DEAR SHAREHOLDER

One of the core duties of a Board is to ensure that companies evolve to meet the ever changing challenges and opportunities they face. A Board must set the pace in this, refreshing and strengthening its membership with deeper expertise, new perspectives and greater diversity.

Since becoming Chairman in 2014 I am pleased with the evolutionary changes we have made at Smith & Nephew. I believe these build on the successes of the past and position the Company well for further progress.

STRENGTHENING THE BOARD

We have been able to attract new Non-Executive Directors of high calibre to replace Board members retiring after completing their service.

Angie Risley, who joined in September 2017, is currently Group HR Director of J Sainsbury plc and was previously Non-Executive Director of Arriva plc, Biffa plc and Serco plc where she was also chairman of the Remuneration Committee. Marc Owen, recently retired from the Executive Committee of Fortune 500 healthcare business McKesson Corp, where he was Chairman of Celesio AG and President of McKesson Specialty Health, and previously a healthcare and technology specialist at McKinsey, joined in October 2017. Roland Diggelmann, Chief Executive Officer at Roche Diagnostics and a member of the Corporate Executive Committee of F. Hoffmann-La Roche Ltd, and previously a senior executive at Zimmer GmbH, will join on 1 March 2018.

Marc and Roland strengthen the Board's knowledge of commercial healthcare and the medical devices sector while Angie will provide effective leadership to our Remuneration Committee when Joe Papa steps down at the AGM in April. Joe has been a highly valued colleague and exemplary steward of Smith & Nephew. On behalf of the whole Board, I thank him for his service.

CHIEF EXECUTIVE OFFICER

In October Olivier Bohuon notified the Board of his intention to retire by the end of 2018, after seven years as Chief Executive Officer. Under Olivier’s leadership Smith & Nephew has undergone important and necessary change and he has significantly strengthened the foundations of our Company. As Smith & Nephew enters its next chapter, the Board is determined to build on this.
Olivier continues to lead Smith & Nephew and drive the Company’s growth initiatives and operating plans. In this he is supported by our new Chief Financial Officer, Graham Baker, who joined in March 2017.

The Board has been impressed with Graham’s strong start as he quickly developed his understanding of the business and we welcome his commercial acumen and attention to detail. Our views of Graham have been echoed by the positive shareholder feedback we have received.

GOVERNANCE AND CULTURE
In 2017 the Board invested significant time meeting local management and employees and understanding market dynamics. These included visiting our offices in Dubai, Tokyo and Hull, as well as some Board members spending time with our salesforce to better appreciate their role and meeting customers. In addition to giving us commercial insight, such activities let us get anecdotal evidence of the culture at Smith & Nephew, something the Board puts great value on.

We strive to set the tone from the top, and review data to demonstrate performance, but it is only by meeting employees from all levels of the Company that we can be certain that Smith & Nephew’s values of I perform, I innovate and I earn trust are being lived across the business.

FINANCIAL HIGHLIGHTS

<table>
<thead>
<tr>
<th>$4,765m</th>
<th>+2%</th>
<th>35.0¢</th>
<th>+14%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>Reported</td>
<td>Dividend per share</td>
<td></td>
</tr>
</tbody>
</table>

Group revenue was up 2% on a reported basis (including -1% headwind from the 2016 Gynaecology business disposal) and 3% on an underlying basis, in line with guidance.

<table>
<thead>
<tr>
<th>$934m</th>
<th>+17%</th>
<th>$1,048m</th>
<th>+3%</th>
<th>$1,048m</th>
<th>+3%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating profit</td>
<td></td>
<td>Trading profit¹</td>
<td></td>
<td>Trading profit margin¹ was 22.0%, up 20bps year on year, in line with guidance.</td>
<td></td>
</tr>
<tr>
<td>Operating profit margin of 19.6% is up 240bps year-on-year due to more favourable non-trading items.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>94.5¢</th>
<th>+14%</th>
<th>14.3%</th>
<th>+280bps</th>
<th>5%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adjusted Earnings per share¹ (EPSA)</td>
<td></td>
<td>Return on Invested Capital¹ (ROIC)</td>
<td></td>
<td>R&amp;D expenditure</td>
</tr>
<tr>
<td>Reflects one-off tax benefits, improvements in trading profit margin and the tax rate on trading²</td>
<td></td>
<td>Reflects improvements in operating profit, the lower tax rate and a stable asset base.</td>
<td></td>
<td>To drive innovation, we maintain our investment in R&amp;D at around 5% of Group revenue.</td>
</tr>
</tbody>
</table>

¹ These non-IFRS financial measures are explained and reconciled to the most directly comparable financial measure prepared in accordance with IFRS on pages 178–181.

2017 PERFORMANCE
The Board receives regular updates on the performance of the business from the CEO and CFO, together with members of the senior management team attending Board meetings over the course of the year.

We could clearly see areas of the business where the Company excelled in 2017, such as Global Operations where we have improved quality and supply, and R&D, where we have an exciting new product pipeline. It is no coincidence that both of these areas of the business have effective leaders who impressed the Board during 2017.

Whilst the trading performance of the Group was better than in 2016, and we delivered within our guidance, we continue to endorse the Chief Executive’s view that this business can and should deliver better results and reinforce the need for continued focus on driving better execution.

The 2017 full year dividend of 35.0¢ per share reflects the strong growth in adjusted earnings per share.

The Board approaches 2018 with optimism. Olivier has built a strong foundation and we expect to attract someone of the highest calibre to accelerate business performance from this base. Thank you for your support and engagement in 2017 and the Board looks forward to serving you into an exciting next chapter for Smith & Nephew.

Yours sincerely,
Roberto Quarta
Chairman
DEAR SHAREHOLDER

We delivered on our promises to improve the top and bottom line in 2017. Our healthy balance sheet, good cash generation and increased dividend demonstrate the robust foundations underpinning our business. In 2018, I expect Smith & Nephew to build on 2017 by delivering another year of improved performance driven by our strong product portfolio and pipeline of innovative products.

STRATEGIC PRIORITIES

In my first year as Chief Executive, in 2011, we set five strategic priorities that have shaped a fundamental management and operational restructuring of the Group as a foundation to improving its growth and profit profile. Through these priorities we continue to drive our business forward.

In 2017 I was pleased with the resultant commercial performance in many areas. In Knee Implants we had an outstanding year, Trauma and Extremities and Advanced Wound Devices also, and we returned the Emerging Markets to double-digit revenue growth.

Of course, there are some areas that did not meet my expectations, such as in Arthroscopic Enabling Technologies and European Wound Care. These are not because of new issues, but they are taking longer to improve than expected. We are attacking the underlying issues with renewed vigour in 2018.

You can read more about our performance against each of the strategic priorities in the next few pages (pages 10–15). I would like to draw your attention to how our strong new product portfolio reflects our decision of a few years ago to increase our investment in disruptive R&D and technology acquisitions.
One of our best recent achievements was to create a global R&D organisation that became fully operational in 2017 and is building on these successes. We now have greater visibility across our development portfolio to ensure we back the winners of the future in areas such as digital, robotics and biologics. We are making better decisions and hitting milestones consistently, and this will underpin our success for many years to come.

**ACCELERATING PERFORMANCE & INNOVATION**
As we have transformed Smith & Nephew, so our markets and industry have changed. We are seeing an increasingly competitive environment: new selling models, new entrants, pricing pressure and increasing costs – which in some markets are outpacing our growth. We also see great opportunity to invest behind pioneering technologies which take market share, offer a wider selection of commercial terms to suit more customers, expand our reach in the emerging markets and start to realise the benefits of the digital revolution for our industry.

In late 2017 we undertook a review of our business to look for opportunities to achieve higher growth targets, strengthen our competitive position, and make us more agile to changes in the market. As a result, in early 2018 we introduced the APEX programme, which stands for ‘Accelerating Performance and Execution’. APEX will make key enhancements to our business and ways of working over the next five years. We expect this programme to deliver $160 million of annualised benefits by 2022. APEX is now possible because of the work put in to create our strong Group structure, and it will build on this robust base. More information on APEX can be found on page 14.

**BUILDING A WINNING CULTURE**
Our success as a Company is made possible by talented employees working together for our shared mission: to support healthcare professionals in their efforts to improve patients’ lives. This is why being a great place to work is important to us, and why every two years we measure our progress toward this goal with our Global Employee Survey.

Our survey tool is the Great Place to Work Institute’s Trust Index, and in 2017 we performed strongly across the dimensions of vision, recognition, pride and equality. We now have nine countries accredited as a Great Place to Work. We put great store by our culture, and work to embrace diversity, encourage progression, and reward success. We also want our employees to put something back into their communities. Our People section on pages 25–28 describes our commitments and actions across all of these areas.

**LOOKING TO THE FUTURE**
In October 2017 I announced my decision to retire from Smith & Nephew by the end of 2018. As I looked ahead to the next long-term phase of growth, I decided that it was the right time to announce my retirement plans, providing ample time to identify a successor and ensure a smooth transition.

In the meantime, I remain resolutely focused on delivering our commitments for 2018, while positioning the Company for further success. Looking further ahead, our greater focus on commercial execution gives us confidence we will outgrow our markets and the new APEX programme supports our expectation of improved trading profit margin.

Yours sincerely,

Olivier Bohuon
Chief Executive Officer
WITH MORE THAN 15,000 EMPLOYEES

OUR VALUES AND HOW WE ACT

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

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

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

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

AN INTEGRATED BUSINESS

UNITED STATES (US)
The United States is the Group’s largest market representing 48% of our global revenue. Due to its commercial importance to the Group, its revenue is reported separately. The United States is also home to a number of our manufacturing facilities.

2017 revenue
$2,306m
0% Reported +2% Underlying

OTHER ESTABLISHED MARKETS
Other Established Markets comprise commercial operations in Europe, Australia, Japan, Canada and New Zealand. We have manufacturing facilities in the UK, Germany and Switzerland.

2017 revenue
$1,678m
0% Reported 0% Underlying

EMERGING MARKETS
Emerging Markets include our commercial businesses in China, Asia, India, Russia, Middle East, Africa and Latin America. These generated 16% of Group revenue in 2017. We have manufacturing facilities in China, Costa Rica, India, Russia and Curaçao.

2017 revenue
$781m
+13% Reported +12% Underlying

ORTHOPAEDIC RECONSTRUCTION AND TRAUMA
SPORTS MEDICINE
ADVANCED WOUND MANAGEMENT
GLOBAL FUNCTIONS

1 These non-IFRS financial measures are explained and reconciled to the most directly comparable financial measure prepared in accordance with IFRS on pages 178–181.
2 Commercial Excellence including Global Marketing, R&D, Manufacturing & Supply Chain, Central Support.
SELLING NINE PRODUCT FRANCHISES

- KNEE IMPLANTS
- HIP IMPLANTS
- TRAUMA & EXTREMITIES
- SPORTS MEDICINE JOINT REPAIR
- ARTHROSCOPIC ENABLING TECHNOLOGIES
- OTHER SURGICAL BUSINESSES
- ADVANCED WOUND CARE
- ADVANCED WOUND BIOACTIVES
- ADVANCED WOUND DEVICES

SUPPORTING HEALTHCARE PROFESSIONALS IN MORE THAN 100 COUNTRIES

Revenue by products:
- A. KNEE IMPLANTS $984m
- B. HIP IMPLANTS $599m
- C. TRAUMA & EXTREMITIES $419m
- D. SPORTS MEDICINE JOINT REPAIR $627m
- E. ARTHROSCOPIC ENABLING TECHNOLOGIES $615m
- F. OTHER SURGICAL BUSINESSES $189m
- G. ADVANCED WOUND CARE $720m
- H. ADVANCED WOUND BIOACTIVES $342m
- I. ADVANCED WOUND DEVICES $194m

Revenue by geography:
- A. UNITED STATES $2,306m
- B. OTHER ESTABLISHED MARKETS $1,678m
- C. EMERGING MARKETS $781m
THE RESOURCES WE NEED

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

RESEARCH & DEVELOPMENT
Innovation is part of our culture and we invest 5% of our revenue to develop new products that will help improve patients’ lives.

MANUFACTURING & QUALITY
We operate our global manufacturing efficiently, and at the highest possible standards, to ensure product quality at competitive pricing.

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

ETHICS & COMPLIANCE
We are committed to doing business the right way and apply strict business principles to the way we deal with our customers and partners.

TRAINING & EDUCATION
Every year, thousands of healthcare professionals attend our training courses around the world. Education is fundamental to how we support our customers.

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

PIONEERING APPROACH
We take a pioneering approach to the design of our products and services. Smith & Nephew has a long history of innovation, dating back to our foundations in the 19thcentury, and today we support customers to manage and prevent disease states, and enable swifter recovery for their patients.

ENSURING WIDER ACCESS
We strive to secure wider access to our advanced technologies for more customers globally. In emerging markets we have built an entrepreneurial business resourced to reach and support an ever greater number of customers in delivering affordable healthcare.

ENABLING BETTER OUTCOMES
We seek to enable better outcomes for patients and healthcare systems, providing high quality products and appropriate training to improve clinical outcomes, enabling healthcare professionals to treat more patients and improving the economic outcome for payers.
THE OUTPUT OF WHAT WE DO

FINANCIAL PERFORMANCE
Targeting higher revenue growth and a better trading profit margin.

$4,765m
Revenue

$934m
Operating Profit

$1,048m
Trading Profit1

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

$269m
Dividend

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

100+
countries

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

45,000+
surgeon training instances

GREAT PLACE TO WORK
Supporting and encouraging employees to live our values.

15,000+
employees

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

160+
years of proud history

1 These non-IFRS Financial measures are explained and reconciled to the most directly comparable financial measure prepared in accordance with IFRS on pages 178–181.

We have leadership positions in Orthopaedic Reconstruction and Trauma, Advanced Wound Management and Sports Medicine:
- Knee Implants
- Hip Implants
- Trauma & Extremities
- Sports Medicine
- Joint Repair
- Arthroscopic Enabling Technologies
- Other Surgical Businesses
- Advanced Wound Care
- Advanced Wound Bioactives
- Advanced Wound Devices

We service our customers through our dedicated and highly trained global sales force and selected third party sellers:
- Surgeons
- Nurses
- Nurse specialists
- Physicians, GPs
- Healthcare systems
- Procurement groups
- Payers, administrators
- Retail, consumers, patients

OUR PRODUCTS PAGE 18

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

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

Our strategic priorities, introduced in 2011, guide our actions in delivering these twin aspirations of supporting healthcare professionals and transforming our growth profile.
Established Markets for Smith & Nephew are the US, Europe, Australia, Japan, Canada and New Zealand. Smith & Nephew delivered 84% of its revenue from these countries in 2017.

In the United States, our single largest country representing 48% of global revenue, reported revenue growth was flat and underlying growth was 2%. The Other Established Markets growth rate was flat on both an underlying and reported basis.

In 2017 we focused on improving our commercial execution. With a simpler and more agile commercial structure in each country, supported by global functions, we sought to drive improved performance and greater efficiency. This was supported by sales force excellence initiatives including a sharper focus on both health economic and clinical evidence to support our products.

In Reconstruction, the Knee Implants franchise performed well, with the JOURNEY™ II Total Knee System driving good growth, as did the LEGION™ Revision Knee System. In Hip Implants, the new REDAPT™ Revision and POLARSTEM™ Cementless Stem systems were well received. In Trauma & Extremities, new clinical evidence supported increased uptake of our TRIGEN™ INTERTAN® hip fracture system.

