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

The Directors are responsible for preparing this Annual Report and Form 20-F Information and the Group and Parent Company Financial Statements, in accordance with applicable law and regulations.

Company law requires the Directors to prepare Group and Parent Company Financial Statements for each financial year; the Group Financial Statements are required to be prepared in accordance with IFRSs, as adopted by the EU, and applicable law and the Directors have elected to prepare the Parent Company Financial Statements in accordance with UK Accounting Standards, including FRS 101 *Reduced Disclosure Framework*.

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

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- for the Group Financial Statements, state whether they have been prepared in accordance with IFRSs, as adopted by the EU;
- for the Parent Company Financial Statements, state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the Parent Company Financial Statements; and
- prepare the Financial Statements on the going concern basis unless it is inappropriate to presume that the Group and the Parent Company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Parent Company's transactions and disclose with reasonable accuracy at any time the financial position of the Parent Company and enable them to ensure that its Financial Statements comply with the Companies Act. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

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

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

RESPONSIBILITY STATEMENT OF THE DIRECTORS IN RESPECT OF THE ANNUAL REPORT

We confirm that to the best of our knowledge:

- the Financial Statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Group; and
- the Strategic Report and Directors' Report includes a fair review of the development and performance of the business and the financial position of the Group, together with a description of the principal risks and uncertainties that they face.

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

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

- Overview (pages 2 to 7);
- Our Business and Marketplace (pages 8 to 17);
- Operational Review (pages 18 to 38);
- Financial Review (pages 39 to 41);
- Risk (pages 42 to 46);

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

By order of the Board, 22 February 2017

Susan M Swabey

Susan Swabey
Company Secretary

INDEPENDENT AUDITOR'S UK REPORT

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

The report set out below is provided in compliance with International Standards on Auditing (UK and Ireland). KPMG LLP has also issued reports in accordance with standards of the Public Company Accounting Oversight Board in the US, which will be included in the Annual Report on Form 20-F to be filed with the US Securities and Exchange Commission. Those reports are unqualified and include opinions on the Group Financial Statements and on the effectiveness of internal control over financial reporting as at 31 December 2016 (Sarbanes-Oxley Act Section 404).

The Directors' statement on internal control over financial reporting is set out on page 75.

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

OPINIONS AND CONCLUSIONS ARISING FROM OUR AUDIT

1 Our opinion on the financial statements is unmodified

We have audited the financial statements of Smith & Nephew plc for the year ended 31 December 2016 set out on pages 108 to 168.

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the Parent Company's affairs as at 31 December 2016 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union;
- the Parent Company financial statements have been properly prepared in accordance with UK Accounting Standards, including FRS 101 Reduced Disclosure Framework; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006; and, as regards the Group financial statements, Article 4 of the IAS Regulation.

As explained in the accounting policies set out in the Group Financial Statements, the Group, in addition to complying with its legal obligation to apply IFRS as adopted by the EU, has also applied IFRS as issued by the IASB. In our opinion, the Consolidated Financial Statements comply with IFRS as issued by the IASB.

2 Our assessment of risks of material misstatement

We summarise below the risks of material misstatement (unchanged from 2015) that had the greatest effect on our audit (in decreasing order of audit significance), our key audit procedures to address those risks and our findings from those procedures in order that the Company's members as a body may better understand the process by which we arrived at our audit opinion.

Our findings are based on procedures undertaken in the context of, and solely for the purpose of our statutory audit opinion on the financial statements as a whole and consequently are incidental to that opinion, and we do not express discrete opinions on separate elements of the financial statements.

