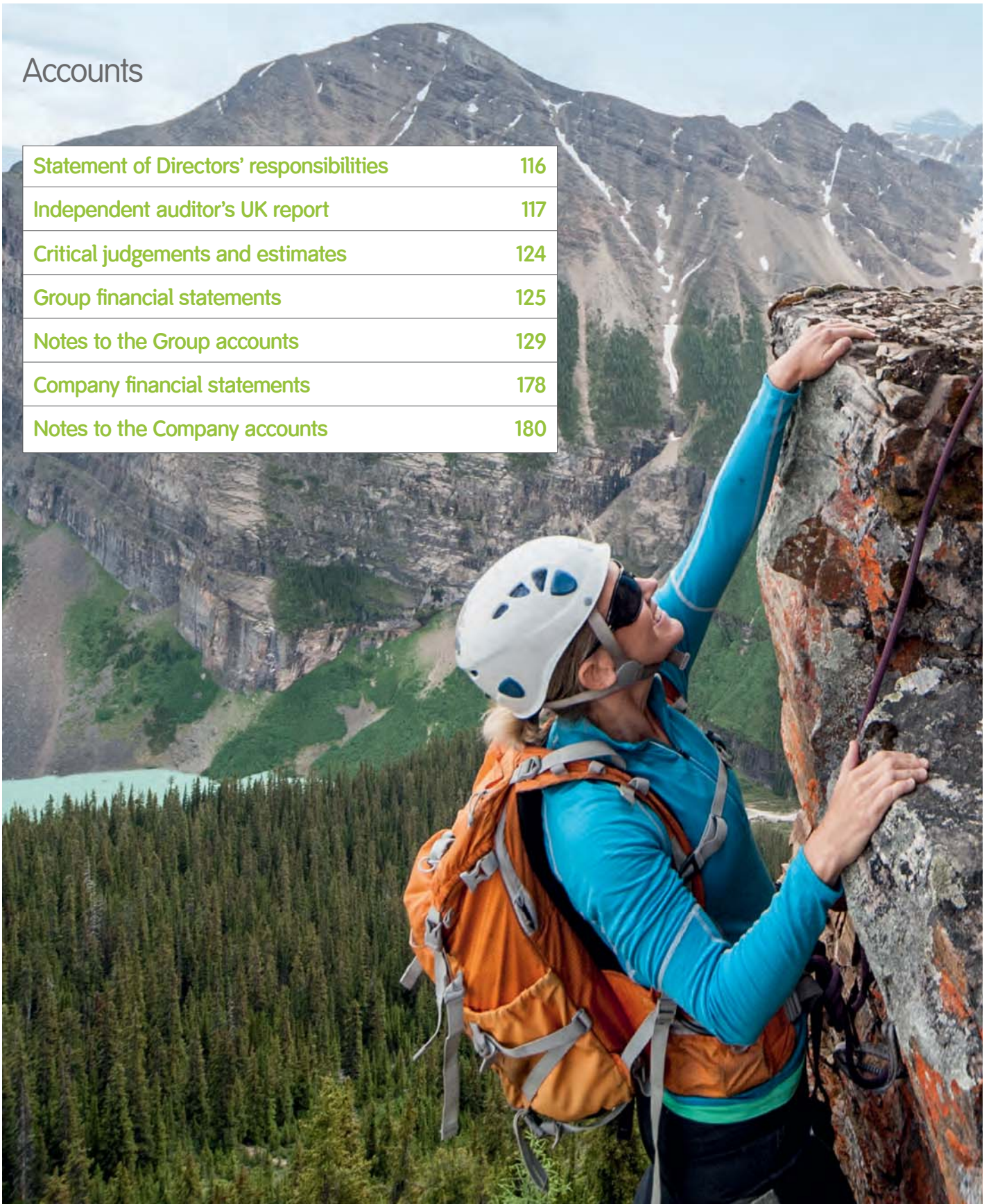


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GROUP FINANCIAL STATEMENTS

Statement of Directors' Responsibilities in respect of the Annual Report and the Financial Statements

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

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

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

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

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

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

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

RESPONSIBILITY STATEMENT OF THE DIRECTORS IN RESPECT OF THE ANNUAL REPORT

We confirm that to the best of our knowledge:

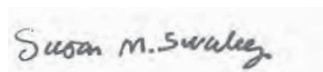
- the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole; and
- the Strategic Report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

The Strategic Report, which has been prepared in accordance with the requirements of the Companies Act 2006, comprises pages 2–51.

The Directors' Report has also been prepared in accordance with the Companies Act 2006 and The Small Companies and Groups (Accounts and Directors' Report) Regulations 2008 comprising of pages 2, 10–11, 24–25, 32–39, 40–83, 116, 154–156, 173 and pages 187–209 of the Annual Report, and has been approved and signed on behalf of the Board.

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

By order of the Board, on 21 February 2019



Susan Swabey
Company Secretary



Independent auditor's UK report

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

1. Our opinion is unmodified

We have audited the financial statements of Smith & Nephew plc ("the Company") for the year ended 31 December 2018 which comprise the Group Income Statement, Group Statement of Comprehensive Income, Group Balance Sheet, Group Cash Flow Statement, Group Statement of Changes in Equity, Company Balance Sheet, Company Statement of Changes in Equity, and the related notes which includes the accounting policies.

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the Parent Company's affairs as at 31 December 2018 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs as adopted by the EU);
- the Parent Company financial statements have been properly prepared in accordance with UK accounting standards, including FRS 101 Reduced Disclosure Framework; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

Additional opinion in relation to IFRSs as issued by the IASB

As explained in the accounting policies set out in the Group financial statements, the Group, in addition to complying with its legal obligation to apply IFRS as adopted by the EU, has also applied IFRS as issued by the International Accounting Standards Board (IASB).

In our opinion, the Group financial statements have been properly prepared in accordance with IFRS as issued by the IASB.

Basis for opinion

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

We were appointed as auditor by the shareholders on 9 April 2015. The period of total uninterrupted engagement is for the 4 financial years ended 31 December 2018. We have fulfilled our ethical responsibilities under, and we remain independent of the Group in accordance with, UK ethical requirements including the FRC Ethical Standard as applied to listed public interest entities. No non-audit services prohibited by that standard were provided.

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

Key audit matters are those matters that, in our professional judgment, were of most significance in the audit of the financial statements and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by us, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. We summarise below the key audit matters (unchanged from 2017), in decreasing order of audit significance, in arriving at our audit opinion above, together with our key audit procedures to address those matters and, as required for public interest entities our results from those procedures. These matters were addressed, and our results are based on procedures undertaken, in the context of, and solely for the purpose of, our audit of the financial statements as a whole, and in forming our opinion thereon, and consequently are incidental to that opinion, and we do not provide a separate opinion on these matters.

GROUP FINANCIAL STATEMENTS

Independent auditor's UK report continued

RECOGNITION AND MEASUREMENT OF PROVISIONS FOR UNCERTAIN DIRECT TAX

Risk vs 2017:



The risk	Our response
<p>UNCERTAIN OUTCOME</p> <p>Provisions for tax uncertainties require the directors to make judgements and estimates in relation to tax issues and exposures given that the Group operates in a number of tax jurisdictions, the complexities of transfer pricing and other international tax legislation and the time taken for tax matters to be agreed with tax authorities.</p> <p>A provision of \$178 million (2017: \$201 million) has been recognised for uncertain tax positions, including \$nil in respect of a potential exposure under EU State Aid rules.</p> <p>The effect of these matters is that, as part of our risk assessment, we determined that the provision has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole. The financial statements (note 5.1) disclose the range estimated by the Group.</p>	<p>Our procedures included:</p> <ul style="list-style-type: none"> – Control operation: Testing the design and operating effectiveness of controls that the Group has in place to identify and quantify its uncertain direct tax exposures. – Our taxation expertise: With the assistance of our international and local tax specialists, assessing the Group's direct tax positions and analysing and challenging the assumptions used to determine tax provisions and contingencies based on our knowledge and experience of the application of international and local legislation by the relevant authorities and courts. – Test of detail: Examining the calculations prepared by the Directors and agreeing key inputs used to underlying data. – Inspecting correspondence with relevant tax authorities and assessing third party tax advice received to evaluate the conclusions drawn from the advice where relevant to the significant exposures faced by the Group. – Assessing transparency: Assessing the adequacy of the Group's disclosures in respect of the uncertain direct tax provisioning. <p>Our results:</p> <ul style="list-style-type: none"> – We found the level of provisioning in respect of uncertain direct tax positions and related contingent liabilities to be acceptable (2017: acceptable).

⇒ Refer to page 77 (Audit Committee Report), page 139 (accounting policy) and pages 140–141 (financial disclosures).

LIABILITY PROVISIONING FOR METAL-ON-METAL HIP PRODUCTS

Risk vs 2017:



The risk	Our response
<p>SUBJECTIVE ESTIMATE</p> <p>As disclosed in note 17 the Group holds a provision of \$192 million (2017: \$157 million) in respect of potential liabilities arising from the ongoing exposure for metal-on-metal hip products.</p> <p>The estimate for this provision requires the Directors to use a statistical model and make a number of key assumptions which include the expected number of claimants, projected value of each settlement and the likely time period expected for the settlements.</p> <p>The financial statements (note 17.1) disclose the range estimated by the Group.</p>	<p>Our procedures included:</p> <ul style="list-style-type: none"> – Control operation: Testing the design and operating effectiveness of controls that Group has in place to identify and quantify its provision for metal-on-metal hip products. – Enquiry of lawyers: Inspection of correspondence with external counsel and written enquiries of external counsel on the status of open cases. – Test of detail: Examining the calculations prepared by the Directors and agreeing key inputs used to underlying data. – For the cases identified from written enquiries of external counsel assessing whether these have been adequately considered by the Directors in making their estimate. – Our actuarial expertise: With the assistance of our actuarial specialists, challenging the critical assumptions used in statistical projections in determining the estimated liability by reference to historical data including settlement amounts. – Assessing transparency: Assessing the adequacy of the Group's disclosures in respect of the metal-on-metal hip provision. <p>Our results:</p> <ul style="list-style-type: none"> – We found the level of provisioning in respect of metal-on-metal hip products to be acceptable (2017: acceptable).

⇒ Refer to page 77 (Audit Committee Report), page 162 (accounting policy) and page 162–163 (financial disclosures).

REVENUE RELATED REBATES

Risk vs 2017



The risk

RISK OF ERROR

The Group has a variety of agreements with wholesalers and distributors whereby contractual rebates are due to customers. As disclosed in note 2.1 rebates deducted against revenue in the year amounted to \$335 million.

The contractual arrangement for rebates can vary by customer, product type and jurisdiction.

The amount of revenue recognised for products sold through these channels (wholesale customers and distributors) require the Directors to calculate these contractual rebates which are deducted in arriving at revenue recorded in the period.

Due to the variations in complexity of these arrangements, we consider that there is a risk or error in calculating the rebate or amounts that have yet to be agreed with the customer.

Our response

Our procedures included:

- **Control operation:** Evaluating the design and operating effectiveness of controls that the Group has in place over the identification, estimation and settlement of rebates.
- **Inspection of customer contracts:** Inspecting underlying contractual terms and correspondence with customers for a selection of arrangements in place and considering whether the terms of the rebate, discount and/or returns have been applied correctly in calculating the rebate.
- **Test of detail:** Performing detailed testing on a sample basis of the largest rebates with particular attention to whether the adjustments were recognised in the correct period and the completeness of any rebates accrued at the year-end by comparison with contractual commitments agreed with customers.

Our results:

The results of our testing were satisfactory and we considered the rebates estimated to be acceptable (2017: acceptable).

⇒ Refer to page 133 (accounting policy) and page 133–134 (financial disclosures).

EXCESS AND OBSOLESCENCE (E&O) PROVISION FOR ORTHOPAEDICS INVENTORY

Risk vs 2017:



The risk

FORECAST-BASED VALUATION

In line with industry practice, the Group has high levels of orthopaedics inventory located at customer premises to be available for immediate use by surgeons. Complete product sets include outsizes which are used infrequently. Towards the end of a product's life cycle, finished goods inventory levels may exceed requirements, in particular as it relates to inventory used less frequently.

Historical sales of inventory are indicative of future usage, adjusted for changes in market demand, technological advancements or other factors.

In calculating the provision for excess and obsolete inventory (E&O provision) disclosed in note 12 of \$305 million (2017: \$296 million) the Directors have to estimate the utilisation of inventory on hand based on forecast production and sales.

Our response

Our procedures included:

- **Control operation:** Evaluating the design and operating effectiveness of controls the Group has in place over the preparation, review and approval of E&O provision.
- **Methodology implementation:** Considering whether the Group accounting policy was in line with accounting standards and comparing the calculation of E&O provision to the principles outlined in the Group accounting policy.
- **Test of detail:** Assessing key underlying assumptions in the E&O provision calculation. These include expected usage of inventory based on historical sales and other internal or external factors such as new product launches and delays in regulatory approvals which may impact the demand for the product. Corroborating key assumptions (historical revenue and future revenue projections) against prior year actuals and challenging budgets/forecasts with reference to historic performance.
- **Inquiry of management:** Performing inquiry of finance personnel to corroborate the Directors' plans for launching new or discontinuing product lines.
- **Historical comparisons:** Comparing provisions held in prior years to actual inventory write-offs to assess the accuracy by which the Directors were able to forecast this E&O provision.
- **Assessing transparency:** Assessing the adequacy of the Group's disclosures in respect of E&O provision.

Our results:

The results of our testing were satisfactory and we considered the E&O provisions made to be acceptable (2017: acceptable).

⇒ Refer to page 77 (Audit Committee Report), page 151 (accounting policy) and page 152 (financial disclosures).

GROUP FINANCIAL STATEMENTS

Independent auditor's UK report continued

PARENT COMPANY FINANCIAL STATEMENTS: RECOVERABILITY OF PARENT COMPANY'S INVESTMENT IN SUBSIDIARIES

Risk vs 2017: 

The risk	Our response
<p>LOW RISK, HIGH VALUE</p> <p>The carrying amount of the Parent Company's investments in subsidiaries held at cost less impairment represents 78% (2017: 86%) of the Parent Company's total assets.</p> <p>We do not consider the valuation of these investments to be at a high risk of significant misstatement, or to be subject to a significant level of judgement. However, due to their materiality in the context of the Parent Company financial statements as a whole, this is considered to be the area which had the greatest effect on our overall audit strategy and allocation of resources in planning and completing our parent company audit.</p>	<p>Our procedures included:</p> <ul style="list-style-type: none"> – Test of details: Comparing a sample of the highest value investments representing 98% (2017: 98%) of the total investment balance with the relevant subsidiaries' draft balance sheets to identify whether their net assets, being an approximation of their minimum recoverable amount, were in excess of their carrying amount and assessing whether those subsidiaries have historically been profit-making. – Assessing subsidiary audits: Assessing the work performed by the subsidiary audit team on that sample of subsidiaries and considering the results of their work, on those subsidiaries' profits and net assets. – Comparing valuations: For the investments where the carrying amount exceeded the net asset value, comparing the carrying amount of the investment with the expected value of the business based on a suitable multiple of subsidiaries' profits. <p>Our results:</p> <ul style="list-style-type: none"> – We found the Company's assessment of the recoverability of the investment in subsidiaries to be acceptable (2017: acceptable).

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

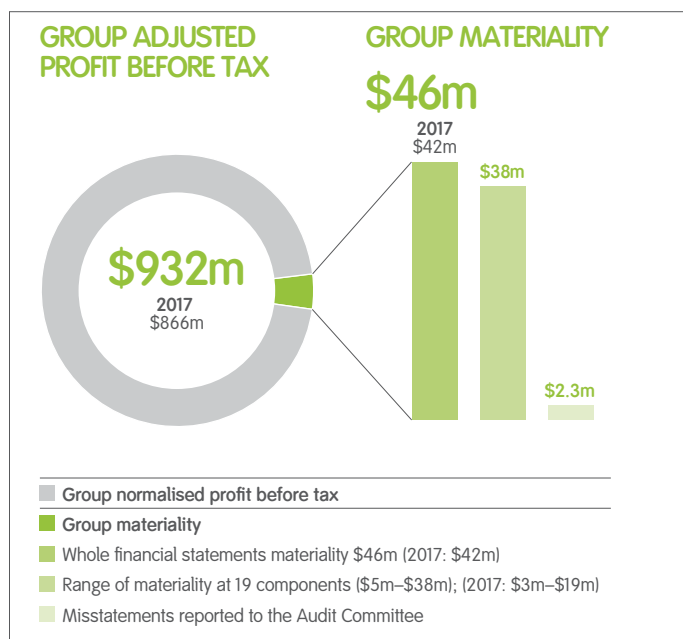
Materiality for the Group financial statements as a whole was set at \$46 million (2017: \$42 million), determined with reference to a benchmark of Group profit before tax, normalised to exclude restructuring costs of \$120 million (2017: \$nil), legal and other charges of \$38 million (2017: net credit of \$13 million), a credit of \$7 million (2017: \$10 million) related to acquisition items and an impairment charge of \$nil (2017: £10 million) as disclosed in note 2.2 of which it represents 4.9% (2017: 4.8%).

Materiality for the Parent Company financial statements as a whole was set at \$36 million (2017: \$31 million), determined with reference to a benchmark of company total assets, of which it represents 0.4% (2017: 0.4%).

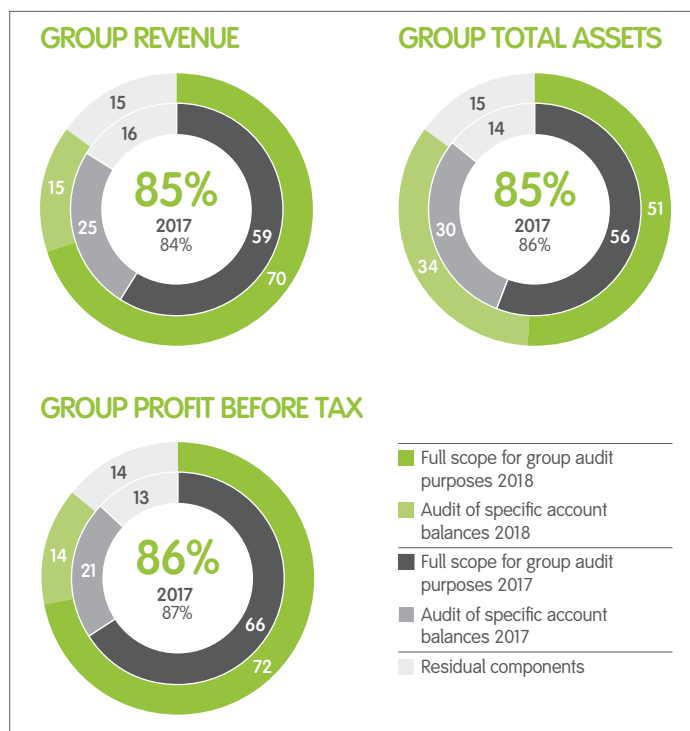
We agreed to report to the Audit Committee any corrected or uncorrected identified misstatements exceeding \$2.3 million (2017: \$2.0 million), in addition to other identified misstatements that warranted reporting on qualitative grounds.

Of the Group's 109 (2017: 110) reporting components, we subjected 9 (2017: 24) to full scope audits for Group purposes and 27 (2017: 13) to audits of specific account balances including revenue, receivables, cash (6 (2017: 6)) and inventory (3 (2017: 3)).

The latter were not individually financially significant enough to require a full scope audit for Group purposes, but did present specific individual risks that needed to be addressed or were included in the scope of our Group reporting work in order to provide further coverage over the Group's results.



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



The remaining 15% (2017: 16%) of total Group revenue, 14% (2017: 13%) of Group profit before tax and 15% (2017: 14%) of total Group assets is represented by 73 (2017: 73) reporting components, none of which individually represented more than 2% (2017: 2%) of any of total Group revenue, Group profit before tax or total Group assets. For these residual components, we performed analysis at an aggregated Group level to re-examine our assessment that there were no significant risks of material misstatement within these.

The Group team instructed component auditors as to the significant areas to be covered, including the relevant risks detailed above and the information to be reported back. The Group team approved component materiality, which ranged from \$5 million to \$38 million (2017: \$3 million to \$19 million), having regard to the mix of size and risk profile of the Group across the components. The work on 19 of the 36 components (2017: 19 of the 37 components) was performed by component auditors and the rest, including the audit of the Parent Company, was performed by the Group team. The Group team performed procedures on the items excluded from normalised Group profit before tax.

