DEAR SHAREHOLDER,

A good Board pressure tests strategy, provides leadership on matters of governance and ensures their company is equipped to handle risk. In 2016 Smith & Nephew faced and overcame challenges in all these areas, confirming my strong belief that this is a Company set well to succeed in challenging times.

In early 2016 we announced that our Chief Executive Officer, Olivier Bohuon, had been diagnosed with cancer, and would require treatment across much of the year. We were delighted to welcome him back to work full time in October.

During the intervening months my Board colleagues and I were able to provide additional support to the executive team. I attended the Managing Directors’ annual meeting, and engaged with various members of the executive team, supporting them on a number of matters. The Board met with numerous commercial and operational leaders across the year. This culminated in a visit to our Andover, Massachusetts site in November where we saw first-hand the exciting progress being made by our Sports Medicine business.

These meetings gave Board members first-hand experience of the high quality team that has been assembled by Olivier to deliver on his strategy to transform Smith & Nephew. Following a number of changes implemented in recent years, the structure of the organisation is fully aligned to the strategic priorities, and the commitment and dedication to the business at all levels was evident for us to see.

FINANCIAL PERFORMANCE

Smith & Nephew’s financial performance is shown on these pages.

Although the Group delivered revenue growth in 2016, the outturn is below where we had set our sights at the start of the year. Whilst some geographies and franchises performed well, we were buffeted by trading conditions in the Gulf States and China, as well as a few areas where we believe we can execute better in 2017. We faced a headwind in China entering the year, and it is pleasing to see how management delivered the improvements in this market as they said they would.

The Board continues to have great confidence in the business and is proposing a final dividend for the year of 18.5¢ per share, giving a total dividend distribution for 2016 of 30.8¢. In-line with our dividend policy, the declared dividend is flat year-on-year despite the decline in adjusted earnings per share.

Directors’ biographies start on page 48
GOVERNANCE AND CULTURE
Corporate governance, especially Director responsibilities, remuneration and diversity, has been in the spotlight in 2016. The Board has welcomed our discussions with shareholders around such important topics and we are mindful of how the landscape is changing in some areas. The Board is committed to continuing to refine our governance structure and practices to reflect what is in the best interests of all stakeholders.

Culturally, we believe that openness and transparency, accountability and responsibility should run throughout the Company. The Board takes matters of ethics and compliance very seriously, and aims to set a tone at the top which pervades throughout the organisation. We review processes and practices and oversee quality and regulatory matters. We take great interest in how we attract, retain and develop talent and the work underway to make Smith & Nephew a great place to work for all employees.

Our Chief Financial Officer, Julie Brown, left the Company in January 2017. We are grateful for her contribution during her four years at Smith & Nephew and wish her well in her new career at Burberry plc. Graham Baker will join as Chief Financial Officer from 1 March 2017 when he will also be appointed to the Board as an Executive Director. Having held multiple senior roles at AstraZeneca and elsewhere, I have no doubt that he will successfully ensure effective financial stewardship and I welcome him to Smith & Nephew.

Brian Larcombe will be retiring from the Board at the Annual General Meeting on 6 April 2017. Brian has served Smith & Nephew for many years, as our Senior Independent Director since 2014, and as a member of the Audit, Nomination & Governance and Remuneration Committees. I am personally grateful that he agreed to stay on for one extra year to provide continuity while Olivier was receiving treatment. We will miss his great wisdom and experience. On behalf of the whole Board I thank him for his service. We are fortunate that Ian Barlow has agreed to become Senior Independent Non-Executive Director. Ian has been a Non-Executive Director since 2010, and has been a diligent Chair of our Audit Committee. Robin Freestone will be appointed Chairman of the Audit Committee in his place.

Finally, Joe Papa has graciously agreed to stay on beyond his nine-year term as we undertake a search for a new Chair of the Remuneration Committee. As we make this, and indeed all appointments, we are conscious of the need to continue to seek individuals who bring diversity in its broadest sense, including background, thinking and gender.

In conclusion, 2016 has been a year where we have continued to make progress in the face of a number of headwinds. As a result, I believe we enter 2017 as a stronger business. There is no doubt that the world is facing a period of greater geo-political risk and companies need to be robust. The Board takes its responsibilities very seriously, to ensure that we perform financially, strategically and ethically against this changing and challenging backdrop. We thank you for your continued support and look forward to serving you in 2017.

Yours sincerely,

Roberto Quarta
Chairman

1 The non-IFRS financial measures are explained and reconciled to the most directly comparable financial measure prepared in accordance with IFRS on pages 173-177.
Innovative products and deep customer relationships

We now have the right structure and capability in place and are focused on improving execution across the Group.

DEAR SHAREHOLDER,

In 2016 I was pleased with our performance in areas such as Sports Medicine and Knee Implants, where we maintained strong momentum. However, whilst we delivered growth in 2016, it was not at the level we had wanted. Market conditions in China and the Gulf States together shaved more than a percentage point of growth off the Group in the year.

As we enter 2017, I am confident we now have the right structure and capability in place and are focused on improving execution across the Group, with a clear set of actions underway. As a result, I expect us to deliver a stronger performance in 2017.

COMMERCIAL PROGRESS

In our Established Markets, 2016 highlights included the performance across Sports Medicine, where we continue to reap the benefits of the acquisition of ArthroCare. PICO™, our novel single-use Negative Pressure Wound Therapy (NPWT) system, is transforming the use of this therapy option. Our world class Knee Implant portfolio was further strengthened by the acquisition of NAVIO™, an exciting robotics-assisted surgery platform, from which we delivered more than 50% revenue growth in 2016.

“We have spent the last five years reshaping Smith & Nephew to make the Company more agile, stronger, more efficient and simpler. We are proud of what we have done.”

Directors’ Biographies start on page 48
Most of our Emerging Markets businesses generated double-digit growth as we benefited from our investments in recent years. In China, the slow-down in end-markets seen since mid-2015 was compounded by destocking in the distributor channel. By the end of the year most franchises had returned to positive growth as the level of stock in the channel was adjusted. In the oil-dependent Gulf States we also saw difficult trading conditions. As a matter of course we expect to see some volatility in the Emerging Markets, but we continue to see significant long-term growth potential and are very well positioned in our chosen markets.

DELIVERING INNOVATION

We continue to innovate for value with new product launches and disruptive business models. A number of important new platforms were introduced in 2016. In Sports Medicine we successfully launched our new LENS® Surgical Imaging System and the WEREWOLF® COBLATION® System for resecting soft tissue. We also introduced the ULTRABUTTON® Adjustable Fixation Device which provides advanced fixation strength for soft tissue to bone fixation in ACL/PCL repair and reconstruction. In Knee Implants we began limited market release of our JOURNEY® II XR, an innovative bi-cruciate retaining knee and the newest addition to the JOURNEY II Active Knee family. We also conducted the first total knee procedures on the NAVIO platform in 2016. In Hip Implants we added to the REDAPT® Revision System with a new Acetabular Fully Porous Cup designed for cases where compromised bone makes implant fixation and stability more difficult.

In 2016 we also delivered significant efficiencies. Our Group Optimisation programme realised the expected $120 million of savings one year ahead of schedule.

And we created compelling value when we divested our Gynaecology business for $350 million. We returned the proceeds to shareholders through a $300 million share buy-back.

FOCUSED ON EXECUTION

Over the last few years we have undertaken a fundamental restructuring of Smith & Nephew to improve both our ability to serve our customers in market, and our efficiency. This has included changing the management structure and teams in every market to bring them under a single country managing director, a process we completed in 2016. This has not been without disruption, partly caused by some office re-locations, but now the new teams are bedding into their new roles. We now have the appropriate structure to succeed and are focused on serving our customers without any distractions in 2017.

We are also developing the tools to support better execution. In 2016 we strengthened our commercial platform by creating a global commercial organisation under a newly created role of Chief Commercial Officer. Tasked with driving commercial performance across the Group, this organisation includes our commercial regions and the global marketing teams for our product franchises. It also includes a Commercial Excellence team which is focused on bringing material improvements in areas such as pricing strategy and sales force excellence across the Group, starting in 2017.

We are targeting an increase in disruptive innovation. In 2016 I appointed a President of Research and Development, reporting directly to me, to lead a newly formed single global R&D organisation. In addition to executing our technology pipeline, this leader will be responsible for driving breakthrough innovation and defining a clear path from concept to market. In 2017 the team is focused on increasing productivity, improving processes and better leveraging our resources and expertise. A more aligned organisation has also allowed us to centralise our approach to developing evidence that demonstrates the clinical and economic benefits of our products, supporting our commercial teams in positioning our products more effectively.

Finally, we will continue to drive efficiency, with programmes underway to optimise global manufacturing, strengthen our supply chain, upgrade our IT infrastructure and deliver shared business services across the Group.

“

We are well set to deliver a stronger performance, generating higher revenue growth and a better trading profit margin in the future.

“

THANK YOU

As you know I undertook medical treatment during 2016 and I want to thank shareholders and employees who sent me their best wishes during this time. Moreover, I want to thank all of our employees who continue to strive to deliver on our commitments, embodying a Smith & Nephew culture immersed in our values of innovation, trust and performance. It is good to be back at work full-time amongst such inspiring people.

We have spent the last five years reshaping Smith & Nephew to make the Company more agile, stronger, more efficient and simpler. We are proud of what we have done. 2017 will see a strong emphasis on execution. Beyond this, with our innovative products and deep customer relationships, we are well set to deliver a stronger performance, generating higher revenue growth and a better trading profit margin in the future.

I am energised by our prospects and I look forward to updating you on our progress during the year.

Yours sincerely,

Olivier Bohuon
Chief Executive Officer
One global business
selling nine product franchises...

KNEE IMPLANTS
Smith & Nephew offers an innovative range of products for specialised knee replacement procedures. Knee replacement surgery involves replacing the worn, damaged or diseased portion of a knee with an artificial joint.

Revenue
$932m
Reported
+6%
Underlying
+4%

HIP IMPLANTS
Our Hip Implant franchise offers a range of specialist products for reconstruction of the hip joint. This may be necessary due to conditions such as arthritis, causing persistent pain, and/or as a result of hip fracture.

Revenue
$597m
Reported
-1%
Underlying
-1%

SPORTS MEDICINE JOINT REPAIR
We offer surgeons a broad array of instruments, technologies and implants necessary to perform minimally invasive surgery of the joints, including the repair of soft tissue injuries and degenerative conditions of the knee, hip and shoulder.

Revenue
$587m
Reported
+7%
Underlying
+8%

ARTHROSCOPIC ENABLING TECHNOLOGIES
Products in this franchise are often used in conjunction with products from Sports Medicine Joint Repair to facilitate access to joint spaces, visualise the patient’s anatomy, resect degenerated or damaged tissue and prepare the joint for a soft tissue repair.

Revenue
$631m
Reported
+0%
Underlying
+2%

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

Revenue
$475m
Reported
-4%
Underlying
-4%

OTHER SURGICAL BUSINESSES
The Other Surgical Businesses franchise includes our Ear, Nose & Throat (ENT) business and the NAVIO® robotic surgical business, acquired at the start of 2016. It included our Gynaecology business until its disposal in August 2016.

Revenue
$214m
Reported
+5%
Underlying
+15%

ADVANCED WOUND CARE
The Advanced Wound Care franchise consists of several groups of brands, including exudate management, infection management and our cornerstone ranges of products.

Revenue
$719m
Reported
-5%
Underlying
-3%

ADVANCED WOUND BIOACTIVES
Our Advanced Wound Bioactives franchise comprises novel, cost-effective biopharmaceuticals that provide a unique approach to debridement, dermal repair and tissue regeneration.

Revenue
$342m
Reported
-1%
Underlying
0%

ADVANCED WOUND DEVICES
Our Advanced Wound Devices franchise is comprised of our Negative Pressure Wound Therapy (NPWT) and surgical debridement businesses.

Revenue
$172m
Reported
+3%
Underlying
+5%

1 The non-IFRS financial measures are explained and reconciled to the most directly comparable financial measure prepared in accordance with IFRS on pages 175-177.
to over 100 countries

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

Other Established Markets comprise commercial operations in Australia, Canada, Europe, Japan and New Zealand, which accounted for 36% of Group revenue in 2016. We have manufacturing facilities in the UK, Germany and Switzerland.

Emerging Markets include our commercial businesses in China, Asia, India, Russia, Middle East, Africa and Latin America. These generated 15% of Group revenue in 2016. We have manufacturing facilities in China, India, Russia, Costa Rica and Curaçao.

1 The non-IFRS financial measures are explained and reconciled to the most directly comparable financial measure prepared in accordance with IFRS on pages 175-177.
How we create value

Smith & Nephew aims to bring together the sharpest minds in the industry to create and supply the most exciting and differentiated products and services to our customers, supporting them in the most noble of missions: to improve the lives of patients worldwide.

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

We take a pioneering approach to the design of our products and services.

We have leadership positions in Orthopaedic Reconstruction, Advanced Wound Management, Sports Medicine and Trauma & Extremities.

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

Performance means being responsive to the needs of our customers, setting ourselves clear goals and standards and achieving them.
INNOVATION
Innovation means being energetic, creative and passionate about everything we do, anticipating customers' needs and overcoming barriers and developing opportunities.

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

OUTPUTS
ENSURING WIDER ACCESS
We strive to secure wide access to our diverse technologies for more customers globally.

ENABLING BETTER OUTCOMES
We enable better outcomes for patients and healthcare systems.

