of assets	159	139	135
Total market value of assets	1,556	1,413	1,350

No plans invest directly in property occupied by the Group or in financial securities issued by the Group.

Both the UK and US Plans hold a mixture of growth assets and matching assets. The growth assets of the UK and US Plans are invested in a diversified range of industries across a broad range of geographies. The UK Plan matching assets include liability matching assets and annuity policies purchased by the trustees, which aim to match the benefits to be paid to certain members from the plan and therefore remove the investment, inflation and demographic risks in relation to those liabilities. The terms of the policy define that the contract value exactly matches the amount and timing of the pensioner obligations covered by the contract. In accordance with IAS19R *Employee Benefits*, the fair value of the insurance contract is deemed to be the present value of the related obligations which is discounted at the AA corporate bond rate. In December 2014, the low risk asset portfolio held by the UK Plan was transferred into liability driven investments (LDI) which invests in a mixture of gilts and swaps.

18.4 Expenses recognised in the income statement

The total expense relating to retirement benefits recognised for the year is $64m (2016: $23m, 2015: $58m). Of this cost recognised for the year, $51m (2016: $48m, 2015: $49m) relates to defined contribution plans and $13m (2016: $25m net credit, 2015: $9m net expense) relates to defined benefit plans.

The cost charged in respect of the Group's defined contribution plans represents contributions payable to these plans by the Group at rates specified in the rules of the plans. These were charged to operating profit in selling, general and administrative expenses. There were $nil outstanding payments as at 31 December 2017 due to be paid over to the plans (2016: $nil, 2015: $nil).

In 2016, the $25m net credit for the year includes a $44m curtailment gain arising from the closure of the UK Plan to future accrual and $5m past service credit relating to redundancies.

In 2015, the $9m net expense for the year includes a $16m past service cost credit arising from amendments to the US Retirement Healthcare plan and a $5m gain arising from benefit options offered to members of the UK Plan.

Defined benefit plan costs comprise service cost which is charged to operating profit in selling, general and administrative expenses and net interest cost and administration costs and taxes which are reported as other finance costs.

The defined benefit pension costs charged for the UK and US Plans are:

	2017		2016		2015	
	UK Plan $ million	US Plan $ million	UK Plan $ million	US Plan $ million	UK Plan $ million	US Plan $ million
Service cost	–	–	7	–	9	–
Past service credit	–	–	(49)	–	(7)	–
Settlement loss	–	–	1	–	2	–
Net interest cost, administration and taxes	1	2	–	3	3	4
	1	2	(41)	3	7	4

18.5 Principal actuarial assumptions

The following are the principal financial actuarial assumptions used at the reporting date to determine the UK and US defined benefit obligations and expense.

	2017 % per annum	2016 % per annum	2015 % per annum
UK Plan:			
Discount rate	2.4	2.6	3.8
Future salary increases	n/a	3.8	3.6
Future pension increases	3.2	3.3	3.1
Inflation (RPI)	3.2	3.3	3.1
Inflation (CPI)	2.2	2.3	2.1
US Plan:			
Discount rate	3.5	4.0	4.3
Future salary increases	n/a	n/a	n/a
Inflation	n/a	n/a	n/a

NOTES TO THE GROUP ACCOUNTS continued

18 RETIREMENT BENEFIT OBLIGATIONS continued

Actuarial assumptions regarding future mortality are based on mortality tables. The UK uses the S2NA with projections in line with the CMI 2016 table and the US uses the RP2014 table with MP2016 scale. The current longevities underlying the values of the obligations in the defined benefit plans are as follows:

	2017 years	2016 years	2015 years
Life expectancy at age 60			
UK Plan:			
Males	28.8	29.7	29.6
Females	30.3	31.1	31.3
US Plan:			
Males	25.2	25.1	25.8
Females	27.4	27.4	28.2
Life expectancy at age 60 in 20 years' time			
UK Plan:			
Males	31.0	32.5	32.6
Females	31.8	33.0	33.4
US Plan:			
Males	25.5	25.4	27.6
Females	28.0	27.9	29.9

18.6 Sensitivity analysis

The calculation of the defined benefit obligation is sensitive to the assumptions used. The following table summarises the increase/decrease on the UK and US defined benefit obligation and pension costs as a result of reasonably possible changes in some of the assumptions while holding all other assumptions consistent. The sensitivity to the inflation assumption change includes corresponding changes to the future salary increases and future pension increase assumptions. The analysis does not take into account the full distribution of cash flows expected under the plan.

Changes to the inflation assumption will not have any effect on the US Pension Plan as it was closed to future accrual in 2014.

	Increase in pension obligation		Increase in pension cost	
$ million	+50bps/+1yr	-50bps/-1yr	+50bps/+1 yr	-50bps/-1yr
UK Plan:				
Discount rate	–80.9	+92.6	–2	+2
Inflation	+88.1	–77.3	+2	–2
Mortality	+38.0	–37.7	+1	–1
US Plan:				
Discount rate	–25.5	+27.9	–1	+1
Inflation	n/a	n/a	n/a	n/a
Mortality	+11.4	–11.6	–	–

18.7 Risk

The pension plans expose the Group to the following risks:

Interest rate risk	Volatility in financial markets can change the calculations of the obligation significantly as the calculation of the obligation is linked to yields on AA-rated corporate bonds. A decrease in the bond yield will increase the measure of plan liabilities, although this will be partially offset by increases in the value of matching plan assets such as bonds and insurance contracts. In the UK, the liability matching portfolio held in conventional and index-linked gilts was transferred into liability driven investments in order to reduce interest rate risk.
Inflation risk	The UK Plan is linked to inflation. A high rate of inflation will lead to a higher liability. This risk is managed by holding inflation-linked bonds and an inflation-linked insurance contract in respect of some of the obligation. In the UK, the liability matching portfolio held in conventional and index-linked gilts was transferred into liability driven investments in order to reduce inflation risk. The UK and US Plans have been closed to future accrual which eliminates the exposure to this risk.
Investment risk	If the return on plan assets is below the discount rate, all else being equal, there will be an increase in the plan deficit. In the UK, this risk is partially managed by a portfolio of liability matching assets and a bulk annuity, together with a dynamic de-risking policy to switch growth assets into liability matching assets over time. The US Plan has a dynamic de-risking policy to shift plan assets into longer-term stable asset classes. The policy established 10 pre-determined funded status levels and when each trigger point is reached, the plan assets are re-balanced accordingly. In 2017, two trigger points were reached and the plan assets were re-balanced such that there was reduced investment in equity securities and increased investment in government and corporate bonds.
Longevity risk	The present value of the plans defined benefit liability is calculated by reference to the best estimate of the mortality of the plan participants both during and after their employment. An increase in the life expectancy of plan participants above that assumed will increase the benefit obligation. The UK Plan, in order to minimise longevity risk, has entered into an insurance contract which covers a portion of pensioner obligations.
Salary risk	The calculation of the defined benefit obligation uses the future estimated salaries of plan participants. Increases in the salary of plan participants above that assumed will increase the benefit obligation. The exposure to salary risk in the UK and US has been eliminated with the closure of these Plans to future accrual.

18.8 Funding

A full valuation is performed by actuaries for the Trustees of each plan to determine the level of funding required. Employer contributions rates, based on these full valuations, are agreed between the Trustees of each plan and the Group. The assumptions used in the actuarial valuations used for funding purposes may differ from those assumptions above.

UK Plan

The most recent full actuarial valuation of the UK Plan was undertaken as at 30 September 2015. The next full actuarial valuation will take place as at 30 September 2018. Contributions to the UK Plan in 2017 were $24m (2016: $32m, 2015: $37m). This included supplementary payments of $24m (2016: $26m, 2015: $29m).

The Group has currently agreed to pay annual supplementary payments of $25m until 2021. These supplementary payments will be reviewed when the 30 September 2018 valuation has been completed.

US Plan

A full actuarial valuation for the US Plan was last undertaken as at 20 September 2013 before the closure of the Plan to future accrual. Contributions to the US Plan were $20m (2016: $20m, 2015: $20m) which represented supplementary payments of $20m.

The planned supplementary contribution for 2018 is being kept under review given the funding status.

NOTES TO THE GROUP ACCOUNTS continued

19 EQUITY

Accounting policy

Incremental costs directly attributable to the issue of ordinary shares, net of any tax effects, are recognised as a deduction from equity.

When shares recognised as equity are repurchased, the amount of the consideration paid, which includes directly attributable costs, net of any tax effects, is recognised as a deduction from equity. Repurchased shares are classified as treasury shares and are presented in the treasury share reserve. When treasury shares are sold or reissued subsequently, the amount received is recognised as an increase in equity and the resulting surplus or deficit on the transaction is presented within share premium.

19.1 Share capital

	Ordinary shares (20¢)		Deferred shares (£1.00)		Total
	Thousand	$ million	Thousand	$ million	$ million
Authorised					
At 31 December 2015	1,223,591	245	50	–	245
At 31 December 2016	1,223,591	245	50	–	245
At 31 December 2017	1,223,591	245	50	–	245
Allotted, issued and fully paid					
At 1 January 2015	917,942	184	50	–	184
Share options	1,855	–	–	–	–
Shares cancelled	(4,350)	(1)	–	–	(1)
At 31 December 2015	915,447	183	50	–	183
Share options	1,283	–	–	–	–
Shares cancelled	(13,007)	(3)	–	–	(3)
At 31 December 2016	903,723	180	50	–	180
Share options	655	–	–	–	–
Shares cancelled	(13,523)	(2)	–	–	(2)
At 31 December 2017	890,855	178	50	–	178

The deferred shares were issued in 2006 in order to comply with English Company law. They are not listed on any stock exchange and have extremely limited rights and effectively have no value. These rights are summarised as follows:

- The holder shall not be entitled to participate in the profits of the Company;
- The holder shall not have any right to participate in any distribution of the Company's assets on a winding up or other distribution except that after the return of the nominal amount paid up on each share in the capital of the Company of any class other than the deferred shares and the distribution of a further $1,000 in respect of each such share there shall be distributed to a holder of a deferred share (for each deferred share held) an amount equal to the nominal value of the deferred share;
- The holder shall not be entitled to receive notice, attend, speak or vote at any general meeting of the Company; and
- The Company may create, allot and issue further shares or reduce or repay the whole or any part of its share capital or other capital reserves without obtaining the consent of the holders of the deferred shares.

The Group's objectives when managing capital are to ensure the Group has adequate funds to continue as a going concern and sufficient flexibility within the capital structure to fund the ongoing growth of the business and to take advantage of business development opportunities including acquisitions.

The Group determines the amount of capital taking into account changes in business risks and future cash requirements. The Group reviews its capital structure on an ongoing basis and uses share buy-backs, dividends and the issue of new shares to adjust the retained capital.

The Group considers the capital that it manages to be as follows:

	2017 $ million	2016 $ million	2015 $ million
Share capital	178	180	183
Share premium	605	600	590
Capital redemption reserve	17	15	12
Treasury shares	(257)	(432)	(294)
Retained earnings and other reserves	4,101	3,595	3,475
	4,644	3,958	3,966

19.2 Treasury shares

Treasury shares represent the holding of the Company's own shares in respect of the Smith & Nephew Employees' Share Trust and shares bought back as part of the share buy-back programme. In 2017 the Group purchased a total of 3.2m shares for a cost of $52m as part of the ongoing programme to buy back an equivalent number of shares to those vesting as part of the employee share plans. During 2016, a total of 24.0m (2.7%) ordinary shares were purchased at a cost of $368m and 13.0m (1.5%) ordinary shares were cancelled. This included a $300m share buy-back programme following the sale of the Group's Gynaecology business that completed in December 2016.

The Smith & Nephew 2004 Employees' Share Trust (Trust) was established to hold shares relating to the long-term incentive plans referred to in the 'Directors' Remuneration Report'. The Trust is administered by an independent professional trust company resident in Jersey and is funded by a loan from the Company. The cost of the Trust is charged to the income statement as it accrues. A dividend waiver is in place in respect of those shares held under the long-term incentive plans. The Trust only accepts dividends in respect of nil-cost options and deferred bonus plan shares. The waiver represents less than 1% of the total dividends paid.

The movements in Treasury shares and the Employees' Share Trust are as follows:

	Treasury $ million	Employees' Share Trust $ million	Total $ million
At 1 January 2016	264	30	294
Shares purchased	368	–	368
Shares transferred from treasury	(18)	18	–
Shares transferred to Group beneficiaries	(13)	(27)	(40)
Shares cancelled	(190)	–	(190)
At 31 December 2016	411	21	432
Shares purchased	52	–	52
Shares transferred from treasury	(19)	19	–
Shares transferred to Group beneficiaries	(9)	(17)	(26)
Shares cancelled	(201)	–	(201)
At 31 December 2017	234	23	257

	Number of shares million	Number of shares million	Number of shares million
At 1 January 2016	18.9	2.3	21.2
Shares purchased	24.0	–	24.0
Shares transferred from treasury	(1.2)	1.2	–
Shares transferred to Group beneficiaries	(0.9)	(2.0)	(2.9)
Shares cancelled	(13.0)	–	(13.0)
At 31 December 2016	27.8	1.5	29.3
Shares purchased	3.2	–	3.2
Shares transferred from treasury	(1.3)	1.3	–
Shares transferred to Group beneficiaries	(0.6)	(1.2)	(1.8)
Shares cancelled	(13.5)	–	(13.5)
At 31 December 2017	15.6	1.6	17.2

NOTES TO THE GROUP ACCOUNTS continued

19 EQUITY continued

19.3 Dividends

	2017 $ million	2016 $ million	2015 $ million
The following dividends were declared and paid in the year:			
Ordinary final of 18.5¢ for 2016 (2015: 19.0¢, 2014: 18.6¢) paid 10 May 2017	162	170	166
Ordinary interim of 12.3¢ for 2017 (2016: 12.3¢, 2015: 11.8¢) paid 1 November 2017	107	109	106
	269	279	272

A final dividend for 2017 of 22.7¢ per ordinary share was proposed by the Board on 8 February 2018 and will be paid, subject to shareholder approval, on 9 May 2018 to shareholders on the Register of Members on 6 April 2018. The estimated amount of this dividend is $198m. The Group pursues a progressive dividend policy, with the aim of increasing the US Dollar value of ordinary dividends over time broadly based on the Group's underlying growth in earnings, while taking into account capital requirements and cash flows. Future dividends will be dependent upon future earnings, the future financial condition of the Group and the Board's dividend policy. The Board reviews the appropriate level of total annual dividend each year at the time of the full year results. The Board intends that the interim dividend will be set by a formula and will be equivalent to 40% of the total dividend for the previous year. Smith & Nephew plc, the Parent Company of the Group, is a non-trading investment holding company which derives its distributable reserves from dividends paid by subsidiary companies. The distributable reserves of the parent company approximate to the balance on the profit and loss account reserve, less treasury shares and exchange reserves, which at 31 December 2017 amounted to $2,569m.

20 CASH FLOW STATEMENT

Accounting policy

In the Group cash flow statement, cash and cash equivalents includes cash at bank, other short-term liquid investments with original maturities of three months or less and bank overdrafts. In the Group balance sheet, bank overdrafts are shown within bank overdrafts and loans under current liabilities.

Analysis of net debt

			Borrowings				
	Cash $ million	Overdrafts $ million	Due within one year $ million	Due after one year $ million	Net currency swaps $ million	Net interest swaps $ million	Total $ million
At 1 January 2015	93	(28)	(11)	(1,666)	(1)	–	(1,613)
Net cash flow impact	34	9	(17)	231	15	1	273
Exchange adjustment	(7)	1	–	1	(16)	–	(21)
At 31 December 2015	120	(18)	(28)	(1,434)	(2)	1	(1,361)
Net cash flow impact	(18)	(45)	4	(129)	25	(2)	(165)
Exchange adjustment	(2)	1	–	(1)	(22)	–	(24)
At 31 December 2016	100	(62)	(24)	(1,564)	1	(1)	(1,550)
Net cash flow impact	64	49	9	139	(24)	(1)	236
Termination of finance lease	–	–	2	3	–	–	5
Exchange adjustment	5	(1)	–	(1)	25	–	28
At 31 December 2017	169	(14)	(13)	(1,423)	2	(2)	(1,281)

Reconciliation of net cash flow to movement in net debt

	2017 $ million	2016 $ million	2015 $ million
Net cash flow from cash net of overdrafts	113	(63)	43
Settlement of currency swaps	(24)	25	15
Net cash flow from borrowings	147	(127)	215
Change in net debt from net cash flow	236	(165)	273
Termination of finance lease	5	–	–
Exchange adjustment	28	(24)	(21)
Change in net debt in the year	269	(189)	252
Opening net debt	(1,550)	(1,361)	(1,613)
Closing net debt	(1,281)	(1,550)	(1,361)

Cash and cash equivalents

For the purposes of the Group cash flow statement cash and cash equivalents at 31 December 2017 comprise cash at bank net of bank overdrafts.

	2017 $ million	2016 $ million	2015 $ million
Cash at bank	169	100	120
Bank overdrafts	(14)	(62)	(18)
Cash and cash equivalents	155	38	102

The Group operates in over 100 countries around the world, some of which impose restrictions over cash movement. These restrictions have only a minimal impact of the management of the Group's cash.

Cash (inflows)/outflows arising from financing activities

							2017
	Repayment of bank loans $ million	Borrowing of bank loans $ million	Cash (inflow)/outflow from other $ million	Dividends $ million	Purchase of own shares $ million	Proceeds from own shares/issue of ordinary shares $ million	Total $ million
Debt	770	(623)	(24)	–	–	–	123
Equity	–	–	–	269	52	(10)	311
Total	770	(623)	(24)	269	52	(10)	434

							2016
	Repayment of bank loans $ million	Borrowing of bank loans $ million	Cash (inflow)/outflow from other $ million	Dividends $ million	Purchase of own shares $ million	Proceeds from own shares/issue of ordinary shares $ million	Total $ million
Debt	797	(924)	25	–	–	–	(102)
Equity	–	–	–	279	368	(16)	631
Total	797	(924)	25	279	368	(16)	529

							2015
	Repayment of bank loans $ million	Borrowing of bank loans $ million	Cash (inflow)/outflow from other $ million	Dividends $ million	Purchase of own shares $ million	Proceeds from own shares/issue of ordinary shares $ million	Total $ million
Debt	1,088	(873)	15	–	–	–	230
Equity	–	–	–	272	77	(21)	328
Total	1,088	(873)	15	272	77	(21)	558

21 ACQUISITIONS AND DISPOSALS

Accounting policy

The Group accounts for business combinations using the acquisition method when control is transferred to the Group. The consideration transferred in the acquisition is measured at fair value, as are the identifiable net assets acquired. Any goodwill that arises is tested annually for impairment. Any gain on a bargain purchase is recognised in profit or loss immediately. Transaction costs are expensed as incurred, except if related to the issue of debt or equity securities.