VALUATION OF ACQUIRED INTANGIBLE ASSETS (INCLUDED IN INTANGIBLE ASSETS OF 2016: $1,411 MILLION; 2015: $1,502 MILLION)

Risk vs 2015:

THE RISK	OUR RESPONSE
The Group has significant intangible assets, of which the most significant relate to acquisitions in respect of ArthroCare (acquired in 2014) and Healthpoint (acquired in 2012). There is a risk that due to changes in the competitive landscape, regulatory or other external factors the acquired assets underperform in comparison to their original investment case and that the carrying value may be impaired. The carrying values of intangibles assets are reviewed for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. If such indicators exist, the recoverable amount of the asset is estimated on the basis of discounted future cash flow forecasts which are inherently judgemental. An impairment charge of $32 million (2015: impairment charge of $40m) has been recognised in relation to Oasis, a brand acquired from the Healthpoint acquisition which has continued to underperform against the original investment case. The remaining carrying value of Oasis following the impairment charge and current year amortisation is $9 million.	Our procedures included challenging the directors' process by which they identified intangible assets with indicators of impairment that required detailed impairment reviews. For those assets selected for detailed impairment reviews, we tested the principles and integrity of the Group's discounted cash flow models and corroborated key assumptions made on revenue and profitability projections through interviews with commercial personnel, checking the consistency with strategic plans for the assets and by reference to external market data if available. We tested the sensitivity of the value in use calculated to the key assumptions. We also assessed the adequacy of related disclosures in the Group's financial statements, including whether the Group's disclosures about the sensitivity of the outcome of the impairment assessment to changes in key assumptions reflected the key risks inherent in the valuation of acquired intangibles. **Our results** As a result of our work, we determined that the quantum of impairment recognised in 2016 and the related disclosures were appropriate. (2015: appropriate).

REFER TO PAGE 72 (AUDIT COMMITTEE REPORT), PAGES 108 AND 130 TO 131 (ACCOUNTING POLICY AND FINANCIAL DISCLOSURES)

INDEPENDENT AUDITOR'S UK REPORT continued

LIABILITY PROVISIONING (INCLUDED WITHIN PROVISIONS OF 2016: $261 MILLION; 2015: $303 MILLION)

Risk vs 2015: ▼

THE RISK

The development, manufacture and sale of medical devices entails risk of product liability claims and patent infringement issues due to the technological nature of the products and the competitive nature of the industry. Determining the impact and likely outcome of any litigation matters is inherently subjective and the amounts involved are potentially material.

As disclosed in Note 17, the Group continues to hold a provision of $163 million in respect of potential liabilities arising from the ongoing exposure for Metal-on-Metal hip products.

OUR RESPONSE

We tested the Group's controls surrounding litigation and contingent liabilities, inspected a sample of legal invoices and corresponded directly with external legal advisers to understand the fact patterns and ensure that all significant cases had been adequately considered by the Directors in making their judgement on any provisioning that may be required.

We tested the key estimates of provisions, including the Directors assessment of potential royalties payable for past sales for intellectual property disputes and expected settlement of product liability cases. We challenged the assumptions made based on the fact pattern of similar historic cases which may be indicative of the likely settlement.

For the liability recognised in respect of the expected payouts for Metal-on-Metal claims we involved our actuarial specialists to challenge the critical assumptions used in statistical projections in determining the estimate. The key assumptions included: expected number of claimants; projected value of each settlement; and the likely time period expected for settlement.

We also considered the adequacy of the Group's disclosures in respect of litigation reserves and contingent liabilities.

Our results
From the evidence obtained, we considered the level of provisioning and related disclosures to be acceptable (2015: acceptable).

REFER TO PAGE 72 (AUDIT COMMITTEE REPORT), PAGES 108 AND 143 TO 144 (ACCOUNTING POLICY AND FINANCIAL DISCLOSURES)

TAX PROVISIONING (INCLUDED IN CURRENT TAX PAYABLE OF 2016: $231 MILLION; 2015: $263 MILLION)

Risk vs 2015: ◀▶

THE RISK

Accruals for tax contingencies require the Directors to make judgements and estimates in relation to tax issues and exposures. Given that the Group operates in a number of tax jurisdictions, there are complexities of transfer pricing and other international tax legislation and the time taken for tax matters to be agreed with the tax authorities can be extensive.

OUR RESPONSE

In this area our procedures included the support of our own international and local tax specialists in assessing the Group's tax positions, its correspondence with the relevant tax authorities, and analysing and challenging the key assumptions used to determine tax provisions based on our knowledge and experiences of the application of the international and local legislation by the relevant authorities and courts.