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

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>$4,669m</td>
</tr>
<tr>
<td>Operating Profit</td>
<td>$801m</td>
</tr>
<tr>
<td>Trading Profit</td>
<td>$1,020m</td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividend</td>
<td>$279m</td>
</tr>
<tr>
<td>Share buy-back</td>
<td>$300m</td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Countries</td>
<td>100+</td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Training instances</td>
<td>40,000</td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employees</td>
<td>15,000+</td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Years of history</td>
<td>160+</td>
</tr>
</tbody>
</table>

1 The non-IFRS financial measures are explained and reconciled to the most directly comparable financial measure prepared in accordance with IFRS on pages 175-177.

OUR CUSTOMERS
We service our healthcare professional customers through our dedicated and highly trained global sales force and selected third party sellers.

1 SURGEONS
2 NURSES, NURSE SPECIALISTS
3 HEALTHCARE SYSTEMS, PROCUREMENT GROUPS
4 PAYERS, ADMINISTRATORS
5 PHYSICIANS, GPS
6 RETAIL CONSUMERS, PATIENTS
Maximising our performance

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

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

Our strategic priorities, introduced in 2011, guide our actions in delivering these twin aspirations of supporting healthcare professionals and transforming our growth profile.

Our STRATEGIC PRIORITIES

BUILD A STRONG POSITION IN ESTABLISHED MARKETS
Build on existing strong positions, win market share through greater product and commercial innovation and drive efficiencies to liberate resources.

FOCUS ON EMERGING MARKET
Deliver leadership in the Emerging Markets by building strong, direct customer relationships, widening access to our premium products and developing portfolios designed for the economic mid-tier population.

INNOVATE FOR VALUE
Deliver pioneering products and business models that improve clinical and economical outcomes and widen access across geographies and patient groups.

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

SUPPLEMENT ORGANIC GROWTH WITH ACQUISITIONS
Build our platform by acquiring complementary technologies, manufacturing and distribution capabilities in the Emerging Markets and complementary products or businesses in our higher growth segments.
Build a strong position in Established Markets

We delivered 4% reported and 3% underlying growth in the United States, our largest market.

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

Smith & Nephew delivered 85% of its revenue from these Established Markets in 2016. Within this, we delivered 4% reported growth and 3% underlying revenue growth in the United States, our largest market. Reported Growth was down -1% and underlying growth was flat across our other Established Markets. Overall, reported revenue growth was 1% and underlying revenue growth was 2% across all our Established Markets.

The Sports Medicine franchises continue to perform strongly as we build on our broad portfolio of joint repair products, instruments and enabling technologies. It is now two years since we completed the acquisition of ArthroCare. The expected benefits are coming through and we are on track to deliver the expected $85 million of sales synergies by the end of 2017.

Our Reconstruction business continues to have good momentum, driven by our Knee Implant business. The Knee Implant portfolio was further strengthened by the acquisition of NAVIO, an exciting robotics platform, from which we delivered more than 50% revenue growth in 2016, in line with previous guidance.

In early 2016 we undertook further changes to our organisational structure, creating a single Commercial Organisation led by Mike Frazzette, Chief Commercial Officer, who is overseeing all our Established Markets. Overall, reported revenue growth was 1% and underlying revenue growth was 2% across all our Established Markets.

The single MD model is enabling us to improve our customer focus, commercial agility and operating efficiency.

Unplanned readmissions are costly to hospitals, surgeons and patients and, in the US, can result in significant financial implications for hospitals and other healthcare organisations under the Comprehensive Care for Joint Replacement Model (CJR) and Bundled Payments for Care Improvement (BPCI) initiative. For patients, an unplanned readmission can complicate and extend the recovery period and the resumption of normal activities. For hospitals and surgeons focused on value, as defined by quality outcomes achieved through efficiency, unplanned readmissions can negatively influence overall quality scores.

In response, Smith & Nephew pioneered its Episode of Care Assurance Program (eCAP), an innovation designed to mitigate risk for our customers. It pairs together Smith & Nephew’s entire line of primary total hip and knee reconstructive systems with two of its most innovative wound care products: PICO® Single Use NPWT and ACTICOAT® Flex 7 Silver-coated Antimicrobial Barrier Dressing. Smith & Nephew warrants that the products will perform as expected, based on the product labels. If a patient is readmitted within 90 days following a procedure for a surgical site infection or to revise the implant due to a failure of a Smith & Nephew product, we will pay a hospital’s unreimbursed costs for the readmission up to the aggregate purchase prices of the implant, PICO and ACTICOAT Flex 7.
Focus on Emerging Markets

Our Emerging Markets represent 15% of Smith & Nephew’s revenue, up from 8% in 2010.

Our Emerging Markets represent those outside the Established Markets, including the BRIC group of Brazil, Russia, India and China. These countries represent 15% of Smith & Nephew’s revenue, up from 8% in 2010.

In the Emerging Markets revenue was down -3% on a reported basis and flat on an underlying basis. Most of our Emerging Markets businesses continue to generate double-digit growth as we benefit from our investments in our business platform in recent years.

In China, the slow-down in end-markets first seen in mid-2015 was compounded by destocking in the distributor channel during 2016. We first saw this in Sports Medicine, subsequently followed by Trauma and Advanced Wound Management. The effect was not so visible in the more mature Reconstruction market, where stock levels were not geared to a rapid market expansion. As we progressed through 2016, Sports Medicine returned to growth and Trauma followed. We expect Advanced Wound Management to continue to be impacted in the first half of 2017. Strategically, the growth prospects in China remain very attractive and we believe current end-market growth rates are solid double-digit. We are confident that we have taken all necessary measures and that China remains a very attractive market in which we are committed to building our business.

In the oil-dependent Gulf States we saw very difficult trading conditions, particularly in our tender business, which are likely to persist. As a matter of course we expect to see some volatility in the Emerging Markets, but we continue to see significant long-term growth potential and are very well positioned in our chosen markets.

ANTHEM™ TOTAL KNEE LAUNCHES IN EMERGING MARKETS

2016 saw the commercial launch of the ANTHEM Total Knee System. This platform was developed specifically to address the needs of patients and surgeons across Asia, the Middle East, Africa and Latin America. The unique design creates a knee offering fit for all ethnicities based on both intraoperative measurements and the analysis of CT images from patients across the world.

ANTHEM utilises the ORTHOMATCH™ instrumentation platform which reduces weight, footprint and unnecessary cost without compromising on quality or clinical outcomes.

Smith & Nephew has partnered with Touch Surgery to develop a surgical simulation app for the ANTHEM Total Knee System, providing surgeons and healthcare professionals with a virtual training platform to learn, simulate and rehearse the knee replacement procedure in a 3D operating room environment. ANTHEM, ORTHOMATCH and Touch Surgery together provide an advanced and globally relevant knee implant that is accessible to all orthopaedic surgeons and patients in the Emerging Markets.

<table>
<thead>
<tr>
<th>$691m</th>
<th>-3%</th>
<th>0%</th>
<th>15%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue from Emerging Markets</td>
<td>Reported</td>
<td>Underlying</td>
<td>Of Group revenue</td>
</tr>
</tbody>
</table>

**Why is the KPI important?**
Track underlying growth of Emerging Markets to global growth.

**How have we performed?**
Double digit growth across most markets was offset by China and the Gulf States.

- 2012: $483m
- 2013: $563m
- 2014: $677m
- 2015: $715m
- 2016: $691m

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Innovate for value

In 2016 we took a significant step to increase our disruptive innovation.

We continue to innovate for value with new product launches and disruptive business models. A number of exciting new platforms were introduced in 2016.

In Sports Medicine we introduced our new LENS® Surgical Imaging System and WEREWOLF® COBLATION® System for resecting soft tissue. We also launched the ULTRABUTTON® Adjustable Fixation Device which provides advanced fixation strength for soft tissue to bone fixation in ACL/PCL repair and reconstruction.

In Knee Implants we began limited market release of our JOURNEY™ II XR, an innovative bi-cruciate retaining knee and the newest addition to the JOURNEY II Active Knee family. We are augmenting our own work with acquisitions, such as the purchase of NAVIO™, which has given us an exciting robotics platform with opportunities across the spectrum of knee reconstruction. We conducted the first total knee procedures using our NAVIO surgical robotics platform in 2016.

In Hip Implants we added to the REDAPT™ Revision System with a new Acetabular Fully Porous Cup designed for cases where compromised bone makes implant fixation and stability more difficult.

In 2016 we took a significant step to increase our disruptive innovation, appointing a President of Research and Development, Vasant Padmanabhan, to lead a newly formed single global R&D organisation. In addition to executing our technology pipeline, this leader will be responsible for driving breakthrough innovation and defining a clear path from concept to market. In 2017 the team is focused on increasing productivity, improving processes and better leveraging our resources and expertise. A more aligned organisation has also allowed us to centralise our approach to developing evidence that demonstrates the clinical and economic benefits of our products, supporting our commercial teams in positioning our products more effectively.

$230m
R&D expenditure

Why is the KPI important?
Through this KPI we monitor our underlying investment in R&D.

How have we performed?
We met our target to keep investment in R&D at around 5% of Group revenue.

4.9%
Of Group revenue

INNOVATING IN THE OPERATING ROOM

Developed in-house and launched in 2016, the LENS® Integrated Visualisation System provides integrated three in one design, incorporating a Console (which consists of the Camera Control Unit, LED Light Source and Image Management System), Camera Head (1080p broadcast grade image technology), and iPad® Application.

Employing the latest in CMOS chip technology, the LENS System captures High Definition images and produces clear live video.

The Camera Head is autoclavable, durable and ergonomic, and the Smith & Nephew proprietary iPad® application takes media management and versatility to a whole new level.

New innovations such as LENS and the WEREWOLF® COBLATION® System are vital components to advance our operating room (OR) tower strategy. A tower is made up of visualisation or camera system, COBLATION resection controllers, mechanical resection or blade controllers and fluid management or pump components. Customers look at a tower as a solution to complete an arthroscopic procedure and Smith & Nephew is well positioned with our new products and established strength in DYONICS® Shaver Blades and GoFLO® Pumps.
NEW MANUFACTURING FACILITY OPENS

In 2016 we opened a new manufacturing facility in Costa Rica. The new plant will support the global demand for Smith & Nephew’s COBLATION™ technology. COBLATION is an arthroscopic procedure that involves the creation and application of an energy field, which is used for the precise removal of soft tissue with minimal damage to untargeted tissue.

Smith & Nephew's position within the global sports medicine market was strengthened significantly in 2014, with the acquisition of ArthroCare Corporation. The transaction added highly complementary products to the existing portfolio, as well as manufacturing expertise in Costa Rica.
Supplement organic growth with acquisitions

Our two largest acquisitions are delivering good returns.

In recent years we have undertaken a number of acquisitions, strengthening both our technology and product portfolio and our Emerging Markets business. We have delivered good returns with the success of our two larger acquisitions, Healthpoint and ArthroCare, establishing a strong track record in Mergers and Acquisitions (M&A).

With Healthpoint Biotherapeutics, acquired in 2012 for $782 million, our third year return on capital has exceeded our expectations. ArthroCare, acquired in 2014 for $1.5 billion, is performing in line with our expectations. We are ahead of our plan to deliver $85 million of synergies by 2017 and have achieved almost all our targeted cost savings.

In 2016, we continued to invest in acquisitions. The acquisition of Blue Belt Technologies, completed in January, has given us a leading position in the fast growing area of robotics-assisted orthopaedic surgery. Its NAVIO® surgical system provides robotics-assistance in partial knee replacement surgery and we intend to expand it into total knee, bi-cruciate retaining knee and revision knee implants, potentially delivering further upside. The expansion of our NAVIO robotics platform is progressing at pace, with the first total knee completed in 2016.

In addition, we created compelling value by selling our Gynaecology business for $350 million (2015 revenue: $56 million) in August 2016. We had built this business rapidly on the back of Smith & Nephew’s resection technology and expertise. We completed the associated $300 million share buy-back programme in December 2016, returning the value created directly to shareholders.

The Board periodically reviews acquisitions to evaluate longer-term performance and capture lessons learned to help improve strategy and process. As you would expect, some of our recent smaller acquisitions have out-performed our initial expectations, whereas others have underperformed. Collectively we are pleased with the performance of the technology and Emerging Markets acquisitions we have made.
Our marketplace is driven by longer-term trends

The major trends that drive the markets in which Smith & Nephew operates have remained consistent for many years. Ageing populations, together with obesity, diabetes and other lifestyle diseases (often linked with increased prosperity), all contribute to rising demand for healthcare.

According to the World Health Organisation (WHO), between 2015 and 2050 the proportion of the world’s population over 60 years will nearly double from 12% to 22%. In 2014, the WHO estimated that more than 1.9 billion adults were overweight. Of these, over 600 million were classified as obese, a major risk factor for diseases such as diabetes and musculoskeletal disorders.

Additionally, the WHO estimates that by 2020, people aged 60 years and older around the world will outnumber children younger than five. This changing dynamic will decrease the level of funds available for healthcare raised through taxes. As a result governments and healthcare providers are under pressure to look for ways to reduce their overall healthcare expenditure, while at the same time maintaining the quality of care and treatment provided. Healthcare reform therefore is near the top of many national agendas.

CUSTOMERS
Our customers include surgeons, nurses, healthcare payers and administrators, and healthcare systems and procurement groups.

In certain parts of the world, including the UK, much of Continental Europe, Canada and Japan, healthcare providers are often government organisations funded by tax revenues. In the US, our major customers are public and private hospitals, which receive revenue from private health insurance and government reimbursement programmes. Medicare is the major source of reimbursement in the US for knee and hip reconstruction procedures and for wound treatment regimes. In the Emerging Markets, demand is driven by self-pay patients.