Sports Medicine Joint Repair performance was driven by good demand for our shoulder repair portfolio, and we added an exciting new technology when we acquired Rotation Medical (see page 15 for more). Arthroscopic Enabling Technologies was impacted by continued softness in mechanical resection. The roll-out of our LENS® visualisation and WEREWOLF® COBLATION® systems are underway and we expect an increasing contribution from these in 2018.

In the US, and other countries, we are seeing a shift towards day-case surgery for total joints starting to take place in Ambulatory Surgery Centre (ASCs), something Smith & Nephew is uniquely positioned to benefit from. Through Sports Medicine we are already a partner to many ASCs. We believe we can leverage this customer knowledge and relationships to improve the performance of our knee implants franchise. Our portfolio is well-suited for ASCs where early mobility and efficiency are key, as is our robotic NAVIO® Surgical System due to its small footprint, portability and cost.

Advanced Wound Care franchise delivered strong growth in the US, but was held back by softer market conditions in Europe. In Advanced Wound Bioactives, SANTYL® benefited from a new analysis demonstrating its effectiveness in advancing pressure ulcers through the healing process, improving performance in the second half of the year. Advanced Wound Devices performed strongly across the year, led by the continued success of our single use negative pressure wound therapy (sNPWT) device PICO®.

**SUPPORTING CUSTOMERS AT THE ECC**

“It’s very humbling to know we are helping improve patients’ outcomes.”

Natalia Zielinska  Bioskills Laboratory Manager

Smith & Nephew is proud to support surgeons and nurses by enabling them to learn from experts in their field of speciality. We do this at our state-of-the art training and innovation centres. In early 2017 we opened the Expert Connect Centre (ECC) in Croxley Park, Watford, on the outskirts of London, UK. This is already establishing itself as a flagship destination for healthcare professionals from the UK, Europe and the Emerging Markets.
Our Emerging Markets represent those outside the Established Markets, including Brazil, Russia, India and China. The Emerging Markets accounted for 16% of Smith & Nephew’s revenue in 2017.

In 2017 we returned our Emerging Markets business to sustainable double-digit revenue growth, up 13% on a reported basis and 12% on an underlying basis. This was a significant improvement over the flat underlying performance of 2016.

In China, our largest Emerging Markets country, we delivered double-digit revenue growth as we improved our commercial execution. In the oil-dependent Gulf States we returned to growth by focusing on securing more private healthcare business to compensate for the reduction in government tenders. The majority of our other Emerging Markets continued to do well across 2017.

We have been early investors in many of the Emerging Markets. There continue to be quarterly fluctuations in the growth rates, and differences in performance between countries, so we look at the longer term trends when making decisions, and those are very favourable.

We also see the next wave of sustained growth coming from the ‘mid-tier’, essentially growth from widening access to a greater proportion of the population in these countries. We are addressing this by steadily building a dedicated product portfolio and specific distribution model.

We are well positioned to continue to drive strong growth from the Emerging Markets over the medium term. The much improved performance in 2017 is in line with where we see the medium term prospects for this increasingly important segment of Smith & Nephew’s business.

**Revenue from Emerging Markets**

<table>
<thead>
<tr>
<th>Year</th>
<th>Reported</th>
<th>Underlying</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>$715m</td>
<td>$715m</td>
</tr>
<tr>
<td>2016</td>
<td>$691m</td>
<td>$691m</td>
</tr>
<tr>
<td>2017</td>
<td>$781m</td>
<td>$781m</td>
</tr>
</tbody>
</table>

16% of Group revenue

+13% Reported +12% Underlying

**WHY THIS KPI IS IMPORTANT**

We use this KPI to track the growth of Emerging Markets relative to global growth.

**HOW WE PERFORMED**

Performance in the Emerging Markets improved strongly over the previous year.

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**RETURNING CHINA TO GROWTH**

“We have seen a return to double-digit growth in the attractive Chinese market.”

Olivier Bohuon Chief Executive Officer

China is our largest Emerging Market country. Here we faced challenges in 2016 as the market growth slowed down. In 2017 we improved our commercial execution and management of, and involvement in, the channel inventory. Looking to the medium term, we believe that our growth prospects in China remain very attractive.
In 2017 we began to benefit from a suite of exciting new products, solutions and business models as we deliver on our strategic priority to innovate for value.

In robotics, NAVIO is a unique and compelling system. In 2017 we successfully extended its indications and introduced it to new countries such as India. We launched the total knee arthroplasty (TKA) application for our JOURNEY II, LEGION and GENESIS II Total Knee Systems. Surgeons completed the world’s first robotic-assisted bi-cruciate retaining total knee replacement procedures. This new approach used NAVIO to implant the new JOURNEY II XR (bi-cruciate retaining total knee system) currently in limited market release. This is the first and only bi-cruciate retaining robotics application commercially available.

In the Emerging Markets we continue to build our mid-tier portfolio. Our ANTHEM Total Knee System, which, alongside the ORTHOMATCH Universal Instrumentation Platform, has been designed to provide wider market access to affordable knee treatments, performed well following its 2016 launch. During the year we launched into more markets, including Russia and Saudi Arabia, and introduced a new Cruciate Retaining (CR) variant, extending the options available to surgeons.

In Sports Medicine our new LENS Surgical Imaging System and WEREWOLF COBLATION System for resecting soft tissue are being rolled out to customers. In Reconstruction we expanded our REDAPT Hip and LEGION Knee revision systems. In Advanced Wound Management our pioneering disposable single-use negative pressure wound therapy (sNPWT) device PICO continued to perform strongly and we extended our ALLEVYN LIFE foam dressing range with a new non-border version.

We also focus on providing customers with the evidence that demonstrates the effectiveness of our innovative products. In 2017, PICO benefitted from new clinical evidence showing its effectiveness at reducing surgical site infections and the TRIGEN INTERTAN hip fracture system also performed strongly supported by new clinical evidence.

We continue to develop new business models to address changing or unmet customer needs. During 2017 we ran the first study of our innovative Episode of Care Assurance Program (eCAP) that combines our hip and knee implants with PICO and ACTICOAT Flex 7 Antimicrobial Barrier Dressings. The first results showed eCAP delivering a 97% decrease in hospital readmission rates following total joint replacement surgery (based on 1,380 joint arthroplasties with only two readmissions, a readmission rate of only 0.145% as compared to published rates of 5.3% or more).

In 2017 we announced a long-term partnership with the University of Hull to create one of the world’s largest Wound Care Research Clusters with the aim of developing scientific insights and innovative treatments.

This includes the creation of eight PhD studentships and a programme of collaboration between Smith & Nephew's new Hull Research & Development centre and the University’s new Health Campus.
Since 2011 Smith & Nephew has undertaken two successful efficiency programmes that have delivered significant savings and created an integrated Group structure.

As announced with our Third Quarter 2017 Results, we believe that we now have the Group structure to allow us to strengthen our competitive position by driving further opportunities to accelerate performance through better execution, while at the same time realising savings through greater efficiency.

In 2017 we completed our assessment of these opportunities and started to implement a programme called APEX – Accelerating Performance and Execution in early 2018.

APEX is expected to deliver an annualised benefit of $160 million by 2022, with around three-quarters of this expected by 2020, for a cash cost of up to $240 million, of which a charge of around $100 million is expected in 2018.

APEX has three workstreams:

1. **MANUFACTURING, WAREHOUSING AND DISTRIBUTION**
   - We have already made significant improvements over the last two years, and see further opportunities to simplify in line with best practices to reduce overall cost, while improving quality and delivery through:
     - A best practice facility footprint with larger manufacturing hubs supported by specialty facilities where appropriate.
     - A product portfolio that meets the needs of our customers and complies with regulations, while minimising cost, complexity and inventory.
     - A supply chain that is streamlined and efficient so that we are positioned to achieve the highest levels of delivery at benchmark cost.

2. **GENERAL AND ADMINISTRATIVE (G&A) EXPENSES**
   - We have improved our G&A expense ratio over the last five years, but with our global function structure we are now able to identify additional areas of opportunity to reduce costs and improve service through:
     - Best-in-class Global Business Services that includes a full-spectrum of support services delivered quickly and efficiently, enabling full focus on our customers and business objectives.
     - Service hubs in locations that align to our regional needs and deliver the best value for money.
     - System infrastructure that drives maximum efficiency, including rationalisation of legacy IT systems and adopting a ‘cloud-first’ strategy.

3. **COMMERCIAL EFFECTIVENESS**
   - Whilst the commercial opportunities and competitive environment continue to evolve with changing customer expectations, new go-to-market approaches and price pressure, we expect to improve overall productivity and accelerate top line growth through:
     - Increased sales and marketing effectiveness.
     - Selective refinement of structures and territories to meet customer and market demands.
     - Being more responsive to customers’ use of tenders and changing service level demands.
     - More accurate demand forecasting to improve inventory management.

### Operating Profit Margin

<table>
<thead>
<tr>
<th>Year</th>
<th>Margin</th>
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</thead>
<tbody>
<tr>
<td>2015</td>
<td>13.6%</td>
</tr>
<tr>
<td>2016</td>
<td>17.2%</td>
</tr>
<tr>
<td>2017</td>
<td>19.6%</td>
</tr>
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### Trading Profit Margin

<table>
<thead>
<tr>
<th>Year</th>
<th>Margin</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>23.7%</td>
</tr>
<tr>
<td>2016</td>
<td>21.8%</td>
</tr>
<tr>
<td>2017</td>
<td>22.0%</td>
</tr>
</tbody>
</table>

**A MORE AGILE STRUCTURE**

“Based on the preliminary work undertaken when I took over as CFO, we undertook a thorough review of our business over the last few months. Our objective was to look afresh at opportunities to strengthen our competitive position and be more efficient.

“We have now substantially completed this analysis and begun executing our programmes…”

Graham Baker Chief Financial Officer
Supplement Organic Growth with Acquisitions

Whilst our focus in 2017 has been on improving our execution across our existing business, we have made one acquisition and a number of strategic agreements that give us access to new technologies.

In 2017 we acquired Rotation Medical, Inc., the developer of a novel tissue regeneration technology for shoulder rotator cuff repair, for an initial cash consideration of $125 million and up to $85 million over the next five years, contingent on financial performance. Its bioinductive implant is highly complementary to our Sports Medicine portfolio, serving an unmet clinical need and providing a compelling new treatment option for our customers.2,3,4

We signed distribution agreements with Leaf Healthcare, a developer of a unique wireless patient monitoring system for pressure ulcer/injury prevention, and MolecuLight i:X®, a handheld point-of-care imaging device that uses fluorescence imaging to display potentially harmful concentrations of bacteria in wounds in real-time.

2017 marked the third anniversary of our largest acquisition, ArthroCare. This strengthened our Sports Medicine business, with highly complementary product portfolios and customer relationships.

ArthroCare also had a strong pipeline of innovations, many of which have been launched since the acquisition. The ArthroCare acquisition has met all of the three-year targets that we set, many ahead of time.

The Board periodically reviews all acquisitions to evaluate longer-term performance and capture lessons learned to help improve strategy and process. Collectively we are pleased with the performance of the technology and Emerging Markets acquisitions we have made. We continue to seek further opportunities to strengthen our technology and product portfolio and Emerging Markets business.

1 These non-IFRS financial measures are explained and reconciled to the most directly comparable financial measure prepared in accordance with IFRS on pages 178–181.


ArthroCare

In 2014 we acquired ArthroCare for $1.5 billion to strengthen our Sports Medicine business through complementary product portfolios and customer relationships.

$50m+ of additional sales from cross-selling

$85m of total synergies on trading profit level

Why THIS KPI IS IMPORTANT
We use this KPI to demonstrate the returns from acquisitions.

How We Performed
ArthroCare has met or exceeded all of the three-year targets, many ahead of time. We achieved both the cost and revenue synergies totalling $85m on a trading profit level, and the Return on Invested Capital in year three exceeded our target.

Strengthening Sports Medicine

“We are proud of the impact our technology has made in healthcare and are excited by the opportunity to reach many more customers and their patients as an integrated part of Smith & Nephew’s extensive Sports Medicine portfolio.”

Martha Shadan Chief Executive Officer, Rotation Medical, Inc.

The bioinductive implant from Rotation Medical, Inc. has shown the ability to heal by inducing the growth of new tendon-like tissue.2,3,4 With its small sales force, Rotation Medical, Inc. achieved revenue of $17m in 2017.

We expect rapid growth as we roll out the product across our large Sports Medicine sales force, first focusing on the US where the product has FDA approval.
HEALTHY FUNDAMENTALS, BUT COST REMAINS AN ISSUE

According to a study commissioned by the Bill and Melinda Gates Foundation (Lancet, April 2017) global healthcare spend, amounting to c. $9 trillion in 2014, is set to grow at a real rate of c. 3% per annum per capita, reaching c. $16 trillion in 2030 and c. $24 trillion in 2040, representing c. 8% of the global economy.

The medical devices and supplies segment of healthcare is today worth approximately $340 billion per annum. Within that, Smith & Nephew’s addressable segment is approximately $34 billion, growing at around 4% annually.

The main drivers for healthcare demand include demographic shift towards older populations, increases in lifestyle related ailments such as obesity, advances in technology leading to increased scope for treatment, and economic growth increasing the access and demand for healthcare – especially in the Emerging Markets. Additionally, patients increasingly seek to influence the choice of care as they become more and more informed about the range and nature of treatment options available.

Today healthcare expenditure already constitutes a significant share of the overall global economy, especially in developed markets where populations are ageing rapidly. As an example, the share of US GDP spent on healthcare has reached nearly 17% and is set to continue to rise (Lancet, April 2017). As a result, cost and cost control remain the dominant issues across the sector and healthcare systems increasingly shift towards more efficient and effective value-based care.

SHIFT TOWARDS VALUE RATHER THAN VOLUME

The traditional approach to healthcare provision has been symptom and volume (fee-for-service) oriented which – in combination with current demographic trends – has put upward pressure on healthcare costs. In response, stakeholders are increasingly seeking to shift the focus from ‘break-fix’ to a more holistic and value-based approach focused on disease prevention and treatment results (fee-for-outcome).

Healthcare practitioners are no longer the only decision-makers, but are part of larger multi-stakeholder purchasing processes. Economic stakeholders have increasing influence on the purchase process for medical devices. New payment models, such as bundled procedure payments, risk sharing, or quality incentives/penalties, are shifting the focus from clinical utility and safety alone to clinical outcomes and health economic performance, which in turn drives demand for Health Economic and Outcomes Research (HEOR) to demonstrate clinical end economic value.

As an example, the US Centers for Medicare & Medicaid Services (CMS) aims by 2018 to spend 50% of its Medicare fee-for-service payments through alternative payment models and link 90% of its fee-for-service to quality (CMS, Jan 2015).

FOCUS ON LOWERING COSTS AND INCREASING EFFICIENCY

The desire to lower costs and increase efficiency gives rise to several trends including, for example: healthcare providers increasingly seeking to treat patients in outpatient or community settings; the increasing use of digital technologies to ensure that care is as efficient and effective as possible; the acceptance of ‘good enough’ products in some circumstances; and the sector increasingly seeing efforts to cooperate across the value chain. As an example, the UK National Health Service (NHS) is automating data exchange between its institutions and suppliers and has mandated all suppliers to provide pricing information through the Global Data Synchronization Network (GDSN) by October 2018 (NHS, Feb 2016).
GOVERNMENTS, REGULATIONS & COMPLIANCE

Governments and other public bodies are key stakeholders in our marketplace.

In the US, where healthcare spending is higher as a percentage of GDP than most other countries, politicians and regulators are focused on reducing cost and simplifying the regulatory burden on the industry. Although common ground is hard to find, there is a general consensus that the US healthcare system needs to be restructured.