We also considered the adequacy of the Group's disclosures in respect of tax and uncertain tax positions.

Our results
From the evidence obtained, we considered the level of provisioning and related disclosures to be acceptable (2015: acceptable).

REFER TO PAGE 72 (AUDIT COMMITTEE REPORT), PAGES 108 AND 123 TO 125 (ACCOUNTING POLICY AND FINANCIAL DISCLOSURES)

INVENTORY VALUATION – 2016: $1,244 MILLION (2015: $1,217 MILLION)

Risk vs 2015:

THE RISK

Inventory comprises finished goods and raw materials.

The Group has high levels of finished goods, some of which are located at customer premises to be available for immediate use. Complete sets of products have to be made available in this way including outsizes which are used less frequently. Towards the end of a product's life cycle, finished goods inventory levels may exceed requirements.

High volumes of raw materials, which are highly specific to individual product franchises are maintained on hand to support the production cycle. Where actual usage differs from expectation due to their usage in the future production of finished goods any excess materials may become obsolete.

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

In estimating the net realisable value for inventory, management has to apply judgement on how much of the inventory on hand will ultimately be used or sold in arriving at its estimate of excess and obsolete inventory.

OUR RESPONSE

The key inputs used in estimating the Excess and Obsolescence (E&O) provision include assumptions around expected usage of inventory which are based on historical sales and other internal or external factors which may impact the demand for the product.

We tested the design and effectiveness of controls surrounding the review of the E&O provision.

On a sample basis we corroborated historic sales back to underlying source data. We tested the accuracy and integrity of the underlying calculations of the provisions. We also corroborated on a sample basis the expected usage of inventory with the Director's plans for launching new product lines or discontinuing product lines.

We considered the historical accuracy of the provision against actual inventory write-offs to consider the accuracy of the historic assumptions made by the Directors.

We also considered the adequacy of the Group's disclosures in respect of inventory valuation.

Our results
From the evidence obtained, we considered the level of provisioning for inventory and related disclosures to be acceptable (2015: acceptable).

REFER TO PAGE 72 (AUDIT COMMITTEE REPORT), PAGES 108 AND 133 (ACCOUNTING POLICY AND FINANCIAL DISCLOSURES)

ADVANCED WOUND CARE, BIOACTIVES AND DEVICES REVENUE – 2016: $1,233 MILLION (2015: $1,266 MILLION)

Risk vs 2015:

THE RISK

One of the key areas of focus of our audit is to consider that both the timing and the amount of revenue being recognised is appropriate. The amount of revenue being recognised requires the Directors to appropriately reflect estimates for contractual rebates, chargebacks and returns which are deducted in arriving at revenue from wholesale customers and distributors.

OUR RESPONSE

Our procedures included testing the Group's controls surrounding the timing of revenue recognition and key controls in the order-to-cash transaction cycle, including reconciliations between sales systems and the general ledger.

We assessed whether appropriate revenue recognition policies are applied through comparison with accounting standards, in particular around the timing of revenue recognition. Other procedures included analysis of product sales year-on-year, comparing movements with expectations and inspection of contracts with customers to determine if all key contractual terms have been appropriately reflected in the calculations of deductions from revenue.

Our work in respect of the contractual rebates, chargebacks and returns included testing key controls including the Group's review and approval of chargebacks, returns and rebates.

We also assessed the accuracy of the contractual rebates, charge backs and returns calculations, corroborated inputs with source documents, and considered the historical accuracy of the accruals held in prior years to assess the accuracy by which the Directors were able to forecast these accruals.

We also assessed the adequacy of the Group's disclosures of its revenue recognition policy and other related disclosures.

Our results
The results of our testing were satisfactory and we considered that the amount of revenue recognised and related disclosures are appropriate (2015: appropriate).