The Group team visited 6 (2017: 10) component locations in USA, Australia, Turkey, Japan, Switzerland and Germany (2017: USA, China, France, Italy, Spain, UK, South Africa, Costa Rica, Switzerland and Germany) to assess the audit risk and strategy. Video and telephone conference meetings were also held with these component auditors and others that were not physically visited. At these visits and meetings, the findings reported to the Group team were discussed in more detail, and any further work required by the Group team was then performed by the component auditor.

4. We have nothing to report on going concern

The Directors have prepared the financial statements on the going concern basis as they do not intend to liquidate the Company or the Group or to cease their operations, and as they have concluded that the Company's and the Group's financial position means that this is realistic. They have also concluded that there are no material uncertainties that could have cast significant doubt over their ability to continue as a going concern for at least a year from the date of approval of the financial statements ("the going concern period").

Our responsibility is to conclude on the appropriateness of the Directors' conclusions and, had there been a material uncertainty related to going concern, to make reference to that in this audit report. However, as we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgements that were reasonable at the time they were made, the absence of reference to a material uncertainty in this auditor's report is not a guarantee that the Group and the Company will continue in operation.

In our evaluation of the Directors' conclusions, we considered the inherent risks to the Group's and Company's business model, including the impact of Brexit, and analysed how those risks might affect the Group's and Company's financial resources or ability to continue operations over the going concern period.

The risks that we considered most likely to adversely affect the Company's available financial resources over this period were:

- Pricing and reimbursement pressures or currency exchange volatility leading to a major loss of revenues and profit;
- Inability to launch new products losing significant market share to the competition;
- Product liability claims – giving rise to significant claims and legal fees; and
- Temporary loss of key production capability – resulting in an inability to manufacture a key product for a period of time.

GROUP FINANCIAL STATEMENTS

Independent auditor's UK report continued

As these were risks that could potentially cast significant doubt on the Company's ability to continue as a going concern, we considered sensitivities over the level of available financial resources indicated by the Company's financial forecasts taking account of reasonably possible (but not unrealistic) adverse effects that could arise from these risks individually and collectively and evaluated the achievability of the actions the Directors consider they would take to improve the position should the risks materialise. We also considered less predictable but realistic second order impacts, such as the impact of a disorderly Brexit which could result in a rapid reduction of available financial resources.

Based on this work, we are required to report to you if:

- we have anything material to add or draw attention to in relation to the directors' statement in page 116 to the financial statements on the use of the going concern basis of accounting with no material uncertainties that may cast significant doubt over the Group and Company's use of that basis for a period of at least twelve months from the date of approval of the financial statements; or
- the related statement under the Listing Rules set out on page 82 is materially inconsistent with our audit knowledge.

We have nothing to report in these respects, and we did not identify going concern as a key audit matter.

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

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

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

Strategic report and directors' report

Based solely on our work on the other information:

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

Directors' remuneration report

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

Disclosures of principal risks and longer-term viability

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

- the directors' confirmation within the viability statement on page 82 that they have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency and liquidity;
- the Principal Risks disclosures describing these risks and explaining how they are being managed and mitigated; and
- the directors' explanation in the viability statement of how they have assessed the prospects of the Group, over what period they have done so and why they considered that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

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

Our work is limited to assessing these matters in the context of only the knowledge acquired during our financial statements audit. As we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgements that were reasonable at the time they were made, the absence of anything to report on these statements is not a guarantee as to the Group's and Company's longer-term viability.

Corporate governance disclosures

We are required to report to you if:

- we have identified material inconsistencies between the knowledge we acquired during our financial statements audit and the directors' statement that they consider that the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy; or
- the section of the annual report describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.

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

We have nothing to report in these respects.

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

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

- adequate accounting records have not been kept by the Parent Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the Parent Company financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns; or

- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

We have nothing to report in these respects.

7. Respective responsibilities

Directors' responsibilities

As explained more fully in their statement set out on page 116, the directors are responsible for: the preparation of the financial statements including being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the Group and parent Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the Group or the Parent Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities

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

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

Irregularities – ability to detect

We identified areas of laws and regulations that could reasonably be expected to have a material effect on the financial statements from our general commercial and sector experience and through discussion with the directors and other management (as required by auditing standards), and from inspection of the Group's regulatory and legal correspondence and discussed with the directors and other management the policies and procedures regarding compliance with laws and regulations. We communicated identified laws and regulations throughout our team and remained alert to any indications of non-compliance throughout the audit. This included communication from the Group to component audit teams of relevant laws and regulations identified at group level.

The potential effect of these laws and regulations on the financial statements varies considerably.

Firstly, the Group is subject to laws and regulations that directly affect the financial statements including financial reporting legislation (including related companies legislation), distributable profits legislation and taxation legislation and we assessed the extent of compliance with

these laws and regulations as part of our procedures on the related financial statement items.

Secondly, the Group is subject to many other laws and regulations where the consequences of non-compliance could have a material effect on amounts or disclosures in the financial statements, for instance through the imposition of fines or litigation or the loss of the Group's licence to operate. We identified the following areas as those most likely to have such an effect: Food and Drug Administration regulations in the US and the compliance of business practices with the UK Bribery Act and the US Foreign Corrupt Practices Act recognising the regulated nature of the Group's activities. Auditing standards limit the required audit procedures to identify non-compliance with these laws and regulations to enquiry of the directors and other management and inspection of regulatory and legal correspondence, if any. These limited procedures did not identify actual or suspected non-compliance.

Owing to the inherent limitations of an audit, there is an unavoidable risk that we may not have detected some material misstatements in the financial statements, even though we have properly planned and performed our audit in accordance with auditing standards. For example, the further removed non-compliance with laws and regulations (irregularities) is from the events and transactions reflected in the financial statements, the less likely the inherently limited procedures required by auditing standards would identify it. In addition, as with any audit, there remained a higher risk of non-detection of irregularities, as these may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls. We are not responsible for preventing non-compliance and cannot be expected to detect non-compliance with all laws and regulations.

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

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

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

Chartered Accountants
15 Canada Square, London E14 5GL
21 February 2019

GROUP FINANCIAL STATEMENTS

Critical judgements and estimates

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

The Group's accounting policies do not include any critical judgements. The Group's accounting policies are set out in Notes 1–24 of the Notes to the Group Accounts. Of those, the policies which require the most use of management's estimation are as follows:

VALUATION OF INVENTORIES

A feature of the Orthopaedic Reconstruction and Trauma & Extremities franchises (whose inventory make up approximately 60% of the Group's total inventory) is the high level of product inventory required, some of which is located at customer premises and is available for customers' immediate use. Complete sets of products, including large and small sizes, have to be made available in this way. These sizes are used less frequently than standard sizes and towards the end of the product life cycle are inevitably in excess of requirements. Adjustments to carrying value are therefore required to be made to orthopaedic inventory to anticipate this situation. These adjustments are calculated in accordance with a formula based on levels of inventory compared with historical usage. This formula is applied on an individual product line basis and is first applied when a product group has been on the market for two years. This method of calculation is considered appropriate based on experience, but it does require management estimate in respect of customer demand, effectiveness of inventory deployment, length of product lives, phase-out of old products and efficiency of manufacturing planning systems.

IMPAIRMENT

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

LIABILITY PROVISIONING

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

TAXATION

The Group operates in numerous tax jurisdictions around the world and it is Group policy to submit its tax returns to the relevant tax authorities as promptly as possible. At any given time, the Group is involved in disputes and tax audits and will have a number of tax returns potentially subject to audit. Significant issues may take several years to resolve. In estimating the probability and amount of any tax charge, management takes into account the views of internal and external advisers and updates the amount of tax provision whenever necessary. The ultimate tax liability may differ from the amount provided depending on factors including interpretations of tax law, settlement negotiations or changes in legislation.

Group income statement

	Notes	Year ended 31 December 2018 \$ million	Year ended 31 December 2017 \$ million	Year ended 31 December 2016 \$ million
Revenue	2	4,904	4,765	4,669
Cost of goods sold		(1,298)	(1,248)	(1,272)
Gross profit		3,606	3,517	3,397
Selling, general and administrative expenses	3	(2,497)	(2,360)	(2,366)
Research and development expenses	3	(246)	(223)	(230)
Operating profit	2 & 3	863	934	801
Interest income	4	8	6	6
Interest expense	4	(59)	(57)	(52)
Other finance costs	4	(20)	(10)	(16)
Share of results of associates	11	(11)	6	(3)
Profit on disposal of business	21	–	–	326
Profit before taxation		781	879	1,062
Taxation	5	(118)	(112)	(278)
Attributable profit for the year¹		663	767	784
Earnings per ordinary share¹	6			
Basic		76.0¢	87.8¢	88.1¢
Diluted		75.7¢	87.7¢	87.8¢

Group statement of comprehensive income

	Notes	Year ended 31 December 2018 \$ million	Year ended 31 December 2017 \$ million	Year ended 31 December 2016 \$ million
Attributable profit for the year¹		663	767	784
Other comprehensive income:				
<i>Items that will not be reclassified to income statement</i>				
Re-measurement of net retirement benefit obligations	18	11	64	(81)
Taxation on other comprehensive income	5	(1)	(9)	10
Total items that will not be reclassified to income statement		10	55	(71)
<i>Items that may be reclassified subsequently to income statement</i>				
Cash flow hedges – forward foreign exchange contracts:				
Gains/(losses) arising in the year		21	(45)	(15)
Losses transferred to inventories for the year		2	21	20
Fair value remeasurement of available for sale asset		–	(10)	10
Exchange differences on translation of foreign operations		(132)	181	(134)
Taxation on other comprehensive income	5	(3)	–	–
Total items that may be reclassified subsequently to income statement		(112)	147	(119)
Other comprehensive (loss)/income for the year, net of taxation		(102)	202	(190)
Total comprehensive income for the year¹		561	969	594

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

⇨ The Notes on pages 129–177 are an integral part of these accounts.

GROUP FINANCIAL STATEMENTS

Group balance sheet

	Notes	At 31 December 2018 \$ million	At 31 December 2017 \$ million
Assets			
Non-current assets			
Property, plant and equipment	7	1,062	1,049
Goodwill	8	2,337	2,371
Intangible assets	9	1,210	1,371
Investments	10	34	21
Investments in associates	11	105	118
Other non-current assets	13	16	16
Retirement benefit assets	18	92	62
Deferred tax assets	5	126	127
		4,982	5,135
Current assets			
Inventories	12	1,395	1,304
Trade and other receivables	13	1,317	1,258
Cash at bank	15	365	169
		3,077	2,731
Total assets		8,059	7,866
Equity and liabilities			
Equity attributable to owners of the Company			
Share capital	19	177	178
Share premium		608	605
Capital redemption reserve		18	17
Treasury shares	19	(214)	(257)
Other reserves		(340)	(228)
Retained earnings		4,625	4,329
Total equity		4,874	4,644
Non-current liabilities			
Long-term borrowings	15	1,301	1,423
Retirement benefit obligations	18	114	131
Other payables	14	53	128
Provisions	17	153	97
Deferred tax liabilities	5	99	97
		1,720	1,876
Current liabilities			
Bank overdrafts, borrowings and loans	15	164	27
Trade and other payables	14	957	957
Provisions	17	121	129
Current tax payable	5	223	233
		1,465	1,346
Total liabilities		3,185	3,222
Total equity and liabilities		8,059	7,866

The accounts were approved by the Board and authorised for issue on 21 February 2019 and are signed on its behalf by:

Roberto Quarta
Chairman

Namal Nawana
Chief Executive Officer

Graham Baker
Chief Financial Officer

⇒ The Notes on pages 129–177 are an integral part of these accounts.

Group cash flow statement

	Notes	Year ended 31 December 2018 \$ million	Year ended 31 December 2017 \$ million	Year ended 31 December 2016 \$ million
Cash flows from operating activities				
Profit before taxation		781	879	1,062
Net interest expense	4	51	51	46
Depreciation, amortisation and impairment		435	447	463
Loss on disposal of property, plant and equipment and software		19	13	15
Share-based payments expense (equity settled)	23	35	31	27
Share of results of associates	11	11	(6)	3
Profit on disposal of business	21	–	–	(326)
Net movement in post-retirement benefit obligations		(35)	(40)	(85)
Increase in inventories		(152)	(17)	(47)
Increase in trade and other receivables		(108)	(40)	(74)
Increase/(decrease) in trade and other payables and provisions		71	(45)	(49)
Cash generated from operations¹		1,108	1,273	1,035
Interest received		2	2	3
Interest paid		(54)	(50)	(48)
Income taxes paid		(125)	(135)	(141)
Net cash inflow from operating activities		931	1,090	849
Cash flows from investing activities				
Acquisitions, net of cash acquired	21	(29)	(159)	(214)
Capital expenditure	2	(347)	(376)	(392)
Purchase of investments	10	(4)	(8)	(2)
Distribution from associate	11	2	–	–
Proceeds on disposal of business	21	–	–	343
Tax on disposal of business		–	–	(118)
Net cash used in investing activities		(378)	(543)	(383)
Cash flows from financing activities				
Proceeds from issue of ordinary share capital		3	5	10
Purchase of own shares		(48)	(52)	(368)
Proceeds from borrowings due within one year	20	24	53	34
Settlement of borrowings due within one year	20	(30)	(64)	(38)
Proceeds from borrowings due after one year	20	370	570	890
Settlement of borrowings due after one year	20	(371)	(706)	(759)
Proceeds from own shares		10	5	6
Settlement of currency swaps	20	(8)	24	(25)
Equity dividends paid	19	(321)	(269)	(279)
Net cash used in financing activities		(371)	(434)	(529)
Net increase/(decrease) in cash and cash equivalents		182	113	(63)
Cash and cash equivalents at beginning of year	20	155	38	102
Exchange adjustments	20	(4)	4	(1)
Cash and cash equivalents at end of year²		333	155	38

1 Includes \$83m (2017: \$15m, 2016: \$62m) of outgoings on restructuring and rationalisation expenses, \$3m (2017: \$3m, 2016: \$24m) of acquisition-related costs and \$104m (2017: \$25m, 2016: \$36m) of legal and other costs.

2 Cash and cash equivalents is net of bank overdrafts of \$32m (2017: \$14m, 2016: \$62m).

⇒ The Notes on pages 129–177 are an integral part of these accounts.

GROUP FINANCIAL STATEMENTS

Group statement of changes in equity

	Share capital \$ million	Share premium \$ million	Capital redemption reserve \$ million	Treasury shares ² \$ million	Other reserves ³ \$ million	Retained earnings \$ million	Total equity \$ million
At 31 December 2015	183	590	12	(294)	(256)	3,731	3,966
Attributable profit for the year ¹	–	–	–	–	–	784	784
Other comprehensive expense	–	–	–	–	(119)	(71)	(190)
Equity dividends declared and paid	–	–	–	–	–	(279)	(279)
Share-based payments recognised	–	–	–	–	–	27	27
Taxation on share-based payments	–	–	–	–	–	2	2
Purchase of own shares	–	–	–	(368)	–	–	(368)
Cost of shares transferred to beneficiaries	–	–	–	40	–	(34)	6
Cancellation of treasury shares	(3)	–	3	190	–	(190)	–
Issue of ordinary share capital ⁴	–	10	–	–	–	–	10
At 31 December 2016	180	600	15	(432)	(375)	3,970	3,958
Attributable profit for the year ¹	–	–	–	–	–	767	767
Other comprehensive income	–	–	–	–	147	55	202
Equity dividends declared and paid	–	–	–	–	–	(269)	(269)
Share-based payments recognised	–	–	–	–	–	31	31
Taxation on share-based payments	–	–	–	–	–	(3)	(3)
Purchase of own shares	–	–	–	(52)	–	–	(52)
Cost of shares transferred to beneficiaries	–	–	–	26	–	(21)	5
Cancellation of treasury shares	(2)	–	2	201	–	(201)	–
Issue of ordinary share capital ⁴	–	5	–	–	–	–	5
At 31 December 2017	178	605	17	(257)	(228)	4,329	4,644
Adjustment on initial application of IFRS 9 (net of tax)	–	–	–	–	–	(11)	(11)
Adjusted balance as at 1 January 2018	178	605	17	(257)	(228)	4,318	4,633
Attributable profit for the year ¹	–	–	–	–	–	663	663
Other comprehensive income	–	–	–	–	(112)	10	(102)
Equity dividends declared and paid	–	–	–	–	–	(321)	(321)
Share-based payments recognised	–	–	–	–	–	35	35
Taxation on share-based payments	–	–	–	–	–	1	1
Purchase of own shares	–	–	–	(48)	–	–	(48)
Cost of shares transferred to beneficiaries	–	–	–	40	–	(30)	10
Cancellation of treasury shares	(1)	–	1	51	–	(51)	–
Issue of ordinary share capital ⁴	–	3	–	–	–	–	3
At 31 December 2018	177	608	18	(214)	(340)	4,625	4,874

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

2 Refer to Note 19.2 for further information.

3 Other reserves comprises gains and losses on cash flow hedges, foreign exchange differences on translation of foreign operations and net changes on fair value of trade investments. The cumulative translation loss within other reserves at 31 December 2018 was \$339m (2017: \$207m loss, 2016: \$388m loss).

4 Issue of ordinary share capital in connection with the Group's share incentive plans.

⇒ The Notes on pages 129–177 are an integral part of these accounts.

Notes to the Group accounts

1 BASIS OF PREPARATION

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

As required by the European Union's IAS Regulation and the Companies Act 2006, the Group has prepared its accounts in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU) effective as at 31 December 2018. The Group has also prepared its accounts in accordance with IFRS as issued by the International Accounting Standards Board (IASB) effective as at 31 December 2018. IFRSs as adopted by the EU differs in certain respects from IFRS as issued by the IASB. However, the differences have no impact for the periods presented.

The preparation of accounts in conformity with IFRS requires management to use estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the accounts and the reported amounts of revenues and expenses during the year. The accounting policies requiring management to use significant estimates and assumptions are: inventories, impairment, taxation and liability provisions. These are discussed on page 124. Although these estimates are based on management's best knowledge of current events and actions, actual results ultimately may differ from those estimates. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to estimates are recognised prospectively.

The Directors continue to adopt the going concern basis for accounting in preparing the annual financial statements. The Directors have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. Further information regarding the Group's business activities, together with the factors likely to affect its future development, performance and position, are set out on pages 10–22.

As described in Note 15, the Group meets its funding requirements through a mixture of shareholders' funds, bank borrowings and private placement notes. At 31 December 2018 the Group had committed borrowing facilities of \$2.4bn and total liquidity of \$1.3bn, including net cash and cash equivalents of \$333m and undrawn committed borrowing facilities of \$1bn. The earliest expiry date of the Group's committed borrowing facilities is in respect of \$125m of Senior Notes due to expire in November 2019. In addition, Note 16 includes the Group's objectives, policies and processes for managing its capital; our financial risk management objectives; details of our financial instruments and hedging activities; and our exposures to foreign exchange, interest rate and credit risk.

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

New accounting standards effective 2018

IFRS 15 Revenue From Contracts With Customers

On 1 January 2018, the Group adopted IFRS 15 *Revenue from contracts with customers* using the modified retrospective method for contracts which were not completed as of that date. The Group applied the practical expedients in relation to contracts with variable consideration and contracts that were completed at the beginning of the earliest period presented and/or modified before the beginning of the earliest period presented.

Under IFRS 15, revenue is recognised as the performance obligations to deliver products or services are satisfied and revenue is recorded based on the amount of consideration expected to be received in exchange for satisfying the performance obligations. The Group undertook a detailed impact assessment applying IFRS 15 to all the existing ways in which the Group delivers products or services to customers to identify divergence with previous accounting practice governed by IAS 18 *Revenue* and concluded that IFRS 15 does not have a significant impact on the timing and recognition of revenue. Accordingly, there was no adjustment required on transition to IFRS 15.

IFRS 9 Financial Instruments

On 1 January 2018, the Group adopted IFRS 9 *Financial Instruments*. The Group has not restated comparative information for prior periods with respect to classification and measurement (including loss allowance) requirements.

The amendments to IFRS 9 mainly relate to the classification and measurement of financial instruments. IFRS 9 largely retains the existing requirements in IAS 39 *Financial Instruments: Recognition and Measurement* for the classification and measurement of financial liabilities; however, it eliminates the previous IAS 39 categories for financial assets of held to maturity, loans and receivables and available for sale. The Group elected, from 1 January 2018, to present changes in the fair value of trade investments in the income statement. The Group also elected to continue to apply the hedge accounting guidance in IAS 39 *Financial Instruments: Recognition and Measurement*.