New commercial purchasing models are being adopted by health systems as a solution to improving resource allocation. One notable trend is the greater focus on payment-for-outcomes rather than fee-for-service reward models, particularly in the US where the Comprehensive Care for Joint Replacement (CJR) model began on 1 April 2016. The CJR model aims to drive better and more efficient care by incentivising hospitals, physicians, and post-acute care providers to work together through a bundled payment system.

There is also a desire for more patients to be treated in an outpatient or community setting. Treatment in hospitals, often entailing operating room time and overnight stays, is expensive. New models such as ambulatory care centres now offer outpatient orthopaedic treatment and there is pressure for more wound care to be provided in the community setting.

Product innovation remains of vital importance with increasing focus on products which simplify and increase the efficiency of procedures as well as robotics which increase precision and enhance procedure outcomes.

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

Pricing of products is largely influenced in most developed markets by governmental reimbursement programmes. Initiatives sponsored by government agencies, legislative bodies and the private sector to limit the growth of healthcare costs are ongoing and include price regulation, excise taxes and competitive pricing. Governments and healthcare providers are increasingly requesting health economic data to justify the pricing of products and procedures or reimbursement requests. More collaboration between industry and data research institutions is emerging as a result.

REGULATORY STANDARDS AND COMPLIANCE IN THE HEALTHCARE INDUSTRY
Alongside healthcare provision and payment becoming more complex, the regulation of the medical device industry is also intensifying. Regulatory requirements are important in determining whether substances and materials can be developed into effective products in an environmentally sustainable way.

National regulatory authorities administer and enforce a complex series of laws and regulations that govern the design, development, approval, manufacture, labelling, marketing and sale of healthcare products. They also review data supporting the safety and efficacy of such products. Of particular importance is the requirement in many countries that products be authorised or registered prior to their placement on market and that such authorisation or registration be subsequently maintained. The industry is focusing its resources on meeting the increased regulatory pressure around the world.

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600 million
Obese adults in 2014, a major risk factor for diseases such as diabetes and musculoskeletal disorders (WHO).

2020
The WHO estimates that by 2020, people aged 60 years and older around the world will outnumber children younger than five.

22%
Proportion of the world’s population over 60 years will nearly double from 12% to 22% by 2050 (WHO).
The major regulatory agencies for Smith & Nephew’s products include the Food and Drug Administration (FDA) in the USA, the Medicines and Healthcare products Regulatory Agency in the UK, the Ministry of Health, Labour and Welfare in Japan, the China Food and Drug Administration and the Australian Therapeutic Goods Administration.

In general, with the aforementioned industry trends, safety standards and regulations in the medical device industry are becoming more stringent. Regulatory agencies are intensifying audits of manufacturing facilities and the approval time for new products has lengthened. Regulation for marketing medical devices in the European Union will tighten with the introduction of the Medical Device Regulations (MDR), a draft of which was published in June 2016 and is expected to be fully implemented by late 2019.

Legislation covering corruption and bribery, such as the UK Bribery Act and the US Foreign Corrupt Practices Act, also applies to all our global operations. We are committed to ensuring regulatory compliance and to doing business with integrity and we welcome the trend towards higher standards in the healthcare industry. We and other companies in the industry are subject to regular inspections and audits by regulatory agencies and notified bodies, and in some cases remediation activities have required and will continue to require significant financial and resource investment.

SEASONALITY

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

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

Data: 2016 estimates generated by Smith & Nephew based on publicly available sources and internal analysis.

1 Representing access, resection and repair products.
2 A division of Johnson & Johnson.
Smith & Nephew offers an innovative range of products for specialised knee replacement procedures. Knee replacement surgery involves replacing the worn, damaged or diseased portion of a knee with an artificial joint. Every year more than two million patients receive total, partial or revision knee replacements.

Smith & Nephew’s knee systems include the LEGION™/GENESIS™ II Total Knee System, a comprehensive system designed to allow surgeons to address a wide range of knee procedures, and our JOURNEY™ II family of Active Knees. JOURNEY II has been engineered to empower patients with a renewed active lifestyle by breaking through traditional knee replacement barriers and delivering function, motion and durability through PHYSIOLOGICAL MATCHING™.

In 2016 we began limited market release of our JOURNEY II XR product, an innovative bi-cruciate retaining knee implant, which is designed to retain the anterior and posterior cruciate ligaments (ACL/PCL) and deliver normal proprioception and muscle control.

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

In 2016 we launched the ANTHEM™ Total Knee System. This was designed from both intraoperative measurements and the analysis of CT images from patients, to create a knee offering fit for all ethnicities. ANTHEM utilises the ORTHOMATCH™ instrumentation platform, reduces weight, footprint and unnecessary cost without compromising on quality or clinical outcomes.

During 2015, we acquired the Zimmer® Unicompartmental High Flex Knee (ZUK) system in the US market, giving us a strong position in the attractive partial knee joint reconstruction segment.

In early 2016 we completed the acquisition of Blue Belt Technologies, securing a leading position in the fast-growing area of orthopaedic robotics assisted surgery. Blue Belt’s NAVIO™ surgical system provides robotics assistance in partial knee replacement surgery. We anticipate significant upside from a range of new product launches that will expand into indications beyond partial knees, the first of which is the total knee application with the first procedures being completed in 2016.

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1 The non-IFRS financial measures are explained and reconciled to the most directly comparable financial measure prepared in accordance with IFRS on pages 175-177.

Preserving active lifestyles

We continued to drive strong uptake of JOURNEY II, our kinematic knee platform. Looking ahead, we expect this momentum to continue as we train new surgeons and expand the JOURNEY II family of products to include our bi-cruciate retaining design, JOURNEY II XR.

The first surgeries using the JOURNEY II XR were completed in 2016. With the kinematic design, the expectation is that patients will experience a more natural feeling knee, with better rotational stability – retaining both cruciate ligaments. This, along with early, high mobility, and higher patient satisfaction are the goals we set out to achieve with XR. We are on track for the launch of JOURNEY II XR in mid-2017, and the plan is to make XR available on the NAVIO platform in due course.

Journey II XR
Kinematic knee platform

Smith & Nephew’s Hip Implant franchise offers a range of specialist products for reconstruction of the hip joint. This may be necessary due to conditions such as arthritis, causing persistent pain, and/or as a result of hip fracture. Every year more than two million patients worldwide undergo total, resurfacing and revision hip replacement procedures.

For Hip Implants, Smith & Nephew has developed a range of primary hip systems. Core systems include the ANTHOLOGY™ Hip System, SYNERGY™ Hip System, the POLARSTEM™ Femoral Hip System, the R3™ Acetabular System and the POLARCUP™ Dual Mobility Hip System. This diversity exemplifies our commitment to providing surgeons with implant and instrumentation options that meet the specific demands of their patients and preferred surgical approach, most notably the direct anterior or posterolateral approach. We also market the BIRMINGHAM HIP™ Resurfacing (BHR) System, an important option for surgeons treating suitable patients.

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Smith & Nephew’s portfolio includes the new REDAPT™ Revision Femoral System. The need to perform a revision can occur for a variety of reasons including infection, dislocation, or failure of the implants to achieve biologic fixation. REDAPT is designed to turn such complex hip revisions into efficient, reproducible surgeries, allowing surgeons to effectively recreate a patient’s unique functionality, while quickly and easily addressing issues such as poor bone quality. The REDAPT Revision Femoral System comprises a monolithic stem and a Fully Porous Shell. The use of additive manufacturing (also called 3D printing) to create a titanium shell, with first to market features that improve intraoperative usability and greatly enhance implant stability, was received with great enthusiasm amongst hip surgeons.

**Making good technology spectacular**

The REDAPT™ Fully Porous Acetabular Cup with CONCELOC™ Technology was launched in 2016. To allow ingrowth, an additive, or 3D printing, manufacturing process is used to produce an entirely porous implant that mimics the structure of cancellous bone. New variable-angle locking screws can be used to enhance implant stability and minimise micromotion after surgery, which when coupled with placement of hole patterns, optimises surgical flexibility and access, particularly in difficult to reach areas of revision cases.

The 3D printing method allows for complex design geometries that would be difficult, expensive or impossible to achieve with traditional manufacturing methods. For example, solid reinforcements can be built directly into the porous structure to provide extra strength in precise locations.

Our Trauma & Extremities franchise supports healthcare professionals by pioneering solutions for surgeons to stabilise severe fractures, correct bone deformities, treat arthritis, and heal soft tissue complications. Performance in 2016 in this franchise was held back by the destocking in our China business and reduced tender activity in the Gulf States.

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

The EVOS Mini Fragment Plate and Screw System is a dedicated Trauma mini fragment system. This is a stainless steel highly versatile system with a multitude of plate geometries and longer screw lengths than standard mini fragment systems. Complementing this is our VLP+ MINI-MOD+ Small Bone Plating System for the fixation of small bones and small bone fragments, specifically designed to match the contour of small bones needed in treating hand, wrist, elbow, foot and ankle fractures.

For extremities and limb restoration, we offer the TAYLOR SPATIAL FRAME® Circular Fixation System as well as a range of plates, screws, arthroscopes, instrumentation, resection and suture anchor products for orthopaedic surgeons including foot and ankle and hand and wrist specialists, and trauma surgeons. This year, TAYLOR SPATIAL FRAME External Fixator celebrated its 20 year anniversary, and we conducted a systematic review of the clinical outcomes. The results showed post-operative success in more than 99% of patients. 2016 saw the first implantation of the ATLAS HF Nail in South Africa and India. It is the first Smith & Nephew nail specifically designed for the Emerging Markets.

Key products in this franchise include the FAST-FIX® family of meniscal repair systems, the ENDOBUTTON® family for knee ligament reconstruction, HEALICOIL™ PK, FOOTPRINT™ PK and TWINFIX® Suture anchors for repairs of the hip and rotator cuff. The open architecture of the HEALICOIL™ PK Suture Anchor allows for new bone to fill the fenestrations between threads and into the central channel. The SUTUREFIX® Ultra soft suture anchor is an attractive option for procedures in which anatomic space is very limited while still delivering high fixation strength.

Smith & Nephew also offers products made from REGENESORB®, an advanced bioresorbable shown to be absorbed and completely replaced by bone within 24 months in pre-clinical studies. Smith & Nephew markets a suite of products for Rotator Cuff Repair (RCR), one of the most common sports medicine procedures. These include ULTRATAPE®, a suture that provides greater tendon-to-bone contact when compared to traditional #2 suture, and may enhance repair. FIRSTPASS® ST, a sterile-packaged retrograde suture passer that eliminates the steps of loading and unloading needles and cartridges; and MULTIFIX® S, an all-PEEK knotless screw-in anchor. All these recently launched products can be used together or in conjunction with existing products from the Smith & Nephew portfolio in a single procedure, significantly expanding the breadth of our RCR Solutions. The Q-FIX® All-Suture Anchor is ideal for a variety of arthroscopic shoulder and hip repairs, offering fixation performance superior to commonly used all-suture anchors and traditional anchors.

1 The non-IFRS financial measures are explained and reconciled to the most directly comparable financial measure prepared in accordance with IFRS on pages 175-177.
2 05036 V1 INTERTAN Claims Brochure 0616.
3 07037 V1 Bone & Joint Outcome. The TAYLOR SPATIAL FRAME for External Fixation. A Systematic Literature Review Following 20 Years of Clinical Outcomes. 1016.
4 Smith & Nephew Evaluation Reports 15002113, 15002112, 15002117.
8 Data on File, Smith & Nephew report 15000897.
9 Results of in vivo simulation have not been shown to quantitatively predict clinical performance.
The WEREWOLF™ COBLATION™ System is the latest innovation in COBLATION technology. Featuring an all new controller and designed to support a broad variety of wands, WEREWOLF delivers an unparalleled range of performance capabilities and advanced safety features – WEREWOLF carries broad indications across Sports Medicine.

The COBLATION process involves the creation and application of an energy field called ‘glow discharge plasma’, which acts to ablate molecules in the tissue. COBLATION Technology provides advantages to the surgeon by operating at lower temperatures than other radio frequency-based technologies, and allowing for precise removal of soft tissue with minimal damage to untargeted tissue.

ARThROSCOPIC ENABLING TECHNOLOGY

Our Arthroscopic Enabling Technologies (AET) franchise offers a high performance array of minimally invasive surgery-enabling systems and devices.

AET platforms work in concert to facilitate access to various joint spaces, visualise the patient’s anatomy, resect degenerated or damaged tissue and prepare the joint for a soft tissue repair. Products in this franchise are often used in conjunction with products from our Sports Medicine Joint Repair franchise.

Systems include high definition imaging solutions, industry leading energy based and mechanical resection platforms, fluid management and access portfolios, along with anatomic repair-aiding limb positioners and holders.

Key products include the LENS™ Integrated system which provides an integrated three in one design incorporating the Console (CCU, LED Light Source and Image Management System), Camera Head and iPad app. Also, WEREWOLF® and Quantum 2™ COBLATION™ controllers and a wide range of high performance COBLATION Technology radio frequency (RF) wands ablate, resect and coagulate soft tissue and enable haemostasis of blood vessels.

We also market the DYONICS® Shaver blades, handpiece, and controller, which provide superior resection due to their sharpness and reduce clogging with their debris evacuation capabilities, GoFLO™ and DoublePump fluid management consoles that distend joint space while providing haemostasis and a medium to perform arthroscopic procedures, SPIDER2™/T-MAX procedure-enabling limb positioning systems, and ACUFEX® Hand Held Instruments.