Any contingent consideration payable is measured at fair value at the acquisition date. If the contingent consideration is classified as equity, then it is not re-measured and settlement is accounted for within equity. Otherwise, subsequent changes in the fair value of the contingent consideration are recognised in profit or loss.

NOTES TO THE GROUP ACCOUNTS continued

21 ACQUISITIONS AND DISPOSALS continued

21.1 Acquisitions

Year ended 31 December 2017

During the year ended 31 December 2017, the Group acquired one medical technology business deemed to be a business combination within the scope of IFRS 3 *Business Combinations*.

On 5 December 2017, the Group completed the acquisition of 100% of the share capital of Rotation Medical, Inc., a developer of a novel tissue regeneration technology for shoulder rotator cuff repair. The acquisition furthers our strategy to invest in disruptive technologies that accelerate the transformation of Smith & Nephew to higher growth. The maximum consideration payable of $210m has a fair value of $196m and includes $17m of deferred and $72m of contingent consideration. The fair value of the contingent consideration is determined from the acquisition agreement, the Board-approved acquisition model and a risk-free discount rate of 2.5%. The maximum contingent consideration is $85m. The provisional fair values of assets acquired and liabilities assumed are set out below:

	$ million
Intangible assets	61
Property, plant & equipment and inventory	3
Trade and other receivables	2
Trade and other payables	(3)
Net deferred tax assets	1
Net assets	64
Goodwill	132
Consideration (net of $nil cash acquired)	196

The goodwill is attributable to the control premium, the acquired workforce and the synergies that can be expected from integrating Rotation Medical, Inc. into the Group's existing business. The goodwill is not expected to be deductible for tax purposes.

During the year ended 31 December 2017, the contribution to revenue and attributable profit from this acquisition is immaterial. If the acquisition had occurred at the beginning of the year, its contribution to revenue and attributable profit would have also been immaterial.

Year ended 31 December 2016

During the year ended 31 December 2016, the Group acquired two medical technology businesses deemed to be business combinations within the scope of IFRS 3 *Business Combinations*. The acquisition accounting was completed during 2017 with no measurement adjustments made.

On 4 January 2016, the Group completed the acquisition of 100% of the share capital of Blue Belt Holdings Inc., a business specialising in robotic technologies. The acquisition secures a leading position in the fast growing area of Orthopaedic robotics-assisted surgery. The fair value of consideration is $265m and includes $51m deferred consideration. The fair values of assets acquired were:

	$ million
Aggregate identifiable assets acquired and liabilities assumed	
Intangible assets	70
Property, plant & equipment and inventory	13
Trade and other payable	(11)
Provisions	(10)
Deferred tax assets	16
Net assets	78
Goodwill	184
Consideration (net of $3m cash acquired)	262

The goodwill is attributable to the revenue synergies of providing a full robotic surgery offering and future applications of the technological expertise. The goodwill is not expected to be deductible for tax purposes.

On 8 January 2016 the Group completed the acquisition of BST-CarGel, a first-line cartilage repair product from Piramal Healthcare (Canada) Limited. The fair value of the consideration is $42m and included $37m of deferred and contingent consideration. The fair values of net assets acquired are: product intangible assets of $15m, inventory of $1m, and a deferred tax liability of $1m. The goodwill, which is expected to be deductible for tax purposes, arising on the acquisition is $27m, is attributable to the future penetration into new markets expected from the transaction.

During the year ended 31 December 2016, the contribution to revenue and attributable profit from these acquisitions is immaterial. If the acquisitions had occurred at the beginning of the year, their contribution to revenue and attributable profit would have also been immaterial.

Year ended 31 December 2015

During the year ended 31 December 2015, the Group acquired its distributor in Colombia and its distributor and a manufacturer in Russia. The acquisitions are deemed to be business combinations within the scope of IFRS 3 *Business Combinations*. The aggregated total fair value of the consideration was $68m and included $23m of contingent consideration and $13m through the settlement of working capital commitments. The acquisition accounting was completed in 2016 with no measurement adjustments being made.

The following table summarises the aggregate consideration transferred and the aggregate fair value amounts of assets acquired and liabilities assumed at the acquisition date:

	$ million
Identifiable assets acquired and liabilities assumed	
Intangible assets	19
Other assets[1]	29
Liabilities	(14)
Net assets	34
Goodwill	34
Consideration (net of $1m cash acquired)	68

1 Including net cash of $1m.

The aggregated goodwill arising on the acquisitions is $34m. This is attributable to the additional economic benefits expected from the transactions, including the assembled workforces, which have been transferred as part of the acquisitions. The goodwill recognised is not deductible for tax purposes. The contribution to revenue and attributable profit from these acquisitions for the year ended 31 December 2015 was immaterial. If the acquisitions had occurred at the beginning of the year, their contributions to revenue and attributable profit for the year ended 31 December 2015 would also have been immaterial.

21.2 Disposal of business

During the year ended 31 December 2016 the Group disposed of its Gynaecology business for cash consideration of $350m. The net assets disposed included $6m plant and equipment, and $4m inventory. Disposal related costs of $7m and liabilities of $7m resulted in a pre-tax gain on disposal of $326m.

For the years ended 31 December 2015 and 31 December 2017, the Group did not dispose of any businesses.

22 OPERATING LEASES

Accounting policy

Leases are classified as finance leases when the terms of the lease transfer substantially all the risks and rewards of ownership to the Group. All other leases are classified as operating leases.

Payments under operating leases are expensed in the income statement on a straight-line basis over the term of the lease. Lease incentives received are recognised as an integral part of the total lease expense, over the term of the lease.

Future minimum lease payments under non-cancellable operating leases fall due as follows:

	2017 $ million	2016 $ million
Land and buildings:		
Within one year	40	33
After one and within two years	35	27
After two and within three years	27	23
After three and within four years	23	16
After four and within five years	19	13
After five years	56	41
	200	153
Other assets:		
Within one year	17	15
After one and within two years	11	11
After two and within three years	5	6
After three and within four years	1	2
	34	34

NOTES TO THE GROUP ACCOUNTS continued

23 OTHER NOTES TO THE ACCOUNTS

23.1 Share-based payments

Accounting policy

The Group operates a number of equity-settled executive and employee share plans. For all grants of share options and awards, the fair value at the grant date is calculated using appropriate option pricing models. The grant date fair value is recognised over the vesting period as an expense, with a corresponding increase in retained earnings.

The Group operates the following equity-settled executive and employee share plans: Smith & Nephew 2001 US Share Plan, Smith & Nephew Global Share Plan 2010, Smith & Nephew ShareSave Plan (2012), Smith & Nephew International ShareSave Plan (2012) and the Smith & Nephew France ShareSave plan (2012). At 31 December 2017, 5,277,000 options (2016: 5,780,000, 2015: 7,235,000) were outstanding with a range of exercise prices from 535 to 1,092 pence.

At 31 December 2017, the maximum number of shares that could be awarded under the Group's long-term incentive plans was 5,854,000 (2016: 5,807,000, 2015: 6,402,000). These include conditional share awards granted to senior employees and equity and performance share awards granted to senior executives under the Global Share Plan 2010.

The expense charged to the income statement for share-based payments for the year is $31m (2016: $27m, 2015: $30m).

23.2 Related party transactions

Trading transactions

In the course of normal operations, the Group traded with its associates detailed in Note 11. The aggregated transactions, which have not been disclosed elsewhere in the financial statements are $nil (2016: $nil, 2015: $nil).

Key management personnel

The remuneration of executive officers (including Non-Executive Directors) during the year is summarised below:

	2017 $ million	2016 $ million	2015 $ million
Short-term employee benefits	15	15	16
Share-based payments expense	7	7	8
Pension and post-employment benefit entitlements	1	1	1
Compensation for loss of office	3	–	–
	26	23	25

Directors' remuneration disclosures are included on pages 83 to 93.

24 POST BALANCE SHEET EVENTS

Subsequent to the year end the Group announced its Accelerating Performance and Execution (APEX) programme. This is a five-year effort to make key enhancements to the Group's business and ways of working in Manufacturing, Warehousing and Distribution, General and Administrative Expenses and Commercial Effectiveness. The programme is expected to require a one-off cash cost of $240m of which a charge of around $100m is expected in 2018. No provisions have been recorded in respect of this programme as at 31 December 2017. A constructive obligation in relation to this programme had not arisen at 31 December 2017 as the Group had not announced the main features of the programme nor raised a valid expectation in those employees affected by the programme.

COMPANY FINANCIAL STATEMENTS

COMPANY BALANCE SHEET

	Notes	At 31 December 2017 $ million	At 31 December 2016 $ million
Fixed assets:			
Investments	2	7,092	5,322
Current assets:			
Debtors	3	1,084	824
Cash and bank	5	88	14
		1,172	838
Creditors: amounts falling due within one year:			
Borrowings	5	(4)	(41)
Other creditors	4	(1,202)	(814)
		(1,206)	(855)
Net current liabilities		(34)	(17)
Total assets less current liabilities		7,058	5,305
Creditors: amounts falling due after one year:			
Borrowings	5	(1,423)	(1,559)
Total assets less total liabilities		5,635	3,746
Equity shareholders' funds:			
Called up equity share capital		178	180
Share premium account		605	600
Capital redemption reserve		17	15
Capital reserve		2,266	2,266
Treasury shares		(257)	(432)
Exchange reserve		(52)	(52)
Profit and loss account		2,878	1,169
Shareholders' funds		5,635	3,746

The accounts were approved by the Board and authorised for issue on 22 February 2018 and signed on its behalf by:

Roberto Quarta
Chairman

Olivier Bohuon
Chief Executive Officer

Graham Baker
Chief Financial Officer

THE PARENT COMPANY FINANCIAL STATEMENTS OF SMITH & NEPHEW PLC ON PAGES 163–170 DO NOT FORM PART OF THE SMITH & NEPHEW'S ANNUAL REPORT ON FORM 20-F AS FILED WITH THE SEC.

COMPANY FINANCIAL STATEMENTS
STATEMENT OF CHANGES IN EQUITY

	Share capital $ million	Share premium $ million	Capital redemption reserve $ million	Capital reserves $ million	Treasury shares $ million	Exchange reserves $ million	Profit and loss account $ million	Total shareholders' funds $ million
At 1 January 2016	183	590	12	2,266	(294)	(52)	1,589	4,294
Attributable profit for the year	–	–	–	–	–	–	58	58
Net gain on cash flow hedges	–	–	–	–	–	–	1	1
Exchange adjustments	–	–	–	–	–	–	(3)	(3)
Equity dividends paid in the year	–	–	–	–	–	–	(279)	(279)
Share-based payments recognised[1]	–	–	–	–	–	–	27	27
Cost of shares transferred to beneficiaries	–	–	–	–	40	–	(34)	6
New shares issued on exercise of share options	–	10	–	–	–	–	–	10
Cancellation of treasury shares	(3)	–	3	–	190	–	(190)	–
Treasury shares purchased	–	–	–	–	(368)	–	–	(368)
At 31 December 2016	180	600	15	2,266	(432)	(52)	1,169	3,746
Attributable profit for the year	–	–	–	–	–	–	2,167	2,167
Net gain on cash flow hedges	–	–	–	–	–	–	1	1
Exchange adjustments	–	–	–	–	–	–	1	1
Equity dividends paid in the year	–	–	–	–	–	–	(269)	(269)
Share-based payments recognised[1]	–	–	–	–	–	–	31	31
Cost of shares transferred to beneficiaries	–	–	–	–	26	–	(21)	5
New shares issued on exercise of share options	–	5	–	–	–	–	–	5
Cancellation of treasury shares	(2)	–	2	–	201	–	(201)	–
Treasury shares purchased	–	–	–	–	(52)	–	–	(52)
At 31 December 2017	178	605	17	2,266	(257)	(52)	2,878	5,635

1 The Company operates a number of equity-settled executive and employee share plans. For all grants of share options and awards, the fair value as at the date of grant is calculated using an appropriate option pricing model and the corresponding expense is recognised over the vesting period. Subsidiary companies are recharged for the fair value of share options that relate to their employees. The disclosure relating to the Company is detailed in Note 23.1 of the Notes to the Group accounts.

Further information on the share capital of the Company can be found in Note 19.1 of the Notes to the Group accounts.

The total distributable reserves of the Company are $2,569m (2016: $685m). In accordance with the exemption permitted by Section 408 of the Companies Act 2006, the Company has not presented its own profit and loss account. The attributable profit for the year dealt with in the accounts of the Company is $2,167m (2016: $58m).

Fees paid to KPMG LLP for audit and non-audit services to the Company itself are not disclosed in the individual accounts because Group financial statements are prepared which are required to disclose such fees on a consolidated basis. The fees for the consolidated Group are disclosed in Note 3.2 of the Notes to the Group accounts.

NOTES TO THE COMPANY ACCOUNTS

1 BASIS OF PREPARATION

Smith & Nephew plc (the Company) is a public limited company incorporated in England and Wales.

The separate accounts of the Company are presented as required by the Companies Act 2006. On 1 January 2015, the Company transitioned from previously extant UK Generally Accepted Accounting Practices to Financial Reporting Standard 101 Reduced Disclosure Framework ('Reduced Disclosure Framework'). These financial statements and accompanying notes have been prepared in accordance with the Reduced Disclosure Framework for all periods presented. There were no transitional adjustments required on adoption of the new standard. The financial information for the Company has been prepared on the same basis as the consolidated financial statements, applying identical accounting policies as outlined throughout the Notes to the Group accounts. The Directors have determined that the preparation of the Company financial statements on a going concern basis is appropriate as the Company receives dividend cash receipts from its subsidiary undertakings which enable it to meet its liabilities as they fall due.

In applying these policies, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the accounts and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on management's best knowledge of current events and actions, actual results ultimately may differ from those estimates.

In these financial statements, the Company has applied the exemptions available under FRS 101 in respect of the following disclosures:

- A Cash Flow Statement and related notes;
- Comparative period reconciliations for share capital and tangible fixed assets;
- Disclosures in respect of transactions with wholly-owned subsidiaries;
- Disclosures in respect of capital management;
- The effects of new but not yet effective IFRSs; and
- Disclosures in respect of the compensation of key management personnel.

As the consolidated financial statements include the equivalent disclosures, the Company has also taken the exemptions under FRS 101 available in respect of the following disclosures:

- IFRS 2 Share Based Payments in respect of group settled share based payments; and
- Certain disclosures required by IFRS 13 *Fair Value Measurement* and the disclosures required by IFRS 7 *Financial Instrument Disclosures*.

The Company proposes to continue to adopt the reduced disclosure framework of FRS 101 in its next financial statements.

2 INVESTMENTS

ACCOUNTING POLICY

Investments in subsidiaries are stated at cost less provision for impairment.

	2017 $ million	2016 $ million
At 1 January	5,322	5,322
Additions	1,770	–
At 31 December	7,092	5,322

Investments represent holdings in subsidiary undertakings. In 2017, the Company increased its investment in Smith & Nephew (Overseas) Limited.

In accordance with Section 409 of the Companies Act 2006, a listing of all entities invested in by the consolidated Group is provided in Note 9.

3 DEBTORS

	2017 $ million	2016 $ million
Amounts falling due within one year:		
Amounts owed by subsidiary undertakings	1,007	735
Prepayments and accrued income	3	3
Current asset derivatives – forward foreign exchange contracts	25	45
Current asset derivatives – forward foreign exchange contracts – subsidiary undertakings	45	36
Current asset derivatives – currency swaps	3	1
Current taxation	1	4
	1,084	824

NOTES TO THE COMPANY ACCOUNTS continued

4 OTHER CREDITORS

	2017 $ million	2016 $ million
Amounts falling due within one year:		
Amounts owed to subsidiary undertakings	1,119	715
Other creditors	10	17
Current liability derivatives – forward foreign exchange contracts	45	36
Current liability derivatives – forward foreign exchange contracts – subsidiary undertakings	25	45
Current liability derivatives – currency swaps	1	–
Current liability derivatives – interest rate swaps	2	1
	1,202	814

5 CASH AND BORROWINGS

ACCOUNTING POLICY

Financial instruments

Currency swaps are used to match foreign currency net assets with foreign currency liabilities. They are initially recorded at fair value and then for reporting purposes remeasured to fair value at exchange rates and interest rates at subsequent balance sheet dates.

Changes in the fair value of derivative financial instruments are recognised in the profit and loss account as they arise.

	2017 $ million	2016 $ million
Bank loans and overdrafts due within one year or on demand	4	41
Borrowings due after one year	1,423	1,559
Borrowings	1,427	1,600
Cash and bank	(88)	(14)
(Debit)/credit balance on derivatives – currency swaps	(2)	1
Credit/(debit) balance on derivatives – interest rate swaps	2	(1)
Net debt	1,339	1,586

All currency swaps are stated at fair value. Gross US Dollar equivalents of $388m (2016: $449m) receivable and $386m (2016: $448m) payable have been netted. Currency swaps comprise foreign exchange swaps and were used in 2017 and 2016 to hedge intra-group loans.

6 CONTINGENCIES

	2017 $ million	2016 $ million
Guarantees in respect of subsidiary undertakings	1	–

The Company gives guarantees to banks to support liabilities and cross guarantees to support overdrafts.

The Company operated defined benefit pension plans in 2004 but at the end of 2005 its pension plan obligations were transferred to Smith & Nephew UK Limited. The Company has provided guarantees to the trustees of the pension plans to support future amounts due from participating employers (see Note 18 of the Notes to the Group accounts).

7 DEFERRED TAXATION

The Company has gross unused capital losses of $90m (2016: $100m) available for offset against future chargeable gains. No deferred tax asset has been recognised on these unused losses as they are not expected to be realised in the foreseeable future.

8 RESULTS FOR THE YEAR

As permitted by Section 408(4) of the Companies Act 2006, the Company has not presented its own profit and loss account. Profit for the year was $2,167m (2016: $58m).