REFER TO PAGE 118 (ACCOUNTING POLICY AND FINANCIAL DISCLOSURES)

INDEPENDENT AUDITOR'S UK REPORT continued

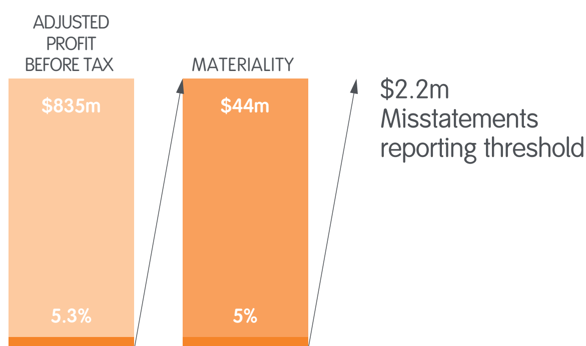
3 Our application of materiality and an overview of the scope of our audit

Materiality

The materiality for the Group financial statements as a whole was set at $44 million (2015: $44 million), determined with reference to a benchmark of 5.3% (2015: 5%) of Group profit before tax normalised to exclude profit on disposal of $326 million, acquisition related costs of $9 million, impairment charges of $48 million, restructuring and rationalisation expenses of $62 million and a net credit for legal and other charges of $20 million as disclosed in Note 3.

We believe that pre-tax profit excluding these items provides us with a consistent year-on-year basis for determining materiality and is the most relevant performance measure to the users of the financial statements.

MATERIALITY FOR THE GROUP FINANCIAL STATEMENTS



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

Scope and coverage

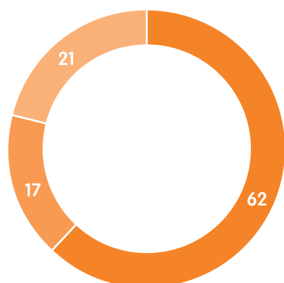
Of the Group's 145 (2015: 143) reporting components, we subjected 46 (2015: 60) to full scope audits for Group reporting purposes and 13 (2015: 9) to audits of specific account balances including revenue, inventory and taxation. The latter were not individually financially significant enough to require an audit for Group reporting purposes, but were included in the scope of our Group reporting work in order to provide further coverage over the identified risks and the Group's results.

The remaining 21% (2015: 22%) of total Group revenue, 9% (2015: 5%) of Group profit before tax and 13% (2015: 13%) of total Group assets is represented by 86 reporting components, none of which individually represented more than 4% of any of total Group revenue, Group profit before tax or total Group assets. For these remaining components, we performed analysis at an aggregated Group level to re-examine our assessment that there were no significant risks of material misstatement within these.

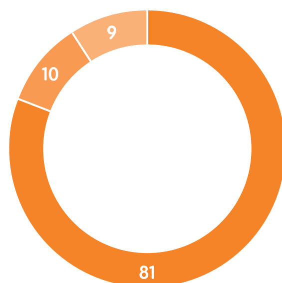
The Group audit team instructed component auditors as to the significant areas to be covered, including the relevant risks detailed above and the information to be reported back. The Group audit team approved the component materialities which ranged from $5 million to $35 million (2015: $5 million to $35 million), having regard to the mix of size and risk profile of the Group across the components. The work on 40 of the 59 components (2015: 32 of the 69 components) was performed by component auditors and the rest by the Group audit team. The group team performed procedures on the items excluded from normalised group profit before tax.

The Group audit team visited components in USA, UK, Brazil, Germany and Switzerland (2015: USA, China, UK, Brazil, Australia, Italy, Germany and Switzerland). Voice conference meetings were also held with these component auditors and the majority of the others that were not physically visited. At these visits and meetings, the findings reported to the Group audit team were discussed in more detail, and any further work required by the Group audit team was then performed by the component auditor.

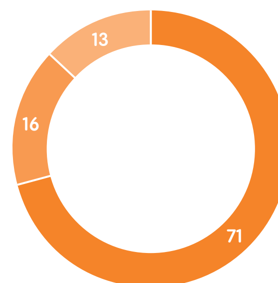
GROUP REVENUE
%



GROUP PROFIT BEFORE TAX
%



TOTAL ASSETS
%



- A Audits for group reporting purposes
- B Audits of specific account balances
- C Remaining components

4 Our opinion on other matters prescribed by the Companies Act 2006 is unmodified

In our opinion:

- the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006; and
- the information given in the Strategic Report and the Directors' Report for the financial year is consistent with the financial statements.

