

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

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

**FORM 20-F**

(Mark One)

**REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934**

**or**

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

**For the fiscal year ended December 31, 2014**

**or**

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

**or**

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

**Commission file number 1-14978**

**Smith & Nephew plc**

**(Exact name of Registrant as specified in its charter)**

**England and Wales**

**(Jurisdiction of incorporation or organization)**

**15 Adam Street, London WC2N 6LA**

**(Address of principal executive offices)**

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

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

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

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

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

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

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

Edgar Filing: SMITH & NEPHEW PLC - Form 20-F

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

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

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

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

Large Accelerated Filer  Accelerated Filer  Non-accelerated filer

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

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

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

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

**Table of Contents**

**Table of Contents**

**Table of Contents**

**Table of Contents**

**What's in this report**

**Strategic Report**

4	<u>Financial highlights</u>
5	<u>Chairman's statement</u>
6	<u>Chief Executive Officer's review</u>
8	<u>Smith &amp; Nephew today</u>
14	<u>Strategic performance</u>
16	<u>Chief Financial Officer's overview</u>
18	<u>Our marketplace</u>
21	<u>Our business</u>
26	<u>Advanced Surgical Devices</u>
30	<u>Advanced Wound Management</u>
34	<u>Financial review and principal risks</u>
40	<u>Sustainability</u>

**Supporting Healthcare professionals**

42	<u>Case studies</u>
----	---------------------

**Corporate Governance**

54	<u>Our Board of Directors*</u>
----	--------------------------------

58	<u>Our Executive Officers*</u>
62	<u>Corporate Governance Statement*</u>
75	<u>Audit Committee Report*</u>
81	<u>Directors Remuneration report</u>

**Financial statements  
and other information**

103	<u>Directors responsibilities for the accounts*</u>
105	<u>Independent auditor s US reports</u>
106	<u>Independent auditor s UK report</u>
110	<u>Group accounts</u>
117	<u>Notes to the Group accounts</u>
166	<u>Company accounts</u>
167	<u>Notes to the Company accounts</u>
170	<u>Group information*</u>
174	<u>Other financial information*</u>
184	<u>Information for shareholders*</u>
200	<u>Smith &amp; Nephew heritage</u>

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



**Table of Contents**

**Our mission**

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

**and this will drive our performance**

**\$4.6bn**  
Revenue<sup>1</sup> up 2%

**\$1,055m**  
Trading profit<sup>1,2</sup> up 3%

**\$749m**  
Operating profit<sup>1</sup> down 8%

**83.2¢**  
Adjusted earnings per share<sup>2</sup> up 8%

**56.1¢**  
Earnings per share down 9%

**29.6¢**  
Dividends per share up 8%

1 The underlying percentage increases/decreases are after adjusting for the effect of currency

translation and the inclusion of the comparative impact of acquisitions and exclusion of disposals.  
2 Explanations of these non-GAAP financial measures are provided on pages 176 to 179.

**Smith & Nephew** Annual report 2014 3

**Table of Contents**

STRATEGIC REPORT

**Financial highlights**

Continuing to improve

our performance

1 The underlying percentage increases/decreases are after adjusting for the effects of currency translation and the inclusion of the comparative impact of acquisitions and exclusion of disposals.

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



**Table of Contents****Chairman's statement****Dear Shareholder,**

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

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

**Board changes**

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

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

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

**First impressions**

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

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

Looking ahead I see many exciting opportunities in the Established Markets where we are challenging the status quo through new commercial models, in the Emerging & International Markets

geographies including India, Africa, South America, the US and UK. Her strong appreciation of customer service and marketing will bring deep insight to Smith & Nephew as we continue to develop innovative ways to serve our markets. Erik Engstrom, the CEO of Reed Elsevier, joined the Board in January 2015. His understanding of how technology can be used to transform a business will be invaluable.

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

Yours sincerely,

**Roberto Quarta**

Chairman

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



**Table of Contents**

STRATEGIC REPORT

Chief Executive Officer's review

A good financial performance while strengthening the business

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

Dear Shareholder

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

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



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

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

### Pioneering design

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

## Table of Contents

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

### Widening access

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

In 2014, we established a new commercial structure to market and expand our mid-tier value product ranges. This will provide wider access to our advanced technologies, helping

ArthroCare, completed in May 2014, has strengthened our Sports Medicine business. Its technology and products significantly enhance our portfolio, and we will use our global presence to drive substantial new growth. The integration is progressing well.

### Enhanced efficiency

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

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

## Our results

22.9%

Trading margin<sup>1</sup> up 20bps

83.2¢

EPSA<sup>1</sup> up 8%

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

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

### Great Place to Work

#### Enabling better outcomes

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

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

#### Strengthening our platform

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

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

Sincerely,

**Olivier Bohuon**

Chief Executive Officer

**Smith & Nephew Annual report 2014**

7

**Table of Contents**

STRATEGIC REPORT

Smith & Nephew today

Our marketplace is growing

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

**Advanced Surgical Devices**

Total segment value

**\$24bn**

+5%

**Advanced Wound Management**

Total segment value

**\$7bn**

+4%

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

Global population

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



**Table of Contents**

Served by our global businesses

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

**Advanced Surgical Devices global**

**1. Orthopaedic Reconstruction**

Specialist hip and knee implant systems.

**Revenue<sup>1</sup>**

**\$1,527m**

**+2%**

2013 \$1,518m

**2. Trauma & Extremities**

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

**Revenue<sup>1</sup>**

**\$506m**

**+4%**

2013 \$486m

**3. Sports Medicine Joint Repair**

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

**Revenue<sup>1</sup>****\$576m****+8%**

2013 \$496m

**4. Arthroscopic Enabling Technologies**

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

**Revenue<sup>1</sup>****\$542m****+1%**

2013 \$441m

**5. Other ASD**

ENT and gynaecology instrumentation.

**Revenue<sup>1</sup>****\$147m****+10%**

2013 \$74m

**Advanced Wound Management global****1. Advanced Wound Care**

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

**Revenue<sup>1</sup>**



<b>\$805m</b>	<b>4%</b>
2013 \$843m	
<b>2. Advanced Wound Devices</b>	
Traditional and single-use Negative Pressure Wound Therapy ( NPWT ) and hydrosurgery systems.	
<b>Revenue<sup>1</sup></b>	
<b>\$192m</b>	<b>9%</b>
2013 \$213m	
<b>3. Advanced Wound Bioactives</b>	
Bioactive technologies that provide unique approaches to debridement and dermal repair and regeneration.	
<b>Revenue<sup>1</sup></b>	
<b>\$322m</b>	<b>+15%</b>
2013 \$280m	

<sup>1</sup> The underlying percentage increases/decreases are after adjusting for the effect of currency translation and the inclusion of the comparative impact of acquisitions and exclusion of disposals.

<b>Smith &amp; Nephew</b> Annual report 2014	9
--	---

**Table of Contents**

**Table of Contents**

---

**Table of Contents**

STRATEGIC REPORT

Smith & Nephew today *continued*

Our business model

delivers value

**Our Capital Allocation Framework**

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

**Resource utilised**

**\$7.3bn**  
Total Assets

**\$235m**  
Investment in R&D

**13,468**  
Employees

**15**  
Manufacturing  
plants worldwide

**\$245m**  
Corporation tax paid



**Table of Contents**

With a strategy to  
drive our performance

**Our strategic priorities**

**Established Markets**

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

**Emerging & International Markets**

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

**Innovate for value**

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

### **Simplify and improve our operating model**

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

### **Supplement organic growth with acquisitions**

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

[u](#) Read more about our strategy in action on pages 42 53





**Table of Contents**

STRATEGIC REPORT

Strategic performance

How we performed

**Established Markets**

**Performance**

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

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

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

**Emerging & International Markets**

**Performance**

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

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

During 2014:

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

**Innovate for value**

**Performance**

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

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

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

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

**Global Outlook**

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

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

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

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

**Global Outlook**

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

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

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

**Table of Contents**

**Simplify and improve  
our operating model**

**Performance**

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

**Key initiatives included:**

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

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

**Supplement organic  
growth with acquisitions**

**Performance**

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

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

million, which is progressing well.

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

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

to rebalance Smith & Nephew towards higher growth opportunities.

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

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

1 The underlying percentage increases/decreases are after adjusting for the effect of currency translation and the inclusion of the comparative impact of acquisitions and exclusion of disposals.

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



---

**Table of Contents**

STRATEGIC REPORT

Chief Financial Officer's overview

We made significant  
progress in 2014...

Dear Shareholder,

Reinvestment & Group  
optimisation

**Our results**

**\$4,617m**

Revenue<sup>1</sup> up 2%

**\$1,055m**

Trading profit<sup>1,2</sup> up 3%

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

**Strong earnings growth**

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

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

1 Globalising functions such as Finance, HR, IT and Legal to ensure that we are operating most effectively to support business growth.

2 Driving procurement savings to get the most value from the money we spend.

3 Rationalising our footprint to simplify the way we work.

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

1 The underlying percentage increases/decreases are after adjusting for the effect of currency translation and the inclusion of the comparative impact of acquisitions and exclusion of disposals.

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

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

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

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

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

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

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

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

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

### Acquisitions

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

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

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



net debt/EBITDA ratio of 1.2x.

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

16 **Smith & Nephew** Annual report 2014

## Table of Contents

...and continued to deliver good

revenue and earnings growth.

### Segment reporting

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

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

### Outlook

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

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

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

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

Sincerely,

**Julie Brown**

Chief Financial Officer



**Table of Contents**

STRATEGIC REPORT

**Our marketplace**

Changing demands

Market trends

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

Cost and Outcomes

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

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

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

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

Self-Care and Prevention

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

Regulatory standards and compliance in the healthcare industry

The international medical device industry is highly regulated.

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

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

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

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

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

Regulatory requirements are important in determining whether substances and materials can be developed into safe and effective products and done so in an environmentally sustainable way.

National regulatory authorities administer and enforce a complex series of laws and regulations that govern the design, development, approval, manufacture, labelling, marketing and sale of healthcare products. They also review data supporting the safety and efficacy of such products. Of particular importance is the requirement in many countries that products be authorised or registered prior to the placement on market and that such authorisation or registration be subsequently maintained. The major regulatory agencies for Smith & Nephew's products include the Food and Drug Administration (FDA) in the US, the Medicines and Healthcare products Regulatory Agency in the UK, the Ministry of Health, Labour and Welfare in Japan, the China Food and Drug Administration and the Australian Therapeutic Goods Administration.

**Table of Contents**

In general, with the aforementioned industry trends, safety standards and regulations in the medical device industry are becoming more stringent. Regulatory agencies are intensifying audits of manufacturing facilities and the approval time for new products has lengthened. Legislation covering corruption and bribery such as the UK Bribery Act and the US Foreign Corrupt Practices Act business also apply to all our global operations.

We are committed to assuring a high level of regulatory compliance and to doing business with integrity and welcome the trend to higher standards in the healthcare industry. We and other companies in the industry are subject to regular inspections and audits by regulatory agencies and notified bodies, and in some cases, remediation activities have and will continue to require significant financial and resource investment. See Legal proceedings on page 146.

### Dependence on government and other funding

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

Pricing of our products is largely influenced in most developed markets by governmental reimbursement authorities. Initiatives sponsored by government agencies, legislative bodies and the private sector to limit the growth of healthcare costs, including price regulation, excise taxes and competitive pricing, are ongoing in markets where we operate. This control may be exercised by

or for an entire procedure. We are exposed to changes in reimbursement policy, tax policy and pricing which may have an adverse impact on revenue and operating profit. There may be an increased risk of adverse changes to government funding policies arising from the deterioration in macro-economic conditions in some of our markets.

### Competitors

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

determining prices for an individual  
product

Manufacturing facility in Suzhou, China.

**Smith & Nephew** Annual report 2014

19



**Table of Contents**

## STRATEGIC REPORT

**Our marketplace *continued***

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

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

Smith & Nephew estimates that the global sports medicine segment (representing access, resection and repair products) is worth approximately \$5 billion and grew by approximately 8% in 2014. Competitors in the

sports medicine segment include Arthrex, Conmed, DePuy Mitek (a division of Johnson & Johnson) and Stryker.

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

**Customers**

In certain parts of the world, including the UK, much of Continental Europe, Canada and Japan, the healthcare providers are largely government organisations funded by tax revenues. In the US, our major customers are public and private hospitals,

which receive revenue from private health insurance and government reimbursement programmes. Medicare is the major source of reimbursement in the US for knee and hip reconstruction procedures and for wound treatment regimes. In the emerging markets, demand is driven by self-pay patients.

**Seasonality**

Orthopaedic and sports medicine procedures tend to be higher in the winter months when accidents and sports related injuries are highest. Conversely, elective procedures tend to slow down in the summer months due to holidays.

Due to the nature of our product range, there is little seasonal impact on the Advanced Wound Management business.

20 **Smith & Nephew** Annual report 2014

**Table of Contents**

STRATEGIC REPORT

**Our business**

**Delivering advanced medical technologies**

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

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

**Research & Development**

**Ethics & Compliance**

**Manufacturing**

**Medical Education**

**Sales & Marketing**

**Research and Development**

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

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

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

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

**Open innovation**

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

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

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

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

We are highly disciplined in project selection. Our R&D experts in the UK, US, Europe, China and India have extensive customer and sector knowledge, which is augmented by ongoing interaction with our marketing teams.

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

## Table of Contents

### STRATEGIC REPORT

#### *Our business continued*

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

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

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

#### Ethics and compliance

##### Code of conduct and business principles

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

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

Smith & Nephew takes into account ethical, social, environmental, legal and financial considerations as part of its operating methods. We have a robust whistle-blowing system in all jurisdictions in which Smith & Nephew operates. We are committed to upholding our promise in our Code that we will not retaliate against anyone who makes a report in good faith.

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

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

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

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

#### Intellectual property

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

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

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

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

#### Global compliance programme

Smith & Nephew has implemented what we believe is a world-class Global Compliance Programme that helps our businesses comply with laws and regulations. Our comprehensive compliance programme includes global policies and procedures; on-boarding and annual training for employees and managers; monitoring and auditing processes; and reporting channels.

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

compliance controls and monitoring visits to review a sample of transactions from their books and records.

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

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

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

in the countries in which we operate.

22 **Smith & Nephew** Annual report 2014

**Table of Contents**

**Manufacturing**

We operate manufacturing facilities in a number of countries across the globe, and a number of central distribution facilities in key geographical areas in which we operate. Products are shipped to individual country locations which hold small amounts of inventory locally for immediate supply to meet customer requirements. We have a defined manufacturing and facility footprint plan in-line with our commercial strategy which we review on a regular basis.

We continue to implement improved processes such as Lean Manufacturing throughout our factories, the global supply chain and the supporting operations to improve and sustain the levels of safety, quality, delivery, productivity and efficiency. We have numerous Core Competences including: materials technology;

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

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

**High quality manufacturing**

An employee at our manufacturing plant in

Tuttlingen, Germany, working on a polished

cementless hip stem.

The Aarau, Tuttlingen, Beijing and Warwick facilities produce a large number of products including key trauma products, the PLUS<sup>à</sup> knee and hip range and the BIRMINGHAM<sup>à</sup> Hip Resurfacing System. The facility in Oklahoma City deals mainly with the assembly of surgical digital equipment, such as HD560<sup>à</sup> Camera.

We operate three main holding warehouses, one in each of Memphis (Tennessee, US), Baar (Switzerland) and Singapore. These facilities consolidate and ship to local country and distributor facilities.

The Advanced Wound Management manufacturing is primarily managed from our factory and offices in Hull (UK). Wound Management products are also made at our facilities in



precision machining, high volume and automated manufacturing for both our Advanced Surgical Devices and Advanced Wound Management products.

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

Suppliers are selected, and standardised contracts negotiated, by a centralised procurement team wherever possible, with a view to ensure value for money based on the total spend across the Group.

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

The Memphis facilities produce key products and instrumentation in our Knee Implants, Hip Implant and Trauma franchises. These include the JOURNEY II and LEGION<sup>®</sup> knees, the ANTHOLOGY<sup>®</sup> Primary Hip System and key Trauma products such as the PERI-LOC<sup>®</sup> Ankle Fusion Plating System and TRIGEN<sup>®</sup> Intramedullary Nails. In addition to this, Memphis is the home to the design and manufacturing process of the VISIONAIRE patient matched instrumentation sets.

The Mansfield facility focuses on sports medicine related products for minimally invasive surgery including the FAST FIX<sup>®</sup> 360 Meniscal Repair System, FOOTPRINT<sup>®</sup> PK Suture Anchor, DYONICS Platinum Shaver Blades, ENDOBUTTON<sup>®</sup> CL Ultra and the HEALICOIL<sup>®</sup> PK suture anchor.

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

The products made at the Hull site cover the therapies of Exudate management (Foam products principally ALLEVYN<sup>®</sup>), Burns treatment (ACTICOAT<sup>®</sup>) and Wound Closure (OPSITE<sup>®</sup> film products). Several products produced in Hull, such as JELONET<sup>®</sup> and BACTIGRAS<sup>®</sup>, transitioned to Suzhou in 2014, as part of our global footprint optimisation programme.

---

**Table of Contents**

STRATEGIC REPORT

**Our business *continued***

**OPSITE Post-Op Visible**

A waterproof, bacteria-proof dressing with

see-through absorbant pad. Unique design allows

continual monitoring of the incision site without the

need to disrupt the healing process.

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

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

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

**Medical education**

Smith & Nephew is dedicated to helping healthcare professionals improve the quality of care for patients. We are proud to support the professional development of surgeons and nurses by providing them with medical education and training on our Advanced Surgical Devices and Advanced Wound Management products.

**Sales and marketing**

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

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

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

Closure products.

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

Manufacturing for Advanced Wound Bioactives takes place in Curaçao, and at various third party facilities in the US. The products are distributed from a third party logistics facility in San Antonio (Texas, US). Advanced Wound Bioactives has facilities for the development and possible production of cell based therapies in Fort Worth (Texas, US).

Every year thousands of customers attend our state-of-the-art training centres in the US, UK and China and Smith & Nephew courses at multiple hospitals and facilities around the world.

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

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

Our US sales forces consist of a mixture of independent contract workers and employees. Sales agents are contractually prohibited from selling products that compete with our products. In most other Established Markets country-specific commercial organisations manage employee sales forces directly.

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

**Table of Contents**

**Our people**

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

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

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

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

**Diversity at Smith & Nephew**

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

Smith & Nephew has a Human Resource Global Standard for diversity and inclusion in the workplace and is committed to creating an inclusive environment that embraces and promotes diversity.

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

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

We are committed to building diversity in a working

overall performance. Employee advancement is merit-based, based on performance as well as demonstration of core competencies which include our core values with an emphasis on ethics and integrity. We prioritise the development and promotion of our existing employees whenever possible.

Each year, Smith & Nephew conducts a comprehensive global development and capability review process to identify high-potential employees and ensure they have robust career development plans. Talented employees are provided with opportunities to develop their skills and career through new assignments and on the job experiences. Current programmes include our Chief Executive Officer (CEO) Forum where small groups of high potential and emerging talent are given the opportunity to learn more about the business from the Company's most senior leaders and to benefit from peer mentorship and the annual Managing Director's Meeting where country and regional commercial leaders begin the year in alignment with the Group's strategy and goals. In addition, the Board reviews succession plans for key executive roles and succession plans are in place for critical positions across our business.

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

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

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

Number of Employees <sup>1</sup>	
Board of Directors	
Male	7
Female	3
<b>Total</b>	<b>10</b>

Senior Managers and above<sup>2</sup>

environment where there is mutual trust and respect and where everyone feels responsible for the performance and reputation of our Company. We are committed to providing healthy and safe working conditions for all employees. We achieve this by ensuring that health and safety and the working environment are managed as an integral part of the business, and we recognise employee involvement as a key part of that process.

We do not use any form of forced, compulsory or child labour. We support the Universal Declaration of Human Rights of the United Nations. This means we respect the human rights, dignity and privacy of the individual and the right of employees to freedom of association, freedom of expression and the right to be heard.

and certify their adherence to this Code.	Male	562
	Female	168
	<b>Total</b>	<b>730</b>

Total employees

	Male	8,485
	Female	5,757
	<b>Total</b>	<b>14,242</b>

1 Number of employees as at 31 December 2014 including part time employees and employees on leave of absence.

2 Senior Managers and above includes all employees classed as Directors, senior Directors, Vice Presidents and Executive officers and includes all statutory Directors of our subsidiary companies.



**Table of Contents**



**Table of Contents**

Overview

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

Orthopaedic Reconstruction

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

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

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

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

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

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

### **Knee Implants**

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

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

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

### **Hip Implants**

For Hip Implants, core systems include the ANTHOLOGY Hip System, SYNERGY<sup>®</sup> Hip System, the SMF<sup>®</sup> Short Modular Femoral Hip System, the R3<sup>®</sup> Acetabular System, the POLARCUP<sup>®</sup> Dual Mobility Hip System and the SL-PLUS<sup>®</sup> Hip Family System.

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

**Table of Contents**

STRATEGIC REPORT

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

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

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

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

Trauma & Extremities

Our Trauma & Extremities franchises offer both internal and external fixation and tissue repair devices, as well as other products used in the stabilisation of severe fractures and deformity correction procedures.

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

Sports Medicine Joint Repair

For extremities and limb restoration, the franchise offers the TAYLOR SPATIAL FRAME<sup>®</sup> Circular Fixation System as well as a range of plates, screws, arthroscopes, instrumentation, resection, and suture anchor products for orthopaedic surgeons including foot and ankle, hand and wrist, and trauma surgeons. For Trauma, the principal internal fixation products are the TRIGEN<sup>®</sup> family of IM nails (TRIGEN

The Sports Medicine Joint Repair franchise offers surgeons a broad array of instruments, technologies and implants necessary to perform minimally invasive surgery of the joints, including knee, hip and shoulder repair.

Other ASD

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

META-NAIL System, TRIGEN Humeral Nail System, TRIGEN SURESHOT<sup>®</sup>, and TRIGEN INTERTAN<sup>®</sup>) and the PERI-LOC<sup>®</sup> Plating System.

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

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

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

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

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

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

Arthroscopic Enabling Technologies ( AET )

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

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

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

removal of damaged tissue.

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

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

28 **Smith & Nephew** Annual report 2014

**Table of Contents**

**VERILAST Technology for Hip**

**Replacement**

The proprietary technology combines

innovation with long-term performance.

Regulatory approvals

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

In the US, 510(k) clearances were given to the D-RAD<sup>®</sup> SMART PACK, VLP<sup>®</sup> MINI-MOD Plates and Screws, EVOS Mini-Fragment Plating System, JOURNEY II BCS Constrained Articular Inserts, BIOSURE HEALICOIL<sup>®</sup> PK screw, Cannulated Captured Screw, N8TIVE ACL Anatomic Reconstruction System and NasaStent<sup>®</sup> CMC Nasal Dressing. Additional 510(k) clearances were also granted for our VISIONAIRE software revisions as well as the Q-Fix<sup>®</sup> Suture Anchor, the Multi-Fix<sup>®</sup> S Knotless Fixations System and the Topaz<sup>®</sup> EZ Microdebrider COBLATION Wand.

In Canada, approvals were granted for our LEGION Narrow OXINIUM and CoCr Femoral Components, HEALICOIL REGENESORB<sup>®</sup> Suture Anchor, the SUTUREFIX<sup>®</sup> ULTRA Suture Anchor, TFCC FAST-FIX Kit, TRUEPASS<sup>®</sup> Suture Passer, DYONICS PLAN, ULTRATAPE<sup>®</sup>, N8TIVE ACL Reconstruction System, BIOSURE HEALICOIL PK screw, KVAc<sup>®</sup> and Ambient KVAc COBLATION Wands, Q-Fix Suture Anchor System and MediENT<sup>®</sup> Turbinate

In Australia, LEGION Narrow OXINIUM, HEALICOIL REGENESORB, LEGION Hinge Knee System, KVAc COBLATION Wand, N8TIVE ACL Reconstruction System, SpeedLock<sup>®</sup> Hip Knotless Fixation System, Multi-Fix S Knotless Fixation Device, Q-Fix Suture Anchor System, Ventera<sup>®</sup> Sinus Dilation System and Serpent<sup>®</sup> Articulating ENT Instrument were approved.

In Latin America, the Quantum<sup>®</sup> 2 COBLATION System and the Magnum<sup>®</sup> 2 Knotless Fixation Device were approved in Argentina; the Speedfix<sup>®</sup> Suture System and the Titan<sup>®</sup> Suture Anchor were approved in Brazil; and the RAPIDRHINO System was approved in Mexico.

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

In Japan, the ANTHOLOGY HA Coated Hip stem, SMF<sup>®</sup> Hip Stem, Osteoraptor<sup>®</sup> OS Suture Anchor, HEALICOIL REGENESORB Suture Anchor, SUTUREFIX ULTRA Suture Anchor,

Implant.

TFCC<sup>à</sup> FAST-FIX Kit, OSTEORAPTOR<sup>à</sup>  
HA curved, TRUEPASS Suture Passer,  
DYONICS PLAN, and ULTRATAPE were  
all approved.

Other approvals include the Speedlock Hip  
Knotless Fixation System in Singapore and  
the ENT Irrigation Pump<sup>à</sup> in Korea.

**Table of Contents**



## Table of Contents

### Overview

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

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

### Advanced Wound Care

#### Exudate management

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

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

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

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

#### Infection management

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

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

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

#### Other

AWM offers a wide range of other wound care products, resulting in Smith & Nephew having one of the most comprehensive ranges of wound care solutions in the industry. These products include our film and post-operative dressings, skincare products and gels.

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

**ALLEVYN Life**

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

**Smith & Nephew** Annual report 2014 31

**Table of Contents**

STRATEGIC REPORT

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

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

VERSAJET

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

Advanced Wound Devices

Advanced Wound Bioactives

Advanced Wound Devices consists of two categories of products: NPWT and VERSAJET<sup>à</sup>.

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

NPWT

Our NPWT solutions include traditional NPWT products (RENASYS products) and the single-use portfolio (PICO and KALYPTO<sup>à</sup> products).

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

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

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

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

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

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

### **Collagenase SANTYL Ointment**

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

32 **Smith & Nephew** Annual report 2014

## **Table of Contents**

OASIS<sup>®</sup>, a family of naturally-derived, extracellular matrix replacement products indicated for the management of both chronic and traumatic wounds completes Smith & Nephew's bioactive portfolio.

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

### **Regulatory approvals**

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

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

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

**Table of Contents**

STRATEGIC REPORT

**Financial review and principal risks**

The Group finished 2014 set to  
benefit from the actions and  
investments we have made

- 1 The underlying percentage increases/decreases are after adjusting for the effect of currency translation and the inclusion of the comparative impact of acquisitions and execution of disposals.
- 2 Explanation of these non-GAAP financial measures are provided on pages 176 to 179.

34 **Smith & Nephew** Annual report 2014



**Table of Contents****Revenue by market**

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

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

**Advanced Surgical Devices**

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

portfolio contributed to the increase.

## Revenue

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

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

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

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

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

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

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

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

<b>Smith &amp; Nephew</b> Annual report 2014	35
--	----

**Table of Contents**

## STRATEGIC REPORT

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

## Trading and operating profit

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

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

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

## Trading and operating profit

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

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

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

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

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

### Advanced Wound Management

#### Revenue

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

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

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

### Principal risks and risk management

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

There are known and unknown risks and uncertainties relating to Smith & Nephew's business. The following pages provide an overview of what the Board considers the most significant risks that could cause the Group's business, financial position and results of operations to differ materially and adversely from expected and historical levels, and how these risks relate to the Group's strategic priorities. Additional detail is set

decline of 4% is after adjusting for foreign currency translation. Conditions across many European markets remain challenging but the introduction of the ALLEVYN Life range continues to make good progress across Europe following product introductions and investment in marketing.

forth under Risk Factors in the Group information section of this report. In addition, other factors not listed here that Smith & Nephew cannot presently identify or does not believe to be equally significant, could also materially adversely affect Smith & Nephew's business, financial position or results of operations.

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

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

**Table of Contents****Product Portfolio Development**

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

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

<p>Failure to receive regulatory approval to successfully commercialise a pipeline product</p>	<p>Global strategic marketing programmes</p> <p>Support an Emerging &amp; International Market product portfolio</p>	<p><b>Emerging &amp; International Markets</b></p> <p>Supplement organic growth through acquisitions</p>
--	--	--

**Acquisitions and Business Development**

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

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



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

**Table of Contents**

## STRATEGIC REPORT

Financial review and principal risks *continued***Government Action, Pricing and Reimbursement Pressure**

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

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

**Specific risks we face****Risk management actions****Possible impacts**

Reduced reimbursement levels and increasing pricing pressures

Develop innovative economic product and service solutions for both Established and Emerging & International markets ( Syncera )

Loss of revenue, profit and cash flows

Reduced demand for elective surgery

Incorporate health economic component into design and development of new products

Lack of compelling health economics data to support reimbursement requests

Enhanced expertise supporting reimbursement strategy and guidance

**Link to Strategic Priority**

Government policies favouring lower priced and locally sourced products

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

**Simplify and improve our operating model**

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

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

**Established Markets**

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

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

**Emerging & International Markets**

Economic downturn impacts demand and collections

## **Business Operations and Business Continuity**

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

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

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

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

38 **Smith & Nephew** Annual report 2014

**Table of Contents**

**Product Safety, Regulation, and Litigation**

National regulatory authorities enforce a complex series of laws and regulations that govern the design, development, approval, manufacture, labelling, marketing and sale of healthcare products. They also review data supporting the safety and efficacy of such products and may also inspect for compliance with appropriate standards, including those relating to Quality Management Systems ( QMS ) or Good Manufacturing Practice ( GMP ) regulations. Design or manufacturing defects in products could result in product recalls and liability claims and impact revenues, profits and reputation.

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

Failure to manage, process and analyse customer complaints and adverse event data Group-wide practices to drive design, our operating model and production line performance and dependability

**Established Markets**

Design for manufacture in product development

**Emerging & International Markets**

Post launch review of product safety and complaint data

**Compliance with Laws and Ethical Behaviour**

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

Specific risks we face	Risk management actions	Possible impacts
------------------------	-------------------------	------------------

Violation of anti-corruption, healthcare, or data privacy laws could result in fines, loss of reimbursement and harm reputation

Strong Board and Executive oversight bodies supported by a global Office of Ethics & Compliance

Loss of profit and reduction in share price

Cultures in certain geographies and acquired businesses may not fully support the Group value to Earn Trust

Code of Conduct/Global Policies and Procedures ( GPPs ) providing guidelines for ethical behaviour and controls for significant compliance risks

Negative impact on brand/ reputation

Rapid growth in Emerging & International Markets with increasing numbers of distributors

Training and e-resources to guide employees and third parties with ethical and compliance responsibilities

**Link to Strategic Priority**

**Simplify and improve**

Third parties retained by the Group may be involved in improper activities which result in penalties or loss of reputation.

Monitoring and auditing programmes to verify implementation **our operating model**

**Emerging & International Markets**

Failure to conduct adequate due diligence or to integrate appropriate internal controls into acquired businesses could result in fines and impact return on investment

Minimum acceptable financial procedures adopted by all businesses wholly owned by the Group

**Established Markets**

Independent reporting channels for employees and third parties to report concerns with confidentiality

Robust investigation procedures to ensure adequate reviews and documentation with significant issues escalated to and monitored by legal and compliance heads

Controls for significant interactions with Health Care Professionals and Government Officials

Higher risk third parties including distributors and agents subject to screening, compliance requirements, training and oversight processes

Due diligence reviews and integration plans and reporting for acquisitions

Risk assessments to determine resources and controls for higher risk



markets

**Smith & Nephew** Annual report 2014 39

**Table of Contents**

STRATEGIC REPORT

**Sustainability**

Protecting the future

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

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

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

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

Safety

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

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

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

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

## Table of Contents

### Water

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

### Waste

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

### Energy and CO<sub>2</sub>

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

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

Transferring manufacturing to China from the UK and acquiring capacity in India has resulted in higher emissions factors and increased CO<sub>2</sub> emissions.

### Greenhouse gases

Methodology, materiality and scope

The data reported relates to areas of largest environmental impact including manufacturing sites, warehouses, research and offices. Smaller locations representing less than 2% of our overall emissions are not included. Acquisitions completed before 2014 are included in the data.

All emissions fall within the scope of our consolidated financial statement and we have used the Greenhouse Gas Protocol: A Corporate Accounting and Reporting Standard (Revised Edition) as guidance for this process. Primary

data from energy suppliers has been used wherever possible. The Biotherapeutics and the Sushrut Adler acquisitions are included in the data for 2014 for the first time. Data from the ArthroCare acquisition is excluded and is in line with our established policy for integration of acquired assets.

Our emissions have been calculated by using specific emissions factors for each country outside the US and regional factors within the US. We have used the US EPA Emissions & Generation Resource Integrated Database (eGRID) for US regions and the UK Government DEFRA Conversion Factors for Greenhouse Gas Reporting for elsewhere. The emissions from all years have been recalculated using the most up-to-date factors available in 2014. Fugitive emissions are included from the manufacturing and research locations and arise from the losses of refrigerant gases.

	2014	2013
<b>CO<sub>2</sub>e Emissions (tonnes) from:</b>		
Direct emissions	<b>11,213</b>	10,152
Indirect emissions	<b>74,797</b>	68,795
Total	<b>86,010</b>	78,947
<b>Intensity ratio</b>		
CO <sub>2</sub> e (t) per \$m revenue*	<b>19.5</b>	19.4
CO <sub>2</sub> e (t) per full-time employee*	<b>6.9</b>	7.5

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

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

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

**Susan Swabey**

Company Secretary

<b>Smith &amp; Nephew</b> Annual report 2014	41
--	----

**Table of Contents**

**Table of Contents**



**Table of Contents**

At the top of

their game

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

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

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

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

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

44	<b>Smith &amp; Nephew</b> Annual report 2014
----	--

**Table of Contents**

**24%**

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

**\$5bn**

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

**Smith & Nephew Annual report 2014**

45

**Table of Contents**

**Better by  
design**

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

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

**JOURNEY II**

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

**HAT-TRICK**

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

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

## **EVOS**

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

## **PICO**

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

46      **Smith & Nephew** Annual report 2014

**Table of Contents**

**Table of Contents**



**Table of Contents**

**Table of Contents**

**Table of Contents**

## Table of Contents

### Realising

#### potential

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

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

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

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

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

### Diverse

**Smith & Nephew believes that diversity fuels innovation. We are committed to employment practices based on equality of opportunity, regardless of colour, creed, race, national origin, sex, age, marital status, sexual orientation or mental or physical disability unrelated to the ability of the person to perform the essential functions of the job. Diversity & Inclusion continues to be a key focus for us and we have a Global Steering team sponsored by the CEO with local councils established across the business. 30% of our Board of Directors and 23% of senior managers are female.**

### Healthy

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

**support all employees.**

### **Safe**

**We are committed to providing healthy and safe working conditions for all employees. We achieve this by ensuring that health and safety and the working environment are managed as an integral part of the business, and we recognise employee involvement as a key part of that process. During 2014, we reduced the lost time injury frequency by 20%, reflecting a sharp focus of leadership on identifying and managing workplace risk.**

**14,000**

Our employees support  
healthcare

professionals in more than 100  
countries

**23%**

of our senior managers are  
female

**Table of Contents**

---

**Table of Contents**

CORPORATE GOVERNANCE

**Our Board of Directors**

**Roberto Quarta (65)**  
Chairman

Joined the Board in December 2013 and appointed Chairman following election by shareholders on 10 April 2014. He was also appointed Chairman of the Nomination & Governance Committee and a Member of the Remuneration Committee on that day.

**Career and Experience**

Roberto is a graduate and a former Trustee of the College of the Holy Cross, Worcester (MA), US. He started his career as a manager trainee at David Gessner Ltd, before moving on to Worcester Controls Corporation and then BTR plc, where he was a divisional Chief Executive. Between 1985 and 1989 he was Executive Vice President of Hitchiner Manufacturing Co. Inc., where he helped the company to expand internationally. He returned to BTR plc in 1989 as Divisional Chief Executive, where he led the expansion in North America and was appointed to the main board. From

**Olivier Bohuon (56)**  
Chief Executive Officer

Joined the Board and was appointed Chief

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

**Career and Experience**

Olivier has had a highly successful career in the pharmaceutical industry. He holds a doctorate from the University of Paris and an MBA from HEC, Paris. His career has been truly global. He started his career in Morocco with Roussel Uclaf and then, with the same company, held a number of positions in the Middle East with increasing levels of responsibility. He joined Abbott in Chicago as head of their anti-infective franchise with Abbott International, before

**Julie Brown (52)**  
Chief Financial Officer

Joined the Board as Chief Financial Officer in February 2013.

**Career and Experience**

Julie is a graduate, Chartered Accountant and Fellow of the Institute of Taxation. She trained with KPMG before working at AstraZeneca PLC, where she served as Vice President Group Finance, and ultimately, as Interim

Chief Financial Officer. Prior to that she was

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

Strategy and R&D Chief

here he moved to BBA Aviation plc, as CEO from 1993 to 2001 and then as Chairman, until 2007. He has held several board positions, including Non-executive Director of Powergen plc, Equant N.V., BAE Systems plc and Foster Wheeler AG. His previous Chairmanships include Italtel Group S.p.A. and Rexel S.A. He is currently Chairman Designate of WPP plc, and will shortly retire as Chairman of IMI plc, the global engineering group as soon as a suitable replacement is appointed. He is a partner at Clayton, Dubilier & Rice and he is a member of the Investment Committee of Fondo Strategico Italiano Spa.

**Skills and Competencies**

Roberto's career in private equity brings valuable experience to the Board, particularly when evaluating acquisitions and new business opportunities. He has an in-depth understanding of differing global governance requirements having served as a director and Chairman of a number of UK and international companies. Since his appointment as Chairman in April 2014, he has conducted a comprehensive review into the composition of the Board, and conducted the search for new Non-executive Directors resulting in the appointment of Vinita Bali and Erik Engstrom.

**Nationality**

American/Italian

becoming Pharmaceutical General Manager in Spain. He subsequently spent 10 years with GlaxoSmithKline, rising to Senior Vice President & Director for European Commercial Operations. He then re-joined Abbott as President for Europe, became President of Abbott International (all countries outside of the US), and then President of their Pharmaceutical Division, which was a \$20 billion business, encompassing manufacturing, R&D and commercial operations. He joined Smith & Nephew from Pierre Fabre, where he was Chief Executive.

**Skills and Competencies**

Olivier has extensive international healthcare leadership experience within a number of significant pharmaceutical and healthcare companies. His global experience provides the skillset required to innovate a FTSE100 company with a deep heritage and provide inspiring leadership. He is a Non-executive Director of Virbac group.

**Nationality**

French

Financial Officer. In both Julie's country and regional roles, trading margins increased significantly, improving the efficiency and profitability of the business. Her experience encompasses many areas of the healthcare value chain including Commercial, Operations, R&D and Business Development. She has led multi-billion dollar cost saving and restructuring programmes in Operations, R&D and the Commercial organisations and led major refinancing programmes, including the issuance of \$2 billion US bonds. Julie has so far in her career, fulfilled two Non-executive

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

**Skills and Competencies**

Julie has deep financial expertise and understanding of the healthcare sector, which has enabled her to lead a major transformation project at Smith & Nephew designed to simplify and improve the organisation and deliver margin accretion. She is a recognised leader with a proven ability to build teams. Her commercial experience in Latin America is of particular benefit as we continue to grow in emerging markets. She has held a number of senior commercial roles as well as financial positions, making her a versatile Chief Financial Officer.

**Nationality**



British

54 **Smith & Nephew** Annual report 2014

**Table of Contents**

**Vinita Bali (59)**

**Independent Non-executive Director**

Appointed Independent Non-executive Director on 1 December 2014. She will join the Remuneration and Ethics & Compliance Committees on 1 April 2015.

**Career and Experience**

Vinita holds an MBA from the Jammalal Bajaj Institute of Management Studies, University of Bombay and a bachelor's degree in economics from the University of Delhi. She commenced her career in India with the Tata group, and then joined Cadbury India, subsequently working with Cadbury Schweppes plc in the UK, Nigeria and South Africa. From 1994, she held a number of senior global positions in marketing and general management at The Coca-Cola Company based in the US and South America, becoming President of the Andean Division in 1999 and Vice President, Corporate

**Ian Barlow (63)**

**Independent Non-executive Director**

Appointed Independent Non-executive Director in March 2010 and Chairman of the Audit Committee in May 2010. He was appointed a Member of the Ethics & Compliance Committee on 2 October 2014.

**Career and Experience**

Ian is a Chartered Accountant with considerable financial experience both internationally and in the UK. He was a Partner at KPMG, latterly Senior Partner, London, until 2008. At KPMG, he was Head of UK tax and legal operations, and acted as Lead Partner for many large international organisations operating extensively in North America, Europe and Asia. Ian's previous appointments include Non-executive Director and Chairman of the Audit Committee of PA Consulting Group and Non-executive Director of Candy & Candy. He was Chairman of WSP

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

**Independent Non-executive Director**

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

**Career and Experience**

Virginia gained her MSc in Social Administration from the London School of Economics and Political Science following her first degree. She was appointed a Life Peer in 2005 following her career as a Member of Parliament between 1984 and 2005. She served successively as Secretary of State for Health and then Culture, Media and Sport. Virginia was formerly a director of Bupa and Akzo Nobel NV. She is currently a director of International Resources Group Limited, member of the International Advisory Council of Chugai Pharmaceutical Co.,

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

### Skills and Competencies

Vinita has an impressive track record of achievement with blue-chip global corporations in multiple geographies including India, Africa, South America, the US and UK, all key markets for Smith & Nephew. Additionally, her strong appreciation of customer service and marketing brings deep insight to the Company as we continue to develop innovative ways to serve our markets and grow our business.

### Nationality

Indian

Group plc and of Think London, the inward investment agency. He is currently Lead Non-executive Director chairing the Board of Her Majesty's Revenue & Customs; Non-executive Director of The Brunner Investment Trust PLC; Non-executive Director of Foxtons Group plc; Board Member of the China-Britain Business Council and Chairman of The Racecourse Association.

### Skills and Competencies

Ian's longstanding financial and auditing career and extensive board experience add value to his role as Chairman of the Audit Committee. It was of particular benefit when leading the selection process for the new external auditor in 2014. His appointment as an additional member of the Ethics & Compliance Committee recognises the close links between the activities and oversight role of both committees. His work for a number of international companies gives added insight when reviewing our global businesses.

### Nationality

British

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

### Skills and Competencies

Virginia's extensive experience within government, particularly as Secretary of State for Health brings a unique insight into the healthcare system both in the UK and globally, whilst her experience on the Board of Bupa brings an understanding of the private healthcare sector and an insight into the needs of our customers. Her long association with Hull, the home of many of our UK employees also brings an added perspective.

### Nationality

British



**Table of Contents**

CORPORATE GOVERNANCE

**Our Board of Directors** *continued*

**Erik Engstrom (51)**

**Independent Non-executive Director**  
Appointed Independent Non-executive Director on 1 January 2015 and Member of the Audit Committee.

**Michael Friedman (71)**

**Independent Non-executive Director**  
Appointed Independent Non-executive Director in April 2013. He was appointed Chairman of the Ethics & Compliance Committee on 1 August 2014.

**Brian Larcombe (61)**

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

**Career and Experience**

Erik is a graduate of the Stockholm School of Economics (BSc) and of the Royal Institute of Technology in Stockholm (MSc). In 1986, he was awarded a Fulbright scholarship to Harvard Business School, from where he graduated with an MBA in 1988. Erik commenced his career at McKinsey & Co. and then worked in publishing, latterly as President and Chief Operating Officer of

Random House, Inc. and as President and

Chief Executive Officer at Bantam Doubleday

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

**Career and Experience**

Michael graduated with a Bachelor of Arts degree, magna cum laude from Tulane University and a Doctorate in Medicine from the University of Texas. He completed postdoctoral training at Stanford University and the National Cancer Institute, and is board certified in Internal Medicine and Medical Oncology. In 1983, he joined the Division of Cancer Treatment at the National Cancer Institute and went on to become the Associate Director of the Cancer Therapy Evaluation Program. Michael was most recently Chief Executive Officer of City of Hope, the prestigious cancer research and treatment institution in California. He also served as Director of the institution's Cancer Centre and held the Irell & Manella

**Career and Experience**

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

**Skills and Competencies**

Atlantic Partners, a private equity investment firm focusing on information technology, internet and telecommunications businesses. Between 2004 and 2009, he was Chief Executive of Elsevier, the division specialising in scientific and medical information and then from 2009 Chief Executive of Reed Elsevier.

**Skills and Competencies**

Erik has successfully reshaped Reed Elsevier's business in terms of portfolio and geographies. He brings a deep understanding of how technology can be used to transform a business and insight into the development of new commercial models that deliver attractive economics.

**Nationality**

Swedish

Cancer Center Director's Distinguished Chair. He was formerly Senior Vice President of research, medical and public policy for Pharmacia Corporation and also Deputy Commissioner and Acting Commissioner at the US Food and Drug Administration (FDA). He has served on a number of boards in a non-executive capacity, including Rite Aid Corporation. Currently, Michael is a Non-executive Director of Celgene Corporation and Non-executive Director of MannKind Corporation.

**Skills and Competencies**

Michael understands the fundamental importance of research, which is part of Smith & Nephew's value creation process. His varied career in both the public and private healthcare sector has given him a deep insight and a highly respected career. In particular his work with the FDA and knowledge relating to US compliance provides the skillset required to Chair the Ethics & Compliance Committee and resulted in a smooth handover during 2014.

**Nationality**

American

Brian's experience in private equity is particularly useful to us when evaluating acquisitions and new business opportunities. His long service as a Non-executive Director has provided continuity throughout a period of change and his corporate memory and wise counsel continues to support our new Chairman. As Senior Independent Director and member of the Nomination & Governance Committee, he plays an active role in succession planning and the search for new Non-executive Directors. In 2014, he led an insightful review into the effectiveness of the Board.

**Nationality**

British

## **Table of Contents**

### **Joseph Papa (59)**

#### **Independent Non-executive Director**

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

### **Career and Experience**

Joe graduated with a Bachelor of Science degree in Pharmacy from the University of Connecticut and Master of Business Administration from Northwestern University's Kellogg School of Management. In 2012, he received an Honorary Doctor of Science degree from the University of Connecticut School of Pharmacy. He began his commercial career at Novartis International AG as an Assistant Product Manager and eventually rose to Vice President, Marketing, having held senior positions in both Switzerland and the US. He moved on to hold senior positions at Searle Pharmaceuticals and was later President & Chief Operating Officer of DuPont Pharmaceuticals and then Watson Pharma Inc. Between 2004 and 2006,

### **Susan Swabey (53)**

#### **Company Secretary**

Appointed Company Secretary in May 2009.

### **Skills and Experience**

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

### **Nationality**

he was Chairman and Chief Executive Officer of the Pharmaceutical Technologies Services Segment of Cardinal Health, Inc. Joe is currently Chairman and Chief Executive of Perrigo Company plc, one of the largest over-the-counter pharmaceutical companies in the US.

British

### **Skills and Competencies**

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

### **Nationality**

American





**Table of Contents**

CORPORATE GOVERNANCE

**Our Executive Officers**

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

**Julie Brown (52)**  
**Chief Financial Officer**

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

**Rodrigo Bianchi (55)**  
**President, IRAMEA**

Joined Smith & Nephew in July 2013 with responsibility for Greater China, India, Russia, Asia, Middle East and Africa, focusing on continuing our strong momentum in these regions. He is based in Dubai.

**Skills and Competencies**

Julie's experience in the healthcare sector

includes 25 years with AstraZeneca PLC in

progressively senior roles and four years with KPMG. Most recently, she served as Interim Chief Financial Officer of AstraZeneca. She has international experience and a deep understanding of the healthcare sector gained through her previously held Vice President Finance positions in all areas of the healthcare value chain including Commercial, Operations, R&D and Business Development. Julie has also led commercial organisations, being Country President and Regional Vice President in AstraZeneca.

**Skills and Experience**

Rodrigo's experience in the healthcare industry includes 26 years with Johnson & Johnson in progressively senior roles. Most recently, he was Regional Vice President for the Medical Devices and Diagnostics division in the Mediterranean region and prior to that President of Mitek and Ethicon. He started his career at Procter & Gamble Italy.

**Nationality**

Italian

## Nationality

British

### **Helen Maye (55)**

#### **Chief Human Resources Officer**

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

### **Skills and Experience**

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

## Nationality

Irish

### **Diogo Moreira-Rato (53)**

#### **President, Europe and Canada**

Joined Smith & Nephew in May 2014 with responsibility for leading all of our commercial business in Europe and Canada. He is based in Baar, Switzerland.

### **Skills and Experience**

Diogo's experience in the healthcare industry includes 31 years with Johnson & Johnson in progressively senior roles. Most recently, Diogo was President, DePuy Synthes, EMEA, where he led the merger and integration of DePuy and Synthes in EMEA. Prior roles included International Vice President for the Medical Devices and Diagnostics business, President DePuy Orthopaedics and Managing Director of Portugal.

## Nationality

Portuguese



**Table of Contents**

**Jack Campo (60)**  
Chief Legal Officer

Joined Smith & Nephew in June 2008 and heads up the Global Legal function. Initially based in London, he has been based in Andover, Massachusetts since late 2011.

**Skills and Experience**

Prior to joining Smith & Nephew, Jack held a number of senior legal roles within the General Electric Company, including seven years at GE Healthcare (GE Medical Systems) in the US and Asia. He began his career with Davis Polk & Wardwell.