9 GROUP COMPANIES

In accordance with Section 409 of the Companies Act 2006, a full list of subsidiaries, associates, joint arrangements, joint ventures and partnerships are listed below, including their country of incorporation. All companies are 100% owned, unless otherwise indicated. Unless otherwise stated, the share capital disclosed comprises ordinary shares which are indirectly held by Smith & Nephew plc.

Company name	Country of operation and incorporation	Registered Office
UK		
Blue Belt Technologies UK Limited[2]	England & Wales	London
Michelson Diagnostic Limited[3] (13.4%)	England & Wales	Kent
Neotherix Limited[3] (24.9%)	England & Wales	York
Plus Orthopedics (UK) Limited[2]	England & Wales	London
Smith & Nephew (Overseas) Limited[1]	England & Wales	London
Smith & Nephew ARTC Limited	England & Wales	London
Smith & Nephew Beta Limited[2]	England & Wales	London
Smith & Nephew China Holdings UK Limited[1]	England & Wales	London
Smith & Nephew Employees Trustees Limited[2]	England & Wales	London
Smith & Nephew ESN Limited[2]	England & Wales	London
Smith & Nephew Extruded Films Limited[2]	England & Wales	Hull
Smith & Nephew Finance[2]	England & Wales	London
Smith & Nephew Finance Oratec[2]	England & Wales	London
Smith & Nephew Healthcare Limited[2]	England & Wales	Hull
Smith & Nephew Investment Holdings Limited[1]	England & Wales	London
Smith & Nephew Medical Fabrics Limited[2]	England & Wales	London
Smith & Nephew Medical Limited[2]	England & Wales	Hull
Smith & Nephew Nominee Company Limited[2]	England & Wales	London
Smith & Nephew Nominee Services Limited[2]	England & Wales	London
Smith & Nephew Orthopaedics Limited[2]	England & Wales	London
Smith & Nephew Pensions Nominees Limited[2]	England & Wales	London
Smith & Nephew Pharmaceuticals Limited[2]	England & Wales	Hull
Smith & Nephew Raisegrade Limited[2]	England & Wales	London
Smith & Nephew Rareletter Limited[2]	England & Wales	London
Smith & Nephew Trading Group Limited[1]	England & Wales	London
Smith & Nephew UK Executive Pension Scheme Trustee Limited[2]	England & Wales	London
Smith & Nephew UK Limited[1]	England & Wales	London
Smith & Nephew UK Pension Fund Trustee Limited[2]	England & Wales	London
Smith & Nephew USD Limited[1]	England & Wales	London
Smith & Nephew USD One Limited[1]	England & Wales	London
T.J. Smith and Nephew, Limited	England & Wales	Hull
The Albion Soap Company Limited[2]	England & Wales	London
TP Limited[1]	Scotland	Edinburgh

Company name	Country of operation and incorporation	Registered Office
Rest of Europe		
Smith & Nephew GmbH	Austria	Vienna
ArthroCare Belgium SPRL[2]	Belgium	Zaventem
Smith & Nephew S.A.-N.V	Belgium	Zaventem
Smith & Nephew A/S	Denmark	Hoersholm
A2 Surgical[2]	France	Neuilly-sur-Seine
Smith & Nephew France SAS[1]	France	Neuilly-sur-Seine
Smith & Nephew S.A.S.	France	Neuilly-sur-Seine
Smith & Nephew Oy	Finland	Helsinki
Smith & Nephew Business Services GmbH & Co. KG[1]	Germany	Hamburg
Smith & Nephew Business Services Verwaltungs GmbH[1]	Germany	Hamburg
Smith & Nephew Deutschland (Holding) GmbH[1]	Germany	Hamburg
Smith & Nephew GmbH	Germany	Hamburg
Smith & Nephew Orthopaedics GmbH	Germany	Tuttlingen
Plus Orthopedics Hellas SA[2]	Greece	Athens
Smith & Nephew Hellas S.A.[2]	Greece	Athens
Smith & Nephew Limited	Ireland	Dublin 2
Smith & Nephew Finance Ireland Limited[2]	Ireland	Dublin 1
Smith & Nephew S.r.l.	Italy	Milan
ArthroCare Luxembourg Sarl[2]	Luxembourg	Luxembourg
Smith & Nephew Finance S.a.r.l.[2]	Luxembourg	Luxembourg
Smith & Nephew International S.A.[1]	Luxembourg	Luxembourg
Smith & Nephew (Europe) B.V.[1]	Netherlands	Amsterdam
Smith & Nephew B.V.[1]	Netherlands	Amsterdam
Smith & Nephew Management B.V.[1]	Netherlands	Amsterdam
Smith & Nephew Nederland CV	Netherlands	Amsterdam
Smith & Nephew Optics B.V.[4]	Netherlands	Amsterdam
Smith & Nephew A/S	Norway	Oslo
Smith & Nephew sp. z.o.o.	Poland	Warsaw
Smith & Nephew Lda	Portugal	Lisbon
D-Orthopaedics LLC	Russian Federation	Moscow
DC LLC	Russian Federation	Puschino
Smith & Nephew LLC	Russian Federation	Moscow 2
Smith & Nephew S.A.U	Spain	Barcelona
Smith & Nephew Aktiebolag	Sweden	Molndal
Lumina Adhesives AB[3] (11%)	Sweden	Gothenburg
Plus Orthopedics Holding AG[1]	Switzerland	Baar
Smith & Nephew Manufacturing AG	Switzerland	Aarau
Smith & Nephew Orthopaedics AG	Switzerland	Baar
Smith & Nephew Schweiz AG	Switzerland	Baar
Smith & Nephew AG	Switzerland	Baar

NOTES TO THE COMPANY ACCOUNTS continued

9 GROUP COMPANIES continued

Company name	Country of operation and incorporation	Registered Office
US		
Arthrocare Corporation[1]	United States	San Jose
Bioventus LLC[3] (49%)	United States	Wilmington
Blue Belt Holdings, Inc.[1]	United States	Minneapolis
Blue Belt Technologies, Inc.	United States	Pittsburgh
Delphi Ventures V, L.P.[3] (6.9%)	United States	San Mateo
Healicoil, Inc.	United States	Wilmington
Hipco, Inc.	United States	Wilmington
Leaf Healthcare Inc.[3] (11%)	United States	Delaware
Memphis Biomed Ventures I, LP[3] (4.61%)	United States	Delaware
Oratec Interventions, Inc.	United States	Concord
Orthopaedic Biosystems Ltd., Inc.	United States	Phoenix
OsteoBiologics, Inc.	United States	Dallas
Plus Orthopedics LLC	United States	Andover
Rotation Medical, Inc.	United States	Andover
Sinopsys Surgical, Inc.[3] (12.4%)	United States	Boulder
Smith & Nephew Consolidated, Inc.[1]	United States	Wilmington
Smith & Nephew OUS, Inc.[1]	United States	Wilmington
Smith & Nephew, Inc.	United States	Wilmington
Surgical Frontiers Series I, LLC[3] (32%)	United States	Dover
Trice Medical Inc.[3] (6%)	United States	Delaware

Africa, Asia, Australasia and Other America

Company name	Country of operation and incorporation	Registered Office
Smith & Nephew Argentina S.R.L.[2]	Argentina	Buenos Aires
ArthroCare (Australasia) Pty Ltd[2]	Australia	North Ryde
Smith & Nephew Pty Limited	Australia	North Ryde
Smith & Nephew Surgical Holdings Pty Limited[2]	Australia	North Ryde
Smith & Nephew Surgical Pty Limited[2]	Australia	North Ryde
Smith & Nephew Comercio de Produtos Medicos LTDA	Brazil	São Paulo
Smith & Nephew (Alberta) Inc.[2]	Canada	Calgary
Smith & Nephew Inc.	Canada	Toronto
Tenet Medical Engineering, Inc.	Canada	Calgary
Smith & Nephew Finance Holdings Limited[2]	Cayman Islands	South Church Street, George Town
ArthoCare Medical Devices (Beijing) Co. Limited[4]	China	Chao Yang District, Beijing
Plus Orthopedics (Beijing) Co. Limited[4]	China	Shunyi District, Beijing
Plus Trading (Beijing) Co Limited[4]	China	East City, Beijing
Smith & Nephew Medical (Shanghai) Limited	China	Shanghai Free Trade Test Zone
Smith & Nephew Medical (Suzhou) Limited	China	Suzhou City
Smith & Nephew Orthopaedics (Beijing) Co., Ltd	China	Beijing Economic and Technical Development Area
S&N Holdings SAS[1]	Colombia	Bogota
Smith & Nephew Colombia S.A.S	Colombia	Bogota
ArthroCare Costa Rica Srl	Costa Rica	Costa Rica
Smith & Nephew Curaçao N.V.	Curaçao	Willemstad
Smith & Nephew Beijing Holdings Limited[1]	Hong Kong	Hong Kong
Smith & Nephew Limited	Hong Kong	Hong Kong
Smith & Nephew Suzhou Holdings Limited[1]	Hong Kong	Hong Kong
Adler Mediequip Private Limited	India	Pune
ArthoCare India Medical Device Private Limited[2]	India	Mumbai
Smith & Nephew Healthcare Private Limited	India	Mumbai-59
Ortho-Space Ltd.[3] (16.8%)	Israel	Caesarea
Smith & Nephew KK	Japan	Tokyo
Smith & Nephew Chusik Hoesia	Korea, Republic of	Seoul
Smith & Nephew Healthcare Sdn Berhad	Malaysia	Kuala Lumpur
Smith & Nephew S.A. de C.V.	Mexico	Mexico City
Smith & Nephew Limited	New Zealand	Auckland
Smith & Nephew Superannuation Scheme Limited	New Zealand	Auckland 2
Smith & Nephew, Inc.	Puerto Rico	San Juan
Smith & Nephew Pte Limited	Singapore	Singapore
Smith & Nephew (Pty) Limited	South Africa	Westville
Smith & Nephew Pharmaceuticals (Proprietary) Limited[2]	South Africa	Westville
Smith & Nephew Limited	Thailand	Huai Khwang District, Bangkok
Sri Siam Medical Limited[1,3] (48.99%)	Thailand	Lumpini Phatumwan, Bangkok
Smith ve Nephew Medikal Cihazlar Ticaret Limited Sirketi	Turkey	Sariyer, Istanbul
Smith & Nephew FZE	United Arab Emirates	Jebel Ali, Dubai

1 Holding company.
2 Dormant company.
3 Not 100% owned by Smith & Nephew Group.
4 In liquidation.

Registered Office addresses

UK

London	15 Adam Street, London, WC2N 6LA
Kent	Ground Floor, Eclipse House, Eclipse Park, Sittingbourne Road, Maidstone, Kent, ME14 3EN
York	25 Carr Lane, York, YO26 5HT
Hull	101 Hessle Road, Hull, HU3 2BN
Edinburgh	4th Floor, 115 George Street, Edinburgh, EH2 4JN

Rest of Europe

Vienna	Concorde Business Park, 1/C/3 2320, Schwechat, Austria
Zaventem	Hector Heenneaulaan 366, 1930 Zaventem, Belgium
Hoersholm	Slotsmarken 14, Hoersholm, DK-2970, Denmark
Neuilly-sur-Seine	40, Boulevard du Parc, 92200 Neuilly-sur-Seine, France
Helsinki	Ayritie 12 C, 01510, Vantaa, Finland
Hamburg	Friesenweg 4, Haus 21, 22763, Hamburg, Germany
Tuttlingen	Alemannenstrasse 14, 78532, Tuttlingen, Germany
Athens	Protopappa Street 43, GR 16346, Ilioupoli, Athens, Greece
Dublin 1	3rd Floor, Kilmore House, Park Lane, Spencer Dock, Dublin 1, Ireland
Dublin 2	Molyneux House, Bride Street, Dublin 2, Ireland
Milan	Via de Capitani 2A, 20864, Agrate Brianza (MI), Italy
Luxembourg	163, Rue de Kiem, L-8030 Strassen, Luxembourg
Amsterdam	Kruisweg 637, 2132 NB Hoofddorp, The Netherlands
Oslo	Nye Vakas vei 64, 1395, Hvalsted, Norway
Warsaw	Ul Osmanska 12, 02-823, Warsaw, Poland
Lisbon	Estrada Nacional no 10 ao Km. 131, Parque Tejo – Bloco C, 2625-445 Forte de Casa, Vila Franca de Xira, Portugal
Moscow	9a, Bld, 10, 2nd Sinichkina Street, Moscow 111020, Russian Federation
Moscow 2	2nd Syromyatnichesky lane, Moscow, 105120, Russian Federation
Puschino	8/1 Stroiteley Street, 142290, City of Puschino, Moscow Region, Russian Federation
Barcelona	Edificio Conata I, c/ Fructuos Gelabert 2 y 4, San Joan Despi – 08970, Barcelona, Spain
Molndal	PO Box 143, S-431 22 Molndal, Sweden
Baar	Oberneuhofstr 10d, Baar, 6340
Aarau	Schachenallee 29, 5000, Aarau, Switzerland
Gothenburg	Varbergsgatan 2A / 412 65 Göteborg / Sweden

Registered Office addresses

US

San Jose	595 North Pastoria Avenue, Sunnyvale, California, 94086, USA
Minneapolis	2905 Northwest Blvd, Suite 40, Plymouth MN 55441, USA
Pittsburgh	2828 Liberty Ave, Suite 100, Pittsburgh PA 15222, USA
Boulder	5480 Valmont Road, Suite 215, Boulder, Colorado, 80301, USA
Wilmington	CT Corporation, 1209 Orange Street, Wilmington DE 19801, USA
Concord	C T Corporation, 9 Capitol Street, Concord, New Hampshire, 03301, USA
Phoenix	CT Corporation System, 3225 North Central Avenue, Phoenix AZ 85012, USA
Dallas	CT Corporation System, 350 North St. Paul Street, Dallas TX 75201, USA
Andover	150 Minuteman Road, Andover, MA, 01810, USA
San Mateo	160 Bovet Road, Suite 408, San Mateo, CA 94402, USA
Memphis	6075 Poplar Avenue, Suite 335, Memphis, Tennessee, 38119, USA
Tustin	3002 Dow Avenue, Building 100, Unit 138, Tustin, California, 92780, USA
Dover	160 Greentree Drive, Suite 101, Dover, Delaware, 19904, USA

Africa, Asia, Australasia and Other America

Buenos Aires	Maipu 1300, 13th Floor, City of Buenos Aires, Argentina
North Ryde	85 Waterloo Road, North Ryde NSW 2113, Australia
São Paulo	Avenida do Cafe, 277, Centro Empresarial do Aco, Centro Empresarial do Aco, Torre B, 4 andar, conjuto, CEP 04311-000, São Paulo 403, Jabaquara, Brazil
Calgary	3500-855-2 Street SW, Calgary AB AB T2P 4J8, Canada
Toronto	199, Bay Street, 4000, Toronto, Ontario M5L 1A9, Canada
South Church Street, Georgetown	c/o M&C Corporate Services Limited, Ugland House, South Church Street, P.O. Box 309, George Town, Grand Cayman, Cayman Islands
Chao Yang District, Beijing	Room 17-021, Internal B17 floor, B3-24th floor, No 3 Xin Yuan South Rd, Chao Yang District, Beijing, China

NOTES TO THE COMPANY ACCOUNTS continued

9 GROUP COMPANIES continued

Registered Office addresses	
Shunyi District, Beijing	22 Linhe Avenue, Linhe Economic Development Zone, Shunyi District, Beijing, 101300, China
East City, Beijing	No. B-D, Floor 2, A Building, Beijing East Gate Plaza, No. 9, Dong Zhong Street, East City, Beijing, China
Guangzhou	Room 2502 No 33, 6th Jian She Rd, Yue Xiu District, Guangzhou, China
Shanghai	Room 1208-1209, No 168 Middle Xi Zang Rd, Shanghai, China
Shanghai Free Trade Test Zone	Part B, 4th Floor, Tong Yong Building, No 188 Ao Na Rd, Shanghai Free Trade Test Zone, Shanghai, China
Dong Cheng District, Beijing	Unit B1, 2/F, Tower A, East Gate Plaza No.9, Dongshong Street, Dong Cheng District, Beijing, China
Chengdu	No 5. 15th Floor, Unit 1, Building, 1 Li Bao Building, No 62 North Ke Hua Rd, Wu Hou District, Chengdu, China
Middle Xi Zang Rd, Shanghai	Room 1201-1207, No168 Middle Xi Zang Rd, Shanghai, China
Suzhou City	12, Wuxiang Road, West Area of Comprehensive Bonded Zone, Suzhou Industrial Park, Suzhou City, SIP, Jiangsu Province, China
Beijing Economic and Technical Development Area	No. 98 Kechuang Dongliujie, Beijing Economic and Technical Development Area, Beijing, China
Bogota	Calle 100 No. 7 – 33 to 1 P3, Bogota D.C., 0, Colombia
Costa Rica	Building B32, 50 meters South of Revisión Téchnica Vehicular, Province de Alajuela, Canton Alajuela, Coyol Free Zone, District San José, Costa Rica
Willemstad	Pietermaai 15, PO Box 4905, Curaçao
Hong Kong	Unit 813 – 816, 8/F, Delta House, 3 On Yiu Street, Shatin, New Territories, Hong Kong
Pune	Sushrut House, Survey no.288, Phase II next to MIDC, Hinjewadi, at Mann, Taluka Mulshi, Pune, 411057, India
Mumbai	5A, Bakhtawar, 5th Floor, behind The Oberoi, Nariman Point, Mumbai, Maharashtra, 400021, India
Mumbai-59	501-B – 509-B Dynasty Business Park, Andheri Kurla Road, Andheri East, Mumbai-59, Maharashtra, India
Caesarea	7 Halamarish, Caesarea, 3088900, Israel
Tokyo	2-4-1, Shiba -Koen, Minato-Ku, Tokyo 105-0011, Japan
Seoul	13th Floor, ASEM Tower, Gangnam-gu 13th Floor, ASEM Tower, 159-1 Samsung-dong, Seoul, Korea
Kuala Lumpur	Unit 10-02(A), Level 10, Menara TJB, 9, Jalan Syed Mohd Mufti, Johor Bahru, Johor 8000, Malaysia

Registered Office addresses	
Mexico City	Av. Insurgentes Sur, numero 1602, Piso No.7, Oficina 702, Colonia Credito, Constructor, Delegacion Benito Juarez, C.P. 03940, Mexico
Auckland	621 Rosebank Road, Avondale, Auckland 6, New Zealand
Auckland 2	36a Hillside Road, Wairau Valley, Auckland, 0627 NZ, New Zealand
San Juan	Edificio Cesar Castillo, Calle Angel Buonomo #361, Hato Rey, 00917, Puerto Rico
Singapore	50 Raffles Place, #32-01 Singapore Land Tower, 048623, Singapore
Westville	30 The Boulevard, Westway Office Park, Westville, 3629, South Africa
Huai Khwang District, Bangkok	16th Floor Building A, 9th Tower Grand Rama 9, 33/4 Rama 9 Road, Huai Khwang District, Bangkok, 10310, Thailand
Lumpini Phatumwan, Bangkok	16th Floor, GPF Witthayu Tower A, 93/1 Wireless Road, Lumpini, Phatumwan, Bangkok, 10330, Thailand
Sariyer, Istanbul	Bahcekoy Mah., Orkide Sok., No:8/E Bahcekoy, Sariyer Istanbil, Turkey
Jebel Ali, Dubai	PO Box 16993 LB02016, Jebel Ali, Dubai, United Arab Emirates

GROUP INFORMATION

BUSINESS OVERVIEW AND GROUP HISTORY

Smith & Nephew's operations are organised into geographical selling regions and product franchises within the medical technology industry.