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. These regulations will impose tougher requirements of market entry and post market surveillance of medical devices. Although healthcare systems are less costly in Europe than in the US, strained government budgets and demographic challenges are driving an increased focus on value-based healthcare and requirements to demonstrate the value of innovation through evidence. Additionally, some uncertainty exists around the UK’s exit from the European Union where the regulatory impact is not yet clear.

In China, which in recent years has focused on, and succeeded with, increasing access to healthcare, there is a strong focus on compliance and cost control. In 2017 the country introduced the two invoices system which effectively limits length of the supply chain thus increasing transparency and lowering cost to the end consumer. Also in 2017 Chinese regulators initiated a process to lower prices on medical devices. The initial focus of these efforts is on hip implants, drug-eluting stents and implantable cardioverter-defibrillators (ICDs).

The major regulatory agencies for Smith & Nephew’s products include the Food and Drug Administration (FDA) in the USA, the Medicines and Healthcare products Regulatory Agency (MHRA) in the UK, the Ministry of Health, Labour and Welfare in Japan, the China Food and Drug Administration and the Australian Therapeutic Goods Administration. Legislation covering corruption and bribery, such as the UK Bribery Act and the US Foreign Corrupt Practices Act, applies to all our global operations. We, and other companies in the industry, are subject to regular inspections and audits by regulatory agencies and notified bodies, and in some cases remediation activities have required, and will continue to require, significant financial and resource investment.

SEASONALITY

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

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

COMPETITION

Across our franchises we have a number of competitors which differ with respect to both product focus, geographic reach and overall scale. Whereas our key surgical competitors are generally larger and more exposed to the US, our key wound competitors are generally not US centric.

In Orthopaedic Reconstruction and Trauma we are one of four leading players as we compete against Stryker (US), Zimmer Biomet (US) and Johnson & Johnson (US). In Sports Medicine we hold a leading position behind Arthrex, while also competing against the aforementioned companies.

Our Advanced Wound Management business is the second largest in our marketplace. We lead the somewhat fragmented Advanced Wound Care sub-segment alongside Mölnlycke (Sweden). In Advanced Wound Devices we are the primary challenger to US based NWPT incumbent Acelity (US). In Advanced Wound Bioactives our key products lead their respective categories.
Smith & Nephew has nine global product franchises

- **KNEE IMPLANTS** $984m
- **HIP IMPLANTS** $599m
- **TRAUMA & EXTREMITIES** $495m
- **SPORTS MEDICINE JOINT REPAIR** $627m
- **ARTHROSCOPIC ENABLING TECHNOLOGIES** $615 m
- **OTHER SURGICAL BUSINESSES** $189 m
- **ADVANCED WOUND CARE** $720m
- **ADVANCED WOUND BIOACTIVES** $342m
- **ADVANCED WOUND DEVICES** $194 m

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

Smith & Nephew’s knee systems include the LEGION/GENESIS II Total Knee System, a comprehensive system designed to allow surgeons to address a wide range of knee procedures, and our JOURNEY II family of Active Knees. The anatomical shape of the JOURNEY II is designed to reproduce normal knee kinematics and thereby delivers improved functional outcomes and high patient satisfaction.

In 2017 we progressed the limited market release of our JOURNEY II XR, an innovative bi-cruciate retaining knee implant, which is designed to retain the anterior and posterior cruciate ligaments (ACL/PCL) and deliver normal perception of movement and muscle control.

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

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

In 2017 we expanded the geographic scope of the ANTHEM Total Knee System, which, alongside the ORTHOMATCH Universal Instrumentation Platform, has been designed to provide a wider market access to affordable knee treatment. ANTHEM is tailored to meet the anatomical needs of patients from Asia, the Middle East, Africa and Latin America and the ORTHOMATCH instrumentation platform reduces weight, footprint and unnecessary cost without compromising on quality or clinical outcomes. In 2017 we expanded the geographic scope of the system which is now available in many markets including India, South Africa, Mexico, Colombia, Chile, Russia and the Middle East. We began the limited market release of a cruciate retaining version in 2017.

In early 2017 we launched the NAVIO Total Knee Arthroplasty (TKA) system, adding to the indications offered on our leading robotics platform. In the fourth quarter, we initiated the limited market release for the NAVIO XR system, which we believe will be a key technology enabler for the JOURNEY II XR knee. The robotics team continues to expand to major geographies such as India, South Africa and Australia. For more information on NAVIO see page 22.

In 2017 performance in this franchise was driven by strong demand for the JOURNEY II Total Knee System supported by growth from the LEGION Revision Knee System and ANTHEM Total Knee System.

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1. These non-IFRS financial measures are explained and reconciled to the most directly comparable financial measure prepared in accordance with IFRS on pages 178–181.
Smith & Nephew’s Hip Implants franchise offers a range of specialist products for reconstruction of the hip joint. This may be necessary due to conditions such as arthritis causing persistent pain and/or as a result of hip fracture. Every year more than two million patients worldwide undergo total, resurfacing and revision hip replacement procedures.

For Hip Implants, Smith & Nephew has developed a range of primary hip systems. Core systems include the ANTHOLOGY™ Hip System, SYNERGY™ Hip System, the POLARSTEM Femoral Hip System, the R3 Acetabular System and the POLARCUP™ Dual Mobility Hip System. This diversity exemplifies our commitment to providing surgeons with implant and instrumentation options that meet the specific demands of their patients and preferred surgical approach, most notably the direct anterior or posterolateral approach.

Traditional knee replacement options don’t meet the need for higher functionality, improved motion or long-term durability\textsuperscript{2,3,4,5}. Most significantly, these systems fall short in providing a return to a normal pattern of motion meaning less satisfaction for patients.

For orthopaedic surgeons seeking treatment solutions beyond traditional knee replacements, JOURNEY II Active Knee Solutions have been engineered to empower patients to return to an active lifestyle.

We also market the BIRMINGHAM HIP Resurfacing (BHR) System, an important option for surgeons treating suitable patients.

Smith & Nephew’s portfolio also includes the REDAPT Revision Femoral System.

The need to perform a revision can occur for a variety of reasons including infection, dislocation, or failure of the implants to achieve biologic fixation. REDAPT is designed to turn such complex hip revisions into efficient, reproducible surgeries, allowing surgeons to effectively recreate a patient’s unique functionality, while quickly and easily addressing issues such as poor bone quality.

The REDAPT Revision Femoral System comprises a monolithic stem and a Fully Porous Shell. A Fully Porous Acetabular Cup with CONCELOC™ Technology was introduced in 2016. To allow ingrowth, an additive, or 3D printing, manufacturing process is used to produce an entirely porous implant that mimics the structure of cancellous bone. The 3D printing method allows for complex design geometries that would be difficult, expensive or impossible to achieve with traditional manufacturing methods. For example, solid reinforcements can be built directly into the porous structure to provide extra strength in precise locations.

In 2017 we introduced a number of REDAPT Augments to be used in conjunction with the fully porous shell which will allow surgeons to treat more difficult acetabular revisions.

In 2017 performance in this franchise was better in the second half of the year, driven by new REDAPT Revision and POLARSTEM Cementless Stem systems.

\textsuperscript{1} These non-IFRS financial measures are explained and reconciled to the most directly comparable financial measure prepared in accordance with IFRS on pages 178–181.

\textsuperscript{2} US Department of Health and Human Services Agency (HHSA) for Healthcare Research and Quality (AHRQ) Knee Replacements Up Dramatically Among Adults 45 to 64 Years Old. AHRQ News and Numbers, November 3, 2011. Agency for Healthcare Research and Quality, Rockville, MD.


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

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

The EVOS Mini Fragment Plate and Screw System is a dedicated Trauma mini fragment system. This is a stainless steel highly versatile system with a multitude of plate geometries and longer screw lengths than standard mini fragment systems. In 2017, we introduced the EVOS Small Fragment system for lower extremity fractures and general trauma utilisation. This new system features more points of fixation and greater breadth of plate options. EVOS Small takes an evolutionary approach to simplifying and unifying small fragment plating systems.

For extremities and limb restoration, we offer the TAYLOR SPATIAL FRAME™ Circular Fixation System as well as a range of plates, screws, arthroscopes, instrumentation, resection and suture anchor products including foot and ankle and hand and wrist specialists. In addition, we introduced INVISIKNOT®, a unique syndesmotic fixation device for the ankle.

2017 saw the global launch of the ATLAS™ Hip Fracture Nail in South Africa and India. It is the first Smith & Nephew nail specifically designed for the Emerging Markets.

In 2017 performance in this franchise was driven by growth from our TRIGEN INTERTAN hip fracture system where new clinical evidence continued to support increased uptake.

1 These non-IFRS financial measures are explained and reconciled to the most directly comparable financial measure prepared in accordance with IFRS on pages 178–181.
2 Smith & Nephew INTERTAN claims brochure “The evidence is in...”

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

Key products for knee repair include the FAST-FIX™ family of meniscal repair systems, the ENDOBUTTON™ and ULTRABUTTON™ fixed and adjustable loop devices for knee ligament reconstruction, BIOSURE® interference screws for ligament procedures, and CARGEL® for the repair of articular cartilage.

First and only bi-cruciate retaining robotics application

2017 saw the world’s first robotics-assisted bi-cruciate retaining total knee replacement procedures, utilising our NAVIO robotics-assisted surgical system and the JOURNEY II XR bi-cruciate retaining total knee system.

The JOURNEY II XR has the potential to deliver the best possible outcome for the surgeon and patient through the preservation of important anatomical structures such as the Anterior Cruciate Ligament (ACL). The NAVIO robotics-assisted surgical system enables accurate tibial implant placement to deliver a more reproducible surgical technique. We are proud to be the only company to offer the unique combination of NAVIO robotics-assistance and the JOURNEY II XR Knee System.
For shoulder, Smith & Nephew markets a suite of products for Rotator Cuff Repair (RCR), one of the most common sports medicine procedures. These include ULTRATAPE®, a suture that provides greater tendon-to-bone contact when compared to traditional #2 suture and may enhance repair7, FIRSTPASS® ST, a sterile-packaged retrograde suture passer that eliminates the steps of loading and unloading needles and cartridges; MULTIFIX®, an all-PEEK knotless screw-in anchor; and HEALICOIL®, a family of suture anchors featuring open architecture that allows new bone to fill the fenestrations between screw threads. All these products can be used together or in conjunction with other existing products from the Smith & Nephew portfolio in a single procedure, significantly expanding the breadth of our RCR Solutions.

In 2017 we acquired Rotation Medical, Inc., the developer of a novel tissue regeneration technology for RCR, for an initial cash consideration of $125 million and up to $85 million over the next five years, contingent on financial performance. The Rotation Medical Rotator Cuff System incorporates a breakthrough technology and technique that balances biomechanics and biology to enhance the body’s natural healing response, helping tendons heal by inducing growth of new tendon-like tissue8,9,10. Rotation Medical is highly complementary to our Sports Medicine portfolio, serving an unmet clinical need and providing a compelling new treatment option for our customers.

The Smith & Nephew joint repair portfolio includes two next-generation anchors made of soft, all-suture material – Q-FIX® and SUTUREFIX®. The Q-FIX All-Suture Anchor is ideal for a variety of arthroscopic shoulder and hip repairs, offering fixation performance superior to commonly used all-suture anchors and traditional anchors10,11,12. The SUTUREFIX Ultra anchor is an attractive option for procedures in which anatomic space is very limited while still delivering high fixation strength10,11,12.

Smith & Nephew offers joint repair implants made from REGENESORB®, including versions of the HEALICOIL® suture anchors for shoulder repair and BIOSURE® interference screws for knee repair. REGENESORB® is an advanced biocomposite material shown to be absorbed and completely replaced by bone within 24 months in pre-clinical studies13,14.

Smith & Nephew supports specific joint repair procedures for shoulder, knee and hip with a line of instruments, positioners and holders, including SPIDER2®/T-MAX procedure-enabling limb positioning systems and ACUFEX® Hand Held Instruments. In 2017 performance in this franchise was driven by strong demand for our leading shoulder repair portfolio.

Our Arthroscopic Enabling Technologies (AET) franchise includes high definition imaging solutions, industry leading energy based and mechanical resection platforms, and fluid management and access portfolios. AET platforms work in concert to facilitate access to various joint spaces, visualise the patient’s anatomy, resect degenerated or damaged tissue and prepare the joint for a soft tissue repair. Products in this franchise are often used in conjunction with products from our Sports Medicine Joint Repair franchise.

Key AET products include the LENS® Integrated visualisation system which provides outstanding image quality and functionality in a simple three-in-one Console (CCU, LED Light Source and Image Management System), Camera Head and iPad application.

We also offer the WEREWOLF and QUANTUM® COBLATION® controllers and a wide range of high performance COBLATION Technology radio frequency (RF) wands to precisely ablate, resect and coagulate soft tissue and enable haemostasis of blood vessels.

The WEREWOLF COBLATION System is the latest innovation in our market-leading COBLATION technology. Featuring an all new controller and designed to support a broad variety of wands, WEREWOLF delivers an unparalleled range of performance capabilities and advanced safety features – WEREWOLF carries broad indications across Sports Medicine.

DYONICS® Shaver blades provide superior resection due to their sharpness and reduce clogging with their debris evacuation capabilities, GoFlo® and Double® Pump RF fluid management consoles expand the joint space while providing haemostasis and maintaining the saline environment necessary to perform arthroscopic procedures.

Within an operating room, our AET products are typically kept together in an arthroscopic tower, often comprising a visualisation or camera system, COBLATION or energy based resection controllers, mechanical resection or blade controllers and fluid management or pump components. Because of the strong link between the arthroscopic tower and consumables, we will showcase our industry leading tower components, such as LENS, COBLATION and DYONICS shaver blades, when selling the broader Sports Medicine portfolio.

In 2017 performance in this franchise was impacted by continued softness in mechanical resection and the legacy RF technology during the year. Our new LENS visualisation system and WEREWOLF COBLATION system are growing in share within our portfolio and we expect a gradual improvement in 2018.

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2 Shrieve, M., et al. EST-CarGel Treatment Maintains Cartilage Repair Superiority over Microfracture at 6 Years in a Multicenter Randomized Controlled Trial. Cartilage 2015; Vol 6:62-72.
7 ArthroCare Report #P/N 54231-01 Rev. A, ArthroCare Report #P/N 54231-01 Rev. A.
10 Smith & Nephew 2013. Resultsof in vivo simulation have not been shown to quantitatively predict clinical performance.
OUR PRODUCTS continued

The NAVIO Surgical System is a next generation handheld robotics platform designed to aid surgeons with implant alignment, ligament balancing and bone preparation. Furthermore, the NAVIO robotics-assisted system does not require a preoperative image, such as a CT scan. This allows patients to receive the benefits of robotics-assistance without the extra steps, costs and radiation associated with additional preoperative imaging.

In 2017 we successfully expanded the NAVIO platform into total knees, which comprise 80% of all knee replacement surgeries globally. The total knee arthroplasty (TKA) application supports Smith & Nephew’s JOURNEY II, LEGION Primary and GENESIS II Total Knee Systems.

Also during 2017 surgeons completed the world’s first robotics-assisted bi-cruciate retaining total knee replacement procedures. With this launch, NAVIO now offers both partial and total knee options that include the first and only robotics-assisted bi-cruciate retaining knee procedure, commercially available today.

In 2017 performance in this franchise was driven by the Ear, Nose & Throat business and continued demand for our hand-held robotics NAVIO Surgical System including the new Total Knee Application. The decline in reported revenues reflects the impact of the disposal of the Gynaecology business in 2016.

Silver and iodine drive our infection management portfolio.

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

Our cadexomer iodine based product, IODOSORB®, has a unique mode of action to deliver low level, slow release elemental iodine without cytotoxic effects and effectively eradicates biofilms. A recent expert consensus showed biofilms contribute to the delay in healing of chronic wounds.