NOTES TO THE GROUP ACCOUNTS continued

1 BASIS OF PREPARATION continued

With respect to loss allowances for trade receivables, IFRS 9 replaces the 'incurred loss' model in IAS 39 with an 'expected credit loss' (ECL) model. The Group, from 1 January 2018, has measured loss allowances for trade receivables at an amount equal to lifetime expected credit losses. In determining credit risk, the Group considers reasonable and supportable information that is relevant and available without undue cost or effort. This includes both quantitative and qualitative information and analysis based on the Group's historical experience, and forward-looking information. The Group considers the model and some of the assumptions used in calculating these ECLs as sources of estimation uncertainty. The Group performed the calculation of ECL rates separately for customer groups which were segmented based on common risk characteristics such as credit risk grade and type of customer (for example government and non-government). While not material, the Group has determined that the application of IFRS 9 at 1 January 2018 results in an additional loss allowance for trade receivables of \$14m. This transition adjustment gives rise to a deferred tax credit of \$3m.

The following table and the accompanying notes below explain the original measurement categories under IAS 39 and the new measurement categories under IFRS 9 for each class of the Group's financial assets and financial liabilities as at 1 January 2018.

The effect of adopting IFRS 9 on the carrying amounts of financial assets at 1 January 2018 relates solely to the loss allowance for trade receivables as described above.

	Original classification under IAS 39	New classification under IFRS 9	Original carrying amount under IAS 39 \$ million	New carrying amount under IFRS 9 \$ million
Financial assets				
Forward foreign exchange contracts	Fair value – hedging instrument	Fair value – hedging instrument	25	25
Investments	Available for sale	Fair value through profit or loss	21	21
Currency swaps	Fair value through profit or loss	Fair value through profit or loss	3	3
Trade and other receivables	Loans & receivables	Amortised cost	1,148	1,134
Cash at bank	Loans & receivables	Amortised cost	169	169
Total financial assets			1,366	1,352
Financial liabilities				
Acquisition consideration	Fair value through profit or loss	Fair value through profit or loss	(160)	(160)
Forward foreign exchange contracts	Fair value – hedging instrument	Fair value – hedging instrument	(45)	(45)
Currency swaps	Fair value through profit or loss	Fair value through profit or loss	(1)	(1)
Interest rate swaps	Fair value – hedging instrument	Fair value – hedging instrument	(2)	(2)
Private placement debt	Other financial liabilities	Other financial liabilities	(1,123)	(1,123)
Bank overdrafts	Other financial liabilities	Other financial liabilities	(14)	(14)
Bank loans	Other financial liabilities	Other financial liabilities	(313)	(313)
Trade and other payables	Other financial liabilities	Other financial liabilities	(877)	(877)
Total financial liabilities			(2,535)	(2,535)

A number of other new amendments to standards are effective from 1 January 2018 but they do not have a material effect on the Group's financial statements.

Accounting standards issued but not yet effective

A number of new standards and amendments to standards are effective for annual periods beginning after 1 January 2019 and earlier application is permitted; however, the Group has not early adopted them in preparing these consolidated financial statements. These are not expected to have a significant impact on adoption, apart from IFRS 16 *Leases* which is described below.

The Group will adopt IFRS 16 using the modified retrospective approach and the right of use asset on transition will equal the lease liability. The cumulative effect of initially adopting the IFRS 16 will be recognised as an adjustment to retained earnings at 1 January 2019 with no restatement of comparative information. The Group plans to apply the practical expedient to grandfather the definition of a lease on transition. This means that it will apply IFRS 16 to all contracts entered into before 1 January 2019 and identified as leases in accordance with IAS 17 and IFRIC 4.

The Group intends to avail itself of the exemptions for short-term leases and leases of low-value items. The Group will recognise new assets and liabilities, primarily with regard to its operating leases of property and motor vehicles. In addition the Group will no longer recognise accruals relating to the straight-lining of rent expense for leases which include a rent-free period.

The Group has designed a new lease accounting process and has implemented a new lease accounting software solution. The Group has assessed the estimated impact that initial application of IFRS 16 will have on its consolidated financial statements, as described below. The actual impacts of adopting the standard on 1 January 2019 may change because the Group has not finalised the testing and assessment of controls over its new lease accounting process, and the new accounting policies are subject to change until the Group presents its first financial statements that include the initial application of the standard.

Based on the information currently available, the Group estimates that it will recognise additional lease assets and liabilities of \$145m to \$165m as at 1 January 2019. The Group does not expect the adoption of IFRS 16 to have a material impact on the income statement.

1.1 Consolidation

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

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

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

1.2 Foreign currencies

Functional and presentation currency

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

Foreign currency transactions

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

Foreign operations

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

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

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

	2018	2017	2016
Average rates			
Sterling	1.33	1.29	1.35
Euro	1.18	1.13	1.11
Swiss Franc	1.02	1.02	1.02
Year end rates			
Sterling	1.28	1.35	1.23
Euro	1.14	1.20	1.05
Swiss Franc	1.02	1.02	0.98

NOTES TO THE GROUP ACCOUNTS continued

2 BUSINESS SEGMENT INFORMATION

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

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

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

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

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

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

During 2018, the Group began its transition to a global franchise structure with three dedicated franchises for Orthopaedics, Sports Medicine & ENT, and Advanced Wound Management, each with their own president. From 2019 onwards, with the Group's operating structure organised around three franchises, the chief operating decision maker will be able to monitor performance, make operating decisions and allocate resources on a global franchise basis in contrast with 2018 and prior, where these were done on a Group-wide basis. The franchise presidents will be responsible for implementing the operating decisions for their respective franchise in the US. Regional presidents in EMEA and APAC will be responsible for this implementation in their respective regions. Based on the aforementioned changes from January 2019, the Group has concluded that there will be three reportable segments from this date. The Group will not restate comparative information in 2019, other than revenue, as the Group was managed as one operating segment in 2018 and 2017, and historical financial information is not available on a franchise basis. The Group does have sufficient historical financial information of revenue by franchise to restate the comparative information of revenue by operating segment.

2.1 Revenue by business segment and geography

Accounting policy

Revenue is recognised as the performance obligations to deliver products or services are satisfied and is recorded based on the amount of consideration expected to be received in exchange for satisfying the performance obligations. Revenue is recognised primarily when control is transferred to the customer, which is generally when the goods are shipped or delivered in accordance with the contract terms, with some transfer of services taking place over time. Substantially all performance obligations are performed within one year. There is no significant revenue associated with the provision of discrete services. Payment terms to our customers are based on commercially reasonable terms for the respective markets while also considering a customer's credit rating. Appropriate provisions for returns, trade discounts and rebates are deducted from revenue. Rebates primarily comprise chargebacks and other discounts granted to certain customers. Chargebacks are discounts that occur when a contracted customer purchases directly through an intermediary wholesaler. The contracted customer generally purchases product at its contracted price plus a mark-up from the wholesaler. The wholesaler in turn charges the Group for the difference between the price initially paid by the wholesaler and the contract price paid to the wholesaler by the customer. The provision for chargebacks is based on expected sell-through levels by the Group's wholesale customers to contracted customers, as well as estimated wholesaler inventory levels.

The revenue accounting policy for the year ending 31 December 2017 was consistent with the requirements of IAS 18. Revenue was recognised once the significant risks and rewards of ownership had been transferred to the customer, rather than the satisfaction of the performance obligations to deliver products or services.

Reconstruction, Sports Medicine, Trauma & Other

Reconstruction, Sports Medicine, Trauma & Other consists of the following franchises: Knee Implants and Hip Implants, Sports Medicine Joint Repair, Arthroscopic Enabling Technologies, Trauma & Extremities and Other Surgical Business. Sales of inventory located at customer premises and available for customers' immediate use are recognised when notification is received that the product has been implanted or used. Substantially all other revenue is recognised when control is transferred to the customer, which is generally when the goods are shipped or delivered in accordance with the contract terms. Revenue is recognised for the amount of consideration expected to be received in exchange for transferring the products or services.

In general our Reconstruction, Sports Medicine, Trauma & Other business in Established Markets is direct to hospitals and ambulatory surgery centres whereas in the Emerging Markets we generally sell through distributors.

Advanced Wound Management

Advanced Wound Management consists of the following product franchises: Advanced Wound Care, Advanced Wound Bioactives and Advanced Wound Devices. Substantially all revenue is recognised when control is transferred to the customer, which is generally when the goods are shipped or delivered in accordance with the contract terms. Revenue is recognised for the amount of consideration expected to be received in exchange for transferring the products or services. Appropriate provisions for returns, trade discounts and rebates are deducted from revenue, as explained above.

The majority of our Advanced Wound Management business, and in particular products used in community and homecare facilities, is through wholesalers and distributors. The proportion of sales direct to hospitals is higher in our Advanced Wound Devices business in Established Markets.

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

	2018 \$ million	2017 \$ million	2016 \$ million
Reportable segment revenue			
Revenue from external customers	4,904	4,765	4,669

NOTES TO THE GROUP ACCOUNTS continued

2 BUSINESS SEGMENT INFORMATION continued**Disaggregation of revenue:**

The following table shows the disaggregation of Group revenue by product franchise:

	2018 \$ million	2017 \$ million	2016 \$ million
Revenue by product from continuing operations			
Knee Implants	1,017	984	932
Hip Implants	613	599	597
Trauma & Extremities	493	495	475
Sports Medicine Joint Repair	697	627	587
Arthroscopic Enabling Technologies	600	615	631
Other Surgical Businesses	209	189	214
Advanced Wound Care	740	720	719
Advanced Wound Bioactives	320	342	342
Advanced Wound Devices	215	194	172
Consolidated revenue from continuing operations	4,904	4,765	4,669

The following table shows the disaggregation of Group revenue by geographic market and product category. The disaggregation of revenue into the two product categories below reflects that in general the products in the Advanced Wound Management franchises are sold to wholesalers and intermediaries, while products in the other franchises are sold directly to hospitals, ambulatory surgery centres and distributors. The further disaggregation of revenue by Established Markets and Emerging Markets reflects that in general our products are sold through distributors and intermediaries in the Emerging Markets while in the Established Markets, with the exception of the Advanced Wound Care and Bioactives franchises, products are in general sold direct to hospitals and ambulatory surgery centres. The disaggregation by Established Markets and Emerging Markets also reflects their differing economic factors including volatility in growth and outlook.

	2018			2017			2016		
	Established Markets ¹ \$ million	Emerging Markets \$ million	Total \$ million	Established Markets ¹ \$ million	Emerging Markets \$ million	Total \$ million	Established Markets ¹ \$ million	Emerging Markets \$ million	Total \$ million
Reconstruction, Sports Medicine, Trauma & Other Surgical Businesses	2,944	685	3,629	2,867	642	3,509	2,868	568	3,436
Advanced Wound Management	1,103	172	1,275	1,097	159	1,256	1,092	141	1,233
Total	4,047	857	4,904	3,964	801	4,765	3,960	709	4,669

¹ Established Markets comprises the US, Australia, Canada, Europe, Japan and New Zealand.

In 2018, the Group has presented sales attributed to the country of destination rather than based on the location of the Group's businesses. Comparatives have been presented on a consistent basis with 2018. US revenue for 2018 was \$2,354m (2017: \$2,306m, 2016: \$2,299m) and UK revenue for 2018 was \$211m (2017: \$222m, 2016: \$266m).

Contract assets and liabilities

The nature of our products and services do not generally give rise to contract assets as we do not typically incur costs to fulfil a contract before a product or service is provided to the customer. The Group generally satisfies performance obligations within one year from the contract inception date. There was no material revenue recognised in the current reporting period that related to carried-forward contract liabilities (deferred income) or performance obligations satisfied in the previous year. There is no material revenue that is likely to arise in future periods from unsatisfied performance obligations at the balance sheet date. Therefore, there are no associated significant accrued income and deferred income balances at 31 December 2018. As of 31 December 2018, contract assets principally comprised trade receivables and contract liabilities principally comprise rebates (as described in the accounting policy above). The accrual for rebates at 31 December 2018 was \$65m (2017: \$56m) with \$334m being recognised in revenue in 2018.

Major customers

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

2.2 Trading and operating profit by business segment

Trading profit is a trend measure which presents the long-term profitability of the Group excluding the impact of specific transactions that management considers affect the Group's short-term profitability. The Group presents this measure to assist investors in their understanding of trends. The Group has identified the following items, where material, as those to be excluded from operating profit when arriving at trading profit: acquisition and disposal-related items; amortisation and impairment of acquisition intangibles; significant restructuring programmes; gains and losses arising from legal disputes; and other significant items. Further detail is provided in Notes 2.3, 2.4 and 2.5. Operating profit reconciles to trading profit as follows:

	2018 \$ million	2017 \$ million	2016 \$ million
Operating profit of the business segment	863	934	801
Acquisition and disposal related items	(7)	(10)	9
Restructuring and rationalisation costs	120	–	62
Amortisation and impairment of acquisition intangibles	113	140	178
Legal and other	34	(16)	(30)
Trading profit of the business segment	1,123	1,048	1,020

2.3 Acquisitions and disposal related items

For the year to 31 December 2018 the credit relates to a remeasurement of contingent consideration for a prior year acquisition and adjustments to provisions on disposal of a business, partially offset by costs associated with the acquisition of Rotation Medical, Inc.

For the year to 31 December 2017 the credit relates to a remeasurement of contingent consideration for a prior year acquisition partially offset by costs associated with the acquisition of Rotation Medical, Inc. For the year to 31 December 2016, these costs relate to the costs associated with the integration of Blue Belt Technologies and other acquisitions.

2.4 Restructuring and rationalisation costs

Restructuring and rationalisation costs of \$120m were incurred in 2018 (2017: \$nil, 2016: \$62m) primarily relating to the implementation of the Accelerating Performance and Execution (APEX) programme that was announced in February 2018. In 2016, these costs primarily related to the Group Optimisation Plan.

2.5 Legal and other

For the year ended 31 December 2018 charges primarily relate to legal expenses for ongoing metal-on-metal hip claims and an increase of \$72m in the provision that reflects the present value of the estimated costs to resolve all other known and anticipated metal-on-metal hip claims globally. The year to 31 December 2018 also includes costs for implementing the requirements of the EU Medical Device Regulations that will apply from May 2020. These charges in the year to 31 December 2018 were partially offset by a credit of \$84m relating to settlement agreements with insurers related to product liability claims involving macrotextured components withdrawn from the market in 2003.

For the year ended 31 December 2017 charges primarily relate to legal expenses for patent litigation with Arthrex and ongoing metal-on-metal hip claims and an increase of \$10m in the provision that reflects the present value of the estimated costs to resolve all other known and anticipated metal-on-metal hip claims globally. These charges were offset by a \$54m credit following a settlement payment received from Arthrex relating to patent litigation. For the year ended 31 December 2016, the net credit of \$30m primarily relates to a \$44m curtailment credit on post-retirement benefits in the UK pension scheme partially offset by legal expenses incurred for patent litigation with Arthrex. Also included in a net \$1m credit in respect of insurance recoveries of \$24m and legal expenses of \$23m, relating to the ongoing metal-on-metal hip claims globally.

2.6 Assets and liabilities by business segment and geography

	2018 \$ million	2017 \$ million	2016 \$ million
Reconciliation of assets of the business segment to the consolidated Group			
Assets of the business segment	7,476	7,508	7,147
Unallocated corporate assets:			
Deferred tax assets	126	127	97
Retirement benefit assets	92	62	–
Cash at bank	365	169	100
Total assets of the consolidated Group	8,059	7,866	7,344

NOTES TO THE GROUP ACCOUNTS continued

2 BUSINESS SEGMENT INFORMATION continued

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

	2018 \$ million	2017 \$ million	2016 \$ million
Geographical segment assets			
United Kingdom	354	364	335
United States of America	3,186	3,295	3,145
Other	1,224	1,287	1,238
Total non-current assets of the consolidated Group¹	4,764	4,946	4,718

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

	2018 \$ million	2017 \$ million	2016 \$ million
Reconciliation of liabilities of the business segment to the consolidated Group			
Liabilities of the business segment	1,284	1,311	1,247
Unallocated corporate liabilities:			
Long-term borrowings	1,301	1,423	1,564
Retirement benefit obligations	114	131	164
Deferred tax liabilities	99	97	94
Bank overdrafts, borrowings and loans – current	164	27	86
Current tax payable	223	233	231
Total liabilities of the consolidated Group	3,185	3,222	3,386

Depreciation, amortisation and impairment of the business segment

Depreciation of property, plant and equipment	251	243	224
Amortisation of acquisition intangibles	113	130	130
Amortisation of other intangible assets	63	62	61
Total depreciation and amortisation	427	435	415
Impairment losses on property, plant and equipment ¹	5	–	–
Impairment losses on acquisition intangibles ¹	–	10	48
Impairment losses on other intangible assets ¹	3	–	–
Impairment losses on trade investments ¹	–	2	–
Total depreciation, amortisation and impairment	435	447	463

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

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

	2018 \$ million	2017 \$ million	2016 \$ million
Additions to property, plant and equipment	332	308	320
Additions to intangibles	15	68	72
Capital expenditure (excluding business combinations)	347	376	392
Trade investments	4	8	2
Acquisitions – Goodwill	–	132	211
Acquisitions – Intangible assets	–	61	85
Acquisitions – Property, plant and equipment	–	1	2
Capital and acquisition expenditure	351	578	692

3 OPERATING PROFIT

Accounting policies

Research and development

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

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

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

Advertising costs

Advertising costs are expensed as incurred.

	2018 \$ million	2017 \$ million	2016 \$ million
Revenue	4,904	4,765	4,669
Cost of goods sold ¹	(1,298)	(1,248)	(1,272)
Gross profit	3,606	3,517	3,397
Research and development expenses ²	(246)	(223)	(230)
Selling, general and administrative expenses:			
Marketing, selling and distribution expenses	(1,820)	(1,781)	(1,712)
Administrative expenses ^{3,4,5,6}	(677)	(579)	(654)
	(2,497)	(2,360)	(2,366)
Operating profit	863	934	801

1 2018 includes \$4m charge relating to legal and other items (2017: \$nil, 2016: \$nil).

2 2018 includes \$9m charge relating to legal and other items (2017: \$nil, 2016: \$nil).

3 2018 includes \$63m of amortisation of software and other intangible assets (2017: \$62m, 2016: \$61m).

4 2018 includes \$113m of amortisation and impairment of acquisition intangibles and \$120m of restructuring and rationalisation expenses (2017: \$140m of amortisation and impairment of acquisition intangibles, 2016: \$62m of restructuring and rationalisation expenses and \$178m of amortisation and impairment of acquisition intangibles).

5 2018 includes \$21m charge relating to legal and other items (2017: \$16m credit, 2016: \$30m credit).

6 2018 includes \$7m credit of acquisition and disposal related items (2017: \$10m credit, 2016: \$9m charge).

Note that items detailed in 1,2,4,5 and 6 are excluded from the calculation of trading profit, the segment profit measure.

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

	2018 \$ million	2017 \$ million	2016 \$ million
Other operating income	(107)	(66)	(25)
Amortisation of intangible assets	176	192	191
Impairment of intangible assets	3	10	48
Impairment of property, plant and equipment	5	–	–
Depreciation of property, plant and equipment	251	243	224
Loss on disposal of property, plant and equipment and intangible assets	19	13	15
Operating lease payments for land and buildings	32	36	39
Operating lease payments for other assets	25	21	19
Advertising costs	88	102	88

In 2018 other operating income primarily comprises an insurance recovery relating to product liability claims involving macrotextured components voluntarily withdrawn from the market in 2003 and a gain relating to patent litigation (2017: gain relating to patent litigation, 2016: insurance recovery relating to metal-on-metal claims). In 2018, \$84m (2017: \$54m, 2016: \$24m) of other operating income was included with legal and other items, as explained in Note 2.5, and does not form part of the segment trading profit.

NOTES TO THE GROUP ACCOUNTS continued

3 OPERATING PROFIT continued**3.1 Staff costs and employee numbers**

Staff costs during the year amounted to:

	Notes	2018 \$ million	2017 \$ million	2016 \$ million
Wages and salaries ¹		1,330	1,231	1,227
Social security costs		176	178	129
Pension costs (including retirement healthcare) ²	18	65	64	23
Share-based payments	23	35	31	27
		1,606	1,504	1,406

¹ The 2017 wages and salaries cost has been amended from \$1,157m to \$1,231m. This amendment has no impact on the Group Income Statement, Group Statement of Comprehensive Income, Group Balance Sheet, Group Cash Flow Statement and Group Statement of Changes in Equity for any period presented.

² In 2016, pension costs include the past service cost credit of \$49m arising primarily from the closure of the UK defined benefit scheme to future accrual.

During the year ended 31 December 2018, the average number of employees was 16,681 (2017: 16,333, 2016: 15,584).