Within an operating room our AET products are typically kept in tower, often comprising a visualisation or camera system, COBLATION or energy based resection controllers, mechanical resection or blade controllers and fluid management or pump components. Our customers often think about a tower solution to complete an arthroscopic procedure more than the individual components that make up this tower. Our strategy is to showcase our industry leading tower components, such as COBLATION wands and DYONICS shaver blades, when selling the LENS camera system and GoFLO Pump. We articulate this through our ‘Own the Tower’ strategy.

OTHER SURGICAL BUSINESSES

The Other Surgical Businesses franchise includes our Ear, Nose & Throat (ENT) business and the NAVIO® robotic surgical business, acquired at the start of 2016. This franchise included our Gynaecology business sold in August 2016.

Within ENT we offer a wide variety of products including our COBLATION Technology for tissue removal and haemostasis, various articulating instruments and implants for sinus surgery such as balloon sinuplasty, and our RAPID RHINO® Carboxymethylcellulose (CMC) Technology which is featured in both dissolvable and removable nasal and sinus dressings, and epistaxis treatment products. Our NASASTENT™ Dissolvable Nasal Dressing is a structural intranasal splint used to minimise bleeding and prevent post-operative adhesions after sinus surgery. Unlike other nasal dressings which fragment as they degrade, once the NASASTENT dressing absorbs sufficient nasal fluid, it converts into hydrocolloidal gel that simply drains from the cavity as part of the natural outflow.

The acquisition of Blue Belt Technologies was announced in October 2015 and completed in January 2016. This has given us a leading position in the fast growing area of robotics-assisted orthopaedic surgery. Its NAVIO surgical system provides robotics-assistance in partial knee replacement surgery through a unique hand-held, bone-shaping device. NAVIO and our own partial knee implant portfolio form a strong combined business from which to accelerate growth in this attractive area of surgery. Additionally, we intend to expand NAVIO into total knee, bi-cruciate retaining knee and revision knee implants, delivering significant further upside.

$631m
Revenue
0% +2%
Reported Underlying1
2012 $458m 2013 $441m 2014 $516m 2015 $631m 2016 $631m

$214m
Revenue
+5% +15%
Reported Underlying1
2012 $162m 2013 $174m 2014 $147m 2015 $205m 2016 $214m

1 The non-IFRS financial measures are explained and reconciled to the most directly comparable financial measure prepared in accordance with IFRS on pages 175-177.
The Advanced Wound Care (AWC) franchise consists of several groups of brands, including exudate management, infection management and our cornerstone range of products. Performance in this franchise in 2016 reflected the effect of destocking in China and weakness in a couple of European countries, which more than offset the performance in the US.

Exudate management products focus on providing appropriate wound fluid absorption and evaporation properties to promote optimal wound healing environment. This will reduce the burden a wound has on the patients and help them to get on with their lives and at the same time diminish costs for materials and nursing time.

Our key growth brand in this space is ALLEVYN™ Life, an innovative dressing designed to improve the quality of life for patients with chronic wounds, as well as helping healthcare professionals reduce the costs of frequent dressing changes. During the year we announced the publication of a new research paper showing how a comprehensive ulcer prevention programme which included the use of ALLEVYN Life can significantly decrease hospital-acquired pressure ulcers (HAPUs) by 69% in an adult intensive care unit.

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

Smith & Nephew’s cornerstone range offers a wide selection of wound care products, which means we have one of the most comprehensive ranges of wound care solutions in the industry. These products include our film and post-operative dressings, skincare products and gels. OPSITE™ is one of our most successful and pioneering products and has become the global standard of care in post-operative dressings. IV3000®, a specialist premium dressing for intravenous lines, continues to perform well. SECURA® is a proven preventative skin care product which helps maintain and protect skin integrity.

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

Our iodine based product, IODOSORB®, has a unique mode of action to deliver low level, slow release elemental iodine without cytotoxic effects.

In July we announced the first surgical case for our robotics-assisted total knee replacement procedure. The new approach can use the NAVIO® Surgical System to implant the JOURNEY® II BCS and CR total knee systems.

During a total knee replacement surgery, the NAVIO system is designed to deliver consistent and accurate results through the utilisation of a robotics-assisted hand piece, navigation and NAVIO specific cut guides, all of which enable better patient outcomes. The NAVIO intraoperative planning software uses 3D surface capture and kinematic registration to predict joint laxity, enable precise implant positioning, and define a patient specific surgical plan. Unlike other robotics-assisted platforms, the NAVIO system does not require a pre-operative CT scan.

This new indication has the potential to increase system utilisation, as approximately 80% of global knee replacement procedures are primary total knee replacements, compared to less than 10% for partial knee replacements.

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$719m
Revenue
-5%  -3%
Reported  Underlying
$849m  $843m  $805m  $755m  $719m

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Our Advanced Wound Bioactives (AWB) franchise focuses on the development and commercialisation of novel, cost-effective biopharmaceuticals to provide a unique approach to debridement, dermal repair and tissue regeneration.

Currently, our Advanced Wound Bioactives products on the market include Collagenase SANTYL® Ointment (the only FDA-approved biologic enzymatic debriding agent for chronic dermal ulcers and severe burns), OASIS® Wound Matrix and Ultra Tri-Layer Matrix (a naturally-derived, extracellular matrix replacement products indicated for the management of both chronic and traumatic wounds) and REGRANEX® (becaplermin) Gel 0.01% (an FDA-approved platelet-derived growth factor for the treatment of Diabetic Foot Ulcers).

Our most significant product by sales is SANTYL Ointment, which plays an integral role in removing necrotic or dead tissue in chronic dermal ulcers (such as pressure ulcers, diabetic ulcers, and venous ulcers) and severely burned patients. In 2016 we continued to see significant growth in the use of SANTYL Ointment by office-based physicians while we experienced some challenges in the long-term care market as patients experienced shorter stays in nursing homes and transitioned to care in home health. We are concentrated on further establishing the value of SANTYL Ointment in treating patients despite the shift of cost from insurers to the patients. This is being supported through cost-effectiveness data focused on patient outcomes and overall treatment costs. This information is assisting us to further educate physicians, patients, and payers on the critical role that SANTYL Ointment plays in moving the healing process forward.

The wound bioactives market growth has been impacted by changes in the reimbursement landscape that are driving increases in co-pay, deductibles and access in general across the sites of care.

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

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Our Advanced Wound Devices (AWD) franchise is comprised of our Negative Pressure Wound Therapy (NPWT) and surgical debridement businesses.

The PICO™ system, our pioneering single-use, canister-free NPWT solution, performed strongly in 2016. PICO brings the effectiveness of traditional NPWT in a modern, small portable system. It is designed for both open wounds and closed incisions and leverages our leading dressing technology. More than one million PICO systems have now been used to treat patients, changing the treatment landscape for NPWT.

A number of new pieces of evidence supporting PICO were published in 2016. This included new clinical evidence highlighting improved patient outcomes when using PICO following orthopaedic surgery, as well as evidence and expert opinion highlighting the clinical and aesthetic benefits of PICO in mammoplasty and oncological breast reconstructive surgery.

In traditional NPWT, we secured regulatory approval for both RENASYS GO and RENASYS TOUCH in the US and Europe in 2016. RENASYS TOUCH is in a limited launch in Europe and US and we are re-supplying existing US customers with RENASYS GO.

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

More than a million PICO systems

In 2011, Smith & Nephew launched a breakthrough in NPWT – the PICO Single Use NPWT System. In 2016, the millionth application of PICO was used to treat a patient.

The revolutionary four-layer multi-function dressing technology makes the PICO System canister-free and disposable. Each layer works together to ensure that negative pressure is delivered to the wound bed and exudate is removed through absorption and evaporation.

Today PICO is used in the community and hospitals to treat patients. PICO is as easy to apply as a conventional wound dressing, reducing the need for the staff time, intensive training and administrative paperwork associated with traditional NPWT.

For the patient, the PICO system’s one-button pump is easy-to-use and its small size and silent operation provide a discreet, unobtrusive way to carry on daily life with NPWT. For the payer, the PICO system is more affordable than traditional NPWT, and can significantly reduce therapy costs associated with traditional NPWT.

PICO Single Use NPWT System
The revolutionary 4-layer multi-function dressing

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1 Malmsjo, M; Huddleston, E; Martin, R; Biological Effects of a Disposable, Canisterless Negative Pressure Wound Therapy System; Eplasty 2014.
RESEARCH & DEVELOPMENT

Innovation is part of our culture and we invest 5% of our revenue to find new products that will help improve people’s lives.

See opposite

ETHICS & COMPLIANCE

We are focused on doing business the right way and apply strict business principles to the way we deal with our clients and partners.

More on page 28

MANUFACTURING & QUALITY

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

More on page 30

TRAINING & EDUCATION

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

More on page 31

SALES & MARKETING

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

More on page 32

OUR PEOPLE

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

More on pages 33 to 35

RESEARCH & DEVELOPMENT

Our Research & Development (R&D) strategy is at the heart of our business model. Through it we strive to deliver innovation that matters, pioneering products and services that bring value to our customers and the Company.

In 2016 we made significant changes to create a single global R&D structure, led by a new President of Global R&D, reporting directly to the Chief Executive Officer. The new global function has moved quickly to sharpen our focus onto the three areas which will accelerate the value created by R&D.

First, we are refining our R&D roadmap to identify and support projects that will make a meaningful difference to our customers and their patients. This includes continuing to invest in incremental innovation to improve existing products in a way that improves outcomes. It also involves driving greater efficiency through innovation, potentially reducing our costs of goods. By making instrument sets more procedure and patient-specific, we will reduce complexity and cost, to the benefit of customers and the Company. Finally, by seeking more meaningfully disruptive products and services, we will harness transformational innovation to provide access to new technologies to people across the world.

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

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

Science is at the heart of ensuring our products are safe and efficacious. In 2016 we made important investments to support and develop our scientific expertise. In Hull, UK, we announced plans to invest $10 million in creating a new R&D centre. More than a 100 roles will be based here and the breadth and scale of scientific specialties housed in the new centre will make us one of the most capable and well equipped centres in Europe for Medical Device R&D. The new centre will allow us to strengthen links with regional universities to support research & recruitment activities. The Hull facility will be fully operational by the second quarter of 2017.

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

In 2016, we invested $230 million in R&D, in-line with our commitment, set out in 2011, to maintain our investment level at around 5% of revenue. We expect to maintain this proportion going forward, but to realise greater benefit through our new structure and strategic focus.

INVESTMENT IN RESEARCH & DEVELOPMENT in 2016

$230m
ETHICS & COMPLIANCE

CODE OF CONDUCT AND BUSINESS PRINCIPLES
Smith & Nephew earns trust with patients, customers, healthcare professionals, government authorities and the public by acting in an honest and fair manner in all aspects of its operations.

We expect the same from those with whom we do business, including vendors who provide us with services and distributors and independent agents that sell our products. Our Code of Conduct and Business Principles governs the way we operate to achieve these objectives.

Smith & Nephew takes into account ethical, social, environmental, legal and financial considerations as part of its operating methods. We have a robust whistle-blowing system in all jurisdictions in which we operate. We are committed to upholding our promise in our contracts, which includes ensuring that our third parties are subject to screening and are contractually obligated to comply with applicable laws and our Code of Conduct.

GLOBAL COMPLIANCE PROGRAMME
Smith & Nephew has implemented a world-class Global Compliance Programme that helps our businesses comply with laws and regulations. Our comprehensive compliance programme includes: Board and executive oversight committees; global policies and procedures; on-boarding and annual training for employees and managers; training for distributors and agents and higher risk vendors; monitoring and auditing processes; reporting channels and recognition for demonstrating our values.

Through our global intranet, we provide resources and tools to guide employees to make decisions that comply with the law, local industry code and our Company Code of Conduct. We conduct regular audits and on-going reviews to ensure that our policies are effective in managing risk and protecting our businesses. We also conduct regular reviews of our compliance training and certifications to ensure that they are up-to-date and relevant.

In 2016 we introduced a new model for the annual manager certification, so we followed the same model in 2016. Managers were required to have an ‘ethics/compliance conversation’ with some of their direct reports.

We also began conducting increased follow-up with internal reporters of potential compliance issues. The follow-up process includes several touchpoints with the reporter during the investigation process, as well as a follow-up call with the reporter approximately 60 days after the close of the investigation. The goal of the programme is to ensure that reporters understand their concerns are being actively investigated, and to confirm after the close of the investigation whether the reporter has feedback on the process or any additional concerns to raise.

We had positive feedback on our approach to the annual manager certification, so we followed the same model in 2016. Managers were required to have an ‘ethics/compliance conversation’ with some of their direct reports. They were given centrally-created materials focusing on the importance of earning trust and then provided with specific, topic-based scenarios to discuss with their staff actions that would demonstrate this core Smith & Nephew value. This model enhanced dialogue on ethics, compliance and the importance of earning trust between managers and staff.

Finally, we continue to improve our controls testing universe. We refreshed our programme to require auditors to dig deeper when they encounter potential risks. We also moved to a new reporting format that allows the auditors to provide more detail about their testing process and the results. We continued with our early warning Local Monitoring Programme, where Regional Compliance Officers test higher-risk activities within their markets.
Young professionals driving innovation

Smith & Nephew is proud to support young professionals’ development within our Company. We recognise that we need to create an environment where our employees have opportunities to grow. We are actively working to put young professionals at the forefront of our business.