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

In 2017 performance in this franchise was impacted by softer market conditions in Europe, which offset strong growth in the US.

1 These non-IFRS financial measures are explained and reconciled to the most directly comparable financial measure prepared in accordance with IFRS on pages 178–181.
Helping customers get closer to zero...

Smith & Nephew supports healthcare professionals in reducing the human and economic cost of wounds through pioneering solutions that improve outcomes and at the same time conserve resources for health systems. Our aim is to help our customers get closer to zero surgical site complications, pressure ulcer incidence, delay in wound healing, diabetic foot amputations, and waste of healthcare. Customer insights have confirmed the need to augment our treatment offering with solutions that support the clinician in making informed decisions and achieving consistency of practice.

In 2017 we entered two distribution relationships for innovative products in the Pressure Ulcer Prevention and Infection Management categories – Leaf and MolecuLight i:X – which extended our solutions beyond treatment options.

Leaf

An estimated 2.5 million pressure ulcers/injuries are treated each year in US acute care facilities alone\(^1\), with the cost to treat a single full thickness pressure ulcer/injury as high as $70,000\(^2\) and an estimated annual burden of $11 billion\(^3\). Proven prevention strategies focus on protecting vulnerable areas, maintaining skin integrity and consistent offloading through patient turning. However, despite the best efforts, maintaining these schedules with a consistent execution is often difficult. In particular, turning regimes for patients at high risk can be difficult to adhere to, going against the latest best practice guidance. The Leaf Patient monitoring system is a patient worn wireless sensor which monitors the patient’s position. The constant processing of the positional data facilitates real time alerts to patient needs and turning schedules. This data can help reduce the incidence of hospital-acquired pressure injuries and help improve operational efficiency as part of a full protocol of care.

In an independently conducted RCT\(^4\), evaluating optimal patient turning, Leaf induced a 43% relative increase in turning protocol compliance in high-risk patients. Patients treated with Leaf were 73% less likely to develop a pressure injury.

MolecuLight i:X

Currently wound assessments are made with the naked eye which can lack the accuracy required to most effectively guide clinical decision making.\(^5\) Using fluorescence, MolecuLight i:X quickly, safely, and easily visualises potentially harmful bacteria\(^6,7\) in wounds which may otherwise lack signs or symptoms of infection. It enhances a clinician’s ability to choose the right therapy, at the right time for their patient\(^7\) and can help to guide wound sampling and debridement\(^7,9,10\), monitor wound progression\(^7,9\), improve patient engagement\(^5,9\) and simplify wound documentation\(^6\).

Clinical data from wound assessments demonstrates that incorporating the MolecuLight i:X into standard of care facilitated more objective medical decision making and led to up to nine times faster wound healing\(^6\) and 54% more accurate swabbing.\(^11\) MolecuLight i:X is not yet available in the US.

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8 MolecuLight Inc. Case Study (000) Track Wound Site and Bacterial Presence with the MolecuLight i:X. 2016.
Our Advanced Wound Bioactives (AWB) franchise focuses on the commercialisation of novel, topical biologic and skin substitute products that provide a unique approach to debridement, dermal repair and tissue regeneration.

Currently, our AWB portfolio includes Collagenase SANTYL Ointment (the only FDA-approved biologic enzymatic debriding agent for chronic dermal ulcers and severe burns), OASIS® Wound Matrix and Ultra Tri-Layer Matrix (naturally-derived, extracellular matrix replacement products indicated for the management of both chronic and traumatic wounds) and REGRANEX® (becaplermin) Gel 0.01% (an FDA-approved platelet-derived growth factor for the treatment of lower extremity diabetic neuropathic ulcers).

Our most significant product by sales is SANTYL Ointment, which plays an integral role in removing necrotic or dead tissue in chronic dermal ulcers (such as pressure ulcers, diabetic ulcers, and venous ulcers) and severely burned patients.

SANTYL Ointment is often considered as the reference debridement product, especially in the hospital and nursing home markets. Additionally, in 2017 we continued to see growth in the use of SANTYL Ointment by office-based physicians and have been able to stabilise the nursing home market.

We continue to focus on further establishing the value of SANTYL Ointment in treating patients. We are also working to lower overall treatment costs, improve outcomes and patient satisfaction, and further educate physicians, patients, and payers on the critical role that SANTYL Ointment plays in moving patients forward through the healing process.

The wound bioactives market growth continues to be impacted by changes in the reimbursement landscape that are driving increases in out-of-pocket expenses for patients and access in general across all sites of care.

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

In 2017 performance in this franchise reflected SANTYL returning to growth in the second half of the year as it benefited from new analysis of its effectiveness in advancing pressure ulcers through the healing process offset by the reimbursement environment for OASIS which remained a headwind, as expected.

In 2017 the evidence base supporting PICO in our target surgical indications continued to build. A Level 1 meta-analysis containing 10 Randomised Controlled Trials and 1,863 patients demonstrated significant reduction in surgical site infections (58% reduction, p<0.0001), significant reduction in dehiscence (26% reduction, p<0.01) and significant reduction in length of stay (0.47 days reduction, p<0.0001). This summation of the evidence demonstrates the positive impact PICO is having on patient outcomes and system costs.

For our traditional NPWT system, RENASYS®, evidence was published demonstrating the effectiveness in the treatment of challenging wounds and its compatibility with ACTICOAT, where high bacterial burden is impacting wound progression.

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

In 2017 performance in this franchise was led by PICO, which continued to perform strongly across the year.

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

WE ARE PIONEERS WITH A PURPOSE
Smith & Nephew is a company of pioneers, extending access to advanced medical technologies and enabling better outcomes for patients globally. We've been doing this since 1856.

From our beginnings as a small family pharmacy in Hull, England, we have grown in size and scope. Over the past six years, we have fundamentally changed the structure of our Company, creating greater alignment and presenting one face to our customers. We have brought pioneering products and technologies to market, such as JOURNEY II and PICO, and have successfully completed many significant acquisitions, widening our customer base around the world.

We are proud of the work we do and share a mission to support healthcare professionals in their daily efforts to improve the lives of their patients. We achieve this by working together to deliver our strategic priorities.

Every employee has a role in our success, and so it is crucial that all employees feel engaged in their work and know its importance. We start each year by setting clear and measurable objectives based on our strategy scorecard.

The personal objectives of the Chief Executive Officer are cascaded through the organisation, with each employee setting aligned objectives according to his or her role.

Through this process, each employee can clearly see how their efforts contribute to the overall success of the business, which drives execution, accountability and engagement.

This engagement is measured through a biennial Global Employee Survey using the Great Place to Work Trust Index. In 2017, 88% of our global employees participated in this survey, providing meaningful results that have driven actions for improvement. We track our progress against these actions using regular pulse surveys.

In 2017 we raised our overall Trust Index score by five percentage points, to 67%, meeting our target for improvement. We achieved Great Place to Work recognition in a further five countries, ahead of our target of two more. In total we have received recognition in nine countries.

In addition to the Trust Index, we have implemented a culture dashboard which includes key metrics such as employee retention, business performance and feedback from new hires. The foundation of this dashboard is our values: to Perform, Innovate and Earn Trust. It provides a clear framework for our senior leaders to track progress and identify areas for additional focus, action or reinforcement.

The CEO Awards salute employees at all levels who make outstanding contributions for the benefit of Smith & Nephew.

In 2017 Lorraine Belleville, a Packaging Operator and Team Coordinator at our Mansfield facility in the US, was recognised for her significant contributions to Mansfield’s improvement of ‘Finished Goods’ production by nearly 30% since 2016. Lorraine took initiatives to improve the flow of work at the facility by introducing important tools such as a tracking scheme, daily production sheet and visual management.
WE ENCOURAGE AND REWARD HIGH PERFORMANCE

We set ambitious targets and we achieve them by creating a sense of purpose and urgency. While achievement of these targets is crucial, our Performance Management Process measures not only what was achieved, but also that the behaviours displayed in doing so match our core values.

Smith & Nephew’s compensation philosophy is to pay for performance. This means compensating employees for sustained performance that helps deliver timely and tangible results to drive the business forward. By following this philosophy we have found that we not only attract, retain, and motivate talent, but it also helps drive better business results and provides an equitable work environment. We are Living Wage Accredited in the UK, voluntarily paying above the government required minimum as we believe employees should receive fair compensation for the work they do.

The Company’s ‘Going the Extra Mile’ global employee recognition programme is used by executives, managers and employees alike to recognise and reward performance and our corporate values.

We are committed to working with employees to develop each individual’s talents, skills and abilities.

Employee advancement is merit-based, reflecting performance as well as demonstration of core competencies which include our values, with an emphasis on ethics and integrity. We prioritise the development and promotion of existing employees whenever possible. Each year Smith & Nephew conducts a comprehensive global development and capability review process to identify high potential employees and ensure they have well defined career development plans. The Board reviews succession plans for key executive roles and such plans are in place for other critical positions across our business.

In 2017, we added to our development programme three new opportunities: Leadership Edge, Pioneer and Continuous Learning Journeys. In 2017, 560 employees have participated in these programmes. These are designed to embed and enhance essential leadership skills for new and experienced managers, respectively through a combination of guided and self-service learning tools. Our ‘myLearning’ self-directed online learning portal was nominated for a Learning Technologies Award for the ‘Best Online Distance Learning Programme’ this year.

Employees are provided with opportunities to develop their skills and career through new assignments and on the job experiences.
WE FOSTER AND EMBRACE DIVERSITY OF EXPERIENCE, BACKGROUND AND IDEAS

Smith & Nephew’s global diversity and inclusion programme, called ‘Valuing Difference’, is designed to highlight the value of bringing different ideas and perspectives in from our work and personal experiences. Through storytelling and manager tools and discussion guides, the programme encourages open dialogue and an appreciation of the benefits of diverse teams.

We believe that diversity fuels innovation and are committed to employment practices based on equality of opportunity and the ability of the person to perform the essential functions of the job, regardless of colour, creed, race, national origin, sex, age, marital status, sexual orientation or mental or physical disability.

When we recognise and appreciate these differences, they can help us better reflect the wide range of cultures, customers, and patients we serve, so we can better meet their needs and be a better business – thereby building credibility with all. Diversity is regarded as an asset and it is further guarded by our global policies regarding ‘Diversity and Inclusion’ and ‘Respectful Workplace’.

Our Valuing Difference Programme is sponsored by Chief Executive Officer Olivier Bohuon, and Steering Committee members include our Chief Human Resources Officer, Members of the Executive Committee and Regional Presidents. Together, the committee agrees the strategy which is then executed at the regional and country-level in order to have the greatest possible impact.

Local diversity councils meet regularly and work to translate strategy to local needs, execute specific actions and share best practice.

An example of a Valuing Difference Initiative is the ‘Elevate’ programme, which was attended by more than 275 female professionals in 2017. Elevate is specifically designed to develop our female leaders and includes a mix of skill development and motivational support.

The programme has been highly successful, with the majority of participants stating they prioritise making time to attend the monthly webinar sessions and more than one-third promoted or changed roles in the past year.

Gender diversity and equity are important areas of focus for us. Our goal is to have 33% women in senior management positions by 2020, in accordance with best practice as defined in the Hampton Alexander Report. Currently just over a quarter of senior management roles are held by women, in line with the FTSE100 average as defined by the 2017 Hampton Alexander Review. We are also committed to ensuring that our performance management and associated rewards are equitable and free from any unconscious gender bias. The UK government has introduced a requirement that all employers publish their gender pay ratio in the UK by 4 April 2018, which we will do on our website.

We recruit, employ and promote employees on the sole basis of the qualifications and abilities needed for the work to be performed. We do not tolerate discrimination on any grounds and provide equal opportunity based on merit. We do not use any form of forced, compulsory or child labour. We support the Universal Declaration of Human Rights of the United Nations. This means we respect the human rights, dignity and privacy of the individual and the right of employees to freedom of association, freedom of expression and the right to be heard. As a global medical technology business, Smith & Nephew recognises that we have a responsibility to take a robust approach to preventing slavery and human trafficking. Smith & Nephew is committed to preventing slavery and human trafficking in its corporate activities, and its supply chains. Our full policy on preventing slavery is available on our website.

WE DO THE RIGHT THING EVEN WHEN NO ONE IS WATCHING

All employees receive our Code of Conduct and Business Principles when they join the Company, and renew their training and commitment to the Code on an annual basis.

Smith & Nephew’s Global Compliance Programme not only helps our businesses comply with laws and regulations, but also creates the culture of trust we deem essential to our success. Our comprehensive programme includes: Board and executive oversight committees, global policies and procedures, on-boarding and annual training for employees and managers, training for third-party sellers; monitoring and auditing processes; and reporting channels and recognition for demonstrating our values. Annual training is required of all employees and any stakeholders who represent Smith & Nephew.

Through our global intranet, we provide resources and tools to guide employees to make decisions that comply with the law, local industry code and our Company Code of Conduct. We require advance approval for significant interactions with healthcare professionals or government officials and we regularly assess existing and emerging risks in the countries in which we operate. See page 32 for more information on our global compliance programme.

WE VIEW INNOVATION AS AN ESSENTIAL SKILL

Innovation is owned by all of us who question the status quo, dare to propose new solutions and seek to be the best at what we do for the benefit of our customers.

At Smith & Nephew, we recognise that innovation includes the entire value chain within our organisation from R&D to engineering, manufacturing, distribution, sales, marketing, and even facility utilisation and investment strategy. We also acknowledge only a few innovations will be truly disruptive, while others will result in equally as important incremental changes. To help aid this, Smith & Nephew has introduced an Innovation Council to support its culture of innovation and signal its importance in the Company’s continued success.

The Council consists of ‘Innovation Champions’ who reflect the diversity of the Smith & Nephew employee base and have a strong appetite for trying new things. These champions will be responsible for generating creative ways to embed this value and look for opportunities to raise innovative opportunities to the leadership team and to celebrate success.
WE CARE ABOUT EACH OTHER’S WELLBEING AND THE SUSTAINABILITY OF SMITH & NEPHEW

Each of us treats our Company’s resources and the world’s natural resources as if they were our own, and we take our responsibility to our communities seriously. Smith & Nephew not only applauds, but also supports the donations of employees’ time and resources.

We encourage all our employees to volunteer their time and talents by providing eight hours per year paid time for volunteer efforts. Many functions structure their team building activities around group volunteering opportunities such as Make a Wish Foundation events and the Helping Hands Project which builds prosthetic hands for amputees in third-world countries.

Charity efforts are also coordinated across entire sites, and beyond. In 2017, Smith & Nephew brought together many local companies in Hull with a ‘More Together’ initiative to raise tens of thousands of pounds for local charities. Smith & Nephew was also a major sponsor of the Hull City of Culture celebrations, with employees contributing to and benefiting from the year of activities on-site and across the city.

Our social responsibility strategy is to materially contribute to the delivery of our Company Mission by engaging employees to prioritise philanthropic resources and efforts on areas that align with our business strategy and values. Resources include product donations, matching gifts, and employee volunteerism.

We believe selection and management of charitable and non-profit organisations and activities is best accomplished at the local level within the framework of our social responsibility strategy. Each location’s Site Leadership Council and/or Camaraderie Council will design, construct, and operate the local programme, including arrangement of funding. These Councils build out the local social responsibility programme, selecting charitable organisations and activities that best engage the local employee population and underpin our Mission.

We Innovate.
We Perform.
We earn Trust.
We are Smith & Nephew.