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

	2018 \$ million	2017 \$ million	2016 \$ million
Audit services:			
Group accounts	2.6	2.4	2.0
Local statutory audit pursuant to legislation	3.4	2.0	2.0
Other services:			
Non-audit services	–	0.1	0.5
Taxation services:			
Compliance services	–	–	0.1
Advisory services	–	–	–
Total auditor's remuneration	6.0	4.5	4.6
Arising:			
In the UK	2.4	2.5	2.5
Outside the UK	3.6	2.0	2.1
	6.0	4.5	4.6

4 INTEREST AND OTHER FINANCE COSTS**4.1 Interest income/(expense)**

	2018 \$ million	2017 \$ million	2016 \$ million
Interest income	8	6	6
Interest expense:			
Bank borrowings	(11)	(11)	(9)
Private placement notes	(38)	(38)	(37)
Other	(10)	(8)	(6)
	(59)	(57)	(52)
Net interest expense	(51)	(51)	(46)

4.2 Other finance costs

	Notes	2018 \$ million	2017 \$ million	2016 \$ million
Retirement benefit net interest expense	18	(3)	(5)	(7)
Unwinding of discount		(9)	(5)	(9)
Other		(8)	–	–
Other finance costs		(20)	(10)	(16)

Foreign exchange gains or losses arose primarily on the translation of intercompany and third party borrowings and amounted to a net \$11m gain in 2018 (2017: net \$25m loss, 2016: net \$22m gain). These amounts were matched by the fair value gains or losses on currency swaps held to manage this currency risk.

5 TAXATION

Accounting policy

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

The Group operates in numerous tax jurisdictions around the world and it is Group policy to submit its tax returns to the relevant tax authorities as promptly as possible. At any given time, the Group is involved in disputes and tax audits and will have a number of tax returns potentially subject to audit. Significant issues may take several years to resolve. In estimating the probability and amount of any tax charge, management takes into account the views of internal and external advisers and updates the amount of tax provision whenever necessary. The ultimate tax liability may differ from the amount provided depending on factors including interpretations of tax law, settlement negotiations or changes in legislation.

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

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

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

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

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

NOTES TO THE GROUP ACCOUNTS continued

5 TAXATION continued**5.1 Taxation charge attributable to the Group**

	2018 \$ million	2017 \$ million	2016 \$ million
Current taxation:			
UK corporation tax	27	23	23
Overseas tax	131	177	261
Current income tax charge	158	200	284
Adjustments in respect of prior periods	(33)	(60)	(53)
Total current taxation	125	140	231
Deferred taxation:			
Origination and reversal of temporary differences	(3)	32	24
Changes in tax rates	1	(49)	–
Adjustments to estimated amounts arising in prior periods	(5)	(11)	23
Total deferred taxation	(7)	(28)	47
Total taxation as per the income statement	118	112	278
Taxation in other comprehensive income	(4)	9	(10)
Taxation in equity	(1)	3	(2)
Taxation attributable to the Group	113	124	266

The 2018 net prior period adjustment benefits of \$38m mainly relate to the expiry of statute of limitations and tax accrual to tax return adjustments, partially offset by an increase in certain other tax provisions. The 2017 and 2016 net prior period adjustment benefits of \$71m and \$30m respectively mainly relate to provision releases following agreement reached with the IRS on US tax matters after the conclusion of US tax audits in 2017 and 2016, provision releases on the expiry of statute of limitations, and tax accrual to tax return adjustments, partially offset by an increase in certain other tax provisions.

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

Total taxation as per the income statement of \$118m includes a \$51m net credit (2017: \$58m net credit, 2016: \$48m net charge) as a consequence of restructuring and rationalisation costs, acquisitions and disposals, amortisation and impairment of acquisition intangibles, and legal and other items. In 2017, the net credit included a net benefit from US tax reform.

Factors affecting future tax charges

The Group operates in numerous tax jurisdictions around the world and is subject to factors that may affect future tax charges including the review by the European Commission into whether the UK CFC financing exemption rules constitute illegal State Aid (see below), transfer pricing, tax rate changes, tax legislation changes, tax authority interpretation, expiry of statute of limitations and resolution of tax audits and disputes.

At any given time the Group has unagreed years outstanding in various countries and is involved in tax audits and disputes, some of which may take several years to resolve. Provisions are based on best estimates and management's judgements concerning the likely ultimate outcome of the audit or dispute. Management consider the specific circumstances of each tax position and takes external advice, where appropriate, to assess the range of potential outcomes and estimate additional tax that may be due. Current tax payable of \$223m (2017: \$233m) includes \$178m (2017: \$201m) of provisions, penalties and interest for uncertain tax positions which relate to multiple issues across the jurisdictions in which the Group operates. Other creditors includes \$8m of other interest on these provisions. The anticipated impact of IFRIC 23 is not expected to give rise to a material difference to the tax risk provisions.

The Group believes that it has made adequate provision in respect of additional tax liabilities that may arise from unagreed years and tax audits and disputes, the majority of which relate to transfer pricing matters as would be expected for a Group operating internationally. However, the actual liability for any particular issue may be higher or lower than the amount provided, resulting in a negative or positive effect on the tax charge in any given year. A reduction in the tax charge may also arise for other reasons such as an expiry of the relevant statute of limitations. Whilst the impact can vary from year-to-year, we believe the possibility of a material adverse impact on the tax charge for 2019 is remote. Depending on the final outcome of certain tax audits which are currently in progress, possible statute of limitations expiry and other factors, a credit to the tax charge at or around similar levels in recent years could arise. In respect of the risks provided for at 31 December 2018, we do not envisage circumstances that would give rise to a release of more than approximately half of the provisions held.

As referenced in our 2017 Annual Report, one of the factors that may affect our future tax charge is the review by the European Commission (EC) into whether the UK CFC financing exemption rules between 2013 and 2018 constituted illegal State Aid. The EC issued its preliminary view in October 2017 that the financing exemption did constitute State Aid and their final decision, following their investigation, is expected in 2019. Depending on the outcome, this may then be subject to a further legal process. The financing exemption was introduced into UK legislation by the British government in 2013. In line with many other UK-based international groups which have followed this legislation, we may be affected by the final outcome. If the preliminary findings of the EC investigation were ultimately to be upheld, we calculate our maximum potential liability as at 31 December 2018 to be approximately \$147m. We do not consider at present that any provision is required in respect of this amount based on our current assessment of the issue.

In December 2016, the Group appealed to the First Tier Tribunal in the UK against a decision by HM Revenue and Customs (HMRC) relating to the tax deductibility of historical foreign exchange losses. The decision of the Tribunal was released on 8 February 2017 and it upheld the Group's appeal. HMRC appealed against this decision and their appeal was heard by the Upper Tribunal in June 2018. The decision was released on 29 November 2018 and it upheld the decision of the First Tier Tribunal. In the event that HMRC either is not granted leave to appeal or is not successful in their appeal, with the result that the Group is ultimately successful in the Courts, the Group's tax charge would be reduced in the year of success. Whether HMRC will be granted leave to appeal in the Court of Appeal is uncertain at the present date. No tax benefit for these losses has been taken to date. Should the case become final in 2019, we estimate that we would receive a tax refund of approximately \$100m. In addition, remaining losses would be potentially available to offset future profits, the benefit of which will depend on future facts and circumstances.

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

The UK standard rate of corporation tax for 2018 is 19.0% (2017: 19.3%, 2016: 20.0%). Overseas taxation is calculated at the rates prevailing in the respective jurisdictions. The table below reconciles the expected tax charge at the UK statutory rate with the actual tax charge:

	2018 \$ million	2017 \$ million	2016 \$ million
Profit before taxation	781	879	1,062
Expected taxation at UK statutory rate of 19.0% (2017: 19.3%, 2016: 20.0%)	148	169	212
Differences in overseas taxation rates ¹	(5)	48	34
Disposal of the Gynaecology business (mainly at the US tax rate)	–	–	56
Benefit of US Manufacturing deduction	–	(9)	(7)
R&D tax credits	(6)	(3)	(3)
Tax losses not recognised	4	10	1
Utilisation of previously unrecognised tax losses	(1)	(6)	(9)
Impact of US tax reform	–	(32)	–
Expenses not deductible for tax purposes	15	11	23
Changes in tax rates	1	(5)	1
Adjustments in respect of prior years ²	(38)	(71)	(30)
Total taxation as per the income statement	118	112	278

1 Reflects the geographical mix of profits offset by the impact of intra-group loans provided to finance US acquisitions and business operations.

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

NOTES TO THE GROUP ACCOUNTS continued

5 TAXATION continued**5.2 Deferred taxation**

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

	Accelerated tax depreciation \$ million	Intangibles \$ million	Retirement benefit obligations \$ million	Macrotexture claims \$ million	Inventory, provisions, losses and other differences \$ million	Total \$ million
At 31 December 2016	(73)	(209)	28	52	205	3
Exchange adjustment	1	(2)	2	–	13	14
Movement in income statement – current year	(9)	15	(6)	(1)	(31)	(32)
Movement in income statement – prior years	2	4	–	–	5	11
Movement in other comprehensive income	–	–	(17)	–	4	(13)
Movement in equity	–	–	–	–	(3)	(3)
Changes in tax rate	29	71	–	(18)	(33)	49
Acquisitions	–	(22)	–	–	23	1
At 31 December 2017	(50)	(143)	7	33	183	30
Adjustment on initial application of IFRS 9	–	–	–	–	3	3
Adjusted balance at 1 January 2018	(50)	(143)	7	33	186	33
Exchange adjustment	–	2	–	–	(7)	(5)
Movement in income statement – current year	11	14	–	(33)	11	3
Movement in income statement – prior years	(12)	1	4	–	12	5
Movement in other comprehensive income	–	–	(6)	–	(3)	(9)
Movement in equity	–	–	–	–	1	1
Changes in tax rate	(1)	–	–	–	–	(1)
At 31 December 2018	(52)	(126)	5	–	200	27

Represented by:

	2018 \$ million	2017 \$ million
Deferred tax assets	126	127
Deferred tax liabilities	(99)	(97)
Net position at 31 December	27	30

The Group has gross unused trading and non-trading tax losses of \$149m (2017: \$271m) and gross unused capital losses of \$102m (2017: \$113m) available for offset against future profits of which \$14m of trading losses will expire within 3-8 years from the balance sheet date if not utilised. A deferred tax asset of \$28m (2017: \$38m) has been recognised in respect of \$74m (2017: \$132m) of the trading and non-trading tax losses. No deferred tax asset has been recognised on the remaining unused tax losses as they are not expected to be realised in the foreseeable future. There are no temporary differences in respect of investments in subsidiaries and associates for which deferred tax liabilities have not been recognised (2017: \$nil).

6 EARNINGS PER ORDINARY SHARE

Accounting policies

Earnings per share

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

Diluted earnings per share

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

Adjusted earnings per share

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

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

	2018 \$ million	2017 \$ million	2016 \$ million
Earnings			
Attributable profit for the year	663	767	784
Adjusted attributable profit (see below)	881	826	735

Attributable profit is reconciled to adjusted attributable profit as follows:

	Notes	2018 \$ million	2017 \$ million	2016 \$ million
Attributable profit for the year		663	767	784
Acquisition and disposal related items		(7)	(10)	9
Restructuring and rationalisation costs	3	120	–	62
Amortisation and impairment of acquisition intangibles ¹	9	118	140	178
Legal and other ²		38	(13)	(20)
Profit on disposal of business	21	–	–	(326)
US tax reform	5	–	(32)	–
Taxation on excluded items	5	(51)	(26)	48
Adjusted attributable profit		881	826	735

¹ Amortisation and impairment of acquisition intangibles includes a \$113m charge within operating profit and a \$5m charge within share of result of associates.

² Legal and other charge in 2018 includes \$34m (2017: \$16m credit, 2016: \$30m credit) within operating profit (refer to Note 2.5) and a \$4m charge (2017: \$3m charge, 2016: \$5m charge) within other finance costs for unwinding of the discount on the provision for known, anticipated and settled metal-on-metal hip claims globally. In 2016, legal and other credit also includes a \$5m charge within share of results of associates for expenses incurred by Bioventus for an aborted initial public offering of shares.

NOTES TO THE GROUP ACCOUNTS continued

6 EARNINGS PER ORDINARY SHARE continued

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

	2018	2017	2016
Number of shares (millions)			
Basic weighted number of shares	873	874	890
Dilutive impact of share incentive schemes outstanding	3	1	3
Diluted weighted average number of shares	876	875	893
Earnings per ordinary share			
Basic	76.0¢	87.8¢	88.1¢
Diluted	75.7¢	87.7¢	87.8¢
Adjusted ³	100.9¢	94.5¢	82.6¢

³ Adjusted earnings per share is calculated using the basic weighted number of shares.

7 PROPERTY, PLANT AND EQUIPMENT**Accounting policies****Property, plant and equipment**

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

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

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

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

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

Impairment of assets

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

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

	Notes	Land and buildings		Plant and equipment		Assets in course of construction \$ million	Total \$ million
		Freehold \$ million	Leasehold \$ million	Instruments \$ million	Other \$ million		
Cost							
At 1 January 2017		165	119	1,116	1,023	115	2,538
Exchange adjustment		6	1	63	33	3	106
Acquisitions	21	–	–	–	1	–	1
Additions		1	–	176	28	103	308
Disposals		–	(27)	(73)	(79)	(12)	(191)
Transfers		56	(20)	2	56	(115)	(21)
At 31 December 2017		228	73	1,284	1,062	94	2,741
Exchange adjustment		(5)	(1)	(45)	(20)	(1)	(72)
Additions		3	3	179	21	126	332
Disposals		–	–	(73)	(24)	(1)	(98)
Impairment		–	–	–	–	(1)	(1)
Transfers		33	1	43	(7)	(89)	(19)
At 31 December 2018		259	76	1,388	1,032	128	2,883
Depreciation and impairment							
At 1 January 2017		50	42	781	672	11	1,556
Exchange adjustment		3	–	45	24	–	72
Charge for the year		6	7	146	84	–	243
Disposals		–	(22)	(67)	(74)	(11)	(174)
Transfers		2	3	(1)	(9)	–	(5)
At 31 December 2017		61	30	904	697	–	1,692
Exchange adjustment		(2)	–	(30)	(14)	–	(46)
Charge for the year		8	6	163	74	–	251
Impairment		–	1	–	3	–	4
Disposals		–	–	(59)	(21)	–	(80)
Transfers		5	–	23	(28)	–	–
At 31 December 2018		72	37	1,001	711	–	1,821
Net book amounts							
At 31 December 2018		187	39	387	321	128	1,062
At 31 December 2017		167	43	380	365	94	1,049

Land and buildings includes land with a cost of \$21m (2017: \$21m) that is not subject to depreciation. There were no assets held under finance leases at 31 December 2018 and 2017.

Transfers from assets in course of construction includes \$19m (2017: \$4m) of software and \$nil (2017: \$12m) net book value of other non-current assets.

Group capital expenditure relating to property, plant and equipment contracted but not provided for amounted to \$16m (2017: \$26m).

The amount of borrowing costs capitalised in 2018 and 2017 was minimal.

NOTES TO THE GROUP ACCOUNTS continued

8 GOODWILL**Accounting policy**

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

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

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

	Notes	2018 \$ million	2017 \$ million
Cost			
At 1 January		2,371	2,188
Exchange adjustment		(34)	51
Acquisitions	21	–	132
At 31 December		2,337	2,371
Impairment			
At 1 January and 31 December		–	–
Net book amounts		2,337	2,371

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

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

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

	2018 \$ million	2017 \$ million
Orthopaedics	727	566
Other Surgical Devices	1,313	1,501
Advanced Wound Management	297	304
	2,337	2,371

Impairment reviews were performed as of September 2018 and September 2017 by comparing the recoverable amount of each CGU with its carrying amount, including goodwill. These were updated during December, taking into account any significant events that occurred between September and December.

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

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

8.1 Orthopaedics CGU

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

Revenue growth rates for the three-year period ranged from 3.6% to 4.5% for the various components of the Orthopaedics CGU. The average growth rate used to extrapolate the cash flows beyond the three-year period in calculating the terminal value is 2.0%. The pre-tax discount rate used in the Orthopaedics CGU value-in-use calculation reflects the geographical mix and is 9.6%.

8.2 Other Surgical Devices CGU

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

Revenue growth rates for the three-year period ranged from 2.6% to 4.7% for the various components of the Other Surgical Devices CGU. The weighted average growth rate used to extrapolate the cash flows beyond the three-year period in calculating the terminal value is 2.0%. The pre-tax discount rate used in the Other Surgical Devices CGU value-in-use calculation reflects the geographical mix of the revenues and is 9.6%.

8.3 Advanced Wound Management CGU

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

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

Revenue growth rates for the three-year period ranged from 2.8% to 4.2% for the various components of the Advanced Wound Management CGU. The weighted average growth rate used to extrapolate the cash flows beyond the three-year period in calculating the terminal value is 2.0%. The pre-tax discount rate used in the Advanced Wound Management CGU value-in-use calculation reflects the geographical mix and industry sector and is 9.6%.

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

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

Growth of market and market share – management has considered the impact of a variance in market growth and market share.

The value-in-use calculations shows that if the assumed long-term growth rates were reduced to nil, the recoverable amount of each CGU would still be greater than its carrying value.

Discount rate – management has considered the impact of an increase in the discount rate applied to the value-in-use calculations. This sensitivity analysis shows that for the recoverable amount of each CGU to be less than its carrying value, the discount rate would have to be increased to 21.5% for the Orthopaedics CGU, 13.5% for the Other Surgical Devices CGU and 20.8% for the Advanced Wound Management CGU.

NOTES TO THE GROUP ACCOUNTS continued

9 INTANGIBLE ASSETS**Accounting policies****Intangible assets**

Intangible assets acquired separately from a business combination (including purchased patents, know-how, trademarks, licences and distribution rights) are initially measured at cost. The cost of intangible assets acquired in a material business combination (referred to as acquisition intangibles) is the fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. All intangible assets are amortised on a straight-line basis over their estimated useful economic lives. The estimated useful economic life of an intangible asset ranges between 3–20 years depending on its nature. Internally-generated intangible assets are expensed in the income statement as incurred. Purchased computer software and certain costs of information technology projects are capitalised as intangible assets. Software that is integral to computer hardware is capitalised as plant and equipment.

Impairment of intangible assets

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

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

	Technology \$ million	Product- related \$ million	Customer and distribution related \$ million	Software \$ million	Assets in course of construction \$ million	Total \$ million
Cost						
At 1 January 2017	301	1,849	121	329	–	2,600
Exchange adjustment	10	38	1	12	–	61
Acquisitions ¹	59	2	–	–	–	61
Additions	–	2	3	63	–	68
Disposals	(6)	(43)	(5)	(5)	–	(59)
Transfers	(6)	6	–	4	–	4
At 31 December 2017	358	1,854	120	403	–	2,735
Exchange adjustment	(4)	(18)	(8)	(6)	–	(36)
Additions	–	1	–	8	6	15
Disposals	–	(1)	–	(4)	–	(5)
Transfers	–	–	–	12	7	19
At 31 December 2018	354	1,836	112	413	13	2,728
Amortisation and impairment						
At 1 January 2017	36	886	80	187	–	1,189
Exchange adjustment	2	21	1	6	–	30
Charge for the year:						
Amortisation	6	133	15	38	–	192
Impairment	–	10	–	–	–	10
Disposals	11	(61)	(3)	(4)	–	(57)
Transfers	(4)	4	–	–	–	–
At 31 December 2017	51	993	93	227	–	1,364
Exchange adjustment	(1)	(14)	(4)	(3)	–	(22)
Charge for the year:						
Amortisation	24	103	6	43	–	176
Impairment	–	–	–	3	–	3
Disposals	–	(1)	–	(2)	–	(3)
At 31 December 2018	74	1,081	95	268	–	1,518
Net book amounts						
At 31 December 2018	280	755	17	145	13	1,210
At 31 December 2017	307	861	27	176	–	1,371

¹ In 2017 this relates to technology and product-related intangibles acquired with the purchase of Rotation Medical, Inc.

Transfers into software and assets in course of construction includes \$19m (2017: \$4m) of software transferred from property, plant and equipment.

NOTES TO THE GROUP ACCOUNTS continued

9 INTANGIBLE ASSETS continued

Amortisation and impairment of acquisition intangibles is set out below:

	2018 \$ million	2017 \$ million
Technology	24	6
Product-related	86	124
Customer and distribution related	3	10
Total	113	140

Group capital expenditure relating to software contracted but not provided for amounted to \$nil (2017: \$nil). There was no impairment charge in 2018. In 2017, a product-related intangible asset was determined to have a value in use below its carrying value, resulting in an impairment charge of \$10m being recognised.