The Group has a history dating back 160 years to the family enterprise of Thomas James Smith who opened a small pharmacy in Hull, UK in 1856. Following his death in 1896, his nephew Horatio Nelson Smith took over the management of the business.

By the late 1990s, Smith & Nephew had expanded into being a diverse healthcare conglomerate with operations across the globe, producing various medical devices, personal care products and traditional and advanced wound care treatments. In 1998, Smith & Nephew announced a major restructuring to focus management attention and investment on three global business units – Advanced Wound Management, Endoscopy and Orthopaedics – which offered high growth and margin opportunities. In 2011, the Endoscopy and Orthopaedics businesses were brought together to create an Advanced Surgical Devices division. In 2015, the Advanced Wound Management and Advanced Surgical Devices divisions were brought together to form a global business across nine product franchises, managed as three geographical selling regions with global functions for operations, R&D and corporate support functions.

Smith & Nephew was incorporated and listed on the London Stock Exchange in 1937 and in 1999 the Group was also listed on the New York Stock Exchange. In 2001, Smith & Nephew became a constituent member of the FTSE 100 index in the UK. This means that Smith & Nephew is included in the top 100 companies traded on the London Stock Exchange measured in terms of market capitalisation.

Today, Smith & Nephew is a public limited company incorporated and headquartered in the UK and carries out business around the world.

PROPERTIES

The table below summarises the main properties which the Group uses and their approximate areas.

	Approximate area (square feet 000's)
Group head office in London, UK	13
UK office and surgical training facility in Watford, UK	60
Manufacturing and office facilities in Memphis, Tennessee, US	968
Wound management manufacturing, research and office facility in Hull, UK	473
Manufacturing facility in Suzhou, China	288
Manufacturing facility in Alajuela, Costa Rica	265
Distribution facility in Memphis, Tennessee, US	248
Manufacturing facility in Beijing, China	192
Bioactives headquarters and laboratory space in Fort Worth, Texas, US	165
Manufacturing, research and office facility in Austin, Texas, US	157
Manufacturing facility in Oklahoma City, Oklahoma, US	155
Regional headquarters in Andover, Massachusetts, US	144
Manufacturing facility in Aarau, Switzerland	121
Manufacturing facility in Mansfield, Massachusetts, US	98
Manufacturing facility in Devrukh, India	74
Regional headquarters and distribution facility in Baar, Switzerland	71
Manufacturing facility in Tuttlingen, Germany	50

The Group Global Operations strategy includes ongoing assessment of the optimal facility footprint. The Orthopaedics manufacturing facilities in Memphis, Tennessee are largely freehold, a portion of Tuttlingen and the Advanced Wound Management facilities in Hull are freehold while other principal locations are leasehold. The Group has freehold and leasehold interests in real estate in other countries throughout the world, but no other is individually significant to the Group. Where required, the appropriate governmental authorities have approved the facilities.

OFF-BALANCE SHEET ARRANGEMENTS

Management believes that the Group does not have any off-balance sheet arrangements, as defined by the SEC in item 5E of Form 20-F, that have or are reasonably likely to have a current or future effect on the Group's financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors.

RELATED PARTY TRANSACTIONS

Except for transactions with associates (see Note 23.2 of Notes to the Group accounts), no other related party had material transactions or loans with Smith & Nephew over the last three financial years.

GROUP INFORMATION continued

RISK FACTORS

There are known and unknown risks and uncertainties relating to Smith & Nephew's business. The factors listed on pages 172–175 could cause the Group's business, financial position and results of operations to differ materially and adversely from expected and historical levels. In addition, other factors not listed here that Smith & Nephew cannot presently identify or does not believe to be equally significant could also materially adversely affect Smith & Nephew's business, financial position or results of operations.

Highly competitive markets

The Group competes across a diverse range of geographic and product markets. Each market in which the Group operates contains a number of different competitors, including specialised and international corporations. Significant product innovations, technical advances or the intensification of price competition by competitors could adversely affect the Group's operating results.

Some of these competitors may have greater financial, marketing and other resources than Smith & Nephew. These competitors may be able to initiate technological advances in the field, deliver products on more attractive terms, more aggressively market their products or invest larger amounts of capital and research and development (R&D) into their businesses.

There is a possibility of further consolidation of competitors, which could adversely affect the Group's ability to compete with larger companies due to insufficient financial resources. If any of the Group's businesses were to lose market share or achieve lower than expected revenue growth, there could be a disproportionate adverse impact on the Group's share price and its strategic options.

Competition exists among healthcare providers to gain patients on the basis of quality, service and price. There has been some consolidation in the Group's customer base and this trend is expected to continue. Some customers have joined group purchasing organisations or introduced other cost containment measures that could lead to downward pressure on prices or limit the number of suppliers in certain business areas, which could adversely affect Smith & Nephew's results of operations and hinder its growth potential.

Continual development and introduction of new products

The medical devices industry has a rapid rate of new product introduction. In order to remain competitive, the Group must continue to develop innovative products that satisfy customer needs and preferences or provide cost or other advantages. Developing new products is a costly, lengthy and uncertain process. The Group may fail to innovate due to low R&D investment, a R&D skills gap or poor product development. A potential product may not be brought to market or not succeed in the market for any number of reasons, including failure to work optimally, failure to receive regulatory approval, failure to be cost-competitive, infringement of patents or other intellectual property rights and changes in consumer demand. The Group's products and technologies are also subject to marketing attack by competitors. Furthermore, new products that are developed and marketed by the Group's competitors may affect price levels in the various markets in which the Group operates. If the Group's new products do not remain competitive with those of competitors, the Group's revenue could decline.

The Group maintains reserves for excess and obsolete inventory resulting from the potential inability to sell its products at prices in excess of current carrying costs. Marketplace changes resulting from the introduction of new products or surgical procedures may cause some of the Group's products to become obsolete. The Group makes estimates regarding the future recoverability of the costs of these products and records a provision for excess and obsolete inventories based on historical experience, expiration of sterilisation dates and expected future trends. If actual product life cycles, product demand or acceptance of new product introductions are less favourable than projected by management, additional inventory write-downs may be required.

Dependence on government and other funding

In most markets throughout the world, expenditure on medical devices is ultimately controlled to a large extent by governments. Funds may be made available or withdrawn from healthcare budgets depending on government policy. The Group is therefore largely dependent on future governments providing increased funds commensurate with the increased demand arising from demographic trends.

Pricing of the Group's products is largely governed in most markets by governmental reimbursement authorities. Initiatives sponsored by government agencies, legislative bodies and the private sector to limit the growth of healthcare costs, including price regulation, excise taxes and competitive pricing, are ongoing in markets where the Group has operations. This control may be exercised by determining prices for an individual product or for an entire procedure. The Group is exposed to government policies favouring locally sourced products. The Group is also exposed to changes in reimbursement policy, tax policy and pricing which may have an adverse impact on revenue and operating profit. Provisions in US healthcare legislation which previously imposed significant taxes on medical device manufacturers have been suspended for two years but may be reinstated. There may be an increased risk of adverse changes to government funding policies arising from deterioration in macro-economic conditions from time to time in the Group's markets.

The Group must adhere to the rules laid down by government agencies that fund or regulate healthcare, including extensive and complex rules in the US. Failure to do so could result in fines or loss of future funding.

World economic conditions

Demand for the Group's products is driven by demographic trends, including the ageing population and the incidence of osteoporosis and obesity. Supply of, use of and payment for the Group's products are also influenced by world economic conditions which could place increased pressure on demand and pricing, adversely impacting the Group's ability to deliver revenue and margin growth. The conditions could favour larger, better capitalised groups, with higher market shares and margins. As a consequence, the Group's prosperity is linked to general economic conditions and there is a risk of deterioration of the Group's performance and finances during adverse macro-economic conditions.

During 2017, economic conditions worldwide continued to create several challenges for the Group, including deferrals of joint replacement procedures, heightened pricing pressure, significant declines in capital equipment expenditures at hospitals and increased uncertainty over the collectability of government debt, particularly those in the Emerging Markets and the oil-dependent Gulf States. These factors tempered the overall growth of the Group's global markets and could have an increased impact on growth in the future.

Political uncertainties

The Group operates on a worldwide basis and has distribution channels, purchasing agents and buying entities in over 100 countries. Political upheaval in some of those countries or in surrounding regions may impact the Group's results of operations. Political changes in a country could prevent the Group from receiving remittances of profit from a member of the Group located in that country or from selling its products or investments in that country. Furthermore, changes in government policy regarding preference for local suppliers, import quotas, taxation or other matters could adversely affect the Group's revenue and operating profit. War, economic sanctions, terrorist activities or other conflict could also adversely impact the Group. These risks may be greater in Emerging Markets, which account for an increasing portion of the Group's business.

In June 2016 the UK voted to leave the European Union. The UK's withdrawal will be effective from 29 March 2019 at 11pm GMT. As negotiations regarding the terms of the withdrawal continue, the nature of the trade agreements and the closeness of the economic ties between the UK and the EU beyond the withdrawal date remains uncertain. We continue to monitor the situation. Among the potential impacts of Brexit, the regulatory framework for medical devices could be affected, as it is unclear whether the UK will ascribe to the new Medical Devices Regulation which will become applicable in May 2020.

Currency fluctuations

Smith & Nephew's results of operations are affected by transactional exchange rate movements in that they are subject to exposures arising from revenue in a currency different from the related costs and expenses. The Group's manufacturing cost base is situated principally in the US, the UK, China and Switzerland, from which finished products are exported to the Group's selling operations worldwide. Thus, the Group is exposed to fluctuations in exchange rates between the US Dollar, Sterling and Swiss Franc and the currency of the Group's selling operations, particularly the Euro, Australian Dollar and Japanese Yen. If the US Dollar, Sterling or Swiss Franc should strengthen against the Euro, Australian Dollar and the Japanese Yen, the Group's trading margin could be adversely affected.

The Group manages the impact of exchange rate movements on revenue and cost of goods sold by a policy of transacting forward foreign currency commitments when firm purchase orders are placed. In addition, the Group's policy is for forecast transactions to be covered between 50% and 90% for up to one year. However, the Group is exposed to medium to long-term adverse movements in the strength of currencies compared to the US Dollar.

The Group uses the US Dollar as its reporting currency. The US Dollar is the functional currency of Smith & Nephew plc. The Group's revenues, profits and earnings are also affected by exchange rate movements on the translation of results of operations in foreign subsidiaries for financial reporting purposes. See 'Liquidity and capital resources' on page 39.

Manufacturing and supply

The Group's manufacturing production is concentrated at main facilities in Memphis, Mansfield and Oklahoma City in the US, Hull and Warwick in the UK, Aarau in Switzerland, Tuttlingen in Germany, Devrukh in India, Suzhou and Beijing in China, Alajuela in Costa Rica, Puschino in Russia and Curaçao, in Dutch Caribbean. If major physical disruption took place at any of these sites, it could adversely affect the results of operations. Physical loss and consequential loss insurance is carried to cover such risks but is subject to limits and deductibles and may not be sufficient to cover catastrophic loss. Management of orthopaedic inventory is complex, particularly forecasting and production planning. There is a risk that failures in operational execution could lead to excess inventory or individual product shortages.

The Group is reliant on certain key suppliers of raw materials, components, finished products and packaging materials or in some cases on a single supplier. These suppliers must provide the materials and perform the activities to the Group's standard of quality requirements.

A supplier's failure to meet expected quality standards could create liability for the Group and adversely affect sales of the Group's related products.

The Group may be forced to pay higher prices to obtain raw materials, which it may not be able to pass on to its customers in the form of increased prices for its finished products. In addition, some of the raw materials used may become unavailable, and there can be no assurance that the Group will be able to obtain suitable and cost effective substitutes. Any interruption of supply caused by these or other factors could negatively impact Smith & Nephew's revenue and operating profit.

The Group will, from time to time including as part of the APEX programme, outsource or insource the manufacture of components and finished products to third parties and will periodically relocate the manufacture of product and/or processes between existing and/or new facilities. While these are planned activities, with these transfers there is a risk of disruption to supply.

GROUP INFORMATION continued

RISK FACTORS continued

Attracting and retaining key personnel

The Group's continued development depends on its ability to hire and retain highly-skilled personnel with particular expertise. This is critical, particularly in general management, research, new product development and in the sales forces. If Smith & Nephew is unable to retain key personnel in general management, research and new product development or if its largest sales forces suffer disruption or upheaval, its revenue and operating profit would be adversely affected. Additionally, if the Group is unable to recruit, hire, develop and retain a talented, competitive workforce, it may not be able to meet its strategic business objectives.

Proprietary rights and patents

Due to the technological nature of medical devices and the Group's emphasis on serving its customers with innovative products, the Group has been subject to patent infringement claims and is subject to the potential for additional claims.

Claims asserted by third parties regarding infringement of their intellectual property rights, if successful, could require the Group to expend time and significant resources to pay damages, develop non-infringing products or obtain licences to the products which are the subject of such litigation, thereby affecting the Group's growth and profitability. Smith & Nephew attempts to protect its intellectual property and regularly opposes third party patents and trademarks where appropriate in those areas that might conflict with the Group's business interests. If Smith & Nephew fails to protect and enforce its intellectual property rights successfully, its competitive position could suffer, which could harm its results of operations.

Product liability claims and loss of reputation

The development, manufacture and sale of medical devices entail risk of product liability claims or recalls. Design and manufacturing defects with respect to products sold by the Group or by companies it has acquired could damage, or impair the repair of, body functions. The Group may become subject to liability, which could be substantial, because of actual or alleged defects in its products. In addition, product defects could lead to the need to recall from the market existing products, which may be costly and harmful to the Group's reputation.

There can be no assurance that customers, particularly in the US, the Group's largest geographical market, will not bring product liability or related claims that would have a material adverse effect on the Group's financial position or results of operations in the future, or that the Group will be able to resolve such claims within insurance limits. As at 31 December 2017, a provision of $157m is recognised relating to the present value of the estimated costs to resolve all unsettled known and unknown anticipated metal-on-metal hip implant claims.

Regulatory standards and compliance in the healthcare industry

Business practices in the healthcare industry are subject to regulation and review by various government authorities. In general, the trend in many countries in which the Group does business is towards higher expectations and increased enforcement activity by governmental authorities. While the Group is committed to doing business with integrity and welcomes the trend to higher standards in the healthcare industry, the Group and other companies in the industry have been subject to investigations and other enforcement activity that have incurred and may continue to incur significant expense. Under certain circumstances, if the Group were found to have violated the law, its ability to sell its products to certain customers could be restricted.

International regulation

The Group operates across the world and is subject to extensive legislation, including anti-bribery and corruption and data protection, in each country in which the Group operates. Our international operations are governed by the UK Bribery Act and the US Foreign Corrupt Practices Act which prohibit us or our representatives from making or offering improper payments to government officials and other persons or accepting payments for the purpose of obtaining or maintaining business. Our international operations in the Emerging Markets which operate through distributors increase our Group exposure to these risks.

The Group will also be required to comply with the requirements of the EU General Data Protection Regulation (GDPR) concerning personal data of data subjects residing in the EU when it comes into force in May 2018.

Enforcement of such legislation has increased in recent years with significant fines and penalties being imposed on companies and individuals where breaches are found to have occurred.

Regulatory approval

The international medical device industry is highly regulated. Regulatory requirements are a major factor in determining whether substances and materials can be developed into marketable products and the amount of time and expense that should be allotted to such development.

National regulatory authorities administer and enforce a complex series of laws and regulations that govern the design, development, approval, manufacture, labelling, marketing and sale of healthcare products. They also review data supporting the safety and efficacy of such products. Of particular importance is the requirement in many countries that products be authorised or registered prior to manufacture, marketing or sale and that such authorisation or registration be subsequently maintained. The major regulatory agencies for Smith & Nephew's products include the Food and Drug Administration (FDA) in the US, the Medicines and Healthcare products Regulatory Agency in the UK, the Ministry of Health, Labour and Welfare in Japan, the China Food and Drug Administration and the Australian Therapeutic Goods Administration. At any time, the Group is awaiting a number of regulatory approvals which, if not received, could adversely affect results of operations. In 2017, the European Union reached agreement on a new set of Medical Device Regulations which entered into force on 25 May 2017. These have a three-year transition period; therefore will fully apply in EU Member States from 26 May 2020.

The trend is towards more stringent regulation and higher standards of technical appraisal. Such controls have become increasingly demanding to comply with and management believes that this trend will continue.

Regulatory requirements may also entail inspections for compliance with appropriate standards, including those relating to Quality Management Systems or Good Manufacturing Practices regulations. All manufacturing and other significant facilities within the Group are subject to regular internal and external audit for compliance with national medical device regulation and Group policies.

Payment for medical devices may be governed by reimbursement tariff agencies in a number of countries. Reimbursement rates may be set in response to perceived economic value of the devices, based on clinical and other data relating to cost, patient outcomes and comparative effectiveness. They may also be affected by overall government budgetary considerations. The Group believes that its emphasis on innovative products and services should contribute to success in this environment.

Failure to comply with these regulatory requirements could have a number of adverse consequences, including withdrawal of approval to sell a product in a country, temporary closure of a manufacturing facility, fines and potential damage to Company reputation.