RESEARCH & DEVELOPMENT (R&D)

$223m
Investment in R&D in 2017

Smith & Nephew has a single global R&D function, led by the President of Global R&D, reporting directly to the Chief Executive Officer. This team strives to increase value created by research and development by focusing on three imperatives: Disruptive Innovation that matters, flawless execution of new product development, and compelling evidence of clinical and economic value.

The Portfolio Innovation Board drives our innovation strategy and framework. This Board identifies and selects only those projects that will make a meaningful difference to our customers and their patients. This includes continuing to invest in incremental innovation to improve existing products in a way that improves outcomes. It also involves driving greater efficiency through innovation, potentially reducing our costs of goods. For instance, by making instrument sets more procedure and patient-specific, we will reduce complexity and cost, to the benefit of customers and the Company. Finally, by seeking more meaningfully disruptive products and services, we will harness transformational innovation to provide access to new technologies to people across the world.

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

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

During 2017 we secured a long-term partnership with the University of Hull to create one of the world’s largest Wound Care Research Clusters with the aim of developing scientific insights and innovative treatments. This includes the creation of eight PhD studentships and a programme of collaboration between Smith & Nephew’s new Hull R&D centre and the University’s new Health Campus, both of which opened in 2017.

We also announced a three-year partnership with Imperial College London to develop enhanced surgical techniques relating to ligament function, biomechanics and soft tissue injuries of the knee, including the most common injuries of torn menisci and anterior cruciate ligament rupture. See opposite page.

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

In 2017, we invested $223 million in R&D, in line with our commitment, set out in 2011, to maintain our investment level at around 5% of revenue. We expect to maintain this proportion going forward, but to realise greater benefit through our new structure and strategic focus.
Smith & Nephew takes great pride in its expertise in manufacturing products to the highest quality and ensuring they reach our customers in a timely manner. We operate manufacturing facilities in a number of countries across the globe, and a number of central distribution facilities in key geographical areas. Products are shipped to individual country locations which hold small amounts of inventory locally for immediate supply to meet customer requirements.

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

Quality has always been paramount to Smith & Nephew. We have a unified Quality Assurance and Regulatory Affairs team to ensure consistency across our country business units. Requirements of global regulatory agencies have become more stringent in recent years and we expect them to continue to do so. We are continuing to expand our portfolio globally through new product development and by registering our existing products in new markets. In order to meet the expectations of regulators and support this added complexity we continued to invest in our Quality and Regulatory expertise in 2017.

Smith & Nephew is working with Imperial College London to develop enhanced surgical techniques relating to ligament function, biomechanics and soft tissue injuries of the knee, including the most common injuries of torn menisci and anterior cruciate ligament rupture.

"The partnership with Smith & Nephew is priceless for our work. It allows a strategic attack on the unanswered biomechanical issues in knee surgery. Knowing funding is secure for three years allows a step-by-step ‘due diligence’ approach to investigating these issues rather than sporadic studies. This is the best way to translate from the lab to patient care" said Mr Andy Williams, Lead Surgical Researcher, Imperial College London and Fortius Clinic.

Meniscus repair is one of the greatest challenges of Sports Medicine. By combining the clinical expertise of Imperial College with our pioneering approach to new product development we expect to be able both to advance surgical techniques and accelerate the development of next generation products.
OUR MANUFACTURING FACILITIES

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

In Sports Medicine, our Alajuela (Costa Rica) facility, opened in 2016, manufactures COBLATION technology. Our Mansfield (Massachusetts, US) facility manufactures products for minimally invasive surgery including the FAST FX 360 Meniscal Repair System, FOOTPRINT® PK Suture Anchor, DYONICS Platinum Shaver Blades, ENDOBUTTON CL Ultra and the HEALICOIL PK suture anchor.

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

Our Oklahoma City (Oklahoma, US) facility produces and services electro/mechanical capital equipment as well as single use sterile devices and also assembles some of our NPWT devices using components from third parties.

The majority of our wound management products are manufactured at our facilities in Hull, Suzhou and Curaçao. These include pioneering products such as PICO and ALLEVYN Life as well as our complex silver coating technology for ACTICOAT. In Suzhou, we also manufacture our wound care products for the mid-tier in the Emerging Markets. Manufacturing of our Advanced Wound Bioactive products takes place in Curaçao and at various third party facilities in the US.

PROCUREMENT

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

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

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

GLOBAL SUPPLY CHAIN

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

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

SALES & MARKETING

Our customers are the providers of medical and surgical treatments and services in over 100 countries worldwide, ranging from orthopaedic surgeons to wound care nurses, general practitioners and other clinicians, but increasingly also economic stakeholders. These include purchasing professionals in hospitals, healthcare insurers, materials managers and others.

We serve these customers through our sales force and other channels. Our sales representatives are highly trained and skilled individuals. Becoming a sales representative requires intense training, including passing a strict certification programme. Depending on their area of specialism, representatives in our surgical businesses must be able to demonstrate a detailed knowledge of all the surgical instruments used to implant a device, or have specific understanding of the various surgical techniques a customer might use.

In our advanced wound management business, sales representatives must have a detailed understanding of how patients live with wounds and how clinicians seek to prevent and treat them, as well as deep knowledge of the clinical and economic benefits of using our products within treatment protocols.

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

Our Global Commercial Organisation oversees all commercial activities (sales, marketing, market access, and commercial strategy) across the Group for our full line of business. The organisation is led by two regional sales presidents for the US and International, and our Chief Marketing Officer (CMO). Within our International region there are several regional leaders for Europe & Canada, Asia Pacific and Latin America.

Our sales forces in the Established Markets are specialised by channel and consist of a mixture of independent contract workers and employees. In our Emerging Markets we operate through direct selling and marketing operations led by country managing directors, and through third party sellers.
Smith & Nephew has three global marketing teams who set the strategic direction of our businesses, guide our research & development teams by specifying new products & services needed to realise those strategies, and develop the promotional assets and guidance to commercialise our products. They utilise a variety of traditional and novel means to market to our customers, including scientific congresses, commercial trade shows, advertising in medical journals and, increasingly, digital channels. These include product websites, social media channels, mobile applications and our professional educational platform called Education & Evidence.

Also reporting to our CMO is the global Commercial Excellence team, which drives numerous initiatives to strengthen commercial execution in both the sales organisation and our global marketing teams. There is a strong focus on Sales Force Excellence to increase efficiency and effectiveness of our sales teams, and on Pricing to increase discipline in our transactional pricing and define better value creation strategies for our innovative products. Other activities in Commercial Excellence include strategic planning, business intelligence and market research, digital marketing, and marketing communications.

In addition, our Health Economics and Outcomes Research (HEOR) team generates evidence on the economic impact of our products and provides supporting assets and tools to commercialise our products. They do this through collaboration with leading medical centres in the world as well as existing registries that track usage of our products. The HEOR team also reports to our CMO.

A DAY IN THE LIFE…

Mustafa works as a Territory Manager in our Sports Medicine franchise in the UK.

“Every day is different. My time is split between supporting customers and their operating theatre teams in hospitals, meeting with potential customers, learning and researching techniques and trends, and keeping in touch with my colleagues, the business and my existing customers.

“My favourite part of the job is the interactions I have with my customers. I believe that we sell solutions rather than products, so everything I do is about helping my customers to find answers to the problems they face, to enable better outcomes for their patients.

“We’re very lucky in the UK to be able to offer an excellent training facility to the surgeons we support. It’s a great feeling to be able to support a consultant to refine their surgical techniques. I’m also a mentor providing expertise and guidance on our Resection and Camera products to my colleagues in the UK.”
We assess the compliance controls in Smith & Nephew’s businesses. We conduct audits, supported by data analytics, and local monitoring. We review the issues our testing generates to identify patterns.

New distributors and other higher-risk third parties are subject to screening and are contractually obligated to comply with applicable laws and our Code of Conduct. Compliance training and certifications are included in this process.

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

GLOBAL COMPLIANCE PROGRAMME: NEW ELEMENTS IN 2017

In 2017, we created an Ethical Leadership model, which includes four pillars: Advise, Lead, Observe, and Coach or Report. We introduced this model during annual manager training, reinforced the model through further communications, and gave managers resources they can use to raise awareness of compliance risks and rules.

We benchmarked our whistle-blower programme against industry metrics. The benchmarking confirmed that all Smith & Nephew reporting and substantiation rates met industry practices. We conducted a comprehensive review of the guidelines recently issued by the US Department of Justice on compliance programme effectiveness and by the International Organisation of Standards on Anti-Bribery Management Systems, and are also identifying any actions needed to align to this new guidance.

We applied enhanced standards prospectively for new, potential partners and retrospectively for existing distributors. We also developed new guidelines for distributors or agents who need to enter the operating room when acting on our behalf. We worked with our Procurement colleagues to integrate compliance controls into the Company’s new purchasing system. We also conducted a comprehensive review of the types of complementary workers we engage to ensure they receive appropriate anti-bribery and corruption compliance training and will implement an updated training strategy in 2018.

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

In February 2017, we inaugurated our ‘Expert Connect Centre’ in the UK. This new centre for HCP training is a state-of-the-art learning environment with the latest audio-visual capabilities and 14-station bio-skills laboratory for all levels of HCPs from around the globe. In 2017, we provided more than 45,000 instances of training to surgeons through our Smith & Nephew training centres in the US, UK and China, as well as running many courses at third party centres around the world.

Working under expert guidance, attendees learn new techniques and refine skills, to ensure the safe and effective use of our products.

These courses are attended by residents, fellows and practicing surgeons who work together to review, discuss and train on current and forward-looking surgical techniques in their areas of clinical expertise. Our courses help up-and-coming surgeons develop trust and gain the experience and confidence necessary to become experts in their field.

Thousands of nurses receive face-to-face training from Smith & Nephew representatives every year, including attending courses at our centres, and through our representatives visiting them at their place of work. In 2017 almost 45,000 clinicians in the US alone benefited from our wound care educational resources.

In addition, we provide healthcare professionals our online resources such as the Global Wound Academy, The Wound Institute and, for surgeons, our Education and Evidence website. Recently we began utilising innovative, digital technologies to accelerate the learning experience of surgeons. In 2017 we doubled the number of healthcare professionals trained digitally on Smith & Nephew products and techniques to 180,000.
SUSTAINABILITY IS BETTER BUSINESS

TAking sustainability to the core of the business

We began to deliver in 2017 our commitment to sustainability embodied in our refreshed Group Sustainability Strategy. This strategy, approved in 2016, both drives and is driven by implementation of the Group Business Strategy, ensuring that all three main aspects of sustainability – economic prosperity, social responsibility and environmental stewardship – advance as one.

This is a summary report of our sustainability activities and progress in 2017. Our annual Sustainability Report, published at the same time as this Annual Report, describes the Group Sustainability Strategy and its associated goals in more detail. It also specifies targets to move our performance towards these goals, and provides further information regarding our 2017 progress. It is available on our website.

GROUP SUSTAINABILITY STRATEGY

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

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

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

Longer term goals need medium-term SMART (specific, measurable, achievable, realistic and timebound) targets to ensure we are making the right progress. And we have taken such targets through 2020. These targets are discussed in more detail in the 2017 Sustainability Report which is available on our website.

SUSTAINABILITY VISION AND MISSION

We envision a world in which healthcare professionals have access to the solutions they need to help patients restore their health, engage in society, enhance the environment and improve their wellbeing.

Our sustainability strategy aims to achieve this vision. It outlines the steps we'll take with a view to leading our industry in the development and use of products and services that:

- Satisfy unmet health needs and promote greater access to treatment;
- Offer easier, better, faster and more effective treatment, enabling productive engagement in society;
- Prioritise materials that are reused, remanufactured, or recycled;
- Are manufactured using raw materials sourced from an environmentally and socially sound supply chain;
- Use natural resources efficiently;
- Are manufactured by processes that are not hazardous to people or the environment; and
- Implement the most sustainable product options.

Our plan focuses on both the foundational and competitive advantage elements required to deliver our value proposition sustainably. We employ a continuous improvement approach based upon the implementation of forward-looking solutions (such as investing in new materials and processes that provide significant benefits with respect to human rights, safety, energy, waste and/or communities) and bridging technologies to secure future game-changing performance.

2017 was a year in which our refreshed sustainability strategy was put into action. We delivered improvements across our traditional areas of focus: employee health and safety, carbon emissions and water consumption. In addition, we began to get a fuller understanding of our impacts in the areas of material efficiency, life cycle environmental impacts, and labour practices. We adopted a social responsibility strategy which will drive employee engagement and improve the communities in which we operate.

EMPLOYEE SAFETY, WELLNESS AND VOLUNTEERING

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

Engagement with the communities in which we operate continued to broaden and deepen through the active attention of site leadership, establishment and empowerment of local camaraderie councils, broader application of company-paid volunteering allowance, and increase in the company match for employee donations to charity. We continue to strengthen and deepen employee wellness programmes with a focus on enabling healthy lifestyle choices.

SOCIAL RESPONSIBILITY STRATEGY IMPLEMENTATION

In 2017, we developed and adopted a social responsibility strategy aimed at improving the alignment of our charitable donation, volunteering, wellness and professional development with both our Group Business Strategy and the needs and desires of our employees. The aim is to positively impact both employee engagement and the quality of life in communities in which we operate. We have improved our understanding of compliance to labour standards in our value chain, product and service attributes which are important to customers and our employees' view of the role of the organisation in society. In 2018, we will use these and other social success factors, informed by our Group Business Strategy as well as our Company values, to deploy a series of platforms and actions which advance our cause.
### Our 10 long-term aspirational goals