**Nationality**

American

**Michael Frazzette (53)**  
President, Advanced Surgical Devices

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

**Skills and Experience**

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

**Gordon Howe (52)**  
President, Global Operations

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

**Skills and Experience**

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

**Nationality**

American

## Nationality

American

### **Cyrille Petit (44)**

Chief Corporate Development

Officer

Joined Smith & Nephew in 2012 and leads the Corporate Development function. He is based in London.

### **Skills and Experience**

Cyrille spent the previous 15 years of his career with General Electric Company, where he held progressively senior positions beginning with GE Capital, GE Healthcare and ultimately as the General Manager, Global Business Development of the Transportation Division. Cyrille's career began in investment banking at BNP Paribas and then Goldman Sachs.

### **Nationality**

French

### **Glenn Warner (52)**

President, Advanced Wound Management

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

### **Skills and Experience**

Glenn has a broad-based background in pharmaceuticals and medical products including extensive international experience, having served most recently as AbbVie Vice President and Corporate Officer, Strategic Initiatives, where he was responsible for the development and execution of pipeline and asset management strategies. Prior to that he was President and Officer, Japan Commercial Operations in Abbott's international pharmaceutical business and Executive Vice President, TAP Pharmaceutical Products, Inc. Additional senior level roles included international positions in Germany and Singapore for Abbott's Diagnostics business.

**Nationality**

American

**Smith & Nephew** Annual report 2014 59

## **Table of Contents**

### CORPORATE GOVERNANCE

#### Chairman's letter

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

#### Dear Shareholder,

I am delighted to present my first Corporate Governance Statement as your Chairman following my appointment at the Annual General Meeting in April 2014. I feel very strongly that good corporate governance lies at the heart of a well-run company. Openness and transparency, accountability and responsibility should run through everything that we do, both as a Board and throughout the business as a whole. The Board and I aim to set the tone at the top which should pervade throughout the rest of the organisation.

Later in this statement, as well as all the standard corporate governance disclosures we are required to make, you will find reports from Ian Barlow, Michael Friedman, myself and Joseph Papa, the Chairmen of our Board Committees on the activities of those committees throughout the year. These reports will explain to you where we have focused our work in 2014. Firstly, however I should like to explain the key issues that we, as a Board, have been handling:

#### Board succession planning

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

#### Mergers and acquisitions

Following the successful acquisition of our Biotherapeutics business in 2012, we continued to make further acquisitions throughout 2013 of the Adler business in India, two distributorships in Brazil and one in Turkey. In January 2014, we announced the acquisition of ArthroCare Corporation and this deal completed in May. You will read elsewhere in this Annual Report about the successful integration of ArthroCare into our Company. We also undertook



post acquisition reviews of the transaction and earlier acquisitions to monitor actual performance against expected performance at the time of acquisition and we continued to review and evaluate other potential acquisitions for the future to support our Strategic Priorities.

### Succession planning below Board level

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

### Understanding the business more deeply

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

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

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

The Board is committed to the highest standards of corporate governance and we comply with all of the provisions of the UK Corporate Governance Code 2012 ( the Code ). The Company's American Depositary Shares are listed on the New York Stock Exchange (NYSE) and we are therefore subject to the rules of the NYSE as well as to the US securities laws and the rules of the Securities Exchange Commission (SEC) applicable to foreign private issuers. We comply with the requirements of the NYSE and SEC except that the Nomination & Governance Committee is not comprised wholly of Independent Directors as required by the NYSE, but consists of a majority of Independent Directors in accordance with the Code. We shall explain in this Corporate Governance Statement and in the reports on the Audit Committee, the Nomination & Governance Committee, the Ethics & Compliance Committee and the Remuneration Committee, how we have applied the provisions and principles of the Financial Conduct Authority's (FCA) Listing Rules, Disclosure & Transparency Rules (DTRs) and the Code throughout the year.

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

**Table of Contents**

**Working together as a Board**

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

Yours sincerely,

**Roberto Quarta**

Chairman

**Overview**

The Board is committed to the highest standards of corporate governance. We maintain these standards through a clear definition of our roles, continuing development and

evaluation and accountability through the work of the Board  
Committees.

**Smith & Nephew** Annual report 2014

61

---

**Table of Contents**

CORPORATE GOVERNANCE

**Corporate Governance Statement**

Leadership

Diversity and experience

Role of Directors

Whilst we all share collective responsibility for the activities of the Board, some of our roles have been defined in greater detail. In particular, the roles of the Chairman and the Chief Executive Officer are clearly defined.

<b>Chairman</b>	Building a well-balanced Board
	Chairing Board meetings and setting Board agendas
	Ensuring effectiveness of Board and enabling the annual review of effectiveness
	Encouraging constructive challenge and facilitating effective communication between Board members
	Promoting effective Board relationships
	Ensuring appropriate induction and development programmes
	Ensuring effective two-way communication and debate with shareholders

	Promoting high standards of corporate governance
	Maintaining appropriate balance between stakeholders.
<b>Chief Executive Officer</b>	Developing and implementing Group strategy
	Recommending the annual budget and five-year strategic and financial plan
	Ensuring coherent leadership of the Group
	Managing the Group's risk profile and establishing effective internal controls
	Regularly reviewing organisational structure, developing executive team and planning for succession
	Ensuring the Chairman and Board are kept advised and updated regarding key matters
	Maintaining relationships with shareholders and advising the Board accordingly
	Setting the tone at the top with regard to compliance and sustainability matters
	Day-to-day running of the business.

**Table of Contents****Role of Directors *continued***

The roles of the Non-executive Directors, Senior Independent Director and the Company Secretary are defined as follows:

<b>Non-executive Directors</b>	<ul style="list-style-type: none"> <li>Providing effective challenge to management</li> <li>Assisting in development and approval of strategy</li> <li>Serving on the Board Committees</li> </ul>
<b>Senior Independent Director</b>	<ul style="list-style-type: none"> <li>Providing advice to management.</li> <li>Chairing meetings in the absence of the Chairman</li> <li>Acting as a sounding board for the Chairman on Board-related matters</li> <li>Acting as an intermediary for the other Directors where necessary</li> <li>Available to shareholders on matters which cannot otherwise be resolved</li> <li>Leading the annual evaluation into the Board's effectiveness</li> <li>Leading the search for a new Chairman, if necessary.</li> </ul>
<b>Company Secretary</b>	<ul style="list-style-type: none"> <li>Advising the Board on matters of corporate governance</li> <li>Supporting the Chairman and Non-executive Directors</li> <li>Point of contact for investors on matters of corporate governance</li> <li>Ensuring good governance practices at Board level and throughout the Group.</li> </ul>

**Changes to the Board**

### Chairman

**Roberto Quarta** replaced Sir John Buchanan on 10 April 2014

### Independent Non-executive Directors

#### Left the Board during 2014

**Ajay Piramal** (resigned 24 March 2014)

**Richard De Shutter** (retired 10 April 2014)

**Pamela Kirby** (retired 31 July 2014)

#### Joined the Board during 2014

**Vinita Bali** (appointed 1 December 2014)

**Erik Engstrom** (appointed 1 January 2015, since year-end)

#### Role changed during 2014

**Brian Larcombe** replaced Richard De Schutter as Senior Independent Director on 10 April 2014

**Michael Friedman** replaced Pamela Kirby as Chairman of the Ethics & Compliance Committee on 31 July 2014

**Table of Contents**

CORPORATE GOVERNANCE

Corporate Governance Statement *continued*

Leadership

Corporate Governance Framework

The Board is responsible to shareholders for approving the strategy of the Group, for overseeing the performance of the Group and evaluating and monitoring the management of risk.

Each member of the Board has access collectively and individually to the Company Secretary and is also entitled to obtain independent professional advice at the Company's expense, should they decide it is necessary in order to fulfil their responsibilities as Directors.

The day-to-day running of the business is delegated to Olivier Bohuon, the Chief Executive Officer, and his executive team comprising the Executive Officers who are shown on pages 58 to 59.

The Executive Officers form the Commercial and Operations Committee which advises the Chief Executive Officer in decisions relating to the commercial and operational aspects of the business.

The Chief Executive Officer in turn delegates the day-to-day management of the Group functions and regional commercial operations divisions to the Executive Officers, who are assisted in their decision making by their own leadership teams and other committees and councils.



---

**Table of Contents**

**Independence of Directors**

We require our Non-executive Directors to remain independent from management so that they are able to exercise independent oversight and effectively challenge management. We therefore continually assess the independence of each of our Non-executive Directors. The Executive Directors have determined that all our Non-executive Directors are independent in accordance with both UK and US requirements. None of our Non-executive Directors or their immediate families has ever had a material relationship with the Group. None of them receives additional remuneration apart from Directors' fees, nor do they participate in the Group's share plans or pension schemes. None of them serve as directors of any companies or affiliates in which any other Director is a director.

More importantly, each of our Non-executive Directors is prepared to question and challenge management, to request more information and to ask the difficult question. They insist on robust responses both within the Boardroom and sometimes, between meetings. The Chief Executive Officer is open to challenge from the Non-executive Directors and uses this positively to provide more detail and to reflect further on issues.

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

**Re-appointment of Directors**

In accordance with the Code, all Directors offer themselves to shareholders for re-election annually, except those who are retiring immediately after the Annual General Meeting. Vinita Bali and Erik Engstrom, who were appointed to the Board on 1 December 2014 and 1 January 2015 respectively, will offer themselves for election at the Annual General Meeting. Each Director may be removed at any time by the Board or the shareholders.

**Director Indemnity Arrangements**

Each Director is covered by appropriate directors' and officers' liability insurance and there are also Deeds of Indemnity in place between the Company and each Director. These Deeds of Indemnity mean that the Company indemnifies Directors in respect of any proceedings brought by third parties against them personally in their capacity as Directors of the Company. The Company would also fund ongoing costs in defending a legal action as they are incurred rather than after judgment has been given. In the event of an unsuccessful defence in an action against them, individual directors would be liable to repay the Company for any damages and to repay defence costs to the extent funded by the Company.

**Liaison with shareholders**

The Board meets with retail investors at the Annual General Meeting and responds to many letters and emails from shareholders throughout the year.

Non-executive Directors have been appointed.

### Management of Conflicts of Interest

None of our Directors or their connected persons, has any family relationship with any other Director or Officer, nor has a material interest in any contract to which the Company or any of its subsidiaries are, or were, a party during the year or up to 23 February 2015.

Each of us as a Director has a duty under the Companies Act 2006 to avoid a situation in which we have or may have a direct or indirect interest that conflicts or might conflict with the interests of the Company. This duty is in addition to the existing duty owed to the Company to disclose to the Board any interest in a transaction or arrangement under consideration by the Company.

If any Director becomes aware of any situation which might give rise to a conflict of interest, they inform the rest of the Board immediately and the Board is then permitted under the Company's Articles of Association to authorise such conflict. This information is then recorded in the Company's Register of Conflicts, together with the date on which authorisation was given. In addition, each Director certifies on an annual basis that the information contained in the Register is correct.

When the Board decides whether or not to authorise a conflict, only the Directors who have no interest in the matter are permitted to participate in the discussion and a conflict is only authorised if the Board believes that it would not have an impact on the Board's ability to promote the success of the Company in the long term. Additionally, the Board may determine that certain limits or conditions must be imposed when giving authorisation. No actual conflicts have been identified, which have required approval by the Board. However, six situations have been identified which could potentially give rise to a conflict of interest and these have been duly authorised by the Board and are reviewed on an annual basis.

The Executive Directors also meet regularly with institutional investors to discuss the Company's business and financial performance both at the time of the announcement of results and at industry investor events. During 2014, the Executive Directors held meetings with institutional investors, including investors representing approximately 46% of the share capital as at December 2014.

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

Joseph Papa, the Chairman of the Remuneration Committee also offered to meet with key institutional investors towards the end of 2014. Most investors were overwhelmingly supportive of our remuneration arrangements and we have made no changes to these arrangements over the year. He therefore met with four investors holding around 2% of the share capital. These were useful discussions giving insight into current investor thinking.

Ian Barlow, the Chairman of the Audit Committee also offered to meet with institutional investors to discuss audit related matters and in particular, the tender process we had followed to select new auditors. The meetings held with five investors holding around 5.45% of the issued share capital were interesting and useful and we welcomed some insightful comments on possible improvements to the Audit Committee Report.

Members of the Board are always happy to engage with investors, if they have matters they wish to raise

with the Non-executive team.

### Outside Directorships

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

A short report on our major shareholders and any significant changes in their holdings since the previous meeting is reviewed at each Board meeting. The Chairman and Non-executive Directors report back to the Board following their meetings with investors. Olivier Bohuon and Julie Brown routinely report on any concerns or issues that shareholders have raised with them in their meetings. Copies of analyst reports on the Company and its peers are also circulated to Directors.

**Table of Contents**

CORPORATE GOVERNANCE

Corporate Governance Statement *continued*

Effectiveness

Board timetable

Responsibility of the Board

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

**Strategy**

Approving the Group strategy including major changes to corporate and management structure

Approving acquisitions, mergers, disposals, capital transactions in excess of \$50 million

Setting priorities for capital investment across the Group

Approving annual budget, financial plan, five-year business plan

**Risk**

Overseeing the Group's risk management programme

Regularly reviewing the risk register

Overseeing risk management processes (see pages 36 to 39 for further details).

**Shareholder Communications**

Approving major borrowings and finance and banking arrangements

Approving changes to the size and structure of the Board and the appointment and removal of Directors and the Company Secretary

Approving Group policies relating to corporate social responsibility, health and safety, Code of Conduct and Code of Share Dealing and other matters

Approving the appointment and removal of key professional advisers.

**Performance**

Reviewing performance against strategy, budgets and financial and business plans

Overseeing Group operations and maintaining a sound system of internal control

Determining the dividend policy and dividend recommendations

Approving the appointment and removal of the external Auditor on the recommendation of the Audit Committee

Approving significant changes to accounting policies or practices

Approving preliminary announcement of annual results, the publication of the Annual Report, the half-yearly report, the quarterly financial announcements, the release of price sensitive announcements and any listing particulars, circulars or prospectuses

Approving the Sustainability Report prior to publication

Maintaining relationships and continued engagement with shareholders.

**Providing Advice**

Using experience gained within other companies and organisations to advise management both within and between Board meetings.

The Schedule of Matters Reserved to the Board describes the role and responsibilities of the Board more fully and can be found on our website at [www.smith-nephew.com](http://www.smith-nephew.com)

Overseeing succession planning at Board and Executive Officer level.

Approving the use of the Company's shares in relation to employee and executive share incentive plans on the recommendation of the Remuneration Committee.

66 **Smith & Nephew** Annual report 2014

**Table of Contents****What we did**

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

(Approval of Q1 results)

**July**

(Approval of H1 results)

Reviewed the results for the first half 2014 and approved the H1 announcement, having considered management's judgement in a number of areas and approved payment of interim dividend  
 Received and considered a report analysing the progress of recent acquisitions against expectations at the time of acquisition  
 Received and discussed annual review of defence planning  
 Received update reports from Group Taxation and Group Treasury  
 Approved the appointment of Deutsche Bank as ADR Depository Bank and the change of the ratio of ADR to ordinary shares  
 Updated and approved the Schedule of Matters Reserved to the Board

**Early October**

(Strategy Review)

Approved the Strategic Plan for 2015 to 2019 over a two-day Strategy Review with the executive team  
 Approved the renewal of the Directors' and Officers' Liability insurance  
 Authorised the executive team to arrange the private placement of debt

Singapore

**Late October**

(Approval of Q3 Results)

Reviewed the results for the third quarter 2014 and approved the Q3 announcement  
 Received and considered the annual report from the executive team on executive Succession Planning  
 Received an update on the progress of the integration of ArthroCare  
 Approved the appointment of Vinita Bali as a Non-executive Director

Fort Worth, Texas

**December**

(Approval of Budget)

Approved the Budget for 2015  
 Authorised the executive team to conduct a selection process for new corporate brokers  
 Received a report on the progress of our investment in Bioventus LLP  
 Received an update on the HR transformation project  
 Received an update on the Commercial structure within Europe

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

Since the year end, we have also approved the Annual Report and Accounts for 2014 and have concluded that, taken as a whole, they are fair, balanced and understandable. We have approved the Notice of Annual General Meeting, recommended the final dividend to shareholders and have received and discussed the report on the effectiveness of the Board in 2014.



Each meeting was preceded by a meeting between the Chairman and the Non-executive Directors without Executive Directors and management in attendance. Unless otherwise stated, meetings are held in London.

At each meeting, we approved the minutes of the previous meetings, reviewed matters arising and received reports and updates from the Chief Executive Officer, the Chief Financial Officer, the Chief Business Development Officer, the Chief Legal Officer and the Company Secretary. We also received reports from the chairmen of the Board Committees on the activities of these Committees since the previous meeting.

**Table of Contents**

## CORPORATE GOVERNANCE

Corporate Governance Statement *continued*

## Effectiveness

## Board and Committee Attendance

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

Joseph Papa	9 / 9	8 / 8	4 / 4		4 / 4
Ajay Piramal <sup>5</sup>	1 / 3				
Richard De Schutter <sup>6</sup>	4 / 4	3 / 3	2 / 2	1 / 1	2 / 2

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

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

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

**4** Pamela Kirby retired from the Board on 31 July 2014

**5** Ajay Piramal retired from the Board on 24 March 2014

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

**7** Roberto Quarta joined the Remuneration Committee on 10 April 2014

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

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

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

### Dear Shareholder,

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

The Board scores highly on all the key assessments of our responsibilities for approving strategy, monitoring performance, determining risk, diligence of members

developing an excellent working relationship with Olivier. He has invested the time to understand the business, getting to know the senior executives and the major shareholders and has made excellent progress in strengthening the Board with appointment of new Non-executive Directors. The Committees of the Board were also found to be operating effectively.

There has been some healthy discussion around the role played by the Board, with the Non-executives eager to play a more active role in agenda planning, setting the strategy, organisational change and management succession and the appointment of

attendance and quality of discussion. Roberto Quarta, Chairman of the Board is universally respected for his professionalism, chairmanship skills and for

advisers.

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

Action identified

Make more effective use of the annual Board Planner to ensure that all key strategic issues were timetabled appropriately throughout the year

Encourage the executive team to access the diverse competencies of the Non-executive Directors more between Board meetings

Continue the practice of inviting members of the executive team to present regularly to the Board

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

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

Succession Planning at Non-executive Director level would be a key priority following the retirement of a number of long serving Non-executive Directors during the year.

Nomination & Governance Committee undertook a comprehensive search for new Non-executive Directors leading to the appointment of Vinita Bali on 1 December 2014 and of Erik Engstrom on 1 January 2015. This process is ongoing. Details of the full search process are given in the Nomination & Governance Committee Report on page 70.

Timing and length of the Board and Committee meetings could be reviewed to consider whether the current pattern of meetings was most effective.

The timing and frequency of Board meetings has been reviewed by the Chairman and the Chief Executive Officer, who have concluded that the current pattern of meetings is appropriate for the Company and fits in well with the programme of executive activities throughout the year. The reporting schedule inhibits changing the Board timetable.

Yours sincerely,

**Brian Larcombe**

Senior Independent Director

68 **Smith & Nephew** Annual report 2014

**Table of Contents****Board Development Programme**

Our Board Development Programme is directed to the specific needs and interests of our Directors. We focus the development sessions on facilitating a greater awareness and understanding of our business rather than formal training in what it is to be a Director. We value our visits to the different Smith & Nephew sites around the world, where we meet with the local managers of our businesses and see the daily operations in action. Meeting our local managers helps us to understand the challenges they face and their plans to meet those challenges. We also take these opportunities to look at our products and in particular the new products being developed by our R&D teams. This direct contact with the business in the locations in which we operate around the world helps us to make investment and strategic decisions. Meeting our local managers also helps us when making succession planning decisions below Board level.

During the course of the year, we receive updates at the Board and Committee meetings on external corporate governance changes likely to impact the Company in the future.

**Development activities**

The following development sessions covering both the Smith & Nephew business and wider market issues were held during the year:

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

In 2014, we particularly focused on the changes to Narrative Reporting and reporting on Remuneration as well as the changes incorporated in the UK Corporate Governance Code 2014 and the Financial Reporting Council's Audit Quality Thematic Review into fraud risks and laws and regulations. New Directors receive tailored induction programmes when they join the Board. In 2014, Vinita Bali commenced her induction programme with a series of meetings with key senior executives and a briefing on UK Company Law and Corporate Governance delivered jointly by our corporate lawyers, Freshfields and our Company Secretary, Susan Swabey. Since the year end, Vinita Bali and Erik Engstrom have continued meeting with key senior executives and a series of visits to our major facilities is planned for them both over the next few months. All Non-executive Directors are encouraged to visit our overseas businesses, if they happen to be travelling for other purposes. Our local management teams enjoy welcoming Non-executive Directors to their business and it emphasises the interest the Board takes in all our operations. The Chairman regularly reviews the development needs of individual Directors and the Board as a whole.

<b>July</b>	Joint presentation from our corporate brokers on equity markets and investor perceptions of Smith & Nephew
<b>September</b>	Meetings with our ASEAN management team in Singapore with presentations from the local Managing Directors in Singapore, Malaysia and Thailand Presentation from a leading Indian hip surgeon on the challenges in the Indian market Presentations from the entire Executive team as part of the Board's Strategy review Board discussion on Risk as part of the Board's Strategy discussions
<b>October</b>	Visit to the Biotherapeutics facility in Fort Worth, Texas and meetings with the Biotherapeutics research and development teams Series of presentations from our Advanced Wound Management US Commercial team on the challenges faced by the business, our strategy and initiatives to meet these challenges and an update on progress made since the previous year

### Succession Planning

The Board is responsible for ensuring that there are effective succession plans in place to ensure the orderly appointment of directors to the Board, as and when vacancies arise. The report from the Nomination & Governance Committee on pages 70 to 71 explains the process the Board and the Nomination & Governance Committee followed in 2014 to build a balanced board for the future in undertaking the search for new Non-executive Directors.

Building a successful executive team is the responsibility of the Chief Executive Officer, although this process is also overseen by the Board. The Chief Executive Officer and Chief Human Resources Officer present a report to the Board on Succession Planning on an annual basis, at which the performance and potential of members of the executive team are discussed and considered. The Board is also given a number of opportunities during the course of the year to meet key

members of the executive team at the Strategy Review held annually in September and at the site visits held in October each year. Executive Officers and their direct reports also make regular presentations on different aspects of the business. The Board recognises the importance of getting to know the executive team below Board level both for the purpose of understanding the business better but also in order to plan for executive succession.

By order of the Board, on 25 February 2015

**Roberto Quarta**

Chairman





---

**Table of Contents**

CORPORATE GOVERNANCE

**Accountability**

**Accountability**

**Nomination & Governance**

**Committee Report**

**Dear Shareholder**

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

**Current Members in 2014**

**Roberto Quarta**

Committee Chairman

**Brian Larcombe**

Senior Independent Non-executive Director

**Virginia Bottomley (from 10 April 2014)**

Independent Non-executive Director

**Olivier Bohuon**

Chief Executive Officer

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

### Key activities

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

Oversee governance aspects of the Board and its Committees.

### 2015 focus

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

### Role of the Nomination & Governance Committee

Our work falls into the following two areas:

#### **Board Composition**

Reviewing the size and composition of the Board

Overseeing Board succession plans

Recommending the appointment of Directors

Monitoring Board diversity.

#### **Corporate Governance**

Overseeing governance aspects of the Board and its Committees

Overseeing the review into the effectiveness of the Board

Considering and updating the Schedule of Matters Reserved to the Board and the Terms of Reference of the Board Committees

Monitoring external corporate governance activities and keeping the Board updated

Overseeing the Board Development Programme and the induction process for new Directors. The terms of reference of the Nomination & Governance Committee describe our role and responsibilities more fully and can be found on our website at [www.smith-nephew.com](http://www.smith-nephew.com)

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

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

##### **Early February (Activities related to the year end)**

Considered and approved the re-appointment of directors who had completed three or six years service and the annual appointment of directors serving in excess of nine years

Reviewed and updated the Schedule of Matters Reserved to the Board and the Terms of Reference of the Board Committees

Considered and discussed the results of the annual review into the effectiveness of the Board

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

##### **Early September (Appointment of Vinita Bali)**

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

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

70 **Smith & Nephew** Annual report 2014

**Table of Contents**

**End October (Appointment of Erik Engstrom)**

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

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

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

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

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

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

Agreed to hold further meetings with other candidates.

**Diversity**

**Early December (Appointment of Non-executive Directors)**

We aim to have a Board which represents a wide range of backgrounds, skills and experiences. We also value a diversity of outlook, approach and style in our Board members. We believe that a balanced Board is better equipped to consider matters from a broader perspective and therefore come to decisions that have considered a wider range of issues and perspectives than would be the case in a more homogenous Board. Diversity is not simply a matter of gender, ethnicity or other easily measurable characteristic. Diversity of outlook and approach is harder to measure than

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

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

### Non-executive Directors

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

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

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

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

gender or ethnicity but is equally important. A Board needs a range of skills from technical adherence to governance or regulatory matters for an understanding of the business in which we operate. It needs some members with a long corporate memory and others who bring new insights from other fields. There needs to be both support and challenge on the Board as well as a balance of gender, commercial and international experience. When selecting new members for the Board, we take these considerations into account, as well as professional background. A new Board member needs to fit in with their fellow Board members, but also needs to provide a new way of looking at things.

In 2012, we stated that our expectation would be that by 2015, 25% of our Board would be female and we have met this expectation. 30% of our Board is female. We do not regard this as a fixed percentage as the number of Board members will fluctuate from time to time and we would not necessarily expect to replace any retiring Director with a new Director of the same gender. We will still continue to appoint Directors on merit, valuing the unique contribution that they will bring to the Board, regardless of gender.

### Governance

During the year, the Nomination & Governance Committee also addressed a number of governance matters. We also received updates from the Company Secretary on new developments in corporate governance and reporting in both the UK and Europe. We reviewed the independence of our Non-executive Directors, considered potential conflicts of interest and the diversity of the Board and made recommendations concerning these matters to the Board.

Yours sincerely,

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

**Roberto Quarta**

Chairman of the Nomination & Governance Committee

Experience as a Chief Executive Officer in another listed company;

At least one new female Non-executive Director;

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

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

Russell Reynolds prepared a long list of candidates satisfying one or more of the above criteria and Brian Larcombe and I met with them to discuss the longlist and select a shortlist of suitable candidates

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





---

**Table of Contents**

CORPORATE GOVERNANCE

*Accountability continued*

**Ethics & Compliance**

**Committee Report**

**Dear Shareholder**

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

**Current Members in 2014**

**Michael A. Friedman (from 31 July 2014)**

Committee Chairman

**Ian Barlow (from 2 October 2014)**

Independent Non-executive Director

**Joseph Papa**

Independent Non-executive Director

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

### Key activities

Reviews ethics and compliance processes and practices across the Group.

Oversees quality and regulatory matters.

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

### 2015 focus

Develop a deeper oversight of quality and regulatory matters.

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

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

### Role of the Ethics & Compliance Committee

Our work falls into the following two general areas:

#### **Ethics & Compliance**

Overseeing ethics and compliance programmes

Monitoring ethics and compliance policies and training programmes

Reviewing compliance performance based on monitoring, auditing and investigations data

Reviewing allegations of significant compliance issues

Overseeing the Group's internal and external communications relating to ethics and compliance matters

Reviewing external developments and compliance activities

Receiving reports from the Group's Ethics & Compliance Committee meetings and from the Chief Compliance Officer and the Chief Legal Officer.

**Quality Assurance and Regulatory Assurance**

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

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

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

72 **Smith & Nephew** Annual report 2014

**Table of Contents**

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

In 2014, we held four physical meetings. Each meeting was attended by all members of the Committee. The Company Secretary, the Chief Legal Officer, the Chief Compliance Officer and the SVP Quality Assurance and Regulatory Assurance also attended by invitation. Our programme of work in 2014 included the following:

**February**

Noted that the SEC and DOJ had confirmed the termination of the independent monitorship in January 2014 and that the Company was now subject to self-reporting. Discussed and noted the requirements of self-reporting

Noted the ethics and compliance due diligence and integration work being undertaken in respect of recent transactions in India, Turkey and Brazil and the Biotherapeutics business

Noted the preparations being made in capturing data to be filed under the US Sunshine Act and considered the Sunshine legislation in other territories.

**April**

Reviewed the processes in place to ensure oversight over third party sellers

Noted the ethics and compliance due diligence and integration work being undertaken in respect of recent transactions in India, Turkey and Brazil and ArthroCare

Noted that the first aggregate payment report under the US Sunshine Act had been filed in March 2014 and considered the Sunshine legislation in other territories.

**July**

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

**October**

Reviewed the results of 2014 ethics survey

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

Received a report from the SVP Quality Assurance and Regulatory Assurance on the activities of the QARA function, reviewing the quality and regulatory challenges faced across the Company and initiatives to address them. At each meeting we noted and considered the activities of enforcement agencies and investigation of possible improprieties. We also reviewed a report on the activities of the Group Ethics & Compliance Committee and reviewed the progress of the Global Compliance Programme.

Since the year end, we have also reviewed the work of the Group Ethics & Compliance Committee meeting held in November 2014, considered the compliance implications of recent acquisitions and continued our oversight of the Quality Assurance and Regulatory Assurance function.

### Employee Compliance Programme

New employees are trained on our Code of Conduct, which sets out the basic legal and ethical principles for conducting business. A copy of the Code of Conduct can be found on our website at [www.smith-nephew.com](http://www.smith-nephew.com)

Further support is provided through a comprehensive set of tools and resources located on our global intranet platform. These tools and resources are regularly updated.

The Code of Conduct includes our whistle-blower policy, which enables employees and members of the public to contact us anonymously through an independent provider (where allowed by local law). Individuals can also report any concern to their direct manager or a manager in Compliance, Legal or Human Resources. All calls and contacts are investigated and the appropriate action taken, including reports for senior management or the Board, where warranted. As stated in the Code of Conduct, we also enforce our non-retaliation policy with respect to anyone who makes a report in good faith. The Ethics & Compliance Committee is advised of any potentially significant improprieties from time to time, and the Company's response.

In 2014, we continued to work to enhance the employee compliance training programme. New employees receive training on our Code of Conduct ( Code ), and we assign annual compliance training to employees. In 2014, we updated our Code training. The new module is more interactive, role-based and allows individuals to apply the Code in different scenarios.

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



**Table of Contents**

CORPORATE GOVERNANCE

*Accountability continued*

**Compliance Programme for Third Parties**

We continually review our compliance programme with third party sellers (such as distributors and sales agents), particularly in higher risk markets. This programme includes due diligence, contracts with compliance terms and compliance training. To increase oversight, we have augmented monitoring and auditing programmes in 2014.

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

We have continued to strengthen controls over other third parties engaged by us to provide services other than selling our products, such as customs, registration and travel agents. In 2014, we focused on potentially higher risk third parties. We have established a policy and process requiring that managers prioritise our oversight of third parties and take appropriate steps, including performing a risk assessment, conducting due diligence and assigning training, based on third party type and risk profile.

**Compliance implications around acquisitions**

In both 2013 and 2014, there has been increased strategic acquisition activity across the Group. In all cases, we

**Oversight of Quality Assurance and Regulatory Assurance Function**

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

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

Yours sincerely,

undertake comprehensive due diligence evaluation prior to acquisition and implement compliance integration plans from the point of executing the acquisition. This is to ensure that new businesses are integrated into the Smith & Nephew compliance culture as soon and consistently as possible and that all new employees are immediately made aware of how we do things at Smith & Nephew.

**Michael A. Friedman**

Chairman of the Ethics & Compliance Committee

74 **Smith & Nephew** Annual report 2014



**Table of Contents**

**Audit Committee Report**

**Dear Shareholder**

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

**Current Members in 2014**

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

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

**Key activities**

Undertake independent assessment of the financial affairs of the Company.

**Role of the Audit Committee**

Our work falls into the following five areas:

**Financial Reporting**

Reviewing significant financial reporting judgments and accounting policies and compliance with accounting standards

Ensuring the integrity of the financial statements and their compliance with UK and US statutory requirements

Ensuring the Annual Report and Accounts are fair, balanced and understandable and recommending their adoption by the Board

Oversee system of control and risk management throughout the Group.

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

#### 2015 focus

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

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

Monitoring announcements relating to the Group's financial performance.

### **Internal Controls and Risk Management**

Monitoring the effectiveness of internal controls and compliance with the UK Corporate Governance Code 2012 and the Sarbanes Oxley Act, specifically sections 302 and 404

Reviewing the operation of the Group's risk management processes and the control environment over financial risks.

### **Fraud and Whistle-blowing**

Receiving reports on the processes in place to prevent fraud and to enable whistle-blowing

If required, receiving reports of fraud incidents.

### **Internal Audit**

Agreeing internal audit plans and reviewing reports of internal audit work

Monitoring the effectiveness of the internal audit function.

## **External Audit**

Overseeing the Board's relationship with the external auditor

Monitoring and reviewing the independence and performance of the external auditor and evaluating their effectiveness

Making recommendations to the Board for the appointment or re-appointment of the external auditor.

The terms of reference of the Audit Committee describe our role and responsibilities more fully and can be found on our website at [www.smith-nephew.com](http://www.smith-nephew.com)

**Table of Contents**

## CORPORATE GOVERNANCE

*Accountability continued***Activities of the Audit Committee in 2014 and since the year end**

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

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

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

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

Since the year end, we have also reviewed the Annual Report and Accounts for 2014 and have concluded that taken as a whole, they are fair balanced and understandable and have advised the full Board accordingly. In coming to this conclusion, we have considered the description of the Group's strategy and key risks, the key elements of the business model, which is set out on page 12, and the key performance indicators and their link to the strategy.



**Table of Contents****Significant matters related to the financial statements**

We considered the following key areas of judgement in relation to the 2014 accounts and at each reporting quarter end, which we discussed in all cases with management and the external auditor:

**Area of judgement****Valuation of inventories**

A feature of the orthopaedic business model (whose finished goods inventory makes up 81% of the Group total finished goods inventory) is the high level of product inventory required, some of which is located at customer premises and is available for customers immediate use. Complete sets of product, including large and small sizes have to be made available in this way. These sizes are used less frequently than standard sizes and towards the end of the product life cycle are inevitably in excess of requirements. Adjustments to carrying value are therefore required to be made to orthopaedic inventory to anticipate this situation.

**Liability provisioning**

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

**Impairment**

In carrying out impairment reviews of goodwill, intangible assets and property, plant and equipment, a

**Our action**

At each quarter end, we received reports from and discussed with management the level of provisioning and material areas at risk. The provisioning level was 21.5% at 31 December 2014 (26.0% as at 31 December 2013). We concluded that the proposed levels were appropriate.

As members of the Board, we receive regular updates from the Chief Legal Officer. These updates form the basis for the level of provisioning. These judgements have not moved materially during the year, with some cases having been resolved, and we have determined that the proposed levels at year end of \$74 million in 2014 (\$86 million in 2013) were appropriate in the circumstances.

We reviewed management's reports on the key assumptions with respect to goodwill, acquisition

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

#### Taxation

Provisioning for potential current tax liabilities and the level of deferred tax asset recognition in relation to accumulated tax losses are underpinned by a range of judgments about the future statutory profitability of constituent entities of the Group.

#### Business combinations

The Group has identified growth through acquisitions as one of its Strategic Priorities. During 2014, we acquired ArthroCare Corporation; the determination of the balance sheet fair value acquired is dependent upon understanding the circumstances at acquisition and estimates of the future results of the acquired business and management judgement is a factor in making these determinations.

intangible assets and investments in associates particularly the forecast future cash flows and discount rates used to make these calculations. We have also considered the disclosure surrounding these reviews, and concluded that the review and disclosure were appropriate.

We annually review our processes and approve the principles for management of tax risks. We review quarterly reports from management evaluating existing risks and tax provisions, concluding that the levels of provisions was appropriate.

For completed acquisitions, we received a report from management setting out the significant assets and liabilities acquired, details of the provisional fair value adjustments applied, an analysis of the intangible assets acquired, the assumptions behind the valuation of these acquired intangible assets and the proposed useful economic life of each intangible asset class. For material acquisitions, management engage third party specialists to perform a detailed analysis, summaries of which are included in management reports. We reviewed, discussed and approved these reports.

We note that within the External Audit report there is a principal risk associated with the timing of revenue recognition and measurement of related reserves as required by auditing standards. We have considered this and have concluded that we have appropriate procedures and controls in place not to include this as a significant area of judgement.



## **Table of Contents**

### CORPORATE GOVERNANCE

#### *Accountability continued*

#### External Auditor

##### **Independence of External Auditors**

The independence of our external auditors is critical for the integrity of the audit. Our Auditor Independence Policy, which ensures that this independence is maintained, is available on the Company's website. We believe that the implementation of this policy helps ensure that auditor objectivity and independence is safeguarded. The policy governs our approach when we require our external auditor to carry our non-audit services, and all such services are strictly governed by this policy. During 2014, fees paid to Ernst & Young LLP, our external auditor, for non-audit work totalled \$1.8 million, representing 35% of total audit fees. Full details are shown in Note 3.2 of the Notes to the Group accounts. During 2014, fees paid to KPMG LLP, who will be appointed as our external auditors at the Annual General Meeting, amounted to \$3.9 million. The provision of non-audit services by KPMG will be subject to our Auditor Independence Policy and the level of these services will be monitored closely. It is not expected that the level of non-audit services provided by KPMG will be as high in 2015.

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

##### **Effectiveness of External Auditors**

Although EY will cease to be the Company's external auditors at the Annual General Meeting, we felt that it would still be useful to carry out a review of the effectiveness of the external audit process and the quality of the audit, as the findings could be of use to KPMG, the incoming external auditor. We therefore conducted a review into the effectiveness of the external audit as part of the 2014 year-end process, in line with previous years. We sought the views of key members of the finance management team, considered the feedback from this process and shared it with management, EY and KPMG.

During the year, we also considered the inspection reports from the Audit Oversight Boards in the UK and US and determined that we were satisfied with the audit quality provided by EY.

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

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

##### **Appointment of External Auditors at Annual General Meeting**

Ernst & Young LLP will be retiring as the Company's external auditor at the Annual General Meeting. The reports of Ernst & Young LLP on the Company's financial statements for the past two fiscal years did not contain an adverse

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

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

### Disclosure of Information to the Auditors

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

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

### Audit and Professional Fees paid to the Auditor

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

	2014 \$ million	2013 \$ million
Audit	3	3
Audit-related fees		
Tax	2	3
Other		
Total	5	6
<b>Internal Audit</b>		

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

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

Financial systems and processes;

Systems that ensure compliance with our Code of Conduct, regulation and laws; and

Quality management systems in our manufacturing activities.

In all three areas, they act as a third line of defence behind operational management's front line and the Company's internal assurance activities within Group Finance Compliance and Quality Assurance. During the year, they completed 26 reviews across the business. The Audit Committee receives a quarterly report of the activities of the Internal Audit function and reviews the results of the Internal Audit reports, looking in detail at any reports with unsatisfactory ratings. We also receive a quarterly report detailing any unremediated and overdue control recommendations and oversee the effective and timely remediation of any recommendations.

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

In 2015, we will continue to monitor Internal Audit's scope of work and operational methods to ensure that it continues to play a full role in providing assurance over the Group's identification and management of risk and its associated controls.

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

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

**Table of Contents****Tender of External Audit Services**

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

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

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

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

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

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

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

Throughout the process, we were mindful of the need to preserve the independence of the external audit. As part of the tender, each firm was required to disclose all existing relationships with the Company and explain their proposals for ensuring that these relationships would not cause any conflict of interest after 1 January 2015. Given that up until 2008, I was Senior Partner in London with KPMG,

We were conscious that the audit tender process is time and resource consuming, both for the firms involved and for the Company, and were therefore determined to have a concise yet thorough process, ensuring equivalent access to management for each firm. We undertook the following process over just six weeks:

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

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

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

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

### Risk Management and Internal Control

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

In coming to this conclusion:

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

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

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

**Table of Contents**

CORPORATE GOVERNANCE

*Accountability continued*

**Evaluation of Internal Controls**

Management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) and 15d-15(f) under the US Securities Exchange Act of 1934.

There is an established system of internal control throughout the Group and our Divisions. The main elements of the internal control framework are:

The management of each Division is responsible for the establishment and review of effective financial controls within their Division.

The Group Finance manual sets out, amongst other things, financial and accounting policies and minimum internal financial control standards.

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

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

The Audit Committee reviews the Group whistle-blower procedures.

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

This system of internal control has been designed to manage rather than eliminate material risks to the achievement of our strategic and business objectives and can provide only reasonable, and not absolute, assurance against material misstatement or loss. Because of inherent limitation, our internal controls over financial reporting may not prevent or detect all misstatements. In addition, our projections of any evaluation of effectiveness in future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. The system of internal control is not applied to the entities in which the Group does not hold a controlling interest. This process complies with the Financial Reporting Council's Internal Control: Revised Guidance for Directors on the Combined Code and additionally contributes to our compliance with the obligations under the Sarbanes-Oxley Act 2002 and other internal assurance activities. Other than the integration of ArthroCare there has been no change in the Group's internal control over financial reporting during the period covered by this Annual Report that has materially affected, or is reasonably likely to materially affect, the Group's internal control over financial reporting.

The Board is responsible overall for reviewing and approving the adequacy and effectiveness of the risk management framework and the system of internal controls over financial, operational including quality management and ethical compliance processes operated by the Group. The Board has delegated responsibility for this review to the Audit Committee. The Audit Committee, through the Internal Audit function, reviews the adequacy and effectiveness of internal control procedures and identifies any weaknesses and ensures these are remediated within agreed timelines. The latest review covered the

financial year to 31 December 2014 and included the period up to the approval of this Annual Report.

The main elements of this annual review are as follows:

The Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of the design and operation of the Group's disclosure controls and procedures as at 31 December 2014. Based upon this evaluation, the Chief Executive Officer and Chief Financial Officer concluded on 23 February 2015 that the disclosure controls were effective as at 31 December 2014.

Management is responsible for establishing and maintaining adequate internal control over financial reporting. Management assessed the effectiveness of the Group's internal control over financial reporting as at 31 December 2014 in accordance with the requirements in the US under s404 of the Sarbanes-Oxley Act. In making that assessment, they used the criteria set forth by the Committee of Sponsoring Organisations of the Treadway Commission in Internal Control-Integrated Framework. Based on their assessment, management concluded and reported that, as at 31 December 2014, the Group's internal control over financial reporting is effective based on those criteria.

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

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



### **Code of Ethics for Senior Financial Officers**

We have adopted a Code of Ethics for Senior Financial Officers, which applies to the Chief Executive Officer, the Chief Financial Officer, the Senior Vice President Group Finance and the Group's senior financial officers. There have been no waivers to any of the Code's provisions nor have there been any amendments to the Code during 2013 or up until 23 February 2015. A copy of the Code of Ethics for Senior Financial Officers can be found on our website at [www.smith-nephew.com](http://www.smith-nephew.com).

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

### **Evaluation of Effectiveness of the Audit Committee**

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

Yours sincerely,

**Ian Barlow**

Chairman of the Audit Committee

80 **Smith & Nephew** Annual report 2014

**Table of Contents**

CORPORATE GOVERNANCE

**Remuneration report**

**Remuneration**

**Dear Shareholder,**

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

We drove a much improved performance in US Hip and Knee Implants, and maintained our momentum in Sports Medicine Joint Repair and Trauma & Extremities.

We strengthened our higher growth platforms, acquiring ArthroCare to give us a broader sports medicine portfolio.

We created new growth platforms, the mid-tier portfolio for Emerging markets, and Syncera, as well as delivering double-digit growth from our recent acquisition Advanced Wound Bioactives.

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

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

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

Our remuneration arrangements have essentially remained unchanged from last year and we will therefore not be asking shareholders to vote on a new remuneration policy. We have however chosen to replicate the policy you

approved last year following the annual report on remuneration for ease of reference.

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

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

Yours sincerely,

**Joseph Papa**

Chairman of the Remuneration Committee

**Table of Contents**

CORPORATE GOVERNANCE

Remuneration report *continued*

<b>Measure in our Variable Pay Plans</b>	<b>Link to Strategic Priorities</b>
--	-------------------------------------

**Financial measures in Annual Incentive Plans**

Revenue, Trading profit, Cash	We need to generate cash in our Established Markets to be able to invest in Emerging & International Markets, innovation, organic growth and acquisitions in order to continue to grow in the future. Cash flow is therefore important and this in turn is derived from increased revenues and healthy trading profits.
----------------------------------	---

**Business objectives in Annual Incentive Plans**

Business process	We need to release resources from the businesses through improved structures, efficiencies and business processes in order to re-invest in our higher growth areas, including Emerging & International Markets, innovation, organic growth and acquisitions.
------------------	--

People	We need to attract and retain the right people to achieve our strategy through improving our operating model.
--------	---

Customer Our mission is to deliver advanced medical technologies that help healthcare professionals, our customers, improve the quality of life of their patients.

### Performance measures in our Performance Share Plan

Free Cash flow Cash flow from our Established Markets is necessary in order to fund growth in Emerging & International Markets, innovation, organic growth and acquisitions.

Revenue in Emerging & International markets Our long-term strategy depends on our ability to grow in Emerging & International Markets.

TSR If we execute our strategy successfully, this will lead to an increased return for our shareholders.

### Compliance statement

We have prepared this Directors' remuneration report (the **Report**) in accordance with The Enterprise and Regulatory Reform Act 2012-2013 (clauses 81-84) and The Large and Medium-Sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013 (the **Regulations**). The Report also meets the relevant requirements of the Financial Conduct Authority ( **FCA** ) Listing Rules.

The first part of the Report (pages 83 to 93) is the annual report on remuneration (the **Implementation Report**). The Implementation Report will be put to shareholders for approval as an advisory vote at the Annual General Meeting on 9 April 2015. The Implementation Report explains how the remuneration policy was implemented during 2014 and also how it is currently being implemented in 2015. Pages 85, and 88 to 90 have been audited by Ernst & Young LLP.

The second part of the Report (pages 94 to 102) is the Directors Remuneration Policy Report (the Policy Report ) which was approved by shareholders at the Annual General Meeting held in 2014. The Policy Report describes our remuneration policy as it relates to the Directors of the Company. All payments we make to any Director of the Company will be in accordance with this remuneration policy. We intend that this remuneration policy will remain in place unchanged for at least the next two years and will next be put to shareholder vote at the Annual General Meeting to be held in 2017. We will bring the policy report back to shareholders earlier in the event that we make any material change to the remuneration policy or shareholders do not approve the annual report on remuneration. The level of base salary and benefits paid and performance measures shown in the Policy Report are as at 2014, when the Policy Report was approved by shareholders. Full details of any changes to these details since then, in accordance with the Policy Report are given in the Implementation Report.

**Table of Contents**

The Implementation Report

**Remuneration Committee**

The Remuneration Committee presents the annual report on remuneration, (the Implementation Report ), which together with the annual statement from the Chairman of the Remuneration Committee will be put to shareholders as an advisory vote at the Annual General Meeting to be held on 9 April 2015.

**Current Members in 2014**

**Joseph Papa** Committee Chairman

**Virginia Bottomley** Independent Non-executive Director

**Brian Larcombe** Senior Independent Non-executive Director

**Roberto Quarta (from 10 April 2014)** Chairman of the Board

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

**Role of the Remuneration Committee**

Our work falls into the following three areas:

**Determination of Remuneration Policy and Packages**

Determination of remuneration policy for Executive Directors and senior executives

Approval of individual remuneration packages for Executive Directors and Executive Officers at least annually and any major changes to individual packages throughout the year

Consideration of remuneration policies and practices across the Group

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

### Key activities

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

Approval of all share plans operating throughout the Group.

### 2015 focus

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

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

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

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

Determination of pay-outs under short-term and long-term incentive plans for Executive Directors and senior executives.

### **Oversight of all Company Share Plans**


Determination of the use of long-term incentive plans and oversees the use of shares in all executive and all-employee plans.

### **Reporting and Engagement with shareholders on**

### **Remuneration Matters**

Approval of Directors remuneration report ensuring compliance with related governance provisions





Continuance of constructive engagement on remuneration issues with shareholders.

The terms of reference of the Remuneration Committee describe our role and responsibilities more fully and can be found on our website at [www.smith-nephew.com](http://www.smith-nephew.com)

**Smith & Nephew** Annual report 2014 83

**Table of Contents**

## CORPORATE GOVERNANCE

**Remuneration report *continued*****Activities of the Remuneration Committee in 2014 and since the year end**

In 2014, we held four physical meetings and determined four matters by written resolution. Each meeting was attended by all members of the Committee. The Chief Executive Officer, the Chief Human Resources Officer and the Senior Vice President, Global Reward, key members of the finance function and the Company Secretary also attended all or part of some of the meetings, except when their own remuneration was being discussed. We also met with the independent Remuneration Consultants, Towers Watson without management present. Our programme of work in 2014 was as follows:

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

Remuneration report)

<p><b>Late July</b> (Mid-year Review of Remuneration Arrangements)</p>	<p>Reviewed the shareholder response and support for the Remuneration Policy and Report at the Annual General Meeting</p> <p>Reviewed adherence to shareholding guidelines by Executive Directors, Executive Officers and Senior Executives</p> <p>Monitored dilution limits and the number of shares available for use in respect of executive and all-employee share plans</p> <p>Approved the schedule of share awards made since the previous meeting</p> <p>Approved minor changes to the rules of various share plans in line with local legislative changes</p> <p>Reviewed the performance of long-term awards granted in 2012, 2013 and 2014.</p>
<p><b>December</b> (Review of Remuneration Strategy)</p>	<p>Received a report from the Chairman of the Remuneration Committee on recent engagement with shareholders</p> <p>Approved the Remuneration Strategy for 2015</p> <p>Considered the first draft of the Remuneration report for 2014</p> <p>Reviewed and considered the principles for determining payouts under the short-term and long-term plans due to vest in 2015</p> <p>Approved the schedule of share awards made since the previous meeting.</p>

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

Since the year end, we have also reviewed the financial results for 2014 against the targets under the short-term and long-term incentive arrangements jointly with the Audit Committee, and have agreed the targets for the short-term and long-term incentive plans for 2015. We have also approved increases to the salaries of Executive Directors and Executive Officers and determined cash payments under the Annual Incentive Plan, awards under the Equity Incentive Programme and the Performance Share Programme, and the vesting of awards under the Performance Share Programme granted in 2012. Finally, we approved the wording of this Directors remuneration report.