Failure to make successful acquisitions

A key element of the Group's strategy for continued growth is to make acquisitions or alliances to complement its existing business. Failure to identify appropriate acquisition targets or failure to conduct adequate due diligence or to integrate them successfully would have an adverse impact on the Group's competitive position and profitability. This could result from the diversion of management resources towards the acquisition or integration process, challenges of integrating organisations of different geographic, cultural and ethical backgrounds, as well as the prospect of taking on unexpected or unknown liabilities. In addition, the availability of global capital may make financing less attainable or more expensive and could result in the Group failing in its strategic aim of growth by acquisition or alliance.

Relationships with healthcare professionals

The Group seeks to maintain effective and ethical working relationships with physicians and medical personnel who assist in the research and development of new products or improvements to our existing product range or in product training and medical education. If we are unable to maintain these relationships our ability to meet the demands of our customers could be diminished and our revenue and profit could be materially adversely affected.

Reliance on sophisticated information technology

The Group uses a wide variety of information systems, programmes and technology to manage our business. Our systems are vulnerable to a cyber attack, malicious intrusion, loss of data privacy or any other significant disruption. Our systems have been and will continue to be the target of such threats. We have systems in place to minimise the risk and disruption of these intrusions and to monitor our systems on an ongoing basis for current or potential threats. There can be no assurance that these measures will prove effective in protecting Smith & Nephew from future interruptions and as a result the performance of the Group could be materially adversely affected.

Other risk factors

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

FACTORS AFFECTING SMITH & NEPHEW'S RESULTS OF OPERATIONS

Government economic, fiscal, monetary and political policies are all factors that materially affect the Group's operation or investments of shareholders. Other factors include sales trends, currency fluctuations and innovation. Each of these factors is discussed further in the 'Our Marketplace' on pages 16–17, 'Financial review' on pages 38–39 and 'Taxation information for shareholders' on pages 190–191.

OTHER FINANCIAL INFORMATION

SELECTED FINANCIAL DATA

	2017 $ million	2016 $ million	2015 $ million	2014 $ million	2013 $ million
Income statement					
Revenue	4,765	4,669	4,634	4,617	4,351
Cost of goods sold	(1,248)	(1,272)	(1,143)	(1,162)	(1,100)
Gross profit	3,517	3,397	3,491	3,455	3,251
Selling, general and administrative expenses	(2,360)	(2,366)	(2,641)	(2,471)	(2,210)
Research and development expenses	(223)	(230)	(222)	(235)	(231)
Operating profit[1]	934	801	628	749	810
Net interest (payable)/receivable	(51)	(46)	(38)	(22)	4
Other finance costs	(10)	(16)	(15)	(11)	(11)
Share of results of associates	6	(3)	(16)	(2)	(1)
Profit on disposal of business	–	326	–	–	–
Profit before taxation	879	1,062	559	714	802
Taxation	(112)	(278)	(149)	(213)	(246)
Attributable profit for the year	767	784	410	501	556
Earnings per ordinary share					
Basic earnings per share	87.8¢	88.1¢	45.9¢	56.1¢	61.7¢
Diluted earnings per share	87.7¢	87.8¢	45.6¢	55.7¢	61.4¢
Average number of shares used in basic earnings per share (millions)	874	890	894	893	901
Average number of shares used in diluted earnings per share (millions)	875	893	899	899	906
Adjusted attributable profit[2]					
Attributable profit for the year	767	784	410	501	556
Acquisition related costs	(10)	9	25	125	31
Restructuring and rationalisation expenses	–	62	65	61	58
Legal and other	(13)	(20)	187	(2)	–
Amortisation and impairment of acquisition intangibles	140	178	204	129	88
Profit on disposal of business	–	(326)	–	–	–
US tax reform	(32)	–	–	–	–
Taxation on excluded items	(26)	48	(130)	(71)	(40)
Adjusted attributable profit	826	735	761	743	693
Adjusted earnings per ordinary share (EPSA)[3]	94.5¢	82.6¢	85.1¢	83.2¢	76.9¢

1 Reconciliation of operating to trading profit is presented below.
2 Non-IFRS financial measures are explained and reconciled to the most directly comparable financial measure prepared in accordance with IFRS on pages 178–181.
3 Adjusted earnings per ordinary share is calculated by dividing adjusted attributable profit by the basic weighted number of shares.

Reconciliation of operating profit to trading profit

	2017 $ million	2016 $ million	2015 $ million	2014 $ million	2013 $ million
Operating profit	934	801	628	749	810
Acquisition related costs	(10)	9	12	118	31
Restructuring and rationalisation costs	–	62	65	61	58
Amortisation and impairment of acquisition intangibles	140	178	204	129	88
Legal and other	(16)	(30)	190	(2)	–
Trading profit	1,048	1,020	1,099	1,055	987

	2017 $ million	2016 $ million	2015 $ million	2014 $ million	2013 $ million
Group balance sheet					
Non-current assets	5,135	4,815	4,692	4,866	3,563
Current assets	2,731	2,529	2,475	2,440	2,256
Total assets	7,866	7,344	7,167	7,306	5,819
Share capital	178	180	183	184	184
Share premium	605	600	590	574	535
Capital redemption reserve	17	15	12	11	10
Treasury shares	(257)	(432)	(294)	(315)	(322)
Retained earnings and other reserves	4,101	3,595	3,475	3,586	3,640
Total equity	4,644	3,958	3,966	4,040	4,047
Non-current liabilities	1,876	2,038	1,857	2,104	699
Current liabilities	1,346	1,348	1,344	1,162	1,073
Total liabilities	3,222	3,386	3,201	3,266	1,772
Total equity and liabilities	7,866	7,344	7,167	7,306	5,819
Group cash flow statement					
Cash generated from operations	1,273	1,035	1,203	961	1,138
Net interest paid	(48)	(45)	(36)	(33)	(6)
Income taxes paid	(135)	(141)	(137)	(245)	(265)
Net cash inflow from operating activities	1,090	849	1,030	683	867
Capital expenditure (including trade investments and net of disposals of property, plant and equipment)	(384)	(394)	(360)	(379)	(340)
Acquisitions and disposals	(159)	(214)	(44)	(1,552)	(67)
Proceeds on disposal of business (net of tax)	–	225	–	–	–
Investment in associate	–	–	(25)	(2)	–
Proceeds from associate loan redemption	–	–	–	188	–
Proceeds from own shares	5	6	5	4	3
Equity dividends paid	(269)	(279)	(272)	(250)	(239)
Issue of ordinary capital and treasury shares purchased	(47)	(358)	(61)	(35)	(183)
Net cash flow from operating, investing and financing activities	236	(165)	273	(1,343)	41
Termination of finance lease	5	–	–	–	–
Exchange adjustments	28	(24)	(21)	(17)	(6)
Opening net debt	(1,550)	(1,361)	(1,613)	(253)	(288)
Closing net debt	(1,281)	(1,550)	(1,361)	(1,613)	(253)
Selected financial ratios					
Gearing (closing net debt as a percentage of total equity)	27.6%	39%	34%	40%	6%
Dividends per ordinary share	35.0¢[1]	30.8¢	30.8¢	29.6¢	27.4¢
Research and development costs to revenue	4.7%	4.9%	4.8%	5.1%	5.3%
Capital expenditure (including intangibles but excluding goodwill and trade investments) to revenue	7.9%	8.4%	7.7%	8.1%	7.8%

1 The Board has proposed a final dividend of 22.7 US cents per share which together with the first interim dividend of 12.3 US cents makes a total for 2017 of 35.0 US cents.

OTHER FINANCIAL INFORMATION continued

NON-IFRS FINANCIAL INFORMATION – ADJUSTED MEASURES

These Financial Statements include financial measures that are not prepared in accordance with International Financial Reporting Standards (IFRS). These measures, which include trading profit, trading profit margin, tax rate on trading results, EPSA, ROIC, trading cash flow, free cash flow, trading profit to trading cash conversion ratio, and underlying growth, exclude the effect of certain cash and non-cash items that Group management believes are not related to the underlying performance of the Group. These non-IFRS financial measures are also used by management to make operating decisions because they facilitate internal comparisons of performance to historical results.

Non-IFRS financial measures are presented in these Financial Statements as the Group's management believe that they provide investors with a means of evaluating performance of the business segment and the consolidated Group on a consistent basis, similar to the way in which the Group's management evaluates performance, that is not otherwise apparent on an IFRS basis, given that certain non-recurring, infrequent, non-cash and other items that management does not otherwise believe are indicative of the underlying performance of the consolidated Group may not be excluded when preparing financial measures under IFRS. These non-IFRS measures should not be considered in isolation from, as substitutes for, or superior to financial measures prepared in accordance with IFRS.

Underlying revenue growth

'Underlying growth in revenue' is used to compare the revenue in a given year to the previous year on a like-for-like basis. This is achieved by adjusting for the impact of sales of products acquired in material business combinations or disposed of and for movements in exchange rates.

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

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

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

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

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

The 'constant currency exchange effect' is a measure of the increase/decrease in revenue resulting from currency movements on non-US Dollar sales and is measured as the difference between: 1) the increase/decrease in the current year revenue translated into US Dollars at the current year average exchange rate and the prior revenue translated at the prior year rate; and 2) the increase/decrease being measured by translating current and prior year revenues into US Dollars using the prior year closing rate.

The 'acquisitions and disposals effect' is the measure of the impact on revenue from newly acquired material business combinations and recent material business disposals. This is calculated by comparing the current year, constant currency actual revenue (which include acquisitions and exclude disposals from the relevant date of completion) with prior year, constant currency actual revenue, adjusted to include the results of acquisitions and exclude disposals for the commensurate period in the prior year. These sales are separately tracked in the Group's internal reporting systems and are readily identifiable.

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

2017 Consolidated revenue by franchise	Reported growth %	Underlying growth %	Reconciling items Acquisitions/disposals %	Reconciling items Currency impact %
Sports Medicine, Trauma & Other	1	3	(2)	–
Sports Medicine Joint Repair	7	6	–	1
Arthroscopic Enabling Technologies	(3)	(3)	–	–
Trauma & Extremities	4	4	–	–
Other Surgical Businesses	(11)	7	(19)	1
Reconstruction	4	3	–	1
Knee Implants	6	5	–	1
Hip Implants	–	–	–	–
Advanced Wound Management	2	2	–	–
Advanced Wound Care	–	–	–	–
Advanced Wound Bioactives	–	–	–	–
Advanced Wound Devices	13	13	–	–
Total	2	3	(1)	–

2016 Consolidated revenue by franchise	Reported growth %	Underlying growth %	Reconciling items Acquisitions/disposals %	Reconciling items Currency impact %
Sports Medicine, Trauma & Other	1	3	(1)	(1)
Sports Medicine Joint Repair	7	8	–	(1)
Arthroscopic Enabling Technologies	–	2	–	(2)
Trauma & Extremities	(4)	(4)	1	(1)
Other Surgical Businesses	5	15	(9)	(1)
Reconstruction	3	2	2	(1)
Knee Implants	6	4	3	(1)
Hip Implants	(1)	(1)	–	–
Advanced Wound Management	(3)	(1)	–	(2)
Advanced Wound Care	(5)	(3)	–	(2)
Advanced Wound Bioactives	(1)	–	–	(1)
Advanced Wound Devices	3	5	–	(2)
Total	1	2	–	(1)

Trading profit, trading profit margin, trading cash flow and trading profit to cash conversion ratio

Trading profit, trading profit margin (trading profit expressed as a percentage of revenue), trading cash flow and trading profit to cash conversion ratio (trading cash flow expressed as a percentage of trading profit) are trend measures, which present the long-term profitability of the Group excluding the impact of specific transactions that management considers affect the Group's short-term profitability and cash flows. The Group has identified the following items, where material, as those to be excluded from operating profit and cash generated from operations when arriving at trading profit and trading cash flow, respectively: acquisition and disposal related items arising in connection with business combinations, including amortisation of acquisition intangible assets, impairments and integration costs; restructuring events; gains and losses resulting from legal disputes and uninsured losses. In addition to these items, gains and losses that materially impact the Group's profitability or cash flows on a short-term or one-off basis and the cash cost to fund defined benefit pension schemes that are closed to future accrual are excluded from operating profit and cash generated from operations when arriving at trading profit and trading cash flow, respectively.

Adjusted earnings per ordinary share (EPSA)

EPSA is a trend measure, which presents the long-term profitability of the Group excluding the post-tax impact of specific transactions that management considers affect the Group's short-term profitability and the one-off impact of US tax reform. The Group presents this measure to assist investors in their understanding of trends. Adjusted attributable profit is the numerator used for this measure and is determined by adjusting attributable profit for the items that are excluded from operating profit when arriving at trading profit and items that are recognised below operating profit that affect the Group's short-term profitability. The most directly comparable financial measure calculated in accordance with IFRS is basic earnings per ordinary share ('EPS').

OTHER FINANCIAL INFORMATION continued

NON-IFRS FINANCIAL INFORMATION – ADJUSTED MEASURES continued

	Revenue $ million	Operating profit[1] $ million	Profit before tax[2] $ million	Taxation[3] $ million	Attributable profit[4] $ million	Cash generated from operating activities[5] $ million	Earnings per share[6] ¢
2017 Reported	4,765	934	879	(112)	767	1,273	87.8
Acquisition-related costs and profit on disposal	–	(10)	(10)	2	(8)	3	(0.9)
Restructuring and rationalisation costs	–	–	–	–	–	15	–
Amortisation and impairment of acquisition intangibles	–	140	140	(40)	100	–	11.4
Legal and other[7]	–	(16)	(13)	12	(1)	25	(0.1)
US tax reform	–	–	–	(32)	(32)	–	(3.7)
Capital expenditure	–	–	–	–	–	(376)	–
2017 Adjusted	4,765	1,048	996	(170)	826	940	94.5

Acquisition-related costs and cash flows: For the year to 31 December 2017 the credit relates to a remeasurement of contingent consideration for a prior year acquisition partially offset by costs associated with the acquisition of Rotation Medical, Inc.

Restructuring and rationalisation costs: There were no restructuring and rationalisation costs in the year to 31 December 2017. The restructuring and rationalisation cash flows relate to the implementation of the Group Optimisation plan that was announced in May 2014 and completed at the end of 2016.

Amortisation and impairment of acquisition intangibles: For the year to 31 December 2017 the charge relates to the amortisation of intangible assets acquired in material business combinations and an impairment charge of $10m.

Legal and other: For the year to 31 December 2017 the charge relates primarily to legal expenses for patent litigation with Arthrex, ongoing metal-on-metal hip claims and an increase of $10m in the provision that reflects the present value of the estimated costs to resolve all other known and anticipated metal-on-metal hip claims. A $54m credit has been recognised in the year to 31 December 2017 following a settlement payment received from Arthrex relating to patent litigation. For the year to 31 December 2017 $44m of cash funding to closed defined benefit pension schemes is excluded from trading cash flow following the closure of the UK scheme to future accrual in December 2016.

	Revenue $ million	Operating profit[1] $ million	Profit before tax[2] $ million	Taxation[3] $ million	Attributable profit[4] $ million	Cash generated from operating activities[5] $ million	Earnings per share[6] ¢
2016 Reported	4,669	801	1,062	(278)	784	1,035	88.1
Acquisition-related costs and profit on disposal	–	9	(317)	120	(197)	24	(22.2)
Restructuring and rationalisation costs	–	62	62	(14)	48	62	5.4
Amortisation and impairment of acquisition intangibles	–	178	178	(59)	119	–	13.4
Legal and other	–	(30)	(20)	1	(19)	36	(2.1)
Capital expenditure	–	–	–	–	–	(392)	–
2016 Adjusted	4,669	1,020	965	(230)	735	765	82.6

Acquisition-related costs and cash flows: For the year to 31 December 2016 these costs relate to the costs associated with the integration of Blue Belt Technologies and other acquisitions. Taxation and attributable profit include the effect of the disposal of the Gynaecology business.

Restructuring and rationalisation costs: For the year to 31 December 2016 these costs primarily relate to the ongoing implementation of the Group Optimisation plan that was announced in May 2014.

Amortisation and impairment of acquisition intangibles: For the year to 31 December 2016 these charges relate to the amortisation of intangible assets acquired in material business combinations and a total impairment of $48m including $32m relating to Oasis, a product acquired with the Healthpoint acquisition in 2013.

Legal and other: For the year to 31 December 2016 the net credit of $30m primarily relates to a $44m curtailment credit on post-retirement benefits in the UK pension scheme partially offset by legal expenses incurred for patent litigation with Arthrex. Also included is a net $1m credit in respect of insurance recoveries of $24m and legal expenses of $23m, relating to the ongoing metal-on-metal hip claims.

1 Represents a reconciliation of operating profit to trading profit.
2 Represents a reconciliation of reported profit before tax to trading profit before tax.
3 Represents a reconciliation of reported tax to trading tax.
4 Represents a reconciliation of reported attributable profit to adjusted attributable profit.
5 Represents a reconciliation of cash generated from operations to trading cash flow.
6 Represents a reconciliation of basic earnings per ordinary share to adjusted earnings per ordinary share (EPSA).
7 From 1 January 2017, the ongoing funding of closed defined benefit pension schemes is not included in management's definition of trading cash flow as there is no defined benefit service cost for these schemes.

Free cash flow

Free cash flow is a measure of the cash generated for the Group to use after capital expenditure according to its capital allocation framework, it is defined as the net cash flow from operating activities less: capital expenditure and cash flows from interest and income taxes. A reconciliation from net cash flow from operating activities, the most comparable IFRS measure, to free cash flow is set out below:

	2017 $ million	2016 $ million	2015 $ million
Net cash flow from operating activities	1,273	1,035	1,203
Capital expenditure	(376)	(392)	(358)
Interest received	2	3	8
Interest paid	(50)	(48)	(44)
Income taxes paid	(135)	(141)	(137)
Free cash flow	714	457	672

Return on invested capital (ROIC)

Return on invested capital (ROIC) is a measure of the return generated on capital invested by the Group. It provides a metric for long-term value creation and encourages compounding reinvestment within the business and discipline around acquisitions with low returns and long payback.

ROIC is defined as: Net Operating Profit less Adjusted Taxes/((Opening Net Operating Assets + Closing Net Operating Assets)/2).