Angela Blackburn, based in Memphis, Tennessee was hired in April 2016 as an Engineer and quickly expressed an interest in networking with her peers across the wider business. From this, she and two colleagues developed the ‘Young Professionals Organisation’ that brings together graduates and new starters with the aim of providing networking and career development opportunities in addition to sharing their experiences. The kick-off meeting, held in Memphis, was attended by over 150 young professionals and continues to be well supported.

Recognising Angela’s talent and desire to create opportunities for her peers, she was promoted to become Programme Manager for Graduate Hires. This is a global role responsible for more than 100 newly qualified engineers recruited by Smith & Nephew in 2016 to support our R&D, quality and manufacturing programmes.

Angela has relished in connecting diverse young professionals who are all working together to drive innovation in our Company.

“My main ambition is to continue engaging, inspiring and educating people – helping them to embrace the opportunities they are given and the challenges that come with them. I take great pride in creating an environment where young professionals can reach their full potential and I enjoy assisting them in turning their great ideas into action.”
GLOBAL OPERATIONS
Smith & Nephew takes great pride in its expertise in manufacturing products to the highest quality and ensuring they reach our customers in a timely manner. We operate manufacturing facilities in a number of countries across the globe, and a number of central distribution facilities in key geographical areas. Products are shipped to individual country locations which hold small amounts of inventory locally for immediate supply to meet customer requirements.

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

In 2016 we made good progress across these priorities. Highlights included the opening of a new state-of-the-art facility in Costa Rica which will provide a more efficient operation for current products as well as valuable space for future growth. We also created more than 100 positions for newly qualified graduate engineers across facilities in the US and elsewhere. These individuals, who began their careers with us in 2016, will deliver the pioneering advanced medical devices that enable our healthcare professional customers to continue to improve outcomes for patients during the years to come.

Quality has always been paramount to Smith & Nephew. We have a unified Quality Assurance and Regulatory Affairs team to ensure consistency across our country business units. Requirements of global regulatory agencies have become more stringent in recent years and we expect them to continue to do so. We are continuing to expand our portfolio globally through new product development and by registering our existing products in new markets. In order to meet the expectations of regulators and support this added complexity we continued to invest in our Quality and Regulatory expertise in 2016.

OUR MANUFACTURING FACILITIES
Our largest manufacturing operation is based in Memphis, Tennessee, USA. The Memphis facilities produce key products and instrumentation in our Knee Implant, Hip Implant and Trauma franchises. These include the JOURNEY® II and LEGION® knees, the ANTHOLOGY® Primary Hip System and key Trauma products such as the PERI-LOC® Ankle Fusion Planting System and TRIGEN® Intramedullary Nails. In addition to this, Memphis is home to the design and manufacturing process of the VISIONAIRE patient matched instrumentation sets, and OXINUM® Oxidised Zirconium, a patented metal alloy available for many of our knee and hip implant systems.


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

Our Oklahoma City, Oklahoma, USA facility produces and services electro/mechanical capital equipment as well as single use sterile devices and also assembles our NPWT devices using components brought in from third parties.

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

In Hull we manufacture some of the most high-technology wound care products on the market. Over the last few years we have introduced pioneering products such as PICO, DURAFIBER and ALLEVYN life, all of which are manufactured in Hull. Since 2011, we have invested approximately £50 million in capital projects at our Hull site. This has included bringing the manufacturing of our complex silver coating technology for ACTICOAT to Hull and installing a Film Extrusion manufacturing line. We run two second lines for some of our products in Suzhou, China, and this site also manufactures our wound care products for the mid-tier in the Emerging Markets.

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

PROCUREMENT
We procure raw materials, components, finished products and packaging materials from suppliers in various countries. These purchases include metal forgings and castings for orthopaedic products, optical and electronic sub-components for sports medicine products, active ingredients and semi-finished goods for Advanced Wound Management as well as packaging materials across all product ranges. Suppliers are selected, and standardised contracts negotiated, by a centralised procurement team wherever possible, with a view to ensuring value for money based on the total spend across the Group. On an ongoing basis, we work closely with our key suppliers to ensure high quality, delivery performance and continuity of supply.

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

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

We operate three main holding warehouses, one in each of Memphis (Tennessee, US), Baar (Switzerland) and Singapore. These facilities consolidate and ship to local country and distributor facilities. Our distribution hubs for advanced wound products are located in Neunkirchen (Germany), Derby (UK) and Lawrenceville (Georgia, USA).
Smith & Nephew is dedicated to helping healthcare professionals improve the quality of care for patients. We are proud to support the development of surgeons and nurses by providing skills training and education on our products and techniques.

Every year, thousands of customers attend our state-of-the-art training centres in the US, UK and China and Smith & Nephew courses at multiple hospitals and facilities around the world. In 2016, we provided training to more than 40,000 surgeons. Working under expert guidance, attendees learn new techniques and refine skills, to ensure the safe and effective use of our products. These courses are attended by residents, fellows and practicing surgeons who work together to review, discuss and train on current and forward-looking surgical techniques in their areas of clinical expertise. Our courses help up-and-coming surgeons develop trust and gain the experience and confidence necessary to become experts in their field.

We also support nurses across the world, with many thousands receiving face-to-face training from our representatives every year. For instance, in 2016 we completed our first Wound Care Academy for the Kingdom of Saudi Arabia. The week long intensive course was a theoretical and practical based learning initiative that aimed to enhance the wound care knowledge of local healthcare professionals.

We also support healthcare professionals through our online resources such as the Global Wound Academy, The Wound Institute and, for surgeons, our Education and Evidence website. In 2016 more than 90,000 healthcare professionals trained digitally with Smith & Nephew.
Starting conversations with clinical evidence

In September 2016, Smith & Nephew served as a Diamond Sponsor at the World Union of Wound Healing Societies 2016 (WUHWS) conference held in Florence, Italy. Known as the ‘Olympics of Wound Care’, the conference unites the greatest thought-leaders in wound management under one roof every four years.

This year, our Sales & Marketing team combined their efforts with the Scientific & Medical Affairs (SMA) team, conducting hundreds of on-stand product demonstrations as well as three well-attended symposia presented in front of more than 1,000 delegates, each delivering a strong message based on clinical data and evidence. Working together enabled us to engage visitors in evidence-based conversations, reinforcing our position as thought-leaders in wound healing.

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

We serve our customers through our sales force. Our sales representatives are highly trained and skilled individuals. Becoming a sales representative requires intense training, including passing a strict certification programme, before engaging in discussions with, and ultimately selling products to, customers. Depending on their area of specialism, representatives must be able to demonstrate a detailed knowledge of all the surgical instruments used to implant a device, or have specific understanding of the various surgical techniques a customer might use. In our advanced wound franchises, sales representatives will have a detailed understanding of how patients live with wounds and how clinicians seek to prevent and treat them, as well as deep knowledge of the clinical and economic benefits of using our products within treatment protocols.

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

Our Global Commercial Organisation, led by the Chief Commercial Officer, oversees all commercial activities (sales, marketing, market access, and commercial strategy) across the Group for our full line of business. Its mission is to define and drive best practice in commercial execution across our geographies and in marketing across the franchises.

Our sales force is structured by region, with three commercial organisations serving the US, Europe & Canada, and Asia Pacific and the Emerging Markets. Each is led by a regional President, who reports to the Chief Commercial Officer.

Our US sales forces are specialised by channel. They consist of a mixture of independent contract workers and employees. Sales agents are contractually prohibited from selling products that compete with our products. In most Established Markets outside of the US, country-specific commercial organisations led by the country managing director lead employee sales forces directly. The largest single customer worldwide is the National Health Service (NHS) and associated purchasing groups in the UK, in the UK, which represent less than 5% of our worldwide revenue in 2016. In our Emerging Markets we operate through direct selling and marketing operations led by country managing directors, and/or through distributors.

Smith & Nephew has three global marketing teams who set the strategic direction of our businesses and develop all the promotional assets and guidance to commercialise our products in Advanced Wound Management, Sports Medicine and Orthopaedics. For that they utilise a variety of traditional and novel means to market to our customers. For example, congresses (educational conferences or trade shows) represent a traditional and efficient way for Smith & Nephew to reach a large number of healthcare professionals at once, often in terms of both advertising/promotion and education. From an awareness perspective, Smith & Nephew displays its latest innovative products and, from an educational standpoint, may also provide satellite symposia or other forms of medical education around these products.

The Global Commercial Organisation also includes a global Commercial Excellence team, who support both the commercial teams and the global marketing teams with several expertise groups. These include strategic planning, business intelligence and market research, digital marketing, pricing, sales force excellence and marketing communications.

We also leverage digital media to connect with our customers. Our digital communications activities have been evolving as technologies and user habits evolve. Content and messaging is currently delivered via global market websites, social media channels and mobile applications. One core use of digital technology to communicate and market to our customers has been Education & Evidence, a membership-driven clinical education website.

"What was most pleasing, from a Scientific and Medical Affairs point of view, was the level of spontaneous attendance we received at the booth. The team, comprising both internal and external experts, were challenged with inquisitive questions which led to numerous constructive conversations on improving clinical outcomes.”

Vice President of Scientific & Medical Affairs
BUILDING CULTURE BY LIVING OUR VALUES

Smith & Nephew is proud of its culture. This culture both endures and evolves, having been shaped by thousands of employees over more than 160 years. Today, it is framed by our values of trust, innovation and performance.

Our Chief Executive Officer, Olivier Bohuon, is responsible for ensuring that we support and encourage our employees to live these values. This includes the multiple programmes and actions that align how we work – our culture – with what we do – our strategy.

COMMUNICATION

Building trust requires open and transparent sharing of information through regular and timely communication. We clearly communicate our business goals and performance standards and also provide employees with the training and information that empowers them to succeed. We listen to our employees, holding regular surveys, open dialogue at town hall meetings and focus groups and small group discussions on topics of importance to employees and our business.

Two years ago, Smith & Nephew conducted its biennial employee survey. The Company had recently reorganised to a less siloed but more matrixed structure, moving from Global Business Units to a regional structure with centralised global functions. The results of the survey showed employees wanted a greater feeling of team and connectivity at our major sites. In response to this, site Leadership Councils were formed at our major locations. These councils were dedicated to enhancing the Smith & Nephew culture and making our Company a great place to work. Each council includes representatives from various functional areas across the site location. Each organises site and community events, and takes ownership for ensuring that employees at the site feel informed and engaged.

CODE OF CONDUCT AND BUSINESS PRINCIPLES

Our Code of Conduct and Business Principles defines our expectations for ethical and legal behaviour not only for our employees but to all who conduct business on our behalf. In this way we build trust with our customers, and with each other. All employees review and reaffirm their commitment to the Code of Conduct on an annual basis. The positive impact of clearly defined expectations and regular training has been evident in the results of our Global Employee Survey, which shows employees know and understand the expectations for ethical behaviour and how to report behaviour that does not meet our high standards.

RECOGNITION

To reinforce our core value of trust, we regularly recognise employees who go above and beyond to earn trust through our Spotlight on Trust awards programme. At the same time, we encourage employees to report incidents of noncompliance or misconduct, and ensure they are protected from retaliation. This process applies to all employees, suppliers, agents, contractors and customers alike.

EMPLOYEE WELLNESS

As a Company we are committed to ensuring our employees work in a safe and healthy environment. Smith & Nephew offers wellness programmes which include annual wellness days, fitness support and healthy eating support. For example, the Virgin Pulse programme offered to US-based employees, promotes health and wellness by helping them track their activity, providing fun wellness challenges and allowing them to earn discounts on their healthcare plans. Global Employee Assistance Programmes (EAPs) also support wellness by helping employees manage stress and work/life issues and problems. Through EAP, we provide counselling, webinars and web tools and other resources across many work/life topics. Counselling can span from traditional EAP counselling to financial, legal and everyday family assistance.

VALUE: We innovate

We view innovation as an essential skill to be demonstrated by all employees. Everyone is empowered to innovate in their job, to question the status quo, to propose new solutions, to continuously improve and to seek the best for the benefit of our customers.

OBJECTIVE SETTING

Innovation is captured formally in the annual objective setting process and employees are encouraged to continuously and pro-actively innovate to improve our costs, processes, services and products.

RECOGNITION

Our annual CEO Award, open to all employees, recognises employees who deliver exceptional results in line with our core values, encouraging innovation and a spirit of continuous improvement at all levels. In 2016 the winners included Bill McGee, who saved the Company $500,000 by suggesting enhancements to our shaver blade manufacturing process in Mansfield, US and Nham Nguyen, who works at our Oklahoma City facility and was instrumental in improving productivity by 20% in her unit.

Our global employee recognition programme, Going the Extra Mile (GEM), encourages employees to recognise the performance of colleagues and the demonstration of our values of Performance, Innovation and Trust. The GEM programme includes non-monetary and monetary options based on the level of achievement – from a simple note of ‘thanks’ to valuable merchandise. Going the Extra Mile also serves as our platform for a global Long Service Award programme.
EXECUTIVE SPONSORSHIP
Each year we hold a CEO Forum for our Top Talent, providing them with the opportunity to work closely with our executive team and with their peers on strategic challenges. One recent output from the Forum has been the creation of the Innovation Task Force to define what innovation looks like in Smith & Nephew and the characteristics that we should seek to embed to encourage innovation across the organisation.

DIVERSITY
We believe that diversity fuels innovation. We are committed to employment practices based on equality of opportunity, regardless of colour, creed, race, national origin, sex, age, marital status, sexual orientation or mental or physical disability unrelated to the ability of the person to perform the essential functions of the job. Our Valuing Difference programme is designed to reinforce this belief and to feature examples of the value of diversity across our business.