During the year, the Remuneration Committee received information and advice from Towers Watson, an independent executive remuneration consultancy firm appointed by the Remuneration Committee in 2011 following a full tender process. They provided advice on market trends and remuneration issues in general, attended Remuneration Committee meetings, assisted in the review of the Directors remuneration report and in determining the third performance measure for the Performance Share Programme. The fees paid to Towers Watson for Remuneration Committee advice during 2014, charged on a time and expense basis was £39,745 in total. Towers Watson also provided other human resources and compensation advice to the Company for the level below the Board. Towers Watson comply with the Code of Conduct in relation to Executive Remuneration

Consulting in the United Kingdom and the Remuneration Committee is satisfied that their advice is objective and independent.

84 **Smith & Nephew** Annual report 2014

**Table of Contents**

## Single total figure on remuneration Executive Directors

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

These figures have been calculated as follows:

**Base salary:** the actual salary receivable for the year.

**Payment in lieu of pension:** the value of the salary supplement paid by the Company in lieu of a pension.

**Benefits:** the gross value of all taxable benefits (or benefits that would be taxable in the UK) received in the year. Prior years are restated to reflect amounts not known at the date of signing the previous annual report.

**Annual Incentive Plan cash:** the value of the cash incentive payable for performance in respect of the relevant financial year.

**Annual Incentive Plan equity:** the value of the equity element awarded in respect of performance in the relevant financial year, but subject to an ongoing performance test as described on pages 87 and 88 of this report.

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

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

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

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

**Total:** the sum of the above elements.

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

### Base salary

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

	2013	2014
Olivier Bohuon	1,081,500	<b>1,111,782</b>
Julie Brown	£500,000	<b>£514,000</b>

In February 2015, we reviewed the base salaries of the Executive Directors, having considered general economic conditions and average salary increases across the rest of the Group, which have averaged at 3%. The Remuneration Committee has therefore agreed that the Executive Directors' base salaries will increase by 3% with effect from 1 April 2015 to the following:

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

### Payment in lieu of pension

In 2014, both Olivier Bohuon and Julie Brown received a salary supplement of 30% of their basic salary to apply towards their retirement savings, in lieu of membership of one of the Company's pension schemes. The same arrangement will apply in 2015.

### Benefits

In 2014, both Olivier Bohuon and Julie Brown received death in service cover of seven times basic salary, of which four times salary is payable as a lump sum with the balance used to provide for any spouse and dependent persons. They also received health cover for themselves and their families, a car allowance and financial consultancy advice. Oliver Bohuon also received assistance with travel costs between London and Paris. The same arrangements will apply in 2015. The following table summarises the value of benefits on an element-by-element basis in respect of 2013 and 2014.

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

<sup>(i)</sup> Previous years are restated to reflect amounts not known at the date of signing of the previous Annual Report.

<sup>(ii)</sup> The level of financial consultancy advice fees for Olivier Bohuon in 2014 reflects that he is a French national working in a global role of a company headquartered in the UK.

**Table of Contents**

## CORPORATE GOVERNANCE

Remuneration report *continued*

## Annual Incentive Plan

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

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

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

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

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

Below



Edgar Filing: SMITH & NEPHEW PLC - Form 20-F

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

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

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

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

#### Business Objectives

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

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

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

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

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

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

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

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

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

**Table of Contents**

Commentary on 2014 performance

Reinvestment and Group Optimisation

**Olivier Bohuon**

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

**Julie Brown**

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

Business objectives

**Olivier Bohuon**

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

**Julie Brown**

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

People

**Olivier Bohuon**

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

**Julie Brown**

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

Customer

**Olivier Bohuon**

**Julie Brown**

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

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

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

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

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

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

### Annual Incentive Plan 2015

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

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

The Board has determined that the disclosure of performance targets at this time is commercially sensitive. As explained on page 96, these targets are determined within the context of a five-year plan and the disclosure of these targets could give information to our competitors about details of our strategy which would enable them to compete more effectively with us to the detriment of our performance. At present, the Board would not be in a position to declare these targets at a later date, but will keep this under review.

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

Details of awards made under the Equity incentive Programme

Details of conditional awards over shares, granted as part of the Annual Equity Incentive Programme to Executive Directors under the rules of the Global Share Plan 2010 in 2014 are shown below. The performance conditions and performance periods applying to these awards are detailed above.

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

**Table of Contents**

## CORPORATE GOVERNANCE

**Remuneration report *continued***

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

**Performance Share Programme grants**

Performance share awards in 2014 were made to Executive Directors under the Global Share Plan 2010 to a maximum value of 190% of salary (95% for target performance). Performance will be measured over the three financial years beginning in 2014 and will vest subject to performance and continued employment in 2017. 50% of the award will vest subject to free cash flow performance, 25% to revenue in Emerging & International Markets and 25% to TSR.

Free cash flow is defined as net cash inflow from operating activities, less capital expenditure. Free cash flow is the most appropriate measure of cash flow performance because it relates to cash generated to finance additional investments in business opportunities, debt repayments and distribution to shareholders. This measure includes significant elements of operational financial performance and helps to align Executive Director awards with shareholder value creation.

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

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

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

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

**Revenue in Emerging &**

International Markets	Award vesting as % of salary
Below Threshold	Nil
Threshold	11.875%
Target	23.75%

Maximum or above	47.5%
------------------	-------

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

25% of the award will vest based on the Company's Total shareholder Return (TSR) performance relative to a bespoke peer group of companies in the medical devices sector over a three-year period commencing 1 January 2014 as follows:

Relative TSR ranking	Award vesting as % of salary
Below median	Nil
Median	11.875%
Upper quartile	47.5%

Awards will vest on a straight-line basis between these points. If the Company's TSR performance is below median, none of this part of the award will vest.

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

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

### Performance Share Programme 2015

Performance share awards will be made in 2015 to Executive Directors under the Global Share Plan 2010 to a maximum value of 190% of salary (95% for target performance). Performance will be measured over the three financial years commencing 1 January 2015 and will vest subject to performance and continued employment in 2018. Vesting will be subject to the same three performance measures as applies to the awards made in 2014 using the same definitions and same comparator group. 50% of the award will vest subject to free cash flow performance, 25% to revenue in Emerging & International Markets and 25% to TSR.

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

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

The free cash flow performance measure target for 2015 is lower than the same target in 2014, primarily due to exchange rate movement, as well as the continued impact of the RENASYS hold in the US and restructuring charges

associated with the Group Optimisation Plan, both of which were not factored in when setting the prior year target.

### Vesting of Awards made in 2012

Since the end of the year, the Remuneration Committee has reviewed the vesting of conditional awards made to Executive Directors under the Global Share Plan 2010 in 2012. Vesting of the conditional awards made in 2012 was subject to performance conditions based on TSR and cumulative free cash flow measured over a three-year period commencing 1 January 2012.

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

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

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

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



**Table of Contents**

## Summary of scheme interests awarded during the financial year

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

Please see Policy Table on pages 96 to 97 for details of how the above plans operate. The number of shares is calculated using the closing share price on the day before the grant, which for the awards granted on 7 March 2014 was 943.5 pence.

## Details of awards made under the Performance Share Programme

Details of conditional awards over shares granted to Executive Directors subject to performance conditions are shown below. These awards were granted under the Global Share Plan 2010. The performance conditions and performance periods applying to these awards are detailed on pages 96 to 97.

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

(i) On 3 February 2015, 43% of the award granted to Olivier Bohuon lapsed following completion of the performance period.

## Details of option grants under the All-Employee ShareSave Plan

Edgar Filing: SMITH & NEPHEW PLC - Form 20-F

Details of options held by Executive Directors under the Smith & Nephew ShareSave Plan (2012) are shown below.

Director	Date granted	Number of shares		Date of vesting	Exercise period	Option price
		under option				
Julie Brown	17 September 2013	2,400 ordinary shares		1 November 2018	1 November 2018 to 30 April 2019	£6.25

Details of one-off awards

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

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

Single total figure on remuneration Chairman and Non-executive Directors

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

Edgar Filing: SMITH & NEPHEW PLC - Form 20-F

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

- (i) The basic annual fee includes shares purchased for the Chairman and Non-executive Directors in lieu of part of the annual fee, details of which can be found on the table on page 101.
- (ii) Appointed to the Board on 4 December 2013 and as Chairman of the Company on 10 April 2014. (iii) Appointed to the Board on 1 December 2014. (iv) Retired from the Board on 10 April 2014.
- (v) Retired from the Board on 31 July 2014 (vi) Retired from the Board on 24 March 2014 (vii) Retired from the Board on 10 April 2014 (vi) Erik Engstrom is not included in the table because he joined the Board on 1 January 2015.

**Table of Contents**

## CORPORATE GOVERNANCE

Remuneration report *continued*

## Chief Executive Officer's remuneration compared to employees generally

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

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

(i) The average cost of wages and salaries for employees generally increased by 1.57% in 2014 (see Notes 2.4 and 3.1 of the Notes to the Group accounts.) Figures for annual cash bonuses are included in the numbers.

## Payments made to past Directors

No payments were made to former directors in the year.

## Payments for loss of office

No payments were made in respect of a Director's loss of office in 2014.

## Outside Directorships

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

## Directors' interests in ordinary shares

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

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

Share options					
Performance share awards <sup>(ii)</sup>	735,779	<b>688,536</b>	573,595	132,886	<b>233,554</b>
Equity Incentive awards	143,387	<b>147,114</b>	147,114	0	<b>26,497</b>
Other awards	66,666	<b>0</b>	0	75,000	<b>50,000</b>

(i) The latest practicable date for this Annual Report.

(ii) These share awards are subject to further performance conditions before they may vest, as detailed on pages 96 to 97.

(iii) The ordinary shares held by Olivier Bohuon on 23 February 2015 represent 304.9% of his base annual salary.

(iv) The ordinary shares held by Julie Brown on 23 February 2015 represent 87.8% of her base annual salary.

(v) This option was granted under the Smith & Nephew ShareSave Plan (2012).

The beneficial interest of each Executive Director is less than 1% of the ordinary share capital of the Company. In addition, Olivier Bohuon holds 50,000 deferred shares. Following the redenomination of ordinary shares into US dollars on 23 January 2006, the Company issued 50,000 deferred shares. These shares are normally held by the Chief Executive Officer and are not listed on any Stock exchange and have extremely limited rights attached to them.

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

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

- (i) The latest practicable date for this Annual Report.
- (ii) Calculated using the closing share price of 1,181p per ordinary share and \$36.49 per ADS on 23 February 2015, and an exchange rate of £1/\$1.5449.
- (iii) Michael Friedman and Joseph Papa hold some of their shares in the form of ADS.  
The beneficial interest of each Non-executive Director is less than 1% of the ordinary share capital of the Company.

**Table of Contents****Relative importance of spend on pay**

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

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

(i) Share buy-back programme ceased during 2014 following the acquisition of ArthroCare. Shares are bought in the market in respect of shares issued as part of the executive and employee share plans.

See note 19.2 on page 154 for further information.

**Total Shareholder Return**

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

**Six Year Total Shareholder Return**

(measured in UK sterling, based on monthly spot values)

However, as we compare the Company's performance to a tailored sector peer group of medical devices companies (see page 88, when considering TSR performance in the context of the Global Share Plan 2010, we feel that the following graph showing the TSR performance of this peer group is also of interest.

**Six Year Total Shareholder Return**

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

<b>Smith &amp; Nephew</b> Annual report 2014	91
--	----



**Table of Contents**

## CORPORATE GOVERNANCE

**Remuneration report *continued***

## Table of historic data

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

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

(i) Appointed Chief Executive Officer on 1 April 2011

(ii) Resigned as Chief Executive Officer on 1 April 2011

(iii) Includes recruitment award of 1,400,000 cash and a share award over 200,000 ordinary shares with a value of 1,410,000 on grant

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

**Implementation of remuneration policy in 2015**

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

**Statement of voting at Annual General Meeting held in 2014**

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

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

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

**Table of Contents****Other remuneration matters****Senior Management remuneration**

The Group's administrative, supervisory and management body (the Senior Management) is comprised for US reporting purposes, of Executive Directors and Executive officers. Details of the current Executive Directors and Executive Officers are given on pages 54 to 59.

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

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

As at 23 February 2015, the Senior Management owned 376,202 shares and 100,855 ADSs, constituting less than 0.1% of the share capital of the Company.

Details of share awards granted during the year and held as at 23 February 2015 by members of Senior Management are as follows:

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

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

insufficient new shares are available, there are processes in place to purchase shares in the market to satisfy vesting awards and to net-settle option exercises.

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

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

By order of the Board, on 25 February 2015

**Joseph Papa**

Chairman of the Remuneration Committee

**Table of Contents**

CORPORATE GOVERNANCE

Remuneration report *continued*

**The Policy Report**

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

**Future policy table**

Executive Directors

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

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

How the component supports the short- and long-term strategy of the Company

How the component operates

**Base salary and benefits**

**Base salary**

We are a FTSE 50 listed company, operating in over 100 countries around the world. Our strategy to generate cash from Established Markets in order to invest for growth in Emerging Markets means that we are competing for international talent and our base salaries therefore need to reflect what our Executive Directors would receive if they were to work in another international company of a similar size, complexity and geographical scope.

Salaries are normally reviewed annually, with any increase applying from 1 April.

Salary levels and increases take account of:

market movements within a peer group of similarly sized UK listed companies;

scope and responsibility of the position;

skill/experience and performance of the individual Director;

general economic conditions in the relevant geographic market; and

average increases awarded across the Company, with particular regard to increases in the market in which the Executive is based.

### **Payment in lieu of pension**

In order to attract and retain Executive Directors with the capability of driving our corporate strategy, we need to provide market-competitive retirement benefits similar to the benefits they would receive if they were to work for one of our competitors.

At the same time, we seek to avoid exposing the Company to defined benefit pension risks, and where possible will make payments in lieu of providing a pension.

Current Executive Directors receive an allowance in lieu of membership of a Company-run pension scheme.

Base salary is the only component of remuneration that is pensionable.

### **Benefits**

In order to attract and retain Executive Directors with the capability of driving our corporate strategy, we need to provide a range of market-competitive benefits similar to the benefits they would receive if they were to work for one of our competitors.

A wide range of benefits may be provided depending on the benefits provided for comparable roles in the location in which the Executive Director is based. These benefits will include, as a minimum, healthcare cover, life assurance, long-term disability, annual medical examinations, company car or car allowance. The Committee retains the discretion to provide additional benefits where necessary or relevant in the context of the Executive's location.

It is important that our Executive Directors are free to focus on the Company's business without being diverted by concerns about medical provision, risk benefit cover or, if required, relocation issues.

Where applicable, relocation costs may be provided in line with Company's relocation policy for employees, which may include removal costs, assistance with accommodation, living expenses for self and family and financial consultancy advice. In some cases such payments may be grossed up.

### All-employee arrangements

#### All-employee share plans

To enable Executive Directors to participate in all-employee share plans on the same basis as other employees.

ShareSave Plans are operated in the UK and 27 other countries internationally. In the US, an Employee Stock Purchase Plan is operated. These plans enable employees to save on a regular basis and then buy shares in the Company. Executive Directors are able to participate in such plans on a similar basis to other employees, depending on where they are located.

**Table of Contents**

Maximum levels of payment

Framework in which performance is assessed

The base salary of the Executive Directors with effect from 1 April 2014 will be as follows:

Performance in the prior year is one of the factors taken into account and poor performance is likely to lead to a zero salary increase.

Olivier Bohuon 1,111,782

Julie Brown £514,000

The factors noted in the previous column will be taken into consideration when making increases to base salary and when appointing a new Director.

In normal circumstances, base salary increases for Executive Directors will relate to the geographic market and peer group. In addition, the average increases for employees across the Group will be taken into account. The Remuneration Committee retains the right to approve higher increases when there is a substantial change in the scope of the Executive Director's role. A full explanation will be provided in the Implementation Report should higher increases be approved in exceptional cases.



Up to 30% of base salary.

The level of payment in lieu of a pension paid to Executive Directors is not dependent on performance.

The policy is framed by the nature of the benefits that the Remuneration Committee is willing to provide to Executive Directors. The maximum amount payable will depend on the cost of providing such benefits to an employee in the location at which the Executive Director is based. Shareholders should note that the cost of providing comparable benefits in different jurisdictions may vary widely.

The level and cost of benefits provided to Executive Directors is not dependent on performance but on the package of benefits provided to comparable roles within the relevant location.

As an indication, the cost of such benefits provided in 2013 was as follows:

Olivier Bohuon 80,705

Julie Brown £14,400

The maximum amount payable in benefits to an Executive Director, in normal circumstances, will not be significantly more than amounts paid in 2013 (or equivalent in local currency). The Remuneration Committee retains the right to pay more than this should the cost of providing the same underlying benefits increase or in the event of a relocation. A full explanation will be provided in the Implementation Report should the cost of benefits provided be significantly higher.

Executive Directors may currently invest up to £250 per month in the UK ShareSave Plan. The Remuneration Committee may exercise its discretion to increase this amount up to the maximum permitted by the HM Revenue & Customs. Similar limits will apply in different locations.

The potential gains from all-employee plans are not based on performance but are linked to growth in the share price.

**Table of Contents**

CORPORATE GOVERNANCE

Directors remuneration report *continued*

Future policy table

Executive Directors *continued*

How the component supports the short-

and long-term strategy of the Company

How the component operates

Annual incentives

**Annual Incentive Plan Cash Incentive**

To motivate and reward the achievement of specific annual financial and business objectives related to the Company's strategy and sustained through a clawback mechanism explained more fully in the notes.

The Annual Incentive Plan comprises a cash and an equity component, both based on the achievement of financial and business objectives set at the start of the year.

The objectives which determine the payment of the annual cash incentive and the level of the annual equity award are linked closely to the Group strategy.

The cash component is paid in full after the end of the performance year.

The financial measures of revenue, trading profit and cash flow underlie our strategy for growth and the need to generate cash to fund future growth.

At the end of the year, the Remuneration Committee determines the extent to which performance against these has been achieved and sets the award level.

The business objectives are also linked to the Group strategy. These change from year to year to reflect the evolving strategy, but will typically be linked to the Strategic Priorities set out in this Annual Report. The Implementation Report each year will explain how each objective is linked to a specific strategic priority.

For example, a Reinvestment objective links to the priority of improving the efficiency of the business model and investment in higher growth segments and geographies and Processes and People objectives link to developing the right organisation.

### **Annual Incentive Plan    Equity Incentive**

To drive share ownership and encourage sustained high standards through the application of a malus provision over three years, explained more fully in the notes.

The equity award component comprises conditional share awards (made at the time of the cash award), with vesting phased over the following three years.

The equity component vests  $\frac{1}{3}$ ,  $\frac{1}{3}$ ,  $\frac{1}{3}$  on successive award anniversaries, only if performance remains satisfactory over each of these three years; otherwise the award will lapse.

Participants will receive an additional number of shares equivalent to the amount of dividend payable per vested share during the relevant performance period.

### **Long-term incentives (awards actively being made)**

### **Performance Share Programme**

To motivate and reward longer term performance linked to the long-term strategy and share price of the Company. The Performance Share Programme comprises conditional share awards which vest after three years, subject to the achievement of stretching performance targets linked to the Company's strategy.

The performance measures which determine the level of vesting of the Performance Share Awards are linked to our corporate strategy. Awards may be subject to clawback in the event of material financial misstatement or misconduct.

Our strategy requires the generation of cash in order to invest for growth. Cash flow is therefore a key performance measure in our performance share plan. Participants will receive an additional number of shares equivalent to the amount of dividend payable per vested share during the relevant performance period.

Growth in our Emerging & International Markets is a key part of our strategy. Revenue in our Emerging & International Markets is therefore included as one of our performance share plan measures.

If our strategy succeeds, the total return to our shareholders will also increase and therefore we include a relative TSR measure in our long-term share plan.

### **One-off share awards**

In order to implement our Group strategy, we recognise that it is not always possible to promote from within the Company. In the event that we recruit an Executive Director who is currently employed by another company, we recognise that we might be required to compensate that Executive Director for cash or share awards, they may forfeit on leaving their former employer. Our policy regarding such awards is detailed in the notes. One-off share awards may be made under the provisions of Listing Rule 9.4.2 to facilitate the appointment of a new Executive Director. Such awards will be made on a case-by-case basis depending on the circumstances at the time to take account of amounts forfeited elsewhere on accepting appointment.

**Table of Contents**

Maximum levels of payment

Framework in which performance is assessed

The total maximum payable under the Annual Incentive Plan is 215% of base salary (150% Cash Incentive and 65% Equity Incentive).

The cash and share awards are subject to malus and clawback as detailed in the notes following this table.

50% salary awarded for threshold performance.

70% of the cash component is based on financial performance measures, which currently include revenue, trading profit and trading cash. The Remuneration Committee retains the discretion to adopt any financial performance measure that is relevant to the Company.

100% salary awarded for target performance.

150% salary awarded for maximum performance.

30% of the cash component is based on other business goals linked to the Company's strategy, which could include financial and non-financial measures.

Performance assessed against individual objectives and Group financial targets.

The Remuneration Committee has the discretion to apply a multiplier, adjusting the outcome up or down by 10% to reward or penalise conduct in respect of leadership, corporate reputation, ethics, organisational behaviours and representing the Company both internally and externally.

The maximum opportunity shown to the left cannot be exceeded through the application of the multiplier.

0% of salary awarded for performance below target.

The Remuneration Committee will use their judgement of the individual's performance in determining the level of equity award that may be awarded within the range of 50% to 65% of salary.

50% of salary awarded for target performance.

The equity component will vest in three equal tranches over a three-year period, provided that the annual performance conditions set at the beginning of each year continue to be met.

65% of salary awarded for maximum performance.

Performance assessed against individual performance which includes an element of Group financial targets.

Currently:

Annual awards:

50% of the award vests on achievement of a three-year cumulative free cash-flow target

47.5% of salary for threshold performance.

25% of the award vests subject to three-year Total Shareholder Return (TSR) at median performance relative to industry peers

95% of salary for target performance.

25% of the award vests subject to the achievement of revenue targets in Emerging & International Markets

190% of salary for maximum performance.

These measures are described in more detail in the notes and the targets and performance against them will be disclosed in the Implementation Report if appropriate

The Performance Share Award will vest on the third anniversary of the date of grant, depending on the extent to which the performance conditions are met over the three-year period commencing in the year the award was made

The Remuneration Committee retains the discretion to change the measures and their respective weightings to ensure continuing alignment with the Company's strategy

The cash and share awards are subject to malus and clawback as detailed in the notes following this table.

Awards made prior to 2014 were subject to TSR and cash flow targets.

Each award will be determined on a case-by-case basis. In normal circumstances such awards will be no more beneficial than the value of amounts forfeited by the Executive Director on leaving a previous company to join the Board.

The Remuneration Committee has the discretion to apply performance conditions to one-off awards if appropriate. However, if it is impossible to replicate the vesting conditions applicable to awards granted by other companies, awards may be made without performance conditions.



**Table of Contents**

CORPORATE GOVERNANCE

Remuneration report *continued*

Notes to Future policy table Executive Directors

Changes to remuneration policy

The remuneration policy described in the future policy table Executive Directors is the same remuneration policy in respect of Executive Directors that has been in force since the beginning of 2012. It is anticipated that this policy will apply at least until the Annual General Meeting in 2017. The only change made has been to introduce a third performance measure to our Performance Share Programme.

Performance measures Annual Incentive Plan

The performance measures which apply to the Annual Incentive Plan for Executive Directors comprise 70% financial measures and 30% business goals linked to the Company's strategy, which could include financial and non-financial measures.

The financial measures may differ from year to year to provide continued alignment with the Company strategy. Measures to be used in 2014 are detailed in the Implementation Report. Each year the measures are chosen in order to relate to our Strategic Priorities and in turn to our key performance indicators, which are set out in this Annual report. The performance targets are set by taking into account the strategy of the Company and are designed to be realistic yet stretching.

The business measures will differ from year to year as the evolving corporate strategy means that we will wish to set Executive Directors different business objectives in order to meet the current corporate needs. The business objectives are personal to each Executive Director, and are tailored to reflect their role and responsibilities during the year. These are set at the start of the year and reflect the most important areas of strategic focus for the Company. The Remuneration Committee sets annual measurement criteria (performance targets) that are appropriate to motivate and measure an Executive Director's performance in any one year. The factors taken into consideration include the three-year strategic plan, prior years' delivered performance and budgeted performance. In the past, measures have included R&D investment, succession planning, employee engagement, compliance, development of product portfolio, M&A activity and shared services implementation.

Performance measures

Performance Share Programme

The performance measures which apply to the Performance Share Programme awards made in 2014 relate to cumulative free cash flow, revenue in Emerging & International Markets and Total Shareholder Return. We have chosen three measures which are relevant for the long-term success of the Company.

The free cash flow measure is important for us in a period of growth, when we need to generate cash to fund both organic and inorganic investment.

Revenue in Emerging & International Markets is important for us when we are seeking to generate profitable revenue in new markets and from new products.

The Total Shareholder Return measure, which compares our long-term performance against that of our peers, seeks to align the payout of the Performance Share Programme with the experience of our shareholders. This helps Executive Directors relate to the shareholder experience and ensure that vesting is aligned to the out-performance of our sector.

The Remuneration Committee will keep these performance measures under review and retains the discretion to alter the measures or their respective weightings to ensure continuing alignment to the corporate strategy.

#### Malus and clawback

The Remuneration Committee may determine that an unvested award or part of an award may not vest (regardless of whether or not the performance conditions have been met) or may determine that any cash bonus, vested shares, or their equivalent value in cash be returned to the Company in the event that any of the following matters is discovered:

A material misstatement of the Company's financial results; or

A material error in determining the extent to which any performance condition has been satisfied; or

A significant adverse change in the financial performance of the Company, or a significant loss at a general level or at the division or function in which a participant worked; or

Inappropriate conduct (for example reputational issues), capability or performance by a participant, or within a team business area or profit centre.

These provisions apply to share awards under the Global Share Plan 2010 and cash amounts under the Annual Cash Incentive Plan.

## Table of Contents

### Illustrations of the application of the remuneration policy

The following charts show the potential split between the different elements of the Executive Directors' remuneration under three different performance scenarios:

*Figures as at salary levels in 2014, when the Policy report was approved by shareholders*

#### Chief Executive Officer

#### Chief Financial Officer

Total Remuneration by Performance Scenario for 2014 Financial Year

#### Chief Executive Officer Chief Financial Officer

Data for the Chief Executive Officer assumes an exchange rate of 1 = £0.8494.

### Policy on recruitment arrangements

Our policy on the recruitment of Executive Directors is to pay a fair remuneration package for the role being undertaken and the experience of the Executive Director appointed. In terms of base salary, we will seek to pay a salary comparable, in the opinion of the Committee, to that which would be paid for an equivalent position elsewhere. The Remuneration Committee will determine a base salary in line with the policy and having regard to the parameters set out on in the future policy table. Incoming Executive Directors will be entitled to pension, benefit and incentive arrangements which are the same as provided to existing Executive Directors. On that basis, awards would not exceed 405% of base salary.

We recognise that in the event that we require a new Executive Director to relocate to take up a position with the Company, we will also pay relocation and related costs as described in the future policy table, which is in line with the relocation arrangements we operate across the Group.

We also recognise that in many cases, an external appointee may forfeit sizeable cash bonuses and share awards if they choose to leave their former employer and join us. The Remuneration Committee therefore believes that we need the ability to compensate new hires for incentive awards they give up on joining us. The Committee will use its discretion in setting any such compensation, which will be decided on a case-by-case basis. We will only provide

compensation which is no more beneficial than that given up by the new appointee and we will seek evidence from the previous employer to confirm the full details of bonus or share awards being forfeited. As far as possible, we will seek to replicate forfeited share awards using Smith & Nephew incentive plans or through reliance on 9.4.2 in the Listing Rules, whilst at the same time aiming for simplicity.

If we appoint an existing employee as an Executive Director of the Company, pre-existing obligations with respect to remuneration, such as pension, benefits and legacy share awards, will be honoured. Should these differ materially from current arrangements, these will be disclosed in the next Implementation Report.

We will supply details via an announcement to the London Stock Exchange of an incoming Executive Director's remuneration arrangements at the time of their appointment.

### Service contracts

We employ Executive Directors on rolling service contracts with notice periods of up to 12 months from the Company and six months from the Executive Director. On termination of the contract, we may require the Executive Director not to work their notice period and pay them an amount equivalent to the base salary and payment in lieu of pension and benefits they would have received if they had been required to work their notice period.

Under the terms of the Executive Director's service contract, Executive Directors are restricted for a period of 12 months after leaving the employment of the Company from working for a competitor, soliciting orders from customers and offering employment to employees of Smith & Nephew. The Company retains the right to waive these provisions in certain circumstances. In the event that these provisions are waived and the former Executive Director commences employment earlier than at the end of the notice period, no further payments shall be made in respect of the portion of notice period not worked. Directors' service contracts are available for inspection at the Company's registered office: 15 Adam Street, London WC2N 6LA.

**Table of Contents**

CORPORATE GOVERNANCE

Remuneration report *continued*

**Policy on payment for loss of office**

Our policy regarding termination payments to departing Executive Directors is to limit severance payments to pre-established contractual arrangements. In the event that the employment of an Executive Director is terminated, any compensation payable will be determined in accordance with the terms of the service contract between the Company and the Executive Director, as well as the rules of any incentive plans.

Under normal circumstances (excluding termination for gross misconduct) all leavers are entitled to receive termination payments in lieu of notice equal to base salary, payment in lieu of pension, and benefits. In some circumstances additional benefits may become payable to cover reimbursement of untaken holiday leave, repatriation and outplacement fees, legal and financial advice.

In addition, we may also in exceptional circumstances exercise our discretion to pay the Executive Director a proportion of the annual cash incentive they would have received had they been required to work their notice period. Any entitlement or discretionary payment may be reduced in line with the Executive Director's duty to mitigate losses, subject to applying our non-compete clause.

We will supply details via an announcement to the London Stock Exchange of a departing Executive Director's termination arrangements at the time of departure.

In the case of a change of control which results in the termination of an Executive Director or a material alteration to their responsibilities or duties, within 12 months of the event, the Executive Director would be entitled to receive 12 months' base salary plus payment in lieu of pension and benefits. In addition, the Remuneration Committee has discretion to pay an Executive Director in these circumstances an annual cash incentive. For Directors appointed prior to 1 November 2012, an automatic annual cash incentive is payable at target.

In the event that an Executive Director leaves for reasons of ill-health, death, redundancy or retirement in agreement with the Company, then the vesting of any outstanding annual cash incentive and equity incentive awards will generally depend on the Remuneration Committee's assessment of performance to date. Performance share awards will be pro-rated for the time worked during the relevant performance period, and will remain subject to performance over the full performance period.

For all other leavers, the annual cash incentive will generally be forfeited and outstanding equity incentive awards and performance share awards will lapse.

One-off awards granted on appointment will normally lapse on leaving except in cases of death, retirement, redundancy, or ill-health. The Remuneration Committee has discretion to permit such awards to vest in other circumstances and will be subject to satisfactorily meeting performance conditions if applicable.

The Remuneration Committee retains discretion to alter these provisions on a case-by-case basis following a review of circumstances and to ensure fairness for both shareholders and Executive Directors.

We will supply details via an announcement to the London Stock Exchange of an out-going Executive Director's remuneration arrangements around the time of leaving.

### Policy on shareholding requirements

The Remuneration Committee believes that one of the best ways our Executive Directors can have a greater alignment with shareholders is for them to hold a significant number of shares in the Company. Executive Directors are therefore expected to build up a holding of Smith & Nephew shares worth two-times their base salary. In order to reinforce this expectation, we require them to retain 50% of all shares vesting under the Company share plans (after tax) until this holding has been met recognising that differing international tax regimes affect the pace at which an Executive Director may fulfil the shareholding requirement. When calculating whether or not this requirement has been met, we will include ordinary shares or ADRs held by the Executive Director and their immediate family and the intrinsic value of any vested but unexercised options.

### Statement of consideration of employment conditions elsewhere in the Company and differences to the Executive Director Policy

All employees across the Group including the Executive Directors are incentivised in a similar manner. Although the salary levels and maximum opportunities under bonus and share plans differ, generally speaking the same targets and performance conditions relating to the Company's strategy apply throughout the organisation.

Executive Director base salaries will generally increase at a rate in line with the average salary increases awarded across the Company. Given the diverse geographic markets within which the Company operates, the Committee will generally be informed by the average salary increase in both the market local to the Executive and the UK, recognising the Company's place of listing, and will also consider market data periodically.

A range of different pension arrangements operate across the Group depending on location and/or length of service. Executive Directors and Executive Officers either participate in the legacy pension arrangements relevant to their local market or receive a cash payment of 30% of salary in lieu of a pension. Senior Executives who do not participate in a local Company pension plan receive a cash payment of 20% of salary in lieu of pension. Differing amounts apply for lower levels within the Company.

The Company has established a benefits framework under which the nature of benefits varies by geography. Executive Directors participate in benefit arrangements similar to those applied for employees within the applicable location.

All employees are set objectives at the beginning of each year, which link through to the objectives set for the Executive Directors. Annual cash incentives payable to employees across the Company depend on the satisfactory completion of these objectives as well as performance against relevant Group and divisional financial targets relating to revenue, trading profit and trading cash, similar to the financial targets set for the Executive Directors.

Executive Officers and Senior Executives (72 as at 2014) participate in the annual Equity Incentive Programme and the Performance Share Programme. The maximum amounts payable are lower, but the performance conditions are the same as those that apply to the Executive Directors.

No specific consultation with employees has been undertaken relating to Director remuneration. However, regular employee surveys are conducted across the Group, which cover a wide range of issues relating to local employment conditions and an understanding of Group-wide strategic matters. As at 2014, over 4,500 employees in 32 countries participate in one or more of our global share plans.

100 **Smith & Nephew** Annual report 2014

**Table of Contents****Future policy table****Chairman and Non-executive Directors**

The following table and accompanying notes explain the different elements of remuneration we pay to our Chairman and Non-executive Directors. No element of their remuneration is subject to performance. All payments made to the Chairman are determined by the Remuneration Committee, whilst payments made to the Non-executive Directors are determined by the Directors who are not themselves Non-executive Directors, currently the Chairman, the Chief Executive Officer and the Chief Financial Officer.

How the component supports the short-

and long-term strategy of the Company

How the component operates

Maximum levels of payment

**Annual fees****Basic annual fee**

To attract and retain Directors by setting fees at rates comparable to what would be paid in an equivalent position elsewhere.

Fees will be reviewed periodically. In future, any increase will be paid in shares until 25% of the total fee is paid in shares.

Annual fees are currently as follows:

£63,000 in cash plus £3,150 in shares; or

A proportion of the fees are paid in shares in the third quarter of each year in order to align Non-executive Directors fees with the interest of shareholders.

Fees are set in line with market practice for fees paid by similarly sized UK listed companies.

\$120,000 in cash plus \$6,000 in shares.

Annual fees are set and paid in UK sterling or US dollars depending on the location of the Non-executive Director. If appropriate, fees may be set and paid in alternative currencies.

Chairman fee:

£400,000 plus £20,000 in shares (to April 2014).



£300,000 plus £100,000 in shares  
(from April 2014).

Whilst it is not expected to increase the fees paid to the Non-executive Directors and the Chairman by more than the increases paid to employees generally, in exceptional circumstances, higher fees might become payable.

The total maximum aggregate fees payable to the Non-executive Directors will not exceed £1.5m as set out in the Company's articles of association.

#### **Fee for Senior Independent Director and Committee Chairmen**

To compensate Non-executive Directors for the additional time spent as Committee Chairmen or as the Senior Independent Director.

A fixed fee is paid, which is reviewed periodically. £15,000 in cash; or

\$27,000 in cash.

Whilst it is not expected that the fees paid to the Senior Independent Director or Committee Chairman will exceed the increases paid to employees generally, in exceptional circumstances, higher fees might become payable.

#### **Intercontinental travel fee**

To compensate Non-executive Directors for the time spent travelling to attend meetings in another continent.

A fixed fee is paid, which is reviewed periodically. £3,500 in cash; or

\$7,000 in cash.

Whilst it is not expected to increase these fees by more than the increases paid to employees generally, in exceptional circumstances, higher fees might become payable.

*Figures as at salary levels in 2014, when the Policy report was approved by shareholders*

**Smith & Nephew** Annual report 2014 101

## **Table of Contents**

### CORPORATE GOVERNANCE

#### Remuneration report *continued*

#### Notes to Future policy table Non-executive Directors

##### Changes to remuneration policy

The Board has altered the policy regarding the payment of Non-executive Directors and to the Chairman in one respect in 2013, by introducing the payment of a proportion of the fees in the form of shares. The fees paid to the Non-executive Directors and to the Chairman were reviewed in July 2013 and it was agreed that the basic fee should be increased by 5% (there having been no increase to these fees since August 2011) and that the increase be paid in the form of shares. The amount of the increase less applicable taxes was used to purchase shares in the market on 15 August 2013. Going forward any increase in the level of fees paid to a Non-executive Director will be paid in the form of shares until 25% of the Non-executive Director's fee is paid in the form of shares. We have made this change in order to align the fees paid to Non-executive Directors with the experience of our shareholders. With the appointment of Roberto Quarta as Chairman of the Company with effect from the Annual General Meeting, we have taken the opportunity to pay 25% of his fees in the form of shares immediately.

##### Policy on recruitment arrangements

Any new Non-executive Director shall be paid in accordance with the current fee levels on appointment, in line with the policy set out above. With respect to the appointment of a new Chairman, fee levels will take into account market rates, the individual's profile and experience, the time required to undertake the role and general business conditions. In addition, the Remuneration Committee retains the right to authorise the payment of relocation assistance or an accommodation allowance in the event of the appointment of a Chairman not based within the UK.

##### Letters of appointment

The Chairman and Non-executive Directors have letters of appointment which set out the terms under which they provide their services to the Company and are available for inspection at the Company's registered office: 15 Adam Street, London WC2N 6LA. The appointment of Non-executive Directors is not subject to a notice period, nor is there any compensation payable on loss of office, for example, should they not be re-elected at an Annual General Meeting. The appointment of the Chairman is subject to a notice period of six months.

The Chairman and Non-executive Directors are required to acquire a shareholding in the Company equivalent in value to one times their basic fee within two years of their appointment to the Board.

#### Statement of consideration of shareholder views

This policy report sets out the remuneration policy in relation to Executive Directors, which has been in place since 2012. As this policy evolved at the end of 2011 and during 2012, we engaged actively with shareholders to explain our remuneration arrangements and to discuss their views on our proposals. At the time, Joseph Papa, the Chairman of the Remuneration Committee and members of the Senior Executive Team met with the holders of around 30% of our

shares, including collectively with a number of smaller engaged investors, as well as shareholder advisory bodies. We discussed the structure of our remuneration package, our policies on termination, recruitment, shareholding requirements and the operation of Annual Incentive Plan. The Directors' remuneration report was approved by 96% of shareholders who voted at the Annual General Meeting in 2013 and we received feedback from shareholders around the time of this meeting that they understood and approved of our remuneration arrangements. Although the remuneration policy has remained essentially unchanged as in previous years, given the changes in remuneration reporting, we also conducted an engagement programme with our larger shareholders in 2013. Joseph Papa met with the holders of around 20% of our shares, and with a number of shareholder advisory bodies. He has also been available to discuss any aspect of our remuneration programme with shareholders throughout the year. The shareholders who have engaged with us have all been supportive of our approach to remuneration, recognising the link between the corporate strategy and executive reward.

**Table of Contents**

**Directors responsibilities for the accounts**

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

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

select suitable accounting policies in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* and then apply them consistently;

present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;

provide additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Group's financial position and financial performance; and

state that the Group has complied with IFRS, subject to any material departures disclosed and explained in the accounts.

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

select suitable accounting policies and then apply them consistently;

make judgements and estimates that are reasonable and prudent;

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

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

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

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

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

#### [Fair, Balanced and Understandable](#)

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

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

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

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

[Directors' responsibility statement pursuant to disclosure and transparency Rule 4](#)

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

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

the Company accounts in this report, which have been prepared in accordance with UK Generally Accepted Accounting Practice and the Companies Act 2006, give a true and fair view of the assets, liabilities, financial position and profit of the Company; and

the Financial review and principal risks section and commentary on pages 34 to 39 contained in the accounts includes a fair review of the development and performance of the business and the financial position of the Company and the Group taken as a whole, together with a description of the principal risks and uncertainties that they face.

#### Going concern

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

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

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

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

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

#### Directors' Report

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

By order of the Board, 25 February 2015

**Susan Swabey**

Company Secretary





## **Table of Contents**

### FINANCIAL STATEMENTS

#### **Critical accounting policies**

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

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

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

#### **Valuation of inventories**

A feature of the Orthopaedic Reconstruction and Trauma & Extremities franchises (whose finished goods inventory makes up approximately 79% of the Group total finished goods inventory) is the high level of product inventory required, some of which is located at customer premises and is available for customers' immediate use. Complete sets of products, including large and small sizes, have to be made available in this way. These sizes are used less frequently than standard sizes and towards the end of the product life cycle are inevitably in excess of requirements. Adjustments to carrying value are therefore required to be made to orthopaedic inventory to anticipate this situation. These adjustments are calculated in accordance with a formula based on levels of inventory compared with historical usage. This formula is applied on an individual product line basis and is first applied when a product group has been on the market for two years. This method of calculation is considered appropriate based on experience, but it does involve management judgements on customer demand, effectiveness of inventory deployment, length of product lives, phase-out of old products and efficiency of manufacturing planning systems.

#### **Impairment**

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

#### **Liability provisioning**

The recognition of provisions for legal disputes is subject to a significant degree of estimation. Provision is made for loss contingencies when it is considered probable that an adverse outcome will occur and the amount of the loss can

be reasonably estimated. In making its estimates, management takes into account the advice of internal and external legal counsel. Provisions are reviewed regularly and amounts updated where necessary to reflect developments in the disputes. The ultimate liability may differ from the amount provided depending on the outcome of court proceedings and settlement negotiations or if investigations bring to light new facts.

### Taxation

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

### Business combinations

The group has identified growth through acquisitions as one of its Strategic Priorities. During 2014, we acquired ArthroCare Corporation; the determination of the balance sheet fair value acquired is dependent upon the understanding of the circumstances at acquisition and estimates of the future results of the acquired business and management judgement is a factor in making these determinations.

**Table of Contents**

**Independent auditor's US reports**

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

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

**Auditor's responsibility**

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

**Opinion**

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

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

**Ernst & Young LLP**

London, England

25 February 2015

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

We have audited Smith & Nephew plc's internal control over financial reporting as of 31 December 2014, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework), (the COSO criteria). Smith & Nephew plc's management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Evaluation of Internal Controls. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

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

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Smith & Nephew plc maintained, in all material respects, effective internal control over financial reporting as of 31 December 2014, based on the COSO criteria.

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

**Ernst & Young LLP**

London, England

25 February 2015

**Smith & Nephew** Annual report 2014

105

**Table of Contents**

FINANCIAL STATEMENTS

**Independent auditor's UK report**

Independent auditor's report to the members

of Smith & Nephew plc

Opinion on financial statements

In our opinion:

the financial statements give a true and fair view of the state of the group and of the parent company's affairs as at 31 December 2014;

the group financial statements give a true and fair view of the profit for the year ended 31 December 2014;

the group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and IFRSs as adopted by the International Accounting Standards Board (IASB);

the parent company financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice;

the group and the parent company financial statements have been prepared in accordance with the requirements of the Companies Act 2006; and

the group financial statements have been prepared in accordance with Article 4 of the IAS Regulation.

**What we have audited**

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

Group

Company

The Group income statement

The Company balance sheet

The Group statement of comprehensive income

The related notes 1 to 9.

The Group balance sheet

The Group cash flow statement

The Group statement of changes in equity

The related notes 1 to 23.

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

## Overview

Materiality

Overall Group materiality of \$45 million which represents 5% of adjusted profit before tax

Audit scope

We performed an audit of the complete financial information of two components and audit procedures on specific balances for a further ten components.

The 12 reporting components where we performed audit procedures accounted for 81% of the group's total assets, 64% group revenue and 85% of

the group's profit before tax and 86% of the group's adjusted profit before tax.

Areas of focus

Recognition and measurement of provisions for litigation reserves and contingent liabilities

Recognition and measurement of provisions for taxation

Existence and valuation of inventory

Timing of revenue recognition and measurement of related reserves

Judgements determining purchase price allocation on acquisitions

[Our application of materiality](#)

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

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

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

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

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



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

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

106 **Smith & Nephew** Annual report 2014

---

## Table of Contents

### Scope of our audit

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

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

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

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

### Our assessment of risks of material misstatement

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

Principal risk area and rationale

Audit response

Recognition and measurement of provisions for litigation reserves and contingent liabilities

The development, manufacture and sale of medical devices entails risk of product liability claims and patent infringement issues due to the surgical nature of the products and the competitive nature of the industry.

The litigation reserve at 31 December 2014, included in legal and other provisions of \$118m in note 17.1 to the financial statements, covers a number of open legal matters as described in detail in note 17.3 to the financial statements. We held discussions with in-house legal counsel to understand the status of litigation cases. We read legal invoices and corresponded directly with external legal advisors to understand the fact patterns of the cases. We reviewed management's calculations of provisions, including their assessment of potential royalties payable for past sales and challenged and corroborated key assumptions.

Determining the impact and likely outcome of any litigation matters requires significant judgement due to the uncertainty of the litigation process and the level of royalty that may be payable for infringed products and raises the risk that those legal provisions may be incorrect.

Recognition and measurement of provisions for taxation

The tax charge of profits is determined according to complex tax laws and regulations. Where the effect of these tax laws and regulations is unclear, judgements are used in determining the liability for the tax to be paid.

The details of the tax charge are included in note 5.1 to the financial statements.

As a multinational Company, tax audits can be ongoing in a number of jurisdictions at any point in time and tax returns are subject to possible challenge in most locations in which the Company operates.

We involved tax specialists in the US and the UK to assist us in assessing and challenging the assumptions and judgements made by the company in their recognition and measurement of provisions for taxation. We tested tax calculations and challenged the company's transfer pricing arrangements, tax planning activities and status and findings from ongoing tax audits to assess the reasonableness of the provisions recorded. This included an assessment of the likelihood that known uncertain tax positions would result in a tax liability to the company.

There can be significant judgement involved in determining the provision for tax liabilities.

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



**Table of Contents**

FINANCIAL STATEMENTS

**Independent auditor's UK report *continued***

Principal risk area and rationale

Audit response

Existence and valuation of inventory

The Company has high levels of finished goods inventory, as detailed in note 12 to the financial statements, some of which are located at customer premises to be available for immediate use.

We carried out tests of controls over routine inventory processes, including cycle counts and period end counts.

Complete sets of products, including outsizes, have to be made available in this way, with these sizes used less frequently. Towards the end of a product's life cycle, these inventory levels are more than is required and therefore excess to requirements.

We independently counted or confirmed inventory levels at key component locations and also reviewed the results of management's testing results for a sample of counts that we did not attend.

In estimating the appropriate value for inventory, management has to apply judgement on how much of the inventory on hand will ultimately be used, considering the length of product lives predicted, product usage and how quickly products will be phased out.

We challenged management's judgements and assumptions used in determining the inventory excess and obsolescence provision in order to assess that their calculation represents excess and obsolete inventory. We understood their plans for launching new product lines or discontinuing product lines to assess the adequacy of the provision, as well as reflecting on the adequacy of prior year provisions.

We tested management's calculation to eliminate intercompany profit held in inventory as goods are sold between group companies, including the recalculation and vouching of margins on a sample basis.

Timing of revenue recognition and measurement of related reserves

Revenue recognition is one of the key areas of audit focus, particularly in respect of the risk of management override and the risk of cut-off of revenue for sales to distributors with the need for the risks and rewards of ownership to have passed before revenue is recognised.

We carried out tests of controls over revenue recognition, including the timing of revenue recognition, as well as substantive testing, analytical procedures and assessing whether the revenue recognition policies adopted complied with IFRS as detailed in note 2.1 to the financial statements.

Procedures included independent confirmation with distributors, reviewing shipping terms for items despatched to test that the risk and reward of ownership had passed, cut off testing of items despatched close to the year end date and a review of returns and credit notes issued subsequent to the year end.

We also performed detailed trend analysis by period and by major customer to identify unusual fluctuations.

#### Judgements determining purchase price allocation on acquisitions

On 27 May 2014, the Group acquired ArthroCare Corporation for \$1.7bn.

The acquisition accounting includes the need to determine the fair value of the acquired assets and liabilities at the acquisition date. This included complex valuation considerations and required the use of specialists.

The most significant judgements relate to the valuation of intangible assets acquired, the uplift to the value of inventory and property, plant and equipment and the value of any provisions recorded.

We focused on this area given the significant judgements involved in assessing the fair values of assets and liabilities acquired as this directly impacts the amount of goodwill recognised on acquisition. The fair values are based on valuation techniques built, in part, on assumptions around the future performance of the business. We challenged the assumptions underpinning the valuations, assessed the fair value of the identified assets and liabilities, audited the accounting differences upon IFRS conversion and evaluated the adequacy of the disclosures.