10 INVESTMENTS**Accounting policy**

Investments, other than those related to associates, are initially recorded at fair value plus any directly attributable transaction costs on the trade date. The Group has investments in unquoted entities and an entity that holds mainly unquoted equity securities, which by their nature have no fixed maturity date or coupon rate. These investments are classed as fair value through profit or loss. The fair value of these investments is based on the underlying fair value of the equity securities: marketable securities are valued by reference to closing prices in the market; and non-marketable securities are estimated considering factors including the purchase price; prices of recent significant private placements of securities of the same issuer and estimates of liquidation value. Changes in fair value based on externally observable valuation events are recognised in profit or loss.

The investments accounting policy for the year ending 31 December 2017 was consistent with the requirements of IAS 39. Changes in fair value were recorded through other comprehensive income, rather than through profit or loss.

	2018 \$ million	2017 \$ million
At 1 January	21	25
Additions	4	8
Fair value remeasurement ¹	9	(10)
Impairment	–	(2)
At 31 December	34	21

¹ The Group adopted IFRS 9 on 1 January 2018 and elected to present changes in the fair value of trade investments in the income statement from that date. The fair value remeasurement of trade investments in 2017 was recognised in other comprehensive income.

11 INVESTMENTS IN ASSOCIATES**Accounting policy**

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

At 31 December 2018 and 31 December 2017, the Group holds 49% of Bioventus LLC (Bioventus). Bioventus is a limited liability company operating as a partnership. The company's headquarters is located in Durham, North Carolina, US. Bioventus focuses its medical product development around its core competencies of orthobiologic therapies and orthopaedic diagnostics from which it develops and markets clinically proven orthopaedic therapies and diagnostic tools, including osteoarthritis pain treatments, bone growth stimulators and ultrasound devices. Bioventus sells bone healing stimulation devices and is a provider of osteoarthritis injection therapies. The Group's ability to recover the value of its investment is dependent upon the ongoing clinical and commercial success of these products. The loss after taxation recognised in the income statement relating to Bioventus was \$11m (2017: \$6m profit).

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

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

	2018 \$ million	2017 \$ million
Balance sheet	105	118
Income statement (loss)/profit	(11)	6

Summarised financial information for significant associates

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

	2018 \$ million	2017 \$ million
Summarised statement of comprehensive income		
Revenue	320	301
Attributable (loss)/profit for the year	(19)	1
Group adjustments ¹	(3)	11
Total comprehensive (loss)/profit	(22)	12
Group share of (loss)/profit for the year at 49%	(11)	6

	2018 \$ million	2017 \$ million
Summarised balance sheet		
Non-current assets	296	332
Current assets	149	122
Non-current liabilities	(234)	(246)
Current liabilities	(56)	(47)
Net assets	155	161
Group's share of net assets at 49%	76	79
Group adjustments ¹	26	35
Group's carrying amount of investment at 49%	102	114

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

During the year the Group received a \$2m (2017: \$nil) cash distribution from Bioventus.

At December 2018, the Group held an equity investment in one other associate (2017: one) with a carrying value of \$3m (2017: \$3m).

12 INVENTORIES

Accounting policy

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

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

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

NOTES TO THE GROUP ACCOUNTS continued

12 INVENTORIES continued

	2018 \$ million	2017 \$ million	2016 \$ million
Raw materials and consumables	219	207	213
Work-in-progress	88	69	55
Finished goods and goods for resale	1,088	1,028	976
	1,395	1,304	1,244

Reserves for excess and obsolete inventories were \$305m (2017: \$296m, 2016: \$303m). The increase in reserves of \$9m in the year comprised a \$19m increase in the reserve relating to the write-off of inventory which was partially offset by foreign exchange movements of \$10m.

The determination of the estimate of excess and obsolete inventory is a critical accounting estimate and includes assumptions on the future usage of all different items of finished goods. This estimate is not considered to have a range of potential outcomes that is significantly different to the \$305m held at 31 December 2018.

The cost of inventories recognised as an expense and included in cost of goods sold amounted to \$1,126m (2017: \$1,013m, 2016: \$1,131m). In addition, \$94m was recognised as an expense within cost of goods sold resulting from inventory write-offs (2017: \$68m, 2016: \$85m).

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

13 TRADE AND OTHER RECEIVABLES**Accounting policy**

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

The trade and other receivables accounting policy for the year ending 31 December 2017 was consistent with the requirements of IAS 39. Provisions against trade receivables were based on incurred losses, rather than the expected credit loss allowance.

The Group manages credit risk through credit limits which require authorisation commensurate with the size of the limit and which are regularly reviewed. Credit limit decisions are made based on available financial information and the business case. Significant receivables are regularly reviewed and monitored at Group level. The Group has no significant concentration of credit risk, with exposure spread over a large number of customers and geographies. Furthermore, the Group's principal customers are backed by government and public or private medical insurance funding, which historically represent a lower risk of default. The maximum exposure to credit risk at the reporting date is the fair value of each class of receivable. The Group does not hold any collateral as security. Allowance losses are calculated by reviewing lifetime expected credit losses using historic and forward-looking data on credit risk. The Group performed the calculation of expected credit loss rates separately for customer groups which were segmented based on common risk characteristics such as credit risk grade and type of customer (such as government and non-government).

	2018 \$ million	2017 \$ million	2016 \$ million
Trade and other receivables due within one year			
Trade receivables	1,166	1,125	1,042
Less: loss allowance	(62)	(69)	(54)
Trade receivables – net	1,104	1,056	988
Derivatives – forward foreign exchange, currency swaps and interest rate contracts	37	28	48
Other receivables	107	92	76
Prepayments	69	82	73
	1,317	1,258	1,185
Due after more than one year			
Other non-current assets	16	16	–
	1,333	1,274	1,185

Trade receivables are classified as loans and receivables. Management considers that the carrying amount of trade and other receivables approximates to the fair value. Allowance losses are calculated by reviewing lifetime expected credit losses using historic and forward-looking data on credit risk. The loss allowance expense for the year was \$14m (2017: \$17m expense, 2016: \$7m expense). Other non-current assets primarily relate to long-term prepayments.

The following table provides information about the ageing of and expected credit losses for trade receivables:

	2018 Weighted average loss rate %	2018 Loss allowance \$ million	2018 Gross carrying amount \$ million	2017 Gross carrying amount \$ million	2016 Gross carrying amount \$ million
Not past due	0.3%	(2)	647	664	725
Past due not more than 3 months	0.4%	(1)	271	225	142
Past due not more than 3–6 months	2.6%	(2)	78	65	51
Past due more than 6 months	33.5%	(57)	170	171	124
		(62)	1,166	1,125	1,042
Loss allowance			(62)	(69)	(54)
Trade receivables – net			1,104	1,056	988

The Group's expected credit loss accounting policy includes guidance on how the expected credit loss percentages should be determined; it does not include preset limits as the customer groups and risk profiles are not consistent across all of our markets. Each market determines their own percentages based on their historic experience and future expectations, and in line with the general guidance in the Group's policy.

Movements in the loss allowance were as follows:

	2018 \$ million	2017 \$ million	2016 \$ million
At 31 December	69	54	64
Adjustment on initial application of IFRS 9	14		
Adjusted balance at 1 January	83		
Exchange adjustment	(3)	3	(3)
Reclassification ¹	(8)	–	–
Acquisitions	–	1	–
Net receivables provided during the year	14	17	7
Utilisation of provision	(24)	(6)	(14)
At 31 December	62	69	54

¹ On transition to IFRS 9, the Group reclassified a credit note provision from the loss allowance to gross trade receivables.

Trade receivables include amounts denominated in the following major currencies:

	2018 \$ million	2017 \$ million	2016 \$ million
US Dollar	527	418	416
Sterling	45	54	57
Euro	201	212	193
Other	331	372	322
Trade receivables – net	1,104	1,056	988

14 TRADE AND OTHER PAYABLES

	2018 \$ million	2017 \$ million
Trade and other payables due within one year		
Trade and other payables	854	873
Derivatives – forward foreign exchange, currency swaps and interest rate contracts	25	48
Acquisition consideration	78	36
	957	957
Other payables due after one year		
Acquisition consideration	49	124
Other payables	4	4
	53	128

NOTES TO THE GROUP ACCOUNTS continued

14 TRADE AND OTHER PAYABLES continued

The acquisition consideration includes \$99m (2017: \$104m) contingent upon future events.

The acquisition consideration due after more than one year is expected to be payable as follows: \$21m in 2020, \$23m in 2021, \$1m in 2022, \$1m in 2023, and \$3m due in over five years (2017: \$50m in 2019, \$24m in 2020, \$43m in 2021, \$2m in 2022, and \$5m due in over five years).

15 CASH AND BORROWINGS**15.1 Net debt**

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

	2018 \$ million	2017 \$ million
Bank overdrafts, borrowings and loans due within one year	164	27
Long-term bank borrowings	304	300
Private placement notes	997	1,123
Borrowings	1,465	1,450
Cash at bank	(365)	(169)
Credit/(debit) balance on derivatives – currency swaps	1	(2)
Credit balance on derivatives – interest rate swaps	3	2
Net debt	1,104	1,281

Borrowings are repayable as follows:

	Within one year or on demand \$ million	Between one and two years \$ million	Between two and three years \$ million	Between three and four years \$ million	Between four and five years \$ million	After five years \$ million	Total \$ million
At 31 December 2018							
Bank loans	7	–	–	304	–	–	311
Bank overdrafts	32	–	–	–	–	–	32
Private placement notes	125	–	262	125	105	505	1,122
	164	–	262	429	105	505	1,465
At 31 December 2017							
Bank loans	13	–	300	–	–	–	313
Bank overdrafts	14	–	–	–	–	–	14
Private placement notes	–	124	–	264	125	610	1,123
	27	124	300	264	125	610	1,450

15.2 Liquidity risk exposures

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

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

The Group has available committed facilities of \$2.4bn (2017: \$2.4bn). The interest payable on borrowings under committed facilities is either at fixed or floating rates. Floating rates are typically based on the LIBOR (or other reference rate) relevant to the term and currency concerned.

The Company is subject to restrictive covenants under its principal facility agreements. These financial covenants are tested at the end of each half year for the 12 months ending on the last day of the testing period. As of 31 December 2018, the Company was in compliance with these covenants. The facilities are also subject to customary events of default, none of which are currently anticipated to occur.

The Group's committed facilities are:

Facility	Date due
\$80 million 2.47% Senior Notes	November 2019
\$45 million Floating Rate Senior Notes	November 2019
\$75 million 3.23% Senior Notes	January 2021
\$190 million 2.97% Senior Notes	November 2021
\$75 million 3.46% Senior Notes	January 2022
€265 million bilateral, term loan facility	April 2022
\$50 million 3.15% Senior Notes	November 2022
\$1.0 billion syndicated, revolving credit facility	June 2023
\$105 million 3.26% Senior Notes	November 2023
\$100 million 3.89% Senior Notes	January 2024
\$305 million 3.36% Senior Notes	November 2024
\$25 million Floating Rate Senior Notes	November 2024
\$75 million 3.99% Senior Notes	January 2026

15.3 Year end financial liabilities by contractual maturity

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

	Within one year or on demand \$ million	Between one and two years \$ million	Between two and five years \$ million	After five years \$ million	Total \$ million
At 31 December 2018					
Non-derivative financial liabilities:					
Bank overdrafts and loans	39	–	304	–	343
Trade and other payables	854	1	1	2	858
Private placement notes	164	35	571	522	1,292
Acquisition consideration	78	21	25	3	127
Derivative financial liabilities:					
Currency swaps/forward foreign exchange contracts – outflow	2,394	–	–	–	2,394
Currency swaps/forward foreign exchange contracts – inflow	(2,393)	–	–	–	(2,393)
	1,136	57	901	527	2,621
At 31 December 2017					
Non-derivative financial liabilities:					
Bank overdrafts and loans	27	–	300	–	327
Trade and other payables	873	1	1	2	877
Private placement notes	36	161	476	647	1,320
Acquisition consideration	36	50	69	5	160
Derivative financial liabilities:					
Currency swaps/forward foreign exchange contracts – outflow	2,737	–	–	–	2,737
Currency swaps/forward foreign exchange contracts – inflow	(2,739)	–	–	–	(2,739)
	970	212	846	654	2,682

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

NOTES TO THE GROUP ACCOUNTS continued

15 CASH AND BORROWINGS continued**15.4 Liquidity and capital resources**

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

At 31 December 2018, the Group held \$333m (2017: \$155m, 2016: \$38m) in cash net of bank overdrafts. The Group had committed facilities available of \$2,429m at 31 December 2018 of which \$1,429m was drawn. Smith & Nephew intends to repay the amounts due within one year using available cash and drawing down on the longer term facilities.

The principal variations in the Group's borrowing requirements result from the timing of dividend payments, acquisitions and disposals of businesses, timing of capital expenditure and working capital fluctuations. Smith & Nephew believes that its capital expenditure needs and its working capital funding for 2019, as well as its other known or expected commitments or liabilities, can be met from its existing resources and facilities. The Group's net debt decreased from \$1,281m at the beginning of 2018 to \$1,104m at the end of 2018, representing an overall decrease of \$177m.

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

16 FINANCIAL INSTRUMENTS AND RISK MANAGEMENT**Accounting policy****Derivative financial instruments**

Derivative financial instruments are initially recognised at fair value on the date a derivative contract is entered into and are subsequently remeasured at their fair value at subsequent balance sheet dates. Changes in the fair value of derivative financial instruments that are designated and effective as cash flow hedges of forecast third party transactions are recognised in other comprehensive income until the associated asset or liability is recognised. Amounts taken to other comprehensive income are transferred to the income statement in the period in which the hedged transaction affects profit and loss. Where the hedged item is the cost of a non-financial asset, the amounts taken to other comprehensive income are transferred to the initial carrying value of the asset.

Changes in the fair values of hedging instruments that are designated and effective as net investment hedges are matched in other comprehensive income against changes in value of the related net assets. Interest rate derivatives transacted to fix interest rates on floating rate borrowings are accounted for as cash flow hedges and changes in the fair values resulting from changes in market interest rates are recognised in other comprehensive income. Amounts taken to other comprehensive income are transferred to the income statement when the hedged transaction affects profit and loss. Interest rate derivatives transacted to convert fixed rate borrowings into floating rate borrowings are accounted for as fair value hedges and changes in the fair values resulting from changes in market interest rates are recognised in the income statement. Any ineffectiveness on hedging instruments and changes in the fair value of derivative financial instruments that do not qualify for hedge accounting are recognised in the income statement within other finance costs as they arise.

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

16.1 Foreign exchange risk management

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

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

The impact of currency movements on the cost of purchases is partly mitigated by the use of forward foreign exchange contracts. The Group uses forward foreign exchange contracts, designated as cash flow hedges, to hedge forecast third party trading cash flows up to one year. When a commitment is entered into, forward foreign exchange contracts are normally used to increase the hedge to 100% of the exposure. Cash flows relating to cash flow hedges are expected to occur within 12 months of inception and profits and losses on hedges are expected to enter into the determination of profit (within cost of goods sold) within a further 12-month period. The principal currencies hedged by forward foreign exchange contracts are US Dollars, Euros, Sterling and Singapore Dollars. At 31 December 2018, the Group had contracted to exchange within one year the equivalent of \$2.1bn (2017: \$2.3bn). Based on the Group's net borrowings as at 31 December 2018, if the US Dollar were to weaken against all currencies by 10%, the Group's net borrowings would increase by \$25m (2017: decrease by \$3m) principally due to the €265m term loan.

If the US Dollar were to weaken by 10% against all other currencies, then the fair value of the forward foreign exchange contracts as at 31 December 2018 would have been \$38m lower (2017: \$53m lower). Similarly, if the Euro were to weaken by 10% against all other currencies, then the fair value of the forward foreign exchange contracts as at 31 December 2018 would have been \$15m higher (2017: \$12m higher). Movements in the fair value of forward foreign exchange contracts would be recognised in other comprehensive income and accumulated in the hedging reserve.

A 10% strengthening of the US Dollar or Euro against all other currencies at 31 December 2018 would have had the equal but opposite effect to the amounts shown above, on the basis that all other variables remain constant.

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

16.2 Interest rate risk management

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

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

Based on the Group's gross borrowings and cash as at 31 December 2018, if interest rates were to increase by 100 basis points in all currencies then the annual net interest charge would increase by \$3m (2017: \$6m). A decrease in interest rates by 100 basis points in all currencies would have an equal but opposite effect to the amounts shown above.

16.3 Credit risk management

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

The maximum credit risk exposure on derivatives at 31 December 2018 was \$37m (2017: \$28m), being the total debit fair values on forward foreign exchange contracts and currency swaps. The maximum credit risk exposure on cash at bank at 31 December 2018 was \$365m (2017: \$169m). The Group's exposure to credit risk is not material as the amounts are held in a wide number of banks in a number of different countries.

Credit risk on trade receivables is detailed in Note 13.

NOTES TO THE GROUP ACCOUNTS continued

16 FINANCIAL INSTRUMENTS AND RISK MANAGEMENT continued

The amounts relating to items designated as hedging instruments were as follows:

	Nominal amount \$ million	Carrying Amount: Assets \$ million	Carrying Amount: Liabilities \$ million	Changes in fair value in OCI \$ million	Hedge ineffectiveness in profit or loss \$ million	Amounts reclassified from hedging reserve to profit or loss \$ million	Line item in profit or loss
At 31 December 2018							
Foreign currency risk							
Forward exchange contracts ¹	2,394	37	(22)	23	–	2	Cash flow hedges
Interest rate risk							
Interest rate swaps ²	(200)	–	(3)	–	–	–	N/A
At 31 December 2017							
Foreign currency risk							
Forward exchange contracts ¹	2,737	25	(45)	(24)	–	21	Cash flow hedges
Interest rate risk							
Interest rate swaps ²	(200)	–	(2)	–	–	–	N/A

1 Presented in Trade and other receivables and Trade and other payables on the Balance Sheet.

2 Presented in Trade and other payables on the Balance Sheet.

16.4 Net investment hedge

Part of the Group's net investment in its Euro subsidiaries is hedged by a new €265m Euro-denominated bank loan which mitigates the foreign currency risk arising from the subsidiaries' net assets. The loan is designated as a hedging instrument for the changes in the value of the net investment that is attributable to changes in the EUR/USD spot rate, and is 100% hedged.

To assess hedge effectiveness, the Group determines the economic relationship between the hedging instrument and the hedged item by comparing changes in the carrying amount of the debt that is attributable to a change in the spot rate with changes in the investment in the foreign operation due to movements in the spot rate (the offset method). The Group's policy is to hedge the net investment only to the extent of the debt principal. Hedge ineffectiveness occurs if the value of the Euro-denominated bank loan exceeds the value of the Euro subsidiaries.

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

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

Currency and interest rate profile of interest bearing liabilities:

	Gross borrowings \$ million	Currency swaps \$ million	Interest rate swaps \$ million	Total liabilities \$ million	Floating rate liabilities \$ million	Fixed rate liabilities \$ million	Weighted average interest rate %	Weighted average time for which rate is fixed Years
At 31 December 2018								
US Dollar	(1,142)	(193)	(3)	(1,338)	(483)	(855)	3.4	4.8
Other	(323)	(61)	–	(384)	(384)	–	–	–
Total interest bearing liabilities	(1,465)	(254)	(3)	(1,722)	(867)	(855)		
At 31 December 2017								
US Dollar	(1,428)	(291)	(2)	(1,721)	(866)	(855)	3.4	5.8
Other	(22)	(95)	–	(117)	(117)	–	–	–
Total interest bearing liabilities	(1,450)	(386)	(2)	(1,838)	(983)	(855)		

In 2018, the Group also had liabilities due for deferred and contingent acquisition consideration (denominated in US Dollars, Euros and Russian Rubles) totalling \$127m (2017: \$160m, 2016: \$120m) on which no interest was payable (see Note 14). There were no other significant interest bearing or non-interest bearing financial liabilities. Floating rates on liabilities are typically based on the one, three or six-month LIBOR (or other reference rate) relevant to the currency concerned. The weighted average interest rate on floating rate borrowings as at 31 December 2018 was 4% (2017: 3%).