Based solely on the work required to be undertaken in the course of the audit of the financial statements and from reading the Strategic report and the Directors' report:

- we have not identified material misstatements in those reports; and
- in our opinion, those reports have been prepared in accordance with the Companies Act 2006.

5 We have nothing to report on the disclosures of principal risks

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

- the directors' statement of viability on page 47, concerning the principal risks, their management, and, based on that, the directors' assessment and expectations of the group's continuing in operation over the 3 years to December 2019; or
- the disclosures in Note 1 of the financial statements concerning the use of the going concern basis of accounting.

6 We have nothing to report in respect of the matters on which we are required to report by exception

Under ISAs (UK and Ireland) we are required to report to you if, based on the knowledge we acquired during our audit, we have identified other information in the annual report that contains a material inconsistency with either that knowledge or the financial statements, a material misstatement of fact, or that is otherwise misleading.

In particular, we are required to report to you if:

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

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

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

Under the Listing Rules we are required to review:

- the directors' statements, set out on pages 47 and 74, in relation to going concern and longer-term viability; and
- the part of the Corporate Governance Statement on page 54 in the Corporate Governance report relating to the Company's compliance with the eleven provisions of the 2014 UK Corporate Governance Code specified for our review.

We have nothing to report in respect of the above responsibilities.

Scope and responsibilities

As explained more fully in the Directors' Responsibilities Statement set out on page 102, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate. This report is made solely to the Company's members as a body and is subject to important explanations and disclaimers regarding our responsibilities, published on our website at www.kpmg.com/uk/auditscopeukco2014b, which are incorporated into this report as if set out in full and should be read to provide an understanding of the purpose of this report, the work we have undertaken and the basis of our opinions.

Stephen Oxley (Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
15 Canada Square
London
E14 5GL
22 February 2017

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 make up approximately 78.4% of the Group's total finished goods inventory) is the high level of product inventory required, some of which is located at customer premises and is available for customers' immediate use. Complete sets of products, including large and small sizes, have to be made available in this way. These sizes are used less frequently than standard sizes and towards the end of the product life cycle are inevitably in excess of requirements. Adjustments to carrying value are therefore required to be made to orthopaedic inventory to anticipate this situation. These adjustments are calculated in accordance with a formula based on levels of inventory compared with historical usage. This formula is applied on an individual product line basis and is first applied when a product group has been on the market for two years. This method of calculation is considered appropriate based on experience, but it does involve management judgement 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 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 2016, we acquired Blue Belt Technologies; 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.

GROUP INCOME STATEMENT

	Notes	Year ended 31 December 2016 $ million	Year ended 31 December 2015 $ million	Year ended 31 December 2014 $ million
Revenue	2	4,669	4,634	4,617
Cost of goods sold		(1,272)	(1,143)	(1,162)
Gross profit		3,397	3,491	3,455
Selling, general and administrative expenses	3	(2,366)	(2,641)	(2,471)
Research and development expenses	3	(230)	(222)	(235)
Operating profit	2 & 3	801	628	749
Interest income	4	6	11	13
Interest expense	4	(52)	(49)	(35)
Other finance costs	4	(16)	(15)	(11)
Share of results of associates	11	(3)	(16)	(2)
Profit on disposal of business	21	326	–	–
Profit before taxation		1,062	559	714
Taxation	5	(278)	(149)	(213)
Attributable profit for the year[1]		784	410	501
Earnings per ordinary share[1]	6			
Basic		88.1¢	45.9¢	56.1¢
Diluted		87.8¢	45.6¢	55.7¢