We also discussed the specialist valuations with the specialists and read their reports, with involvement of our own specialists to conclude on the appropriateness of the valuation.

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

108 **Smith & Nephew** Annual report 2014

## Table of Contents

### Opinion on other matter prescribed by

#### the Companies Act 2006

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

### Respective responsibilities of directors and auditor

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

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

### Matters on which we are required to report

#### by exception

We have nothing to report in respect of the following:

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

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

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

is otherwise misleading.

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



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

certain disclosures of directors' remuneration specified by law are not made; or

we have not received all the information and explanations we require for our audit.  
Under the Listing Rules we are required to review:

the directors' statement, set out on page 103, in relation to going concern.

the part of the Corporate Governance Statement relating to the company's compliance with the nine provisions of the UK Corporate Governance Code specified for our review.

**Michael Rudberg (Senior statutory auditor)**

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

London

25 February 2015

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

**Table of Contents**

## FINANCIAL STATEMENTS

**Group income statement**

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

**Group statement of comprehensive income**

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

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

(i) Attributable to equity holders of the Company and wholly derived from continuing operations. The Notes on pages 117 to 165 are an integral part of these accounts.

## **Table of Contents**

### **Commentary on the Group income statement and Group statement of comprehensive income**

#### **Revenue**

Group revenue increased by \$266m (6% on a reported basis), from \$4,351m in 2013 to \$4,617m in 2014.

The underlying increase is 2%, after adjusting for the 5% impact of the acquisitions of ArthroCare and a Brazilian distributor and 1% attributable to the unfavourable impact of currency movements. Despite flat growth in the Established Markets, growth of 17% in the Emerging & International Markets contributed to this underlying increase of 2%.

#### **Cost of goods sold**

Cost of goods sold increased by \$62m (6% on a reported basis) from \$1,100m in 2013 to \$1,162m in 2014. The underlying movement is 5% after adjusting for the net impact of 4% from the ArthroCare acquisition and 3% attributable to the unfavourable impact of currency movements. The movement in underlying costs of goods sold of 5% is largely attributable to the increase in underlying trading.

During 2014, \$12m of restructuring and rationalisation expenses (2013 \$12m) and \$23m of acquisition related costs (2013 \$5m) were charged to cost of goods sold.

#### **Selling, general and administrative expenses**

Selling, general and administrative expenses increased by \$261m (12% on a reported basis) from \$2,210m in 2013 to \$2,471m in 2014. The underlying movement is 5% after adjusting for the net impact of 7% from the ArthroCare acquisition. Currency movements had no impact.

The underlying increase of 5% is due to the promotion of new product and costs associated with the RENASYS distribution hold and HP802 termination and the underlying increase in trading.

In 2014, administrative expenses included \$62m of amortisation of other intangible assets (2013 \$64m), \$49m of restructuring and rationalisation expenses (2013 \$46m), an amount of \$129m relating to amortisation of acquisition intangibles (2013 \$88m) and \$95m of acquisition related costs (2013 \$26m).

#### **Research and development expenses**

Research and development expenditure as a percentage of revenue remained broadly consistent at 5.1% in 2014 (2013 5.3%). Actual expenditure was \$235m in 2014 compared to \$231m in 2013. The Group continues to invest in innovative technologies and products to differentiate it from competitors.

#### **Operating profit**

Operating profit decreased by \$61m to \$749m from \$810m in 2013. This comprised an increase of \$6m in Advanced Surgical Devices and a decrease of \$67m in Advanced Wound Management.

The movement in Advanced Surgical Devices is attributable to the continuing pressure on margins and its investment in the Emerging & International Markets. Advanced Wound Management has been adversely impacted by the costs associated with the RENASYS distribution hold and the impairment and costs associated with the termination of the HP802 programme.

#### Net interest receivable/(payable)

Net interest payable increased by \$26m, from a net \$4m receivable in 2013 to a net payable of \$22m in 2014. This movement is primarily due to an increase in interest payable as a result of financing the ArthroCare acquisition. Interest receivable also decreased following the repayment by Bioventus LLC of their loan note in October 2014.

#### Other finance costs

Other finance costs in 2014 remained at \$11m and principally relate to costs associated with the Group's retirement benefit schemes.

#### Taxation

The taxation charge decreased, by \$33m, to \$213m from \$246m in 2013. The rate of tax was 29.9%, compared with 30.5% in 2013.

After adjusting for specific transactions that management considers affect the Group's short-term profitability, restructuring and rationalisation expenses, amortisation of acquisition intangibles, acquisition related costs and legal and other items) the tax rate was 27.7% (2013 29.2%).

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

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

**Table of Contents**

## FINANCIAL STATEMENTS

**Group balance sheet**

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

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

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

<b>Roberto Quarta</b>	<b>Olivier Bohuon</b>	<b>Julie Brown</b>
Chairman	Chief Executive Officer	Chief Financial Officer

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

## **Table of Contents**

### **Commentary on the Group balance sheet**

#### **Non-current assets**

Non-current assets increased by \$1,303m to \$4,866m in 2014 from \$3,563m in 2013. This is principally attributable to the following:

Property, plant and equipment increased by \$75m from \$816m in 2013 to \$891m in 2014. Depreciation of \$222m was charged during 2014, assets with a net book value of \$15m were disposed of and \$14m was impaired relating to HP802. These movements were offset by \$298m of additions relating primarily to instruments and other plant & machinery and \$62m of additions arising on the acquisitions of ArthroCare. The balance relates to unfavourable currency movements totalling \$34m.

Goodwill increased by \$771m from \$1,256m in 2013 to \$2,027m in 2014. Of this movement, \$829m arose on the acquisition of ArthroCare and \$15m on the acquisition in Brazil. The remaining balance relates to unfavourable currency movements totalling \$73m.

Intangible assets increased by \$693m from \$1,054m in 2013 to \$1,747m in 2014. Intangible assets totalling \$817m and \$16m arose on the acquisition of ArthroCare and Brazil respectively. Amortisation of \$191m was charged during the year and assets with a net book value of \$1m were disposed of. A total of \$77m relates to the cost of intellectual property, distribution rights and software acquired. The balance relates to unfavourable currency movements totalling \$25m.

Investment in associates of \$112m in 2014 has increased from \$107m in 2013. The loan to the associate was fully repaid in the year.

Deferred tax assets decreased by \$68m in the year from \$145m in 2013 to \$77m in 2014.

#### **Current assets**

Current assets increased by \$184m to \$2,440m from \$2,256m in 2013. The movement relates to the following:

Inventories rose by \$175m to \$1,181m in 2014 from \$1,006m in 2013. This movement is principally attributable to the acquisitions of ArthroCare and distributor in Brazil which increased inventory by \$70m and \$36m relating to the purchase of an advanced quantity of an ingredient to ensure continued supply of REGRANEX.

The level of trade and other receivables increased by \$53m to \$1,166m in 2014 from \$1,113m in 2013. The movement primarily relates to the increase in underlying revenues and \$54m from the ArthroCare acquisition offset



by \$75m of unfavourable currency movements.

Cash at bank has fallen by \$44m to \$93m from \$137m in 2013.

#### Non-current liabilities

Non-current liabilities increased by \$1,405m from \$699m in 2013 to \$2,104m in 2014. This movement relates to the following items:

Long-term borrowings have increased from \$347m in 2013 to \$1,666m in 2014 as a result of the \$1.1bn private placements and \$400m additional long-term facility use to fund the acquisition of ArthroCare.

The Retirement benefit obligation increased by \$3m to \$233m in 2014 from \$230m in 2013.

Deferred tax liabilities increased by \$48m in the year from \$50m in 2013 to \$98m in 2014.

#### Current liabilities

Current liabilities increased by \$89m from \$1,073m in 2013 to \$1,162m in 2014. This movement is attributable to:

Bank overdrafts and current borrowings have decreased by \$5m from \$44m in 2013 to \$39m in 2014.

Trade and other payables have increased by \$53m to \$838m in 2014 from \$785m in 2013. This increase includes \$75m of trade and other payables arising on the acquisition of ArthroCare and distributor in Brazil offset by \$34m of favourable currency movements.

Current tax payable is \$218m at the end of 2014 compared to \$184m in 2013.

#### Total equity

Total equity decreased by \$7m from \$4,047m in 2013 to \$4,040m in 2014. The principal movements were:

	Total equity \$ million
1 January 2014	4,047
Attributable profit	501
Currency translation losses	(196)
Hedging reserves	12
Actuarial losses on retirement benefit obligations	(94)
Dividends paid during the year	(250)
Purchase of own shares	(75)
Taxation on Other Comprehensive Income and equity items	19
Net share-based transactions	76

31 December 2014

4,040

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

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

**Smith & Nephew** Annual report 2014 113

**Table of Contents**

## FINANCIAL STATEMENTS

**Group cash flow statement**

	Notes	<b>Year ended 31 December 2014 \$ million</b>	Year ended 31 December 2013 \$ million	Year ended 31 December 2012 \$ million
<b>Cash flows from operating activities</b>				
Profit before taxation		714	802	1,092
Net interest payable/(receivable)	4	22	(4)	(2)
Depreciation, amortisation and impairment		427	361	312
Loss on disposal of property, plant and equipment and software		11	23	12
Distribution from investment		1		
Share-based payments expense	23	32	28	34
Share of results of associates	11	2	1	(4)
Dividends received from associates	11		1	7
Profit on disposal of manufacturing facility	21	(9)		
Profit on disposal of net assets held for sale	3			(251)
Net movement in post retirement benefit obligations		(81)	(27)	(28)
(Increase)/Decrease in inventories		(168)	(99)	12
Increase in trade and other receivables		(76)	(70)	(5)
Increase in trade and other payables and provisions		86	122	5
Cash generated from operations (i) (ii)		961	1,138	1,184
Interest received		3	4	4
Interest paid		(36)	(10)	(8)
Income taxes paid		(245)	(265)	(278)
Net cash inflow from operating activities		683	867	902
<b>Cash flows from investing activities</b>				
Acquisitions, net of cash acquired	21	(1,572)	(74)	(782)
Proceeds on disposal of net assets held for sale				103
Capital expenditure	2	(375)	(340)	(265)
Investment in associate	11	(2)		(10)
Purchase of investments	10	(4)		
Proceeds from associate loan redemption	11	188		
Proceeds on disposal of manufacturing facility	21	20		
Cash received on disposal of associate			7	
Net cash used in investing activities		(1,745)	(407)	(954)
<b>Cash flows from financing activities</b>				
Proceeds from issue of ordinary share capital		40	48	77
Purchase of own shares		(75)	(231)	

Edgar Filing: SMITH & NEPHEW PLC - Form 20-F

Proceeds of borrowings due within one year	20	30	12	40
Settlement of borrowings due within one year	20	(52)	(6)	(296)
Proceeds on borrowings due after one year	20	3,390	695	415
Settlement of borrowings due after one year	20	(2,068)	(779)	(1)
Proceeds from own shares		4	3	6
Settlement of currency swaps	20	(11)	(1)	(1)
Equity dividends paid	19	(250)	(239)	(186)
Net cash from/(used in) financing activities		1,008	(498)	54
Net (decrease)/increase in cash and cash equivalents		(54)	(38)	2
Cash and cash equivalents at beginning of year	20	126	167	161
Exchange adjustments	20	(7)	(3)	4
<b>Cash and cash equivalents at end of year</b>		<b>65</b>	126	167

(i) Includes \$60m (2013 \$54m, 2012 \$55m) of outgoings on restructuring and rationalisation expenses.

(ii) Includes \$112m (2013 \$25m, 2012 \$3m) of acquisition-related costs and \$23m (2013 \$nil, 2012 \$22m) of legal and other costs

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

## Table of Contents

### [Commentary on the Group cash flow statement](#)

The main elements of the Group's cash flow and movements in net debt can be summarised as follows:

#### [Net cash inflow from operating activities](#)

Cash generated from operations in 2014 of \$961m (2013 \$1,138m, 2012 \$1,184m) is after paying out \$112m (2013 \$25m, 2012 \$3m) of acquisition-related costs, \$60m (2013 \$54m, 2012 \$55m) of restructuring and rationalisation expenses and \$23m (2013 \$nil, 2012 \$22m) relating to legal and other exceptional costs.

#### [Capital expenditure](#)

The Group's ongoing capital expenditure and working capital requirements were financed through cash flow generated by business operations and, where necessary, through short-term committed and uncommitted bank facilities. In 2014, capital expenditure on tangible and intangible fixed assets represented approximately 8% of continuing Group revenue (2013 8%, 2012 6%).

In 2014, capital expenditure amounted to \$375m (2013 \$340m, 2012 \$265m). The principal areas of investment were the placement of orthopaedic instruments with customers, patents and licences, plant and equipment and information technology.

At 31 December 2014, \$34m (2013 \$41m, 2012 \$4m) of capital expenditure had been contracted but not provided for which will be funded from cash inflows.

#### [Acquisitions and disposals](#)

In the three-year period ended 31 December 2014, \$2,428m was spent on acquisitions, funded from net debt and cash inflows. This comprised, \$782m for Healthpoint acquired in December 2012, \$74m relating to acquisitions in Turkey, Brazil and India completed in quarter four of 2013, \$1,546m for ArthroCare acquired in May 2014 and \$26m for the acquisition in Brazil completed in quarter one 2014.

During 2012, the Group completed the transfer of its Biologics and Clinical Therapies business (CT) to Bioventus for total consideration of \$367m. As part of this transaction the Group received a 49% interest in Bioventus with a value of \$104m and subsequently invested a further \$10m.

During 2014, the Group received repayment of the \$160m loan note to Bioventus and \$28m of accrued interest.

Proceeds of \$20m have been received on the disposal of the Group's manufacturing plant in Gilberdyke, UK.

#### [Liquidity and capital resources](#)

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

At 31 December 2014, the Group held \$65m (2013 \$126m, 2012 \$167m) in cash net of bank overdrafts. The group had committed facilities available of \$2,525m at 31 December 2014 of which \$1,655m was drawn. Smith & Nephew intends to repay the amounts due within one year by using available cash and drawing down on the longer term facilities. In addition, Smith & Nephew has finance lease commitments of \$12m.

During the year ended 31 December 2014, the Group refinanced its principal banking facilities. The Group has signed a new five-year committed \$1 billion multi-currency revolving credit facility with a maturity date of March 2019. In addition, the Group signed a \$1.4 billion committed term loan facility with a maturity date of February 2016. The Group drew down its \$1.4 billion committed term loan facility to fund the acquisition of ArthroCare. \$1 billion of this loan was repaid during the year partly from private placement proceeds.

During the year ended 31 December 2014, the Group received the entire proceeds of the \$325 million private placement debt agreement signed in December 2013. The funds have a weighted average fixed rate of 3.7% and mature between 2021 and 2026. The Group also received \$800 million of proceeds from a second private placement agreement signed in November 2014. The funds have a weighted average fixed rate of 3.1% and mature between 2019 and 2024.

The principal variations in the Group's borrowing requirements result from the timing of dividend payments, acquisitions and disposals of businesses, timing of capital expenditure and working capital fluctuations. Smith & Nephew believes that its capital expenditure needs and its working capital funding for 2015, as well as its other known or expected commitments or liabilities, can be met from its existing resources and facilities. The Group's net debt increased from \$288m at the beginning of 2013 to \$1,613m at the end of 2014, representing an overall increase of \$1,325m.

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

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

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

**Table of Contents**

## FINANCIAL STATEMENTS

**Group statement of changes in equity**

	<b>Share capital \$ million</b>	<b>Share premium \$ million</b>	<b>Capital redemption reserve \$ million</b>	<b>Treasury shares (ii) \$ million</b>	<b>Other reserves (iii) \$ million</b>	<b>Retained earnings \$ million</b>	<b>Total equity \$ million</b>
At 31 December 2011	191	413		(766)	91	3,258	3,187
Total comprehensive income (i)					30	736	766
Equity dividends declared and paid						(186)	(186)
Share-based payments recognised						34	34
Cost of shares transferred to beneficiaries				31		(25)	6
Issue of ordinary share capital (iv)	2	75					77
At 31 December 2012	193	488		(735)	121	3,817	3,884
Total comprehensive income (i)					(1)	552	551
Equity dividends declared and paid						(239)	(239)
Share-based payments recognised						28	28
Deferred taxation on share-based payments						3	3

Purchase of own shares				(231)			(231)
Cost of shares transferred to beneficiaries				21		(18)	3
Cancellation of treasury shares	(10)		10	623		(623)	
Issue of ordinary share capital (iv)	1	47					48
At 31 December 2013	184	535	10	(322)	120	3,520	4,047
Total comprehensive income (i)					(184)	426	242
Equity dividends declared and paid						(250)	(250)
Share-based payments recognised						32	32
Purchase of own shares				(75)			(75)
Cost of shares transferred to beneficiaries				25		(21)	4
Cancellation of treasury shares	(1)		1	57		(57)	
Issue of ordinary share capital (iv)	1	39					40
At 31 December 2014	184	574	11	(315)	(64)	3,650	4,040

(i) Attributable to equity holders of the Company and wholly derived from continuing operations.

(ii) Refer to Note 19.2 for further information.

(iii) Other reserves comprises gains and losses on cash flow hedges, foreign exchange differences on translation of foreign operations and the difference arising as a result of translating share capital and share premium at the rate ruling on the date of redenomination instead of the rate at the balance sheet date. The cumulative translation adjustments within Other Reserves at 31 December 2014 were \$(78)m (2013 \$118m, 2012 \$124m).

(iv) Issue of ordinary share capital as a result of options being exercised.



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

116      **Smith & Nephew** Annual report 2014

## Table of Contents

### Notes to the Group accounts

#### 1 Basis of preparation

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

As required by the European Union's IAS Regulation and the Companies Act 2006, the Group has prepared its accounts in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU) effective as at 31 December 2014. The Group has also prepared its accounts in accordance with IFRS as issued by the International Accounting Standards Board (IASB) effective as at 31 December 2014. IFRS as adopted by the EU differs in certain respects from IFRS as issued by the IASB. However, the differences have no impact for the periods presented.

The preparation of accounts in conformity with IFRS requires management to use estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the accounts and the reported amounts of revenues and expenses during the reporting period. The accounting policies requiring management to use significant estimates and assumptions are; inventories, impairment, taxation, liability provisions and business combinations. These are discussed under Critical accounting policies on page 104. Although these estimates are based on management's best knowledge of current events and actions, actual results ultimately may differ from those estimates. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to estimates are recognised prospectively.

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

There have been no new accounting pronouncements impacting the Group in 2014.

A number of new standards, amendments to standards and interpretations are effective for the Group's annual periods beginning on or after 1 January 2015, and have not been applied in preparing these consolidated accounts. With the exception of IFRS 9 *Financial Instruments* and IFRS 15 *Revenue*, which the Group does not intend to early adopt and for which the extent of the impact is still being determined, none of these is expected to have a significant effect on the consolidated accounts of the Group.

#### Consolidation

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

Subsidiaries are entities controlled by the Group. The Group controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over

the entity. Subsidiaries are consolidated in the Group accounts from the date that the Group obtains control, and continue to be consolidated until the date that such control ceases. Intra-group balances and transactions, and any unrealised income and expenses arising from intra-group transactions, are eliminated on consolidation. All subsidiaries have year ends which are co-terminus with the Group's.

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

Foreign currencies

### Functional and presentation currency

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

### Foreign currency transactions

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

### Foreign operations

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

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

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

	2014	2013	2012
<b>Average rates</b>			
Sterling	1.65	1.56	1.58
Euro	1.33	1.33	1.28
Swiss Franc	1.09	1.08	1.07
<b>Year-end rates</b>			
Sterling	1.56	1.66	1.63
Euro	1.21	1.38	1.32
Swiss Franc	1.01	1.12	1.09

<b>Smith &amp; Nephew</b> Annual report 2014	117
--	-----

**Table of Contents**

FINANCIAL STATEMENTS

**Notes to the Group accounts *continued***

**2 Business segment information**

During 2014 for management purposes the Group was organised into two global divisions according to the nature of its products which represented two reportable business segments – Advanced Surgical Devices and Advanced Wound Management.

As part of the Reinvestment & Group Optimisation programme management have created a single unified operating structure with a single cost base, led by a managing director in each major country (outside the US). The change in structure took effect on 1 January 2015 and as such the Group will report as a single segment from this date.

The types of products and services offered by each business segment in 2014 are:

Smith & Nephew's Advanced Surgical Devices ( ASD ) business offers the following products and technologies:

Orthopaedic Reconstruction which includes Hip Implants, Knee Implants and ancillary products such as bone cement and mixing systems used in cemented reconstruction joint surgery

Trauma & Extremities consisting of internal and external devices used in the stabilisation of severe fractures and deformity correction procedures

Sports Medicine Joint Repair, which offers surgeons a broad array of instruments, technologies and implants necessary to perform minimally invasive surgery of the joints

Arthroscopy Enabling Technologies which offer healthcare providers a variety of technologies such as fluid management equipment for surgical access, high definition cameras, digital image capture, scopes, light sources and monitors to assist with visualisation inside the joints, radio frequency wands, electromechanical and mechanical blades, and hand instruments for removing damaged tissue

Other ASD which includes gynaecological instrumentation and the remaining Clinical Therapies geographies which are in the process of being transferred to Bioventus.

Smith & Nephew's Advanced Wound Management ( AWM ) business offers a range of products:

Advanced Wound Care includes products for the treatment of acute and chronic wounds, including leg, diabetic and pressure ulcers, burns and post-operative wounds

Advanced Wound Devices consists of traditional and single-use Negative Pressure Wound Therapy and hydrosurgery systems

Advanced Wound Bioactives includes biologics and other bioactive technologies that provide unique approaches to debridement and dermal repair/regeneration.

Management monitors the operating results of its business segments separately for the purposes of making decisions about resource allocation and performance assessment. Group financing (including interest receivable and payable) and income taxes are managed on a Group basis and are not allocated to business segments.

The following tables present revenue, profit, asset and liability information regarding the Group's operating segments as they existed during the year. Investments in associates and loans to associates are segmentally allocated to Advanced Surgical Devices.

## 2.1 Revenue by business segment and geography

### ACCOUNTING POLICY

Revenue comprises sales of products and services to third parties at amounts invoiced net of trade discounts and rebates, excluding taxes on revenue. Revenue from the sale of products is recognised upon transfer to the customer of the significant risks and rewards of ownership. This is generally when goods are delivered to customers. Sales of inventory located at customer premises and available for customers' immediate use are recognised when notification is received that the product has been implanted or used. Appropriate provisions for returns, trade discounts and rebates are deducted from revenue. Rebates comprise retrospective volume discounts granted to certain customers on attainment of certain levels of purchases from the Group. These are accrued over the course of the arrangement based on estimates of the level of business expected and adjusted at the end of the arrangement to reflect actual volumes.

	<b>2014</b> \$ million	2013 \$ million	2012 \$ million
<b>Revenue by business segment</b>			
Advanced Surgical Devices	<b>3,298</b>	3,015	3,108
Advanced Wound Management	<b>1,319</b>	1,336	1,029
	<b>4,617</b>	4,351	4,137

There are no material sales between business segments.

	<b>2014</b> <b>\$ million</b>	2013 \$ million	2012 \$ million
<b>Revenue by geographic market</b>			
United States	<b>2,012</b>	1,862	1,651
United Kingdom	<b>299</b>	293	297
Other Established Markets	<b>1,629</b>	1,633	1,706
Emerging & International Markets	<b>677</b>	563	483
	<b>4,617</b>	4,351	4,137

Revenue has been allocated by basis of destination. No revenue from a single customer is in excess of 10% of the Group's revenue.

**Table of Contents**

## 2.2 Trading and operating profit by business segment

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

	Notes	2014 \$ million	2013 \$ million	2012 \$ million
Operating profit		749	810	846
Acquisition-related costs	3	118	31	11
Restructuring and rationalisation expenses	3	61	58	65
Amortisation of acquisition intangibles and impairments	9	129	88	43
Legal and other	3	(2)		
Trading profit		1,055	987	965
<b>Trading profit by business segment</b>				
Advanced Surgical Devices		810	712	728
Advanced Wound Management		245	275	237
		1,055	987	965
<b>Operating profit by business segment reconciled to</b>				
<b>attributable profit for the year</b>				
Advanced Surgical Devices		626	620	632
Advanced Wound Management		123	190	214
Operating profit		749	810	846
Net interest (payable)/receivable		(22)	4	2
Other finance costs		(11)	(11)	(11)
Share of results of associates		(2)	(1)	4
Profit on disposal on net assets held for sale				251
Taxation		(213)	(246)	(371)
<b>Attributable profit for the year</b>		501	556	721

## 2.3 Assets and liabilities by business segment and geography

	2014 \$ million	2013	2012
--	--------------------	------	------



		\$ million	\$ million
<b>Balance sheet</b>			
Assets:			
Advanced Surgical Devices	5,368	3,684	3,518
Advanced Wound Management	1,761	1,848	1,776
Operating assets by business segment	7,129	5,532	5,294
Unallocated corporate assets	177	287	348
<b>Total assets</b>	<b>7,306</b>	<b>5,819</b>	<b>5,642</b>
Liabilities:			
Advanced Surgical Devices	697	609	530
Advanced Wound Management	315	308	256
Operating liabilities by business segment	1,012	917	786
Unallocated corporate liabilities	2,254	855	972
<b>Total liabilities</b>	<b>3,266</b>	<b>1,772</b>	<b>1,758</b>

**Table of Contents**

## FINANCIAL STATEMENTS

**Notes to the Group accounts *continued*****2 Business segment information *continued***

Unallocated corporate assets and liabilities comprise the following:

	2014	2013	2012
	\$ million	\$ million	\$ million
Deferred tax assets	77	145	164
Retirement benefit asset	7	5	6
Cash at bank	93	137	178
Unallocated corporate assets	177	287	348
Long-term borrowings	1,666	347	430
Retirement benefit obligations	233	230	266
Deferred tax liabilities	98	50	61
Bank overdrafts and loans due within one year	39	44	38
Current tax payable	218	184	177
Unallocated corporate liabilities	2,254	855	972

	2014	2013	2012
	\$ million	\$ million	\$ million
<b>Capital expenditure (including acquisitions)</b>			
Advanced Surgical Devices	2,045	327	188
Advanced Wound Management	73	124	839
	2,118	451	1,027

Capital expenditure segmentally allocated above comprises:

	2014	2013	2012
	\$ million	\$ million	\$ million
Additions to property, plant and equipment	298	242	197
Additions to intangible assets	77	98	68
Capital expenditure (excluding business combinations)	375	340	265
Trade investments	4		
Acquisitions Goodwill	844	53	73

Edgar Filing: SMITH & NEPHEW PLC - Form 20-F

Acquisitions Intangible assets	833	53	662
Acquisitions Property, plant and equipment	62	5	27
Capital expenditure	2,118	451	1,027
	2014	2013	2012
	\$ million	\$ million	\$ million
<b>Depreciation, amortisation and impairment</b>			
Advanced Surgical Devices	320	268	274
Advanced Wound Management	107	93	38
	427	361	312

**Table of Contents**

Amounts comprise depreciation of property, plant and equipment, amortisation of other intangible assets, impairment of investments and amortisation of acquisition intangibles and impairments as follows:

	<b>2014</b> \$ million	2013 \$ million	2012 \$ million
Amortisation of acquisition intangibles	129	88	43
Depreciation of property, plant and equipment	222	209	212
Impairment of property, plant and equipment	14		
Impairment of goodwill and investments			6
Amortisation of other intangible assets	62	64	51
	<b>427</b>	361	312

\$14m impairments were recognised within operating profit in 2014 (2013 \$nil, 2012 \$6m, recognised within the administrative expenses line). In 2014, the impairment was segmentally allocated to Advanced Wound Management (2012: Advanced Surgical Devices).

**Geographic**

	<b>2014</b> \$ million	2013 \$ million
<b>Assets by geographic location</b>		
United States	3,104	2,086
United Kingdom	379	255
Other Established Markets	1,101	902
Emerging & International Markets	198	170
Non-current operating assets by geographic location	4,782	3,413
United States	1,104	1,121
United Kingdom	234	288
Other Established Markets	706	486
Emerging & International Markets	303	224
Current operating assets by geographic location	2,347	2,119
Unallocated corporate assets (see page 120)	177	287
<b>Total assets</b>	<b>7,306</b>	5,819

## 2.4 Other business segment information

	<b>2014</b> \$ million	2013 \$ million	2012 \$ million
<b>Other significant expenses recognised within operating profit</b>			
Advanced Surgical Devices	106	51	57
Advanced Wound Management	71	38	19

The \$177m incurred in 2014 relates to \$61m restructuring and rationalisation expenses and \$118m acquisition related costs and a net \$2m credit related to legal and other (2013 \$58m relates to restructuring and rationalisation expenses and \$31m acquisition related costs, 2012 \$65m relates to restructuring and rationalisation expenses and \$11m acquisition related costs).

	<b>2014 numbers</b>	2013 numbers	2012 numbers
<b>Average number of employees</b>			
Advanced Surgical Devices	<b>9,273</b>	7,066	7,194
Advanced Wound Management	<b>4,195</b>	3,970	3,283
	<b>13,468</b>	11,036	10,477

**Table of Contents**

FINANCIAL STATEMENTS

**Notes to the Group accounts *continued***

3 Operating profit

ACCOUNTING POLICIES

Research and development

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

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

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

Advertising costs

Expenditure on advertising costs is expensed as incurred.

	<b>2014</b>	2013	2012
	<b>\$ million</b>	\$ million	\$ million
Revenue	<b>4,617</b>	4,351	4,137
Cost of goods sold (i)(ii)	<b>(1,162)</b>	(1,100)	(1,070)
Gross profit	<b>3,455</b>	3,251	3,067
Research and development expenses	<b>(235)</b>	(231)	(171)
Selling, general and administrative expenses:			
Marketing, selling and distribution expenses	<b>(1,670)</b>	(1,535)	(1,440)
Administrative expenses (iii) (iv) (v) (vi)	<b>(801)</b>	(675)	(610)
	<b>(2,471)</b>	(2,210)	(2,050)
<b>Operating profit</b>	<b>749</b>	810	846

- (i) 2014 includes \$12m of restructuring and rationalisation expenses (2013 \$12m, 2012 \$3m).
- (ii) 2014 includes \$23m of acquisition-related costs (2013 \$5m, 2012 \$nil).
- (iii) 2014 includes \$62m of amortisation of other intangible assets (2013 \$64m, 2012 \$51m).
- (iv) 2014 includes \$49m of restructuring and rationalisation expenses and \$129m of amortisation of acquisition intangibles (2013 \$46m of restructuring and rationalisation expenses and \$88m of amortisation of acquisition intangibles, 2012 \$62m of restructuring and rationalisation expenses and \$43m of amortisation of acquisition intangibles).
- (v) 2014 includes \$2m credit relating to legal and other exceptionals (2013 \$nil, 2012 \$nil).
- (vi) 2014 includes \$95m of acquisition-related costs (2013 \$26m, 2012 \$11m).

Note that items detailed in (i), (ii), (iv), (v) and (vi) are excluded from the calculation of trading profit.

Operating profit is stated after charging the following items:

	<b>2014</b>	2013	2012
	<b>\$ million</b>	\$ million	\$ million
Amortisation of acquisition intangibles	<b>129</b>	88	43
Amortisation of other intangible assets	<b>62</b>	64	51
Impairment of goodwill and investments			6
Depreciation of property, plant and equipment	<b>222</b>	209	212
Loss on disposal of property, plant and equipment and software	<b>25</b>	23	12
Minimum operating lease payments for land and buildings	<b>38</b>	32	29
Minimum operating lease payments for other assets	<b>18</b>	19	21
Advertising costs	<b>96</b>	91	74

122      **Smith & Nephew** Annual report 2014



**Table of Contents**

## 3.1 Staff costs

Staff costs during the year amounted to:

	Notes	2014 \$ million	2013 \$ million	2012 \$ million
Wages and salaries		1,237	998	886
Social security costs		127	106	97
Pension costs (including retirement healthcare)	18	17	72	72
Share-based payments	23	32	28	34
		1,413	1,204	1,089

## 3.2 Audit Fees information about the nature and cost of services provided by auditors

	2014 \$ million	2013 \$ million	2012 \$ million
Audit services: Group accounts	2	1	1
Other services:			
Local statutory audit pursuant to legislation	1	2	2
Taxation services:			
Compliance services	1	2	1
Advisory services	1	1	1
<b>Total auditors remuneration</b>	<b>5</b>	<b>6</b>	<b>5</b>
Arising:			
In the UK	3	3	2
Outside the UK	2	3	3
	5	6	5

## 3.3 Acquisition related costs

Acquisition related costs of \$118m (2013 \$31m, 2012 \$11m) were incurred within operating profit in the twelve month period to 31 December 2014. These costs relate to professional and adviser fees and integration costs in connection with the acquisitions of ArthroCare and the distributor in Brazil completed in 2014, the acquisitions in Turkey, Brazil and India during 2013 and the acquisition of Healthpoint Biotherapeutics completed in 2012. In addition, \$7m of debt-related acquisition costs were incurred in the year.

## 3.4 Restructuring and rationalisation expenses

Restructuring and rationalisation costs of \$61m (2013 \$58m, 2012 \$65m) were incurred in the twelve month period to 31 December 2014. These related mainly to charges of \$49m (2013 \$nil, 2012 \$nil) incurred in relation to the Group Optimisation programme announced in May 2014. Charges of \$12m (2013 \$58m, 2012 \$65m) were also incurred relating to people costs and contract termination costs associated with the structural and process changes

announced in August 2011.

### 3.5 Legal and other

The legal and other net credit within operating profit of \$2m (2013 \$nil, 2012 \$251m) relates to a settlement credit and past service gain on the closure of the US Pension Plan of \$46m and a gain on the disposal of a UK manufacturing facility of \$9m, offset by a charge of \$25m relating to the likely costs of a distribution hold on RENASYS in the US pending new regulatory approvals, and a charge of \$28m relating to the HP802 programme which was stopped in the fourth quarter.

In 2012, a profit on disposal of \$251m was recorded relating to the disposal of our Clinical Therapies business.

**Table of Contents**

## FINANCIAL STATEMENTS

**Notes to the Group accounts *continued*****4 Interest and other finance costs****4.1 Interest receivable/(payable)**

	<b>2014</b>	2013	2012
	<b>\$ million</b>	\$ million	\$ million
Interest receivable	<b>13</b>	14	11
Interest payable:			
Bank borrowings	<b>(19)</b>	(8)	(7)
Private placement notes	<b>(14)</b>		
Other	<b>(2)</b>	(2)	(2)
	<b>(35)</b>	(10)	(9)
<b>Net interest (payable)/receivable</b>	<b>(22)</b>	4	2

**4.2 Other finance costs**

	Notes	<b>2014</b>	2013	2012
		<b>\$ million</b>	\$ million	\$ million
Retirement benefit net interest expense	18	<b>(10)</b>	(11)	(11)
Other		<b>(1)</b>		
<b>Other finance costs</b>		<b>(11)</b>	(11)	(11)

Foreign exchange gains or losses recognised in the income statement arose primarily on the translation of intercompany and third party borrowings and amounted to a net \$21m gain in 2014 (2013 net \$1m gain, 2012 net \$5m loss). These amounts were fully matched in the income statement by the fair value gains or losses on currency swaps (carried at fair value through profit and loss) held to manage this currency risk.

**5 Taxation**

## ACCOUNTING POLICY

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

The Group operates in multiple tax jurisdictions around the world and records provisions for taxation liabilities and tax audits when it is considered probable that a tax charge will arise and the amount can be reliably estimated. Although Group policy is to submit its tax returns to the relevant tax authorities as promptly as possible, at any time the Group has un-agreed years outstanding and is involved in disputes and tax audits. Significant issues may take many years to resolve. In estimating the probability and amount of any tax charge, management takes into account the views of internal and external advisers and updates the amount of the provision whenever necessary. The ultimate tax liability may differ from the amount provided depending on interpretations of tax law, settlement negotiations or changes in legislation.

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

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

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

Deferred tax assets are reviewed at each reporting date.

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

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

124 **Smith & Nephew** Annual report 2014

**Table of Contents**

## 5.1 Taxation charge attributable to the Group

	2014 \$ million	2013 \$ million	2012 \$ million
Current taxation:			
UK corporation tax at 21.5% (2013 23.3%, 2012 24.5%)	39	50	53
Overseas tax	235	229	248
Current income tax charge	274	279	301
Adjustments in respect of prior periods	(6)	(5)	(17)
<b>Total current taxation</b>	<b>268</b>	274	284
Deferred taxation:			
Origination and reversal of temporary differences	(52)	(23)	88
Changes in tax rates		(4)	(3)
Adjustments to estimated amounts arising in prior periods	(3)	(1)	2
<b>Total deferred taxation</b>	<b>(55)</b>	(28)	87
Total taxation as per the income statement	213	246	371
Deferred taxation in other comprehensive income	(19)	16	(20)
Deferred taxation in equity		(3)	
<b>Taxation attributable to the Group</b>	<b>194</b>	259	351

The tax charge was reduced by \$71m as a consequence of restructuring and rationalisation expenses, amortisation of acquisition intangibles and acquisition related costs and legal and other. In 2013, the tax charge was reduced by \$40m as a consequence of restructuring and rationalisation expenses, amortisation of acquisition intangibles and acquisition related costs. In 2012, the tax charge was increased by \$82m as a consequence of restructuring and rationalisation expenses, amortisation of acquisition intangibles and legal provision.

The applicable tax for the year is based on the UK standard rate of corporation tax of 21.5% (2013 23.3%, 2012 24.5%). Overseas taxation is calculated at the rates prevailing in the respective jurisdictions. The average effective tax rate differs from the applicable rate as follows:

	2014 %	2013 %	2012 %
UK standard rate	21.5	23.3	24.5
Non-deductible/non-taxable items	0.5	(1.0)	0.4
Prior year items	(1.2)	(0.5)	(1.3)
Tax losses incurred not relieved	1.6	0.9	0.8
Overseas income taxed at other than UK standard rate	7.5	7.8	9.3
<b>Total effective tax rate</b>	<b>29.9</b>	30.5	33.7

The enacted UK tax rate applicable from 1 April 2014 is 21%. The UK Government have enacted legislation to reduce the tax rate to 20% from 1 April 2015.

<b>Smith &amp; Nephew</b> Annual report 2014	125
--	-----

**Table of Contents**

## FINANCIAL STATEMENTS

**Notes to the Group accounts** *continued***5 Taxation** *continued***5.2 Deferred taxation**

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

	<b>Accelerated tax depreciation \$ million</b>	<b>Intangibles \$ million</b>	<b>Retirement benefit obligation \$ million</b>	<b>Macrotecture \$ million</b>	<b>Inventory, provisions and other differences \$ million</b>	<b>Total \$ million</b>
At 1 January						
2013	(90)	(28)	87	52	82	103
Exchange adjustment		1			(5)	(4)
Movement in income statement current year	(3)	5	(3)		28	27
Movement in income statement prior years	2	(1)				1
Movement in other comprehensive income			(16)			(16)
Charge to equity					3	3
Acquisition					(19)	(19)
Transfers		1			(1)	
At 31 December						
2013	(91)	(22)	68	52	88	95
Exchange adjustment	<b>2</b>	<b>1</b>	<b>(2)</b>		<b>(10)</b>	<b>(9)</b>
Movement in income	<b>18</b>	<b>16</b>	<b>(18)</b>		<b>36</b>	<b>52</b>



statement current year						
Movement in income statement prior years	1	(1)			3	3
Movement in other comprehensive income			22		(3)	19
Acquisition At 31 December 2014	(70)	(226)	70	52	153	(21)

Represented  
by:

	2014 \$ million	2013 \$ million
Deferred tax assets	77	145
Deferred tax liabilities	(98)	(50)
<b>Net position at 31 December</b>	<b>(21)</b>	<b>95</b>

The Group has unused tax losses of \$92m (2013 \$31m) available for offset against future profits. A deferred tax asset has been recognised in respect of \$47m (2013 \$3m) of these losses. No deferred tax asset has been recognised on the remaining unused tax losses as they are not expected to be realised in the foreseeable future. The aggregate amount of temporary differences in respect of investments in subsidiaries and associates for which deferred tax liabilities have not been recognised is approximately \$449m (2013 \$nil).

**Table of Contents**

## 6 Earnings per ordinary share

## ACCOUNTING POLICIES

## Earnings per share

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

## Adjusted earnings per share

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

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

	<b>2014</b> <b>\$ million</b>	2013 \$ million	2012 \$ million
<b>Earnings</b>			
Attributable profit for the year	<b>501</b>	556	721
Adjusted attributable profit (see below)	<b>743</b>	693	671

Attributable profit is reconciled to adjusted attributable profit as follows:

	Notes	2014 \$ million	2013 \$ million	2012 \$ million
Attributable profit for the year		501	556	721
Acquisition-related costs	3	125	31	11
Restructuring and rationalisation expenses	3	61	58	65
Amortisation of acquisition intangibles and impairments	9	129	88	43
Profit on disposal of net assets held for sale	3			(251)
Legal and other	3	(2)		
Taxation on excluded items	5	(71)	(40)	82
<b>Adjusted attributable profit</b>		<b>743</b>	<b>693</b>	<b>671</b>

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

	2014	2013	2012
<b>Number of shares (millions)</b>			
Basic weighted number of shares	893	901	897
Dilutive impact of share options outstanding	6	5	4
Diluted weighted average number of shares	899	906	901
<b>Earnings per ordinary share</b>			
Basic	56.1¢	61.7¢	80.4¢
Diluted	55.7¢	61.4¢	80.0¢
Adjusted: Basic	83.2¢	76.9¢	74.8¢
Adjusted: Diluted	82.6¢	76.5¢	74.5¢

There were no share options which were not included in the diluted EPS calculation because they were non-dilutive in the period (2013 0.5m, 2012 8.2m).

**Table of Contents**

FINANCIAL STATEMENTS

**Notes to the Group accounts *continued***

7 Property, plant and equipment

ACCOUNTING POLICIES

Property, plant and equipment

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

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

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

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

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

other finance costs are expensed as incurred.

#### Impairment of assets

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

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

**Table of Contents**

	Land and buildings		Plant and equipment		Assets in course of construction \$ million	Total \$ million
	Freehold \$ million	Leasehold \$ million	Instruments \$ million	Other \$ million		
<b>Cost</b>						
At 1 January 2013	143	52	1,042	919	73	2,229
Exchange adjustment	1	(1)	(16)	6		(10)
Acquisitions (see Note 21)		1	2	2		5
Additions	2	1	139	23	77	242
Disposals	(3)		(102)	(80)	(2)	(187)
Transfers				68	(68)	
At 31 December 2013	143	53	1,065	938	80	2,279
Exchange adjustment	(4)	(1)	(68)	(35)	(2)	(110)
Acquisitions (see Note 21)	11	4	9	17	21	62
Additions			158	57	83	298
Disposal of business				(12)		(12)
Disposals	(2)	(3)	(108)	(40)	(4)	(157)
Transfers	1	1	4	38	(44)	
<b>At 31 December 2014</b>	<b>149</b>	<b>54</b>	<b>1,060</b>	<b>963</b>	<b>134</b>	<b>2,360</b>
<b>Depreciation and impairment</b>						
At 1 January 2013	46	29	738	623		1,436
Exchange adjustment	(1)	(1)	(10)	5		(7)
Charge for the year	1	3	135	70		209
Disposals	(3)		(99)	(73)		(175)
At 31 December 2013	43	31	764	625		1,463
Exchange adjustment	(2)		(50)	(24)		(76)
Charge for the year	5	4	137	76		222
Impairment				3	11	14
Disposal of business				(7)		(7)
Disposals	(1)	(3)	(107)	(36)		(147)
<b>At 31 December 2014</b>	<b>45</b>	<b>32</b>	<b>744</b>	<b>637</b>	<b>11</b>	<b>1,469</b>

**Net book  
amounts****At 31 December  
2014**

<b>104</b>	<b>22</b>	<b>316</b>	<b>326</b>	<b>123</b>	<b>891</b>
------------	-----------	------------	------------	------------	------------

At 31 December

2013

100	22	301	313	80	816
-----	----	-----	-----	----	-----

Land and buildings includes land with a cost of \$20m (2013 \$15m) that is not subject to depreciation. Assets held under finance leases with a net book amount of \$8m (2013 \$10m) are included within land and buildings.

The impairment charge in the year relates to certain assets which related to the production of HP802, which the Group has decided not to continue.

Historically, capital expenditure represents the Group's expected annual investment in property, plant and equipment and other intangible assets. This varies between 6% and 8% (2013 6% and 8%) of annual revenue.

Group capital expenditure relating to property, plant and equipment contracted but not provided for amounted to \$27m (2013 \$20m).

The amount of borrowing costs capitalised in 2014 and 2013 was minimal.

**Table of Contents**

## FINANCIAL STATEMENTS

**Notes to the Group accounts *continued***

## 8 Goodwill

## ACCOUNTING POLICY

Goodwill is not amortised but is reviewed for impairment annually. Goodwill is allocated to the cash-generating unit ( CGU ) that is expected to benefit from the acquisition. The recoverable amount of CGUs to which goodwill has been allocated is tested for impairment annually. The CGUs, monitored by management, are at the business segment level, Advanced Surgical Devices and Advanced Wound Management.

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

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

	2014	2013
	\$ million	\$ million
<b>Cost</b>		
At 1 January	1,256	1,186



Exchange adjustment		(73)	17
Acquisitions (i)	21	844	53
At 31 December		2,027	1,256
<b>Impairment</b>			
At 1 January and 31 December			
<b>Net book amounts</b>		2,027	1,256

(i) 2013 includes an adjustment of \$16m following the finalisation of the Healthpoint acquisition balance sheet.

Each of the Group's business segments represent a CGU and include goodwill as follows:

	2014	2013
	\$ million	\$ million
Advanced Surgical Devices	1,686	918
Advanced Wound Management	341	338
	2,027	1,256

In September 2014 and 2013 impairment reviews were performed by comparing the recoverable amount of each CGU with its carrying amount, including goodwill. These are updated during December, taking into account significant events that occurred between September and December.

For each CGU, the recoverable amounts are based on value-in-use which is calculated from pre-tax cash flow projections for five years using data from the Group's budget and strategic planning process, the results of which are reviewed and approved by the Board. These projections exclude any estimated future cash inflows or outflows expected to arise from future restructurings. The five-year period is in-line with the Group's strategic planning process.

The calculation of value-in-use for the identified CGUs is most sensitive to discount and growth rates as set out below:

The discount rate reflects management's assessment of risks specific to the assets of each CGU. The pre-tax discount rate used in the Advanced Surgical Devices business is 10% (2013 10%) and for the Advanced Wound Management business it is 11% (2013 10%).

In determining the growth rate used in the calculation of the value-in-use, the Group considered annual revenue growth. Projections are based on anticipated volume and value growth in the markets served by the Group and assumptions as to market share movements. Each year the projections for the previous year are compared to actual results and variances are factored into the assumptions used in the current year. Revenue growth rates for the five-year period for the Advanced Surgical Devices business franchises vary from 2% to 15% (2013 1% to 20%) and for the Advanced Wound Management business franchises from 4% to 19% (2013 2% to 22%).

---

**Table of Contents**

Specific considerations and strategies taken into account in determining the sales growth and trading profit margin for each CGU are:

**Advanced Surgical Devices** Management intends to deliver growth through continuing to focus on widening access to the customer, strengthening our portfolio and global presence, innovative product development and through continuing to make efficiency improvements

**Advanced Wound Management** Management intends to develop this CGU by focusing on widening access to the customer, the higher added value sectors of healing chronic wounds and tissue repair using bioactives, and by continuing to improve efficiency.

Following the detailed first 5 years, management has used an unchanged size of the market and Group's share thereof in the pre-tax cash flows used to calculate the terminal value of both the Advanced Surgical Devices business (2013 increase at 3% per year) and Advanced Wound Management businesses (2013 increase at 5% per year), which were considered to be the Group's CGUs in 2014.

Management has considered the following sensitivities:

**Growth of market and market share** Management has considered the impact of a variance in market growth and market share. The value-in-use calculation shows that if the assumed long-term growth rate was reduced to nil, the recoverable amount of all of the CGUs independently would still be greater than their carrying values

**Discount rate** Management has considered the impact of an increase in the discount rate applied to the calculation. The value-in-use calculation shows that for the recoverable amount of the CGU to be less than its carrying value, the discount rate would have to be increased to 28% (2013 33%) for the Advanced Surgical Devices business and 17% (2013 65%) for the Advanced Wound Management business.

[9 Intangible assets](#)

ACCOUNTING POLICIES

Intangible assets

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

Purchased computer software and certain costs of information technology projects are capitalised as intangible assets. Software that is integral to computer hardware is capitalised as plant and equipment.