Our local Valuing Difference Councils are run by passionate and dedicated people. They meet as a global team quarterly and work to translate strategy to local needs, execute specific actions and share best practice. In 2016 we implemented Communication Toolkits which provide interactive exercises for teams to improve their awareness and education, along with employee case studies placed on the Company’s intranet. We also launched an online development programme for female professionals and eLearning programmes with a specific focus on Valuing Difference.

We recruit, employ and promote employees on the sole basis of the qualifications and abilities needed for the work to be performed. We do not tolerate discrimination on any grounds and provide equal opportunity based on merit. We do not use any form of forced, compulsory or child labour. We support the Universal Declaration of Human Rights of the United Nations. This means we respect the human rights, dignity and privacy of the individual and the right of employees to freedom of association, freedom of expression and the right to be heard.

VALUE:
We perform

TALENT AND CAPABILITY DEVELOPMENT
Attracting the best talent and developing our employees is critical to achieving our business objectives. We are committed to working with employees to develop each individual’s talents, skills and abilities. Employee advancement is merit-based, reflecting performance as well as demonstration of core competencies which include our values, with an emphasis on ethics and integrity. We prioritise the development and promotion of our existing employees whenever possible.

Each year Smith & Nephew conducts a comprehensive global development and capability review process to identify high-potential employees and ensure they have robust career development plans. Employees are provided with opportunities to develop their skills and career through new assignments and on the job experiences. In addition, the Board reviews succession plans for key executive roles and succession plans are in place for other critical positions across our business.

PERFORMANCE MANAGEMENT
We provide fair recognition and reward based on performance. Our performance management process ensures all employees set objectives which align to our overall business goals and have clear line-of-sight to how their individual contributions benefit the Company. Our performance management system assesses and rewards both performance and behaviour, in line with our Code of Conduct. All employees have a specific annual objective to adhere to the Code of Conduct and to complete training certifying their compliance with this Code.

NUMBER OF EMPLOYEES

<table>
<thead>
<tr>
<th>Category</th>
<th>Male</th>
<th>Female</th>
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</thead>
<tbody>
<tr>
<td>Board of Directors</td>
<td>8</td>
<td>3</td>
</tr>
<tr>
<td>Senior Managers(^2) and above in 2016</td>
<td>594</td>
<td>210</td>
</tr>
<tr>
<td>Total employees in 2016</td>
<td>9,230</td>
<td>6,414</td>
</tr>
</tbody>
</table>
GREAT PLACE TO WORK

Being a Great Place to Work is one of our goals as a Company. To earn this recognition, employees in each country must complete the Great Place to Work Trust Index survey and country management must participate in a Culture Audit. Both evaluate performance on key dimensions of engagement: Credibility, Respect, Fairness, Pride and Camaraderie.

Smith & Nephew uses the Great Place to Work Institute’s Trust Index as the basis for our Global Employee Survey. Our last full survey was in 2014, which demonstrated improvement from 2012 across all four areas of focus: understanding of our Strategic Direction improved by 10%, Empowerment by 20%, Cross-business coordination by 12% and Customer focus by 27%. We are conducting our current employee survey in two waves: Wave 1 was completed in some countries in 2016 and all other countries where Smith & Nephew operates will take part in Wave 2 during 2017.

In 2016 Canada, Denmark and Greater China joined Spain and Italy as countries where we have been recognised. As the Great Place to Work Institute did not have an accreditation component in South Africa at that time, we carried out a similar survey there that does have accreditation capabilities – Deloitte’s ‘Best Company to Work for Survey’ – following which South Africa received a Gold Seal from Deloitte.

In Canada, a winning attitude, improved communications and celebrating successes have created a team spirit based on trust. For Denmark, initiatives such as ‘30 minutes with management’ and activities focused on day-to-day employee wellbeing and career development have led to a strong culture. In Greater China, recognition was achieved through initiatives such as regular town halls, a People Development Forum, an employee ‘Juice Club’ and communicating via the WeChat platform.

A Family Day, quarterly employee town halls and leadership team lunches with new starters, along with a successful graduate internship programme and the day to day focus on employee wellbeing, are examples of why South Africa achieved this recognition.

For Smith & Nephew, being a Great Place to Work means having a workplace where employees are proud and excited to come to work each day because they are making a difference for customers and patients. It is not about programmes or initiatives, it is about people and we believe our people make Smith & Nephew a Great Place to Work.

A place where employees enjoy their work

In the US alone, more than 150 employees volunteer their time to manage Camaraderie Councils. These councils lead and uphold the Smith & Nephew culture through various team and charitable activities. Their primary objective is to make the Company a place where employees enjoy their work, as well as take pride in the work they do.

A critical aspect of the Council is helping our teams support dozens of local non-profit organisations. For example, Smith & Nephew’s Fort Worth, Texas site conducted a community clean up event where 20 employees volunteered on a Saturday to paint houses in a local neighbourhood. In Andover, Massachusetts, the site celebrated ‘Volunteer Month’ in May where employees could choose from a number of scheduled activities or coordinate their own event. The site also hosted its first 5K Fun Run where more than 90 employees, friends and family took part in support of a local children’s hospital.

In Austin, Texas, employees volunteered to create a menu, grocery shop, and prepare meals for families staying at the local Ronald McDonald House, a global not-for-profit organisation. Our Memphis, Tennessee employees conducted community focused events every month in 2016 including taking part in a ‘Walk to Cure Arthritis’ where more than 100 employees attended. The US Field Camaraderie Council manages community outreach events for Smith & Nephew’s more than 2,000 sales representatives across the nation. Since inception in June 2016 it has hosted more than 15 events in support of 15 different non-profit organisations. Thanks to the efforts of the US Camaraderie Councils, we improve morale, promote camaraderie and make a positive impact on the communities where we live and work.

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1 Number of employees as at 31 December 2016 including part time employees and employees on leave of absence.
2 Senior Managers and above includes all employees classed as Directors, Senior Directors, Vice Presidents and Executive Officers and includes all statutory directors and Directors of our subsidiary companies.
TAKING SUSTAINABILITY TO THE CORE OF THE BUSINESS

We significantly advanced our commitment to sustainability in 2016 through ratification of a Group Sustainability Strategy which is fully aligned to the Group Business Strategy. The Group Sustainability Strategy both drives and is driven by implementation of the Group Business Strategy, ensuring that all three main aspects of sustainability – economic prosperity, social responsibility and environmental stewardship – advance as one. This shift in focus communicates clearly that in order to be successful we must advance simultaneously in all three aspects.

This is a summary report of our sustainability activities and progress in 2016. Our annual Sustainability Report, to be published in April 2017, will provide further detail regarding our 2016 progress, describe the Group Sustainability Strategy and its associated goals, and specify targets to move our performance toward these goals.

GROUP SUSTAINABILITY STRATEGY

Smith & Nephew has been committed to working in a sustainable, ethical and responsible manner everywhere we do business. We are proud of our achievements over many years, as witnessed by our recurring inclusion in leading indices such as FTSE4Good and the Dow Jones Sustainability Index. Sustainability is a journey, and in 2016 we thought deeply about our destination for the longer-term. The result was a new Group Sustainability Strategy. At the heart of this are ten long-term aspirational goals. These encompass all aspects of our business, and will inform and drive our business strategy for years to come. The Board has endorsed these and executive management is behind them. These goals are set out on this page.

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

Of course, longer-term goals need medium term SMART targets to ensure we are making the right progress. We are finalising these for the next five years and will provide more detail in our Sustainability Report, due to be published in April 2017.

Our ten long-term aspirational goals

1. Zero work-related injuries and illnesses across the value chain
2. Water: Total water impacts of our products and solutions are balanced with local human and ecosystem needs
3. Waste: All materials are either shipped as part of product or returned for beneficial use
4. Carbon: 80% absolute reduction in total life cycle greenhouse gas emissions by 2050
5. Ethical Business Practices: All activities are conducted in compliance with applicable International Labour Organisation (ILO) conventions, involve no environmental degradation, and are free from corruption
6. Zero product-related and service-related patient injuries
7. Robust social responsibility programmes which contribute to the attraction and retention of top talent
8. Products and services are aligned to market economic, social and environmental expectations and anticipate future market conditions:
   All products have identified and clearly-described sustainability attributes
   R&D and New Product Development (NPD) processes deliver environmental-, social-, and healthcare economically-advantaged innovations
9. Strategic risks and opportunities are understood and business activities are aligned to risk appetite
10. Environmental, social, and economic impacts of (1) potential acquisitions, (2) technologies to be extended to Emerging Markets, (3) innovative business models, (4) cost of quality reduction initiatives, and (5) manufacturing siting, functional optimisation and site utilisation alternatives are fully understood and appropriately balanced

2016 was not just a year of planning. We continued to focus on delivering improvements across many areas of our business such as health, safety and environment, energy and water consumption and waste management. The highlights are found on the opposite page, and much greater detail will also be included in the 2016 Sustainability Report.
2016 SUSTAINABILITY ACTIVITIES
AND PROGRESS

Employee safety, wellness
and volunteering

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

Engagement with the communities in which we operate was significantly extended through employee volunteering and we have strengthened and deepened employee wellness programmes with a focus on enabling healthy lifestyle choices.

In 2016, our employee total incident rate (TIR), or recordable injury rate, reduced by 4% to 0.52, from 0.54 which continues to confirm our position in the top quartile of safety performance in our sector. This was achieved through the implementation of our sustainability management system, an active Internal Audit programme, a number of behavioural based safety campaigns and robust incident reporting and investigation systems across the Group. This was offset by a slight increase in the accident severity as there was an increase in our lost time incident frequency rate (LTIFR) of 15% to 0.23, from 0.20. There were no employee or contractor fatalities.

Our headline safety performance includes all employees and supervised contractors, it excludes unsupervised contractors. We adopt the industry standard USA Occupational Safety and Health Administration (OSHA) system to record incidents of occupational injury and ill-health.

Lost-time incidents are defined as those which result in a person not being able to report for work on the day or shift following the incident. Performance is expressed as a rate of the number of incidents per 200,000 hours worked.

Waste

Growth and acquisitions within the business have resulted in a wider environmental footprint. As a direct result the volume of waste arising from our operations increased by 11% in 2016. We continue to identify recycling opportunities and ways of diverting our waste away from landfill. In 2016, we recycled 74% of our waste, including waste diverted for energy recovery.

Water

Significant progress was made in 2016 to reduce our water consumption, particularly at our Memphis, US manufacturing location where we replaced water-cooled air compressor units with air-cooled radiator units. This investment reduced water consumption by the equivalent of the volume of fifteen Olympic-sized swimming pools, contributing to an annual reduction in water usage across the Group of 11%.

Energy and greenhouse gas emissions

Over the past year our energy use has increased by 5% with a corresponding 5% increase in carbon dioxide equivalent (CO₂e) emissions, driven by organic growth, acquisitions and changes in our manufacturing footprint.

Methodology, materiality and scope

The data reported relates to areas of largest environmental impact including manufacturing sites, warehouses, research and offices. Smaller locations representing less than 2% of our overall emissions are not included. Acquisitions completed before 2016 are included in the data. Each year we work with an independent partner to verify our sustainability data and gain assurance.

All emissions fall within the scope of our consolidated financial statement and we have used the Greenhouse Gas Protocol: A Corporate Accounting and Reporting Standard (Revised Edition) as guidance for this process. Primary data from energy suppliers has been used wherever possible. The acquisitions of Blue Belt Technologies and DC Manufacturing in Russia are included in 2016 for the first time, this is in line with our established policy for integration of acquired assets.
In 2016, we ran various campaigns to improve employee safety awareness. These included launching an ‘HSE’ brand to promote health, safety and environmental matters across the business. This was called ‘Target Zero’: No Incidents, No Injuries, No Harm. We also provided useful safety posters called ‘safety splashes’ that could be printed or used at locations on video screens in our buildings for employees, contractors and visitors to read.

### CO₂e Emissions (tonnes) from:

<table>
<thead>
<tr>
<th>Year</th>
<th>Direct emissions</th>
<th>Indirect emissions</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016</td>
<td>9,822</td>
<td>82,415</td>
<td>92,237</td>
</tr>
<tr>
<td>2015</td>
<td>11,011</td>
<td>77,191</td>
<td>88,202</td>
</tr>
<tr>
<td>2014</td>
<td>11,208</td>
<td>74,178</td>
<td>85,386</td>
</tr>
</tbody>
</table>

### Intensity ratio

- CO₂e (t) per $m sales revenue: 19.6, 19.2, 19.4
- CO₂e (t) per full-time employee: 5.9, 6.0, 6.9

### Notes

- 2014 data adjusted to exclude ArthroCare.
- 2015 data adjusted to exclude recent acquisitions in Russia and Colombia.
- 2016 data includes all data, including acquisitions since 2015. Direct CO₂e emissions exclude purchased steam at one manufacturing location, which has now been correctly included in indirect emissions.

### Target Zero

In 2016, we ran various campaigns to improve employee safety awareness. These included launching an ‘HSE’ brand to promote health, safety and environmental matters across the business. This was called ‘Target Zero’: No Incidents, No Injuries, No Harm. We also provided useful safety posters called ‘safety splashes’ that could be printed or used at locations on video screens in our buildings for employees, contractors and visitors to read.

### Financial Review

- **Full-time employee data** 2016: 15,584; 2015: 14,698; 2014: 12,437.