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<th>Goal</th>
<th>2020 targets</th>
<th>Progress since 2016</th>
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<tr>
<td>1 Zero work-related injuries and illnesses across the value chain.</td>
<td>- 10% reduction in Total Injury Rate (TIR) from 2016 actual.</td>
<td>- In 2016 the TIR = 0.52, in 2017 TIR = 0.35 (33% lower).</td>
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<td>2 Water: Total water impacts of our products and solutions are balanced with local human and ecosystem needs.</td>
<td>- Water footprint (1) available for products accounting for 75% of revenue and (2) considerations embedded in new product development process. - Total potable water consumption at S&amp;N sites no higher than 2016 actual.</td>
<td>- Products accounting for 75% of revenue identified. Water footprint tools identified. - Work plan under development, will be approved and commenced in 2018. - Water reduction of 10%.</td>
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<td>3 Waste: All materials are either shipped as part of product or returned for beneficial use.</td>
<td>- Total material efficiency estimated for products accounting for 75% of revenue and 80% or more of waste generated reused, recycled or recovered.</td>
<td>- Products accounting for 75% of revenue identified. Material efficiency tools identified. - Work plan under development, will be approved and commenced in 2018. - We currently reuse, recycle or recover energy from 77% of our total waste, up from 74% in 2016.</td>
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<td>4 Carbon: 80% absolute reduction in total life cycle greenhouse gas emissions by 2050.</td>
<td>- Estimate total life cycle greenhouse gas emissions of products accounting for 75% of revenue. - Total Scope 1 &amp; 2 greenhouse gas emissions reduced by 10% from 2016 actual.</td>
<td>- Products accounting for 75% of revenue identified. Total lifecycle greenhouse gas emissions tools identified. - Work plan under development, will be approved and commenced in 2018. - In 2017 the reduction is 7%.</td>
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<td>5 Ethical Business Practices: All activities are conducted in compliance with applicable International Labour Organization (ILO) conventions, involve no environmental degradation, and are free from corruption.</td>
<td>- Labour practices throughout the supply chain associated with products accounting for 75% of revenue compliant with applicable ILO conventions.</td>
<td>- Products accounting for 75% of revenue identified. Gap assessment to applicable ILO conventions completed for internal operations. Engagement with upstream suppliers and downstream distributors and agents ramping up.</td>
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<td>6 Zero Product-related and service-related patient injuries.</td>
<td>- Robust system in place to detect, record, investigate and eliminate root cause of product-related and service-related patient injuries.</td>
<td>- Systems are in place to detect, record and investigate patient injury incidents. Patterns in the data are being used to craft models which will allow identification of at-risk attributes.</td>
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<td>7 Robust social responsibility programmes that contribute to the attraction and retention of top talent.</td>
<td>- Social responsibility strategy which aligns philanthropy, employee volunteering and wellness to the business strategy in place.</td>
<td>- Social responsibility strategy in place. Alignment of current initiatives to the strategy under way.</td>
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<td>8 Products and services are aligned to market economic, social and environmental expectations and anticipate future market conditions: All products have identified and clearly-described sustainability attributes. R&amp;D and NPD processes deliver environmental-, social-, and healthcare economically-advantaged innovations.</td>
<td>- Sustainability attributes described for products accounting for 75% of revenue Robust emphasis on sustainability attributes of new products/services in place.</td>
<td>- Products accounting for 75% of revenue identified. Product/service sustainability attributes agreed. - New product development (NPD) sustainability focus planning under way.</td>
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<td>9 Strategic risks and opportunities are understood and business activities are aligned to risk appetite.</td>
<td>- Enterprise risk management arrangements are embedded in the routine business decision-making process.</td>
<td>- Risk register reinvigorated. Deep dive programme instituted with focus on both assurance that all relevant risks have been identified and effectiveness of mitigating actions is accurately assessed. - Actions to further embed into the business decision-making process are planned for 2018.</td>
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<td>10 Environmental, social, and economic impacts of (1) potential acquisitions, (2) technologies to be extended to Emerging Markets, (3) innovative business models, (4) cost-of-quality reduction initiatives, and (5) manufacturing siting, functional optimisation and site utilisation alternatives are fully understood and appropriately balanced.</td>
<td>- Formal programmes in place to measure/assess the economic, social and environmental impacts of (1) potential acquisitions, (2) technologies to be extended to Emerging Markets, (3) innovative business models, (4) cost-of-quality reduction initiatives, and (5) manufacturing siting, functional optimisation and site utilisation alternatives.</td>
<td>- Launched our Enterprise Risk Management Policy and Manual. - Trained our risk champions in risk identification and mitigation. - Introduced a product focused approach to risk management. - Conducted a number of ‘deep dives’ into several key risks. - Tools and standards to address new technologies are being developed to support our NPD work above.</td>
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These targets are discussed in more detail in our 2017 Sustainability Report which is available on our website.
CO₂e REPORTING

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<th></th>
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<td>9,822</td>
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<tr>
<td>Indirect emissions</td>
<td>76,107</td>
<td>82,415</td>
<td>77,191</td>
</tr>
<tr>
<td>Total</td>
<td>85,558</td>
<td>92,237</td>
<td>88,202</td>
</tr>
<tr>
<td>Intensity ratio</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CO₂e (t) per $m sales revenue</td>
<td>17.8</td>
<td>19.6</td>
<td>19.2</td>
</tr>
<tr>
<td>CO₂e (t) per full-time employee</td>
<td>5.2</td>
<td>5.9</td>
<td>6.0</td>
</tr>
</tbody>
</table>


Notes
2015 data adjusted to exclude acquisitions in Russia and Colombia.
2017 data includes all data, including acquisitions since 2016.

CO₂e reporting methodology, materiality and scope.

We report the carbon footprint of our Scope 1 and 2 greenhouse gas (GHG) emissions in tonnes of CO₂ equivalent from our business operations for the calendar year ended 31 December 2017. Our focus is on the areas of largest environmental impact including manufacturing sites, warehouses, R&D sites and offices. Smaller locations representing less than 2% of our overall emissions are not included. Acquisitions completed before 2017 are included in the data, with more recent ones being excluded and this is in line with our established policy for integration of acquired assets. Each year we work with an independent partner to verify our sustainability data and gain assurance.

Our GHG emissions reporting represents our core business operations and facilities which fall within the scope of our consolidated financial statements. Primary data from energy suppliers has been used wherever possible.

We report our emissions in two ‘scopes’. Scope 1 figures include: Direct sources of emissions mainly comprise the fuels we use on-site, such as gas and heating oil and fugitive emissions arising mainly from the losses of refrigerant gases.
Scope 2 figures include: Indirect sources of emissions such as purchased electricity and steam we use at our sites.

Location-based emissions are calculated in compliance with the WRI/WBCSD GHG Protocol Corporate Accounting and Reporting Standard and have been calculated using carbon conversion factors published by BEIS/DEFRA for 2017. We have applied the emission factors most relevant to the source data, including DEFRA 2017 (for UK locations), IEA 2015 (for overseas locations) and for the US we have used the US EPA ‘Emissions & Generation Resource Integrated Database’ (eGrid) for the regions in which we operate. All other emission factors for gas, oil, steam and fugitive emissions are taken from DEFRA, 2017.

ABOUT SOLAR

In line with our aspiration to reduce carbon emissions, we are investing in more efficient energy solutions, such as solar power.

Devrukh, India
At our Devrukh site in India, we are running one of our largest renewable energy projects.

By installing the 426 kVA roof top solar panel system, we aim to produce enough energy to provide the site with free power for 25 years, whilst reducing carbon emissions by up to 44% per annum. We are already achieving a cost saving of 44% per year and expect a return on investment in less than five years.

The 1,330 solar panels will also enable us to reduce the inside temperature of the manufacturing floor by five to ten degrees celsius, creating a safer and more pleasant working environment for our employees.

Suzhou, China
In April 2017, we installed 24 sets of solar water heater units on the roof of one of our buildings in Suzhou. The system can produce around 12 tonnes of 55°C hot water every day for the site’s hot water system and will save 291 tonnes of steam every year.
DEAR SHAREHOLDER

I am delighted to address you for the first time in the Annual Report as your Chief Financial Officer.

Under Olivier’s leadership, Smith & Nephew has made significant organisational changes to create a strong global business. I believe that we are just starting to see the benefits of these changes, and I am excited by the prospects for 2018 and beyond as we realise the opportunities in front of us. I am very much looking forward to working with Olivier and, in due course, his successor, to make this happen.

2017 PERFORMANCE

Group revenue in 2017 was $4,765 million, an increase of 2% on a reported basis and 3% on an underlying basis. This was an improvement from underlying growth of 2% in 2016. Trading profit was $1,048 million, and the trading profit margin was 22.0%, up 20bps on 2016. I am pleased to report that both our underlying revenue growth and trading profit margin improvements were in-line with our guidance.

The reported operating profit for 2017 was $934 million, up from $801 million in 2016, with the year-on-year increase primarily reflecting a gain of $54 million from the settlement of an intellectual property matter, no restructuring charges and lower amortisation and impairment of acquisition intangibles in 2017.

The tax rate on trading results was 17.1% (2016: 23.8%). This is a considerable reduction on the 2016 rate and is mainly due to a one-off benefit following the conclusion of a US tax audit, further progress in improving our tax rate, tax provision releases following expiry of statute of limitations and a beneficial geographical mix of profits. The reported tax rate of 12.7% was a result of the lower tax rate on trading results and also included a $32 million net benefit from US tax reform.

Adjusted earnings per share (EPSA) was up 14% at 94.5¢ as a result, and this is reflected in the 14% increase in our full year dividend distribution for 2017. Basic earnings per share (EPS) was 87.8¢ in line with the previous year.
I am pleased to report that trading cash flow\(^1\) was $940 million, up from $765 million in 2016, with a higher trading profit to cash conversion ratio\(^1\) of 90% as we improved our working capital management.

As the result of improved operating profit, the lower tax rate and a stable asset base we saw an improvement in Return On Invested Capital\(^1\) (ROIC – as defined on page 39) from 11.5% in 2016 to 14.3% in 2017.

**CAPITAL RETURNS**

The appropriate use of capital on behalf of shareholders is important to Smith & Nephew. The Board believes in maintaining an efficient, but prudent, capital structure, while retaining the flexibility to make value-enhancing acquisitions.

This approach is set out in our Capital Allocation Framework which we used to prioritise the use of cash and ensure an appropriate capital structure.

Our commitment, in order of priority, is to:

– Continue to invest in the business to drive organic growth;
– Maintain our progressive dividend policy;
– Realise acquisitions in-line with strategy; and
– Return any excess capital to shareholders.

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

**IMPROVING COMPETITIVENESS**

On joining Smith & Nephew I was asked by Olivier and the Board to look afresh at efficiency opportunities within our business. Some preliminary analysis highlighted a number of areas of opportunity, and we conducted a detailed assessment of these during the final months of 2017.

Our conclusion was that we now have the Group structure in place which lets us act on these further opportunities. Through better execution and efficiency we can and will strengthen our competitive position.

We are calling this work the APEX programme, standing for ‘Accelerating Performance and Execution’, and we completed our planning and started to take action in early 2018. Our three workstreams are focused on clear and obtainable improvements in the Group’s manufacturing, warehousing and distribution footprint, reducing our general and administrative expenses, and driving greater commercial effectiveness. More details on APEX and each of these workstreams can be found on page 14.

APEX is expected to deliver an annualised benefit of $160 million by 2022, with at least half of this expected by 2020, for a one-off cash cost of up to $240 million.

**SUCCESSFUL ACQUISITION**

During the year, we continued to seek further opportunities to strengthen our technology and product portfolio. In December we acquired Rotation Medical, Inc., the developer of a novel tissue regeneration technology for shoulder rotator cuff repair, for an initial cash consideration of $125 million and up to a further $85 million over the next five years, contingent on financial performance. I am excited by the potential for this new technology and we remain alert to further opportunities to bring other disruptive innovations into the Group.

**OUTLOOK**

We expect the overall dynamics in our markets to be similar in 2018 to those seen in 2017. Against this backdrop, the Group expects to continue to deliver an improved performance in 2018 driven by our strong product portfolio and pipeline of innovative products.

In terms of revenue, we expect our underlying growth to be in the range of 3% to 4% (which equates to 7% to 8% in reported terms at exchange rates prevailing on 2 February 2018). In terms of trading profit margin we expect to drive a further 30-70bps improvement over 2017. As a result of the recently enacted US tax reform, we expect a tax rate on trading results in the range 20% to 21%, barring any changes to tax legislation or other one-off items.

In 2018, we will continue to push for further success as we build a more competitive Smith & Nephew. I look forward to helping to drive this, and to delivering on our commitments for the benefit of all of our stakeholders.

Yours sincerely,

Graham Baker
Chief Financial Officer
GROUP PERFORMANCE

HIGHLIGHTS FOR THE YEAR ENDED 31 DECEMBER

<table>
<thead>
<tr>
<th></th>
<th>2017 $ million</th>
<th>2016 $ million</th>
<th>Change $ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>4,765</td>
<td>4,669</td>
<td>96</td>
</tr>
<tr>
<td>Operating profit</td>
<td>934</td>
<td>801</td>
<td>133</td>
</tr>
<tr>
<td>Trading profit¹</td>
<td>1,048</td>
<td>1,020</td>
<td>28</td>
</tr>
<tr>
<td>Profit before tax</td>
<td>879</td>
<td>1,062</td>
<td>(183)</td>
</tr>
<tr>
<td>Attributable profit</td>
<td>767</td>
<td>784</td>
<td>(17)</td>
</tr>
<tr>
<td>EPS</td>
<td>87.8¢</td>
<td>88.1¢</td>
<td>(0.3¢)</td>
</tr>
<tr>
<td>EPSA¹</td>
<td>94.5¢</td>
<td>82.6¢</td>
<td>11.9¢</td>
</tr>
<tr>
<td>Goodwill and intangible assets</td>
<td>3,742</td>
<td>3,599</td>
<td>143</td>
</tr>
<tr>
<td>Other non-current assets</td>
<td>1,393</td>
<td>1,216</td>
<td>177</td>
</tr>
<tr>
<td>Current assets</td>
<td>2,731</td>
<td>2,529</td>
<td>202</td>
</tr>
<tr>
<td>Total assets</td>
<td>7,866</td>
<td>7,344</td>
<td>522</td>
</tr>
<tr>
<td>Total equity</td>
<td>4,644</td>
<td>3,958</td>
<td>686</td>
</tr>
<tr>
<td>Non-current liabilities</td>
<td>1,876</td>
<td>2,038</td>
<td>(162)</td>
</tr>
<tr>
<td>Current liabilities</td>
<td>1,346</td>
<td>1,348</td>
<td>(2)</td>
</tr>
<tr>
<td>Total liabilities</td>
<td>3,222</td>
<td>3,386</td>
<td>(164)</td>
</tr>
<tr>
<td>Total liabilities and equity</td>
<td>7,866</td>
<td>7,344</td>
<td>522</td>
</tr>
<tr>
<td>Net debt¹</td>
<td>1,281</td>
<td>1,550</td>
<td>(269)</td>
</tr>
<tr>
<td>Cash flows from operating activities</td>
<td>1,273</td>
<td>1,035</td>
<td>238</td>
</tr>
<tr>
<td>Trading cash flow¹</td>
<td>940</td>
<td>765</td>
<td>175</td>
</tr>
<tr>
<td>Free cash flow¹</td>
<td>714</td>
<td>457</td>
<td>257</td>
</tr>
</tbody>
</table>

CONSOLIDATED INCOME STATEMENT

Reconciling items

US 2017 2,306 2016 2,299 0% 2% (2%) 0%
Other Established Markets 1,678 1,679 0% 0% 0% 0%
Emerging Markets 781 691 13% 12% 0% 1%
Total 4,765 4,669 2% 3% (1%) 0%

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

<table>
<thead>
<tr>
<th></th>
<th>2017 $ million</th>
<th>2016 $ million</th>
<th>Change $ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating profit</td>
<td>934</td>
<td>801</td>
<td>172</td>
</tr>
<tr>
<td>Acquisition-related costs</td>
<td>(10)</td>
<td>9</td>
<td>0.2%</td>
</tr>
<tr>
<td>Restructuring and rationalisation costs</td>
<td>–</td>
<td>62</td>
<td>1.3%</td>
</tr>
<tr>
<td>Amortisation and impairment of acquisition intangibles</td>
<td>140</td>
<td>178</td>
<td>3.8%</td>
</tr>
<tr>
<td>Legal and other</td>
<td>(16)</td>
<td>(30)</td>
<td>(0.7%)</td>
</tr>
<tr>
<td>Trading profit</td>
<td>1,048</td>
<td>1,020</td>
<td>21.8%</td>
</tr>
</tbody>
</table>

NON-IFRS MEASURES

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

RESULTS OF OPERATIONS

In 2017, we delivered reported revenue growth of 2% and underlying revenue growth¹ of 3%. Revenue growth on a reported basis was flat across our US and other Established Markets, with a strong performance in Japan driven by Sports Medicine and Knee Implants counterbalanced by a soft wound care market in the UK where we have now taken steps to adapt our business in response.

In our Emerging Markets reported revenue growth was 13% and underlying growth¹ was 12% in 2017. In China, our largest Emerging Markets country, we delivered double-digit revenue growth as we improved our channel management. In the oil-dependent Gulf States we returned to growth by focusing on securing more private healthcare business to compensate for the reduction in government tenders. We are well positioned to continue to drive strong growth from the Emerging Markets over the medium term.

Operating profit of $934 million (2016: $801 million) is after integration and acquisition costs, as well as amortisation and impairment of acquisition intangibles and legal and other items. The year-on-year increase in operating profit primarily reflects a gain of $54 million from the settlement of an intellectual property matter, no restructuring charges and lower amortisation and impairment of acquisition intangibles in 2017. The sale of the rights to distribute certain non-core products contributed $19m to operating profit in 2017. In 2016 similar product disposals along with provision releases from favourable legal matter outcomes contributed $18m.