#### Impairment of intangible assets

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

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

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



**Table of Contents**

## FINANCIAL STATEMENTS

**Notes to the Group accounts** *continued***9 Intangible assets** *continued*

	<b>Acquisition intangibles \$ million</b>	<b>Software \$ million</b>	<b>Distribution rights \$ million</b>	<b>Patents &amp; Intellectual property \$ million</b>	<b>Total \$ million</b>
<b>Cost</b>					
At 1 January 2013	1,109	205	43	176	1,533
Exchange adjustment	3				3
Acquisitions	53				53
Additions		53	27	18	98
Disposals		(29)			(29)
At 31 December 2013	1,165	229	70	194	1,658
Exchange adjustment	(44)	(11)		(2)	(57)
Acquisitions (ii)	830	3			833
Additions		49	5	23	77
Disposals		(3)			(3)
<b>At 31 December 2014</b>	<b>1,951</b>	<b>267</b>	<b>75</b>	<b>215</b>	<b>2,508</b>
<b>Amortisation and impairment</b>					
At 1 January 2013	283	91	27	68	469
Exchange adjustment	1				1
Charge for the year	88	31	14	19	152
Disposals		(18)			(18)
At 31 December 2013	372	104	41	87	604
Exchange adjustment	(27)	(3)		(2)	(32)
Charge for the year	129	31	10	21	191
Disposals		(2)			(2)
<b>At 31 December 2014</b>	<b>474</b>	<b>130</b>	<b>51</b>	<b>106</b>	<b>761</b>
<b>Net book amounts</b>					
<b>At 31 December 2014</b>	<b>1,477</b>	<b>137</b>	<b>24</b>	<b>109</b>	<b>1,747</b>
At 31 December 2013 (i)	793	125	29	107	1,054

(i) The majority of this balance relates to product rights acquired with Healthpoint Biotherapeutics.

(ii) The majority of this balance relates to technology and product rights acquired with ArthroCare Corp, which are being amortised over 6-20 years. See Note 21.

Group capital expenditure relating to software contracted but not provided for amounted to \$7m (2013 \$21m).

The carrying values of acquisition intangibles are reviewed for impairment and it was noted that an intangible asset relating to a distribution agreement for a brand within our US Advanced Wound Management business had headroom which was highly sensitive to management's estimate of future related earnings growth. Changes in those assumptions of either a decrease in the medium term growth rate from 4% to 1% or an increase in the discount rate of 1% to 11.1% would give rise to a \$3 million impairment.

**Table of Contents**

## 10 Investments

**ACCOUNTING POLICY**

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

	2014 \$ million	2013 \$ million
At 1 January	2	2
Additions	4	
Distribution	(1)	
At 31 December	5	2

## 11 Investments in associates

**ACCOUNTING POLICY**

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

At 31 December 2014 and 31 December 2013, the Group holds 49% of Bioventus LLC ( Bioventus ). Bioventus is a limited liability company operating as a partnership. The Company's headquarters is located in Durham, North Carolina, US. Bioventus focuses its medical product development around its core competencies of orthobiologic therapies and orthopaedic diagnostics from which it develops and markets clinically proven orthopaedic therapies and diagnostic tools, including osteoarthritis pain treatments, bone growth stimulators and ultrasound devices. Bioventus sells bone stimulation devices and is a provider of osteoarthritis injection therapies. The loss after taxation recognised

in the income statement relating to Bioventus was \$2m (2013 loss after taxation \$2m).

The carrying amount of this investment was reviewed for impairment as at the balance sheet date. For the purposes of impairment testing the recoverable amount of this investment was based on its fair value less cost to sell, estimated using discounted cash flows. The fair value measurement was categorised as a level 3 fair value based on the inputs and valuation technique used.

In addition to its 49% ownership interest in Bioventus, the Group held a senior secured five year loan note with Bioventus. The loan note was created in May 2012 with a principal amount of \$160m and an annual coupon rate of LIBOR plus 5%. In October 2014, the loan note of \$160 million plus \$28m of accrued interest was repaid by Bioventus following a successful external refinancing. The Group continues to hold 49% of investor equity in Bioventus.

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

	2014 \$ million	2013 \$ million
Balance sheet	112	107
Income statement loss	(2)	(1)



**Table of Contents**

## FINANCIAL STATEMENTS

**Notes to the Group accounts *continued*****11 Investments in associates *continued*****Summarised financial information for associates**

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

	<b>2014</b> \$ million	2013 \$ million
<b>Summarised balance sheet</b>		
Non-current assets	339	315
Current assets	90	129
Non-current liabilities	(220)	(194)
Current liabilities	(48)	(59)
Net assets	161	191
Group's share of net assets at 49%	79	93
Group adjustments (i)	26	14
Group's carrying amount of investment at 49%	105	107
<b>Summarised statement of comprehensive income</b>		
Revenue	242	231
Attributable loss for the year	(5)	(4)
Total comprehensive loss	(5)	(4)
Group share of loss for the year at 49%	(2)	(2)

(i) Group adjustments primarily relate to an adjustment to align the useful life of intangible assets with Group policy.

At December 2014, the Group holds equity investments in two other associates (2013 – none) which are immaterial. The Group's aggregate carrying amount of these investments at 31 December 2014 is \$7m (2013 – nil) and the Group's aggregate share of profits from these investments was \$nil (2013 – nil). The Group's share of loss in 2013 includes a gain of \$1m from two Austrian associates. The Group disposed of the Austrian associates during the year ended 31 December 2013.

**12 Inventories**

## ACCOUNTING POLICY

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

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

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

	<b>2014</b>	2013	2012
	<b>\$ million</b>	\$ million	\$ million
Raw materials and consumables	<b>214</b>	151	138
Work-in-progress	<b>82</b>	72	45
Finished goods and goods for resale	<b>885</b>	783	718
	<b>1,181</b>	1,006	901

Reserves for excess and obsolete inventories were \$317m (2013 \$354m, 2012 \$332m). The decrease in reserves of \$37m in the year comprised releases of \$29m, inventory write-offs of \$4m and foreign exchange movements of \$4m.

The cost of inventories recognised as an expense and included in cost of goods sold amounted to \$1,013m (2013 \$958m, 2012 \$906m). In addition, \$55m was recognised as an expense within cost of goods sold resulting from inventory write offs (2013 \$73m, 2012 \$84m).

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

134 **Smith & Nephew** Annual report 2014

**Table of Contents**

## 13 Trade and other receivables

**ACCOUNTING POLICY**

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

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

	<b>2014</b>	2013	2012
	<b>\$ million</b>	\$ million	\$ million
Trade receivables	<b>1,015</b>	992	964
Less: provision for bad and doubtful debts	<b>(47)</b>	(57)	(49)
Trade receivables net (loans and receivables)	<b>968</b>	935	915
Derivatives forward foreign exchange contracts	<b>49</b>	28	12
Other receivables	<b>51</b>	60	65
Prepayments and accrued income	<b>98</b>	90	73
	<b>1,166</b>	1,113	1,065

Management considers that the carrying amount of trade and other receivables approximates to the fair value.

The provision for bad and doubtful debts is based on specific assessments of risk and reference to past default experience. The bad debt credit for the year was \$4m (2013 expense \$15m, 2012 expense \$16m). Amounts due from insurers in respect of the macro textured claim of \$143m (2013 \$138m, 2012 \$137m) are included within

other receivables and have been provided in full.

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

	<b>2014</b>	2013	2012
	<b>\$ million</b>	\$ million	\$ million
Past due not more than three months	<b>181</b>	206	225
Past due more than three months and not more than six months	<b>49</b>	52	52
Past due more than six months and not more than one year	<b>51</b>	61	52
Past due more than one year	<b>42</b>	70	80
	<b>323</b>	389	409
Neither past due nor impaired	<b>692</b>	603	555
Provision for bad and doubtful debts	<b>(47)</b>	(57)	(49)
Trade receivables net (loans and receivables)	<b>968</b>	935	915

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

At 1 January	<b>57</b>	49	36
Exchange adjustment	<b>(4)</b>	1	
Net receivables (provision released)/provided for during the year	<b>(4)</b>	15	16
Utilisation of provision	<b>(2)</b>	(8)	(3)
At 31 December	<b>47</b>	57	49

Trade receivables include amounts denominated in the following major currencies:

	<b>2014</b>	2013	2012
	<b>\$ million</b>	\$ million	\$ million
US Dollar	<b>353</b>	293	258
Sterling	<b>92</b>	103	100
Euro	<b>225</b>	271	276
Other	<b>298</b>	268	281
Trade receivables net (loans and receivables)	<b>968</b>	935	915



**Table of Contents**

## FINANCIAL STATEMENTS

**Notes to the Group accounts *continued***

## 14 Trade and other payables

	2014	2013
	\$ million	\$ million
<b>Trade and other payables due within one year</b>		
Trade and other payables	807	751
Derivatives – forward foreign exchange contracts	21	20
Acquisition consideration	10	14
	<b>838</b>	785
<b>Other payables due after one year:</b>		
Acquisition consideration	23	7
Other payables	21	7
	<b>44</b>	7

The acquisition consideration due after more than one year is expected to be payable as follows: \$5m in 2016, \$8m in 2017 and \$10m in 2018 (2013 – \$4m in 2015 and \$3m in 2016).

## 15 Cash and borrowings

## 15.1 Net debt

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

	2014	2013
	\$ million	\$ million
Bank overdrafts and loans due within one year	39	44
Long-term bank borrowings	541	347
Private placement notes	1,125	

Borrowings	1,705	391
Cash at bank	(93)	(137)
Credit/(debit) balance on derivatives    currency swaps	1	(1)
Net debt	1,613	253

Borrowings are repayable as follows:

	Within one year or on demand \$ million	Between one and two years \$ million	Between two and three years \$ million	Between three and four years \$ million	Between four and five years \$ million	After five years \$ million	Total \$ million
<b>At 31 December 2014:</b>							
Bank loans	9	400			131		540
Bank overdrafts	28						28
Finance lease liabilities	2	2	2	3	3		12
Private placement notes					125	1,000	1,125
	39	402	2	3	259	1,000	1,705
<b>At 31 December 2013:</b>							
Bank loans	31	335					366
Bank overdrafts	11						11
Finance lease liabilities	2	2	2	2	3	3	14
	44	337	2	2	3	3	391



**Table of Contents**

## 15.2 Assets pledged as security

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

	<b>2014</b> <b>\$ million</b>	2013 \$ million
Finance lease liabilities due within one year	2	2
Finance lease liabilities due after one year	10	12
Total amount of secured borrowings	12	14
Total net book value of assets pledged as security:		
Property, plant and equipment	8	10
	8	10

## 15.3 Currency swap analysis

All currency swaps are stated at fair value. Gross US Dollar equivalents of \$279m (2013 \$146m) receivable and \$280m (2013 \$145m) payable have been netted. Currency swaps comprise foreign exchange swaps and forward contracts and were used in 2014 and 2013 to hedge intragroup loans and other monetary items.

Currency swaps mature as follows:

**At 31 December 2014**

Within one year:

Canadian Dollar  
Chinese Renminbi  
Euro  
Hong Kong Dollar  
Japanese Yen  
Swedish Krona

<b>Amount receivable</b> <b>\$ million</b>	<b>Amount payable</b> <b>Currency million</b>
14	<b>CAD 16</b>
16	<b>CNY 100</b>
17	<b>EUR 14</b>
3	<b>HKD 20</b>
8	<b>JPY 950</b>
	<b>SEK 3</b>
58	

**At 31 December 2014**

Within one year:

Australian Dollar  
Swiss Franc  
Euro  
Sterling  
Japanese Yen

<b>Amount receivable</b> <b>Currency million</b>	<b>Amount payable</b> <b>\$ million</b>
<b>AUD 78</b>	<b>64</b>
<b>CHF 22</b>	<b>22</b>
<b>EUR 62</b>	<b>76</b>
<b>GBP 26</b>	<b>40</b>
<b>JPY 200</b>	<b>2</b>

New Zealand Dollar  
Swedish Krona  
Singapore Dollar

<b>NZD 18</b>	<b>14</b>
<b>SEK 3</b>	
<b>SGD 5</b>	<b>4</b>
	<b>222</b>

<b>Smith &amp; Nephew Annual report 2014</b>	<b>137</b>
--	------------

**Table of Contents**

## FINANCIAL STATEMENTS

**Notes to the Group accounts *continued***15 Cash and borrowings *continued*

At 31 December 2013	Amount receivable \$ million	Amount payable Currency million
Within one year:		
Euro	28	EUR 20
Japanese Yen	13	JPY 1,315
Chinese Renminbi	17	CNY 100
Sterling	11	GBP 7
	69	

At 31 December 2013	Amount receivable Currency million	Amount payable \$ million
Within one year:		
New Zealand Dollar	NZD 9	7
Swiss Franc	CHF 14	16
Swedish Krona	SEK 31	5
Australian Dollar	AUD 41	36
Canadian Dollar	CAD 3	3
Sterling	GBP 6	10
		77

## 15.4 Liquidity risk exposures

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

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

The Group has available committed facilities of \$2.5bn (2013 \$1.7bn). The interest payable on borrowings under committed facilities is either at fixed or floating rates. Floating rates are typically based on the LIBOR (or other reference rate) relevant to the term and currency concerned.

The Company is subject to restrictive covenants under its principal facility agreements. These financial covenants are tested at the end of each half year for the 12 months ending on the last day of the testing period. As of 31 December

2014, the Company was in compliance with these covenants. The facilities are also subject to customary events of default, none of which are currently anticipated to occur.

The Group's principal facilities are:

Facility	Date due
\$400 million syndicated, term loan facility	February 2016
\$1.0 billion syndicated, revolving credit facility	March 2019
\$80 million 2.47% Senior Notes	November 2019
\$45 million Floating Rate Senior Notes	November 2019
\$75 million 3.23% Senior Notes	January 2021
\$190 million 2.97% Senior Notes	November 2021
\$75 million 3.46% Senior Notes	January 2022
\$50 million 3.15% Senior Notes	November 2022
\$105 million 3.26% Senior Notes	November 2023
\$100 million 3.89% Senior Notes	January 2024
\$305 million 3.36% Senior Notes	November 2024
\$25 million Floating Rate Senior Notes	November 2024
\$75 million 3.99% Senior Notes	January 2026

138 **Smith & Nephew** Annual report 2014

**Table of Contents**

## 15.5 Year-end financial liabilities by contractual maturity

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

	Within one year or on demand \$ million	Between one and two years \$ million	Between two and five years \$ million	After five years \$ million	Total \$ million
<b>At 31 December 2014</b>					
<b>Non-derivative financial liabilities:</b>					
Bank overdrafts and loans	37	400	131		568
Trade and other payables	807	21			828
Finance lease liabilities	3	3	9		15
Private placement notes			125	1,000	1,125
Acquisition consideration	10	13	10		33
<b>Derivative financial liabilities:</b>					
Currency swaps/forward foreign exchange contracts outflow	1,811				1,811
Currency swaps/forward foreign exchange contracts inflow	(1,810)				(1,810)
	858	437	275	1,000	2,570
<b>At 31 December 2013</b>					
<b>Non-derivative financial liabilities:</b>					
Bank overdrafts and loans	42	335			377
Trade and other payables	751				751
Finance lease liabilities	3	3	9	3	18
Acquisition consideration	14	4	3		21
<b>Derivative financial liabilities:</b>					
Currency swaps/forward foreign exchange contracts outflow	1,734				1,734
Currency swaps/forward foreign exchange contracts inflow	(1,733)				(1,733)
	811	342	12	3	1,168

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



**Table of Contents**

## FINANCIAL STATEMENTS

**Notes to the Group accounts *continued***15 Cash and borrowings *continued*

## 15.6 Finance leases

## ACCOUNTING POLICY

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

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

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

	<b>2014</b>	2013
	<b>\$ million</b>	\$ million
Within one year	<b>3</b>	3
After one and within two years	<b>3</b>	3
After two and within three years	<b>3</b>	3
After three and within four years	<b>3</b>	3
After four and within five years	<b>3</b>	3
After five years		3
Total minimum lease payments	<b>15</b>	18
Discounted by imputed interest	<b>(3)</b>	(4)
Present value of minimum lease payments	<b>12</b>	14



Present value of minimum lease payments can be split out as: \$2m (2013 \$2m) due within one year, \$10m (2013 \$9m) due between one to five years and \$nil (2013 \$3m) due after five years.

## 16 Financial instruments and risk management

### ACCOUNTING POLICY

#### Derivative financial instruments

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

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

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

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

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

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

140      **Smith & Nephew** Annual report 2014

---

**Table of Contents****16.1 Foreign exchange exposures**

The Group operates in over 100 countries and as a consequence has transactional and translational foreign exchange exposure. It is Group policy for operating units not to hold material unhedged monetary assets or liabilities other than in their functional currencies.

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

The impact of currency movements on the cost of purchases is partly mitigated by the use of forward foreign exchange contracts. The Group uses forward foreign exchange contracts, designated as cash flow hedges, to hedge forecast third party and intercompany trading cash flows for forecast foreign currency inventory purchases for up to one year. When a commitment is entered into, forward foreign exchange contracts are normally used to increase the hedge to 100% of the exposure. Cash flows relating to cash flow hedges are expected to occur within 12 months of inception and profits and losses on hedges are expected to enter into the determination of profit (within cost of goods sold) within a further 12-month period. The principal currencies hedged by forward foreign exchange contracts are US Dollars, Euros and Sterling. At 31 December 2014, the Group had contracted to exchange within one year the equivalent of \$1.5bn (2013 \$1.6bn).

Based on the Group's net borrowings as at 31 December 2014, if the US Dollar were to weaken against all currencies by 10%, the Group's net borrowings would decrease by \$6m (2013 decrease by \$2m) as the Group held a higher amount of foreign denominated cash than foreign denominated borrowings. In respect of borrowings held in a different currency to the relevant reporting entity, if the US Dollar were to weaken by 10% against all other currencies, the Group's borrowings would increase by \$1m (2013 increase by \$4m).

If the US Dollar were to weaken by 10% against all other currencies, then the fair value of the forward foreign exchange contracts as at 31 December 2014 would have been \$37m lower (2013 \$34m). Similarly, if the Euro were to weaken by 10% against all other currencies, then the fair value of the forward foreign exchange contracts as at 31 December 2014 would have been \$26m higher (2013 \$27m). Movements in the fair value of forward foreign exchange contracts would be recognised in other comprehensive income and accumulated in the hedging reserve.

A 10% strengthening of the US Dollar or Euro against all other currencies at 31 December 2014 would have had the equal but opposite effect to the amounts shown above, on the basis that all other variables remain constant.

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

## 16.2 Interest rate exposures

The Group is exposed to interest rate risk on cash, borrowings and certain currency swaps which are all at floating rates. When required the Group uses interest rate derivatives to meet its objective of protecting borrowing costs within parameters set by the Board. Interest rate derivatives are accounted for as cash flow hedges and, as such, changes in fair value resulting from changes in market interest rates are recognised in other comprehensive income and accumulated in the hedging reserve, with the fair value of the interest rate derivatives recorded in the balance sheet. The cash flows resulting from interest rate derivatives match cash flows on the underlying borrowings so that there is no net cash flow from movements in market interest rates on the hedged items.

Based on the Group's gross borrowings as at 31 December 2014, if interest rates were to increase by 100 basis points in all currencies then the annual net interest charge would increase by \$6m (2013 \$4m). A decrease in interest rates by 100 basis points in all currencies would have an equal but opposite effect to the amounts shown above.

## 16.3 Credit risk exposures

The Group limits exposure to credit risk on counterparties used for financial instruments through a system of internal credit limits which, with certain minor exceptions due to local market conditions, require counterparties to have a minimum A rating from one of the major ratings agencies. The financial exposure of a counterparty is determined as the total of cash and deposits, plus the risk on derivative instruments, assessed as the fair value of the instrument plus a risk element based on the nominal value and the historic volatility of the market value of the instrument. The Group does not anticipate non-performance of counterparties and believes it is not subject to material concentration of credit risk as the Group operates within a policy of counterparty limits designed to reduce exposure to any single counterparty.

The maximum credit risk exposure on derivatives at 31 December 2014 was \$49m (2013 \$29m), being the total debit fair values on forward foreign exchange contracts and currency swaps. The maximum credit risk exposure on cash at bank at 31 December 2014 was \$93m (2013 \$137m). The Group's exposure to credit risk is not material as the amounts are held in a wide number of banks in a number of different countries.

Credit risk on trade receivables is detailed in Note 13.

**Table of Contents**

## FINANCIAL STATEMENTS

**Notes to the Group accounts *continued***16 Financial instruments and risk management *continued*

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

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

## Currency and Interest Rate Profile of Interest Bearing Liabilities:

	Gross borrowings \$ million	Currency swaps \$ million	Total liabilities \$ million	Floating rate liabilities \$ million	Fixed rate liabilities \$ million	Fixed rate liabilities Weighted average interest rate %	Weighted average time for which rate is fixed Year
<b>At 31 December 2014:</b>							
US Dollar	1,685	208	1,893	826	1,067	3.4	8
Euro	10	35	45	45			
Other	10	37	47	47			
<b>Total interest bearing liabilities</b>	<b>1,705</b>	<b>280</b>	<b>1,985</b>	<b>918</b>	<b>1,067</b>		
<b>At 31 December 2013:</b>							
US Dollar	297	77	374	360	14	7.1	
Euro	59	28	87	87			
Other	35	40	75	75			
<b>Total interest bearing liabilities</b>	<b>391</b>	<b>145</b>	<b>536</b>	<b>522</b>	<b>14</b>		

At 31 December 2014, \$12m (2013 \$14m) of fixed rate liabilities relate to finance leases. In 2014, the Group also had liabilities due for deferred acquisition consideration (denominated in US Dollars and Brazilian Real) totalling \$33m (2013 \$21m, 2012 \$8m) on which no interest was payable (see Note 14). There are no other significant interest bearing financial liabilities.

Floating rates on liabilities are typically based on the one or three-month LIBOR (or other reference rate) relevant to the currency concerned. The weighted average interest rate on floating rate borrowings as at 31 December 2014 was

1% (2013 1%).

Currency and Interest Rate Profile of Interest Bearing Assets:

	Cash at bank \$ million	Currency swaps \$ million	Total assets \$ million	Floating rate assets \$ million
<b>At 31 December 2014:</b>				
US Dollars	13	79	92	92
Other	80	200	280	280
<b>Total interest bearing assets</b>	<b>93</b>	<b>279</b>	<b>372</b>	<b>372</b>
At 31 December 2013:				
US Dollars	8	69	77	77
Other	129	77	206	206
<b>Total interest bearing assets</b>	<b>137</b>	<b>146</b>	<b>283</b>	<b>283</b>

Floating rates on assets are typically based on the short-term deposit rates relevant to the currency concerned. There were no fixed rate assets at 31 December 2014 or 31 December 2013.

**Table of Contents**

16.5 Fair value of financial assets and liabilities

**ACCOUNTING POLICY**

Measurement of fair values

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

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

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

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

Designated at fair value	Fair value hedging	Loans and	Available for sale	Carrying amount Other financial liabilities	Total	Level 2	Level 3	Fair value
--------------------------	--------------------	-----------	--------------------	--	-------	---------	---------	------------

At 31 December 2014	value instruments receivables								
	\$ million	\$ million	\$ million	\$ million	\$ million	\$ million			
<b>Financial assets measured at fair value</b>									
Forward foreign exchange contracts		48				48	48		
Investments				5		5		5	
Currency swaps	1					1	1		
	1	48		5		54	49	5	
<b>Financial liabilities measured at fair value</b>									
Acquisition consideration	(33)					(33)		(33)	
Forward foreign exchange contracts		(19)				(19)	(19)		
Currency swaps	(2)					(2)	(2)		
	(35)	(19)				(54)	(21)	(33)	
<b>Financial assets not measured at fair value</b>									
Trade and other receivables			1,117			1,117			
Cash at bank			93			93			
			1,210			1,210			
<b>Financial liabilities not measured at fair value</b>									
Bank overdrafts					(28)	(28)			
Bank loans					(540)	(540)			
Private placement debt					(1,125)	(1,125)	(1,144)		(1,144)
Finance lease liabilities					(12)	(12)			
					(828)	(828)			



Trade and  
other payables

(2,533) (2,533)

**Smith & Nephew** Annual report 2014

143

**Table of Contents**

## FINANCIAL STATEMENTS

**Notes to the Group accounts *continued*****16 Financial instruments and risk management *continued***

	Designated	Fair value	Loans		Carrying amount			
	at fair	hedging	and	Available	financial	Total	Level 2	Level 3
At	value	instruments	receivables	for sale	liabilities			
31 December								
2013	\$ million	\$ million	\$ million	\$ million	\$ million	\$ million	\$ million	\$ million
<b>Financial assets measured at fair value</b>								
Forward foreign exchange contracts		28				28	28	
Investments				2		2		2
Currency swaps	1					1	1	
	1	28		2		31	29	2
<b>Financial liabilities measured at fair value</b>								
Acquisition consideration	(21)					(21)		(21)
Forward foreign exchange contracts		(20)				(20)	(20)	
	(21)	(20)				(41)	(20)	(21)
<b>Financial assets not measured at</b>								

**fair value**

Trade and other receivables	1,085	1,085
Cash at bank	137	137
	1,222	1,222

**Financial liabilities not measured at fair value**

Bank overdrafts	(11)	(11)
Bank loans	(366)	(366)
Finance lease liabilities	(14)	(14)
Trade and other payables	(751)	(751)
	(1,142)	(1,142)

The Group enters into derivative financial instruments with financial institutions with investment grade credit ratings. The fair value of forward foreign exchange contracts is calculated by reference to quoted market forward exchange rates for contracts with similar maturity profiles. The fair value of currency swaps is determined by reference to quoted market spot rates. As a result, foreign forward exchange contracts and currency swaps are classified as Level 2 within the fair value hierarchy.

As at 31 December 2014 and 31 December 2013, the fair value of derivatives is net of a credit valuation adjustment attributable to derivative counterparty default risk. The changes in counterparty credit risk had no material effect on the hedge effectiveness for derivatives designated in hedge relationships and other financial instruments recognised at fair value.

The fair value of contingent consideration is estimated using a discounted cash flow model. The valuation model considers the present value of expected payment, discounted using a risk-adjusted discount rate. The expected payment is determined by considering the possible scenarios, which relate to the achievement of established milestones and targets, the amount to be paid under each scenario and the probability of each scenario. As a result, contingent consideration is classified as Level 3 within the fair value hierarchy.

There were no transfers between level 1, 2 and 3 during 2014 and 2013.

For cash and cash equivalents, short-term loans and receivables, overdrafts and other short-term liabilities which have a maturity of less than three months the book values approximate the fair values because of their short-term nature.

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

144 **Smith & Nephew** Annual report 2014

**Table of Contents**

## 17 Provisions and contingencies

**ACCOUNTING POLICY**

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

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

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

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

## 17.1 Provisions

<b>Rationalisation provisions \$ million</b>	<b>Legal and other provisions \$ million</b>	<b>Total \$ million</b>
--	--	-----------------------------

At 1 January 2013	25	97	122
Charge to income statement	15	22	37
Utilised	(22)	(12)	(34)
At 31 December 2013	18	107	125
Acquisitions		<b>24</b>	<b>24</b>
Charge to income statement	<b>17</b>	<b>15</b>	<b>32</b>
Utilised	<b>(22)</b>	<b>(28)</b>	<b>(50)</b>
Exchange adjustment	<b>(1)</b>		<b>(1)</b>
<b>At 31 December 2014</b>	<b>12</b>	<b>118</b>	<b>130</b>
Provisions due within one year	<b>12</b>	<b>55</b>	<b>67</b>
Provisions due after one year		<b>63</b>	<b>63</b>
<b>At 31 December 2014</b>	<b>12</b>	<b>118</b>	<b>130</b>
Provisions due within one year	18	42	60
Provisions due after one year		65	65
At 31 December 2013	18	107	125

The principal provisions within rationalisation provisions relate to the Group Optimisation programme (mainly severance) announced in May 2014 and people costs associated with the structural and efficiency programme announced in August 2011.

Included within the legal and other provisions are:

A provision of \$10m (2013 \$nil) relating to the distribution hold on RENASYS.

A provision of \$7m (2013 \$nil) relating to the HP802 programme which was stopped in the fourth quarter of 2014.

The remaining balance largely represents provisions for various patent disputes and other litigation. All provisions are expected to be substantially utilised within three years of 31 December 2014 and none are treated as financial instruments.

---

**Table of Contents**

## FINANCIAL STATEMENTS

**Notes to the Group accounts *continued*****17 Provisions and contingencies *continued*****17.2 Contingencies**

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

In August 2003, the Group withdrew voluntarily from all markets the macrot textured versions of its OXINIUM femoral knee components. A charge of \$154m was recorded in 2004 for anticipated expenses in connection with macrot texture claims. Most of that amount has since been applied to settlements of such claims, and almost all have been resolved. The aggregate cost at 31 December 2014 related to this matter is approximately \$215m. The Group has sought recovery from its primary and excess insurers for costs of resolving the claims. The primary insurance carrier has paid \$60m in full settlement of its policy liability. However, the excess carriers have denied coverage, citing defences relating to the wording of the insurance policies and other matters. In December 2004, the Group brought suit against them in the US district court for the Western District of Tennessee. Trial has not yet begun. An additional \$22m was received during 2007 from a successful settlement with a third party.

**17.3 Legal proceedings****Product liability claims**

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

In recent years, there has been heightened concern about possible adverse effects of hip implant products with metal-on-metal bearing surfaces, and the Group has incurred and will continue to incur expenses to defend claims in this area. As of January 2015 approximately 930 such claims were pending with the Group around the world, of which 539 had given rise to pending legal proceedings. Most of the pending legal proceedings are in the United States. Most claims relate to the Group's Birmingham Hip Resurfacing ( BHR ) product and the Birmingham Hip Modular Head ( BHMH ) and R3 Metal Liner ( R3ML ) components. In 2012, the Group restricted instructions for use of the BHMH and ceased offering the R3ML. In 2013, the Group's US subsidiary agreed with lawyers representing metal-on-metal claimants to consolidate pre-trial proceedings (such as discovery) in their lawsuits in a state court in Memphis, Tennessee, and those lawsuits account for most of the US proceedings. These lawsuits are being vigorously defended,

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

The Group has requested indemnity from its product liability insurers for most of these metal-on-metal hip implant claims. In general, the insurers are investigating the claims and have reserved rights under their respective policies. As noted above, there can be no assurance that insurance will be available or adequate to cover all claims.

### **Business practice investigations**

Business practices in the healthcare industry are subject to regulation and review by various government authorities. From time to time authorities undertake investigations of the Group's activities to verify compliance. In September 2007, the SEC notified the Group that it was conducting an informal investigation of companies in the medical devices industry, including the Group, regarding possible violations of the Foreign Corrupt Practices Act (FCPA) in connection with the sale of products in certain countries outside of the US. The US Department of Justice (DOJ) subsequently joined the SEC's request.

On 6 February 2012, Smith & Nephew announced that it had reached settlement with the SEC and DOJ in connection with this matter. Smith & Nephew paid slightly less than \$23m in fines and profit disgorgement and committed to maintain an enhanced compliance programme and appoint an independent monitor for at least 18 months to review and report on its compliance programme. The monitor's final report was filed in late 2013, and the independent monitorship was terminated. The settlement agreements had three-year terms. The deferred prosecution agreement with the DOJ expired on 6 February 2015 and the DOJ moved to dismiss a related court action against Smith & Nephew. The agreement with the SEC is scheduled to expire on 3 March 2015.

### **Intellectual property disputes**

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

The Group has won a jury verdict in the US district court for Oregon against Arthrex Inc. for infringement of the Group's patents relating to suture anchors. A number of issues have been disputed and appealed since the case was first filed in 2003; Arthrex's latest appeal was argued in January 2015. Arthrex asserted other patents against the Group in 2014 in the US district court for the Eastern District of Texas.

### **Other matters**

In April 2009, the Group was served with a subpoena by the US Department of Justice in Massachusetts requiring the production of documents from 1995 to 2009 associated with the marketing and sale of the Group's EXOGEN bone growth stimulator. Similar subpoenas have been served on a number of competitors in the bone growth stimulator market. Around the same time a qui tam or whistle-blower complaint concerning the industry's sales and marketing of those products, originally filed in 2005 against the primary manufacturers of bone growth stimulation products (including Smith & Nephew), was unsealed in federal court in Boston, Massachusetts. A motion to dismiss that complaint was denied in December 2010.



146 **Smith & Nephew** Annual report 2014

---

**Table of Contents**

The Group is subject to country of origin requirements under the US Buy American and Trade Agreements Acts with regard to sales to certain US government customers. In 2008 the Group voluntarily disclosed to the US Veterans Administration and the US Department of Defense that a small percentage of the products sold to the US government may have originated from countries that are not eligible for such sales except with government consent. In December 2008, three months after Smith & Nephew's initial voluntary disclosure, a whistle-blower suit was filed in the US district court for the Western District of Tennessee alleging these violations. Smith & Nephew's motion to dismiss the suit was denied in November 2010, and it was settled in 2014.

In January 2014, before agreeing to be acquired by the Group, ArthroCare announced a settlement of charges by the US DOJ relating to securities fraud in which certain members of prior management were implicated. ArthroCare paid a \$30m fine and signed a deferred prosecution agreement that imposes reporting, compliance and other requirements on ArthroCare for a two-year term.

[18 Retirement benefit obligations](#)

## ACCOUNTING POLICY

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

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

A number of key assumptions are made when calculating the fair value of the Group's defined benefit pension plans. These assumptions impact the balance sheet asset and liabilities, operating profit and finance income/costs. The most critical assumptions are the discount rate, the rate of inflation and mortality assumptions to be applied to future

pension plan liabilities. The discount rate is based on the yield at the reporting date on bonds that have a credit rating of AA, denominated in the currency in which the benefits are expected to be paid and have a maturity profile approximately the same as the Group's obligations. In determining these assumptions management take into account the advice of professional external actuaries and benchmarks its assumptions against external data.

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

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

#### 18.1 Retirement benefit net (assets)/obligations

The Group's retirement benefit obligations comprise:

	2014 \$ million	2013 \$ million
Funded plans:		
UK Plan	16	50
US Plan	74	65
Other Plans	42	28
	<b>132</b>	143
Unfunded Plans:		
Other Plans	48	39
Retirement Healthcare	46	43
	<b>226</b>	225
Amount recognised on the balance sheet – liability	<b>233</b>	230
Amount recognised on the balance sheet – asset	<b>(7)</b>	(5)

The Group sponsors pension plans for its employees in 16 countries and these are established under the laws of the relevant country. Funded plans are funded by the payment of contributions and the assets are held by separate trust funds or insurance companies. In countries where there is no Company-sponsored pension plan, state benefits are considered by management to be adequate. Employees' retirement benefits are the subject of regular management review. The Group's defined benefit plans provide employees with an entitlement to retirement benefits varying between 1.3% and 66.7% of final salary on attainment of retirement age. The level of entitlement is dependent on the year of service of the employee.

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

<b>Smith &amp; Nephew</b> Annual report 2014	147
--	-----

**Table of Contents**

## FINANCIAL STATEMENTS

**Notes to the Group accounts *continued*****18 Retirement benefit obligations *continued***

The UK Plan operates under trust law and responsibility for its governance lies with a Board of Trustees. This Board is composed of representatives of the Group, plan participants and an independent trustee who act on behalf of members in accordance with the terms of the Trust Deed and Rules and relevant legislation. The UK Plan's assets are held by the trust. Annual increases on benefits in payment are dependent on inflation. The main uncertainties affecting the level of benefits payable under the UK Plan are future inflation levels (including the impact of inflation on future salary increase) and the actual longevity of the membership.

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

**18.2 Reconciliation of benefit obligations and pension assets**

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

	<b>Obligation \$ million</b>	<b>Asset \$ million</b>	<b>2014 Total \$ million</b>	<b>Obligation \$ million</b>	<b>Asset \$ million</b>	<b>2013 Total \$ million</b>
Amounts recognised on the balance sheet at beginning of the period	<b>(1,581)</b>	<b>1,356</b>	<b>(225)</b>	(1,487)	1,227	(260)
Income statement expense:						
Current service cost	<b>(22)</b>		<b>(22)</b>	(29)		(29)
Past service cost	<b>36</b>		<b>36</b>			
Settlements	<b>71</b>	<b>(60)</b>	<b>11</b>			
Interest (expense)/income	<b>(67)</b>	<b>60</b>	<b>(7)</b>	(59)	51	(8)
Administration costs and taxes	<b>(3)</b>		<b>(3)</b>	(3)		(3)
Costs recognised in Income statement	<b>15</b>		<b>15</b>	(91)	51	(40)
Re-measurements:						

Edgar Filing: SMITH & NEPHEW PLC - Form 20-F

Actuarial gain due to liability experience	5	5	1	1		
Actuarial (loss)/gain due to financial assumptions change	(179)	(179)	16	16		
Actuarial loss due to demographic assumptions	(30)	(30)	(42)	(42)		
Return on plan assets greater than discount rate	110	110	37	37		
Re-measurements recognised in OCI	(204)	110	(94)	(25)	37	12
Cash:						
Employer contributions		65	65	67	67	
Employee contributions	(5)	5	(4)	4		
Benefits paid directly by the Group, taxes and administration costs paid from scheme assets	3	3	3	(3)		
Benefits paid	51	(54)	(3)	45	(45)	
Net cash	49	16	65	44	23	67
Exchange rates	84	(71)	13	(22)	18	(4)
Amount recognised on the balance sheet	(1,637)	1,411	(226)	(1,581)	1,356	(225)
Amount recognised on the balance sheet liability	(1,611)	1,378	(233)	(1,548)	1,318	(230)
Amount recognised on the balance sheet asset	(26)	33	7	(33)	38	5

Represented by:

	Obligation \$ million	Asset \$ million	2014 Total \$ million	Obligation \$ million	Asset \$ million	2013 Total \$ million
UK Plan	(879)	863	(16)	(855)	805	(50)
US Plan	(482)	408	(74)	(482)	417	(65)
Other Plans	(276)	140	(136)	(244)	134	(110)
<b>Total</b>	<b>(1,637)</b>	<b>1,411</b>	<b>(226)</b>	<b>(1,581)</b>	<b>1,356</b>	<b>(225)</b>

All benefits are vested at the end of each reporting period. The weighted average duration of the defined benefit obligation at the end of the reporting period is 20 years and 14 years for the UK and US plans respectively. For 2013, this was 20 years for the UK Plan and 16 years for the US Plan.



**Table of Contents**

## 18.3 Plan assets

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

	2014 \$ million	2013 \$ million	2012 \$ million
<b>UK Plan:</b>			
Assets with a quoted market price:			
Cash and cash equivalents	6	8	11
Equity securities	237	220	249
Government bonds    fixed interest		61	92
index linked		109	282
Liability driven investments	227		
Diversified growth funds	155	159	110
	625	557	744
Other assets:			
Insurance contract	238	248	
Market value of assets	863	805	744
<b>US Plan:</b>			
Assets with a quoted market price:			
Cash and cash equivalents		6	1
Equity securities	167	181	242
Government bonds    fixed interest	121	64	106
Corporate bonds	120	151	
Hedge funds		15	10
Market value of assets	408	417	359
<b>Other Plans:</b>			
Assets with a quoted market price:			
Cash and cash equivalents	6	6	5
Equity securities	33	32	26
Government bonds    fixed interest	7	9	7
index linked	13	11	34
Corporate bonds	12	13	2
Insurance contracts	31	24	
Property	6	6	5
Other quoted securities	3	3	11
	111	104	90
Other assets:			
Equities			2
Insurance contracts	29	29	31
Investment property		1	1
Market value of assets	140	134	124



Total market value of assets	1,411	1,356	1,227
No plans invest directly in property occupied by the Group or in financial securities issued by the Group.			

The US and UK plan assets are invested in a diversified range of industries across a broad range of geographies. These assets include liability matching assets and annuity policies purchased by the trustees of each plan, which aim to match the benefits to be paid to certain members from the plan and therefore remove the investment, inflation and demographic risks in relation to those liabilities.

In December 2014, the low risk asset portfolio held by the UK Plan was transferred into liability driven investments (LDI) in order to maintain the same level of hedging against interest rate and inflation risks.

The UK Plan also has an insurance contract with Rothesay Life covering a subset of the UK Plan pensioner liabilities. The terms of this policy define that the contract value exactly matches the amount and timing of the pensioner obligations covered by the contract. In accordance with IAS19R *Employee Benefits*, the fair value of the insurance contract is deemed to be the present value of the related obligations which is discounted at the AA corporate bond rate.

**Table of Contents**

## FINANCIAL STATEMENTS

**Notes to the Group accounts *continued*****18 Retirement benefit obligations *continued*****18.4 Expenses recognised in the income statement**

The total expense relating to retirement benefits recognised for the year is \$17m (2013 \$72m, 2012 \$72m). Of this cost recognised for the year, \$32m (2013 \$32m, 2012 \$32m) relates to defined contributions and \$15m net income (2013 \$40m expense, 2012 \$40m expense) relates to defined benefit plans.

The cost charged in respect of the Group's defined contribution plans represents contributions payable to these plans by the Group at rates specified in the rules of the plans. These were charged to operating profit in selling, general and administrative expenses. There were \$nil outstanding payments as at 31 December 2014 due to be paid over to the plans (2013 \$nil, 2012 \$nil).

Included in the \$15m net income recognised for defined benefits plans are a \$35m past service cost credit which arose on the closure of the US plan to future accrual in March 2014 and a \$11m gain on settlement of benefits as a result of a member buyout in December 2014.

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

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

	2014		UK Plan \$ million	2013		2012	
	UK Plan \$ million	US Plan \$ million		US Plan \$ million	UK Plan \$ million	US Plan \$ million	
Service cost	10	2	7	10	8	11	
Past service cost		(35)					
Settlement gain		(11)					
Net interest cost, administration and taxes	3	3	1	7	1	7	
	13	(41)	8	17	9	18	

18.5 Principal actuarial assumptions

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

	<b>2014</b>	2013	2012
	<b>% per annum</b>	% per annum	% per annum
<b>UK Plan:</b>			
Discount rate	<b>3.7</b>	4.4	4.5
Future salary increases	<b>3.5</b>	3.9	3.5
Future pension increases	<b>3.0</b>	3.4	3.0
Inflation (RPI)	<b>3.0</b>	3.4	3.0
Inflation (CPI)	<b>2.0</b>	2.4	2.2
<b>US Plan:</b>			
Discount rate	<b>4.0</b>	4.9	4.0
Future salary increases	<b>n/a</b>	3.0	3.0
Inflation	<b>n/a</b>	2.5	2.5

**Table of Contents**

Actuarial assumptions regarding future mortality are based on mortality tables. The UK uses the S1NA with projections in line with the CMI 2011 table and the US uses the RP2000 table with scale AA. The current longevity assumptions underlying the values of the obligations in the defined benefit plans are as follows:

	2014 years	2013 years	2012 years
<b>Life expectancy at age 60</b>			
<b>UK Plan:</b>			
Males	29.4	29.3	28.7
Females	31.2	31.1	30.2
<b>US Plan:</b>			
Males	26.0	23.8	22.9
Females	28.5	25.5	25.0
<b>Life expectancy at age 60 in 20 years time</b>			
<b>UK Plan:</b>			
Males	32.4	32.2	31.2
Females	33.3	33.2	31.9
<b>US Plan:</b>			
Males	27.8	23.8	24.6
Females	30.2	25.5	25.0

## 18.6 Sensitivity analysis

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

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

\$ million	Increase in pension obligation		Increase in pension cost	
	+50bps/+1yr	-50bps/-1yr	+50bps/+1 yr	-50bps/-1yr
<b>UK Plan:</b>				
Discount rate	-80	+91	-4	+4
Inflation	+90	-78	+4	-4
Mortality	+31	-31	+1	-1

**US Plan:**

Discount rate	-33	+36	-2	+1
Inflation	n/a	n/a	n/a	n/a
Mortality	+12	-12		

**Smith & Nephew** Annual report 2014 151

**Table of Contents**

FINANCIAL STATEMENTS

**Notes to the Group accounts *continued***

**18 Retirement benefit obligations *continued***

**18.7 Risk**

The pension plans expose the Group to the following risks:

**Interest rate risk** Volatility in financial markets can change the calculations of the obligation dramatically as the calculation of the obligation is linked to yields on AA-rated corporate bonds. A decrease in the bond yield will increase the measure of plan liabilities, although this will be partially offset by increases in the value of matching plan assets such as bonds and insurance contracts.

**Inflation risk** In the UK, the liability matching portfolio held in conventional and index-linked gilts was transferred into liability driven investments in order to reduce interest rate risk. The UK Plan is linked to inflation. A high rate of inflation will lead to a higher liability. This risk is managed by holding inflation-linked bonds and an inflation-linked insurance contract in respect of some of the obligation. In the UK, the liability matching portfolio held in conventional and index-linked gilts was transferred into liability driven investments in order to reduce inflation risk.

**Investment risk** The US Plan has been closed to future accrual which eliminates the exposure to this risk. If the return on plan assets is below the discount rate, all else being equal, there will be an increase in the plan deficit.

In the UK, this risk is partially managed by a portfolio of liability matching assets and a bulk annuity, together with a dynamic de-risking policy to switch growth assets into liability matching assets over time.

The US Plan has a dynamic de-risking policy to shift plan assets into longer term stable asset classes. The policy established ten pre-determined funded status levels and when each trigger point is reached, the plan assets are re-balanced accordingly.

**Longevity risk**

The present value of the plans defined benefit liability is calculated by reference to the best estimate of the mortality of the plan participants both during and after their employment. An increase in the life expectancy of plan participants above that assumed will increase the benefit obligation.

The UK Plan, in order to minimise longevity risk, entered into an insurance contract which covers a portion of pensioner obligations.

**Salary risk**

The calculation of the defined benefit obligation uses the future estimated salaries of plan participants. Increases in the salary of plan participants above that assumed will increase the benefit obligation. The exposure to salary risk in the US has been eliminated with the closure of the US Plan to future accrual.

**18.8 Funding**

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

**UK Plan**

The most recent full actuarial valuation of the UK Plan was undertaken as at 30 September 2012. Valuations are performed every two years, however in 2014, the Trustees have agreed that they will defer the 2014 valuation for one year and it will be performed in September 2015. Contributions to the UK Plan in 2014 were \$33m (2013 \$37m, 2012 \$39m). This included supplementary payments of \$23m (2013 \$31m, 2012 \$30m).

The Group has agreed to pay the supplementary payments each year until 2017. The agreed supplementary contributions for 2015 are \$37m.

**US Plan**

Full actuarial valuations were performed annually for the US Plan with the last undertaken as at 20 September 2013 before the closure of the Plan to future accrual. Contributions to the US Plan were \$22m (2013 \$20m, 2012 \$27m) which included supplementary payments of \$20m. The agreed contributions for 2015 are \$22m.

**Table of Contents**

## 19 Equity

**ACCOUNTING POLICY**

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

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

## 19.1 Share capital

	Ordinary shares (20¢)		Deferred shares (£1.00)		Total
	Thousand	\$ million	Thousand	\$ million	\$ million
<b>Authorised</b>					
At 31 December 2012	1,223,591	245	50		245
At 31 December 2013	1,223,591	245	50		245
At 31 December 2014	1,223,591	245	50		245
<b>Allotted, issued and fully paid</b>					
At 1 January 2012	954,828	191	50		191
Share options	8,752	2			2
At 31 December 2012	963,580	193	50		193
Share options	5,587	1			1
Shares cancelled	(51,000)	(10)			(10)
At 31 December 2013	918,167	184	50		184
Table of Contents					376



Share options	4,180	1			1
Shares cancelled	(4,405)	(1)			(1)
<b>At 31 December 2014</b>	<b>917,942</b>	<b>184</b>	<b>50</b>		<b>184</b>

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

The holder shall not be entitled to participate in the profits of the Company;

The holder shall not have any right to participate in any distribution of the Company's assets on a winding up or other distribution except that after the return of the nominal amount paid up on each share in the capital of the Company of any class other than the deferred shares and the distribution of a further \$1,000 in respect of each such share there shall be distributed to a holder of a deferred share (for each deferred share held by him) an amount equal to the nominal value of the deferred share;

The holder shall not be entitled to receive notice, attend, speak or vote at any general meeting of the Company; and

The Company may create, allot and issue further shares or reduce or repay the whole or any part of its share capital or other capital reserves without obtaining the consent of the holders of the deferred shares.

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

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

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

	<b>2014</b>	2013	2012
	<b>\$ million</b>	\$ million	\$ million
Share capital	<b>184</b>	184	193
Share premium	<b>574</b>	535	488
Capital redemption reserve	<b>11</b>	10	
Treasury shares	<b>(315)</b>	(322)	(735)
Retained earnings and other reserves	<b>3,586</b>	3,640	3,938
	<b>4,040</b>	4,047	3,884

**Smith & Nephew** Annual report 2014

153

**Table of Contents**

## FINANCIAL STATEMENTS

**Notes to the Group accounts *continued*****19 Equity *continued*****19.2 Treasury shares**

Treasury shares represents the holding of the Company's own shares in respect of the Smith & Nephew Employee's Share Trust and shares bought back as part of the share buy-back programme. On 2 May 2013, as part of the new Capital Allocation Framework, the Group announced the start of a new share buy-back programme to return \$300m of surplus capital to its shareholders. The programme was suspended in February 2014 following the announcement of the ArthroCare acquisition. Shares issued in connection with the Group's share incentive plans are brought back on a quarterly basis. During 2014, a total of 4.4m ordinary shares (0.5%) had been purchased at a cost of \$72m and 4.4m ordinary shares (0.5%) had been cancelled. The maximum number of ordinary shares held in treasury during 2014 was 26.9m (2.8%) with a nominal value of \$5.4m.