	2017 $ million	2016 $ million	2015 $ million
Operating profit	934	801	
Taxation	(112)	(278)	
Taxation adjustment[1]	(10)	107	
Net operating profit less adjusted taxes	812	630	
Total equity	4,644	3,958	3,966
Retirement benefit asset	(62)	–	(13)
Investments	(21)	(25)	(13)
Investments in associates	(118)	(112)	(115)
Cash at bank	(169)	(100)	(120)
Long term borrowings	1,423	1,564	1,434
Retirement benefit obligation	131	164	184
Bank overdrafts and loans	27	86	46
Net operating assets	5,855	5,535	5,369
Average net operating assets	5,695	5,452	
Return on invested capital	14.3%	11.5%	

1 Being the taxation on interest income, interest expense, other finance costs, share of results of associates and profit on disposal of business.

OTHER FINANCIAL INFORMATION continued

CONTRACTUAL OBLIGATIONS

Contractual obligations at 31 December 2017 were as follows:

	Payments due by period			
	Less than one year $ million	One to three years $ million	Three to five years $ million	More than five years $ million
Debt obligations	27	300	–	–
Private placement notes	36	194	443	647
Operating lease obligations	57	78	43	56
Retirement benefit obligation	25	50	25	–
Purchase obligations	164	7	–	–
Capital expenditure	26	–	–	–
Other	81	74	45	5
	416	703	556	708

Other contractual obligations represent $45m of foreign exchange contracts and $160m of acquisition consideration. Provisions that do not relate to contractual obligations are not included in the above table.

The agreed contributions for 2018 in respect of the Group's defined benefits plans are $25m for the UK Plan.

There are a number of agreements that take effect, alter or terminate upon a change in control of the Company or the Group following a takeover, such as bank loan agreements and Company share plans. None of these are deemed to be significant in terms of their potential impact on the business of the Group as a whole. In addition, there are service contracts between the Company and its Executive Directors which provide for the automatic payment of a bonus following loss of office or employment occurring because of a successful takeover bid. Further details are set out on page 102.

The Company does not have contracts or other arrangements which individually are essential to the business.

EXCHANGE RATES

The Group publishes its consolidated financial statements expressed in US Dollars. The following tables provide certain information concerning the exchange rates between Sterling and US Dollars based on the Bank of England rate.

Year ended 31 December	2017	2016	2015	2014	2013
Year end	1.35	1.23	1.48	1.56	1.66
Average[1]	1.30	1.35	1.53	1.65	1.56
High	1.36	1.48	1.59	1.72	1.66
Low	1.21	1.21	1.46	1.55	1.48

1 The average of the Bank of England rates in effect on the last day of each month during the relevant period.

	February 2018[1]	January 2018	December 2017	November 2017	October 2017	September 2017
High	1.42	1.43	1.35	1.35	1.33	1.36
Low	1.38	1.35	1.33	1.31	1.31	1.30

1 Up to 16 February 2018, the latest practicable date for this Annual Report.

On 16 February 2018, the latest practicable date for this Annual Report, the Bank of England rate was US$1.40 per £1.00.

2016 FINANCIAL HIGHLIGHTS

COMMENTARY ON THE INCOME STATEMENT

- Group revenue increased by $35m, 1% on a reported basis, from $4,634m in 2015 to $4,669m in 2016. The underlying increase is 2%, after adjusting for 1% attributable to the unfavourable impact of currency movements.
- Cost of goods sold increased by $129m, 11% on a reported basis, from $1,143m in 2015 to $1,272m in 2016. The movement is primarily due to underlying trading.
- Selling, general and administrative expenses decreased by $275m (10% on a reported basis) from $2,641m in 2015 to $2,366m in 2016. In 2016, administrative expenses included amortisation of software and other intangible assets of $61m (2015: $66m), $62m of restructuring and rationalisation expenses (2015: $65m), an amount of $178m relating to amortisation and impairment of acquired intangibles (2015: $204m), $9m of acquisition related costs (2015: $12m) and $30m net credit primarily related to a $44m curtailment credit on UK post-retirement benefits (2015: $190m charge for legal and other charges). Excluding the above items, selling, general and administrative expenses were $2,086m in 2016, a decrease of $18m from $2,104m in 2015.
- Research and development expenditure as a percentage of revenue remained broadly consistent at 4.9% in 2016 (2015: 4.8%). Expenditure was $230m in 2016 compared to $222m in 2015. The Group continues to invest in innovative technologies and products to differentiate it from competitors.
- Operating profit increased by $173m from $628m in 2015 to $801m in 2016. This movement in 2016 was primarily driven by the absence of costs recognised in 2015 relating to anticipated and settled metal-on-metal hip claims.
- Net interest expense increased by $8m from a net $38m expense in 2015 to a net $46m expense in 2016. This movement is primarily due to an increase in the effective interest rate and the increase in net debt due to the acquisition of Blue Belt Technologies.
- Other finance costs in 2016 increased by $1m and principally relates to costs associated with the Group's retirement benefit schemes.
- The taxation charge increased by $129m to $278m from $149m in 2015 principally due to the tax charge on the disposal of the Gynaecology business. Our reported tax rate of 26.2% (2015: 26.7%) includes the one-off benefit of a US tax settlement which is partly offset by the tax rate on the disposal of the predominantly US Gynaecology business.

COMMENTARY ON THE GROUP BALANCE SHEET

Non-current assets increased by $123m to $4,815m in 2016 from $4,692m in 2015. This is principally attributable to the following:

- Property, plant and equipment increased by $50m from $932m in 2015 to $982m in 2016. There were $320m of additions together with $2m acquired with the Blue Belt acquisition which was partially offset by $21m of assets disposed. Depreciation of $224m was charged during 2016 and there were unfavourable currency movements of $27m.
- Goodwill increased by $176m from $2,012m in 2015 to $2,188m in 2016. This movement relates to additions of $211m from the acquisition of Blue Belt and BST-CarGel. This was partially offset by unfavourable currency movements of $35m.
- Intangible assets decreased by $91m from $1,502m in 2015 to $1,411m in 2016. There were additions of $72m in 2016 relating to intellectual property, distribution rights and software acquired together with $85m acquired with the Blue Belt and BST-CarGel acquisitions. Amortisation and impairment during 2016 was $239m and there were unfavourable currency movements of $9m.
- Investments increased to $25m from $13m in 2015. The increase was attributable to additions of $2m and fair value remeasurement of $10m.
- Deferred tax assets decreased by $8m in the year from $105m in 2015 to $97m in 2016. The net deferred tax asset position is $3m (2015: asset of $28m). The decrease of $25m is due to tax accrual to tax return adjustments and current year utilisation of net deferred tax assets offset by the impact of acquisitions of $15m.

Current assets increased by $54m to $2,529m from $2,475m in 2015. The movement relates to the following:

- Inventories rose by $27m to $1,244m in 2016 from $1,217m in 2015. This movement is driven by inventory increases in distribution hubs and general increase across the Emerging Markets. This was offset by unfavourable currency movements of $26m.
- The level of trade and other receivables increased by $47m to $1,185m in 2016 from $1,138m in 2015. The movement primarily relates to increased trade receivables of $39m and $10m decrease in the bad debt provision as well as unfavourable currency movements.
- Cash at bank has decreased by $20m from $120m in 2015 to $100m in 2016.

Current liabilities increased by $4m from $1,344m in 2015 to $1,348m in 2016. This movement is attributable to:

- Bank overdrafts and loans increased by $40m from $46m in 2015 to $86m in 2016.
- Trade and other payables increased by $42m from $842m in 2015 to $884m in 2016 primarily due to deferred consideration for acquisitions made in 2016.
- Provisions decreased by $46m from $193m in 2015 to $147m in 2016 primarily due to utilisation of the legal provision for known and anticipated metal-on-metal hip claims.
- Current tax payables decreased by $32m from $263m in 2015 to $231m, mainly attributable to differences in the timing of cash tax payments year-on-year.

INFORMATION FOR SHAREHOLDERS

FINANCIAL CALENDAR

Annual General Meeting	12 April 2018
First quarter Trading Report	3 May 2018
Payment of 2017 final dividend	9 May 2018
Half year results announced	26 July 2018[1]
Third quarter Trading Report	1 November 2018
Payment of 2018 interim dividend	November 2018
Full year results announced	February 2019[1]
Annual Report available	February/March 2019
Annual General Meeting	April 2019

1 Dividend declaration dates.

Annual General Meeting

The Company's Annual General Meeting ('AGM') will be held on Thursday, 12 April 2018 at 2pm at No.11 Cavendish Square, London W1G 0AN. Registered shareholders have been sent either a Notice of Annual General Meeting or notification of availability of the Notice of Annual General Meeting.

Corporate headquarters and registered office

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

ORDINARY SHAREHOLDERS

Registrar

All general enquiries concerning shareholdings, dividends, changes to shareholders' personal details and the AGM should be addressed to:

Computershare Investor Services plc, The Pavilions, Bridgwater Road, Bristol, BS99 6ZZ.

Tel: 0370 703 0047
Tel: +44 (0) 117 378 5450 from outside the UK
Website: www.investorcentre.co.uk

* Lines are open from 8:30am to 5:30pm Monday to Friday, excluding public holidays in England and Wales.

SHAREHOLDER COMMUNICATIONS

We make quarterly financial announcements, which are made available through Stock Exchange announcements and on the Group's website (www.smith-nephew.com). Copies of recent Annual Reports, press releases, institutional presentations and audio webcasts are also available on the website.

We send paper copies of the Notice of Annual General Meeting and Annual Report only to those shareholders and ADS holders who have elected to receive shareholder documentation by post. Electronic copies of the Annual Report and Notice of Annual General Meeting are available on the Group's website at www.smith-nephew.com. Both ordinary shareholders and ADS holders can request paper copies of the Annual Report, which the Company provides free of charge. The Company will continue to send to ordinary shareholders by post the Form of Proxy notifying them of the availability of the Annual Report and Notice of Annual General Meeting on the Group's website. If you elect to receive the Annual Report and Notice of Annual General Meeting electronically you are informed by e-mail of the documents' availability on the Group's website. ADS holders receive the Form of Proxy by post, but will not receive a paper copy of the Notice of Annual General Meeting.

INVESTOR COMMUNICATIONS

The Company maintains regular dialogue with individual institutional shareholders, together with results presentations. To ensure that all members of the Board develop an understanding of the views of major investors, the Executive Directors review significant issues raised by investors with the Board. Non-Executive Directors are sent copies of analysts' and brokers' briefings. There is an opportunity for individual shareholders to question the Directors at the Annual General Meeting and the Company regularly responds to letters from shareholders on a range of issues.

UK CAPITAL GAINS TAX

For the purposes of UK capital gains tax, the price of the Company's ordinary shares on 31 March 1982 was 35.04p.

SMITH & NEPHEW SHARE PRICE

The Company's ordinary shares are quoted on the London Stock Exchange under the symbol SN. The Company's share price is available on the Smith & Nephew website www.smith-nephew.com and at www.londonstockexchange.com where the live financial data is updated with a 15-minute delay.

AMERICAN DEPOSITARY SHARES ('ADSs') AND AMERICAN DEPOSITARY RECEIPTS ('ADRs')

In the USA, the Company's ordinary shares are traded in the form of ADSs, evidenced by ADRs, on the New York Stock Exchange under the symbol SNN. Each American Depositary Share represents two ordinary shares. Deutsche Bank is the authorised depositary bank for the Company's ADR programme.

ADS ENQUIRIES

All enquiries regarding ADS holder accounts and payment of dividends should be addressed to:

Deutsche Bank Shareholder Services
American Stock Transfer and Trust Company
Operations Centre 6201 15th Avenue
Brooklyn, New York
NY 11219

Tel: +1 866 249 2593 (toll free)
E-mail: db@astfinancial.com
Website: www.adr.db.com

The Deutsche Bank Global Direct Investor Services Program is available for US residents, enabling investment directly in ADSs with reduced brokerage commissions and service costs. For further information on Global Direct contact Deutsche Bank Shareholder Services (as above) or visit www.adr.db.com.

INFORMATION FOR SHAREHOLDERS continued

SMITH & NEPHEW ADS PRICE

The Company's ADS price can be obtained from the official New York Stock Exchange website at www.nyse.com and the Smith & Nephew website www.smith-nephew.com where the live financial data is updated with a 15-minute delay, and is quoted daily in the Wall Street Journal.

ADS PAYMENT INFORMATION

The Company hereby discloses ADS payment information for the year ended 31 December 2017 in accordance with the Securities and Exchange Commission rules 12.D.3 and 12.D.4 relating to Form 20-F filings by foreign private issuers. The depositary collects its fees for delivery and surrender of ADSs directly from investors depositing shares or surrendering ADSs for the purpose of withdrawal or from intermediaries acting for them. The depositary collects fees for making distributions to investors, including payment of dividends by the Company by deducting those fees from the amounts distributed or by selling a portion of distributable property to pay the fees. The depositary may collect its annual fee for depositary services by deductions from cash distributions or by directly billing investors or by charging the book-entry system accounts of participants acting for them. The depositary may generally refuse to provide fee-attracting services until its fee for those services are paid.

Persons depositing or withdrawing shares must pay	For
$5.00 (or less) per 100 ADSs (or portion of 100 ADSs) $0.05 (or less) per ADS	Issuance of ADSs, including issuances resulting from a distribution of shares or rights or other property Cancellation of ADSs for the purpose of withdrawal, including if the deposit agreement terminates Any cash distribution to ADS registered holders, including payment of dividend
$0.05 (or less) per ADS per calendar year Registration or transfer fees	Depositary services Transfer and registration of shares on our share register to or from the name of the depositary or its agent when shares are deposited or withdrawn
Taxes and other governmental charges the depositary or the custodian have to pay on any ADS or share underlying an ADS, for example, stock transfer taxes, stamp duty or withholding taxes	As necessary
Any charges incurred by the depositary or its agents for servicing the deposited securities	As necessary

During 2017, a fee of one US cent per ADS was collected on the 2016 final dividend paid in May and a fee of one US cent per ADS was collected on the 2017 interim dividend paid in October. In the period 1 January 2017 to 16 February 2018, the total program payments made by Deutsche Bank Trust Company Americas were $599,992.

DIVIDEND HISTORY

Smith & Nephew has paid dividends on its ordinary shares in every year since 1937. Following the capital restructuring and dividend reduction in 2000, the Group adopted a policy of increasing its dividend cover (the ratio of EPSA, as set out in the 'Selected financial data', to ordinary dividends declared for the year). This was intended to increase the financing capability of the Group for acquisitions and other investments. From 2000 to 2004, the dividend increased in line with inflation and, in 2004, dividend cover stood at 4.1 times. Having achieved this level of dividend cover the Board changed its policy, from that of increasing dividends in line with inflation, to that of increasing dividends for 2005 and after by 10%. Following the redenomination of the Company's share capital into US Dollars, the Board re-affirmed its policy of increasing the dividend by 10% a year in US Dollar terms.

On 2 August 2012, the Board announced its intention to pursue a progressive dividend policy, with the aim of increasing the US Dollar value of ordinary dividends over time broadly based on the Group's underlying growth in earnings, while taking into account capital requirements and cash flows.

At the time of the full year results, the Board reviews the appropriate level of total annual dividend each year. The Board intends that the interim dividend will be set by a formula and will be equivalent to 40% of the total dividend for the previous year. Dividends will continue to be declared in US Dollars with an equivalent amount in Sterling payable to those shareholders whose registered address is in the UK, or who have validly elected to receive Sterling dividends.

An interim dividend in respect of each fiscal year is normally declared in July or August and paid in November. A final dividend will be recommended by the Board of Directors and paid subject to approval by shareholders at the Company's Annual General Meeting.

Future dividends of Smith & Nephew will be dependent upon: future earnings; the future financial condition of the Group; the Board's dividend policy; and the additional factors that might affect the business of the Group set out in 'Special note regarding forward-looking statements' and 'Risk Factors'.

DIVIDENDS PER SHARE

The table below sets out the dividends per ordinary share in the last five years.

	Years ended 31 December				
	2017	2016	2015	2014	2013
Pence per share:					
Interim	9.340	10.080	8.533	7.578	7.211
Final	16.183[1]	14.420	14.300	13.574	11.121
Total	25.523	24.500	22.833	21.152	18.332
US cents per share:					
Interim	12.300	12.300	13.111	12.222	11.556
Final	22.700	18.500	19.000	20.667	18.889
Total	35.000	30.800	32.111	32.889	30.445

1 Translated at the Bank of England rate on 16 February 2018.

From 6 April 2016 dividends below £5,000 per tax year became tax free and dividends above £5,000 per tax year became subject to personal income tax at the rate of 7.5% for basic rate taxpayers, 32.5% for higher rate taxpayers and 38.1% for additional rate taxpayers. A self-assessment form will therefore be required if your dividend income exceeds £5,000 per tax year. This will apply to both cash and dividend reinvestment plan ('DRIP') dividends, although dividends paid on shares held within pensions and ISAs will be unaffected, remaining tax free. Please note, with effect from 6 April 2018, the tax free allowance for dividend income will reduce from £5,000 to £2,000. This will impact the 2017 final dividend, which will be payable on 9 May 2018, subject to shareholder approval.

Dividends shown in the table above, prior to 6 April 2016, include the associated UK tax credit of 10%, but exclude the deduction of withholding taxes.

Since the second interim dividend for 2005, all dividends have been declared in US cents per ordinary share.

In respect of the proposed final dividend for the year ended 31 December 2017 of 22.7 US cents per ordinary share, the record date will be 6 April 2018 and the payment date will be 9 May 2018. The Sterling equivalent per ordinary share will be set following the record date. Shareholders may elect to receive their dividend in either Sterling or US Dollars and the last day for election will be 20 April 2018. The ordinary shares will trade ex-dividend on both the London and New York Stock Exchanges from 5 April 2018.

The proposed final dividend of 22.7 US cents per ordinary share, which together with the interim dividend of 12.3 US cents, makes a total for 2017 of 35.00 US cents.

INFORMATION FOR SHAREHOLDERS continued

SHARE PRICES

The table below sets out, for the periods indicated, the highest and lowest middle market quotations for the Company's ordinary shares (as derived from the Daily Official List of the UK Listing Authority) and the highest and lowest sales prices of its ADSs (as reported on the New York Stock Exchange composite tape).