Currency and interest rate profile of interest bearing assets:

	Interest rate swaps \$ million	Cash at bank \$ million	Currency swaps \$ million	Total assets \$ million	Floating rate assets \$ million	Fixed rate assets \$ million
At 31 December 2018						
US Dollars	–	289	60	349	349	–
Other	–	76	193	269	269	–
Total interest bearing assets	–	365	253	618	618	–
At 31 December 2017						
US Dollars	–	110	94	204	204	–
Other	–	59	294	353	353	–
Total interest bearing assets	–	169	388	557	557	–

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

16.6 Fair value of financial assets and liabilities

Accounting policy

Measurement of fair values

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

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

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

There has been no change in the classification of financial assets and liabilities, the method and assumptions used in determining fair value and the categorisation of financial assets and liabilities within the fair value hierarchy from those disclosed in the Annual Report for the year ended 31 December 2017 other than as disclosed in Note 1.

The Group enters into derivative financial instruments with financial institutions with investment grade credit ratings. The fair value of forward foreign exchange contracts is calculated by reference to quoted market forward exchange rates for contracts with similar maturity profiles. The fair value of currency swaps is determined by reference to quoted market spot rates. As a result, foreign forward exchange contracts and currency swaps are classified as Level 2 within the fair value hierarchy. The changes in counterparty credit risk had no material effect on the hedge effectiveness for derivatives designated in hedge relationships and other financial instruments recognised at fair value. The fair value of investments is based upon third party pricing models for share issues. As a result, investments are considered Level 3 in the fair value hierarchy. There were no transfers between Levels 1, 2 and 3 during 2018 and 2017. For cash and cash equivalents, short-term loans and receivables, overdrafts and other short-term liabilities which have a maturity of less than three months, the book values approximate the fair values because of their short-term nature.

Long-term borrowings are measured in the balance sheet at amortised cost. As the Group's long-term borrowings are not quoted publicly and as market prices are not available, their fair values are estimated by discounting future contractual cash flows to net present values at the current market interest rates available to the Group for similar financial instruments as at the year end. The fair value of the private placement notes is determined using a discounted cash flow model based on prevailing market rates.

NOTES TO THE GROUP ACCOUNTS continued

16 FINANCIAL INSTRUMENTS AND RISK MANAGEMENT continued

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

	Carrying amount						Fair value		
	Fair value – hedging instruments \$ million	Amortised cost \$ million	Fair value through OCI \$ million	Fair value through profit or loss \$ million	Other financial liabilities \$ million	Total \$ million	Level 2 \$ million	Level 3 \$ million	Total \$ million
At 31 December 2018									
Financial assets measured at fair value									
Forward foreign exchange contracts	36	–	–	–	–	36	36	–	36
Investments	–	–	–	34	–	34	–	34	34
Currency swaps	–	–	1	–	–	1	1	–	1
	36	–	1	34	–	71			
Financial liabilities measured at fair value									
Acquisition consideration	–	–	–	(99)	–	(99)	–	(99)	(99)
Forward foreign exchange contracts	(20)	–	–	–	–	(20)	(20)	–	(20)
Currency swaps	–	–	(2)	–	–	(2)	(2)	–	(2)
Interest rate swaps	(3)	–	–	–	–	(3)	(3)	–	(3)
	(23)	–	(2)	(99)	–	(124)			
Financial assets not measured at fair value									
Trade and other receivables	–	1,211	–	–	–	1,211			
Cash at bank	–	365	–	–	–	365			
	–	1,576	–	–	–	1,576			
Financial liabilities not measured at fair value									
Acquisition consideration	–	–	–	(28)	–	(28)			
Bank overdrafts	–	–	–	–	(32)	(32)			
Bank loans	–	–	–	–	(311)	(311)			
Private placement debt in a hedge relationship	–	–	–	–	(197)	(197)			
Private placement debt not in a hedge relationship	–	–	–	–	(925)	(925)			
Trade and other payables	–	–	–	–	(858)	(858)			
	–	–	–	(28)	(2,323)	(2,351)			

During the year ended 31 December 2018, acquisition consideration decreased by \$33m due to \$29m of payments for acquisitions made in prior years and \$4m of remeasurements. The fair value of contingent consideration is estimated using a discounted cash flow model. The valuation model considers the present value of expected payment, discounted using a risk-adjusted discount rate. The expected payment is determined by considering the possible scenarios, which relate to the achievement of established milestones and targets, the amount to be paid under each scenario and the probability of each scenario. As a result, contingent consideration is classified as Level 3 within the fair value hierarchy.

	Fair value – hedging instruments \$ million	Amortised cost \$ million	Fair value through OCI \$ million	Fair value through profit or loss \$ million	Other financial liabilities \$ million	Carrying amount		Fair value	
						Total \$ million	Level 2 \$ million	Level 3 \$ million	Total \$ million
At 31 December 2017									
Financial assets measured at fair value									
Forward foreign exchange contracts	25	–	–	–	–	25	25	–	25
Investments	–	–	–	21	–	21	–	21	21
Currency swaps	–	–	3	–	–	3	3	–	3
	25	–	3	21	–	49			
Financial liabilities measured at fair value									
Acquisition consideration	–	–	–	(104)	–	(104)	–	(104)	(104)
Forward foreign exchange contracts	(45)	–	–	–	–	(45)	(45)	–	(45)
Currency swaps	–	–	(1)	–	–	(1)	(1)	–	(1)
Interest rate swaps	(2)	–	–	–	–	(2)	(2)	–	(2)
	(47)	–	(1)	(104)	–	(152)			
Financial assets not measured at fair value									
Trade and other receivables	–	1,148	–	–	–	1,148			
Cash at bank	–	169	–	–	–	169			
	–	1,317	–	–	–	1,317			
Financial liabilities not measured at fair value									
Acquisition consideration	–	–	–	(56)	–	(56)			
Bank overdrafts	–	–	–	–	(14)	(14)			
Bank loans	–	–	–	–	(313)	(313)			
Private placement debt in a hedge relationship	–	–	–	–	(198)	(198)			
Private placement debt not in a hedge relationship	–	–	–	–	(925)	(925)			
Trade and other payables	–	–	–	–	(877)	(877)			
	–	–	–	(56)	(2,327)	(2,383)			

NOTES TO THE GROUP ACCOUNTS continued

17 PROVISIONS AND CONTINGENCIES**Accounting policy**

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

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

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

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

17.1 Provisions

	Rationalisation provisions \$ million	Metal-on-metal \$ million	Legal and other provisions \$ million	Total \$ million
At 1 January 2017	20	163	98	281
Net charge to income statement	–	10	2	12
Unwinding of discount	–	3	–	3
Utilised	(15)	(19)	(28)	(62)
Transfers	–	–	(9)	(9)
Exchange adjustment	1	–	–	1
At 31 December 2017	6	157	63	226
Net charge to income statement	120	72	(2)	190
Unwinding of discount	–	4	–	4
Utilised	(90)	(41)	(14)	(145)
Exchange adjustment	(1)	–	–	(1)
At 31 December 2018	35	192	47	274
Provisions – due within one year	35	50	36	121
Provisions – due after one year	–	142	11	153
At 31 December 2018	35	192	47	274
Provisions – due within one year	6	73	50	129
Provisions – due after one year	–	84	13	97
At 31 December 2017	6	157	63	226

The principal elements within rationalisation provisions relate to the implementation of the Accelerating Performance and Execution (APEX) programme that was announced in February 2018.

Following the settlement of a group of the US metal-on-metal hip claims (discussed below) the Group has estimated a provision of \$192m (2017: \$157m) relating to the present value at 31 December 2018 of the estimated costs to resolve all other known and anticipated metal-on-metal hip claims globally. The estimated value of the provision has been determined using an actuarial model. Given the inherent uncertainty in assumptions relating to factors such as the number of claims and outcomes, the actual costs may differ significantly from this estimate. A range of expected outcomes between the 5th and 95th percentile generated by the actuarial model would not give rise to a significantly different outcome in 2019. Based on the actuarial model the likelihood of a charge similar to that incurred in 2018 being incurred in 2019 is remote. The provision does not include any possible insurance recoveries on these claims or legal fees associated with defending claims. The Group carries considerable product liability insurance, and will continue to defend claims vigorously.

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

All provisions are expected to be substantially utilised within five years of 31 December 2018 and none are treated as financial instruments.

17.2 Contingencies

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

In August 2003, the Group withdrew voluntarily from all markets the macrotextured versions of its OXINIUM femoral knee components. A charge of \$154m was recorded in 2004 for anticipated expenses in connection with macrotexture claims. Most of that amount has since been applied to settlements of such claims, and all claims have now been resolved. The aggregate cost at 31 December 2018 related to this matter is approximately \$205m. The Group has sought recovery from its primary and excess insurers for costs of resolving the claims. The primary insurance carrier has paid \$60m in full settlement of its policy liability. However, the excess carriers denied coverage, citing defences relating to the wording of the insurance policies and other matters. In December 2004, the Group brought suit against them in the US district court for the Western District of Tennessee. An additional \$22m was received during 2007 from a successful settlement with a third party. In 2018, the Group agreed to settle the suit against the insurers for a total of approximately \$84m which has been recognised in the Group's 2018 operating profit.

17.3 Legal proceedings

Product liability claims

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

In recent years, there has been heightened concern about possible adverse effects of hip implant products with metal-on-metal bearing surfaces, and the Group has incurred, and will continue to incur expenses to defend claims in this area. As of February 2019, and giving effect to the US settlements described below, approximately 1,023 such claims were pending with the Group around the world. Most claims relate to the Group's Birmingham Hip Resurfacing (BHR) product and its two modular metal-on-metal components: the Birmingham Hip Modular Head (BHMH) and the optional metal liner component of the R3 Acetabular System (R3ML). The BHMH and R3ML are no longer on the market: the R3ML was withdrawn in 2012 and the BHMH was phased out in 2014. In 2015, the Group ceased offering smaller sizes of the BHR and restricted instructions for BHR use in female patients. These actions were taken to ensure that the BHR is only used in those patient groups where it continues to demonstrate strong performance.

In 2015 and 2016, the Group's US subsidiary settled a large part of the majority of its US metal-on-metal hip lawsuits in two group settlements, without admitting liability. Insurance receipts covered most of the amounts paid, with the net cash cost being \$25m. In November 2017, the Group's US subsidiary entered into a memorandum of understanding to settle a third group of claims, without admitting liability. The third settlement was finalised in 2018. These cases principally related to the Group's modular metal-on-metal hip components, which are no longer on the market. On 5 April 2017, the Judicial Panel on Multidistrict Litigation (MDL) ordered Smith & Nephew BHR cases pending or later filed in US federal court to be consolidated for pre-trial proceedings and transferred to the federal court in Baltimore, Maryland. As of February 2019, there were approximately 571 cases pending in the MDL in the United States. In England and Wales, the Group's UK subsidiary entered into a group settlement in 2017 to settle 150 claims principally related to the Group's modular metal-on-metal hip component, which are no longer on the market. Metal-on-metal hip implant claims against various companies in England and Wales were consolidated for trials under group litigation orders in the High Court in London. As of February 2019, the majority of the BHR claims pending against the Group in England and Wales have been discontinued.

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

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

Intellectual property disputes

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

NOTES TO THE GROUP ACCOUNTS continued

17 PROVISIONS AND CONTINGENCIES continued

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

In February 2016, ConforMIS, Inc. filed suit against the Group's US subsidiary in the Eastern Division of the US District Court for the District of Massachusetts, alleging that a number of its patents (generally directed to patient specific instrumentation associated with knee arthroplasty) are infringed by Smith & Nephew's VISIONAIRE cutting guides and associated knee implants. The suit requested damages and an injunction. Smith & Nephew sought to invalidate the asserted patents at the US Patent & Trademark Office and has also filed counterclaims for infringement by ConforMIS of the Group's US patents. In September 2018, the Group entered into a settlement with ConforMis whereby Smith & Nephew paid \$10.5m to settle the dispute and obtain a non-exclusive license under ConforMis patents pertaining to patient-specific instruments.

Smith & Nephew brought suit against Hologic in the US District Court for Massachusetts (Boston) in June 2010 for infringement of two patents. A trial was held in September 2012. The jury returned a verdict in Smith & Nephew's favour, finding both asserted patents valid and infringed. Smith & Nephew's motion for permanent injunction was granted, but stayed pending the result of re-examination proceedings instituted by Hologic in the United States Patent & Trademark Office (USPTO). In August 2016, Smith & Nephew divested its Gynaecology business to Medtronic, but retained rights to assert these patents against Hologic. On 25 October 2016, the USPTO upheld validity of one of the patents and Hologic appealed this decision. On 14 March 2018, the Federal Circuit affirmed the USPTO and again upheld validity of the patent. In October 2018, the parties reached a settlement and Hologic agreed to pay an amount approximating \$35m. After deductions of payments to interested third parties, the Group recognised approximately \$23m from this payment in the Group's 2018 operating profit.

17.4 Tax Matters

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

18 RETIREMENT BENEFIT OBLIGATIONS

Accounting policy

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

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

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

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

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

18.1 Retirement benefit net assets/(obligations)

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

	2018 \$ million	2017 \$ million
Funded plans:		
UK Plan	77	53
US Plan	13	9
Other plans	(34)	(46)
	56	16
Unfunded plans:		
Other plans	(60)	(60)
Retirement healthcare	(18)	(25)
	(22)	(69)
Amount recognised on the balance sheet – liability	(114)	(131)
Amount recognised on the balance sheet – asset	92	62

The Group sponsors defined benefit pension plans for its employees or former employees in 14 countries and these are established under the laws of the relevant country. Funded plans are funded by the payment of contributions and the assets are held by separate trust funds or insurance companies. The provision of retirement and related benefits across the Group is kept under regular review. Employees' retirement benefits are the subject of regular management review. The Group's defined benefit plans provide employees with an entitlement to retirement benefits varying between 1.3% and 66.7% of final salary on attainment of retirement age. The level of entitlement is dependent on the years of service of the employee.

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

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

NOTES TO THE GROUP ACCOUNTS continued

18 RETIREMENT BENEFIT OBLIGATIONS continued

The 2018 court case in relation to Guaranteed Minimum Pensions does not impact the UK Plan as members were not contracted out of the State Earnings Related Pension (Serps) between 1990 and 1997.

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

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

18.2 Reconciliation of benefit obligations and pension assets

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

	2018			2017		
	Obligation \$ million	Asset \$ million	Total \$ million	Obligation \$ million	Asset \$ million	Total \$ million
Amounts recognised on the balance sheet at beginning of the period	(1,625)	1,556	(69)	(1,577)	1,413	(164)
Income statement expense:						
Current service cost	(12)	–	(12)	(12)	–	(12)
Past service credit	7	–	7	4	–	4
Settlements	–	–	–	–	–	–
Interest (expense)/income	(40)	40	–	(44)	42	(2)
Administration costs and taxes	(3)	–	(3)	(3)	–	(3)
Costs recognised in income statement	(48)	40	(8)	(55)	42	(13)
Re-measurements:						
Actuarial gain due to liability experience	6	–	6	1	–	1
Actuarial gain/(loss) due to financial assumptions change	97	–	97	(38)	–	(38)
Actuarial gain due to demographic assumptions	11	–	11	42	–	42
Return on plan assets (less than)/more than discount rate	–	(103)	(103)	–	59	59
Re-measurements recognised in OCI	114	(103)	11	5	59	64
Cash:						
Employer contributions	–	44	44	–	53	53
Employee contributions	(4)	4	–	(4)	4	–
Benefits paid directly by the Group	3	(3)	–	2	(2)	–
Benefits paid, taxes and administration costs paid from scheme assets	100	(100)	–	102	(102)	–
Net cash	99	(55)	44	100	(47)	53
Exchange rate movements	50	(50)	–	(98)	89	(9)
Amount recognised on the balance sheet	(1,410)	1,388	(22)	(1,625)	1,556	(69)
Amount recognised on the balance sheet – liability	(245)	131	(114)	(290)	159	(131)
Amount recognised on the balance sheet – asset	(1,165)	1,257	92	(1,335)	1,397	62

Represented by:

	2018			2017		
	Obligation \$ million	Asset \$ million	Total \$ million	Obligation \$ million	Asset \$ million	Total \$ million
UK Plan	(718)	795	77	(854)	907	53
US Plan	(424)	437	13	(481)	490	9
Other Plans	(268)	156	(112)	(290)	159	(131)
Total	(1,410)	1,388	(22)	(1,625)	1,556	(69)

All benefits are vested at the end of each reporting period. The weighted average duration of the defined benefit obligation at the end of the reporting period is 19 years and 11 years for the UK and US Plans respectively.

18.3 Plan assets

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

	2018 \$ million	2017 \$ million	2016 \$ million
UK Plan:			
Assets with a quoted market price:			
Cash and cash equivalents	2	8	6
Equity securities	127	235	213
Other bonds	41	43	38
Liability driven investments	246	192	239
Diversified growth funds	138	152	130
	554	630	626
Other assets:			
Insurance contract	241	277	214
Market value of assets	795	907	840
US Plan:			
Assets with a quoted market price:			
Cash and cash equivalents	–	–	–
Equity securities	79	88	178
Government bonds – fixed interest	91	201	128
Corporate bonds	267	201	128
Market value of assets	437	490	434
Other Plans:			
Assets with a quoted market price:			
Cash and cash equivalents	2	4	4
Equity securities	42	43	35
Government bonds – fixed interest	3	4	3
Government bonds – index linked	3	3	3
Corporate and other bonds	13	11	11
Insurance contracts	34	36	34
Property	20	19	12
Other quoted securities	4	2	2
	121	122	104
Other assets:			
Insurance contracts	35	37	35
Market value of assets	156	159	139
Total market value of assets	1,388	1,556	1,413

NOTES TO THE GROUP ACCOUNTS continued

18 RETIREMENT BENEFIT OBLIGATIONS continued

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

Both the UK and US Plans hold a mixture of growth assets and matching assets. The growth assets of the UK and US Plans are invested in a diversified range of industries across a broad range of geographies. The UK Plan matching assets include liability matching assets and annuity policies purchased by the trustees, which aim to match the benefits to be paid to certain members from the plan and therefore remove the investment, inflation and demographic risks in relation to those liabilities. The terms of the policy define that the contract value exactly matches the amount and timing of the pensioner obligations covered by the contract. In accordance with IAS 19R *Employee Benefits*, the fair value of the insurance contract is deemed to be the present value of the related obligations which is discounted at the AA corporate bond rate. In December 2014, the low risk asset portfolio held by the UK Plan was transferred into liability driven investments (LDI) which invests in a mixture of gilts and swaps.

18.4 Expenses recognised in the income statement

The total expense relating to retirement benefits recognised for the year is \$65m (2017: \$64m, 2016: \$23m). Of this cost recognised for the year, \$57m (2017: \$51m, 2016: \$48m) relates to defined contribution plans and \$8m (2017: \$13m net credit, 2016: \$25m net credit) relates to defined benefit plans.

The cost charged in respect of the Group's defined contribution plans represents contributions payable to these plans by the Group at rates specified in the rules of the plans. These were charged to operating profit in selling, general and administrative expenses. There were \$nil outstanding payments as at 31 December 2018 due to be paid over to the plans (2017: \$nil, 2016: \$nil).

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

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

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

	2018		2017		2016	
	UK Plan \$ million	US Plan \$ million	UK Plan \$ million	US Plan \$ million	UK Plan \$ million	US Plan \$ million
Service cost	–	–	–	–	7	–
Past service credit	–	–	–	–	(49)	–
Settlement loss	–	–	–	–	1	–
Net interest cost, administration and taxes	–	–	1	2	–	3
	–	–	1	2	(41)	3

18.5 Principal actuarial assumptions

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

	2018 % per annum	2017 % per annum	2016 % per annum
UK Plan:			
Discount rate	2.7	2.4	2.6
Future salary increases	n/a	n/a	3.8
Future pension increases	3.2	3.2	3.3
Inflation (RPI)	3.2	3.2	3.3
Inflation (CPI)	2.2	2.2	2.3
US Plan:			
Discount rate	4.2	3.5	4.0
Future salary increases	n/a	n/a	n/a
Inflation	n/a	n/a	n/a

Actuarial assumptions regarding future mortality are based on mortality tables. The UK uses the S2NA with projections in line with the CMI 2016 table and the US uses the RP2014 table with MP2018 scale. The current longevity underlying the values of the obligations in the defined benefit plans are as follows:

	2018 years	2017 years	2016 years
Life expectancy at age 60			
UK Plan:			
Males	28.9	28.8	29.7
Females	30.4	30.3	31.1
US Plan:			
Males	24.9	25.2	25.1
Females	27.1	27.4	27.4
Life expectancy at age 60 in 20 years' time			
UK Plan:			
Males	31.1	31.0	32.5
Females	31.9	31.8	33.0
US Plan:			
Males	25.1	25.5	25.4
Females	27.7	28.0	27.9

18.6 Sensitivity analysis

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

Changes to the inflation assumption will not have any effect on the US Pension Plan as it was closed to future accrual in 2014 and it has no other inflation-linked assumptions.