GROUP STATEMENT OF COMPREHENSIVE INCOME

	Notes	Year ended 31 December 2016 $ million	Year ended 31 December 2015 $ million	Year ended 31 December 2014 $ million
Attributable profit for the year[1]		784	410	501
Other comprehensive income:				
Items that will not be reclassified to income statement				
Re-measurement of net retirement benefit obligations	18	(81)	(8)	(94)
Taxation on other comprehensive income	5	10	10	19
Total items that will not be reclassified to income statement		(71)	2	(75)
Items that may be reclassified subsequently to income statement				
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		(15)	34	31
– losses/(gains) transferred to inventories for the year		20	(50)	(14)
Fair value remeasurement of available for sale asset		10	–	–
Exchange differences on translation of foreign operations		(134)	(176)	(196)
Total items that may be reclassified subsequently to income statement		(119)	(192)	(184)
Other comprehensive expense for the year, net of taxation		(190)	(190)	(259)
Total comprehensive income for the year[1]		594	220	242

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

THE NOTES ON PAGES 116 TO 164 ARE
AN INTEGRAL PART OF THESE ACCOUNTS.

COMMENTARY ON THE GROUP INCOME STATEMENT AND GROUP STATEMENT OF COMPREHENSIVE INCOME

REVENUE

Group revenue increased by $35m, 1% on a reported basis, from $4,634m in 2015 to $4,669m in 2016.

The underlying increase is 2%, after adjusting for 1% attributable to the unfavourable impact of currency movements.

COST OF GOODS SOLD

Cost of goods sold increased by $129m, 11% on a reported basis, from $1,143m in 2015 to $1,272m in 2016. The movement is primarily due to underlying trading.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses decreased by $275m (10% on a reported basis) from $2,641m in 2015 to $2,366m in 2016.

In 2016, administrative expenses included amortisation of software and other intangible assets of $61m (2015: $66m), $62m of restructuring and rationalisation expenses (2015: $65m), an amount of $178m relating to amortisation and impairment of acquired intangibles (2015: $204m), $9m of acquisition related costs (2015: $12m) and $30m net credit primarily related to a $44m curtailment credit on UK post-retirement benefits (2015: $190m charge for legal and other charges).

Excluding the above items, selling, general and administrative expenses were $2,086m in 2016, a decrease of $18m from $2,104m in 2015.

RESEARCH AND DEVELOPMENT EXPENSES

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

OPERATING PROFIT

Operating profit increased by $173m from $628m in 2015 to $801m in 2016.

This movement in 2016 was primarily driven by the absence of costs recognised in 2015 relating to anticipated and settled metal-on-metal hip claims.

INTEREST INCOME/(EXPENSE)

Net interest expense increased by $8m from a net $38m expense in 2015 to a net $46m expense in 2016. This movement is primarily due to an increase in the effective interest rate and the increase in net debt due to the acquisition of Blue Belt Technologies.

OTHER FINANCE COSTS

Other finance costs in 2016 increased by $1m and principally relates to costs associated with the Group's retirement benefit schemes.

PROFIT ON DISPOSAL OF BUSINESS

A profit on disposal of $326m was recognised in 2016 following the sale of the Gynaecology business.

TAXATION

The taxation charge increased by $129m to $278m from $149m in 2015 principally due to the tax charge on the disposal of the Gynaecology business.

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

THE FINANCIAL COMMENTARY ON THIS PAGE FORMS PART OF THE BUSINESS REVIEW AND IS UNAUDITED.
SEE PAGES 178 TO 179 FOR COMMENTARY ON THE 2015 FINANCIAL YEAR.