	Ordinary shares		ADSs	
	High £	Low £	High US$	Low US$
Year ended 31 December:				
2013	8.68	6.80	71.85	52.90
2014[1]	11.93	8.57	97.27	29.39
2015	12.12	10.60	37.78	32.48
2016	13.10	10.51	35.06	27.11
2017	14.31	11.70	38.50	29.90
Quarters in the year ended 31 December:				
2016:				
1st Quarter	11.79	10.51	34.80	30.55
2nd Quarter	12.67	11.12	34.97	31.43
3rd Quarter	13.10	12.11	35.06	32.37
4th Quarter	12.81	10.67	32.97	27.11
2017:				
1st Quarter	12.52	11.70	31.71	29.90
2nd Quarter	13.82	12.16	35.71	30.98
3rd Quarter	13.99	12.94	37.17	33.87
4th Quarter	14.31	12.79	38.50	34.62
2018:				
1st Quarter (to 16 February 2018)	12.94	12.15	37.20	34.12
Last six months:				
August 2017	13.97	13.16	36.40	34.99
September 2017	13.99	13.08	37.17	35.53
October 2017	14.31	13.59	38.50	36.10
November 2017	14.12	13.10	37.42	35.50
December 2017	13.24	12.79	36.13	34.62
January 2018	12.94	12.31	37.20	34.58
February 2018 (to 16 February 2018)	12.80	12.15	36.54	34.12

1 On 14 October 2014, the ratio of ordinary shares per ADS changed from five ordinary shares per ADS to two ordinary shares per ADS.

SHARE CAPITAL

The principal trading market for the ordinary shares is the London Stock Exchange. The ordinary shares were listed on the New York Stock Exchange on 16 November 1999, trading in the form of ADSs evidenced by ADRs. Each ADS represents two ordinary shares from 14 October 2014, before which time one ADS represented five ordinary shares. The ADS facility is sponsored by Deutsche Bank acting as depositary.

All the ordinary shares, including those held by Directors and Executive Officers, rank pari passu with each other. On 23 January 2006, the ordinary shares of 12²⁄₉p were redenominated as ordinary shares of US 20 cents (following approval by shareholders at the Extraordinary General Meeting in December 2005). The new US Dollar ordinary shares carry the same rights as the previous ordinary shares. The share price continues to be quoted in Sterling. In 2006, the Company issued £50,000 of shares in Sterling in order to comply with English law. These were issued as deferred shares, which are not listed on any stock exchange. They have extremely limited rights and therefore effectively have no value. These shares were allotted to the Chief Executive Officer, although the Board reserves the right to transfer them to another member of the Board should it so wish.

Shareholdings

As at 16 February 2018, to the knowledge of the Group, there were 14,877 registered holders of ordinary shares, of whom 96 had registered addresses in the USA and held a total of 207,045 ordinary shares (0.023% of the total issued). Because certain ordinary shares are registered in the names of nominees, the number of shareholders with registered addresses in the USA is not representative of the number of beneficial owners of ordinary shares resident in the USA.

As at 16 February 2018, 33,740,645 ADSs equivalent to 67,481,290 ordinary shares or approximately 7.7% of the total ordinary shares in issue, were outstanding and were held by 87 registered ADS holders.

Major shareholders

As far as is known to Smith & Nephew, the Group is not directly or indirectly owned or controlled by another corporation or by any Government and the Group has not entered into arrangements, the operation of which may at a subsequent date result in a change in control of the Group.

As at 16 February 2018, no persons are known to Smith & Nephew to have any interest (as defined in the Disclosure and Transparency Rules of the FCA) in 3% or more of the ordinary shares, other than as shown below. The following tables show changes over the last three years in the percentage and numbers of the issued share capital owned by shareholders holding 3% or more of ordinary shares, as notified to the Company under the Disclosure and Transparency Rules:

		As at 31 December		
	16 February 2018 %	2017 %	2016 %	2015 %
BlackRock, Inc.	5.2	5.2	5.2	5.2

		As at 31 December		
	16 February 2018 '000	2017 '000	2016 '000	2015 '000
BlackRock, Inc.	46,427	46,427	46,427	46,427

The Company is not aware of any person who has a significant direct or indirect holding of securities in the Company, and is not aware of any persons holding securities which may control the Company. There are no securities in issue which have special rights as to the control of the Company.

Purchase of ordinary shares on behalf of the Company

At the AGM, the Company will be seeking a renewal of its current permission from shareholders to purchase up to 10% of its own shares. In order to avoid shareholder dilution, shares allotted to employees through employee share schemes are bought back on a quarterly basis and subsequently cancelled by the Company.

From 1 January 2017 to 16 February 2018, in the months listed below, the Company has purchased 2,907,586 ordinary shares at a cost of $50,112,844.04.

	Total shares purchased 000s	Average price paid per share pence	Approximate US$ value of shares purchased under the plan
20-21 February 2017 (partial Q4 2016)	429	1,205.0589	$6,451,301
18-22 May 2017 (Q1 2017)	960	1,324.2686	$16,520,793
2 August 2017 (Q2 2017)	309	1,319.9881	$5,410,073
7-8 November 2017 (Q3 2017)	652	1,384.7434	$11,837,805
14-15 February 2018 (Q4 2017)	557	1,261.6308	$9,892,872

The shares were purchased in the open market by J.P. Morgan Securities plc and Merrill Lynch International on behalf of the Company.

Exchange controls and other limitations affecting security holders

There are no UK governmental laws, decrees or regulations that restrict the export or import of capital or that affect the payment of dividends, interest or other payments to non-resident holders of Smith & Nephew's securities, except for certain restrictions imposed from time to time by Her Majesty's Treasury of the United Kingdom pursuant to legislation, such as the United Nations Act 1946 and the Emergency Laws Act 1964, against the Government or residents of certain countries.

There are no limitations, either under the laws of the UK or under the Articles of Association of Smith & Nephew, restricting the right of non-UK residents to hold or to exercise voting rights in respect of ordinary shares, except that where any overseas shareholder has not provided to the Company a UK address for the service of notices, the Company is under no obligation to send any notice or other document to an overseas address. It is, however, the current practice of the Company to send every notice or other document to all shareholders regardless of the country recorded in the register of members, with the exception of details of the Company's dividend reinvestment plan, which are not sent to shareholders with recorded addresses in the USA and Canada.

INFORMATION FOR SHAREHOLDERS continued

TAXATION INFORMATION FOR SHAREHOLDERS

The comments below are of a general and summary nature and are based on the Group's understanding of certain aspects of current UK and US federal income tax law and practice relevant to the ADSs and ordinary shares not in ADS form. The comments address the material US and UK tax consequences generally applicable to a person who is the beneficial owner of ADSs or ordinary shares and who, for US federal income tax purposes, is a citizen or resident of the USA, a corporation (or other entity taxable as a corporation) created or organised in or under the laws of the USA (or any State therein or the District of Columbia), or an estate or trust the income of which is included in gross income for US federal income tax purposes regardless of its source (each a US Holder). The comments set out below do not purport to address all tax consequences of the ownership of ADSs or ordinary shares that may be material to a particular holder and in particular do not deal with the position of shareholders who directly or indirectly own 10% or more of the Company's issued ordinary shares. This discussion does not apply to (i) persons whose holding of ADSs or ordinary shares is effectively connected with or pertains to either a permanent establishment in the UK through which a US Holder carries on a business in the UK or a fixed base from which a US Holder performs independent personal services in the UK, or (ii) persons whose registered address is inside the UK. This discussion does not apply to certain investors subject to special rules, such as certain financial institutions, tax-exempt entities, insurance companies, broker-dealers and traders in securities that elect to use the mark-to-market method of tax accounting, partnerships or other entities treated as partnerships for US federal income tax purposes, US Holders holding ADSs or ordinary shares as part of a hedging, conversion or other integrated transaction or US Holders whose functional currency for US federal income tax purposes is other than the US Dollar. In addition, the comments below do not address the potential application of the provisions of the United States Internal Revenue Code known as the Medicare Contribution Tax, any alternative minimum tax consequences, any US federal tax other than income tax or any US state, local or non-US (other than UK) taxes. The summary deals only with US Holders who hold ADSs or ordinary shares as capital assets for tax purposes. The summary is based on current UK and US law and practice which is subject to change, possibly with retroactive effect. US Holders are recommended to consult their own tax advisers as to the particular tax consequences to them of the ownership of ADSs or ordinary shares. The Company believes, and this discussion assumes, that the Company was not a passive foreign investment company for its taxable year ended 31 December 2017.

This discussion is based in part on representations by the depositary and assumes that each obligation under the deposit agreement and any related agreement will be performed in accordance with its terms. For purposes of US federal income tax law, US Holders of ADSs will generally be treated as owners of the ordinary shares represented by the ADSs. However, the US Treasury has expressed concerns that parties to whom depositary shares are released before shares are delivered to the depositary (pre-released) may be taking actions that are inconsistent with the claiming of foreign tax credits by owners of depositary shares. Such actions would also be inconsistent with the claiming of the reduced rate of tax, described below, applicable to dividends received by certain non-corporate US Holders. Accordingly, the availability of the reduced tax rate for dividends received by certain non-corporate US Holders of ADSs could be affected by actions that may be taken by parties to whom ADSs are pre-released.

Taxation of distributions in the UK and the USA

The UK does not currently impose a withholding tax on dividends paid by a UK corporation, such as the Company.

Distributions paid by the Company will generally be taxed as foreign source dividends to the extent paid out of the Company's current or accumulated earnings and profits as determined for US federal income tax purposes. Because the Company does not maintain calculations of its earnings and profits under US federal income tax principles, it is expected that distributions generally will be reported to US Holders as dividends. Such dividends will not be eligible for the dividends-received deduction generally allowed to corporate US Holders.

Dividends paid to certain non-corporate US Holders of ordinary shares or ADSs may be subject to US federal income tax at lower rates than those applicable to other types of ordinary income if certain conditions are met. Non-corporate US Holders should consult their own tax advisers to determine whether they are subject to any special rules that limit their ability to be taxed at these favourable rates.

Taxation of capital gains

US Holders, who are not resident or ordinarily resident for tax purposes in the UK, will not generally be liable for UK capital gains tax on any capital gain realised upon the sale or other disposition of ADSs or ordinary shares unless the ADSs or ordinary shares are held in connection with a trade carried on in the UK through a permanent establishment (or in the case of individuals, through a branch or agency). Furthermore, UK resident individuals who acquire ADSs or ordinary shares before becoming temporarily non-UK residents may remain subject to UK taxation of capital gains on gains realised while non-resident.

For US federal income tax purposes, gains or losses realised upon a taxable sale or other disposition of ADSs or ordinary shares by US Holders generally will be US source capital gains or losses and will be long-term capital gains or losses if the ADSs or ordinary shares were held for more than one year. The amount of a US Holder's gain or loss will be equal to the difference between the amount realised on the sale or other disposition and such holder's tax basis in the ADSs, or ordinary shares, each determined in US Dollars.

Inheritance and estate taxes

The HM Revenue & Customs imposes inheritance tax on capital transfers which occur on death, and in the seven years preceding death. The HM Revenue & Customs considers that the US/UK Double Taxation Convention on Estate and Gift Tax applies to inheritance tax. Consequently, a US citizen who is domiciled in the USA and is not a UK national or domiciled in the UK will not be subject to UK inheritance tax in respect of ADSs and ordinary shares. A UK national who is domiciled in the USA will be subject to UK inheritance tax but will be entitled to a credit for any US federal estate tax charged in respect of ADSs and ordinary shares in computing the liability to UK inheritance tax. Special rules apply where ADSs and ordinary shares are business property of a permanent establishment of an enterprise situated in the UK.

US information reporting and backup withholding

Payments of dividends on, or proceeds from the sale of, ADSs or ordinary shares that are made within the USA or through certain US-related financial intermediaries generally will be subject to US information reporting, and may be subject to backup withholding, unless a US Holder is an exempt recipient or, in the case of backup withholding, provides a correct US taxpayer identification number and certain other conditions are met.

Any backup withholding deducted may be credited against the US Holder's US federal income tax liability, and, where the backup withholding exceeds the actual liability, the US Holder may obtain a refund by timely filing the appropriate refund claim with the US Internal Revenue Service.

US Holders who are individuals or certain specified entities may be required to report information relating to securities issued by a non-US person (or foreign accounts through which the securities are held), subject to certain exceptions (including an exception for securities held in accounts maintained by US financial institutions). US Holders should consult their tax advisers regarding their reporting obligations with respect to the ADSs or ordinary shares.

UK stamp duty and stamp duty reserve tax

UK stamp duty is charged on documents and in particular instruments for the transfer of registered ownership of ordinary shares. Transfers of ordinary shares in certificated form will generally be subject to UK stamp duty at the rate of ½% of the consideration given for the transfer with the duty rounded up to the nearest £5.

UK stamp duty reserve tax (SDRT) arises when there is an agreement to transfer shares in UK companies 'for consideration in money or money's worth', and so an agreement to transfer ordinary shares for money or other consideration may give rise to a charge to SDRT at the rate of ½% (rounded up to the nearest penny). The charge of SDRT will be cancelled, and any SDRT already paid will be refunded, if within six years of the agreement an instrument of transfer is produced to HM Revenue & Customs and the appropriate stamp duty paid.

Transfers of ordinary shares into CREST (an electronic transfer system) are exempt from stamp duty so long as the transferee is a member of CREST who will hold the ordinary shares as a nominee for the transferor and the transfer is in a form that will ensure that the securities become held in uncertificated form within CREST. Paperless transfers of ordinary shares within CREST for consideration in money or money's worth are liable to SDRT rather than stamp duty. SDRT on relevant transactions will be collected by CREST at ½%, and this will apply whether or not the transfer is effected in the UK and whether or not the parties to it are resident or situated in the UK.

A charge of stamp duty or SDRT at the rate of 1½% of the consideration (or, in some circumstances, the value of the shares concerned) will arise on a transfer or issue of ordinary shares to the depositary or to certain persons providing a clearance service (or their nominees or agents) for the conversion into ADRs and will generally be payable by the depositary or person providing clearance service. In accordance with the terms of the Deposit Agreement, any tax or duty payable by the depositary on deposits of ordinary shares will be charged by the depositary to the party to whom ADRs are delivered against such deposits.

No liability for stamp duty or SDRT will arise on any transfer of, or agreement to transfer, an ADS or beneficial ownership of an ADS, provided that the ADS and any instrument of transfer or written agreement to transfer remains at all times outside the UK, and provided further that any instrument of transfer or written agreement to transfer is not executed in the UK and the transfer does not relate to any matter or thing done or to be done in the UK (the location of the custodian as a holder of ordinary shares not being relevant in this context). In any other case, any transfer of, or agreement to transfer, an ADS or beneficial ownership of an ADS could, depending on all the circumstances of the transfer, give rise to a charge to stamp duty or SDRT.

INFORMATION FOR SHAREHOLDERS continued

ARTICLES OF ASSOCIATION

The following summarises certain material rights of holders of the Company's ordinary shares under the material provisions of the Company's Articles of Association and English law. This summary is qualified in its entirety by reference to the Companies Act and the Company's Articles of Association. In the following description, a 'shareholder' is the person registered in the Company's register of members as the holder of an ordinary share.

The Company is incorporated under the name Smith & Nephew plc and is registered in England and Wales with registered number 324357.

The Company's ordinary shares may be held in certificated or uncertificated form. No holder of the Company's shares will be required to make additional contributions of capital in respect of the Company's shares in the future. In accordance with English law, the Company's ordinary shares rank equally.

Directors

Under the Company's Articles of Association, a Director may not vote in respect of any contract, arrangement, transaction or proposal in which he, or any person connected with him, has any material interest other than by virtue of his interests in securities of, or otherwise in or through, the Company. This is subject to certain exceptions relating to proposals (a) indemnifying him in respect of obligations incurred on behalf of the Company, (b) indemnifying a third party in respect of obligations of the Company for which the Director has assumed responsibility under an indemnity or guarantee, (c) relating to an offer of securities in which he will be interested as an underwriter, (d) concerning another body corporate in which the Director is beneficially interested in less than 1% of the issued shares of any class of shares of such a body corporate, (e) relating to an employee benefit in which the Director will share equally with other employees and (f) relating to any insurance that the Company is empowered to purchase for the benefit of Directors of the Company in respect of actions undertaken as Directors (and/or officers) of the Company.

A Director shall not vote or be counted in any quorum present at a meeting in relation to a resolution on which he is not entitled to vote.

The Directors are empowered to exercise all the powers of the Company to borrow money, subject to the limitation that the aggregate amount of all monies borrowed after deducting cash and current asset investments by the Company and its subsidiaries shall not exceed the sum of $6,500,000,000.

Any Director who has been appointed by the Directors since the previous Annual General Meeting of shareholders, either to fill a casual vacancy or as an additional Director holds office only until the conclusion of the next Annual General Meeting and then shall be eligible for re-election by the shareholders. The other Directors retire and are eligible for re-appointment at the third Annual General Meeting after the meeting at which they were last re-appointed. If not re-appointed, a Director retiring at a meeting shall retain office until the meeting appoints someone in his place, or if it does not do so, until the conclusion of the meeting. The Directors are subject to removal with or without cause by the Board or the shareholders. Directors are not required to hold any shares of the Company by way of qualification.

Under the Company's Articles of Association and English law, a Director may be indemnified out of the assets of the Company against liabilities he may sustain or incur in the execution of his duties.

Rights attaching to ordinary shares

Under English law, dividends are payable on the Company's ordinary shares only out of profits available for distribution, as determined in accordance with accounting principles generally accepted in the UK and by the Companies Act 2006. Holders of the Company's ordinary shares are entitled to receive final dividends as may be declared by the Directors and approved by the shareholders in general meeting, rateable according to the amounts paid up on such shares, provided that the dividend cannot exceed the amount recommended by the Directors.

The Company's Board of Directors may declare such interim dividends as appear to them to be justified by the Company's financial position. If authorised by an ordinary resolution of the shareholders, the Board may also direct payment of a dividend in whole or in part by the distribution of specific assets (and in particular of paid up shares or debentures of the Company).

Any dividend unclaimed after 12 years from the date the dividend was declared, or became due for payment, will be forfeited and will revert to the Company.

There were no material modifications to the rights of shareholders under the Articles during 2017.

Voting rights of ordinary shares

Voting at any general meeting of shareholders is by a show of hands unless a poll, which is a written vote, is duly demanded and held. On a show of hands, every shareholder who is present in person at a general meeting has one vote regardless of the number of shares held. On a poll, every shareholder who is present in person or by proxy has one vote for each ordinary share held by that shareholder. A poll may be demanded by any of the following:

– The chairman of the meeting;
– At least five shareholders present or by proxy entitled to vote on the resolution;
– Any shareholder or shareholders representing in the aggregate not less than one-tenth of the total voting rights of all shareholders entitled to vote on the resolution; or
– Any shareholder or shareholders holding shares conferring a right to vote on the resolution on which there have been paid-up sums in aggregate equal to not less than one-tenth of the total sum paid up on all the shares conferring that right.