Trading profit¹ was $1,048 million (2016: $1,020 million). Trading profit margin¹ was 22.0%, up 20bps year-on-year, in line with guidance.

In 2017, selling, general and administrative expenses included a $10 million credit relating to acquisition-related costs (2016: $9 million charge), $16 million credit for legal and other expenses primarily related to a $44 million curtailment credit related on UK post-retirement benefits and $140 million charge for amortisation and impairment of acquisition intangibles (2016: $178 million charge).

Research and development expenditure as a percentage of revenue remained broadly consistent at 4.7% (2016: 4.9%) with expenditure of $223 million in 2017 compared to $230 million in 2016.
Profit before tax in 2016 includes the $326 million profit on disposal of the Gynaecology business.

The Group has completed its review of the new US tax reform legislation, as enacted in December 2017, 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 tax benefit in 2017 as discussed below. 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.

Included in the total tax charge is a $32 million net benefit as a result of US tax reform legislation 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.

Our reported tax rate of 12.7% (2016: 26.2%) has decreased due to the $32 million net benefit in 2017 from US tax reform, the lower tax rate on trading results and the impact of the Gynaecology disposal in 2016. Our trading tax rate is 17.1% (2016: 23.8%) with the reduction due to a one-off benefit following the conclusion of a US tax audit, further progress in improving our tax rate, tax provision releases following expiry of statute of limitations and a beneficial geographical mix of profits.

BALANCE SHEET
Goodwill increased by $183 million as a result of $132 million arising on the acquisition of Rotation Medical, Inc. and favourable currency movements of $51 million. Intangible assets decreased by $40 million with net movements relating to additions, disposals and transfers of $70 million relating to intellectual property, distribution rights and software acquired together with $61 million recognised with the acquisition of Rotation Medical, Inc. Amortisation and impairment during 2017 was $202 million and there were favourable currency movements of $31 million.

Other non-current assets increased by $177 million primarily due to a $67 million increase in property, plant and equipment with additions offsetting depreciation, and the recognition of retirement benefit assets of $62 million for our UK and US pension schemes. Current assets increased by $202 million with trade and other receivables increasing $73 million primarily due to $45 million of foreign exchange, inventories increasing $60 million primarily due to foreign exchange and cash increasing $69 million due to the timing of receipts.

Non-current liabilities decreased by $162 million primarily due to payments made against our borrowing facilities. Current liabilities decreased by $2 million as a $73 million increase in trade and other payables arising from a $37 million foreign exchange increase and a $28 million timing difference on the payment of expenses associated with a patent litigation gain, which was partially offset by a $59 million decrease in bank overdrafts and loans and $18 million decrease in provisions.

CASH FLOW
Cash generated from operations of $1,273 million (2016: $1,035 million) is after paying out $3 million (2016: $24 million) of acquisition-related costs, $15 million (2016: $62 million) of restructuring and rationalisation expenses and $25 million (2016: $36 million) relating to legal and other costs.

Trading cash flow increased by $175 million primarily related to working capital movements.

Free cash flow increased by $257 million primarily related to working capital movements and lower cash outflows for acquisition-related costs, restructuring and rationalisation expenses and legal and other costs.

During the year ended 31 December 2017, the Group purchased a total of 3.2 million (2016: 24.0 million) ordinary shares at a cost of $52 million (2016: $368 million) as part of the ongoing programme to buy back an equivalent number of shares to those vesting as part of the employee share plans. 2016 share repurchases included a $300 million share buy-back programme following the disposal of the Gynaecology business.

DIVIDENDS
The 2016 final dividend of 18.5 US cents per ordinary share totalling $162 million was paid on 10 May 2017. The 2017 interim dividend of 12.3 US cents per ordinary share totalling $107 million was paid on 1 November 2017.

LIQUIDITY AND CAPITAL RESOURCES
The Group’s policy is to ensure that it has sufficient funding and facilities in place to meet foreseeable borrowing requirements.

The Group’s net debt decreased from $1,550 million at the beginning of 2017 to $1,281 million at the end of 2017, representing an overall decrease of $269 million.

At 31 December 2017, the Group held $155 million (2016: $38 million) in cash net of bank overdrafts. The Group had committed facilities available of $2,425 million at 31 December 2017 of which $1,425 million was drawn. Smith & Nephew intends to repay the $13 million of bank loans due within one year by 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 2017, as well as its other known or expected commitments or liabilities, can be met from its existing resources and facilities.

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

RETURN ON INVESTED CAPITAL
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 increased from 11.5% in 2016 to 14.3% in 2017 as a result of the improved operating profit, the lower tax rate and a stable asset base.

ROIC is defined as:

\[ \text{Return On Invested Capital (ROIC)} = \frac{\text{Net Operating Profit less Adjusted Taxes}}{(\text{Opening Net Operating Assets} + \text{Closing Net Operating Assets})/2} \]

\[ +280\text{bps} \]

\[ 14.3\% \]

**WHY THIS KPI IS IMPORTANT**
ROIC measures the return generated on capital invested by the Group.

**HOW WE PERFORMED**
ROIC was up 280bps year-on-year driven by improved operating profit, the lower tax rate and a stable asset base.

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1 These non-IFRS financial measures are explained and reconciled to the most directly comparable financial measure prepared in accordance with IFRS on pages 178–181.
OUR RISK MANAGEMENT PROCESS

Our Enterprise Risk Management process is based on a holistic approach to risk management, leveraging the best risk identification and risk treatments already in place throughout our Business Areas and Product Groups whilst incorporating the same risk processes into the strategic planning process. Our belief is that the strategic and operational benefits of managing risk are achieved when Enterprise Risk Management is aligned with the strategic and operational goals of the organisation and our process and governance structure firmly aligns to this approach.

In carrying out our business we face many risks and uncertainties and our Risk Management Policy and Enterprise Risk Management Manual ensure that our Risk Community can identify, review and report risks at every level of our business. At the very top of our structure is our Board, setting our risk appetite and monitoring the application of our risk framework through strategy, execution and practically through the outputs of regular risk ‘deep dives’ by the business and Group Risk Team. The Board cascades our risk appetite throughout our organisation through the Risk Committee, Risk Owner Community and our Management Group with a formal ‘bottom up’ process ensuring that risks are escalated back through the process to our Board and form our Principal Risks as appropriate. Providing rigour and independence across this process is our Executive Committee and the Group Risk Team. At the third line of defence is our Internal Audit Function, providing an annual opinion on the effectiveness of our Risk Management process to the Group Risk Committee chaired by the Chief Executive Officer and then to the Board and its committees.

Roles Responsibilities

- **Board of Directors and Board Committees**
  - Responsible for regular oversight of risk management and for our annual strategic risk review
  - Monitors risks through Board processes (Strategy Review, Disclosures, M&A, Investments, Disposals) and Committees (Audit and Ethics & Compliance), management reports and deep dives of selected risk areas
  - Audit Committee is responsible for ensuring oversight of the process by which risks relating to the Company and its operations are managed and for viewing the operating effectiveness of the Group’s Risk Management process

- **Group Risk Committee**
  - Reviews external/internal environment for emerging risks
  - Reviews risk register updates from Business Areas
  - Identifies significant risks and assesses effectiveness of mitigating actions

- **Business area/Product Risk Groups**
  - Business Area/Product Group Risk champion provides support to ensure a framework is designed and implemented for alignment to the requirements of the Enterprise Risk Management Framework
  - Carry out day-to-day risk management activities
  - Identify and assess risk
  - Implement strategy and mitigating actions to treat risk within Business/Product Risk Groups
  - Risk Champions lead regular risk register updates

- **Group Risk Team**
  - Manage implementation of all aspects of the Group’s approach to Enterprise Risk Management including implementation of processes, tools and systems to identify, assess, measure, manage, monitor and report risks
  - Facilitates implementation and coordination through Risk Champions
  - Provides resources and training to support process
  - Prepares Board and Group Risk Committee reports based on Business Area and Product Group updates

- **Annual assessment of effectiveness – Internal audit and control functions**
RISK MANAGEMENT LIFE CYCLE – OUR SEVEN-STEP PROCESS

Our risk management life cycle was refreshed and updated in 2017 to align with our new approach to include Product Groups within our risk portfolio. Our Risk Management Policy was launched in May with sponsorship from the Chief Executive Officer and a revised manual aligning to the new structure was launched shortly after. Risks continue to be managed through a ‘bottom up’ and ‘top down’ process, with monthly oversight from the Executive Committee and quarterly reports to the Board Committees. An overview of our ‘seven step’ process can be found below:

1. Risk Identification
   IDENTIFYING risks associated to achievement of our objectives by function and product and at the Group level. Early and continuous risk identification including existing and horizon risks.

2. Gross (inherent) Risk assessment
   ASSESSING the level of inherent (gross) risk.

3. Current Control identification
   IDENTIFYING existing controls to mitigate risks.

4. Net (residual) Risk
   ASSESSING the level of residual (net) risk after mitigation so that risk levels are managed within defined tolerance thresholds without being over controlled or foregoing desirable opportunities.

5. Risk Response Planning
   IDENTIFYING additional actions required to meet our expected risk tolerance level and ASSIGNING risk owners, timeframes and actions for ongoing management and reporting.

6. Risk Reporting
   REPORTING the status of our most significant risks through the ‘bottom up’ business area processes and the ‘top down’ Executive Committee and Board process. Demonstrating appropriate management of, and response to, our risk profile.

7. Monitoring and review
   MONITORING of risks and actions by management, the accountable Executive and Board. Coordinated and ongoing monitoring of the internal and external risk environment to respond to emerging and horizon risks.

An overview of the Risk Management and Reporting Process
We assess our Principal Risks in terms of their potential impact on our ability to deliver our Strategic Priorities. These links are highlighted across the following pages and further information on the Strategic Priorities is found on page 10.

**LEGAL AND COMPLIANCE RISKS**

Our global remit results in heavy regulation across multiple jurisdictions. There is increasing public scrutiny of ethics in business and ‘doing the right thing’ has become part of our licence to operate. National regulatory authorities enforce a complex pattern of laws and regulations that govern the design, development, approval, manufacture, labelling, marketing and sale of healthcare products.

Operating across this increasingly complex and dynamic legal and compliance environment, including regulations on bribery and corruption, with poor legal and compliance practices can lead to fines, penalties, reputational risk and competitive disadvantage. We have adopted a proactive, holistic approach, which guides the Company towards a culture of compliance and turns the resolution of legal and compliance issues into a source of competitive advantage.

**Risk Tolerance**

In complying with legal and compliance requirements, we have an extremely low tolerance.

**Change from 2016**

No Change

**Examples of risks**

- Failure to act in an ethical manner consistent with our Code of Conduct.
- Violation of anti-corruption or healthcare laws, breach by employee or third party representative.
- Failure to respond adequately to changes in legislation/ regulation.
- Misuse or loss of personal information of patients, employees, research subjects, consumers or customers results in violations of data privacy laws, including General Data Protection Regulations.

**Actions taken by management**

- Ethics & Compliance Committee oversees our ethical and compliance practices.
- All employees are required to undertake annual training and to certify compliance on an annual basis with our Code of Conduct and Business Principles.
- Group monitoring and auditing programmes in place.
- Confidential independent reporting channels for employees and third parties to report concerns.

**CYBER SECURITY**

High profile incidents coupled with increasing government focus has resulted in raised awareness of the extent and potential impact of cyber security breaches. Our increasing business dependence on networked systems and the Internet, the design of new products, connectable products and embedded software and the rapidly evolving cyber security threat landscape provides us with risk exposure not experienced in prior years. In response to this we have undertaken an exercise to understand our threats and vulnerabilities to target cyber security investment in the right places.

**Risk Tolerance**

In managing our cyber risk and the possible disruption and reputational impact we have a low to moderate tolerance for Cyber Security Risk.

**Change from 2016**

Included as ‘other risk’ in 2016

**Examples of risks**

- Loss of Intellectual Property/major data privacy breach or significant impact on business operations from Malware or Ransomware outbreak.
- Cyber Security is not considered in the design of new products with more products being connectable/having embedded software.

**Actions taken by management**

- Security information and event management (SIEM) in place providing real-time analysis of security alerts generated by applications and network hardware.
- Annual Penetration Testing, endpoint protection and Intrusion detection/prevention.
- Annual Mandatory training and continuous awareness training for end-users.
- Security Governance structure in place including a Cyber Security Steering Committee.
NEW PRODUCT INNOVATION, DESIGN & DEVELOPMENT INCLUDING INTELLECTUAL PROPERTY

Our product portfolio is becoming increasingly complex, especially as we move to more innovative connected product technologies and our strategy of ‘owning the disease’. Our success relies on investing in safe products and platforms and aligned internal and external design and development innovation in order to compete effectively. The need to be nimble and considered in our approach to protecting our products, process and Intellectual Property is essential.

Risk Tolerance
In pursuit of our strategy to be innovative but safe in our product offering we have a moderate to high tolerance for risk.

Change from 2016
No Change

Examples of risks
- Insufficient long-term planning to respond to competitor disruptive entries into marketplace.
- Inadequate innovation due to low R&D investment, R&D skills gap or poor product development execution.
- Lower value business segment investment, such as product maintenance and line extension projects.
- Competitors may assert patents or other intellectual property rights against the Company, or fail to respect the Company’s intellectual property rights.

Actions taken by management
- Newly created Global Research & Development (R&D) organisation and governance framework providing strategic direction for allocation of R&D investments across all businesses.
- R&D charter to transform our Innovation pipeline and drive our corporate strategy to Innovate for Value.
- Strengthened Clinical Affairs programme integrated with Global Marketing.
- Cross functional New Product Design and R&D processes focused on identifying new products and potentially disruptive technologies and solutions.
- Monitoring of external market trends and collation of customer insights to develop product strategies.
- Careful attention to intellectual property considerations.

QUALITY AND REGULATORY

Global regulatory bodies continue to increase their expectations on manufacturers and distributors of medical devices. Our products are implanted into human bodies and therefore Patient Safety is of paramount importance. The European Medical Device Regulations, launch of ISO13485-2016, the Medical Device Single Audit Programme and the tightening of the Chinese YY standards have increased the focus on clinical and technical evidence, supplier controls and continual product risk reduction.

Risk Tolerance
Our response to this risk continues to be critical and our ability to align and exceed the standards required to ensure safe and compliant products is the key driver for our extremely low tolerance for risk in this area.

Change from 2016
Modified Principal Risk in 2017 – formerly included as Operational Risk – Quality and Business Continuity

Examples of risks
- Defects in design or manufacturing of products supplied to, and sold by, the Company could lead to product recalls or product removal or result in loss of life or major injury.
- Significant non-compliance with policy, regulations or standards governing products and operations regarding registration, manufacturing, distribution, sales or marketing.
- Failure to obtain proper approvals for new or changed technologies, products or processes.

Actions taken by management
- Comprehensive product quality processes and controls from design to customer supply are in place.
- Careful attention to intellectual property considerations.
- Standardised monitoring and compliance with quality management practices through our Global Quality Assurance and Regulatory Affairs organisation.
- Incident management teams in place to respond immediately in the event of an incident relating to patient safety.
- Governance framework in place for reporting, investigating and responding to instances of product safety and complaints.
PRICING AND REIMBURSEMENT

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

We further face challenging market dynamics, such as consolidation of customers into buying groups, increasing professionalisation of procurement departments and the commoditisation of entire product groups, which continue to challenge prices.