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

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

	<b>Treasury</b>	<b>Employees Share Trust</b>	<b>Total</b>
	<b>\$ million</b>	<b>\$ million</b>	<b>\$ million</b>
At 1 January 2013	730	5	735
Shares purchased	226	5	231
Shares transferred from treasury	(8)	8	
Shares transferred to Group beneficiaries	(7)	(14)	(21)
Shares cancelled	(623)		(623)
At 31 December 2013	318	4	322
Shares purchased	72	3	75
Shares transferred from treasury	(11)	11	
Shares transferred to Group beneficiaries	(8)	(17)	(25)
Shares cancelled	(57)		(57)
<b>At 31 December 2014</b>	<b>314</b>	<b>1</b>	<b>315</b>

	Number of shares  million	Number of shares million	Number of shares million
At 1 January 2013	59.5	0.5	60.0
Shares purchased	18.2	0.4	18.6
Shares transferred from treasury	(0.6)	0.6	
Shares transferred to Group beneficiaries	(0.6)	(1.2)	(1.8)
Shares cancelled	(51.0)		(51.0)
At 31 December 2013	25.5	0.3	25.8
Shares purchased	4.4	0.2	4.6
Shares transferred from treasury	(0.9)	0.9	
Shares transferred to Group beneficiaries	(0.6)	(1.3)	(1.9)
Shares cancelled	(4.4)		(4.4)
<b>At 31 December 2014</b>	<b>24.0</b>	<b>0.1</b>	<b>24.1</b>

### 19.3 Dividends

	2014 \$ million	2013 \$ million	2012 \$ million
The following dividends were declared and paid in the year:			
Ordinary final of 17.0¢ for 2013 (2012 16.20¢, 2011 10.80¢) paid 7 May 2014	152	146	97
Ordinary interim of 11.0¢ for 2014 (2013 10.40¢, 2012 9.90¢) paid 11 November 2014	98	93	89
	<b>250</b>	239	186

A final dividend for 2014 of 18.6 US cents per ordinary share was proposed by the Board on 4 February 2015 and will be paid, subject to shareholder approval, on 6 May 2015 to shareholders on the Register of Members on 17 April 2015. The estimated amount of this dividend on 23 February 2015 is \$166m.

**Table of Contents**

## 20 Cash flow statement

**ACCOUNTING POLICY**

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

## Analysis of net debt

	<b>Cash</b>	<b>Overdrafts</b>	<b>Due within</b>	<b>Due after</b>	<b>Net currency</b>	<b>Borrowings</b>
	<b>\$ million</b>	<b>\$ million</b>	<b>one year</b>	<b>one year</b>	<b>swaps</b>	<b>Total</b>
			<b>\$ million</b>	<b>\$ million</b>	<b>\$ million</b>	<b>\$ million</b>
At 1 January						
2012	184	(23)	(283)	(16)		(138)
Net cash flow	(10)	12	256	(414)	1	(155)
Exchange adjustment	4				1	5
At						
31 December						
2012	178	(11)	(27)	(430)	2	(288)
Net cash flow	(38)		(6)	84	1	41
Exchange adjustment	(3)			(1)	(2)	(6)
At						
31 December						
2013	137	(11)	(33)	(347)	1	(253)
Net cash flow	(35)	(19)	22	(1,322)	11	(1,343)
Exchange adjustment	(9)	2		3	(13)	(17)
<b>At</b>						
<b>31 December</b>						
<b>2014</b>	<b>93</b>	<b>(28)</b>	<b>(11)</b>	<b>(1,666)</b>	<b>(1)</b>	<b>(1,613)</b>

Reconciliation of net cash flow to movement in net debt

	<b>2014</b>	2013	2012
	<b>\$ million</b>	\$ million	\$ million
Net cash flow from cash net of overdrafts	<b>(54)</b>	(38)	2
Settlement of currency swaps	<b>11</b>	1	1
Net cash flow from borrowings	<b>(1,300)</b>	78	(158)
Change in net debt from net cash flow	<b>(1,343)</b>	41	(155)
Exchange adjustment	<b>(17)</b>	(6)	5
Change in net debt in the year	<b>(1,360)</b>	35	(150)
Opening net debt	<b>(253)</b>	(288)	(138)
Closing net debt	<b>(1,613)</b>	(253)	(288)
Cash and cash equivalents			

For the purposes of the Group Cash Flow Statement cash and cash equivalents at 31 December 2014 comprise cash at bank net of bank overdrafts.

	<b>2014</b>	2013	2012
	<b>\$ million</b>	\$ million	\$ million
Cash at bank	<b>93</b>	137	178
Bank overdrafts	<b>(28)</b>	(11)	(11)
Cash and cash equivalents	<b>65</b>	126	167

**Table of Contents**

## FINANCIAL STATEMENTS

**Notes to the Group accounts *continued***

## 21 Acquisitions and disposals

## ACCOUNTING POLICY

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

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

## 21.1 Acquisitions

**Year ended 31 December 2014****Acquisition of ArthroCare**

On 29 May 2014, the Group acquired 100% of the shares of ArthroCare Corporation, an innovative medical device company with a highly complementary sports medicine portfolio. The purchase price was \$48.25 per share, paid in cash with the fair value of the total consideration equalling \$1,715m. The acquisition was financed through existing debt facilities and cash balances, including an existing \$1 billion revolving credit facility and a new two-year \$1.4 billion term loan facility, established in February 2014.

The acquisition is deemed to be a business combination within the scope of IFRS 3 *Business Combinations*. The fair values shown below are provisional. If new information is obtained within the measurement period about facts and circumstances that existed at the acquisition date, the acquisition accounting will be revised. The provisional estimate of the goodwill arising on the acquisition is \$829m. It relates to the value of the additional economic benefits expected from the transaction, including synergies and the assembled workforce. The goodwill recognised is not expected to be deductible for tax purposes.

The following table summarises the consideration transferred, and the recognised amounts of assets acquired and liabilities assumed at the acquisition date.

	\$ million
<b>Identifiable assets acquired and liabilities assumed</b>	
Property, plant and equipment	60
Inventories	66
Trade receivables and prepayments	54
Identifiable intangible assets	817
Investments in associates	4
Trade and other payables	(74)
Provisions	(19)
Current tax payable	(18)
Deferred tax liabilities	(173)
Net assets	717
Goodwill	829
Consideration (net of \$169m of cash acquired)	1,546

The recognised amounts of assets acquired and liabilities assumed are different from those disclosed previously as adjustments to provisional values continue to be recorded during the measurement period. None of the adjustments posted to date are material.

The Group incurred acquisition related costs of \$21m relating to professional and advisor fees. These costs have been recognised in administrative expenses in the income statement.

ArthroCare's contribution to Group revenue was \$207m for the year ended 31 December 2014, representing approximately seven months of sales. This gave rise to a pre-tax profit of \$28m after amortisation of acquisition intangibles. Had ArthroCare been acquired on 1 January 2014, the Group's revenues would have been \$147m higher and pre-tax profit would have been \$5m higher.

#### Acquisition of Brazilian distributor

On 17 March 2014 the Group acquired certain assets and liabilities related to the distribution business for its sports medicine, orthopaedic reconstruction, and trauma products in Brazil. The acquisition is deemed to be a business combination within the scope of IFRS 3 *Business Combinations*. The acquisition date fair value of the consideration was \$31m and included deferred consideration of \$26m and \$5m in relation to the settlement of working capital commitments. The deferred consideration was subsequently settled during the second quarter.



**Table of Contents**

As at the acquisition date, the estimated value of the net assets acquired was \$16m, which included trade and other receivables of \$12m, identifiable intangible assets of \$16m, inventory of \$4m, property, plant and equipment of \$2m, trade payables of \$1m, provisions of \$5m, current tax payable of \$4m and deferred tax liabilities of \$8m. As a result, the provisional estimate of goodwill arising on the acquisition was \$15m. This is attributable to the additional economic benefits expected from the acquisition, including the assembled workforce, which has been transferred as part of the acquisition. The goodwill is not expected to be deductible for tax purposes.

The recognised amounts of assets acquired and liabilities assumed have been determined on a provisional basis. If new information is obtained within the measurement period about facts and circumstances that existed at the acquisition date, the acquisition accounting will be revised.

The contribution to revenue and attributable profit from this acquisition for the year ended 31 December 2014 was immaterial. If the acquisition had occurred at the beginning of the year its contribution to revenue and attributable profit for the year ended 31 December 2014 would also have been immaterial.

**Year ended 31 December 2013****Acquisition of Turkish distributor**

On 30 September 2013, the Group acquired certain assets and liabilities in respect of a Turkish business, which distributes products related to orthopaedic reconstruction, trauma, sports medicine and arthroscopic technologies.

The acquisition is deemed to be a business combination within the scope of IFRS 3.

The estimated fair value of the consideration is \$63m and included \$12m of contingent consideration in respect of agreed milestones and \$36m through the settlement of working capital commitments. The accounting for acquisition was completed during 2014, with no change to the provisional values as at 31 December 2013.

The goodwill arising on the acquisition is \$12m. It is attributable to the additional economic benefits expected from the transaction, including the assembled workforce, which has been transferred as part of the acquisition. The goodwill recognised is expected to be deductible for tax purposes.

The following table summarises the consideration transferred, and the recognised amounts of assets acquired and liabilities assumed at the acquisition date.

	\$ million
<b>Identifiable assets acquired and liabilities assumed</b>	
Property, plant and equipment	4
Inventories	8
Trade receivables and prepayments	24
Identifiable intangible assets	17
Payables and accruals	(2)
Table of Contents	385

Net assets	51
Goodwill	12
Cost of acquisition	63

The Group incurred acquisition-related costs of \$4m, primarily related to external legal fees and due diligence costs. These costs have been recognised in administrative expenses in the Group's income statement.

In 2013, the contribution to revenue and attributable profit from the acquisition was immaterial. If the acquisition had occurred at the beginning of the year the contribution to revenue and attributable profit would have also been immaterial.

### **Other acquisitions**

During the year ended 31 December 2013, the Group acquired a Brazilian distributor of its advanced wound management products and a business based in India primarily engaged in the manufacture and distribution of trauma products. These acquisitions are deemed to be business combinations within the scope of IFRS 3.

The aggregated total fair value of the consideration was \$63m and included \$2m of contingent consideration and \$2m through the settlement of working capital commitments. The accounting for both acquisitions was completed during 2014, with no change to the provisional values as at 31 December 2013.

As at the acquisition date, the aggregated fair value of the net assets acquired was \$38 million, which included property, plant and equipment of \$1m, inventory of \$4m, trade receivables and prepayments of \$3m, identifiable intangible assets of \$47m, payables and accruals of \$3m and deferred tax liabilities of \$14m.

The goodwill arising on the acquisitions is \$25m. This is attributable to the additional economic benefits expected from the transactions, including the assembled workforces, which have been transferred as part of the acquisitions. The goodwill recognised is not expected to be deductible for tax purposes.

In 2013, the contribution to revenue and attributable profit from these acquisitions was immaterial. If these acquisitions had occurred at the beginning of 2013 their contribution to revenue and attributable profit would have also been immaterial.

**Table of Contents**

## FINANCIAL STATEMENTS

**Notes to the Group accounts *continued*****21 Acquisitions and disposals *continued*****21.2 Disposal of business****Year ended 31 December 2014**

During the fourth quarter of 2014, the Group disposed of a manufacturing facility in the UK for cash consideration of \$20 million, resulting in a pre-tax gain on disposal of \$9 million. The 2014 revenue and profit contribution of the disposed business was immaterial.

**22 Operating leases**

## ACCOUNTING POLICY

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

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

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

	<b>2014</b> \$ million	2013 \$ million
Land and buildings:		
Within one year	34	30
After one and within two years	25	22
After two and within three years	18	16
After three and within four years	12	13

After four and within five years	8	7
After five years	8	5
	105	93
Other assets:		
Within one year	15	15
After one and within two years	9	9
After two and within three years	4	4
After three and within four years	3	2
	31	30

**Table of Contents**

## 23 Other Notes to the accounts

## 23.1 Share-based payments

**ACCOUNTING POLICY**

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

**Employee plans**

The Smith & Nephew Sharesave Plan (2002) (adopted by shareholders on 3 April 2002) (the Save As You Earn ( SAYE ) plan), the Smith & Nephew International Sharesave Plan (2002), Smith & Nephew France Sharesave Plan (2002), Smith & Nephew Sharesave Plan (2012) (the Save As You Earn ( SAYE 2012 ) plan) (adopted by shareholders on 12 April 2012), Smith & Nephew International Sharesave Plan (2012) (adopted by shareholders on 12 April 2012) and Smith & Nephew France Sharesave Plan (2012) (adopted by shareholders on 12 April 2012) are together termed the Employee Plans .

The SAYE and SAYE 2012 plans are available to all employees in the UK employed by participating Group companies, subject to three months' service. The schemes enable employees to save up to £250 per month and give them an option to acquire shares based on the committed amount to be saved. The option price is not less than 80% of the average of middle market quotations of the ordinary shares on the three dealing days preceding the date of invitation. The Smith & Nephew International Sharesave Plan (2002) and Smith & Nephew International Sharesave Plan (2012) are available to employees in Australia, Austria, Belgium, Canada, China, Denmark, Finland, France, Germany, Hong Kong, India, Ireland, Italy, Japan, South Korea, Mexico, the Netherlands, New Zealand, Norway, Poland, Portugal, Singapore, South Africa, Spain, Sweden, Switzerland and the United Arab Emirates. Puerto Rico participants were eligible to receive options under the International Plans up to 2011 and were eligible to receive phantom options from 2013 onwards. The Smith & Nephew France Sharesave Plans were available to all employees in France up to 2012. The International and French plans operate on a substantially similar basis to the SAYE plans.

Employees in the US are able to participate in the Employee Stock Purchase Plan, which gives them the opportunity to acquire shares, in the form of ADSs, at a discount of 15% (or more if the shares appreciate in value during the plan's quarterly purchase period) to the market price, through a regular savings plan.

**Executive plans**

The Smith & Nephew 2001 UK Approved Share Option Plan, the Smith & Nephew 2001 UK Unapproved Share Option Plan, the Smith & Nephew 2001 US Share Plan (adopted by shareholders on 4 April 2001), the Smith &

Nephew 2004 Executive Share Option Plan (adopted by shareholders on 6 May 2004) and the Smith & Nephew Global Share Plan 2010 (adopted by shareholders on 6 May 2010) are together termed the Executive Plans .

Under the terms of the Executive Plans, the Remuneration Committee, consisting of Non-Executive Directors, may at their discretion approve the grant of options to employees of the Group to acquire ordinary shares in the Company. Options granted under the Smith & Nephew 2001 US Share Plan (the US Plan ) and the Smith & Nephew 2004 Executive Share Option Plan are to acquire ADSs or ordinary shares. For Executive Plans adopted in 2001 and 2004, the market value is the average quoted price of an ordinary share for the three business days preceding the date of grant or the average quoted price of an ADS or ordinary share, for the three business days preceding the date of grant or the quoted price on the date of grant if higher. For the Global Share Plan adopted in 2010 the market value is the closing price of an ordinary share or ADS on the last trading day prior to the grant date. With the exception of options granted under the 2001 US Plan and the Global Share Plan 2010, the vesting of options granted from 2001 is subject to achievement of a performance condition. Options granted under the 2001 US Plan and the Global Share Plan 2010 are not subject to any performance conditions. Prior to 2008, the 2001 US Plan options became cumulatively exercisable as to 10% after one year, 30% after two years, 60% after three years and the remaining balance after four years. With effect from 2008, options granted under the 2001 US Plan became cumulatively exercisable as to 33.3% after one year, 66.7% after two years and the remaining balance after the third year. The 2001 UK Unapproved Share Option Plan was open to certain employees outside the US and the US Plan was open to certain employees in the US, Canada, Mexico and Puerto Rico. The Global Share Plan 2010 is open to employees globally. The 2004 Plan was open to Senior Executives only.

The maximum term of options granted, under all plans, is 10 years from the date of grant. All share option plans are settled in shares.

From 2012 onwards Senior Executives were granted share awards instead of share options and from 2013 executives were granted conditional share awards instead of share options. The awards vest 33.3% after one year, 66.7% after two years and the remaining balance after the third year subject to continued employment. There are no performance conditions for executives. Vesting for senior executives is subject to personal performance levels. The market value used to calculate the number of awards is the closing price of an ordinary share on the last trading day prior to the grant date.

**Table of Contents**

## FINANCIAL STATEMENTS

**Notes to the Group accounts *continued*****23 Other Notes to the accounts *continued*****23.1 Share based payments continued**

At 31 December 2014 8,708,000 (2013 13,601,000, 2012 19,690,000) options were outstanding under share option plans as follows:

	Number of shares Thousand	Range of option exercise prices Pence		Weighted average exercise price Pence
<b>Employee Plans:</b>				
Outstanding at 1 January 2012	3,580	348.0	640.0	432.8
Granted	947	535.0	535.0	535.0
Forfeited	(402)	348.0	609.0	434.5
Exercised	(925)	348.0	609.0	396.0
Expired	(38)	348.0	640.0	496.2
Outstanding at 31 December 2012	3,162	380.0	609.0	473.1
Granted	1,178		625.0	625.0
Forfeited	(174)	380.0	625.0	488.2
Exercised	(751)	380.0	609.0	453.8
Expired	(128)	380.0	625.0	490.0
Outstanding at 31 December 2013	3,287	380.0	625.0	530.5
Granted	<b>799</b>		<b>831.0</b>	<b>831.0</b>
Forfeited	<b>(289)</b>	<b>380.0</b>	<b>831.0</b>	<b>533.8</b>
Exercised	<b>(743)</b>	<b>380.0</b>	<b>625.0</b>	<b>436.2</b>
Expired	<b>(18)</b>	<b>461.0</b>	<b>556.0</b>	<b>465.7</b>
<b>Outstanding at 31 December 2014</b>	<b>3,036</b>	<b>380.0</b>	<b>831.0</b>	<b>632.7</b>
<b>Options exercisable at 31 December 2014</b>	<b>94</b>	<b>380.0</b>	<b>585.0</b>	<b>439.6</b>
Options exercisable at 31 December 2013	71	461.0	556.0	467.8
Options exercisable at 31 December 2012	152	380.0	609.0	400.8
<b>Executive Plans:</b>				
Outstanding at 1 January 2012	23,736	409.5	703.0	561.2
Granted	3,046	642.0	650.0	650.0
Forfeited	(954)	479.0	703.0	569.0
Exercised	(8,740)	434.0	651.0	547.7
Expired	(560)	435.5	637.8	588.7

Edgar Filing: SMITH & NEPHEW PLC - Form 20-F

Outstanding at 31 December 2012	16,528	409.5	680.5	583.3
Forfeited	(118)	514.0	650.0	618.8
Exercised	(5,540)	435.5	671.0	568.0
Expired	(556)	435.5	650.0	582.3
Outstanding at 31 December 2013	10,314	409.5	680.5	591.1
Forfeited	(115)	599.0	650.0	645.0
Exercised	(4,114)	454.0	671.0	583.0
Expired	(413)	409.5	650.0	587.8
<b>Outstanding at 31 December 2014</b>	<b>5,672</b>	<b>470.0</b>	<b>680.5</b>	<b>596.2</b>
<b>Options exercisable at 31 December 2014</b>	<b>4,713</b>	<b>470.0</b>	<b>680.5</b>	<b>585.3</b>
Options exercisable at 31 December 2013	6,631	409.5	680.5	571.1
Options exercisable at 31 December 2012	8,512	409.5	680.5	562.7

The weighted average remaining contractual life of options outstanding at 31 December 2014 was 5.8 years (2013 6.2 years, 2012 6.6 years) for Executive Plans and 2.5 years (2013 2.5 years, 2012 2.6 years) for Employee Plans.



**Table of Contents**

	<b>2014</b>	2013	2012
	<b>pence</b>	pence	pence
Weighted average share price	<b>994.4</b>	764.7	640.5

Options granted during the year were as follows:

	<b>Weighted average fair value per Options granted</b>	<b>Weighted average share price at grant date</b>	<b>Weighted average exercise price</b>	<b>Weighted average option life</b>
	<b>Thousand</b>	<b>Pence</b>	<b>Pence</b>	<b>Years</b>
Employee Plans	<b>799</b>	<b>255.8</b>	<b>1069.0</b>	<b>3.9</b>

The weighted average fair value of options granted under Employee Plans during 2013 was 203.9p (2012 184.0p) and those under Executive Plans during 2013 was nil (2012 148.7p).

Options granted under Employee Plans are valued using the Black-Scholes option model as management consider that options granted under these plans are exercised within a short period of time after the vesting date.

For all plans the inputs to the option pricing models are reassessed for each grant. The following assumptions were used in calculating the fair value of options granted:

	<b>2014</b>	<b>Employee plans</b>		<b>2014</b>	<b>Executive plans</b>	
		2013	2012		2013	2012
Dividend yield %	<b>2.0</b>	2.0	1.5			1.5
Expected volatility % (i)	<b>20.0</b>	25.0	25.0			25.0
Risk free interest rate % (ii)	<b>1.3</b>	1.3	1.3			1.2
Expected life in years	<b>3.9</b>	3.8	3.8			10.0

(i) Volatility is assessed on a historic basis primarily based on past share price movements over the expected life of the options.

(ii) The risk free interest rate reflects the yields available on zero coupon government bonds over the option term and currency.

**Smith & Nephew** Annual report 2014 161

**Table of Contents**

FINANCIAL STATEMENTS

**Notes to the Group accounts *continued***

**23 Other Notes to the accounts *continued***

**23.1 Share based payments continued**

**Share-based payments long-term incentive plans**

In 2004, a share-based incentive plan was introduced for Executive Directors, Executive Officers and the next level of Senior Executives. The plan included a Performance Share Plan ( PSP ) and a Bonus Co-Investment Plan ( CIP ).

Vesting of the PSP awards is dependent upon performance relative to the FTSE 100 and an index based on major international companies in the medical devices industry.

Under the CIP, participants could elect to use up to a maximum of one-half of their annual bonus to purchase shares. If the shares are held for three years and the Group's EPSA growth targets are achieved participants receive an award of matching shares for each share purchased.

From 2009, the CIP was replaced by the Deferred Bonus Plan. This plan was designed to encourage Executives to build up and maintain a significant shareholding in the Company. Under the plan, up to one-third of any bonus earned at target level or above by an eligible employee was compulsorily deferred into shares which vested, subject to continued employment, in equal annual tranches over three years (ie one-third each year). No further performance conditions applied to the deferred shares.

From 2010, Performance Share awards were granted under the Global Share Plan 2010 for all Executives other than Executive Directors. Awards granted under both plans are combined to provide the figures below.

From 2012, Deferred Bonus Plan and GSP 2010 options for Executive Directors, Executive Officers and the next level of Senior Executives were replaced by Equity Incentive Awards ( EIA ). EIA are designed to encourage Executives to build up and maintain a significant shareholding in the Company. EIA will vest, in equal annual tranches over three years (ie one-third each year), subject to continued employment and personal performance. No further performance conditions apply to the EIA.

The fair values of awards granted under long-term incentive plans are calculated using a binomial model. Performance Share awards under both the PSP and Global Share Plan 2010 contain vesting conditions based on TSR versus a comparator group which represent market-based performance conditions for valuation purposes and an assessment of vesting probability is therefore factored into the award date calculations. The assumptions include the volatilities for the comparator groups. A correlation of 40% (2013 40%, 2012 35%) has also been assumed for the companies in the medical devices sector as they are impacted by similar factors. The Performance Target for the Global Share Plan 2010 is a combination of Free Cash Flow growth, Revenue in Emerging & International Markets and the Group's TSR performance over the three-year performance period.

The other assumptions used are consistent with the Executive scheme assumptions disclosed earlier in this note.

At 31 December 2014 the maximum number of shares that could be awarded under the Group's long-term incentive plans was:

	Number of shares in Thousands				Total
	Other Awards	EIA	PSP	Deferred Bonus Plan	
Outstanding at a January 2012	794		6,268	492	7,554
Awarded	187	1,060	2,190		3,437
Vested	(263)	(49)	(1,785)	(287)	(2,384)
Forfeited		(82)	(1,431)	(41)	(1,554)
Outstanding at 31 December 2012	718	929	5,242	164	7,053
Awarded	1,179	785	1,963		3,927
Vested	(437)	(379)	(411)	(115)	(1,342)
Forfeited	(11)	(51)	(1,597)	(5)	(1,664)
Outstanding at 31 December 2013	1,449	1,284	5,197	44	7,974
Awarded	<b>751</b>	<b>642</b>	<b>1,510</b>		<b>2,903</b>
Vested	<b>(583)</b>	<b>(751)</b>		<b>(44)</b>	<b>(1,378)</b>
Forfeited	<b>(96)</b>	<b>(24)</b>	<b>(2,188)</b>		<b>(2,308)</b>
<b>Outstanding at 31 December 2014</b>	<b>1,521</b>	<b>1,151</b>	<b>4,519</b>		<b>7,191</b>

Other awards mainly comprises of conditional share awards granted under the Global Share Plan 2010.

The weighted average remaining contractual life of awards outstanding at 31 December 2014 was 1.1 years (2013 1.4 years, 2012 0.8 years) for the PSP, nil years (2013 0.2 years, 2012 0.9 years) for the Deferred Bonus Plan, 1.5 years (2013 1.8 years) for the EIA and 2.0 years (2013 2.1 years, 2012 0.9 years) for the other awards.

**Table of Contents****Share-based payments charge to income statement**

The expense charged to the income statement for share-based payments is as follows:

	2014 \$ million	2013 \$ million	2012 \$ million
Granted in current year	9	10	9
Granted in prior years	23	18	25
<b>Total share-based payments expense for the year</b>	<b>32</b>	28	34

Under the Executive Plans, PSP, EIA and CIP the number of ordinary shares over which options and share awards may be granted is limited so that the number of ordinary shares issued or that may be issued during the 10 years preceding the date of grant shall not exceed 5% of the ordinary share capital at the date of grant. The total number of ordinary shares which may be issuable in any 10-year period under all share plans operated by the Company may not exceed 10% of the ordinary share capital at the date of grant.

## 23.2 Related party transactions

**Trading transactions**

In the course of normal operations, the Group traded with its associates detailed in Note 11. The aggregated transactions, which have not been disclosed elsewhere in the financial statements, are summarised below:

	2014 \$ million	2013 \$ million	2012 \$ million
Sales to the associates		5	14
Purchases from the associates	1	2	8

All sale and purchase transactions occur on an arm's length basis.

**Key management personnel**

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

	2014 \$ million	2013 \$ million	2012 \$ million
Short-term employee benefits	14	15	16
Share-based payments expense	8	11	10
Pension and post-employment benefit entitlements	1	1	1
Other benefits	3		

	26	27	27
--	----	----	----

<b>Smith &amp; Nephew</b> Annual report 2014			163
--	--	--	-----

**Table of Contents**

## FINANCIAL STATEMENTS

**Notes to the Group accounts *continued*****23 Other Notes to the accounts *continued*****23.3 Principal subsidiary undertakings**

The information provided below is given for principal trading and manufacturing subsidiary undertakings, all of which are 100% owned, in accordance with Section 410 of the Companies Act 2006. A full list will be appended to Smith & Nephew's next annual return to Companies House:

<b>Company Name</b>	<b>Activity</b>	<b>Country of operation and incorporation</b>
<b>UK:</b>		
T. J. Smith & Nephew, Limited		
Smith & Nephew ARTC Limited	Medical Devices	England & Wales
	Medical Devices	England & Wales
<b>Continental Europe:</b>		
Smith & Nephew GmbH	Medical Devices	Austria
ArthroCare Belgium SPRL	Medical Devices	Belgium
Smith & Nephew SA-NV	Medical Devices	Belgium
Smith & Nephew A/S	Medical Devices	Denmark
Smith & Nephew Oy	Medical Devices	Finland
Smith & Nephew SAS	Medical Devices	France
Smith & Nephew Orthopaedics GmbH	Medical Devices	Germany
Smith & Nephew GmbH	Medical Devices	Germany
Smith & Nephew Hellas SA	Medical Devices	Greece
Smith & Nephew Limited	Medical Devices	Ireland
Smith & Nephew Srl	Medical Devices	Italy
Smith & Nephew Nederland CV	Medical Devices	Netherlands
Smith & Nephew A/S	Medical Devices	Norway
Smith & Nephew Sp Zoo	Medical Devices	Poland
Smith & Nephew Lda	Medical Devices	Portugal
Smith & Nephew SAU	Medical Devices	Spain
Smith & Nephew AB	Medical Devices	Sweden
Smith & Nephew Manufacturing AG	Medical Devices	Switzerland
Smith & Nephew Orthopaedics AG	Medical Devices	Switzerland

Smith & Nephew Schweiz AG	Medical Devices	Switzerland
<b>US:</b>		
ArthroCare Corporation	Medical Devices	United States
ArthroCare Medical Corporation	Medical Devices	United States
Smith & Nephew Inc.	Medical Devices	United States



**Table of Contents**

<b>Company Name</b>	<b>Activity</b>	<b>Country of operation and incorporation</b>
<b>Africa, Asia, Australasia and Other America:</b>		
Smith & Nephew Pty Limited	Medical Devices	Australia
Smith & Nephew Surgical Pty Limited	Medical Devices	Australia
Smith & Nephew Comercio de Productos Medicos LTDA	Medical Devices	Brazil
Smith & Nephew Inc.	Medical Devices	Canada
Smith & Nephew (Alberta) Inc.	Medical Devices	Canada
Tenet Medical Engineering Inc.	Medical Devices	Canada
Smith & Nephew Medical (Shanghai) Limited	Medical Devices	China
Smith & Nephew Medical (Suzhou) Limited	Medical Devices	China
Smith & Nephew Orthopaedics (Beijing) Limited	Medical Devices	China
ArthroCare Costa Rica SRL	Medical Devices	Costa Rica
Smith & Nephew Curaçao NV	Medical Devices	Curaçao
Smith & Nephew Limited	Medical Devices	Hong Kong
Adler Mediequip Private Limited	Medical Devices	India
Smith & Nephew Healthcare Private Limited	Medical Devices	India
Smith & Nephew Endoscopy KK	Medical Devices	Japan
Smith & Nephew Orthopaedics KK	Medical Devices	Japan
Smith & Nephew Wound Management KK	Medical Devices	Japan
Smith & Nephew Chusik Hoesia	Medical Devices	Korea
Smith & Nephew Healthcare Sdn Berhad	Medical Devices	Malaysia
Smith & Nephew SA de CV	Medical Devices	Mexico
Smith & Nephew Limited	Medical Devices	New Zealand
Smith & Nephew Surgical Limited	Medical Devices	New Zealand
Smith & Nephew Inc.	Medical Devices	Puerto Rico
LLC Smith & Nephew	Medical Devices	Russia
Smith & Nephew Pte Limited	Medical Devices	Singapore
Smith & Nephew (Pty) Limited	Medical Devices	South Africa
Smith & Nephew Limited	Medical Devices	Thailand
Smith ve Nephew Medikal Cihazlar Ticaret Limited Sirketi	Medical Devices	Turkey
Smith & Nephew FZE	Medical Devices	United Arab Emirates



**Table of Contents**

## FINANCIAL STATEMENTS

**Company balance sheet**

	Notes	At 31 December 2014 \$ million	At 31 December 2013 \$ million
<b>Fixed assets:</b>			
Investments	3	5,322	3,597
<b>Current assets:</b>			
Debtors	4	2,143	2,140
Cash and bank	6	1	6
		2,144	2,146
<b>Creditors: amounts falling due within one year:</b>			
Borrowings	6	(40)	(2)
Other creditors	5	(1,287)	(1,590)
		(1,327)	(1,592)
<b>Net current assets</b>		817	554
<b>Total assets less current liabilities</b>		6,139	4,151
<b>Creditors: amounts falling due after one year:</b>			
Borrowings	6	(1,655)	(335)
<b>Total assets less total liabilities</b>		4,484	3,816
<b>Equity shareholders funds:</b>			
Called up equity share capital	7	184	184
Share premium account	7	574	535
Capital redemption reserve	7	11	10
Capital reserve	7	2,266	2,266
Treasury shares	7	(315)	(322)
Exchange reserve	7	(52)	(52)
Profit and loss account	7	1,816	1,195
<b>Shareholders funds</b>		4,484	3,816

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

<b>Roberto Quarta</b>	<b>Olivier Bohuon</b>	<b>Julie Brown</b>
Chairman	Chief Executive Officer	Chief Financial Officer

Edgar Filing: SMITH & NEPHEW PLC - Form 20-F

The Parent Company financial statements of Smith & Nephew plc on pages 166 to 169 do not form part of the Smith & Nephew s

Annual Report on Form 20-F as filed with the SEC.

166 **Smith & Nephew** Annual report 2014

## **Table of Contents**

### **1 Basis of preparation**

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

The separate accounts of the Company are presented as required by the Companies Act 2006. The accounts have been prepared under the historical cost convention, modified to include revaluation to fair value of certain financial instruments as described below, and in accordance with applicable UK accounting standards. As consolidated financial information has been disclosed under IFRS 7 Financial Instruments: Disclosures, the Company is exempt from FRS 29 Financial Instruments: Disclosures. The Group accounts have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union and are presented on pages 110 to 165.

The Company has taken advantage of the exemption in FRS 8 Related Party Disclosures not to present its related party disclosures as the Group accounts contain these disclosures. In addition, the Company has taken advantage of the exemption in FRS 1 Cash Flow Statements not to present its own cash flow statement as the Group accounts contain a consolidated cash flow.

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

#### **Foreign currencies**

Transactions in foreign currencies are initially recorded at the exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the rate of exchange ruling at the balance sheet date. All exchange differences are dealt with in arriving at profit before taxation.

#### **Deferred taxation**

Deferred taxation is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events have occurred at that date that will result in an obligation to pay more, or a right to pay less or to receive more, tax.

Deferred tax is measured on an undiscounted basis at the tax rates that are expected to apply in the periods in which timing differences are expected to reverse. These are based on tax rates and laws substantively enacted at the balance sheet date.

### **2 Results for the year**

As permitted by Section 408(4) of the Companies Act 2006, the Company has not presented its own profit and loss account. Profit for the year was \$922m (2013 \$198m).

### **3 Investments**

## ACCOUNTING POLICY

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

	<b>2014</b>	2013
	<b>\$ million</b>	\$ million
At 1 January	<b>3,597</b>	3,597
Additions	<b>1,725</b>	
At 31 December	<b>5,322</b>	3,597

Investments represent holdings in subsidiary undertakings.

The information provided below is given for the principal direct subsidiary undertakings, all of which are 100% owned and, in accordance with Section 410 of the Companies Act 2006, a full list will be appended to Smith & Nephew's next annual return to Companies House.

<b>Company Name</b>	<b>Activity</b>	<b>Country of operation and incorporation</b>
Smith & Nephew UK Limited	Holding Company	England & Wales
Smith & Nephew (Overseas) Limited	Holding Company	England & Wales

Refer to Note 23.3 of the Notes to the Group accounts for the principal trading and manufacturing subsidiary undertakings of the Group.

The Parent Company financial statements of Smith & Nephew plc on pages 166 to 169 do not form part of the Smith & Nephew's

Annual Report on Form 20-F as filed with the SEC.



**Table of Contents**

## FINANCIAL STATEMENTS

**Notes to the Company accounts *continued*****4 Debtors**

	<b>2014</b> <b>\$ million</b>	2013 \$ million
Amounts falling due within one year:		
Amounts owed by subsidiary undertakings	<b>2,074</b>	2,091
Prepayments and accrued income	<b>3</b>	3
Current asset derivatives forward foreign exchange contracts	<b>65</b>	45
Current asset derivatives currency swaps		1
Current taxation	<b>1</b>	
	<b>2,143</b>	2,140

**5 Other creditors**

	<b>2014</b> <b>\$ million</b>	2013 \$ million
Amounts falling due within one year:		
Amounts owed to subsidiary undertakings	<b>1,212</b>	1,533
Other creditors	<b>9</b>	10
Current taxation		2
Current liability derivatives forward foreign exchange contracts	<b>65</b>	45
Current liability derivatives currency swaps	<b>1</b>	
	<b>1,287</b>	1,590

**6 Cash and borrowings**

## ACCOUNTING POLICY

## Financial instruments



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

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

	<b>2014</b>	2013
	<b>\$ million</b>	\$ million
Bank loans and overdrafts due within one year or on demand	<b>40</b>	2
Bank loans due after one year	<b>1,655</b>	335
Borrowings	<b>1,695</b>	337
Cash and bank	<b>(1)</b>	(6)
Credit/(debit) balance on derivatives – currency swaps	<b>1</b>	(1)
Net debt	<b>1,695</b>	330

All currency swaps are stated at fair value. Gross US Dollar equivalents of \$261m (2013 \$146m) receivable and \$262m (2013 \$145m) payable have been netted. Currency swaps comprise foreign exchange swaps and were used in 2014 and 2013 to hedge intragroup loans.

The Parent Company financial statements of Smith & Nephew plc on pages 166 to 169 do not form part of the Smith & Nephew s

Annual Report on Form 20-F as filed with the SEC.

**Table of Contents**

## 7 Equity and reserves

	Share capital \$ million	Share premium \$ million	Capital redemption reserve \$ million	Capital reserves \$ million	Treasury shares \$ million	Exchange reserves \$ million	Profit and loss account \$ million	2013 Total shareholder fund \$ million
At 1 January	184	535	10	2,266	(322)	(52)	1,195	3,811
Attributable profit for the year							922	922
Net losses on cash flow hedges							(5)	(5)
Equity dividends paid in the year							(250)	(250)
Share-based payments recognised							32	32
Cost of shares transferred to beneficiaries					25		(21)	4
New shares issued on exercise of share options	1	39						40
Cancellation of treasury shares	(1)		1		57		(57)	
Treasury shares purchased					(75)			(75)
At 31 December	184	574	11	2,266	(315)	(52)	1,816	4,488

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

The total distributable reserves of the Company are \$1,449m (2013 \$821m). In accordance with the exemption permitted by Section 408 of the Companies Act 2006, the Company has not presented its own profit and loss account. The attributable profit for the year dealt with in the accounts of the Company is \$922m (2013 \$198m).

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

## 8 Share-based payments

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

The disclosure relating to the Company is detailed in Note 23.1 of the Notes to the Group accounts.

## 9 Contingencies

	2014 \$ million	2013 \$ million
Guarantees in respect of subsidiary undertakings	11	25

The Company has given guarantees to banks to support liabilities under foreign exchange and other contracts and cross guarantees to support overdrafts. Such guarantees are not considered to be liabilities as all subsidiary undertakings are trading as going concerns.

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

The Parent Company financial statements of Smith & Nephew plc on pages 166 to 169 do not form part of the Smith & Nephew s

Annual Report on Form 20-F as filed with the SEC.

Smith & Nephew Annual report 2014 169

**Table of Contents**

## OTHER INFORMATION

**Group information****Business overview and Group history**

Smith & Nephew's operations are organised into two primary divisions that operate globally: Advanced Surgical Devices and Advanced Wound Management.

The Group has a history dating back over 150 years to the family enterprise of Thomas James Smith who opened a small pharmacy in Hull, UK in 1856. Following his death in 1896, his nephew Horatio Nelson Smith took over the management of the business.

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

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

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

**Property, plant and equipment**

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

	<b>Approximate area (square feet 000's)</b>
Group head office in London, UK	20
Group research facility in York, UK	84
Advanced Surgical Devices headquarters in Andover, Massachusetts, US	144
Advanced Wound Management headquarters and manufacturing facility in Hull, UK	473
Advanced Surgical Devices manufacturing facilities in Memphis, Tennessee, US	971
Advanced Surgical Devices distribution facility in Memphis, Tennessee, US	210
Advanced Surgical Devices manufacturing facility in Aarau, Switzerland	121
Advanced Surgical Devices manufacturing facility in Beijing, China	192
Table of Contents	412

Advanced Surgical Devices manufacturing and warehouse facility in Warwick, UK	90
Advanced Surgical Devices manufacturing and warehouse facility in Tuttlingen, Germany	64
Advanced Surgical Devices distribution facility and European headquarters in Baar, Switzerland	67
Advanced Surgical Devices manufacturing facility in Mansfield, Massachusetts, US	98
Advanced Surgical Devices manufacturing facility in Oklahoma City, Oklahoma, US	155
Advanced Surgical Devices manufacturing facility in Calgary, Canada	17
Advanced Surgical Devices manufacturing facility in Austin, Texas, US	198
Advanced Surgical Devices manufacturing facility in La Aurora, Costa Rica	36
Advanced Surgical Devices research facility in Irvine, California, US	23
Advanced Surgical Devices manufacturing facility in Sangameshwar, India	39
Advanced Wound Management manufacturing facility in Suzhou, China	288
Advanced Wound Management manufacturing facility in Fort Saskatchewan, Canada	76
Advanced Wound Management US headquarters in St. Petersburg, Florida, US	44
Advanced Wound Bioactives headquarters and laboratory space in Fort Worth, Texas, US	105
Advanced Wound Bioactives manufacturing facility in Curaçao, Dutch Caribbean	16

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

#### [Off-balance sheet arrangements](#)

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

#### [Related party transactions](#)

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

## Table of Contents

### Risk factors

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

#### Highly competitive markets

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

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

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

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

#### Continual development and introduction

##### of new products

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

Group's new products do not remain competitive with those of competitors, the Group's revenue could decline.

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

#### Dependence on government and other funding

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

Pricing of the Group's products is largely governed in most Established Markets by governmental reimbursement authorities. Initiatives sponsored by government agencies, legislative bodies and the private sector to limit the growth of healthcare costs, including price regulation, excise taxes and competitive pricing, are ongoing in markets where the Group has operations. This control may be exercised by determining prices for an individual product or for an entire procedure. The Group is exposed to government policies favouring locally sourced products. The Group is also exposed to changes in reimbursement policy, tax policy and pricing which may have an adverse impact on revenue and operating profit. In particular, changes to the healthcare legislation in the US have imposed significant taxes on medical device manufacturers from 2013. There may be an increased risk of adverse changes to government funding policies arising from the deterioration in macro-economic conditions in some of the Group's markets.

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

#### World economic conditions

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

During 2014, economic conditions worldwide continued to create several challenges for the Group, including deferrals of joint replacement procedures, heightened pricing pressure, significant declines in capital equipment expenditures at hospitals and increased uncertainty over the collectability of European government debt, particularly those in certain parts of southern Europe. These factors tempered the overall growth of the Group's global markets and could have an increased impact on growth in the future.





**Table of Contents**

OTHER INFORMATION

**Group information *continued***

Political uncertainties

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

Currency fluctuations

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

The Group manages the impact of exchange rate movements on revenue and cost of goods sold by a policy of transacting forward foreign currency commitments when firm purchase orders are placed. In addition, the Group's policy is for forecast transactions to be covered between 50% and 90% for up to one year.

The Group uses the US Dollar as its reporting currency and the US Dollar is the functional currency of Smith & Nephew plc. The Group's revenues, profits and earnings are also affected by exchange rate movements on the translation of results of operations in foreign subsidiaries for financial reporting purposes. See "Liquidity and capital resources" on page 115.

Manufacturing and supply

The Group's manufacturing production is concentrated at 15 main facilities in Austin, Memphis, Mansfield and Oklahoma City in the US, Hull and Warwick in the UK, Aarau in Switzerland, Tuttlingen in Germany, Fort Saskatchewan and Calgary in Canada, Sangameshwar in India, Suzhou and Beijing in China, La Aurora in Costa Rica and Curaçao. If major physical disruption took place at any of these sites, it could adversely affect the results of operations. Physical loss and consequential loss insurance is carried to cover such risks but is subject to limits and deductibles and may not be sufficient to cover catastrophic loss. Management of orthopaedic inventory is complex, particularly forecasting and production planning. There is a risk that failures in operational execution could lead to excess inventory or individual product shortages.

Each of the business segments is reliant on certain key suppliers of raw materials, components, finished products and packaging materials or in some cases on a single supplier.

These suppliers must provide the materials and perform the activities to the Group's standard of quality requirements.

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

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

#### Attracting and retaining key personnel

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

#### Proprietary rights and patents

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

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

#### Product liability claims and loss of reputation

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

There can be no assurance that customers, particularly in the US, the Group's largest geographical market, will not bring product liability or related claims that would have a material adverse effect on the Group's financial position or results of operations in the future, or that the Group will be able to resolve such claims within insurance limits.

172 **Smith & Nephew** Annual report 2014

## Table of Contents

### Regulatory standards and compliance in the healthcare industry

Business practices in the healthcare industry are subject to regulation and review by various government authorities. In general, the trend in many countries in which the Group does business is towards higher expectations and increased enforcement activity by governmental authorities. While the Group is committed to doing business with integrity and welcomes the trend to higher standards in the healthcare industry, the Group and other companies in the industry have been subject to investigations and other enforcement activity that have incurred and may continue to incur significant expense. See Note 17 to the Group accounts. Under certain circumstances, if the Group were found to have violated the law, its ability to sell its products to certain customers could be restricted.

### International regulation

The Group operates across the world and is subject to legislation, including anti-bribery and corruption and data protection, in each country in which we operate. Our international operations are governed by the UK Bribery Act and the US Foreign Corrupt Practices Act (FCPA) which prohibit us or our agents from making, or offering, improper payments to foreign governments and their officials for the purpose of obtaining or maintaining business or product approvals. Enforcement of such legislation has increased in recent years with significant fines and penalties being imposed on companies and individuals. Our international operations, particularly in the emerging markets, expose the Group to the risk that our employees or agents will engage in prohibited activities.

### Regulatory approval

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

National regulatory authorities administer and enforce a complex series of laws and regulations that govern the design, development, approval, manufacture, labelling, marketing and sale of healthcare products. They also review data supporting the safety and efficacy of such products. Of particular importance is the requirement in many countries that products be authorised or registered prior to manufacture, marketing or sale and that such authorisation or registration be subsequently maintained. The major regulatory agencies for Smith & Nephew's products include the Food and Drug Administration (FDA) in the US, the Medicines and Healthcare products Regulatory Agency in the UK, the Ministry of Health, Labour and Welfare in Japan, the China Food and Drug Administration and the Australian Therapeutic Goods Administration.

At any time, the Group is awaiting a number of regulatory approvals which, if not received, could adversely affect results of operations.

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

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

and Group medical device regulation and policies.

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

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

Failure to make successful acquisitions

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

Relationships with healthcare professionals

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

Reliance on sophisticated information technology

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

Other risk factors

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

#### [Factors affecting Smith & Nephew's results of operations](#)

Government economic, fiscal, monetary and political policies are all factors that materially affect the Group's operation or investments of shareholders. Other factors include sales trends, currency fluctuations and innovation. Each of these factors is discussed further in the [Our marketplace](#) on pages 18 to 20, [Segment performance](#) on pages 26 to 33 and [Taxation information for shareholders](#) on pages 190 to 191.

<b>Smith &amp; Nephew</b> Annual report 2014	173
--	-----

**Table of Contents**

## OTHER INFORMATION

**Other financial information**

## Selected financial data

	<b>2014</b>	2013	2012	2011	2010
	<b>\$ million</b>	\$ million	\$ million	\$ million	\$ million
<b>Income statement</b>					
Revenue	<b>4,617</b>	4,351	4,137	4,270	3,962
Cost of goods sold	<b>(1,162)</b>	(1,100)	(1,070)	(1,140)	(1,031)
Gross Profit	<b>3,455</b>	3,251	3,067	3,130	2,931
Selling, general and administrative expenses	<b>(2,471)</b>	(2,210)	(2,050)	(2,101)	(1,860)
Research and development expenses	<b>(235)</b>	(231)	(171)	(167)	(151)
Operating profit	<b>749</b>	810	846	862	920
Net interest (payable)/receivable	<b>(22)</b>	4	2	(8)	(15)
Other finance (costs)/income	<b>(11)</b>	(11)	(11)	(13)	(16)
Share of results of associates	<b>(2)</b>	(1)	4		
Profit on disposal of net assets held for sale			251		
Profit before taxation	<b>714</b>	802	1,092	841	889
Taxation	<b>(213)</b>	(246)	(371)	(266)	(280)
Attributable profit for the year	<b>501</b>	556	721	575	609
<b>Earnings per ordinary share</b>					
Basic	<b>56.1¢</b>	61.7¢	80.4¢	64.5¢	68.6¢
Diluted	<b>55.7¢</b>	61.4¢	80.0¢	64.2¢	68.5¢
<b>Adjusted attributable profit</b>					
Attributable profit for the year	<b>501</b>	556	721	575	609
Acquisition-related costs	<b>125</b>	31	11		
Restructuring and rationalisation expenses	<b>61</b>	58	65	40	15
Legal and other	<b>(2)</b>			23	
Amortisation of acquisition intangibles and impairments	<b>129</b>	88	43	36	34
Profit on disposal of net assets held for sale			(251)		
Taxation on excluded items	<b>(71)</b>	(40)	82	(17)	(10)
Adjusted attributable profit	<b>743</b>	693	671	657	648
Adjusted basic earnings per ordinary share ( EPISA ) (i)	<b>83.2¢</b>	76.9¢	74.8¢	73.7¢	73.0¢

Adjusted diluted earnings per ordinary share (ii)	82.6¢	76.5¢	74.5¢	73.4¢	72.9¢
---	-------	-------	-------	-------	-------

(i) Adjusted basic earnings per ordinary share is calculated by dividing adjusted attributable profit by the average number of shares.

(ii) Adjusted diluted earnings per ordinary share is calculated by dividing adjusted attributable profit by the diluted number of shares.