\$ million	Increase in pension obligation		Increase in pension cost	
	+50bps/+1yr	-50bps/-1yr	+50bps/+1 yr	-50bps/-1yr
UK Plan:				
Discount rate	-62.7	+73.0	-2	+2
Inflation	+66.6	-60.2	+1	-1
Mortality	+29.0	-28.8	+1	-
US Plan:				
Discount rate	-21.0	+23.0	-1	+1
Inflation	n/a	n/a	n/a	n/a
Mortality	+10.0	-10.2	-	-

NOTES TO THE GROUP ACCOUNTS continued

18 RETIREMENT BENEFIT OBLIGATIONS continued**18.7 Risk**

The pension plans expose the Group to the following risks:

Interest rate risk	<p>Volatility in financial markets can change the calculations of the obligation significantly as the calculation of the obligation is linked to yields on AA-rated corporate bonds. A decrease in the bond yield will increase the measure of plan liabilities, although this will be partially offset by increases in the value of matching plan assets such as bonds and insurance contracts.</p> <p>In the UK, the liability matching portfolio held in conventional and index-linked gilts was transferred into liability driven investments in order to reduce interest rate risk.</p>
Inflation risk	<p>The UK Plan is linked to inflation. A high rate of inflation will lead to a higher liability. This risk is managed by holding inflation-linked bonds and an inflation-linked insurance contract in respect of some of the obligation. In the UK, the liability matching portfolio held in conventional and index-linked gilts was transferred into liability driven investments in order to reduce inflation risk.</p> <p>The UK Plan is closed to future accrual which reduces the exposure to this risk. The US Plan is also closed to future accrual and has no other inflation-linkage thus eliminating the exposure to this risk.</p>
Investment risk	<p>If the return on plan assets is below the discount rate, all else being equal, there will be an increase in the plan deficit.</p> <p>In the UK, this risk is partially managed by a portfolio of liability matching assets and a bulk annuity, together with a dynamic de-risking policy to switch growth assets into liability matching assets over time.</p> <p>The US Plan has a dynamic de-risking policy to shift plan assets from return-seeking (growth) assets to liability matching assets over time. The US Pension Plan has an established glide path with two remaining funding level triggers that are designed to stabilize funding status by reducing the Plan's exposure to return-seeking assets.</p>
Longevity risk	<p>The present value of the plans defined benefit liability is calculated by reference to the best estimate of the mortality of the plan participants both during and after their employment. An increase in the life expectancy of plan participants above that assumed will increase the benefit obligation.</p> <p>The UK Plan, in order to minimise longevity risk, has entered into an insurance contract which covers a portion of pensioner obligations.</p>

18.8 Funding

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

UK Plan

The most recent full actuarial valuation of the UK Plan was undertaken as at 30 September 2015. The next full actuarial valuation as at 30 September 2018 has commenced. Contributions to the UK Plan in 2018 were \$25m (2017: \$24m, 2016: \$32m). This included supplementary payments of \$25m (2017: \$24m, 2016: \$26m).

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

US Plan

The most recent full actuarial valuation of the US Plan was undertaken as at 1 January 2018. The next full actuarial valuation will take place as at 1 January 2019. Future accruals to the US Plan ceased as at 31 March 2014. Contributions to the US Plan were \$10m (2017: \$20m, 2016: \$20m) which represented supplementary payments of \$10m (2017: \$20m, 2016: \$20m).

The planned supplementary contribution for 2019 is being kept under review given the funding status.

19 EQUITY

Accounting policy

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

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

19.1 Share capital

	Ordinary shares (20¢)		Deferred shares (£1.00)		Total \$ million
	Thousand	\$ million	Thousand	\$ million	
Authorised					
At 31 December 2016	1,223,591	245	50	–	245
At 31 December 2017	1,223,591	245	50	–	245
At 31 December 2018	1,223,591	245	50	–	245
Allotted, issued and fully paid					
At 1 January 2016	915,447	183	50	–	183
Share options	1,283	–	–	–	–
Shares cancelled	(13,007)	(3)	–	–	(3)
At 31 December 2016	903,723	180	50	–	180
Share options	655	–	–	–	–
Shares cancelled	(13,523)	(2)	–	–	(2)
At 31 December 2017	890,855	178	50	–	178
Share options	418	–	–	–	–
Shares cancelled	(3,321)	(1)	–	–	(1)
At 31 December 2018	887,952	177	50	–	177

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

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

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

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

NOTES TO THE GROUP ACCOUNTS continued

19 EQUITY continued

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

	2018 \$ million	2017 \$ million	2016 \$ million
Share capital	177	178	180
Share premium	608	605	600
Capital redemption reserve	18	17	15
Treasury shares	(214)	(257)	(432)
Retained earnings and other reserves	4,285	4,101	3,595
	4,874	4,644	3,958

19.2 Treasury shares

Treasury shares represent the holding of the Company's own shares in respect of the Smith & Nephew Employees' Share Trust and shares bought back as part of the share buy-back programme. In 2018 the Group purchased a total of 2.7m shares for a cost of \$48m as part of the ongoing programme to buy back an equivalent number of shares to those vesting as part of the employee share plans. In 2017 the Group purchased a total of 3.2m shares for a cost of \$52m as part of the same programme.

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

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

	Treasury \$ million	Employees' Share Trust \$ million	Total \$ million
At 1 January 2017	411	21	432
Shares purchased	52	–	52
Shares transferred from treasury	(19)	19	–
Shares transferred to Group beneficiaries	(9)	(17)	(26)
Shares cancelled	(201)	–	(201)
At 31 December 2017	234	23	257
Shares purchased	48	–	48
Shares transferred from treasury	(29)	29	–
Shares transferred to Group beneficiaries	(13)	(27)	(40)
Shares cancelled	(51)	–	(51)
At 31 December 2018	189	25	214

	Number of shares million	Number of shares million	Number of shares million
At 1 January 2017	27.8	1.5	29.3
Shares purchased	3.2	–	3.2
Shares transferred from treasury	(1.3)	1.3	–
Shares transferred to Group beneficiaries	(0.6)	(1.2)	(1.8)
Shares cancelled	(13.5)	–	(13.5)
At 31 December 2017	15.6	1.6	17.2
Shares purchased	2.7	–	2.7
Shares transferred from treasury	(1.9)	1.9	–
Shares transferred to Group beneficiaries	(0.9)	(1.8)	(2.7)
Shares cancelled	(3.3)	–	(3.3)
At 31 December 2018	12.2	1.7	13.9

19.3 Dividends

	2018 \$ million	2017 \$ million	2016 \$ million
The following dividends were declared and paid in the year:			
Ordinary final of 22.7¢ for 2017 (2016: 18.5¢, 2015: 19.0¢) paid 9 May 2018	198	162	170
Ordinary interim of 14.0¢ for 2018 (2017: 12.3¢, 2016: 12.3¢) paid 31 October 2018	123	107	109
	321	269	279

A final dividend for 2018 of 22.0¢ per ordinary share was proposed by the Board on 7 February 2019 and will be paid, subject to shareholder approval, on 8 May 2019 to shareholders on the Register of Members on 5 April 2019. The estimated amount of this dividend is \$192m. The Group pursues a progressive dividend policy, with the aim of increasing the US Dollar value of ordinary dividends over time broadly based on the Group's underlying growth in earnings, while taking into account capital requirements and cash flows. Future dividends will be dependent upon future earnings, the future financial condition of the Group and the Board's dividend policy. The Board reviews the appropriate level of total annual dividend each year at the time of the full year results. The Board intends that the interim dividend will be set by a formula and will be equivalent to 40% of the total dividend for the previous year. Smith & Nephew plc, the Parent Company of the Group, is a non-trading investment holding company which derives its distributable reserves from dividends paid by subsidiary companies. The distributable reserves of the Parent Company approximate to the balance on the profit and loss account reserve, less treasury shares and exchange reserves, which at 31 December 2018 amounted to \$2,274m.

20 CASH FLOW STATEMENT

Accounting policy

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

Analysis of net debt

	Cash \$ million	Overdrafts \$ million	Due within one year \$ million	Due after one year \$ million	Net currency swaps \$ million	Borrowings Net interest swaps \$ million	Total \$ million
At 1 January 2016	120	(18)	(28)	(1,434)	(2)	1	(1,361)
Net cash flow impact	(18)	(45)	4	(129)	25	(2)	(165)
Exchange adjustment	(2)	1	–	(1)	(22)	–	(24)
At 31 December 2016	100	(62)	(24)	(1,564)	1	(1)	(1,550)
Net cash flow impact	64	49	9	139	(24)	(1)	236
Termination of finance lease	–	–	2	3	–	–	5
Exchange adjustment	5	(1)	–	(1)	25	–	28
At 31 December 2017	169	(14)	(13)	(1,423)	2	(2)	(1,281)
Net cash flow/debt movement	200	(18)	(118)	126	8	(1)	197
Exchange adjustment	(4)	–	(1)	(4)	(11)	–	(20)
At 31 December 2018	365	(32)	(132)	(1,301)	(1)	(3)	(1,104)

NOTES TO THE GROUP ACCOUNTS continued

20 CASH FLOW STATEMENT continued**Reconciliation of net cash flow to movement in net debt**

	2018 \$ million	2017 \$ million	2016 \$ million
Net cash flow from cash net of overdrafts	182	113	(63)
Settlement of currency swaps	8	(24)	25
Net cash flow from borrowings	7	147	(127)
Change in net debt from net cash flow	197	236	(165)
Termination of finance lease	–	5	–
Exchange adjustment	(20)	28	(24)
Change in net debt in the year	177	269	(189)
Opening net debt	(1,281)	(1,550)	(1,361)
Closing net debt	(1,104)	(1,281)	(1,550)

Cash and cash equivalents

For the purposes of the Group cash flow statement cash and cash equivalents at 31 December 2018 comprise cash at bank net of bank overdrafts.

	2018 \$ million	2017 \$ million	2016 \$ million
Cash at bank	365	169	100
Bank overdrafts	(32)	(14)	(62)
Cash and cash equivalents	333	155	38

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

Cash (inflows)/outflows arising from financing activities

	Repayment of bank loans \$ million	Borrowing of bank loans \$ million	Cash outflow from other \$ million	Dividends \$ million	Purchase of own shares \$ million	Proceeds from own shares/issue of ordinary shares \$ million	Total \$ million
2018							
Debt	401	(394)	8	–	–	–	15
Equity	–	–	–	321	48	(13)	356
Total	401	(394)	8	321	48	(13)	371
2017							
Debt	770	(623)	(24)	–	–	–	123
Equity	–	–	–	269	52	(10)	311
Total	770	(623)	(24)	269	52	(10)	434
2016							
Debt	797	(924)	25	–	–	–	(102)
Equity	–	–	–	279	368	(16)	631
Total	797	(924)	25	279	368	(16)	529

21 ACQUISITIONS AND DISPOSALS

Accounting policy

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

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

21.1 Acquisitions

Year ended 31 December 2018

The Group made no acquisitions deemed to be business combinations within the scope of IFRS 3 in the year ended 31 December 2018. The cash outflow of \$29m relates to acquisitions completed in prior years.

Year ended 31 December 2017

During the year ended 31 December 2017, the Group acquired one medical technology business deemed to be a business combination within the scope of IFRS 3 *Business Combinations* as follows. The acquisition accounting was completed in 2018 with no adjustments to the provisional fair value disclosed in the Group's 2017 Annual Report.

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

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

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

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

Year ended 31 December 2016

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

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

NOTES TO THE GROUP ACCOUNTS continued

21 ACQUISITIONS AND DISPOSALS continued

\$ million

Aggregate identifiable assets acquired and liabilities assumed

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

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

On 8 January 2016 the Group completed the acquisition of BST-CarGel, a first-line cartilage repair product from Piramal Healthcare (Canada) Limited. The fair value of the consideration is \$42m and included \$37m of deferred and contingent consideration. The fair values of net assets acquired are: product intangible assets of \$15m, inventory of \$1m, and a deferred tax liability of \$1m. The goodwill, which is expected to be deductible for tax purposes, arising on the acquisition is \$27m, is attributable to the future penetration into new markets expected from the transaction. During the year ended 31 December 2016, the contribution to revenue and attributable profit from these acquisitions is immaterial. If the acquisitions had occurred at the beginning of the year, their contribution to revenue and attributable profit would have also been immaterial.

21.2 Disposal of business

During the year ended 31 December 2016 the Group disposed of its Gynaecology business for cash consideration of \$350m. The net assets disposed included \$6m plant and equipment, and \$4m inventory. Disposal related costs of \$7m and liabilities of \$7m resulted in a pre-tax gain on disposal of \$326m. Tax paid on the disposal was \$118m. For the years ended 31 December 2017 and 31 December 2018, the Group did not dispose of any businesses.

22 OPERATING LEASES**Accounting policy**

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

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

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

	2018 \$ million	2017 \$ million
Land and buildings:		
Within one year	37	40
After one and within two years	30	35
After two and within three years	27	27
After three and within four years	22	23
After four and within five years	16	19
After five years	52	56
	184	200
Other assets:		
Within one year	17	17
After one and within two years	11	11
After two and within three years	4	5
After three and within four years	2	1
	34	34

23 OTHER NOTES TO THE ACCOUNTS

23.1 Share-based payments

Accounting policy

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

The Group operates the following equity-settled executive and employee share plans: Smith & Nephew Global Share Plan 2010, Smith & Nephew ShareSave Plan (2012), Smith & Nephew International ShareSave Plan (2012) and the Smith & Nephew France ShareSave plan (2012). At 31 December 2018, 4,911,000 options (2017: 5,277,000, 2016: 5,780,000) were outstanding with a range of exercise prices from 538 to 1,097 pence.

At 31 December 2018, the maximum number of shares that could be awarded under the Group's long-term incentive plans was 5,678,000 (2017: 5,854,000, 2016: 5,807,000). These include conditional share awards granted to senior employees and equity and performance share awards granted to senior executives under the Global Share Plan 2010.

The expense charged to the income statement for share-based payments for the year is \$35m (2017: \$31m, 2016: \$27m).

23.2 Related party transactions

Trading transactions

In the course of normal operations, the Group traded with its associates detailed in Note 11. The aggregated transactions, which have not been disclosed elsewhere in the financial statements are \$nil (2017: \$nil, 2016: \$nil).

Key management personnel

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

	2018 \$ million	2017 \$ million	2016 \$ million
Short-term employee benefits	18	15	15
Share-based payments expense	10	7	7
Pension and post-employment benefit entitlements	2	1	1
Compensation for loss of office	–	3	–
	30	26	23

Directors' remuneration disclosures are included on pages 84–105.

24 POST BALANCE SHEET EVENTS

On 22 January 2019 the Group completed the acquisition of 100% of the share capital of Ceterix Orthopaedics, Inc., the developer of the NovoStitch[®] Pro Meniscal Repair System. This unique device addresses complex tear patterns not adequately served by other repair systems and is highly complementary to the Group's FAST-FIX[®] 360 Meniscal Repair System.

This acquisition will be treated as a business combination under IFRS 3. The maximum consideration, all payable in cash, is \$105m and the provisional fair value consideration is \$96m and includes \$5m of deferred consideration and \$46m of contingent consideration which relates to the achievement of established milestones and targets. The fair value of contingent consideration is determined from the acquisition agreement, the Board approved acquisition model and a risk-free discount rate of 3.3%. Acquired net assets have a provisional value of \$2m which is not expected to have material fair value adjustments. The remaining \$94m will be allocated between identifiable intangible assets including technology, research and development in-progress and goodwill, with the majority expected to be goodwill. Goodwill represents the control premium, the acquired workforce and the synergies expected from integrating Ceterix Orthopaedics, Inc. into the Group's existing business, and is not expected to be deductible for tax purposes. The contribution to revenue and attributable profit from this acquisition is expected to be immaterial for the year ending 31 December 2019.

COMPANY FINANCIAL STATEMENTS

Company balance sheet

	Notes	At 31 December 2018 \$ million	At 31 December 2017 \$ million
Fixed assets			
Investments	2	7,092	7,092
Current assets			
Debtors	3	1,697	1,084
Cash at bank	5	277	88
		1,974	1,172
Creditors: amounts falling due within one year			
Borrowings	5	(145)	(4)
Other creditors	4	(2,277)	(1,202)
		(2,422)	(1,206)
Net current liabilities		(448)	(34)
Total assets less current liabilities		6,644	7,058
Creditors: amounts falling due after one year			
Borrowings	5	(1,301)	(1,423)
Total assets less total liabilities		5,343	5,635
Equity shareholders' funds			
Called up equity share capital		177	178
Share premium account		608	605
Capital redemption reserve		18	17
Capital reserve		2,266	2,266
Treasury shares		(214)	(257)
Exchange reserve		(52)	(52)
Profit and loss account		2,540	2,878
Shareholders' funds		5,343	5,635

The accounts were approved by the Board and authorised for issue on 21 February 2019 and signed on its behalf by:

Roberto Quarta
Chairman

Namal Nawana
Chief Executive Officer

Graham Baker
Chief Financial Officer

⇒ The Parent Company financial statements of Smith & Nephew plc on pages 178–186 do not form part of the Smith & Nephew Annual Report on Form 20-F as filed with the SEC.

Statement of changes in equity

	Share capital \$ million	Share premium \$ million	Capital redemption reserve \$ million	Capital reserves \$ million	Treasury shares \$ million	Exchange reserves \$ million	Profit and loss account \$ million	Total shareholders' funds \$ million
At 1 January 2017	180	600	15	2,266	(432)	(52)	1,169	3,746
Attributable profit for the year	–	–	–	–	–	–	2,167	2,167
Net gain on cash flow hedges	–	–	–	–	–	–	1	1
Exchange adjustments	–	–	–	–	–	–	1	1
Equity dividends paid in the year	–	–	–	–	–	–	(269)	(269)
Share-based payments recognised ¹	–	–	–	–	–	–	31	31
Cost of shares transferred to beneficiaries	–	–	–	–	26	–	(21)	5
New shares issued on exercise of share options	–	5	–	–	–	–	–	5
Cancellation of treasury shares	(2)	–	2	–	201	–	(201)	–
Treasury shares purchased	–	–	–	–	(52)	–	–	(52)
At 31 December 2017	178	605	17	2,266	(257)	(52)	2,878	5,635
Attributable profit for the year	–	–	–	–	–	–	28	28
Net gain on cash flow hedges	–	–	–	–	–	–	1	1
Equity dividends paid in the year	–	–	–	–	–	–	(321)	(321)
Share-based payments recognised ¹	–	–	–	–	–	–	35	35
Cost of shares transferred to beneficiaries	–	–	–	–	40	–	(30)	10
New shares issued on exercise of share options	–	3	–	–	–	–	–	3
Cancellation of treasury shares	(1)	–	1	–	51	–	(51)	–
Treasury shares purchased	–	–	–	–	(48)	–	–	(48)
At 31 December 2018	177	608	18	2,266	(214)	(52)	2,540	5,343

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

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

The total distributable reserves of the Company are \$2,274m (2017: \$2,569m). In accordance with the exemption permitted by Section 408 of the Companies Act 2006, the Company has not presented its own profit and loss account. The attributable profit for the year dealt with in the accounts of the Company is \$28m (2017: \$2,167m).

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

⇒ The Parent Company financial statements of Smith & Nephew plc on pages 178–186 do not form part of the Smith & Nephew Annual Report on Form 20-F as filed with the SEC.

Notes to the Company accounts

1 BASIS OF PREPARATION

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

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

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

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

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

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

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

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

2 INVESTMENTS

Accounting policy

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

	2018 \$ million	2017 \$ million
At 1 January	7,092	5,322
Additions	–	1,770
At 31 December	7,092	7,092

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

In accordance with Section 409 of the Companies Act 2006, a listing of all entities invested in by the consolidated Group is provided in Note 8.

⇒ The Parent Company financial statements of Smith & Nephew plc on pages 178–186 do not form part of the Smith & Nephew Annual Report on Form 20-F as filed with the SEC.

3 DEBTORS

	2018 \$ million	2017 \$ million
Amounts falling due within one year:		
Amounts owed by subsidiary undertakings	1,635	1,007
Prepayments and accrued income	3	3
Current asset derivatives – forward foreign exchange contracts	36	25
Current asset derivatives – forward foreign exchange contracts – subsidiary undertakings	20	45
Current asset derivatives – currency swaps	1	3
Current taxation	2	1
	1,697	1,084

Allowance losses on amounts owed by subsidiary undertakings are calculated by reviewing 12-month expected credit losses using historic and forward-looking data on credit risk. The loss allowance expense for the year was \$nil (2017: \$nil).