### Water (1,000m³)

- 2016: 682.7, -11%
- 2015: 769.5
- 2014: 751.9
- 2013: 795.0
- 2012: 769.5
- 2011: 717.6

### Energy (GWh)

- 2016: 207, +5%
- 2015: 198
- 2014: 194
- 2013: 177
- 2012: 177
- 2011: 178

### Greenhouse gas emissions, CO₂e (t)

- 2016: 92,237, +5%
- 2015: 88,202
- 2014: 85,386
- 2013: 77,682
- 2012: 77,274
- 2011: 76,904

Our emissions have been calculated by using specific emissions factors for each country outside the USA and regional factors within the USA. We have used the US EPA ‘Emissions & Generation Resource Integrated Database’ (eGRID) for US regions and the UK Government DEFRA Conversion Factors for Greenhouse Gas Reporting for elsewhere. The emissions from 2015 were calculated using the most up to date factors available and likewise in 2016.

Direct emissions include fugitive emissions from the manufacturing and research locations and arise from the losses of refrigerant gases, they also include the combustion of fuels on site for the operation of facilities. Indirect emissions include purchased electricity.
Strong platform to build on

REVENUE

Group revenue in 2016 was $4,669 million (2015: $4,634 million), an increase of 1% on a reported basis and 2% on an underlying basis.

In 2016, we delivered reported revenue growth of 4% and underlying revenue growth of 3% in the United States. Revenue growth on a reported basis was -1% and on an underlying basis was flat across our other Established Markets, although Japan and France delivered strong performances. In our Emerging Markets reported revenue growth was -3% and underlying growth was flat in 2016. Most of our Emerging Markets businesses generated double-digit growth which was offset by weakness in China and the Gulf States. In China, the slow-down in end-markets seen since mid-2015 was compounded by destocking in the distributor channel during 2016. By the end of 2016 most franchises in China had returned to growth as the level of stock in the channel was adjusted, although we expect Advanced Wound Management to continue to be impacted in the first half of 2017. In the oil-dependent Gulf States we saw very difficult trading conditions, particularly in our tender business, which are likely to persist. As a matter of course we expect to see some volatility in the Emerging Markets, but we continue to see significant long-term growth potential and are very well positioned in our chosen markets.

The global product franchise highlights in 2016 included our strong performance across Sports Medicine, where we continue to reap the benefits of the acquisition of ArthroCare. PICO®, our novel single-use NPWT system, is transforming the use of this therapy option. Our world class Knee Implant portfolio was further strengthened by the acquisition of NAVIO®, an exciting robotics platform, from which we delivered more than 50% reported revenue growth in 2016.

PROFIT

Operating profit of $801 million (2015: $628 million) includes acquisition and disposal related items, as well as restructuring and rationalisation costs, amortisation and impairment of acquisition intangibles and legal and other items incurred in the year. The 2016 operating profit is before a one-off $326 million gain from the disposal on the Gynaecology business in August 2016. The operating profit margin increased to 17.2% (2015: 13.6%) primarily driven by the costs in 2015 relating to anticipated and settled metal-on-metal hip claims.

Trading profit was $1,020 million (2015: $1,099 million). The trading profit margin was 21.8% (2015: 23.7%). This reduction primarily reflects the significant transactional currency headwind seen in 2016 resulting from the sustained strength of the US Dollar. Additionally, we lost some operational leverage from the lower than anticipated sales growth and our investment in Blue Belt Technologies was dilutive. These factors were somewhat offset by the Group Optimisation programme.

Selling, general and administrative expenses decreased by $275 million (10%) from $2,641 million in 2015 to $2,366 million in 2016. In 2016, administrative expenses included amortisation of software and other intangible assets of $61 million (2015: $66 million), $62 million of restructuring and rationalisation expenses (2015: $65 million), an amount of $178 million relating to amortisation and impairment of acquired intangibles (2015: $204 million), $9 million of acquisition related costs (2015: $12 million) and $30 million net credit primarily related to a $44 million curtailment credit on UK post-retirement benefits (2015: $190 million charge for legal and other charges). Excluding the above items, selling, general and administrative expenses were $2,086 million in 2016, a decrease of $18 million from $2,104 million in 2015.

Research and development expenditure as a percentage of revenue remained broadly consistent at 4.9% in 2016 (2015: 4.8%). Actual expenditure was $230 million in 2016 compared to $222 million in 2015. The Group continues to invest in innovative technologies and products to differentiate it from competitors.

PROFIT ON DISPOSAL

The Group realised a profit on the disposal of its Gynaecology business of $326 million. The business had been primarily internally generated and the disposed assets had a net book value of $10 million. The proceeds were $350 million with associated disposal related costs of $7 million and liabilities of $7 million.

TAXATION

Our reported tax rate of 26.2% (2015: 26.7%) includes the one-off benefit of a US tax settlement which is partly offset by the tax rate on the disposal of the predominantly US Gynaecology business.

1 These non-IFRS financial measures are explained and reconciled to the most directly comparable financial measure prepared in accordance with IFRS on pages 175-177.
The underlying increase in revenues, by market, reconciles to reported growth, the most directly comparable financial measure calculated in accordance with International Financial Reporting Standards (IFRS), as follows:

<table>
<thead>
<tr>
<th>Reconciling items</th>
<th>2016 $ million</th>
<th>2015 $ million</th>
<th>Reported growth %</th>
<th>Underlying growth %</th>
<th>Acquisitions/Disposals %</th>
<th>Currency impact %</th>
</tr>
</thead>
<tbody>
<tr>
<td>US</td>
<td>2,299</td>
<td>2,217</td>
<td>4</td>
<td>3</td>
<td>1</td>
<td>–</td>
</tr>
<tr>
<td>Other Established Markets</td>
<td>1,679</td>
<td>1,702</td>
<td>(1)</td>
<td>–</td>
<td>–</td>
<td>(1)</td>
</tr>
<tr>
<td>Emerging Markets</td>
<td>691</td>
<td>715</td>
<td>(3)</td>
<td>–</td>
<td>2</td>
<td>(5)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>4,669</strong></td>
<td><strong>4,634</strong></td>
<td><strong>1</strong></td>
<td><strong>2</strong></td>
<td></td>
<td><strong>(1)</strong></td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th>Operating profit</th>
<th>2016 $ million</th>
<th>2015 $ million</th>
<th>Operating profit margin %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Acquisition related costs</td>
<td>9</td>
<td>12</td>
<td>0.2%</td>
</tr>
<tr>
<td>Restructuring and rationalising costs</td>
<td>62</td>
<td>65</td>
<td>1.3%</td>
</tr>
<tr>
<td>Amortisation of acquisition intangible and impairments</td>
<td>178</td>
<td>204</td>
<td>3.8%</td>
</tr>
<tr>
<td>Legal and other</td>
<td>(30)</td>
<td>190</td>
<td>0.7%</td>
</tr>
<tr>
<td><strong>Trading profit</strong></td>
<td><strong>1,020</strong></td>
<td><strong>1,099</strong></td>
<td><strong>21.8%</strong></td>
</tr>
</tbody>
</table>

The non-GAAP measures are explained and reconciled to the most directly comparable financial measure prepared in accordance with IFRS on pages 175-177 and page 173.
CAPITAL RETURNS
The efficient use of capital on behalf of shareholders is important to Smith & Nephew. The Board believes in maintaining an efficient, but prudent, capital structure, while retaining the flexibility to make value enhancing acquisitions. This approach is set out in our Capital Allocation Framework which we used to prioritise the use of cash and ensure an appropriate capital structure.

Our commitment, in order of priority, is to:
1. continue to invest in the business to drive organic growth;
2. maintain our progressive dividend policy;
3. realise acquisitions in-line with strategy; and
4. return any excess capital to shareholders.

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

ENHANCING GROUP EFFICIENCY
In 2016 we continued to simplify and improve our operating model and delivered significant efficiencies. In Manufacturing, our Global Operations leadership team is focused on supporting the Group's strategic priorities by ensuring our footprint and expertise are ready to respond to geographical growth, new product development, greater external regulatory scrutiny and the commercial pressure to be ever more efficient. We made good progress across these areas in the year. The Group Optimisation Plan was announced in May 2014 with a stated savings target of annualised benefits of $120 million by the end of 2017. We delivered ahead of plan and reached our target at the end of 2016. These savings have been driven by our focus on efficient procurement, the greater agility of the single country managing director model and rationalisation of our facility footprint in a number of countries.

SUCCESSFUL ACQUISITION TRACK RECORD
In recent years we have undertaken a number of acquisitions, strengthening both our technology and product portfolio, and our Emerging Markets business. We have delivered good returns, establishing a strong track record in M&A. With Healthpoint, acquired in 2012 for $782 million, our third year return on capital exceeded our expectations. ArthroCare, acquired in 2014 for $1.5 billion, is performing well. We have achieved our targeted cost savings and are ahead of our plan to deliver $65 million of synergies by the end of 2017.

In 2016, we continued to invest in acquisitions such as Blue Belt Technologies with its NAVIO robotics surgical platform. In addition, we created compelling value by selling our Gynaecology business for $350 million (2015 revenue: $56 million). We had built this business rapidly on the back of Smith & Nephew’s resection technology and expertise. We completed the associated $300 million share buy-back programme in December 2016, returning the value created directly to shareholders.

MEASURING PERFORMANCE
In 2016 we have worked to develop Return On Invested Capital (ROIC) as a performance metric for the Group. In response to feedback from investors, this metric is proposed as an element of our Performance Share Plan beginning in 2017.

NEW CFO
Julie Brown was the CFO during 2016 until she left Smith & Nephew in January 2017. During her time at Smith & Nephew the Finance function was refocused as a global function supporting the commercial business and providing excellence in finance operations and specialist areas. From March 2017 the Finance function will be led by Graham Baker who will join Smith & Nephew from Alvogen.

OUTLOOK
We expect the dynamics in our markets to be similar in 2017 to those seen in 2016. Against this backdrop, the Group expects to deliver higher underlying revenue growth and an improved trading profit margin in 2017.

Our reported revenue growth is a combination of underlying revenue growth, impact of acquisitions and disposals and foreign exchange. We expect reported revenue growth in the range of 1.2%-2.2% at prevailing exchange rates. We expect 2017 underlying revenue growth to be in the 3-4% range, reflecting not only the dissipation of the headwinds we faced in China and the Gulf States but also, most importantly, our improving execution.
Our approach to risk

OUR RISK MANAGEMENT PROCESS

The following chart shows how our risk management process is an integral part of our business. Individual risk owners within the business areas carry out day-to-day risk management activities within the framework established by the Group Risk Office, including the identification of risks, undertaking risk assessments and treating them. These activities are reviewed by Internal Audit and other control functions, which provide assurance to the Group Risk Committee chaired by the Chief Executive Officer and then to the Board and its committees.

BOARD OF DIRECTORS AND BOARD COMMITTEES

Responsible for regular oversight of risk management and for annual strategic risk review

Monitors risks through Board processes (Strategy Review, Disclosures, M&A, Investments, Disposals) and Committees (Audit and Ethics & Compliance), management reports and deep dives of selected risk areas

Audit Committee reviews effectiveness with support from Internal Audit

GROUP RISK COMMITTEE

Reviews external/internal environment for emerging risks

Reviews risk register updates from Business Areas

Identifies significant risks and assess effectiveness of mitigating actions

BUSINESS AREA

- Carries out day-to-day risk management activities
- Identifies and assesses risk
- Implements strategy and actions to treat risk within business area
- Assigns Risk Owners to lead treatment actions
- Assigns Risk Champions to support regular risk register updates

GROUP RISK OFFICE

- Establishes risk management framework
- Facilitates implementation and coordination through Risk Champions
- Provides resources and training to support process
- Prepares Board and Group Risk Committee reports based on Business Area and other updates
- Assessment of effectiveness of the risk management process

INTERNAL AUDIT AND CONTROL FUNCTIONS

- Reviews risk management process periodically
- All Control Functions (Legal, Compliance, HSE, Quality & Regulatory) provide independent assurance to management and Board on assertions of risk exposure

OUR RISK APPETITE

The Group operates in global markets with long-term growth potential. We are pursuing ambitious growth targets and are prepared to accept a certain level of risk to remain competitive and to continue operating in an ever-changing world. We are very clear about the specific risks our businesses face and the level of risk that we are prepared to accept in each part of our business. We have put in place robust plans for managing those risks, through elimination, avoidance, sharing or mitigation.

Our approach to each risk varies depending on the circumstances and we accept that, over time, our approach towards each risk might change as our business or the external environment evolves.

During the year, the Board undertook an exercise to evaluate its tolerance for risk, recognising that our appetite for risk varies depending on the category of commercial risk. Even within categories of risk, our tolerance for risk may vary from one to another. Our tolerance for each risk is set out opposite in our table of Principal Risks.
Our Principal Risks

Our risk management programme has identified a broad range of risks which we believe could seriously impact the profitability or future prospects of the Company. We define our Principal Risks as those risks which could threaten our business model or the future long-term performance, solvency or liquidity of the Company. These are listed below and each is linked to one or more of our Strategic Priorities as detailed below.

PRICING AND REIMBURSEMENT

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

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

Link to strategy

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

Actions taken by management

- Developing innovative economic product and service solutions for both Established and Emerging Markets, such as Syncera®.
- Maintaining an appropriate breadth of portfolio and geographic spread to mitigate exposure to localised risks.
- Incorporating health economic components into the design and development of new products. Emphasising value propositions tailored to specific stakeholders and geographies through strategic investment and marketing programmes.
- Holding prices within acceptable ranges through global pricing corridors.

Examples of risks

- Reduced reimbursement levels and increasing pricing pressures.
- Reduced demand for elective surgery.
- Lack of compelling health economics data to support reimbursement requests.
- Trading margin will be impacted when the currencies in our main manufacturing countries (US, UK, Costa Rica and China) move against the currencies in the rest of the world where our products are sold.