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

Change from 2016
- No Change

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

Oversight
Board

Examples of risks
- Reduced reimbursement levels and increasing pricing pressures.
- Systemic challenge on number of elective procedures.
- Lack of compelling health economics data to support reimbursement requests.
- Risk of adverse trading margins due to fluctuating foreign currency exchange rates across our main manufacturing countries (US, UK, Costa Rica and China) and where our products are sold.

Actions taken by management
- Development of innovative economic product and service solutions for both Established and Emerging Markets.
- Appropriate breadth of portfolio and geographic spread to mitigate exposure to localised risks.
- Incorporating health economic components into the design and development of new products.
- Emphasising value propositions tailored to specific stakeholders and geographies through strategic investment and marketing programmes.
- Holding prices within acceptable ranges through global pricing corridors.

BUSINESS CONTINUITY AND BUSINESS CHANGE

Operating with a Global Remit, increased outsourcing and more sophisticated materials and product technology has made our manufacturing and supply chain process far more complex, leading to a greater potential for disruptive events. Ensuring our ability to continually execute and operate key sites and facilities in order to develop, manufacture and sell our products within this environment is a key strategic priority of the organisation. In addition, the pace and scope of our business 'change' initiatives increases the execution risk that benefits may not be fully realised, costs of these changes may increase, or that our business as usual activities may not perform in line with our plans.

Risk Tolerance
In operating our business, executing our change programmes and in managing our suppliers and facilities we have a **low to medium tolerance** for this risk.

Change from 2016
- Modified Principal Risk in 2017 – formerly included as Operational Risk – Quality and Business Continuity

Link to strategy
Our Strategic Priority to 'Simplify and Improve our Business Model' requires us to operate effectively and efficiently and to ensure continuity of supply of products and services to customers.

Oversight
Board

Examples of risks
- Failure or significant performance issues experienced at critical/single source facilities.
  - Disruption to manufacturing at single or sole source facility (lack of manufacturing redundancy).
  - Supplier failure impacts ability to meet customer demand (single source suppliers).
  - Natural disaster impacts ability to meet customer demand.
- Significant 'change' prevents our projects and programmes such as APEX achieving the intended benefits and disrupts existing business activities.
- Political and economic 'uncertainty' in the countries in which we operate, e.g. Brexit.

Actions taken by management
- Comprehensive product quality processes and controls are in place from design to customer supply.
- Emergency and Incident management and business recovery plans are in place at major facilities and for key products and key suppliers.
- Second source suppliers identified for critical components or products.
- Undertaking risk based review programmes for critical suppliers.
- Project Management Governance and toolkits and project Steering Committee Oversight to support successful execution of programme and projects. Executive Committee and Audit Committee oversight of Risks to change programmes.
- Brexit Steering Group regularly monitors the evolving impact of Brexit and oversees our response.
MERGERS AND ACQUISITIONS

As the Company grows to meet the needs of our customers and patients, we recognise that we are not able to develop all the products and services required using internal resources and therefore need to undertake mergers and acquisitions in order to expand our offering and to complement our existing business. In other areas, we may divest businesses which are no longer core to our activities. It is crucial for our long-term success that we make the right choices around acquisitions and divestments. We have a well-defined cross-functional process for managing risks associated with mergers and acquisitions that is subject to scrutiny from executive management and the Board of Directors.

Risk Tolerance
In acquiring new businesses and business models, we have a moderate to high tolerance for commercial risk and are willing to accept certain risks in pursuit of new business.

Change from 2016
No Change

Examples of risks
- Failure to identify appropriate acquisitions or to conduct effective acquisition due diligence.
- Failure to integrate newly acquired businesses effectively, including Company standards, policies and financial controls.

Actions taken by management
- Acquisition activity is aligned with corporate strategy and prioritised towards products, franchises and markets identified to have the greatest long-term potential.
- Clearly defined investment appraisal process based on return on capital, in accordance with Capital Allocation Framework and comprehensive post-acquisition review programme.
- Undertaking detailed and comprehensive cross-functional due diligence prior to acquisitions.
- Compliance risks included as part of due diligence reviews, integration plans and reporting for acquisitions.

Link to strategy
Our Strategic Priority to ‘Supplement Organic Growth with Acquisitions’ depends on our ability to identify the right acquisitions, to conduct thorough due diligence and to integrate acquisitions effectively.

Oversight
Board

TALENT MANAGEMENT

We recognise that people management, effective succession planning and the ability to attract and retain talent is of great importance to the success of our Company. In the current economic environment of strong competition and reduced spending, retention of top talent is a critical risk which requires a strong process in relation to retention and engagement. Failure to do so can result in risks in our ability to execute Company strategy and achieve business objectives in relevant functions and to be effective in the chosen market/discipline and leadership of newer workforce which may impact the Company’s future success.

Risk Tolerance
We have a moderate tolerance for this risk.

Change from 2016
Included as ‘other risk’ in 2016

Examples of risks
- Loss of key talent and lack of appropriate succession planning in context of required skill sets for future business needs.
- Loss of competitive advantage due to an inability to attract and retain Top Talent.
- Loss of intellectual capital due to poor retention of talent.

Actions taken by management
- Formal Talent Review process where the Executive Team has accountability for managing talent.
- Identification of high performing individuals and practices to plan for the succession of key roles.
- Consistent and robust performance Management process.
- Development of strategic skills resourcing plan by functional areas.

Link to strategy
All our strategic priorities rely on ensuring we have the right talent within our organisation to deliver maximum efficiency in everything we do and to build strong leaders for the future.

Oversight
Board

Examples of risks
- Loss of competitive advantage due to an inability to attract and retain Top Talent.
- Loss of intellectual capital due to poor retention of talent.

Actions taken by management
- Formal Talent Review process where the Executive Team has accountability for managing talent.
- Identification of high performing individuals and practices to plan for the succession of key roles.
- Consistent and robust performance Management process.
- Development of strategic skills resourcing plan by functional areas.
COMMERCIAL EXECUTION

We continue to make good and strong progress delivering our priorities and are proud of the pace with which our strategic and operational decisions are quickly translated into actions. Effective communication and engagement with our customers are critical to the long-term success of our business. We are confident that we have the right priorities, structures and capabilities across the Group and we acknowledge that only strong and continued execution will keep us ahead of our competitors and best placed to serve our customers. Failure to execute our priorities will impact our ability to continue to grow our business and serve our customers.

Risk Tolerance

In continuing to execute our priorities in an innovative, safe, profitable and compliant way we have a low to moderate tolerance level.

Change from 2016

+ Modified Principal Risk in 2017 – previously incorporated into other principal risks

Examples of risks

- Failure to adequately execute our strategy from high-level ambition to specific actions to make the ambition a reality.
- Inability to keep pace with significant product innovation and technical advances to develop commercially viable products.
- Failure to appropriately adapt our priorities and execution when conditions change meaning that transformational programmes do not deliver the expected outcomes.
- Failure to engage effectively with our key stakeholders to meet their evolving needs leading to loss of customers.

Actions taken by management

- Strengthened our commercial platform by creating a global commercial organisation with a remit to drive commercial performance across the Group through sales force excellence and pricing discipline.
- Newly created Global Research & Development organisation and supporting governance framework.
- Improved Market Development and Launch Execution – Commitment to ‘win’ profitably in our target markets.
- Strategic planning process clearly linked to business and Group Risk.
- Global transformational programmes in place providing agile opportunities for efficiencies, growth and a strengthened competitive position.

DEEP DIVES COMPLETED IN THE YEAR (Group Risk Team/Board and Audit Committee Reviews)

During the year, the risks identified through the ‘bottom up’ and ‘top down’ processes were mapped against each other with the most significant risks forming our Principal Risks. These risks and our tolerance levels were discussed with each member of Executive Committee separately and collectively in August and were presented to the Board during the Strategy Review in September 2017. A further ‘bottom up’ exercise was carried out in November to validate that the risk profile had not significantly changed since the initial exercise in June. No changes were required to our risk profile as a result of this exercise, which was also formally validated by each Accountable Executive.

Throughout 2017, a number of different risk topics were presented to the Board and its Committee and specific ‘Deep Dive’ reviews were also completed by the Group Risk Team as follows.

Board and Audit Committee Deep Dives

Legal, Compliance and Quality

During the year the Ethics & Compliance Committee meetings considers papers from the quality and regulatory, legal and compliance teams. In 2017, the meetings have covered topics including preparation for General Data Protection Regulation (GDPR) in EU, Medical Device Regulations (MDR), FDA & Notified Body Inspection Activities, the Global Quality and Compliance Audit programme, Transactions with Compliance Risks and the outcome of significant Investigations.

Strategic: Research and Development and M&A

The Board has considered a report from the R&D team covering topics/risk in relation to execution, driving high value Innovation Projects and investment in Clinical Evidence and associated strategies to manage these risks. Each Board meeting considers Corporate Development. For 2017, this has focused on the lead up to, and our acquisition of, Rotation Medical. Retrospective reviews have also happened during the year on previous acquisitions compared to the expectations in the deal models.

Manufacturing Operations

Throughout the year, the Board has received presentations from the global operations team with oversight of operational matters, particularly relating to the manufacturing footprint and the risks associated with the current footprint and the proposals to mitigate these risks.

Functional Oversight

The Board and Audit Committee receive regular updates throughout the year from functions such as IT, Tax, Treasury and Financial operations. The Audit Committee also receives an update three times during the year on progress of risk management across the organisation.

IT/Cyber

The Audit Committee received reports on IT and Cyber security, including an assessment of the existing risks and benchmarking against industry standards.

HR

Annual discussion at the Board in relation to talent succession, culture and values.

Group Risk Team Deep Dives

A series of planned ‘Deep Dives’ have been completed in the year across our Business and Product Group Risk Areas, including PICO, Total Knees and ALLEVYN product Groups, Compliance and Europe/Canada Business Areas. These reviews have been newly introduced in 2017 to supplement reports provided to the Board and primarily cover an ‘independent’ assessment of compliance to the expected Risk Management Framework and in particular the adequacy of stated mitigating activities. The results are reported through the Risk Champions and Accountable Executives to the Audit Committee and are tracked and monitored to resolution by the Group Risk Team.
2018 RISK MANAGEMENT PLAN

Our work will continue in 2018 to evolve and strengthen our approach to managing risks across the organisation, including our business areas and product groups. We will continue to ensure a truly collaborative approach to risk management with risk accountability sitting squarely with management and a proactive Group Risk Function influencing decision making through effective challenge and timely consultation. 2018 will see innovation further driven through a new Global Enterprise Risk Management tool, more regular and sophisticated risk reporting across the organisation and further embedding Risk Appetite into decision making.

2018 RISK MANAGEMENT TIMELINE

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<thead>
<tr>
<th>Q1 2018</th>
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<td><strong>Internal Audit</strong></td>
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<td><strong>Deep dive risk reviews</strong></td>
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<td><strong>Group Risk Team</strong></td>
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<td>– Monthly reports to Executive Committee</td>
<td>– Report to Audit Committee</td>
<td>– One to Ones with Executive Committee and Board</td>
<td>– Prepare Review of Principal Risks</td>
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<td>– Monthly reports to Executive Committee</td>
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<td>– Report to Audit Committee</td>
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<td><strong>Business/Product Risk Areas</strong></td>
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<td>– Quarterly Risk Review by Senior Leadership Team</td>
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<td>– Group Risk Team annual certification</td>
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<td>– ‘Top Down’ Review of Principal/Significant Risks</td>
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<td>– Review of significant risks</td>
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<td>– Review and approval of the Group’s 2017 Risk Management Process and Viability Statement</td>
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<td>– Receive report from the Group Risk Team and review Enterprise Risk Management process</td>
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HOW WE ASSESS OUR PROSPECTS

During the year, the Board has carried out a robust assessment of the Principal Risks affecting the Company, particularly those which could threaten the business model. These risks and the actions being taken to manage or mitigate them are explained in detail on pages 42–46 of this Annual Report.

In reaching our Viability Statement conclusion, we have undertaken the following process:

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

– In the summer, a series of detailed one-to-one discussions were held with each member of the Executive Committee and the Group Risk Team. In these discussions, the Executives were asked to consider the significant risks which they believed could seriously impact the profitability and future prospects of the Company and the principal risks that would threaten its business model, future performance, solvency or liquidity.

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

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

– Throughout the year, a number of deep dives into specific risk areas were conducted by the Group Risk Team, the results of which were presented to and discussed by the Audit Committee.

ASSESSMENT PERIOD

The Board have determined that the three-year period to December 2020 is an appropriate period over which to provide its Viability Statement. This period is aligned to the Group’s Strategic Planning process and reflects the Board’s best estimate of the future viability of the business.

2017 SCENARIOS MODELLLED

**Scenario 1 – Pricing**

- Pricing and reimbursement pressures or currency exchange volatility (Principal Risk) – leading to a major loss of revenues and profits.
  
  **Action taken:** We have modelled a 1% reduction in annual price growth/decline for each year from 2018.

**Scenario 2 – Operational risk**

- Execution risk – our inability to launch new products losing significant market share to the competition.
  
  **Action taken:** We have modelled a 1% reduction in annual volume growth rates each year from 2018.

- Product liability claims – giving rise to significant claims and legal fees.
  
  **Action taken:** We have modelled a one-off significant product liability claim in 2019.

- Temporary loss of key production capability – resulting in our inability to manufacture a key product for a period of time.
  
  **Action taken:** We have modelled the loss of a factory, resulting in the loss of production and sales of a key product for two years from 2019.

**Scenario 3 – Legal regulatory and compliance risks**

- Regulatory measures – impacting our ability to continue to sell key products.
  
  **Action taken:** We have modelled the complete loss of revenue from a key product for each year from 2018.

- Bribery and corruption claims – giving rise to significant fines.
  
  **Action taken:** We have assumed a one-off significant fine in 2019.

**Scenario 4 – Cyber security**

- Inability to issue invoices or collect money for a period of time.
  
  **Action taken:** We have modelled one of our key regions being unable to invoice sales and collect cash for one month in 2019.

**Other**

- Political and economic forces – for example political upheaval, which could cause us to withdraw from a major market for a period of time.
  
  **Action taken:** We have modelled the loss of revenue and profits from a medium sized business due to withdrawal from a market from 2019.
SCENARIO TESTING
For the purpose of testing the viability of the Company, we have undertaken a robust scenario assessment of the principal risks and some other risks, which could threaten the viability or existence of the Company. These have been modelled as follows:

In carrying out scenario modelling of the principal and significant risks on the previous page we have also evaluated the impact of a severe but plausible combination of these risks actually occurring over the three-year period. We have considered and discussed a report setting out the terms of our current financing arrangements and potential capacity for additional financing should this be required in the event of one of the scenarios modelled occurring.

We are satisfied that we have robust mitigating actions in place as detailed on pages 42–46 of this Annual Report. We recognise, however, that the long-term viability of the Company could also be impacted by other, as yet unforeseen, risks or that the mitigating actions we have put in place could turn out to be less effective than intended.

VIABILITY STATEMENT
Having assessed the principal risks, the Board has determined that we have a reasonable expectation that the Company will be able to continue in operation and meet its liabilities as they fall due over a period of three years from 1 January 2018. In our long-term planning we consider horizons of both five and ten years. However, as most of our efforts are focused on the coming three years, we have chosen this period when considering our viability.

Our conclusion is based on our current Strategic Plan approved by the Board in January 2018, having regard to longer-term strategic intentions, yet to be formulated in detail. However, we operate in a changing marketplace, which might cause us to adapt our Strategic Plans. In responding to changing external conditions, we will continue to evaluate any additional risks involved which might impact the business model.

By order of the Board, on 22 February 2018

Susan Swabey
Company Secretary