**Table of Contents**

	2014	2013	2012	2011	2010
	\$ million	\$ million	\$ million	\$ million	\$ million
<b>Group balance sheet</b>					
Non-current assets	4,866	3,563	3,498	2,542	2,579
Current assets	2,440	2,256	2,144	2,080	2,154
Assets held for sale				125	
<b>Total assets</b>	<b>7,306</b>	5,819	5,642	4,747	4,733
Share capital	184	184	193	191	191
Share premium	574	535	488	413	396
Capital redemption reserve	11	10			
Treasury shares	(315)	(322)	(735)	(766)	(778)
Retained earnings and other reserves	3,586	3,640	3,938	3,349	2,964
<b>Total equity</b>	<b>4,040</b>	4,047	3,884	3,187	2,773
Non-current liabilities	2,104	699	828	422	1,046
Current liabilities	1,162	1,073	930	1,119	914
Liabilities directly associated with assets held for sale				19	
<b>Total liabilities</b>	<b>3,266</b>	1,772	1,758	1,560	1,960
<b>Total equity and liabilities</b>	<b>7,306</b>	5,819	5,642	4,747	4,733
<b>Group cash flow statement</b>					
Cash generated from operations	961	1,138	1,184	1,135	1,111
Net interest paid	(33)	(6)	(4)	(8)	(17)
Income taxes paid	(245)	(265)	(278)	(285)	(235)
Net cash inflow from operating activities	683	867	902	842	859
Capital expenditure (including trade investments and net of disposals of property, plant and equipment)	(375)	(340)	(265)	(321)	(307)
Acquisitions and disposals	(1,556)	(67)	(782)	(33)	
Proceeds on disposal of net assets held for sale			103		
Investment in associate	(2)		(10)		
Proceeds from associate loan redemption	188				
Proceeds from own shares	4	3	6	7	8
Equity dividends paid	(250)	(239)	(186)	(146)	(132)
Issue of ordinary capital and treasury shares purchased	(35)	(183)	77	11	10
	(1,343)	41	(155)	360	438
Exchange adjustments	(17)	(6)	5	(6)	13
Opening (net debt)/net cash	(253)	(288)	(138)	(492)	(943)

Closing net debt	<b>(1,613)</b>	(253)	(288)	(138)	(492)
<b>Selected financial ratios</b>					
Gearing (closing net debt as a percentage of total equity)	<b>40%</b>	6%	7%	4%	18%
Dividends per ordinary share (i)	<b>29.60¢</b>	27.40¢	26.10¢	17.40¢	15.82¢
Research and development costs to Revenue	<b>5.1%</b>	5.3%	4.1%	3.9%	3.8%
Capital expenditure (including intangibles but excluding goodwill) to revenue	<b>8.1%</b>	7.8%	6.4%	7.5%	7.7%

- (i) The Board has proposed a final dividend of 18.6 US cents per share which together with the first interim dividend of 11.0 US cents makes a total for 2014 of 29.6 US cents.

## **Table of Contents**

### OTHER INFORMATION

#### **Other financial information *continued***

#### **Non-GAAP Financial Information**

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

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

#### **Revenue**

Underlying growth in revenue is used to compare the revenue in a given year to the previous year on a like-for-like basis. This is achieved by adjusting for the impact of sales of products acquired in material business combinations and for movements in exchange rates. Underlying growth in revenue is not presented in the accounts prepared in accordance with IFRS and is therefore a measure not in accordance with Generally Accepted Accounting Principles (a non-GAAP measure).

The Group believes that the tabular presentation and reconciliation of reported revenue growth to underlying revenue growth assists investors in their assessment of the Group s performance in each business segment and for the Group as a whole.

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

The Group considers that revenue from sales of products acquired in material business combinations results in a step-up in growth in revenue in the year of acquisition that cannot be wholly attributed to local management s efforts with respect to the business in the year of acquisition. Depending on the timing of the acquisition, there will usually be a further step change in the following year. A measure of growth excluding the effects of business combinations also

allows senior management to evaluate the performance and relative impact of growth from the existing business and growth from acquisitions. The process of making business acquisitions is directed, approved and funded from the Group corporate centre in line with strategic objectives.

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

within the control of local management, performance of acquisitions is monitored centrally until the business is integrated.

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

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

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

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

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

	2014	2013	2012
	%	%	%
Reported revenue growth	6	5	(3)
Constant currency exchange effect	1	1	2
Acquisition/Disposals effect	(5)	(2)	3
Underlying revenue	2	4	2

A reconciliation of reported revenue growth to underlying revenue growth, by business segment, can be found on page 35.

#### Trading profit, trading profit margin and trading cash flow

Trading profit, trading profit margin and trading cash flow are trend measures, which present the long-term profitability of the Group excluding the impact of specific transactions that management considers affect the Group's short-term profitability and cash flows. The Group has identified the following items, where material, as those to be

excluded from operating profit and cash generated from operations when arriving at trading profit and trading cash flow, respectively: acquisition and disposal related items arising in connection with business combinations, including amortisation of acquisition intangible assets, impairments and integration costs; restructuring events; gains and losses resulting from legal disputes and significant uninsured losses. In addition to these items, gains or losses that materially impact the Group's profitability or cash flows on a short-term or one-off basis are excluded from operating profit and cash generated from operations when arriving at trading profit and trading cash flow, respectively.

**Table of Contents**

Underlying growth in trading profit and trading profit margin (trading profit expressed as a percentage of revenue and trading cash flow) are measures, which present the growth trend in the long-term profitability of the Group.

Underlying growth in trading profit is used to compare the period-on-period growth in trading profit on a like-for-like basis. This is achieved by adjusting for the impact of material business combinations and disposals and for movements in exchange rates in the same manner as underlying revenue growth is determined, as described above.

Adjusted earnings per ordinary share ( EPSA )

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

	Trading results 2014	Acquisition related costs	Restructuring and rationalisation costs	Amortisation of acquisition intangibles	Legal and other
	\$ million	\$ million	\$ million	\$ million	\$ million
<b>For the year ended 31 December 2014</b>					
<b>Revenue</b>	4,617				
Cost of goods sold	(1,127)	(23)	(12)		
<b>Gross profit</b>	3,490	(23)	(12)		
Selling, general and administration expenses	(2,200)	(95)	(49)	(129)	2
Research and development expenses	(235)				
<b>Trading/operating profit</b>	1,055	(118)	(61)	(129)	2
<i>Trading/operating profit margin</i>	22.9%				
Interest receivable	13				
Interest payable	(28)	(7)			
Other finance costs	(11)				
Share of loss from associates	(2)				
<b>Profit before taxation</b>	1,027	(125)	(61)	(129)	2
Taxation	(284)	30	15	35	(9)
<b>Adjusted attributable/attributable profit</b>	743	(95)	(46)	(94)	(7)
<b>EPSA/EPS</b>	83.2¢	(10.6¢)	(5.2¢)	(10.5¢)	(0.8¢)
Weighted average number of shares (m)	893				
<b>Diluted EPSA/EPS</b>	82.6¢	(10.5¢)	(5.1¢)	(10.5¢)	(0.8¢)
Diluted weighted average number of shares (m)	899				

**Trading cash flow/cash generated from operating activities**

781

(112)

(60)

(23)

*Trading profit to cash conversion ratio (%)*

74%

**Acquisition related costs:** For the year ended 31 December 2014, these costs primarily relate to transaction and integration costs associated with the ArthroCare acquisition with a small portion of costs relating to the continued integration of Healthpoint and the recent acquisitions in the Emerging & International Markets. In addition, trading results eliminate the short-term increase in cost of goods sold from recognising acquired inventory at fair value rather than standard cost. For the year ended 31 December 2013, these costs primarily relate to the integration of the Healthpoint business.

**Restructuring and rationalisation costs:** For the year ended 31 December 2014, these costs relate to the Group optimisation programme that was announced in May 2014 and the structural and efficiency programme announced in August 2011.

**Amortisation of acquisition intangibles:** This charge relates to the amortisation of intangible assets acquired in material business combinations.

**Legal and other:** For the year ended 31 December 2014 this net credit relates to a past service gain and a settlement credit on the closure of US Pension Plan of \$46m and a gain on disposal of a UK manufacturing facility of \$9m, offset by a charge of \$25m relating to the likely costs of a distribution hold on RENASYS in the US pending new regulatory approvals and a charge of \$28m relating to the HP802 programme which was stopped in the fourth quarter.

**Table of Contents**

## OTHER INFORMATION

**Other financial information *continued***

	Trading results 2013	Acquisition related costs	Restructuring and amortisation of acquisition costs	Intangibles	Legal and other	Capital expenditure	Reported results 2013
	\$ million	\$ million	\$ million	\$ million	\$ million	\$ million	\$ million
For the year ended 31 December 2013							
<b>Revenue</b>	4,351						4,351
Cost of goods sold	(1,083)	(5)	(12)				(1,100)
<b>Gross profit</b>	3,268	(5)	(12)				3,251
Selling, general and administration expenses	(2,050)	(26)	(46)	(88)			(2,210)
Research and development expenses	(231)						(231)
<b>Trading/operating profit</b>	987	(31)	(58)	(88)			810
<i>Trading/operating profit margin</i>	22.7%						18.6%
Interest receivable	14						14
Interest payable	(10)						(10)
Other finance costs	(11)						(11)
Share of loss from associates	(1)						(1)
<b>Profit before taxation</b>	979	(31)	(58)	(88)			802
Taxation	(286)	6	11	23			(246)
<b>Adjusted attributable/attributable profit</b>	693	(25)	(47)	(65)			556
<b>EPSA/EPS</b>	76.9¢	(2.8¢)	(5.2¢)	(7.2¢)			61.7¢
Weighted average number of shares (m)	901						901
<b>Diluted EPSA/EPS</b>	76.5¢	(2.8¢)	(5.2¢)	(7.1¢)			61.4¢
Diluted weighted average number of shares (m)	906						906
<b>Trading cash flow/cash generated from operating activities</b>	877	(25)	(54)			340	1,138
<i>Trading profit to cash conversion ratio (%)</i>	89%						

**Acquisition related costs:** For the year ended 31 December 2013, these costs primarily relate to the integration of the Healthpoint business.



**Restructuring and rationalisation costs:** For the year ended 31 December 2013 these costs primarily relate to the structural and efficiency programme announced in August 2011.

**Amortisation of acquisition intangibles:** This charge relates to the amortisation of intangible assets acquired in material business combinations.

**Table of Contents**

	Trading results 2012	Acquisition related costs	Restructuring and amortisation costs	Amortisation of intangibles	Legal and other	Capital expenditure	Reported results 2012
	\$ million	\$ million	\$ million	\$ million	\$ million	\$ million	\$ million
For the year ended 31 December 2012							
<b>Revenue</b>	4,137						4,137
Cost of goods sold	(1,067)		(3)				(1,070)
<b>Gross profit</b>	3,070		(3)				3,067
Selling, general and administration expenses	(1,934)	(11)	(62)	(43)			(2,050)
Research and development expenses	(171)						(171)
<b>Trading/operating profit</b>	965	(11)	(65)	(43)			846
<i>Trading/operating profit margin</i>							
Interest receivable	11						11
Interest payable	(9)						(9)
Other finance costs	(11)						(11)
Share of loss from associates	4						4
Profit on disposal of net asset held for sale					251		251
<b>Profit before taxation</b>	960	(11)	(65)	(43)	251		1,092
Taxation	(289)	1	5	7	(95)		(371)
<b>Adjusted attributable/attributionable profit</b>	671	(10)	(60)	(36)	156		721
<b>EPSA/EPS</b>	74.8¢	(1.1)	(6.7)	(4.0)	17.4		80.4¢
Weighted average number of shares (m)	897						897
<b>Diluted EPSA/EPS</b>	74.5¢	(1.1)	(6.7)	(4.0)	17.3		80.0¢
Diluted weighted average number of shares (m)	901						901
<b>Trading cash flow/cash generated from operating activities</b>	999	(3)	(55)		(22)	265	1,184
<i>Trading profit to cash conversion ratio (%)</i>	104%						

**Acquisition related costs:** For the year ended 31 December 2012, these costs primarily relate to professional and advisor fees in connection with the acquisition of Healthpoint Biotherapeutics which was completed on 21 December 2012.

**Restructuring and rationalisation costs:** For the year ended 31 December 2012, these costs relate mainly to people costs and contract termination costs associated with the structural and process changes announced in August 2011.

**Amortisation of acquisition intangibles:** This charge relates to the amortisation of intangible assets acquired in material business combinations.

**Legal and other:** This credit relates to the profit on disposal of the Clinical Therapies business.

#### Transactional and translational exchange

The Group's principal markets outside the US are, in order of significance, Continental Europe, UK, Australia and Japan. Revenues in these markets fluctuate when translated into US Dollars on consolidation. During the year, the average rates of exchange against the US Dollar used to translate revenues and profits arising in these markets changed compared to the previous year as follows: the Euro remained flat at \$1.33 (+0%), Sterling strengthened from \$1.56 to \$1.65 (+6%), the Swiss Franc strengthened from \$1.08 to \$1.09 (1%), the Australian Dollar weakened from \$0.96 to \$0.90 (-6%) and the Japanese Yen weakened from ¥97.6 to ¥105.8 (-8%).

The Group's principal manufacturing locations are in the US (Advanced Surgical Devices), Switzerland (Advanced Surgical Devices), UK (Advanced Wound Management and Advanced Surgical Devices) and China (Advanced Surgical Devices and Advanced Wound Management). The majority of the Group's selling and distribution subsidiaries around the world purchase finished products from these locations. As a result of currency movements compared with the previous year, sales from the US became relatively more profitable to all of these countries. The Group's policy of purchasing forward a proportion of its currency requirements and the existence of an inventory pipeline reduce the short-term impact of currency movements.

#### Contractual obligations

Contractual obligations at 31 December 2014 were as follows:

	Total \$ million	Less than 1 year \$ million	Payments due by period		
			1 3 years \$ million	3 5 years \$ million	More than 5 years \$ million
Debt obligations	568	37	400	131	
Finance lease obligations	12	2	4	6	
Operating lease obligations	136	49	56	23	8
Retirement benefit obligation	74	74			
Purchase obligations	40	32	8		

Capital expenditure

Other

	34	34			
	52	29	23		
	916	257	491	160	8

**Smith & Nephew** Annual report 2014

179

## **Table of Contents**

### OTHER INFORMATION

#### **Other financial information *continued***

Other contractual obligations represent \$19m of foreign exchange contracts and \$33m of acquisition consideration. Provisions that do not relate to contractual obligations are not included in the above table.

The agreed contributions for 2015 in respect of the Group's defined benefits plans are: \$46m for the UK (including \$37m of supplementary payments), \$22m for the US Plan and \$6m for other funded defined benefit plans. The table above does not include amounts payable in respect of 2016 and beyond as these are subject to future agreement and amounts cannot be reasonably estimated.

There are a number of agreements that take effect, alter or terminate upon a change in control of the Company or the Group following a takeover, such as bank loan agreements and Company share plans. None of these are deemed to be significant in terms of their potential impact on the business of the Group as a whole. In addition, there are service contracts between the Company and its Executive Directors which provide for the automatic payment of a bonus following loss of office or employment occurring because of a successful takeover bid. Further details are set out on page 100.

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

#### **2013 Financial highlights**

##### Revenue

Group revenue increased by \$214m (5% on a reported basis), from \$4,137m in 2012 to \$4,351m in 2013. The underlying increase is 4% after adjusting for the net impact of 2% on the Healthpoint acquisition and Clinical Therapies disposal and 1% attributable to the unfavourable impact of currency movements.

##### Cost of goods sold

Cost of goods sold increased by \$30m (3% on a reported basis) from \$1,070m in 2012 to \$1,100m in 2013. The underlying movement is 2% after adjusting for the net impact of 2% on the Healthpoint acquisition and Clinical Therapies disposal and 1% attributable to the favourable impact of currency movements. The movement in underlying costs of goods sold of 2% is largely attributable to the increase in underlying trading.

During 2013, \$12m of restructuring and rationalisation expenses (2012 \$3m) and \$5m of acquisition related costs (2012 \$nil) were charged to cost of goods sold.

##### Selling, general and administration expenses

Selling, general and administrative expenses increased by \$160m (8% on a reported basis) from \$2,050m in 2012 to \$2,210m in 2013. The underlying movement is 6% after adjusting for the net impact of 3% on the Healthpoint acquisition and Clinical Therapies disposal and 1% attributable to the favourable impact of currency movements.

The underlying increase of 6% is due to the continuing investment in Emerging & International Markets, promotion of new products in ASD and AWM and the underlying increase in trading.

In 2013, administrative expenses included \$64m of amortisation of other intangible assets (2012 \$51m), \$46m of restructuring and rationalisation expenses (2012 \$62m), an amount of \$88m relating to amortisation of acquisition intangibles (2012 \$43m) and \$26m of acquisition related costs (2012 \$11m).

#### Research and development expenses

Research and development expenditure as a percentage of revenue increased by 1.2% to 5.3% in 2013 (2012 4.1%). Actual expenditure was \$231m in 2013 compared to \$171m in 2012. The Group continues to invest in innovative technologies and products to differentiate it from competitors.

#### Operating profit

Operating profit decreased by \$36m to \$810m from \$846m in 2012. This comprised a decrease of \$12m in Advanced Surgical Devices and a decrease of \$24m in Advanced Wound Management.

The movement in Advanced Surgical Devices is attributable to the continuing pressure on margins and its investment in the Emerging & International Markets. Advanced Wound Management has continued to invest in new products and new geographic markets throughout the year.

#### Net interest receivable/(payable)

Net interest receivable increased, by \$2m, from net \$2m receivable in 2012 to a net receivable of \$4m in 2013. This increase is principally a consequence of the interest receivable on the Bioventus LLC ( Bioventus ) loan note issued following the disposal of the Clinical Therapies business which has been in place for a full year in 2013 compared to eight months in 2012. This loan note was repaid in full in 2014.

#### Other finance cost

Other finance costs in 2013 remained at \$11m and principally relate to costs associated with the Group's retirement benefit schemes.

#### Taxation

The taxation charge decreased, by \$125m, to \$246m from \$371m in 2012. The rate of tax was 30.5%, compared with 33.7% in 2012.

After adjusting for specific transactions that management considers affect the Group's short-term profitability (profit on disposal of the Clinical Therapies business, restructuring and rationalisation expenses, amortisation of acquisition intangibles and acquisition-related costs) the tax rate was 29.2% (2012 29.9%).

#### Group balance sheet

The following table sets out certain balance sheet data as at 31 December of the years indicated:

	2013	2012
	\$ million	\$ million

Non-current assets	3,563	3,498
Current assets	2,256	2,144
Total assets	5,819	5,642
Non-current liabilities	699	828
Current liabilities	1,073	930
Total liabilities	1,772	1,758
Total equity	4,047	3,884
Total equity and liabilities	5,819	5,642

**Table of Contents**

Non-current assets

Non-current assets increased by \$65m to \$3,563m in 2013 from \$3,498m in 2012. This is principally attributable to the following:

Property, plant and equipment increased by \$23m from \$793m in 2012 to \$816m in 2013. Depreciation of \$209m was charged during 2013 and assets with a net book value of \$12m were disposed of. These movements were offset by \$242m of additions relating primarily to instruments and other plant & machinery and \$5m of additions arising on acquisitions in Turkey, Brazil and India. The balance relates to unfavourable currency movements totalling \$3m

Goodwill increased by \$70m from \$1,186m in 2012 to \$1,256m in 2013. Of this movement, \$37m arose on acquisitions in Turkey, Brazil and India. An additional \$16m arose on finalisation of the Healthpoint opening balance sheet. The remaining balance relates to favourable currency movements totalling \$17m

Intangible assets decreased by \$10m from \$1,064m in 2012 to \$1,054m in 2013. Intangible assets totalling \$64m arose on the acquisition in Turkey, Brazil and India. There was a reduction of \$11m on finalisation of the Healthpoint opening balance sheet. Amortisation of \$152m was charged during the year and assets with a net book value of \$11m were disposed of. A total of \$98m relates to the cost of intellectual property, distribution rights and software acquired. The balance relates to favourable currency movements totalling \$2m

Investment in associates (including a loan to an associate of \$178m in 2013, up from \$167m in 2012) has increased from \$283m in 2012 to \$285m in 2013. This movement relates to the interest of \$11m arising on the Bioventus loan note which was largely offset from the disposal of the Group's 49% interest in the Austrian entities Plus Orthopedics GmbH and Intraplant GmbH and its 20% interest in the German entity Intercus GmbH

Deferred tax assets decreased by \$19m in the year from \$164m in 2012 to \$145m in 2013.

Current assets

Current assets increased by \$112m to \$2,256m from \$2,144m in 2012. The movement relates to the following:

Inventories rose by \$105m to \$1,006m in 2013 from \$901m in 2012. This movement is principally attributable to an increase of \$48m in the US due to inventory build prior to the launch of JOURNEY II BCS and an increase of \$17m due to inventory build in our Hull factory prior to the transfer of part of our Wound production to China. A further increase of \$12m arose on the acquisitions in Turkey, Brazil and India. The movement also includes \$6m of unfavourable currency movement



## Edgar Filing: SMITH & NEPHEW PLC - Form 20-F

The level of trade and other receivables increased by \$48m to \$1,113m in 2013 from \$1,065m in 2012. The movement primarily relates to the increase in underlying revenues and includes \$9m of unfavourable currency movements

Cash at bank has fallen by \$41m to \$137m from \$178m in 2012.

### Non-current liabilities

Non-current liabilities decreased by \$129m from \$828m in 2012 to \$699m in 2013. This movement relates to the following items:

Long-term borrowings have decreased from \$430m in 2012 to \$347m in 2013

The Retirement benefit obligation decreased by \$36m to \$230m in 2013 from \$266m in 2012. This was largely due to the Group's additional pension contributions, together with net actuarial gains for the year

Deferred tax liabilities decreased by \$11m in the year from \$61m in 2012 to \$50m in 2013.

### Current liabilities

Current liabilities increased by \$143m from \$930m in 2012 to \$1,073m in 2013. This movement is attributable to:

Bank overdrafts and current borrowings have increased by \$6m from \$38m in 2012 to \$44m in 2013

Trade and other payables have increased by \$129m to \$785m in 2013 from \$656m in 2012. This increase includes \$50m largely driven from strong sales performance in the US in quarter four and a \$23m increase in Europe associated with promotional activities in Advanced Surgical Devices. A total of \$19m of trade and other payables arose on the acquisitions in Turkey, Brazil and India and an amount of \$5m is attributable to favourable currency movements.

Current tax payable is \$184m at the end of 2013 compared to \$177m in 2012.

### Total equity

Total equity increased by \$163m from \$3,884m in 2012 to \$4,047m in 2013. The principal movements were:

	Total equity \$ million
1 January 2013	3,884
Attributable profit	556

Currency translation gains	(6)
Hedging reserves	5
Actuarial gains on retirement benefit obligations	12
Dividends paid during the year	(239)
Purchase of own shares	(231)
Taxation benefits on Other Comprehensive Income and equity items	(16)
Net share-based transactions	82
31 December 2013	4,047

**Smith & Nephew** Annual report 2014 181

**Table of Contents**

## OTHER INFORMATION

**Other financial information *continued***

## 2013 Financial performance by business segment

## Revenue by market

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

	2013 \$ million	2012 \$ million	Reported growth in revenue %	Constant currency exchange effect %	Acquisition/ Disposal effect %	Underlying growth in revenue %
Advanced Surgical Devices						
US	1,391	1,449	(4)		5	1
Other Established Markets	1,204	1,298	(7)	2	2	(3)
Established Markets	2,595	2,747	(6)	1	4	(1)
Emerging & International Markets	420	361	16	2		18
<b>Advanced Surgical Devices</b>	3,015	3,108	(3)	1	3	1
Advanced Wound Management						
US	471	202	133		(111)	22
Other Established Markets	722	705	3	1	(1)	3
Established Markets	1,193	907	32	1	(23)	10
Emerging & International Markets	143	122	17	3		20
	1,336	1,029	30	1	(20)	11
Table of Contents						443

## Advanced Wound Management

### Advanced Surgical Devices

#### Revenue

ASD revenue decreased by \$93m (-3% on a reported basis) from \$3,108m in 2012 to \$3,015m in 2013. The underlying increase of 1% is after adjusting for a net 3% adverse impact from the disposal of the Clinical Therapies business in 2012 and the acquisitions completed in quarter four 2013, and a 1% unfavourable foreign currency translation.

In the US, revenue decreased by \$58m to \$1,391m in 2013 from \$1,449m in 2012 (-4% on a reported basis). The underlying increase of 1% is after adjusting 5% for the adverse impact of the Clinical Therapies disposal in 2012. In Other Established Markets, revenue was \$1,204m in 2013, a decrease of \$94m from \$1,298m in 2012 (-7% on a reported basis). The underlying decrease was 3% after adjusting for the adverse impact of 2% on the Clinical Therapies disposal in 2012, and 2% from unfavourable foreign currency translation. Our Emerging & International Markets revenue increased by \$59m to \$420m in 2013 from \$361m in 2012 (16% increase on a reported basis). The underlying increase was 18% after adjusting 2% for unfavourable foreign currency translation.

In the global Knee Implant franchise, revenue decreased by \$9m from \$874m in 2012 to \$865m in 2013 (-1% on a reported basis), representing flat underlying revenue performance after 1% of unfavourable currency translation. Growth has been impacted by exposure to a weakening European market with conditions continuing to deteriorate in Germany, our largest European market, and our position in the product life cycle versus our peers. Growth improved in the second half of the year driven by sales of the Journey II BCS Knee System and benefits from the VERILAST bearing surface TV advertising campaign in the US.

Global revenue from the Hip Implant franchise decreased by \$13m from \$666m in 2012 to \$653m in 2013 (-2% on a reported basis), which represented an underlying revenue decline of 1% after 1% unfavourable foreign currency translation. Continuing metal-on-metal headwinds have contributed to this decline.

Trauma & Extremities revenue increased by \$12m from \$474m in 2012 to \$486m in 2013 (3% on a reported basis). This represents underlying revenue growth of 4% after 1% of unfavourable foreign currency translation. During 2013, benefits were seen from the additional extremities US sales representatives recruited earlier in the year.

Sports Medicine Joint Repair revenue increased by \$22m from \$474m in 2012 to \$496m in 2013 (5% on reported basis), representing underlying revenue growth of 7% and 2% of unfavourable foreign currency translation. This reflects a strong contribution across all key joint types and geographies.

Global revenue from Arthroscopic Enabling technologies decreased by \$17m from \$458m in 2012 to \$441m in 2013 (-4% on a reported basis). This decrease represents an underlying revenue decline of 2% and 2% of unfavourable foreign currency translation.

The revenue in the Other ASD franchise fell by \$88m from \$162m in 2012 to \$74m in 2013 following the disposal of the Clinical Therapies business in 2012. Excluding the impact of this disposal, underlying revenue in the Other ASD franchise, which includes gynaecology, grew by 14% with the remaining Clinical Therapies geographies contributing \$9m.

182 **Smith & Nephew** Annual report 2014

**Table of Contents****Trading and operating profit**

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

	2013 \$ million	2012 \$ million
Operating profit	620	632
Acquisition related costs	7	
Restructuring and rationalisation costs	44	57
Amortisation of acquisition intangibles and impairments	41	39
Trading profit	712	728

Trading profit margin increased from 23.4% to 23.6%. Trading profit decreased by \$16m to \$712m from \$728m in 2012. This decrease reflects the impact of the CT disposal in May 2012, the impact of the US medical device excise tax and the cost of planned investments in the Knee Implants and Trauma franchises and Emerging & International Markets offset by benefits from our structural efficiency programme.

Operating profit decreased by \$12m from \$632m in 2012 to \$620m in 2013. This comprises the decrease in trading profit of \$16m discussed above, an increase in acquisition related costs of \$7m, an increase in amortisation of acquisition intangibles of \$2m, partially offset by a decrease in restructuring and rationalisation costs of \$13m.

**Advanced Wound Management****Revenue**

AWM revenue increased by \$307m (30% on a reported basis), from \$1,029m in 2012 to \$1,336m in 2013. The underlying increase of 11% is after adjusting for an increase of 20% for the acquisitions completed in the year and a 1% unfavourable foreign currency translation.

In the US, revenue increased by \$269m to \$471m in 2013 from \$202m in 2012 (133% on a reported basis). The underlying increase of 22% is after adjusting 111% for the impact of acquisitions. In Other Established Markets, revenue was \$722m in 2013, an increase of \$17m from \$705m in 2012 (3% on a reported basis). The underlying revenue increase was also 3% with the 1% impact of acquisitions offset by 1% of unfavourable foreign currency translation. Our Emerging & International Markets revenue increased by \$21m in 2012 (17% on a reported basis). The

underlying increase was 20% after adjusting 3% for unfavourable foreign currency translation.

Advanced Wound Care revenue decreased by \$6m (-1% on a reported basis) from \$849m in 2012 to \$843m in 2013. The underlying growth of 1% is after adjusting for foreign currency translation. Conditions across many European markets remain challenging but the introduction of the ALLEVYN Life range continues to make good progress across Europe following product introductions and investment in marketing.

Advance Wound Devices revenue increased from \$180m in 2012 to \$213m in 2013, a reported increase of \$33m and 18%. The underlying growth of 20% is after adjusting for unfavourable foreign currency translations of 2%. This growth was impacted by continued gain in market share in NPWT, and our recent expansion into the emerging markets.

Advanced Wound Bioactives revenue of \$280m in 2013 (2012 \$nil) relates to Healthpoint acquired in December 2012. The underlying increase, adjusted to include the results of Healthpoint for the commensurate period in 2012, was 47%.

### Trading and operating profit

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

	2013 \$ million	2012 \$ million
Operating profit	190	214
Acquisition related costs	24	11
Restructuring and rationalisation costs	14	8
Amortisation of acquisition intangibles and impairments	47	4
Trading profit	275	237

Trading profit margin decreased from 23.1% to 20.6%. Trading profit increased by \$38m to \$275m from \$237m in 2012. The increase in the year is primarily attributable to the full year benefit of the Healthpoint acquisition and growth in the Emerging & International Markets, partially offset by additional investment in R&D and sales and marketing. The decrease in trading margin reflects these same investments, combined with price and mix changes at a gross margin level.

Operating profit decreased by \$24m from \$214m in 2012 to \$190m in 2013. This comprises of the increase in trading profit of \$38m discussed above, offset by an increase of \$43m in amortisation of acquisition intangibles and an increase in acquisition related costs of \$13m, both due to the Healthpoint acquisition which completed in December 2012, and an increase in restructuring and rationalisation costs of \$6m.

<b>Smith &amp; Nephew</b> Annual report 2014	183
--	-----



## **Table of Contents**

### OTHER INFORMATION

#### **Information for shareholders**

#### **Financial calendar**

Annual General Meeting	9 April 2015
First quarter trading report	30 April 2015
Payment of 2014 final dividend	6 May 2015
Half year results announced	30 July 2015 (i)
Third quarter trading report	29 October 2015
Payment of 2015 interim dividend	November 2015
Full year results announced	February 2016 (i)
Annual Report available	February/March 2016
Annual General Meeting	April 2016

(i) Dividend declaration dates.

Annual General Meeting

The Company's Annual General Meeting (AGM) will be held on 9 April 2015 at 2pm at No. 11 Cavendish Square, London, W1G 0AN. Registered shareholders have been sent either a Notice of Annual General Meeting or notification of availability of the Notice of Annual General Meeting.

#### **Corporate Headquarters and Registered Office**

The corporate headquarters is in the UK and the registered office address is: Smith & Nephew plc, 15 Adam Street, London, W2N 6LA, UK. Registered in England and Wales No. 324357. Tel. +44 (0)20 7401 7646 website: [www.smith-nephew.com](http://www.smith-nephew.com)

#### **Ordinary shareholders**

##### **Registrar**

All general enquiries concerning shareholdings, dividends, changes to shareholders' personal details and the AGM should be addressed to:

Equiniti, Aspect House, Spencer Road, Lancing, West Sussex BN99 6DA

Tel: 0871 384 2081 \*

Tel: +44 (0) 121 415 7072 from outside the UK

Website: [www.shareview.co.uk](http://www.shareview.co.uk)

\*Calls to this number are charged at 8p per minute plus network extras. Lines are open from 8.30am to 5.30pm Monday to Friday, excluding UK public holidays.

Shareholder facilities

## **Shareview**

Equiniti's on-line enquiry and portfolio management service for shareholders. To view information about your shareholdings online, register at [www.shareview.co.uk](http://www.shareview.co.uk). Once registered for Shareview, you will also be able to elect to receive future shareholder communications via the Company's website ([www.smith-nephew.com](http://www.smith-nephew.com)), update your address details or dividend payment instructions and register your proxy instructions on-line.

## **E-communications**

We encourage you to elect to receive communications via e-mail as this has significant environmental and cost benefits. You may register for this service through Equiniti, at [www.shareview.co.uk](http://www.shareview.co.uk). You will receive a confirmation letter from Equiniti at your registered address, containing an Activation Code for future use.

## **Payment of dividends direct to your bank or building society account**

If you who wish to avoid the risk of your dividend awards getting lost or mislaid you can arrange to have your cash dividends paid directly to a bank or building society account. This facility is available to UK resident shareholders who receive sterling dividends. If you do not live in the UK you may be able to register for the overseas payment service. Further information is available at [www.shareview.co.uk](http://www.shareview.co.uk) or by contacting Equiniti (UK and overseas helpline numbers as above).

## **Dividend reinvestment plan (DRIP)**

The Company offers shareholders (except those in North America) the opportunity to participate in a DRIP. This enables you to reinvest your cash dividends in further ordinary shares of Smith & Nephew plc. These are purchased in the market at competitive dealing costs. For further details plus an application form to reinvest future dividends, contact Equiniti.

## **Duplicate accounts**

If you have more than one account due to inconsistency in account details you may avoid duplicate mailings by contacting Equiniti and requesting an amalgamation of your share accounts.

## **Keep your personal details up to date**

Please remember to tell Equiniti if you move house or change bank details or there is any other change in your account information. You can update your information on-line via the Shareview portfolio if you are a Smith & Nephew Shareview member. If you do not have a portfolio you will need to write to Equiniti or complete a change of address form which can be downloaded from Shareview. If you hold 2,500 shares or fewer, you can also change your address or update your bank details quickly and easily over the phone using the contact details provided.

## **Individual savings account (ISA)**

Shareholders who are UK resident may hold Smith & Nephew plc shares in an Individual Savings Account (ISA), which is administered by the Company's registrar. For information about this service please contact Equiniti.

#### [Shareholder communications](#)

We make quarterly financial announcements which are made available through Stock Exchange announcements and on the Group's website ([www.smith-nephew.com](http://www.smith-nephew.com)). Copies of recent Annual Reports, press releases, institutional presentations and audio webcasts are also available on the website.

We send paper copies of the Notice of Annual General Meeting and Annual Report only to those shareholders and ADS holders who have elected to receive shareholder documentation by post. Electronic copies of the Annual Report and Notice of Annual General Meeting are available on the Group's website at [www.smith-nephew.com](http://www.smith-nephew.com). Both ordinary shareholders and ADS holders can request paper copies of the Annual Report, which the Company provides free of charge. The Company will continue to send to ordinary shareholders by post the Form of Proxy notifying them of the availability of the Annual Report and Notice of Annual General Meeting on the Group's website. If you elect to receive the Annual Report and Notice of Annual General Meeting electronically you are informed by e-mail of the documents' availability on the Group's website. ADS holders receive the Form of Proxy by post, but will not receive a paper copy of the Notice of Annual General Meeting.

## Table of Contents

### [Investor communications](#)

The Company maintains regular dialogue with individual institutional shareholders, together with results presentations. To ensure that all members of the Board develop an understanding of the views of major investors, the Executive Directors review significant issues raised by investors with the Board. Non-executive Directors are sent copies of analysts' and brokers' briefings. There is an opportunity for individual shareholders to question the Directors at the Annual General Meeting and the Company regularly responds to letters from shareholders on a range of issues.

### [UK capital gains tax](#)

For the purposes of UK capital gains tax the price of the Company's ordinary shares on 31 March 1982 was 35.04p.

### [Smith & Nephew share price](#)

The Company's ordinary shares are quoted on the London Stock Exchange under the symbol SN. The Company's share price is available on the Smith & Nephew website [www.smith-nephew.com](http://www.smith-nephew.com) and at [www.londonstockexchange.com](http://www.londonstockexchange.com) where the live financial data is updated with a 15-minute delay.

### [ShareGift](#)

If you hold a small number of shares, which would cost more to sell than they are worth, you may wish to consider donating them to the charity ShareGift (registered charity 1052686) which specialises in accepting such shares as donations. There are no implications for Capital Gains Tax purposes (no gain or loss) and it may also be possible to obtain income tax relief. The relevant stock transfer form may be obtained from Equiniti at the address given on page 184.

Further information about ShareGift is available at [www.sharegift.org](http://www.sharegift.org) or by contacting ShareGift at:

ShareGift, PO BOX 72253 London SW1P 9LQ

Tel: (+44) (0) 20 7930 3737

### [Unauthorised brokers \(boiler room scams\)](#)

You are advised to be very wary of any unsolicited advice, offers to buy shares at a discount or offers of free company reports. These are typically from overseas-based brokers who target UK shareholders offering to sell them what often turn out to be worthless or high-risk shares in US or UK investments. These operations are commonly known as boiler rooms.

If you deal with an unauthorised firm, you will not be eligible to receive payment under the Financial Services Compensation Scheme if things go wrong. If you receive any unsolicited investment advice, obtain the correct name of the person and organisation and check that they are properly authorised by the FCA by visiting [www.fca.org.uk/register/](http://www.fca.org.uk/register/).

If you think you have been approached by an unauthorised firm you should contact the FCA consumer helpline on 0800 111 6768 or e-mail [consumer.queries@fca.org.uk](mailto:consumer.queries@fca.org.uk).

More detailed information can be found on the FCA website at [www.fca.org.uk/consumers/protect-yourself/unauthorised-firms](http://www.fca.org.uk/consumers/protect-yourself/unauthorised-firms).

### Social media

Smith & Nephew has a presence across a range of social media channels, including Twitter, Facebook and LinkedIn, which are linked below. Information provided by Smith & Nephew through social media channels is not incorporated by reference herein and does not form part of our annual report on Form 20-F.

<https://twitter.com/SmithNephewPLC>

[www.facebook.com/SmithNephewPlc](http://www.facebook.com/SmithNephewPlc)

<http://www.linkedin.com/company/smith-&-nephew>

### American Depositary Shares (ADSs) and American Depositary Receipts (ADRs)

In the USA, the Company's ordinary shares are traded in the form of ADSs, evidenced by ADRs, on the New York Stock Exchange under the symbol SNN. Each American Depositary Share represents two ordinary shares. Deutsche Bank is the authorised depositary bank for the Company's ADR programme.

### ADS enquiries

All enquiries regarding ADS holder accounts and payment of dividends should be addressed to:

Deutsche Bank Shareholder Services

American Stock Transfer and Trust Company

Operations Centre 6210 15th Avenue

Brooklyn, New York

Tel: +1 800 937-5449 (toll free from US)

Tel: +1 718 921-8124 (direct dial)

E-mail: [DB@amstock.com](mailto:DB@amstock.com)

Website: [www.adr.db.com](http://www.adr.db.com)

The Company provides Deutsche Bank, as depositary, with copies of Annual Reports containing Consolidated Financial Statements and the opinion expressed thereon by its independent auditor. Such financial statements are prepared under IFRS. Deutsche Bank will send these reports to recorded ADS holders who have elected to receive paper copies. The Company also provides to Deutsche Bank all notices of shareholders' meetings and other reports and

communications that are made generally available to shareholders of the Company. Deutsche Bank makes such notices, reports and communications available for inspection by recorded holders of ADSs and sends voting instruction forms by post to all recorded holders of ADSs.

**Table of Contents**

## OTHER INFORMATION

**Information for shareholders *continued*****Smith & Nephew ADS price**

The Company's ADS price can be obtained from the official New York Stock Exchange website at [www.nyse.com](http://www.nyse.com), the Smith & Nephew website [www.smith-nephew.com](http://www.smith-nephew.com), and is quoted daily in the Wall Street Journal where the live financial data is updated with a 15-minute delay.

**ADS payment information**

The Company hereby discloses ADS payment information for the year ended 31 December 2014 in accordance with the Securities and Exchange Commission rules 12.D.3 and 12.D.4 relating to Form 20-F filings by foreign private issuers. The depository collects its fees for delivery and surrender of ADSs directly from investors depositing shares or surrendering ADSs for the purpose of withdrawal or from intermediaries acting for them. The depository collects fees for making distributions to investors, including payment of dividends by the Company by deducting those fees from the amounts distributed or by selling a portion of distributable property to pay the fees. The depository may collect its annual fee for depository services by deductions from cash distributions or by directly billing investors or by charging the book-entry system accounts of participants acting for them. The depository may generally refuse to provide fee-attracting services until its fee for those services are paid.

**Persons depositing or withdrawing shares must pay:**

\$5.00 (or less) per 100 ADSs (or portion of 100 ADSs)

\$0.05 (or less) per ADS

\$0.05 (or less) per ADS per calendar year

Registration or transfer fees

Taxes and other governmental charges the depository or the custodian have to pay on any ADS or share underlying an ADS, for example, stock transfer taxes, stamp duty or withholding taxes

Any charges incurred by the depository or its agents for servicing the deposited securities

**For:**

Issuance of ADSs, including issuances resulting from a distribution of shares or rights or other property

Cancellation of ADSs for the purpose of withdrawal, including if the deposit agreement terminates

Any cash distribution to ADS registered holders, including payment of dividend  
Depository services

Transfer and registration of shares on our share register to or from the name of the depository or its agent when shares are deposited or withdrawn  
As necessary

As necessary

During 2014, a fee of two US cents per ADS was paid on the 2013 final dividend by The Bank of New York Mellon which totaled \$111,563.54.

On 1 October 2014 Smith & Nephew changed ADR bank to Deutsche Bank Trust Company Americas. A fee of one US cent per ADS was deducted from the 2014 interim dividend paid in November which totaled \$178,537.00. Therefore, for the period 1 January 2014 to 23 February 2015, the total reimbursed by The Bank of New York Mellon and Deutsche Bank Trust Company Americas was \$290,100.54.

On 14 October 2014 the ratio for ordinary shares per ADS changed from five ordinary shares per ADS to two ordinary shares per ADS.



**Table of Contents****Dividend history**

Smith & Nephew has paid dividends on its ordinary shares in every year since 1937. Following the capital restructuring and dividend reduction in 2000 the Group adopted a policy of increasing its dividend cover (the ratio of EPSA, as set out in the Selected financial data , to ordinary dividends declared for the year). This was intended to increase the financing capability of the Group for acquisitions and other investments. From 2000 to 2004 the dividend increased in line with inflation and, in 2004, dividend cover stood at 4.1 times. Having achieved this level of dividend cover the Board changed its policy, from that of increasing dividends in line with inflation, to that of increasing dividends for 2005 and after by 10%. Following the redenomination of the Company's share capital into US Dollars the Board re-affirmed its policy of increasing the dividend by 10% a year in US Dollar terms.

On 2 August 2012, the Board announced its intention to pursue a progressive dividend policy, with the aim of increasing the US Dollar value of ordinary dividends over time broadly based on the Group's underlying growth in earnings, while taking into account capital requirements and cash flows.

At the time of the full year results the Board reviews the appropriate level of total annual dividend each year. The Board intends that the interim dividend will be set by a formula and will be equivalent to 40% of the total dividend for the previous year. Dividends will continue to be declared in US Dollars with an equivalent amount in sterling payable to those shareholders whose registered address is in the UK, or who have validly elected to receive sterling dividends.

An interim dividend in respect of each fiscal year is normally declared in August and paid in November. A final dividend will be recommended by the Board of Directors and paid subject to approval by shareholders at the Company's Annual General Meeting.

Future dividends of Smith & Nephew will be dependent upon: future earnings; the future financial condition of the Group; the Board's dividend policy; and the additional factors that might affect the business of the Group set out in Special note regarding forward-looking statements and Risk Factors .

**Dividends per share**

The table below sets out the dividends per Ordinary Share in the last five years.

		Years ended 31 December				
	2014	2013	2012	2011	2010	
Pence per share:						
Interim	7.578	7.211	6.811	4.639	4.233	
Final (i)	13.377	11.233	11.778	7.444	6.639	
Total	20.995	18.444	18.589	12.083	10.872	
US cents per share:						
Interim	12.222	11.556	11.000	7.333	6.667	
Final	20.667	18.889	18.000	12.000	10.911	
Total	32.889	30.445	29.000	19.333	17.578	

(i) Translated at the Bank of England rate on 23 February 2015.

Dividends above include the associated UK tax credit of 10%, but exclude the deduction of withholding taxes. All dividends, up to the second interim dividend for 2005, were declared in pence per ordinary share and translated into US cents per ordinary share at the Noon Buying Rate on the payment date. Since the second interim dividend for 2005 all dividends have been declared in US cents per ordinary share.

The 2014 final dividend will be payable on 6 May 2015, subject to shareholder approval.

In respect of the proposed final dividend for the year ended 31 December 2014 of 18.6 US cents per ordinary share, the record date will be 17 April 2015 and the payment date will be 6 May 2015. The sterling equivalent per ordinary share will be set following the record date. Shareholders may elect to receive their dividend in either sterling or US Dollars and the last day for election will be 17 April 2015. The ordinary shares will trade ex-dividend on both the London and New York Stock Exchanges from 16 April 2015.

The proposed final dividend of 18.6 US cents per ordinary share, which together with the interim dividend of 11 US cents, makes a total for 2014 of 29.6 US cents.

**Table of Contents**

## OTHER INFORMATION

**Information for shareholders *continued*****Share prices**

The table below sets out, for the periods indicated, the highest and lowest middle market quotations for the Company's ordinary shares (as derived from the Daily Official List of the UK Listing Authority) and the highest and lowest sales prices of its ADSs (as reported on the New York Stock Exchange composite tape).

	Ordinary shares		ADSs	
	High £	Low £	High US\$	Low US\$
<b>Year ended 31 December:</b>				
2010	6.97	5.38	53.94	41.29
2011	7.42	5.21	60.19	42.17
2012	6.93	5.80	56.13	45.13
2013	8.68	6.80	71.85	52.90
2014*	<b>11.93</b>	<b>8.57</b>	<b>97.27</b>	<b>29.39</b>
<b>Quarters in the year ended 31 December:</b>				
2013:				
1st Quarter	7.60	6.80	58.00	52.90
2nd Quarter	7.95	7.18	60.17	54.83
3rd Quarter	8.00	7.30	63.06	56.01
4th Quarter	8.68	7.48	71.85	60.05
2014:				
1st Quarter	<b>9.60</b>	<b>8.57</b>	<b>80.18</b>	<b>70.84</b>
2nd Quarter	<b>11.00</b>	<b>8.61</b>	<b>97.27</b>	<b>73.17</b>
3rd Quarter	<b>10.80</b>	<b>9.86</b>	<b>90.45</b>	<b>82.91</b>
4th Quarter*	<b>11.93</b>	<b>9.06</b>	<b>83.14</b>	<b>29.39</b>
2015:				
1st Quarter (to 23 February 2015)	<b>12.00</b>	<b>11.48</b>	<b>36.71</b>	<b>35.07</b>
<b>Last six months:</b>				
August 2014	<b>10.65</b>	<b>9.86</b>	<b>89.50</b>	<b>82.91</b>
September 2014	<b>10.80</b>	<b>10.23</b>	<b>88.15</b>	<b>83.29</b>
October 2014 (1 to 14 October 2014)*	<b>10.32</b>	<b>9.74</b>	<b>83.14</b>	<b>77.36</b>
October 2014 (15 to 31 October 2014)	<b>10.57</b>	<b>9.06</b>	<b>33.83</b>	<b>29.39</b>
November 2014	<b>11.38</b>	<b>10.45</b>	<b>36.12</b>	<b>33.21</b>
December 2014	<b>11.93</b>	<b>10.19</b>	<b>38.52</b>	<b>32.06</b>
January 2015	<b>12.00</b>	<b>11.48</b>	<b>36.40</b>	<b>35.07</b>
February 2015 (to 23 February 2015)	<b>11.98</b>	<b>11.55</b>	<b>36.71</b>	<b>35.17</b>

\* On 14 October 2014 the ratio of ordinary shares per ADS changed from five ordinary shares per ADS to two ordinary shares per ADS.

188 **Smith & Nephew** Annual report 2014

**Table of Contents****Share Capital**

The principal trading market for the ordinary shares is the London Stock Exchange. The ordinary shares were listed on the New York Stock Exchange on 16 November 1999, trading in the form of ADSs evidenced by ADRs. Each ADS represents two ordinary shares from 14 October 2014, before which time one ADS represented five ordinary shares. The ADS facility is sponsored by Deutsche Bank acting as depositary.

All the ordinary shares, including those held by Directors and Executive Officers, rank pari passu with each other. On 23 January 2006 the ordinary shares of 12 2/9p were redenominated as ordinary shares of US 20 cents (following approval by shareholders at the extraordinary general meeting in December 2005). The new US dollar ordinary shares carry the same rights as the previous ordinary shares. The share price continues to be quoted in sterling. In 2006 the Company issued £50,000 of shares in sterling in order to comply with English law. These were issued as deferred shares, which are not listed on any stock exchange. They have extremely limited rights and therefore effectively have no value. These shares were allotted to the Chief Executive Officer, although the Board reserves the right to transfer them to another member of the Board should it so wish.

As at 23 February 2015, to the knowledge of the Group, there were 17,824 registered holders of ordinary shares, of whom 90 had registered addresses in the USA and held a total of 168,578 ordinary shares (less than 0.02% of the total issued). Because certain ordinary shares are registered in the names of nominees, the number of shareholders with registered addresses in the USA is not representative of the number of beneficial owners of ordinary shares resident in the USA.

**Shareholdings**

As at 23 February 2015, 26,707,860 ADSs equivalent to 53,415,720 ordinary shares or approximately 5.97% of the total ordinary shares in issue, were outstanding and were held by 92 registered ADS holders.

**Major shareholders**

As far as is known to Smith & Nephew, the Group is not directly or indirectly owned or controlled by another corporation or by any government and the Group has not entered into arrangements, the operation of which may at a subsequent date result in a change in control of the Group.