A Form of Proxy will be treated as giving the proxy the authority to demand a poll, or to join others in demanding one, as above.

The necessary quorum for a general meeting is two shareholders present in person or by proxy carrying the right to vote upon the business to be transacted.

Matters are transacted at general meetings of the Company by the processing and passing of resolutions of which there are two kinds; ordinary or special resolutions:

- Ordinary resolutions include resolutions for the re-election of Directors, the approval of financial statements, the declaration of dividends (other than interim dividends), the appointment and re-appointment of auditors or the grant of authority to allot shares. An ordinary resolution requires the affirmative vote of a majority of the votes of those persons voting at the meetings at which there is a quorum.
- Special resolutions include resolutions amending the Company's Articles of Association, dis-applying statutory pre-emption rights or changing the Company's name; modifying the rights of any class of the Company's shares at a meeting of the holders of such class or relating to certain matters concerning the Company's winding up. A special resolution requires the affirmative vote of not less than three-quarters of the votes of the persons voting at the meeting at which there is a quorum.

Annual General Meetings must be convened upon advance written notice of 21 days. Other general meetings must be convened upon advance written notice of at least 14 clear days. The days of delivery or receipt of notice are not included. The notice must specify the nature of the business to be transacted. Meetings are convened by the Board of Directors. Members with 5% of the ordinary share capital of the Company may requisition the Board to convene a meeting.

Variation of rights

If, at any time, the Company's share capital is divided into different classes of shares, the rights attached to any class may be varied, subject to the provisions of the Companies Act, with the consent in writing of holders of three-quarters in nominal value of the issued shares of that class or upon the adoption of a special resolution passed at a separate meeting of the holders of the shares of that class. At every such separate meeting, all the provisions of the Articles of Association relating to proceedings at a general meeting apply, except that the quorum is to be the number of persons (which must be two or more) who hold or represent by proxy not less than one-third in nominal value of the issued shares of the class and at any such meeting a poll may be demanded in writing by any person or their proxy who hold shares of that class. Where a person is present by proxy or proxies, he is treated as holding only the shares in respect of which the proxies are authorised to exercise voting rights.

Rights in a winding up

Except as the Company's shareholders have agreed or may otherwise agree, upon the Company's winding up, the balance of assets available for distribution:

- After the payment of all creditors including certain preferential creditors, whether statutorily preferred creditors or normal creditors; and
- Subject to any special rights attaching to any other class of shares;
- Is to be distributed among the holders of ordinary shares according to the amounts paid-up on the shares held by them. This distribution is generally to be made in US Dollars. A liquidator may, however, upon the adoption of any extraordinary resolution of the shareholders and any other sanction required by law, divide among the shareholders the whole or any part of the Company's assets in kind.

Limitations on voting and shareholding

There are no limitations imposed by English law or the Company's Articles of Association on the right of non-residents or foreign persons to hold or vote the Company's ordinary shares or ADSs, other than the limitations that would generally apply to all of the Company's shareholders.

Transfers of shares

The Board may refuse to register the transfer of shares held in certificated form which:

- Are not fully paid (provided that it shall not exercise this discretion in such a way as to prevent stock market dealings in the shares of that class from taking place on an open and proper basis);
- Are not duly stamped or duly certified or otherwise shown to the satisfaction of the Board to be exempt from stamp duty, lodged at the Transfer Office or at such other place as the Board may appoint and (save in the case of a transfer by a person to whom no certificate was issued in respect of the shares in question) accompanied by the certificate for the shares to which it relates, and such other evidence as the Board may reasonably require to show the right of the transferor to make the transfer and, if the instrument of transfer is executed by some other person on his behalf, the authority of that person so to do;
- Are in respect of more than one class of shares; or
- Are in favour of more than four transferees.

Deferred shares

Following the re-denomination of share capital on 23 January 2006, the ordinary shares' nominal value became 20 US cents each. There were no changes to the rights or obligations of the ordinary shares. In order to comply with the Companies Act 2006, a new class of Sterling shares was created, deferred shares, of which £50,000 were issued and allotted in 2006 as fully paid to the Chief Executive Officer though the Board reserves the right to transfer them to another member of the Board should it so wish. These deferred shares have no voting or dividend rights and on winding up only are entitled to repayment at nominal value only if all ordinary shareholders have received the nominal value of their shares plus an additional US$1,000 each.

Amendments

The Company does not have any special rules about amendments to its Articles of Association beyond those imposed by law.

INFORMATION FOR SHAREHOLDERS continued

CROSS REFERENCE TO FORM 20-F

This table provides a cross reference from the information included in this Annual Report to the requirements of Form 20-F.

INFORMATION FOR SHAREHOLDERS continued

GLOSSARY OF TERMS

Unless the context indicates otherwise, the following terms have the meanings shown below:

Term	Meaning
ACL	The anterior cruciate ligament (ACL) is one of the four major ligaments in the human knee.
ADR	In the US, the Company's ordinary shares are traded in the form of American Depositary Shares evidenced by American Depositary Receipts (ADRs).
ADS	In the US, the Company's ordinary shares are traded in the form of American Depositary Shares (ADSs).
Arthroscopic Enabling Technologies	A product group which includes 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, electromechanical and mechanical tissue resection devices, and hand instruments for removing damaged tissue.
Advanced Wound Bioactives	A product group which includes biologics and other bioactive technologies that provide unique approaches to debridement and dermal repair/regeneration.
Advanced Wound Care	A product group which includes products for the treatment and prevention of acute and chronic wounds, including leg, diabetic and pressure ulcers, burns and post-operative wounds.
Advanced Wound Devices	A product group which includes traditional and single-use Negative Pressure Wound Therapy and hydrosurgery systems.
AGM	Annual General Meeting of the Company.
Arthroscopy	Endoscopy of the joints is termed 'arthroscopy', with the principal applications being the knee and shoulder.
Basis Point	One hundredth of one percentage point.
Chronic wounds	Chronic wounds are those with long or unknown healing times including leg ulcers, pressure sores and diabetic foot ulcers.
Company	Smith & Nephew plc or, where appropriate, the Company's Board of Directors, unless the context otherwise requires.
Companies Act	Companies Act 2006, as amended, of England and Wales.
Emerging Markets	Emerging Markets include Greater China, India, Brazil and Russia.
EPSA	EPSA (Adjusted earnings per ordinary share) is a trend measure, which presents the long-term profitability of the Group excluding the post-tax impact of specific transactions that management considers affects the Group's short-term profitability. The Group presents this measure to assist investors in their understanding of trends. Adjusted attributable profit is the numerator used for this measure and is determined by adjusting attributable profit for the items that are excluded from operating profit when arriving at trading profit and items that are recognised below operating profit that affect the Group's short-term profitability.
Endoscopy	Through a small incision, surgeons are able to see inside the body using a monitor and identify and repair defects.
Established Markets	Established Markets include United States of America, Europe, Australia, New Zealand, Canada and Japan.
Euro or €	References to the common currency used in the majority of the countries of the European Union.
FDA	US Food and Drug Administration.
Financial statements	Refers to the consolidated Group Accounts of Smith & Nephew plc.
FTSE 100	Index of the largest 100 listed companies on the London Stock Exchange by market capitalisation.
Group or Smith & Nephew	Used for convenience to refer to the Company and its consolidated subsidiaries, unless the context otherwise requires.
Health economics	A branch of economics concerned with issues related to efficiency, effectiveness, value and behaviour in the production and consumption of health and healthcare.
Hip Implants	A product group which includes specialist products for reconstruction of the hip joint.
IFRIC	International Financial Reporting Interpretations as adopted by the EU and as issued by the International Accounting Standards Board.
IFRS	International Financial Reporting Standards as adopted by the EU and as issued by the International Accounting Standards Board.
Knee implants	A product group which includes an innovative range of products for specialised knee replacement procedures.
LSE	London Stock Exchange.
MHRA	The Medicines and Healthcare products Regulatory Agency in the UK.

Term	Meaning
Negative Pressure Wound Therapy	A technology used to treat chronic wounds such as diabetic ulcers, pressure sores and post-operative wounds through the application of sub-atmospheric pressure to an open wound.
NHS	The UK National Health Service.
NYSE	New York Stock Exchange.
Orthopaedic products	Orthopaedic reconstruction products include joint replacement systems for knees, hips and shoulders and support products such as computer-assisted surgery and minimally invasive surgery techniques. Orthopaedic trauma devices are used in the treatment of bone fractures including rods, pins, screws, plates and external frames. Clinical therapies products include joint fluid therapy for pain reduction of the knee and an ultrasound treatment to accelerate the healing of bone fractures.
Other Surgical Businesses	A product group which includes robotics-assisted surgery, various products and technologies to assist in surgical treatment of the ear, nose and throat, and gynaecological instrumentation, until the Gynaecology business disposal in August 2016.
OXINIUM	OXINIUM material is an advanced load bearing technology. It is created through a proprietary manufacturing process that enables zirconium to absorb oxygen and transform to a ceramic on the surface, resulting in a material that incorporates the features of ceramic and metal. Management believes that OXINIUM material used in the production of components of knee and hip implants exhibits unique performance characteristics due to its hardness, low-friction and resistance to roughening and abrasion.
Parent Company	Smith & Nephew plc.
Pound Sterling, Sterling, £, pence or p	References to UK currency. 1p is equivalent to one hundredth of £1.
SEC	US Securities and Exchange Commission.
Sports Medicine Joint Repair	The Sports Medicine Joint Repair franchise includes instruments, technologies and implants necessary to perform minimally invasive surgery of joints.
Trading results	Trading profit, trading profit margin (trading profit expressed as a percentage of revenue), trading cash flow and trading profit to cash conversion ratio (trading cash flow expressed as a percentage of trading profit) are trend measures, which present the long-term profitability of the Group excluding the impact of specific transactions that management considers affect the Group's short-term profitability and cash flows. The Group has identified the following items, where material, as those to be excluded from operating profit and cash generated from operations when arriving at trading profit and trading cash flow, respectively: acquisition and disposal related items arising in connection with business combinations, including amortisation of acquisition intangible assets, impairments and integration costs; restructuring events; gains and losses resulting from legal disputes and uninsured losses. In addition to these items, gains and losses that materially impact the Group's profitability or cash flows on a short-term or one-off basis and the cash cost to fund defined benefit pension schemes that are closed to future accrual are excluded from operating profit and cash generated from operations when arriving at trading profit and trading cash flow, respectively.
Trauma & Extremities	A product group which includes internal and external devices used in the stabilisation of severe fractures and deformity correction procedures.
UK	United Kingdom of Great Britain and Northern Ireland.
Underlying growth	Growth after adjusting for the effects of currency translation and the inclusion of the comparative impact of acquisitions and exclusion of disposals.
US	United States of America.
US Dollars, $ or cents or ¢	References to US currency. 1 cent is equivalent to one hundredth of US$1.

INFORMATION FOR SHAREHOLDERS continued

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IRAN NOTICE

Section 13(r) of the Exchange Act requires issuers to make specific disclosure in their annual reports of certain types of dealings with Iran, including transactions or dealings with Iranian government-owned entities, as well as dealings with entities sanctioned for activities related to terrorism or proliferation of weapons of mass destruction, even when those activities are not prohibited by US law and do not involve US persons. The Group does not have a legal entity based in Iran, but in 2017 it exported certain medical devices to Iran, via sales by non-US entities, to a new privately owned Iranian distributor for sale in Iran. Prior to 2017, the Group had sold products via non-US entities to a privately owned distributor based in the UAE who sold products into Iran. In both cases, sales were to hospitals that we understand are owned or controlled by the Government of Iran.

The Group's direct and indirect sales of US origin medical devices into Iran are permitted pursuant to section 560.530(a)(3)(i) of the Iranian Transactions and Sanctions Regulations, and its indirect sales of non-US origin medical devices into Iran are made in accordance with applicable law. The Group also provides training to its distributor(s) and surgeons in Iran as necessary and ordinarily incident to the safe and effective use of the medical devices, which is also permitted by applicable law. In 2017, the Group's gross revenues from sales to Iran were approximately $5.2m and net losses were approximately $4.0m, due in part to the transition to the new distributor. For prior years, approximate gross revenues and net profits of the Group from sales to Iran were: 2016: gross revenues $1.2m, net losses $0.4m; 2015: gross revenues $4.0m, net profits $0.8m; 2014: gross revenues $3.8m, net profits $1.1m; and 2013: gross revenues $3.5m, net profits $1.2m.

The Group is reporting the entire gross revenues and net profits for the activities described above, which figures include sales of US origin medical devices. The Group has included sales of US origin medical devices in the total gross revenue and net profit figures above as it does not separately break out revenues and profits by country of origin. The Group intends to continue to engage in the activities described above in accordance with applicable law.

ABOUT SMITH & NEPHEW

The Smith & Nephew Group (the Group) is a global medical devices business operating in the markets for advanced surgical devices comprising orthopaedic reconstruction and trauma, sports medicine and advanced wound management, with revenue of approximately $4.8bn in 2017. Smith & Nephew plc (the Company) is the Parent Company of the Group. It is an English public limited company with its shares listed on the premium list of the UK Listing Authority and traded on the London Stock Exchange. Shares are also traded on the New York Stock Exchange in the form of American Depositary Shares (ADSs).

This is the Annual Report of Smith & Nephew plc for the year ended 31 December 2017. It comprises, in a single document, the Annual Report and Accounts of the Company in accordance with UK requirements and the Annual Report on Form 20-F in accordance with the regulations of the United States Securities and Exchange Commission (SEC).

Smith & Nephew operates on a worldwide basis and has distribution channels in over 100 countries. The Group is engaged in a single business activity, being the development, manufacture and sale of medical technology products and services. The Group is structured as two geographical selling regions: US and International; with a president for each who is responsible for the commercial view of that region. Research & Development, Manufacturing, Supply Chain and Central functions are managed globally for the Group as a whole.

Smith & Nephew's corporate website, www.smith-nephew.com, gives additional information on the Group, including an electronic version of this Annual Report. Information made available on this website, or other websites mentioned in this Annual Report, are not and should not be regarded as being part of, or incorporated into, this Annual Report.

For the convenience of the reader, a Glossary of technical and financial terms used in this document is included on pages 196–197. The product names referred to in this document are identified by use of capital letters and the ◊ symbol (on first occurrence) and are trademarks owned by or licensed to members of the Group.

INFORMATION FOR SHAREHOLDERS continued

PRESENTATION

The Group's fiscal year end is 31 December. References to a particular year in this Annual Report are to the fiscal year, unless otherwise indicated. Except as the context otherwise requires, 'Ordinary Share' or 'share' refer to the ordinary shares of Smith & Nephew plc of 20 US cents each.

The Group Accounts of Smith & Nephew in this Annual Report are presented in US Dollars. Solely for the convenience of the reader, certain parts of this Annual Report contain translations of amounts in US Dollars into Sterling at specified rates. These translations should not be construed as representations that the US Dollar amounts actually represent such Sterling amounts or could be converted into Sterling at the rate indicated.

Unless stated otherwise, the translation of US Dollars and cents to Sterling and pence in this Annual Report has been made at the Bank of England exchange rate on the date indicated. On 16 February 2018, the latest practicable date for this Annual Report, the Bank of England rate was US$1.40 per £1.00.

The results of the Group, as reported in US Dollars, are affected by movements in exchange rates between US Dollars and other currencies. The Group applied the average exchange rates prevailing during the year to translate the results of companies with functional currency other than US Dollars. The currencies which most influenced these translations in the years covered by this report were Sterling, Swiss Franc and the Euro.

The Accounts of the Group in this Annual Report are presented in millions (m) unless otherwise indicated.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

The Group's reports filed with, or furnished to, the US Securities and Exchange Commission (SEC), including this document and written information released, or oral statements made, to the public in the future by or on behalf of the Group, contain 'forward-looking statements' within the meaning of the US Private Securities Litigation Reform Act of 1995, that may or may not prove accurate. For example, statements regarding expected revenue growth and trading profit margins discussed under 'Outlook' and 'Strategic Priorities', market trends and our product pipeline are forward-looking statements. Phrases such as 'aim', 'plan', 'intend', 'anticipate', 'well-placed', 'believe', 'estimate', 'expect', 'target', 'consider' and similar expressions are generally intended to identify forward-looking statements. Forward-looking statements involve known and unknown risks, uncertainties and other important factors that could cause actual results, to differ materially from what is expressed or implied by the statements.

For Smith & Nephew, these factors include: economic and financial conditions in the markets we serve, especially those affecting healthcare providers, payers and customers; price levels for established and innovative medical devices; developments in medical technology; regulatory approvals, reimbursement decisions or other government actions; product defects or recalls; litigation relating to patent or other claims; legal compliance risks and related investigative, remedial or enforcement actions; strategic actions, including acquisitions and dispositions and our success in performing due diligence, valuing and integrating acquired businesses; disruption that may result from transactions or other changes we make in our business plans or organisation to adapt to market developments and numerous other matters that affect us or our markets, including those of a political, economic, business, competitive or reputational nature; relationships with healthcare professionals; reliance on information technology. Specific risks faced by the Group are described under 'Risk factors' on pages 172–175 of this Annual Report. Any forward-looking statement is based on information available to Smith & Nephew as of the date of the statement. All written or oral forward-looking statements attributable to Smith & Nephew are qualified by this caution. Smith & Nephew does not undertake any obligation to update or revise any forward-looking statement to reflect any change in circumstances or in Smith & Nephew's expectations.

PRODUCT DATA

Product data and product share estimates throughout this report are derived from a variety of sources including publicly available competitors' information, internal management information and independent market research reports.

DOCUMENTS ON DISPLAY

It is possible to read and copy documents referred to in this Annual Report at the Registered Office of the Company. Documents referred to in this Annual Report that have been filed with the Securities and Exchange Commission in the US may be read and copied at the SEC's public reference room located at 450 Fifth Street, NW, Washington DC 20549. Please call the SEC at 1-800-SEC-0330 for further information on the public reference rooms and their copy charges. The SEC also maintains a website at www.sec.gov that contains reports and other information regarding registrants that file electronically with the SEC. This Annual Report and some of the other information submitted by the Group to the SEC may be accessed through the SEC website.