4 OTHER CREDITORS

	2018 \$ million	2017 \$ million
Amounts falling due within one year:		
Amounts owed to subsidiary undertakings	2,204	1,119
Other creditors	12	10
Current liability derivatives – forward foreign exchange contracts	20	45
Current liability derivatives – forward foreign exchange contracts – subsidiary undertakings	36	25
Current liability derivatives – currency swaps	2	1
Current liability derivatives – interest rate swaps	3	2
	2,277	1,202

5 CASH AND BORROWINGS

ACCOUNTING POLICY

Financial instruments

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

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

	2018 \$ million	2017 \$ million
Bank loans, borrowings and overdrafts due within one year or on demand	145	4
Borrowings due after one year	1,301	1,423
Borrowings	1,446	1,427
Cash at bank	(277)	(88)
Credit/(debit) balance on derivatives – currency swaps	1	(2)
Credit balance on derivatives – interest rate swaps	3	2
Net debt	1,173	1,339

All currency swaps are stated at fair value. Gross US Dollar equivalents of \$253m (2017: \$388m) receivable and \$254m (2017: \$386m) payable have been netted. Currency swaps comprise foreign exchange swaps and were used in 2018 and 2017 to hedge intra-group loans.

⇒ The Parent Company financial statements of Smith & Nephew plc on pages 178–186 do not form part of the Smith & Nephew Annual Report on Form 20-F as filed with the SEC.

NOTES TO THE COMPANY ACCOUNTS continued

6 CONTINGENCIES

	2018 \$ million	2017 \$ million
Guarantees in respect of subsidiary undertakings	–	1

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

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

7 DEFERRED TAXATION

The Company has gross unused capital losses of \$80m (2017: \$90m) available for offset against future chargeable gains. No deferred tax asset has been recognised on these unused losses as they are not expected to be realised in the foreseeable future.

8 GROUP COMPANIES

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

Company name	Country of operation and incorporation	Registered Office	Company name	Country of operation and incorporation	Registered Office
UK			Smith & Nephew Nominee Company Limited ²	England & Wales	London
Blue Belt Technologies UK Limited ²	England & Wales	London	Smith & Nephew Nominee Services Limited ²	England & Wales	London
Michelson Diagnostic Limited ³ (7%)	England & Wales	Kent	Smith & Nephew Orthopaedics Limited	England & Wales	London
Neotherix Limited ³ (24.9%)	England & Wales	York	Smith & Nephew Pensions Nominees Limited ²	England & Wales	London
Plus Orthopedics (UK) Limited ²	England & Wales	London	Smith & Nephew Pharmaceuticals Limited ²	England & Wales	Hull
Smith & Nephew (Overseas) Limited ^{1, 5}	England & Wales	London	Smith & Nephew Raisegrade Limited ^{1, 2}	England & Wales	London
Smith & Nephew ARTC Limited	England & Wales	London	Smith & Nephew Rareletter Limited ²	England & Wales	London
Smith & Nephew Beta Limited ²	England & Wales	London	Smith & Nephew Trading Group Limited ¹	England & Wales	London
Smith & Nephew China Holdings UK Limited ¹	England & Wales	London	Smith & Nephew UK Executive Pension Scheme Trustee Limited ²	England & Wales	London
Smith & Nephew Consumer Products Limited ²	England & Wales	London	Smith & Nephew UK Limited ^{1, 5}	England & Wales	London
Smith & Nephew Employees Trustees Limited ²	England & Wales	London	Smith & Nephew UK Pension Fund Trustee Limited ²	England & Wales	London
Smith & Nephew ESN Limited ²	England & Wales	London	Smith & Nephew USD Limited ¹	England & Wales	London
Smith & Nephew Extruded Films Limited	England & Wales	Hull	Smith & Nephew USD One Limited ¹	England & Wales	London
Smith & Nephew Finance ²	England & Wales	London	T.J. Smith and Nephew, Limited	England & Wales	Hull
Smith & Nephew Finance Oratec ²	England & Wales	London	The Albion Soap Company Limited ²	England & Wales	London
Smith & Nephew Healthcare Limited ²	England & Wales	Hull	TP Limited ¹	Scotland	Edinburgh
Smith & Nephew Investment Holdings Limited ¹	England & Wales	London			
Smith & Nephew Medical Fabrics Limited ²	England & Wales	London			
Smith & Nephew Medical Limited	England & Wales	Hull			

⇒ The Parent Company financial statements of Smith & Nephew plc on pages 178–186 do not form part of the Smith & Nephew Annual Report on Form 20-F as filed with the SEC.

Company name	Country of operation and incorporation	Registered Office	Company name	Country of operation and incorporation	Registered Office
Rest of Europe			US		
Smith & Nephew GmbH	Austria	Vienna	Arthrocare Corporation ¹	United States	Wilmington
ArthroCare Belgium SPRL ²	Belgium	Zaventem	Bioventus LLC ³ (49%)	United States	Wilmington
Smith & Nephew S.A.-N.V.	Belgium	Zaventem	Blue Belt Holdings, Inc. ¹	United States	Wilmington
Smith & Nephew A/S	Denmark	Hoersholm	Blue Belt Technologies, Inc. ¹	United States	Philadelphia
Smith & Nephew Oy	Finland	Helsinki	Charlie Merger Corp.	United States	Wilmington 19808
A2 Surgical ²	France	Neuilly-sur-Seine	Delphi Ventures V, L.P. ³ (6.9%)	United States	Wilmington
Smith & Nephew France SAS ¹	France	Neuilly-sur-Seine	Healicoil, Inc.	United States	Wilmington
Smith & Nephew S.A.S.	France	Neuilly-sur-Seine	Hipco, Inc.	United States	Wilmington
Smith & Nephew Business Services GmbH & Co. KG ¹	Germany	Hamburg	Leaf Healthcare Inc. ³ (11%)	United States	Wilmington
Smith & Nephew Business Services Verwaltungs GmbH	Germany	Hamburg	Memphis Biomed Ventures I, LP ³ (4.61%)	United States	Dover
Smith & Nephew Deutschland (Holding) GmbH ¹	Germany	Hamburg	Miach Orthopaedics, Inc. ³ (8.3%)	United States	Sherborn
Smith & Nephew GmbH	Germany	Hamburg	Oratec Interventions, Inc.	United States	Wilmington
Smith & Nephew Orthopaedics GmbH	Germany	Tuttlingen	Orthopaedic Biosystems Ltd., Inc.	United States	Phoenix
Plus Orthopedics Hellas S.A. ⁴	Greece	Athens	OsteoBiologics, Inc.	United States	Wilmington
Smith & Nephew Hellas S.A. ⁴	Greece	Athens	Plus Orthopedics LLC	United States	Wilmington
Smith & Nephew (Ireland) Trading Limited	Ireland	Dublin 2	Rotation Medical, Inc.	United States	Wilmington
Smith & Nephew Finance Ireland Limited	Ireland	Dublin 1	Sinopsys Surgical, Inc. ³ (12.4%)	United States	Wilmington
Smith & Nephew S.r.l.	Italy	Milan	Smith & Nephew Consolidated, Inc. ¹	United States	Wilmington
ArthroCare Luxembourg S.a.r.l. ^{1,2}	Luxembourg	Luxembourg	Smith & Nephew OUS, Inc.	United States	Wilmington
Smith & Nephew Finance S.a.r.l. ¹	Luxembourg	Luxembourg	Smith & Nephew, Inc. ¹	United States	Wilmington
Smith & Nephew International S.A. ¹	Luxembourg	Luxembourg	Surgical Frontiers Series I, LLC ³ (33.46%)	United States	Dover
Smith & Nephew (Europe) B.V. ¹	Netherlands	Amsterdam	Trice Medical Inc. ³ (6%)	United States	Wilmington 19808
Smith & Nephew B.V.	Netherlands	Amsterdam	Africa, Asia, Australasia and Other America		
Smith & Nephew Management B.V. ¹	Netherlands	Amsterdam	Smith & Nephew Argentina S.R.L. ²	Argentina	Buenos Aires
Smith & Nephew Nederland CV	Netherlands	Amsterdam	ArthroCare (Australasia) Pty Ltd ⁴	Australia	North Ryde
Smith & Nephew A/S	Norway	Oslo	Smith & Nephew Pty Limited	Australia	North Ryde
Smith & Nephew sp. z.o.o.	Poland	Warsaw	Smith & Nephew Surgical Holdings Pty Limited ^{1,2}	Australia	North Ryde
Smith & Nephew Lda	Portugal	Lisbon	Smith & Nephew Surgical Pty Limited ^{1,2}	Australia	North Ryde
DC LLC	Russian Federation	Puschino	Smith & Nephew Comercio de Produtos Medicos LTDA	Brazil	São Paulo
Smith & Nephew LLC	Russian Federation	Moscow	Smith & Nephew (Alberta) Inc. ²	Canada	Calgary
Smith & Nephew S.A.U	Spain	Barcelona	Smith & Nephew Inc.	Canada	Toronto
Smith & Nephew Aktiebolag	Sweden	Molndal	Tenet Medical Engineering, Inc.	Canada	Calgary
Lumina Adhesives AB ³ (11%)	Sweden	Gothenburg	Smith & Nephew Finance Holdings Limited ^{2, 5}	Cayman Islands	South Church Street, George Town
Plus Orthopedics Holding AG ¹	Switzerland	Baar	ArthroCare Medical Devices (Beijing) Co. Limited ⁴	China	Chao Yang District, Beijing
Smith & Nephew Manufacturing AG	Switzerland	Aarau	Plus Orthopedics (Beijing) Co. Limited ²	China	Shunyi District, Beijing
Smith & Nephew Orthopaedics AG ¹	Switzerland	Baar			
Smith & Nephew Schweiz AG	Switzerland	Baar			
Smith & Nephew AG	Switzerland	Baar			

⇒ The Parent Company financial statements of Smith & Nephew plc on pages 178–186 do not form part of the Smith & Nephew Annual Report on Form 20-F as filed with the SEC.

NOTES TO THE COMPANY ACCOUNTS continued

8 GROUP COMPANIES continued

Company name	Country of operation and incorporation	Registered Office
Smith & Nephew Medical (Shanghai) Limited	China	Shanghai Free Trade Test Zone
Smith & Nephew Medical (Suzhou) Limited	China	Suzhou City
Smith & Nephew Orthopaedics (Beijing) Co., Ltd	China	Beijing Economic and Technical Development Area
S&N Holdings SAS ¹	Colombia	Bogota
Smith & Nephew Colombia S.A.S	Colombia	Bogota
ArthroCare Costa Rica Srl	Costa Rica	Costa Rica
Smith & Nephew Curaçao N.V.	Curaçao	Willemstad
Smith & Nephew Beijing Holdings Limited ¹	Hong Kong	Hong Kong
Smith & Nephew Limited	Hong Kong	Hong Kong
Smith & Nephew Suzhou Holdings Limited ¹	Hong Kong	Hong Kong
Adler Mediequip Private Limited	India	Pune
ArthroCare India Medical Device Private Limited ²	India	Mumbai
Smith & Nephew Healthcare Private Limited	India	Mumbai-59
Ortho-Space Ltd. ³ (16.8%)	Israel	Caesarea
Smith & Nephew KK	Japan	Tokyo
Smith & Nephew Chusik Hoesia	Korea, Republic of	Seoul
Smith & Nephew Healthcare Sdn Berhad	Malaysia	Kuala Lumpur
Smith & Nephew Services SDN. BHD.	Malaysia	Kuala Lumpur
Smith & Nephew S.A. de C.V.	Mexico	Mexico City
Smith & Nephew Limited ¹	New Zealand	Auckland
Smith & Nephew Superannuation Scheme Limited	New Zealand	Auckland
Smith & Nephew, Inc.	Puerto Rico	San Juan
Smith & Nephew Pte Limited ¹	Singapore	Singapore
Smith & Nephew (Pty) Limited ¹	South Africa	Westville
Smith & Nephew Pharmaceuticals (Proprietary) Limited	South Africa	Westville
Smith & Nephew Limited	Thailand	Huai Khwang District, Bangkok
Sri Siam Medical Limited ^{1,3} (48.99%)	Thailand	Lumpini Phatumwan, Bangkok
Smith ve Nephew Medikal Cihazlar Ticaret Limited Sirketi	Turkey	Sariyer, Istanbul
Smith & Nephew FZE	United Arab Emirates	Jebel Ali, Dubai

¹ Holding company.

² Dormant company.

³ Not 100% owned by Smith & Nephew Group.

⁴ In liquidation.

⁵ Directly owned by Smith & Nephew plc.

Registered Office addresses

UK

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

Rest of Europe

Vienna	Concorde Business Park, 1/C/3 2320, Schwechat, Austria
Zaventem	Hector Heenealaan 366, 1930 Zaventem, Belgium
Hoersholm	Slotsmarken 14, Hoersholm, DK-2970, Denmark
Helsinki	Ayritie 12 C, 01510, Vantaa, Finland
Neuilly-sur-Seine	40, Boulevard du Parc, 92200 Neuilly-sur-Seine, France
Hamburg	Friesenweg 4, Haus 21, 22763, Hamburg, Germany
Tuttlingen	Alemannenstrasse 14, 78532, Tuttlingen, Germany
Athens	Protopappa Street 43, GR 16346, Ilioupoli, Athens, Greece
Dublin 1	3rd Floor, Kilmore House, Park Lane, Spencer Dock, Dublin 1, Ireland
Dublin 2	13-18 City Quay, Dublin 2, D02 ED70, Ireland
Milan	Via de Capitani 2A, 20864, Agrate Brianza (MI), Italy
Luxembourg	163, Rue de Kiem, L-8030 Strassen, Luxembourg
Amsterdam	Bloemlaan 2, 2132NP, Hoofddorp, The Netherlands
Oslo	Nye Vakas vei 64, 1395, Hvalsted, Norway
Warsaw	Ul Osmanska 12, 02-823, Warsaw, Poland
Lisbon	Estrada Nacional no 10 ao Km. 131, Parque Tejo – Bloco C, 2625-445 Forte de Casa, Vila Franca de Xira, Portugal
Moscow	2nd Syromyatnicheskyy lane, Moscow, 105120, Russian Federation
Puschino	8/1 Stroiteley Street, 142290, City of Puschino, Moscow Region, Russian Federation
Barcelona	Edificio Conata I, c/Fructuos Gelabert 2 y 4, San Joan Despi – 08970, Barcelona, Spain
Molndal	PO Box 143, S-431 22 Molndal, Sweden
Gothenburg	Varbergsgatan 2A/412 65 Göteborg/Sweden
Baar	Oberneuhofstr 10d, Baar, 6340
Aarau	Schachenallee 29, 5000, Aarau, Switzerland

⇒ The Parent Company financial statements of Smith & Nephew plc on pages 178–186 do not form part of the Smith & Nephew Annual Report on Form 20-F as filed with the SEC.

Registered Office addresses

US

Wilmington	CT Corporation, 1209 Orange Street, Wilmington DE 19801, USA
Philadelphia	CT Corporation 1515 Market Street, Philadelphia, PA 19102, USA
Dover	160 Greentree Drive, Suite 101, Dover, Delaware, 19904, USA
Phoenix	CT Corporation System, 3800 North Central Avenue, Phoenix AZ 85012, USA
Sherborn	c/o Martha Murray 19 Saddlebrook Road Sherborn, MA 01770, USA
Wilmington 19808	251 Little Falls Drive, Wilmington DE 19808, USA

Africa, Asia, Australasia and Other America

Buenos Aires	Maipu 1300, 13th Floor, City of Buenos Aires, Argentina
North Ryde	85 Waterloo Road, North Ryde NSW 2113, Australia
São Paulo	Avenida do Cafe, 277, Centro Empresarial do Aco, Centro Empresarial do Aco, Torre B, 4 andar, conjunto, CEP 04311-000, São Paulo 403, Jabaquara, Brazil
Calgary	3500-855-2 Street SW, Calgary AB AB T2P 4J8, Canada
Toronto	199, Bay Street, 4000, Toronto, Ontario M5L 1A9, Canada
South Church Street, Georgetown	c/o Maples Corporate Services Limited, P.O. Box 309, Uglan House, Grand Cayman, KY1-1104, Cayman Islands
Chao Yang District, Beijing	Room 17-021, Internal B17 floor, B3-24th floor, No 3 Xin Yuan South Rd, Chao Yang District, Beijing, China

Registered Office addresses

Shunyi District, Beijing	22 Linhe Avenue, Linhe Economic Development Zone, Shunyi District, Beijing, 101300, China
Shanghai Free Trade Test Zone	Part B, 4th Floor, Tong Yong Building, No 188 Ao Na Rd, Shanghai Free Trade Test Zone, Shanghai, China
Suzhou City	12, Wuxiang Road, West Area of Comprehensive Bonded Zone, Suzhou Industrial Park, Suzhou City, SIP, Jiangsu Province, China
Beijing Economic and Technical Development Area	No. 98 Kechuang Dongliujie, Beijing Economic and Technical Development Area, Beijing, China
Bogota	Calle 100 No. 7 – 33 to 1 P3, Bogota D.C., Colombia
Costa Rica	Building B32, 50 meters South of Revisión Técnica Vehicular, Province de Alajuela, Canton Alajuela, Coyoil Free Zone, District San José, Costa Rica
Willemstad	Pietermaai 15, PO Box 4905, Curaçao
Hong Kong	Unit 813 – 816, 8/F, Delta House, 3 On Yiu Street, Shatin, New Territories, Hong Kong
Pune	Sushrut House, Survey no.288, Phase II next to MIDC, Hinjewadi, at Mann, Taluka Mulshi, Pune, 411057, India
Mumbai	5A, Bakhtawar, 5th Floor, behind The Oberoi, Nariman Point, Mumbai, Maharashtra, 400021, India
Mumbai-59	501-B – 509-B Dynasty Business Park, Andheri Kurla Road, Andheri East, Mumbai-59, Maharashtra, India
Caesarea	7 Halamarish, Caesarea, 3088900, Israel
Tokyo	2-4-1, Shiba -Koen, Minato-Ku, Tokyo 105-0011, Japan
Seoul	13th Floor, ASEM Tower, Gangnam-gu 13th Floor, ASEM Tower, 159-1 Samsung-dong, Seoul, Korea
Kuala Lumpur	Level 25, Menara Hong Leong, NO. 6 Jalan Damanlela Bukit Damansara Kuala Lumpur W.P. 50490 Kuala Lumpur, Malaysia
Mexico City	Av. Insurgentes Sur, numero 1602, Piso No.7, Oficina 702, Colonia Credito, Constructor, Delegacion Benito Juarez, C.P. 03940, Mexico

⇒ The Parent Company financial statements of Smith & Nephew plc on pages 178–186 do not form part of the Smith & Nephew Annual Report on Form 20-F as filed with the SEC.

NOTES TO THE COMPANY ACCOUNTS continued

8 GROUP COMPANIES continued

Registered Office addresses

Auckland	36a Hillside Road, Wairau Valley, Auckland, 0627 NZ, New Zealand
San Juan	Edificio Cesar Castillo, Calle Angel Buonomo #361, Hato Rey, 00917, Puerto Rico
Singapore	50 Raffles Place, #32-01 Singapore Land Tower, 048623, Singapore
Westville	30 The Boulevard, Westway Office Park, Westville, 3629, South Africa
Huai Khwang District, Bangkok	16th Floor Building A, 9th Tower Grand Rama 9, 33/4 Rama 9 Road, Huai Khwang District, Bangkok, 10310, Thailand

Registered Office addresses

Lumpini Phatumwan, Bangkok	16th Floor, GPF Witthayu Tower A, 93/1 Wireless Road, Lumpini, Phatumwan, Bangkok, 10330, Thailand
Sariyer, Istanbul	Bahcekoy Merkez Mah. Ergene Nehri SK No:8/4 Bahcekoy Sariyer Istanbul, Turkey
Jebel Ali, Dubai	PO Box 16993 LB02016, Jebel Ali, Dubai, United Arab Emirates

9 SUBSIDIARY UNDERTAKINGS EXEMPT FROM AUDIT

The following UK subsidiaries will take advantage of the audit exemption set out within Section 479A of the Companies Act 2006 for the year ended 31 December 2018:

- Smith & Nephew China Holdings UK Limited (*Registration number: 9152387*)
- Smith & Nephew Investment Holdings Limited (*Registration number: 384546*)
- Smith & Nephew Trading Group Limited (*Registration number: 681256*)
- Smith & Nephew USD One Limited (*Registration number: 10428326*)
- TP Limited (*Registration number: SC005366*)

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