As at 23 February 2015, no persons are known to Smith & Nephew to have any interest (as defined in the Disclosure and Transparency Rules of the FCA) in 3% or more of the ordinary shares, other than as shown below. The following tables show changes over the last three years in the percentage and numbers of the issued share capital owned by shareholders holding 3% or more of ordinary shares, as notified to the Company under the Disclosure and Transparency Rules:

		As at 31 December	
<b>23 February 2015</b>	2014	2013	2012
%	%	%	%

Edgar Filing: SMITH & NEPHEW PLC - Form 20-F

BlackRock, Inc.	<b>5.5</b>	5.5	4.7	5.0
Invesco	<b>5.0</b>	5.3	12.1	11.9
Legal & General Group plc				3.0
Newton Investment Management Limited				4.9

	<b>23 February 2015</b>	2014	As at 31 December 2013	2012
	<b>000</b>	000	000	000
BlackRock, Inc.	<b>49,206</b>	49,008	41,870	44,811
Invesco	<b>44,918</b>	47,508	107,823	107,823
Legal & General Group plc				26,906
Newton Investment Management Limited				8,432

The Company is not aware of any person who has a significant direct or indirect holding of securities in the Company, and is not aware of any persons holding securities which may control the Company. There are no securities in issue which have special rights as to the control of the Company.

**Table of Contents**

## OTHER INFORMATION

**Information for shareholders *continued***

## Purchase of ordinary shares on behalf of the Company

At the AGM, the Company will be seeking a renewal of its current permission from shareholders to purchase up to 10% of its own shares. In order to avoid shareholder dilution, shares allotted to employees through employee share schemes are bought back on a quarterly basis and subsequently cancelled by the Company. From 1 January 2014 to 23 February 2015, in the months listed below, the Company has purchased 5,455,000 ordinary shares at a cost of US\$91,595,439.

	<b>Total shares purchased (000s)</b>	<b>Average price paid per share (p)</b>	<b>Approximate US\$ value of shares purchased under the plan</b>
12-22 May 2014	<b>1,825</b>	<b>926.1138</b>	<b>28,687,538</b>
6-19 August 2014	<b>1,380</b>	<b>1,026.3662</b>	<b>23,833,629</b>
4-14 November 2014	<b>1,200</b>	<b>1,056.5981</b>	<b>20,198,882</b>
13-18 February 2015	<b>1,050</b>	<b>1,168.3047</b>	<b>18,875,390</b>

The shares were purchased in the open market by UBS Limited and JP Morgan Cazenove Limited on behalf of the Company.

## Exchange controls and other limitations affecting security holders

There are no UK governmental laws, decrees or regulations that restrict the export or import of capital or that affect the payment of dividends, interest or other payments to non-resident holders of Smith & Nephew's securities, except for certain restrictions imposed from time to time by Her Majesty's Treasury of the United Kingdom pursuant to legislation, such as the United Nations Act 1946 and the Emergency Laws Act 1964, against the government or residents of certain countries.

There are no limitations, either under the laws of the UK or under the Articles of Association of Smith & Nephew, restricting the right of non-UK residents to hold or to exercise voting rights in respect of ordinary shares, except that where any overseas shareholder has not provided to the Company a UK address for the service of notices, the Company is under no obligation to send any notice or other document to an overseas address. It is, however, the current practice of the Company to send every notice or other document to all shareholders regardless of the country recorded in the register of members, with the exception of details of the Company's dividend reinvestment plan, which are not sent to shareholders with recorded addresses in the USA and Canada.

**Taxation information for shareholders**

The comments below are of a general and summary nature and are based on the Group's understanding of certain aspects of current UK and US federal income tax law and practice relevant to the ADSs and ordinary shares not in ADS form. The comments address the material US and UK tax consequences generally applicable to a person who is the beneficial owner of ADSs or ordinary shares and who, for US federal income tax purposes, is a citizen or resident of the USA, a corporation (or other entity taxable as a corporation) created or organised in or under the laws of the USA (or any State therein), or an estate or trust the income of which is included in gross income for US federal income tax purposes regardless of its source (each a "US Holder"). The comments set out below do not purport to address all tax consequences of the ownership of ADSs or ordinary shares which may be material to a particular holder and in particular do not deal with the position of shareholders who directly or indirectly own 10% or more of the Company's issued ordinary shares. This discussion does not apply to (i) persons whose holding of ADSs or ordinary shares is effectively connected with or pertains to either a permanent establishment in the UK through which a US Holder carries on a business in the UK or a fixed base from which a US Holder performs independent personal services in the UK, or (ii) persons whose registered address is inside the UK. This discussion does not apply to certain investors subject to special rules, such as certain financial institutions, tax-exempt entities, insurance companies, broker-dealers, traders in securities that elect to

use the mark to market method of tax accounting, partnerships or other entities treated as partnerships for US federal income tax purposes, US Holders holding ADSs or ordinary shares as part of a hedging, conversion or other integrated transaction or whose functional currency for US federal income tax purposes is other than the US dollar and US Holders liable for alternative minimum tax. In addition, the comments below do not address the potential application of the provisions of the United States Internal Revenue Code, known as the Medicare contribution tax, or any US state, local or non-US (other than UK) taxes. The summary deals only with US Holders who hold ADSs or ordinary shares as capital assets. The summary is based on current UK and US law and practice which is subject to change, possibly with retroactive effect. US Holders are recommended to consult their own tax advisers as to the particular tax consequences to them of the ownership of ADSs or ordinary shares. The Company believes, and this discussion assumes, that the Company was not a passive foreign investment company for its taxable year ended 31 December 2014.

This discussion is based in part on representations by the depositary and assumes that each obligation under the deposit agreement and any related agreement will be performed in accordance with its terms. For purposes of US federal income tax law, US Holders of ADSs will generally be treated as owners of the ordinary shares represented by the ADSs. However, the US Treasury has expressed concerns that parties to whom depositary shares are released before shares are delivered to the depositary ("pre-released") may be taking actions that are inconsistent with the claiming of foreign tax credits by owners of depositary shares. Such actions would also be inconsistent with the claiming of the reduced rate of tax, described below, applicable to dividends received by certain non-corporate US Holders. Accordingly, the availability of the reduced tax rate for dividends received by certain non-corporate US Holders of ADSs could be affected by actions that may be taken by parties to whom ADSs are pre-released.

#### Taxation of dividends in the UK and the USA

The UK does not currently impose a withholding tax on dividends paid by a UK corporation, such as the Company.

Distributions paid by the Company will be treated for US federal income tax purposes as foreign source ordinary dividend income to a US Holder to the extent paid out of the Company's current or accumulated earnings and profits as determined for US federal income tax purposes. Because the Company does not maintain calculations of its earnings and profits under US federal income tax principles, it is expected that distributions generally will be reported to US Holders as dividends. Such dividends will not be eligible for the dividends-received deduction generally allowed to corporate US Holders.





## Table of Contents

Dividends paid to certain non-corporate US Holders of ordinary shares or ADSs may be subject to US federal income tax at lower rates than those applicable to other types of ordinary income if certain conditions are met. Non-corporate US Holders should consult their own tax advisers to determine whether they are subject to any special rules that limit their ability to be taxed at these favourable rates.

### Taxation of capital gains

US Holders, who are not resident or ordinarily resident for tax purposes in the UK, will not generally be liable for UK capital gains tax on any capital gain realised upon the sale or other disposition of ADSs or ordinary shares unless the ADSs or ordinary shares are held in connection with a trade carried on in the UK through a permanent establishment (or in the case of individuals, through a branch or agency). Furthermore, UK resident individuals who acquire ADSs or ordinary shares before becoming temporarily non-UK residents may remain subject to UK taxation of capital gains on gains realised while non-resident.

For US federal income tax purposes, gains or losses realised upon a taxable sale or other disposition of ADSs or ordinary shares by US Holders generally will be US source capital gains or losses and will be long-term capital gains or losses if the ADSs or ordinary shares were held for more than one year. The amount of a US Holder's gain or loss will be equal to the difference between the amount realised on the sale or other disposition and such holder's tax basis in the ADSs, or ordinary shares, determined in US dollars.

### Inheritance and estate taxes

The HM Revenue & Customs imposes inheritance tax on capital transfers which occur on death, and in the seven years preceding death. The HM Revenue & Customs considers that the US/UK Double Taxation Convention on Estate and Gift Tax applies to inheritance tax. Consequently, a US citizen who is domiciled in the USA and is not a UK national or domiciled in the UK will not be subject to UK inheritance tax in respect of ADSs and ordinary shares. A UK national who is domiciled in the USA will be subject to both UK inheritance tax and US federal estate tax but will be entitled to a credit for US federal estate tax charged in respect of ADSs and ordinary shares in computing the liability to UK inheritance tax. Conversely, a US citizen who is domiciled or deemed domiciled in the UK will be entitled to a credit for UK inheritance tax charged in respect of ADSs and ordinary shares in computing the liability for US federal estate tax. Special rules apply where ADSs and ordinary shares are business property of a permanent establishment of an enterprise situated in the UK.

### US information reporting and backup withholding

A US Holder may be subject to US information reporting and backup withholding on dividends paid on or the proceeds of sales of ADSs or ordinary shares made within the USA or through certain US-related financial intermediaries, unless the US Holder is an exempt recipient or, in the case of backup withholding, provides a correct US taxpayer identification number and certain other conditions are met. US backup withholding may apply if there has been a notification from the US Internal Revenue Service of a failure to report all interest or dividends.

Any backup withholding deducted may be credited against the US Holder's US federal income tax liability, and, where the backup withholding exceeds the actual liability, the US Holder may obtain a refund by timely filing the appropriate refund claim with the US Internal Revenue Service.

Certain US Holders who are individuals (and under proposed Treasury regulations, certain entities) may be required to report information relating to securities issued by a non-US person (or foreign accounts through which the securities are held), subject to certain exceptions (including an exception for securities held in accounts maintained by US financial institutions). US Holders should consult their tax advisers regarding their reporting obligations with respect to the ordinary shares or ADSs.

#### UK stamp duty and stamp duty reserve tax

UK stamp duty is charged on documents and in particular instruments for the transfer of registered ownership of ordinary shares. Transfers of ordinary shares in certificated form will generally be subject to UK stamp duty at the rate of  $\frac{1}{2}\%$  of the consideration given for the transfer with the duty rounded up to the nearest £5.

UK stamp duty reserve tax ( SDRT ) arises when there is an agreement to transfer shares in UK companies for consideration in money or money's worth, and so an agreement to transfer ordinary shares for money or other consideration may give rise to a charge to SDRT at the rate of  $\frac{1}{2}\%$  (rounded up to the nearest penny). The charge of SDRT will be cancelled, and any SDRT already paid will be refunded, if within six years of the agreement an instrument of transfer is produced to HM Revenue & Customs and the appropriate stamp duty paid.

Transfers of ordinary shares into CREST (an electronic transfer system) are exempt from stamp duty so long as the transferee is a member of CREST who will hold the ordinary shares as a nominee for the transferor and the transfer is in a form that will ensure that the securities become held in uncertificated form within CREST. Paperless transfers of ordinary shares within CREST for consideration in money or money's worth are liable to SDRT rather than stamp duty. SDRT on relevant transactions will be collected by CREST at  $\frac{1}{2}\%$ , and this will apply whether or not the transfer is effected in the UK and whether or not the parties to it are resident or situated in the UK.

A charge of stamp duty or SDRT at the rate of  $1\frac{1}{2}\%$  of the consideration (or, in some circumstances, the value of the shares concerned) will arise on a transfer or issue of ordinary shares to the depositary or to certain persons providing a clearance service (or their nominees or agents) for the conversion into ADRs and will generally be payable by the depositary or person providing clearance service. In accordance with the terms of the Deposit Agreement, any tax or duty payable by the depositary on deposits of ordinary shares will be charged by the depositary to the party to whom ADRs are delivered against such deposits.

No liability for stamp duty or SDRT will arise on any transfer of, or agreement to transfer, an ADS or beneficial ownership of an ADS, provided that the ADS and any instrument of transfer or written agreement to transfer remains at all times outside the UK, and provided further that any instrument of transfer or written agreement to transfer is not executed in the UK and the transfer does not relate to any matter or thing done or to be done in the UK (the location of the custodian as a holder of ordinary shares not being relevant in this context). In any other case, any transfer of, or agreement to transfer, an ADS or beneficial ownership of an ADS could, depending on all the circumstances of the transfer, give rise to a charge to stamp duty or SDRT.



**Table of Contents**

OTHER INFORMATION

**Information for shareholders *continued***

**Articles of Association**

The following summarises certain material rights of holders of the Company's ordinary shares under the material provisions of the Company's Articles of Association and English law. This summary is qualified in its entirety by reference to the Companies Act and the Company's Articles of Association. In the following description, a shareholder is the person registered in the Company's register of members as the holder of an ordinary share.

The Company is incorporated under the name Smith & Nephew plc and is registered in England and Wales with registered number 324357.

The Company's ordinary shares may be held in certificated or uncertificated form. No holder of the Company's shares will be required to make additional contributions of capital in respect of the Company's shares in the future. In accordance with English law the Company's ordinary shares rank equally.

**Directors**

Under the Company's Articles of Association, a Director may not vote in respect of any contract, arrangement, transaction or proposal in which he, or any person connected with him, has any material interest other than by virtue of his interests in securities of, or otherwise in or through, the Company. This is subject to certain exceptions relating to proposals (a) indemnifying him in respect of obligations incurred on behalf of the Company, (b) indemnifying a third party in respect of obligations of the Company for which the Director has assumed responsibility under an indemnity or guarantee, (c) relating to an offer of securities in which he will be interested as an underwriter, (d) concerning another body corporate in which the Director is beneficially interested in less than 1% of the issued shares of any class of shares of such a body corporate, (e) relating to an employee benefit in which the Director will share equally with other employees and (f) relating to any insurance that the Company is empowered to purchase for the benefit of Directors of the Company in respect of actions undertaken as Directors (and/or officers) of the Company.

A Director shall not vote or be counted in any quorum present at a meeting in relation to a resolution on which he is not entitled to vote.

The Directors are empowered to exercise all the powers of the Company to borrow money, subject to the limitation that the aggregate amount of all monies borrowed after deducting cash and current asset investments by the Company and its subsidiaries shall not exceed the sum of \$6,500,000,000.

Any Director who has been appointed by the Directors since the previous Annual General Meeting of shareholders, either to fill a casual vacancy or as an additional Director holds office only until the conclusion of the next Annual General Meeting and then shall be eligible for re-election by the shareholders. The other Directors retire and are eligible for re-appointment at the third Annual General Meeting after the meeting at which they were last re-appointed. If not re-appointed a Director retiring at a meeting shall retain office until the meeting appoints someone

in his place, or if it does not do so, until the conclusion of the meeting. The Directors are subject to removal with or without cause by the Board or the shareholders. Directors are not required to hold any shares of the Company by way of qualification.

Under the Company's Articles of Association and English law, a Director may be indemnified out of the assets of the Company against liabilities he may sustain or incur in the execution of his duties.

#### Rights attaching to ordinary shares

Under English law, dividends are payable on the Company's ordinary shares only out of profits available for distribution, as determined in accordance with accounting principles generally accepted in the UK and by the Companies Act 2006. Holders of the Company's ordinary shares are entitled to receive final dividends as may be declared by the Directors and approved by the shareholders in general meeting, rateable according to the amounts paid up on such shares, provided that the dividend cannot exceed the amount recommended by the Directors.

The Company's Board of Directors may declare such interim dividends as appear to them to be justified by the Company's financial position. If authorised by an ordinary resolution of the shareholders, the Board may also direct payment of a dividend in whole or in part by the distribution of specific assets (and in particular of paid up shares or debentures of the Company).

Any dividend unclaimed after 12 years from the date the dividend was declared, or became due for payment, will be forfeited and will revert to the Company.

There were no material modifications to the rights of shareholders under the Articles during 2014.

#### Voting rights of ordinary shares

Voting at any general meeting of shareholders is by a show of hands unless a poll, which is a written vote, is duly demanded and held. On a show of hands, every shareholder who is present in person at a general meeting has one vote regardless of the number of shares held. On a poll, every shareholder who is present in person or by proxy has one vote for each ordinary share held by that shareholder. A poll may be demanded by any of the following:

the chairman of the meeting;

at least five shareholders present or by proxy entitled to vote on the resolution;

any shareholder or shareholders representing in the aggregate not less than one-tenth of the total voting rights of all shareholders entitled to vote on the resolution; or

any shareholder or shareholders holding shares conferring a right to vote on the resolution on which there have been paid-up sums in aggregate equal to not less than one-tenth of the total sum paid up on all the shares conferring that right.

A form of proxy will be treated as giving the proxy the authority to demand a poll, or to join others in demanding one, as above.

The necessary quorum for a general meeting is two shareholders present in person or by proxy carrying the right to vote upon the business to be transacted.

192      **Smith & Nephew** Annual report 2014

## Table of Contents

Matters are transacted at general meetings of the Company by the processing and passing of resolutions of which there are two kinds; ordinary or special resolutions:

Ordinary resolutions include resolutions for the re-election of Directors, the approval of financial statements, the declaration of dividends (other than interim dividends), the appointment and re-appointment of auditors or the grant of authority to allot shares. An ordinary resolution requires the affirmative vote of a majority of the votes of those persons voting at the meetings at which there is a quorum.

Special resolutions include resolutions amending the Company's Articles of Association, dis-applying statutory pre-emption rights or changing the Company's name; modifying the rights of any class of the Company's shares at a meeting of the holders of such class or relating to certain matters concerning the Company's winding up. A special resolution requires the affirmative vote of not less than three-quarters of the votes of the persons voting at the meeting at which there is a quorum.

Annual General Meetings must be convened upon advance written notice of 21 days. Other general meetings must be convened upon advance written notice of at least 14 clear days. The days of delivery or receipt of notice are not included. The notice must specify the nature of the business to be transacted. Meetings are convened by the Board of Directors. Members with 5% of the ordinary share capital of the Company may requisition the Board to convene a meeting.

### Variation of rights

If, at any time, the Company's share capital is divided into different classes of shares, the rights attached to any class may be varied, subject to the provisions of the Companies Act, with the consent in writing of holders of three-quarters in nominal value of the issued shares of that class or upon the adoption of a special resolution passed at a separate meeting of the holders of the shares of that class. At every such separate meeting, all the provisions of the articles of association relating to proceedings at a general meeting apply, except that the quorum is to be the number of persons (which must be two or more) who hold or represent by proxy not less than one-third in nominal value of the issued shares of the class and at any such meeting a poll may be demanded in writing by any person or their proxy who hold shares of that class. Where a person is present by proxy or proxies, he is treated as holding only the shares in respect of which the proxies are authorised to exercise voting rights.

### Rights in a winding up

Except as the Company's shareholders have agreed or may otherwise agree, upon the Company's winding up, the balance of assets available for distribution:

after the payment of all creditors including certain preferential creditors, whether statutorily preferred creditors or normal creditors; and



subject to any special rights attaching to any other class of shares;

is to be distributed among the holders of ordinary shares according to the amounts paid-up on the shares held by them. This distribution is generally to be made in US dollars. A liquidator may, however, upon the adoption of any extraordinary resolution of the shareholders and any other sanction required by law, divide among the shareholders the whole or any part of the Company's assets in kind.

#### Limitations on voting and shareholding

There are no limitations imposed by English law or the Company's Articles of Association on the right of non-residents or foreign persons to hold or vote the Company's ordinary shares or ADSs, other than the limitations that would generally apply to all of the Company's shareholders.

#### Transfers of shares

The Board may refuse to register the transfer of shares held in certificated form which:

are not fully paid (provided that it shall not exercise this discretion in such a way as to prevent stock market dealings in the shares of that class from taking place on an open and proper basis);

are not duly stamped or duly certified or otherwise shown to the satisfaction of the Board to be exempt from stamp duty, lodged at the Transfer Office or at such other place as the Board may appoint and (save in the case of a transfer by a person to whom no certificate was issued in respect of the shares in question) accompanied by the certificate for the shares to which it relates, and such other evidence as the Board may reasonably require to show the right of the transferor to make the transfer and, if the instrument of transfer is executed by some other person on his behalf, the authority of that person so to do;

are in respect of more than one class of shares; or

are in favour of more than four transferees.

#### Deferred shares

Following the re-denomination of share capital on 23 January 2006 the ordinary shares' nominal value became 20 US cents each. There were no changes to the rights or obligations of the ordinary shares. In order to comply with the Companies Act 2006, a new class of sterling shares was created, deferred shares, of which £50,000 were issued and allotted in 2006 as fully paid to the Chief Executive Officer though the Board reserves the right to transfer them to another member of the Board should it so wish. These deferred shares have no voting or dividend rights and on winding up only are entitled to repayment at nominal value only if all ordinary shareholders have received the nominal value of their shares plus an additional \$1,000 each.

#### Amendments

The Company does not have any special rules about amendments to its Articles of Association beyond those imposed by law.

<b>Smith &amp; Nephew</b> Annual report 2014	193
--	-----

**Table of Contents**

## OTHER INFORMATION

**Cross Reference to Form 20-F**

This table provides a cross reference from the information included in this Annual Report to the requirements of Form 20-F.

<b>Part I</b>	<b>Page</b>
Item 1 Identity of Directors, Senior Management and Advisers	n/a
Item 2 Offer Statistics and Expected Timetable	n/a
Item 3 Key Information	
A Selected Financial Data	174 175
B Capitalization and Indebtedness	n/a
C Reason for the Offer and Use of Proceeds	n/a
D Risk Factors	171 173
Item 4 Information on the Company	
A History and Development of the Company	170
B Business Overview	3 4, 8 15, 18 39, 118 121, 171 173, 180 183
C Organizational Structure	10 11, 133 134, 164 165
D Property, Plant and equipment	128 129, 170, 172
Item 4A Unresolved Staff Comments	None
Item 5 Operating and Financial Review and Prospects	
A Operating results	8 15, 26, 30, 34 36, 111, 113, 115, 180 183
B Liquidity and Capital Resources	115, 136 140, 155
C Research and Development, patents and licences, etc.	14, 21 22
D Trend information	18 20, 104, 171 173
E Off Balance Sheet Arrangements	170
F Tabular Disclosure of Contractual Obligations	179 180
G Safe Harbor	199
Item 6 Directors, Senior Management and Employees	
A Directors and Senior Management	54 59, 63
B Compensation	81 102
C Board Practices	54 59, 62 80

	D Employees	10 11, 25, 121
	E Share Ownership	90, 159 162
Item 7	Major shareholders and Related Party Transactions	
	A Major shareholders	189
	Host Country shareholders	189
	B Related Party Transactions	163, 170
	C Interests of experts and counsel	n/a
Item 8	Financial information	
	A Consolidated Statements and Other Financial Information	103 165
	Legal Proceedings	145 147
	Dividends	187
	B Significant Changes	None
Item 9	The Offer and Listing	
	A Offer and Listing Details	188 189
	B Plan of Distribution	n/a
	C Markets	189
	D Selling shareholders	n/a
	E Dilution	n/a
	F Expenses of the Issue	n/a

**Table of Contents**

		<b>Page</b>
Item 10	Additional Information	
	A Share capital	n/a
	B Memorandum and Articles of Association	192 193
	C Material Contracts	115, 156 157
	D Exchange Controls	190
	E Taxation	190 191
	F Dividends and Paying Agents	n/a
	G Statement by Experts	n/a
	H Documents on Display	199
	I Subsidiary Information	164 165
Item 11	Quantitative and Qualitative Disclosure about Market Risk	140 144, 171 173
Item 12	Description of Securities Other than Equity Securities	
	A Debt securities	n/a
	B Warrants and rights	n/a
	C Other securities	n/a
	D American Depository shares	185 186
<b>Part II</b>		
Item 13	Defaults, Dividend Arrearages and Delinquencies	None
Item 14	Material Modifications to the Rights of Security Holders and Use of Proceeds	None
Item 15	Controls and Procedures	75 80, 105
Item 16	(Reserved)	n/a
Item 16A	Audit Committee Financial Expert	75
Item 16B	Code of Ethics	80
Item 16C	Principal Accountant Fees and Services	78 79, 123
Item 16D	Exemptions from the Listing Standards for Audit Committees	n/a
Item 16E	Purchases of Equity Securities by the Issuer and Affiliated Purchasers	154, 190
Item 16F	Change in Registrant's Certifying Accountant	78
Item 16G	Corporate Governance	60, 82
Item 16H	Mine Safety Disclosure	n/a
<b>Part III</b>		
Item 17	Financial Statements	n/a
Item 18	Financial Statements	103 165
Item 19	Exhibits	



**Table of Contents**

## OTHER INFORMATION

**Glossary of terms**

Unless the context indicates otherwise, the following terms have the meanings shown below:

<b>Term</b>	<b>Meaning</b>
<b>ACL</b>	The anterior cruciate ligament (ACL) is one of the four major ligaments in the human knee.
<b>ADR</b>	In the US, the Company's ordinary shares are traded in the form of ADSs evidenced by American Depository Receipts ( ADRs ).
<b>ADS</b>	In the US, the Company's ordinary shares are traded in the form of American Depository Shares ( ADSs ).
<b>Advanced Surgical Devices</b>	A product group comprising products for orthopaedic replacement and reconstruction, endoscopy devices and trauma devices. Products for orthopaedic replacement include systems for knees, hips, and shoulders. Endoscopy devices comprise of support products for orthopaedic surgery such as computer assisted surgery and minimally invasive surgery techniques using specialised viewing and access devices, surgical instruments and powered equipment. Orthopaedics trauma devices are used in the treatment of bone fractures including rods, pins, screws, plates and external frames.
<b>Advanced Wound Management</b>	A product group comprising products associated with the treatment of skin wounds, ranging from products that provide moist wound healing using breathable films and polymers to products providing active wound healing by biochemical or cellular action.
<b>AGM</b>	Annual General Meeting of the Company.
<b>Arthroscopy</b>	Endoscopy of the joints is termed arthroscopy , with the principal applications being the knee and shoulder.
<b>ASD</b>	Advanced Surgical Devices division.
<b>AWM</b>	Advanced Wound Management division.
<b>Basis Point</b>	One hundredth of one percentage point.
<b>Chronic wounds</b>	Chronic wounds are those with long or unknown healing times including leg ulcers, pressure sores and diabetic foot ulcers.
<b>Company</b>	Smith & Nephew plc or, where appropriate, the Company's Board of Directors, unless the context otherwise requires.
<b>Companies Act</b>	Companies Act 2006, as amended, of England and Wales.
<b>EBITA</b>	Earnings before interest, tax and amortisation.
<b>EBITDA</b>	Earnings before interest, tax, depreciation and amortisation.
<b>Emerging markets</b>	Emerging markets include Greater China, India, Brazil and Russia.
<b>EPSA</b>	EPSA is a trend measure, which presents the long-term profitability of the Group excluding the post-tax impact of specific transactions that

	<p>management considers affects the Group's short-term profitability. The Group presents this measure to assist investors in their understanding of trends. Adjusted attributable profit is the numerator used for this measure and is determined by adjusting attributable profit for the items that are excluded from operating profit when arriving at trading profit and items that are recognised below operating profit that affect the Group's short-term profitability.</p>
<b>Endoscopy</b>	<p>Through a small incision, surgeons are able to see inside the body using a monitor and identify and repair defects.</p>
<b>ERP</b>	<p>Enterprise Resource Planning: a software system which integrates internal and external management information, facilitating the flow of information across an organisation.</p>
<b>Established Markets</b>	<p>Established Markets include United States of America, Europe, Australia, New Zealand, Canada and Japan.</p>
<b>Euro or</b>	<p>References to the common currency used in the majority of the countries of the European Union.</p>
<b>External fixation</b>	<p>The use of wires or pins transfixed through bone to hold a frame to the position of a fracture.</p>
<b>FDA</b>	<p>US Food and Drug Administration.</p>
<b>Financial statements</b>	<p>Refers to the consolidated Group Accounts of Smith &amp; Nephew plc.</p>
<b>FTSE 100</b>	<p>Index of the largest 100 listed companies on the London Stock Exchange by market capitalisation.</p>
<b>GMP</b>	<p>Good manufacturing practice or GMP is the guidance that outlines the aspects of production and testing that can impact the quality of a product.</p>
<b>Group or Smith &amp; Nephew</b>	<p>Used for convenience to refer to the Company and its consolidated subsidiaries, unless the context otherwise requires.</p>
<b>Health economics</b>	<p>A branch of economics concerned with issues related to efficiency, effectiveness, value and behaviour in the production and consumption of health and healthcare.</p>



**Table of Contents**

<b>Term</b>	<b>Meaning</b>
<b>IFRIC</b>	International Financial Reporting Interpretations as adopted by the EU and as issued by the International Accounting Standards Board.
<b>IFRS</b>	International Financial Reporting Standards as adopted by the EU and as issued by the International Accounting Standards Board.
<b>International markets</b>	International Markets include Middle East, North Africa, Southern Africa, Latin America, ASEAN, South Korea and Eastern Europe.
<b>LSE</b>	London Stock Exchange.
<b>Metal-on-metal hip resurfacing</b>	A less invasive surgical approach to treating arthritis in certain patients whereby only the surfaces of the hip joint are replaced leaving the hip head substantially preserved.
<b>Negative Pressure Wound Therapy</b>	A technology used to treat chronic wounds such as diabetic ulcers, pressure sores and post-operative wounds through the application of sub-atmospheric pressure to an open wound.
<b>NYSE</b>	New York Stock Exchange.
<b>Orthobiologics products</b>	Any product that is primarily intended to act as a scaffold and/or actively stimulates bone growth.
<b>Orthopaedic products</b>	Orthopaedic reconstruction products include joint replacement systems for knees, hips and shoulders and support products such as computer-assisted surgery and minimally invasive surgery techniques. Orthopaedic trauma devices are used in the treatment of bone fractures including rods, pins, screws, plates and external frames. Clinical therapies products include joint fluid therapy for pain reduction of the knee and an ultrasound treatment to accelerate the healing of bone fractures.
<b>OXINIUM</b>	OXINIUM material is an advanced load bearing technology. It is created through a proprietary manufacturing process that enables zirconium to absorb oxygen and transform to a ceramic on the surface, resulting in a material that incorporates the features of ceramic and metal. Management believes that OXINIUM material used in the production of components of knee and hip implants exhibits unique performance characteristics due to its hardness, low-friction and resistance to roughening and abrasion.
<b>Parent Company</b>	Smith & Nephew plc.
<b>Pound Sterling, Sterling, £, pence or p</b>	References to UK currency. 1p is equivalent to one hundredth of £1.
<b>Repair</b>	A product group within ASD comprising specialised devices, fixation systems and bio-absorbable materials to repair joints and associated tissue.
<b>Resection</b>	Products that cut or ablate tissue within ASD comprising mechanical blades, radio frequency wands, electromechanical and hand instruments for resecting tissue.
<b>SEC</b>	US Securities and Exchange Commission
<b>Trading results</b>	Trading profit, trading profit margin and trading cash flow are trend measures, which present the long-term profitability of the Group

excluding the impact of specific transactions that management considers affect the Group's short-term profitability and cash flows. The Group has identified the following items, where material, as those to be excluded from operating profit and cash generated from operations when arriving at trading profit and trading cash flow, respectively: acquisition and disposal related items arising in connection with business combinations, including amortisation of acquisition intangible assets, impairments and integration costs; restructuring events; gains and losses resulting from legal disputes and significant uninsured losses. In addition to these items, gains or losses that materially impact the Group's profitability or cash flows on a short-term or one-off basis are excluded from operating profit and cash generated from operations when arriving at trading profit and trading cash flow, respectively

**UK**  
**UK GAAP**  
**Underlying growth**

United Kingdom of Great Britain and Northern Ireland.  
Accounting principles generally accepted in the United Kingdom.  
Growth after adjusting for the effects of currency translation and the inclusion of the comparative impact of acquisitions and exclusion of disposals.

**US**  
**US Dollars, US \$ or cents**

United States of America.  
References to US currency. 1 cent is equivalent to one hundredth of US\$1.

**US GAAP**

Accounting principles generally accepted in the United States of America.

**Visualisation**

Products within ASD comprising digital cameras, light sources, monitors, scopes, image capture, central control and multimedia broadcasting systems for use in endoscopic surgery with visualisation.

**Wound bed**

An area of healthy dermal and epidermal tissue of a wound.

**Table of Contents**

## OTHER INFORMATION

**Index**

2013 Financial highlights	180
2014 Financial highlights	4
Accounting Policies	117
Accounts Presentation	199
Acquisitions	156
Acquisition related costs	123
Advanced Surgical Devices Business segment review	26
Advanced Wound Management	
Business segment review	30
American Depository Shares	185
Articles of Association	192
Audit fees	123
Board	54
Business overview	12
Business segment information	26
Cash and borrowings	136
Chairman's statement	5
Chief Executive Officer's review	6
Company Balance Sheet	166
Company Notes to the Accounts	167
Contingencies	146
Contractual obligations	179
Corporate Governance Statement	62
Critical accounting policies	104
Cross Reference to Form 20-F	194
Currency fluctuations	172
Currency translation	117
Deferred taxation	126
Directors' Remuneration Report	81
Directors' responsibilities for the accounts	103
Directors' responsibility statement	103
Dividends	154, 187
Earnings per share	127
Employees/People	25, 121
Employees' Share Trust	154
Ethics and compliance	22
Executive officers	58
Factors affecting results of operations	173
Financial instruments	140
Table of Contents	483

Edgar Filing: SMITH & NEPHEW PLC - Form 20-F

Financial position, liquidity and capital resources	115
Glossary of terms	196
Goodwill	130
Group Balance Sheet	112
Group Cash Flow Statement	114
Group history	170, 200
Group Income Statement	110
Group Notes to the Accounts	117
Group overview	12
Group Statement of Changes in Equity	116
Group Statement of Comprehensive Income	110
Independent Auditor's Reports	105
Information for shareholders	184
Intangible assets	131
Intellectual property	22
Interest	124
Inventories	134
Investments	133
Investment in associates	133
Key Performance Indicators	14
Leases	140, 158
Legal and other	123
Legal proceedings	146
Manufacturing	23
Marketplace	18
Medical education	24
New accounting standards	117
Off-Balance Sheet arrangements	170
Operating profit	122
Other finance (costs)/income	124
Outlook and trend information	17, 18
Parent Company accounts	166
Payables	136
People/Employees	25
Principal subsidiary undertakings	164
Provisions	145
Property, plant and equipment	128
Receivables	135
Regulation	18, 22, 29, 33
Related party transactions	163
Research and development	21
Restructuring and rationalisation expenses	123
Retirement benefit obligation	147
Risk factors	171
Risk management	36, 79
Sales and marketing	24
Selected financial data	174
Share based payments	159
Share capital	189
Shareholder return	91
Strategy	13
Table of Contents	484

Sustainability	40
Taxation	124
Taxation information for shareholders	190
Treasury shares	154

198      **Smith & Nephew** Annual report 2014

## Table of Contents

### About Smith & Nephew

The Smith & Nephew Group (the Group) is a global medical devices business operating in the markets for advanced surgical devices comprising orthopaedic reconstruction, trauma and sports medicine and advanced wound management, with revenue of approximately \$4.6 billion in 2014. Smith & Nephew plc (the Company) is the parent company of the Group. It is an English public limited company with its shares listed on the premium list of the UK Listing Authority and traded on the London Stock Exchange. Shares are also traded on the New York Stock Exchange in the form of American Depositary Shares (ADSs).

This is the Annual Report of Smith & Nephew plc for the year ended 31 December 2014. It comprises, in a single document, the Annual Report and Accounts of the Company in accordance with UK requirements and the Annual Report on Form 20-F in accordance with the regulations of the United States Securities and Exchange Commission (SEC).

Smith & Nephew operates on a worldwide basis and has distribution channels in over 100 countries. In the more established countries by revenue, the Group's business operations are organised by divisions. In the majority of the remaining markets, operations are managed by country managers who are responsible for sales and distribution of the Group's entire product range. These comprise the Emerging Markets & International Markets.

Smith & Nephew's corporate website, [www.smith-nephew.com](http://www.smith-nephew.com), gives additional information on the Group, including an electronic version of this Annual Report. Information made available on this website, or other websites mentioned in this Annual Report, are not and should not be regarded as being part of, or incorporated into, this Annual Report.

For the convenience of the reader, a Glossary of technical and financial terms used in this document is included on pages 196 to 197. The product names referred to in this document are identified by use of capital letters and the à symbol (on first occurrence) and are trademarks owned by or licensed to members of the Group.

### Presentation

The Group's fiscal year end is 31 December. References to a particular year in this Annual Report are to the fiscal year, unless otherwise indicated. Except as the context otherwise requires, Ordinary Share or share refer to the ordinary shares of Smith & Nephew plc of 20 US cents each.

The Group Accounts of Smith & Nephew in this Annual Report are presented in US Dollars. Solely for the convenience of the reader, certain parts of this Annual Report contain translations of amounts in US Dollars into Sterling at specified rates. These translations should not be construed as representations that the US Dollar amounts actually represent such Sterling amounts or could be converted into Sterling at the rate indicated.

Unless stated otherwise, the translation of US Dollars and cents to Sterling and pence in this Annual Report has been made at the Bank of England exchange rate on the date indicated. On 23 February 2015, the Bank of England rate was US\$1.5449 per £1.

The results of the Group, as reported in US Dollars, are affected by movements in exchange rates between US Dollars and other currencies. The Group applied the average exchange rates prevailing during the year to translate the results

of companies with functional currency other than US Dollars. The currencies which most influenced these translations in the years covered by this report were Sterling, Swiss Franc and the Euro.

The Accounts of the Group in this Annual Report are presented in millions ( m ) unless otherwise indicated.

### [Special note regarding forward-looking statements](#)

The Group's reports filed with, or furnished to, the US Securities and Exchange Commission ( SEC ), including this document and written information released, or oral statements made, to the public in the future by or on behalf of the Group, contain forward-looking statements within the meaning of the US Private Securities Litigation Reform Act of 1995, that may or may not prove accurate. For example, statements regarding expected revenue growth and trading profit margins discussed under Outlook , Global Outlook and Strategic performance , market trends and our product pipeline are forward-looking statements. Phrases such as aim , plan , intend , anticipate , well-placed , believe , expect , target , consider and similar expressions are generally intended to identify forward-looking statements. Forward-looking statements involve known and unknown risks, uncertainties and other important factors that could cause actual results, to differ materially from what is expressed or implied by the statements.

For Smith & Nephew, these factors include: economic and financial conditions in the markets we serve, especially those affecting health care providers, payers and customers; price levels for established and innovative medical devices; developments in medical technology; regulatory approvals, reimbursement decisions or other government actions; product defects or recalls; litigation relating to patent or other claims; legal compliance risks and related investigative, remedial or enforcement actions; strategic actions, including acquisitions and dispositions and our success in performing due diligence, valuing and integrating acquired businesses; disruption that may result from transactions or other changes we make in our business plans or organisation to adapt to market developments and numerous other matters that affect us or our markets, including those of a political, economic, business, competitive or reputational nature; relationships with healthcare professionals; reliance on information technology. Specific risks faced by the Group are described under Risk factors on pages 171 to 173 of this Annual Report. Any forward-looking statement is based on information available to Smith & Nephew as of the date of the statement. All written or oral forward-looking statements attributable to Smith & Nephew are qualified by this caution. Smith & Nephew does not undertake any obligation to update or revise any forward-looking statement to reflect any change in circumstances or in Smith & Nephew's expectations.

### [Division data](#)

Division data and division share estimates throughout this report are derived from a variety of sources including publicly available competitors' information, internal management information and independent market research reports.

### [Documents on display](#)

It is possible to read and copy documents referred to in this Annual Report at the Registered Office of the Company. Documents referred to in this Annual Report that have been filed with the Securities and Exchange Commission in the US may be read and copied at the SEC's public reference room located at 450 Fifth Street, NW, Washington DC 20549. Please call the SEC at 1-800-SEC-0330 for further information on the public reference rooms and their copy charges. The SEC also maintains a web site at [www.sec.gov](http://www.sec.gov) that contains reports and other information regarding registrants that file electronically with the SEC. This Annual Report and some of the other information submitted by the Group to the SEC may be accessed through the SEC website.

**Smith & Nephew** Annual report 2014 199



**Table of Contents**

**Table of Contents**

**Table of Contents**

**Smith & Nephew plc**

**15 Adam Street**

**London WC2N 6LA**

**United Kingdom**

**T +44 (0) 20 7401 7646**

**F +44 (0) 20 7960 2356**

**[www.smith-nephew.com](http://www.smith-nephew.com)**

**Table of Contents**

**SIGNATURE**

The Registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and has duly caused and authorized the undersigned to sign this Annual Report on its behalf.

Smith & Nephew plc

(Registrant)

By: /s/ Susan Swabey  
Susan Swabey

Company Secretary

London, England

March 5, 2015

**Table of Contents****EXHIBIT INDEX**

<b>Exhibit No.</b>	<b>Description of Document</b>	<b>Incorporated Herein by Reference To</b>	<b>Filed Herewith</b>
1	Articles of Association	Form 20-F for the year ended December 31, 2011 filed on March 1, 2012 (File No. 1-14978)	
2	Smith & Nephew plc is not party to any single instrument relating to long-term debt pursuant to which a total amount of securities exceeding 10% of Smith & Nephew plc's total assets (on a consolidated basis) is authorized to be issued. Smith & Nephew plc hereby agrees to furnish to the SEC, upon its request, a copy of any instrument defining the rights of holders of its long-term debt or the rights of holders of the long-term debt of any of its subsidiaries for which consolidated or unconsolidated financial statements are required to be filed with the SEC.		
4	(a) (i) Material contract: Agreement and Appendices dated 3 February 2014 by and among Smith & Nephew plc, Barclays Bank Plc, The Financial Institutions in Schedule 1, Barclays Bank Plc and J.P. Morgan Chase Bank, N.A. and J.P. Morgan Europe Limited.	Form 20-F for the year ended December 31, 2013 filed on March 6, 2014 (File No.1-14978)	
	(ii) Material contract: Agreement and Plan Merger dated 2 February 2014 by and among Arthrocare Corporation Smith & Nephew, Inc. and Smith & Nephew plc.	Form 20-F for the year ended December 31, 2013 filed on March 6, 2014 (File No.1-14978)	
	(iii) Material contract: Agreement and Appendices dated 24 March 2014 by and among Smith & Nephew plc, Barclays Bank Plc; J.P. Morgan Limited; Bank Of America Merrill Lynch International Limited; Bank Of China Limited, London Branch; The Bank Of Tokyo-Mitsubishi Ufj, Ltd.; HSBC Bank Plc; Mizuho Bank, Ltd.; National Australia Bank Limited; The Royal Bank Of Scotland Plc; Societe Generale; Sumitomo Mitsui Banking Corporation; Wells Fargo Bank International and Deutsche Bank Ag,		X

London Branch

	(iv) Material contract: Agreement and Appendices dated 19 November 2014 by and among Smith & Nephew plc and the purchasers listed in Schedule A.		X
4	(c) (i) Service Agreement of Olivier Bohuon	Form 20-F for the year ended December 31, 2010 filed on March 3, 2011 (File No. 1-14978)	
	(ii) Retirement provisions for David J Illingworth	Form 20-F for the year ended December 31, 2010 filed on March 3, 2011 (File No. 1-14978)	
	(iii) Service Agreement of Julie Brown	Form 20-F for the year ended December 31, 2012 filed on February 28, 2013 (File No. 1-14978)	
	(iv) Side Letter to the Service Agreement of Julie Brown	Form 20-F for the year ended December 31, 2012 filed on February 28, 2013 (File No. 1-14978)	
	(v) Letter of Appointment of Ian Barlow	Form 20-F for the year ended December 31, 2009 filed on March 26, 2010 (File No. 1-14978)	
	(vi) Letter of Appointment of The Rt. Hon Baroness Virginia Bottomley	Form 20-F for the year ended December 31, 2012 filed on February 28, 2013 (File No.1-14978)	
	(vii) Letter of Appointment of Michael Friedman	Form 20-F for the year ended December 31, 2012 filed on February 28, 2013 (File No.1-14978)	

**Table of Contents**

<b>Exhibit No.</b>	<b>Description of Document</b>	<b>Incorporated Herein by Reference To</b>	<b>Filed Herewith</b>
4 (c) (viii)	Letter of Appointment of Ajay Piramal	Form 20-F for the year ended December 31, 2011 filed on March 1, 2012 (File No. 1-14978)	
(ix)	Letter of Re-Appointment of Rolf Stomberg	Form 20-F for the year ended December 31, 2012 filed on February 28, 2013 (File No.1-14978)	
(x)	Letter of Re-Appointment of Richard De Schutter	Form 20-F for the year ended December 31, 2013 filed on March 6, 2014 (File No.1-14978)	
(xi)	Letter of Re-Appointment of Pamela Kirby	Form 20-F for the year ended December 31, 2013 filed on March 6, 2014 (File No.1-14978)	
(xii)	Letter of Re-Appointment of Brian Larcombe	Form 20-F for the year ended December 31, 2013 filed on March 6, 2014 (File No.1-14978)	
(xiii)	Letter of Re-Appointment of Joseph Papa	Form 20-F for the year ended December 31, 2013 filed on March 6, 2014 (File No.1-14978)	
(xiv)	Letter of Appointment of Roberto Quarta	Form 20-F for the year ended December 31, 2013 filed on March 6, 2014 (File No.1-14978)	
(xv)	Letter of Appointment of Vinita Bali		X
(xvi)	Letter of Appointment of Erik Engstrom		X
(xvii)	Letter of Re-Appointment of Brian Larcombe		X
(xviii)	Letter of Re-Appointment of The Rt. Hon Baroness Virginia Bottomley DL		X
(xix)	The Smith & Nephew 2001 UK Approved Share Option Plan	Form 20-F for the year ended December 31, 2004 filed on March 16, 2005 (File No. 1-14978)	
(xx)	The Smith & Nephew 2001 UK Unapproved Share Option Plan	Form 20-F for the year ended December 31, 2004 filed on March 16, 2005 (File No. 1-14978)	
(xxi)	The Smith & Nephew 2001 US Share Plan	Registration Statement on Form S-8 No. 333-13694 filed on July 9, 2001 (File No. 1-14978)	
(xxii)	The Smith & Nephew Sharesave Plan (2002)	Form 20-F for the year ended December 31, 2002 filed on April 25, 2003 (File No. 1-14978)	

Edgar Filing: SMITH & NEPHEW PLC - Form 20-F

(xxiii)	The Smith & Nephew International Sharesave Plan (2002)	Form 20-F for the year ended December 31, 2004 filed on March 16, 2005 (File No. 1-14978)
(xxiv)	The Smith & Nephew Italian Sharesave Plan (2002)	Form 20-F for the year ended December 31, 2002 filed on April 25, 2003 (File No. 1-14978)
(xxv)	The Smith & Nephew Dutch Sharesave Plan (2002)	Form 20-F for the year ended December 31, 2002 filed in April 25, 2003 (File No. 1-14978)
(xxvi)	The Smith & Nephew Belgian Sharesave Plan (2002)	Form 20-F for the year ended December 31, 2002 filed on April 25, 2003 (File No. 1-14978)
(xxvii)	The Smith & Nephew French Sharesave Plan (2002)	Form 20-F for the year ended December 31, 2002 filed on April 25, 2003 (File No. 1-14978)
(xxviii)	Smith & Nephew Irish Employee Share Option Scheme	Form 20-F for the year ended December 31, 2003 filed on March 26, 2004 (File No. 1-14978)
(xxix)	Smith & Nephew 2004 Executive Share Option Scheme	Registration statement on Form S-8 No. 333-122801 filed on February 14, 2005 (File No. 1-14978)
(xxx)	Smith & Nephew 2004 Performance Share Plan	Registration statement on Form S-8 No. 333-122801 filed on February 14, 2005 (File No. 1-14978)
(xxxi)	Smith & Nephew 2004 Co-investment Plan	Registration statement on Form S-8 No. 333-122801 filed on February 14, 2005 (File No. 1-14978)



**Table of Contents**

<b>Exhibit No.</b>	<b>Description of Document</b>	<b>Incorporated Herein by Reference To</b>	<b>Filed Herewith</b>
4	(c) (xxxii) Smith & Nephew U.S. Employee Stock Purchase Plan	Registration statement on Form S-8 No. 333-12052 filed on May 30, 2000 (File No. 1-14978)	
	(xxxiii) Smith & Nephew Long Service Award Scheme	Registration Statement on Form S-8 No. 33-39814 filed on April 5, 1991 (File No. 1-14978)	
	(xxxiv) Smith & Nephew 2004 Performance Share Plan	Registration statement on Form S-8 No. 333-155172 filed on November 7, 2008 (File No. 1-14978)	
	(xxxv) Smith & Nephew 2001 US Share Plan	Registration statement on Form S-8 No. 333-155173 filed on November 7, 2008 (File No. 1-14978)	
	(xxxvi) Smith & Nephew plc Deferred Bonus Plan	Registration statement on Form S-8 No. 333-158239 filed on March 27, 2009 (File No. 1-14978)	
	(xxxvii) Smith & Nephew plc Global Share Plan 2010	Registration statement on Form S-8 No. 333-168544 filed on August 5, 2010 (File No. 1-14978)	
	(xxxviii) Smith & Nephew ShareSave Plan (2012)	Form 20-F for the year ended December 31, 2012 filed on February 28, 2013 (File No. 1-14978)	
	(xxxix) Smith & Nephew International ShareSave Plan (2012)	Form 20-F for the year ended December 31, 2012 filed on February 28, 2013 (File No. 1-14978)	
8	Principal Subsidiaries		X
12	(a) Certification of Olivier Bohuon, filed pursuant to Exchange Act Rule 13a -14(a)		X
	(b) Certification of Julie Brown filed pursuant to Exchange Act Rule 13a -14(a)		X
13	(a) Certification of Olivier Bohuon and Julie Brown furnished pursuant to Exchange Act Rule 13a -14(b)		X
15.1	Consent of Independent Registered Public Accounting Firm		X