PRODUCT INNOVATION, DESIGN AND DEVELOPMENT

The medical devices industry has a history of rapid new product innovation. The sustainability of our business depends on finding and developing suitable products and solutions to meet the needs of our customers and patients to support long-term growth.

In acquiring and developing new technologies and products, we have a moderate to high tolerance for risk and are willing to accept certain risks in pursuit of innovation, whilst having a very low tolerance for product safety risk.

Link to strategy

Our Strategic Priority to ‘Innovate for Value’ depends heavily on our ability to continue to develop new innovative products and bring them to market.

Actions taken by management

- R&D processes focused on identifying new products and potentially disruptive technologies and solutions.
- Increasing prioritisation and allocation of funds for R&D.
- Pursuing business development opportunities, which augment our portfolio.
- Implementing efficient processes to roll out new products to customers.
- Monitoring of external market trends and collation of customer insights to develop product strategies.
- Ensuring that ‘design for manufacture’ is embedded into product development.

Examples of risks

- Insufficient innovation due to low R&D investment, R&D skills gap or poor product development execution.
- Competitors introduce disruptive technologies or business models.
- Inability to prioritise and focus on key projects, investments and strategic initiatives.
### OPERATIONAL RISKS – QUALITY AND BUSINESS CONTINUITY

The Company faces a number of operational risks. Many of our products are implanted or used within the human body. Product safety and quality is therefore of critical importance. Our business also depends on smart procurement of materials, efficient manufacturing, controlled inventory management and the timely supply of our products to our customers. Some of our key products are reliant on one production facility or one supplier for raw materials, components, finished products and packaging materials.

In operating our business, managing our suppliers, and managing our facilities, we have a very low tolerance for risk. We aim to be as efficient as possible and adopt a cautious approach, but recognise that we need to accept certain risks in order to take full advantage of the opportunities open to us.

The Company implements and certifies its Quality Management Systems to accepted national and international standards in order to assure the quality of our products. To manage our exposure to disruptive incidents that could threaten business continuity, we operate a comprehensive framework of emergency management, incident management and business continuity management.

#### Link to strategy

Our Strategic Priority to ‘Simplify and Improve our Business Model’ requires us to operate effectively and efficiently, to produce products of quality and to ensure continuity of supply of products and services to customers.

#### Examples of risks

- Defects in design or manufacturing of products supplied to, and sold by, the Company could lead to product recalls or product removal or result in loss of life or major injury and also cause negative financial and reputational impacts.
- Failure or performance issues at a critical/single source facility or supplier of key products or services may impact revenues or profits.
- If a key facility were rendered unusable by a catastrophe, or we lost a number of leaders or employees in a catastrophe, business plans and targets may not be met.

### MERGERS AND ACQUISITIONS

As the Company grows to meet the needs of our customers and patients, we recognise that we are not able to develop all the products and services required using internal resources and therefore need to undertake mergers and acquisitions in order to expand our offering and to complement our existing business. In other areas, we may divest businesses which are no longer core to our activities. It is crucial for our long term success that we make the right choices around acquisitions and divestments.

In acquiring new businesses and business models, we have a moderate to high tolerance for commercial risk and are willing to accept certain risks in pursuit of new business. However, we have an extremely low tolerance for regulatory or compliance risk.

We have a well-defined cross-functional process for managing risks associated with mergers and acquisitions that is subject to scrutiny from executive management and the Board of Directors.

#### Link to strategy

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

#### Examples of risks

- Failure to identify appropriate acquisitions or to conduct effective acquisition due diligence.
- Failure to integrate newly acquired businesses effectively.
- Inheriting regulatory or compliance risks from previous owners.
- Failure to embed Company standards, policies and financial controls quickly enough following acquisition.
- Failure to allocate capital resources effectively.
LEGAL, REGULATORY AND COMPLIANCE RISKS

The Company operates in an industry which is subject to heavy regulation in multiple jurisdictions. There is increasing public scrutiny of ethics in business and ‘doing the right thing’ has become part of our licence to operate. We also seek to secure appropriate protection for our intellectual property and defend against claims of infringement by others. National regulatory authorities enforce a complex pattern of laws and regulations that govern the design, development, approval, manufacture, labelling, marketing and sale of healthcare products. They also review data supporting the safety and efficacy of such products and may inspect them for compliance with appropriate standards, including those relating to Quality Management Systems or Good Manufacturing Practice regulations.

In complying with laws and regulations, including those relating to bribery and corruption, product safety and patient and employee safety, we have an extremely low tolerance for risk. Despite our efforts, we recognise that, as in any human system, compliance mistakes may occur. We respond to issues as they arise and revise our programme as appropriate.

Link to strategy

Compliance with applicable laws and regulations and doing the right thing is part of our licence to operate and underlies all our Strategic Priorities.

- Leadership from the top with Ethics & Compliance Committees at Board and executive level overseeing our ethical and compliance practices.
- All employees are required to certify compliance on an annual basis with our Code of Conduct and Business Principles.
- Training programmes are in place for all employees, and third parties with ethical and compliance responsibilities; plus monitoring and auditing programmes to verify implementation.
- Confidential independent reporting channels for employees and third parties to report concerns.
- Careful attention to intellectual property considerations.
- Standardising and monitoring compliance with quality management and practices through Global Quality Assurance and Regulatory Affairs organisation.
- Incident management teams in place to respond in the event of an incident relating to patient safety.
- Reviewing product safety and complaint data.

Examples of risks

- Failure to act in an ethical manner consistent with our Code of Conduct.
- Violation of anti-corruption or healthcare laws, breach by employee or third party representative.
- Competitors may assert patents or other intellectual property rights against the Company, or fail to respect the Company’s intellectual property rights.
- Significant non-compliance with policy, regulations or standards governing products and operations regarding registration, manufacturing, distribution, sales or marketing.
- Failure to obtain proper approvals for new or changed technologies, products or processes.
- Failure to implement programmes and supporting resources to ensure product quality and regulatory compliance, including analysis of customer complaints and adverse event data.

OTHER RISKS

Other risks, foreseen or unforeseen, may also threaten the profitability or future prospects of the Company, either in the short-term or – like the risks set forth above – more profoundly. Following, are examples of other such risks.

<table>
<thead>
<tr>
<th>Risk</th>
<th>Response</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cyber security</td>
<td>We have analysed the possible impact of a cyber security attack on the Company and recognise that this could cause significant disruption and reputational damage.</td>
</tr>
<tr>
<td>Political and economic forces</td>
<td>We have analysed the implications of Brexit, the changing political landscape in the US and political and economic conditions in a number of other countries. Whilst the changing environment in some of these countries could be expected to impact our revenues and profits, we believe that our business is sufficiently geographically diverse.</td>
</tr>
<tr>
<td>Talent management</td>
<td>We recognise that people management, effective succession planning and the ability to attract and retain talent is of great importance to the success of our Company.</td>
</tr>
</tbody>
</table>
RISK MANAGEMENT ACTIVITIES IN 2016
The Board and its Committees undertook a number of risk management activities throughout the year as follows:

IDENTIFICATION OF RISKS
We review risk through two processes:

– The ‘bottom-up process’ undertaken by the Risk Champions in the business areas and functions across the Group to identify and manage the risks in their areas; and
– The ‘top-down process’ undertaken by the members of the executive committee to identify the key risks to the strategic priorities, top products and product platforms.

During the year, the key risks identified through these two processes were mapped against each other and regrouped to produce a revised schedule of Significant Risks, which were discussed at the Strategy Review in September. Each Board member was then interviewed to ascertain tolerance for each principal risk.

ASSESSMENT OF MANAGEMENT ACTIONS
The effectiveness of actions undertaken by management to address the key risks identified is assessed in a number of ways:

– The Risk Champions in the business areas and functions across the Group assess the effectiveness of mitigating actions being undertaken locally and regionally;
– All control functions provide independent assurance to management, the Audit Committee and the Board on the effectiveness of management actions and the Internal Audit function periodically reviews the risk management process; and
– We have undertaken a number of ‘deep dives’ at Board and Committee level into the management of the risks being examined (see below).

DEEP DIVES INTO RISKS
We have reviewed at the Board and its Committees a number of different topics during the year relating to risk, including the following areas:

– **Strategic**: R&D presentation to the Board, hands on demonstrations of innovative products at site visits, presentations to the Board and the Audit Committee on China and the Gulf
– **Operational**: Presentations to the Board on inventory and the supply chain, the manufacturing network and dependency on single manufacturing sites, regular reports on quality issues, and complaints to the Ethics & Compliance Committee, pricing and commercial excellence presentation to the Board
– **Financial**: Presentations to the Audit Committee on the tax and treasury functions
– **IT/cyber**: Report to the Audit Committee on IT and cyber security
– **Compliance and legal**: Regular reports on compliance matters and risks to the Ethics & Compliance Committee, covering M&A compliance risk and third party distributors, regular legal reports to the Board including updates on intellectual property and litigation
– **Talent management**: Annual discussion on succession planning at the Board, presentation on culture and values at the Strategy Review.

SINCE THE YEAR END
In February 2017, the Board reviewed the effectiveness of the risk management process, considering the Principal Risks, actions taken by management to manage those risks and the Board's risk appetite in respect of each risk. The Board considered that the risk management process was effective. We recognise that this is an ongoing process and work will continue in 2017 and beyond to ensure that this remains the case.

RISK MANAGEMENT PLAN FOR 2017
In 2017, we shall be further developing our approach of looking at risk management through a product focused lens. We have identified the key products which will drive our multi-year strategic plan and have formed cross functional risk working groups for each of these products and product platforms. Each risk working group consists of members from the commercial, operational, R&D and risk functions and is headed by a senior product risk leader. The risk working groups will evaluate all the risks which could impact the product or product platform through its life from design and development, sourcing of raw materials, the manufacturing process, product launch, marketing, commercialisation, regulatory, legal and compliance risks. The risk working groups will also ensure that appropriate treatment actions are in place. The Risk Champions will continue their work to ensure that any non-product related risks continue to be appropriately identified and managed. Further work will also be undertaken in reviewing the effectiveness of the risk management programme.
Our Viability Statement

During the year, the Board has carried out a robust assessment of the Principal Risks affecting the Company, particularly those which could threaten the business model. These risks and the actions being taken to manage or mitigate them are explained in detail on pages 43 to 46 of this Annual Report.

Having assessed the principal risks, the Board has determined that we have a reasonable expectation that the Company will be able to continue in operation and meet its liabilities as they fall due over a period of three years from 1 January 2017. In our long term planning we consider horizons of both five and ten years. However, as most of our efforts are focused on the coming three years, we have chosen this period when considering our viability.

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

- The Audit Committee reviewed the risk management process at their meetings in February, July and November, receiving presentations from the Group Risk function, explaining the processes followed by management in identifying and managing risk throughout the business.
- As part of the annual Strategy Review in September, the Board considered and discussed the principal risks which could impact the business model over the next three years and discussed with the management team how these risks were being managed and mitigated.
- Throughout the year, a number of deep dives into different risks were conducted by the Board, the Audit Committee and the Ethics & Compliance Committee looking into the nature of the risks and how they were mitigated, as detailed on page 46 of this Annual Report.
- Towards the end of the year, a series of detailed one-to-one discussions were held with each member of the Board and the Company Secretary and the Group Risk Director. In these discussions, the Directors were asked to consider the significant risks which they believed could seriously impact the profitability and future prospects of the Company and the principal risks that would threaten its business model, future performance, solvency or liquidity.

- For the purpose of stress testing the viability of the Company, we have undertaken a robust assessment of the principal risks and some other risks, which could threaten the viability or existence of the Company. The principal and other risks we have identified in this process are:
  - Pricing and reimbursement pressures or currency exchange volatility (Principal Risk) – leading to a major loss of revenues and profits;
  - Operational risk (Principal Risk):
    - Execution risk – meaning that we were unable to launch new products and lose significant market share to the competition;
    - Product liability claims – giving rise to significant claims and legal fees, or
    - Temporary loss of key production capability – meaning that we were unable to manufacture a key product for a period of time;
  - Legal regulatory and compliance risks (Principal Risk):
    - Regulatory measures – impacting our ability to continue to sell a key product;
    - Bribery and corruption claims – giving rise to a significant fine;
  - Other risks:
    - Cyber security – for example meaning that we were unable to issue invoices or collect money for a period of time;
    - Political and economic forces – for example political upheaval, which could cause us to withdraw from a major market for a period of time;

- We have carried out a scenario analysis of these principal and significant risks to evaluate the impact of a severe but plausible combination of these risks actually occurring over the three year period.
- We have considered and discussed a report setting out the terms of our current financing arrangements and potential capacity for additional financing should this be required in the event of one of the scenarios modelled occurring.
- We are satisfied that we have robust mitigating actions in place as detailed on pages 43-46 of this Annual Report.
- We recognise, however, that the long-term viability of the Company could also be impacted by other, as yet unforeseen, risks or that the mitigating actions we have put in place could turn out to be less effective than intended. Based on this analysis, the Directors have a reasonable expectation that the Company will be able to continue in operation and meet its liabilities as they fall due over the three-year period of their assessment.

Our conclusion is based on our current Strategic Plan approved by the Board in September 2016, having regard to longer-term strategic intentions, yet to be formulated in detail. However, we operate in a changing marketplace, which might cause us to adapt our Strategic Plans. In responding to changing external conditions, we will continue to evaluate any additional risks involved which might impact the business model.

By order of the Board, 22 February 2017

Susan Swabey
Company Secretary