GROUP BALANCE SHEET

	Notes	At 31 December 2016 $ million	At 31 December 2015 $ million
Assets			
Non-current assets			
Property, plant and equipment	7	982	932
Goodwill	8	2,188	2,012
Intangible assets	9	1,411	1,502
Investments	10	25	13
Investments in associates	11	112	115
Retirement benefit asset	18	–	13
Deferred tax assets	5	97	105
		4,815	4,692
Current assets			
Inventories	12	1,244	1,217
Trade and other receivables	13	1,185	1,138
Cash at bank	15	100	120
		2,529	2,475
Total assets		7,344	7,167
Equity and liabilities			
Equity attributable to owners of the Company			
Share capital	19	180	183
Share premium		600	590
Capital redemption reserve		15	12
Treasury shares	19	(432)	(294)
Other reserves		(375)	(256)
Retained earnings		3,970	3,731
Total equity		3,958	3,966
Non-current liabilities			
Long-term borrowings	15	1,564	1,434
Retirement benefit obligations	18	164	184
Other payables	14	82	29
Provisions	17	134	133
Deferred tax liabilities	5	94	77
		2,038	1,857
Current liabilities			
Bank overdrafts and loans	15	86	46
Trade and other payables	14	884	842
Provisions	17	147	193
Current tax payable		231	263
		1,348	1,344
Total liabilities		3,386	3,201
Total equity and liabilities		7,344	7,167

The accounts were approved by the Board and authorised for issue on 22 February 2017 and are signed on its behalf by:

Roberto Quarta
Chairman

Olivier Bohuon
Chief Executive Officer

THE NOTES ON PAGES 116 TO 164 ARE AN INTEGRAL PART OF THESE ACCOUNTS.

COMMENTARY ON THE GROUP BALANCE SHEET

NON-CURRENT ASSETS

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

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

CURRENT ASSETS

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

- Inventories rose by $27m to $1,244m in 2016 from $1,217m in 2015. This movement is driven by inventory increases in distribution hubs and general increase across the Emerging Markets. This was offset by unfavourable currency movements of $26m.
- The level of trade and other receivables increased by $47m to $1,185m in 2016 from $1,138m in 2015. The movement primarily relates to increased trade receivables of $39m and $10m decrease in the bad debt provision as well as unfavourable currency movements.
- Cash at bank has decreased by $20m from $120m in 2015 to $100m in 2016. Refer to the Group cash flow statement and related commentary on pages 113 and 114 for further detail.

NON-CURRENT LIABILITIES

Non-current liabilities increased by $181m from $1,857m in 2015 to $2,038m in 2016. This movement principally relates to:

- Long-term borrowing increased from $1,434m in 2015 to $1,564m in 2016 principally due to acquisitions made in 2016.
- The retirement benefit obligation decreased from $184m in 2015 to $164m in 2016 due to past service cost adjustments arising from plan amendments in the UK, favourable asset movements partially offset by decreases in discount rates.
- Deferred tax liabilities increased by $17m from $77m in 2015 to $94m in 2016. Refer to commentary within non-current assets for explanation of the net deferred tax position movement.
- Other payables increased by $53m from $29m in 2015 to $82m in 2016 due to deferred consideration on acquisitions made in 2016.

CURRENT LIABILITIES

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

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

TOTAL EQUITY

Total equity decreased by $8m from $3,966m in 2015 to $3,958m in 2016. The principal movements were:

	Total equity $ million
1 January 2016	3,966
Attributable profit	784
Currency translation losses	(134)
Hedging reserves	5
Fair value remeasurement of available for sale assets	10
Actuarial losses on retirement benefit obligations	(81)
Dividends paid during the year	(279)
Purchase of own shares	(368)
Taxation on other comprehensive income and equity items	12
Net share-based transactions	43
31 December 2016	3,958

THE FINANCIAL COMMENTARY ON THIS PAGE FORMS PART OF THE BUSINESS REVIEW AND IS UNAUDITED.
SEE PAGES 178 TO 179 FOR COMMENTARY ON THE 2015 FINANCIAL YEAR.

GROUP CASH FLOW STATEMENT

	Notes	Year ended 31 December 2016 $ million	Year ended 31 December 2015 $ million	Year ended 31 December 2014 $ million
Cash flows from operating activities				
Profit before taxation		1,062	559	714
Net interest expense	4	46	38	22
Depreciation, amortisation and impairment		463	493	427
Loss on disposal of property, plant and equipment and software		15	15	11
Distribution from trade investments		–	3	1
Share-based payments expense (equity settled)	23	27	29	32
Share of results of associates	11	3	16	2
Profit on disposal of manufacturing facility	21	–	–	(9)
Profit on disposal of business	21	(326)	–	–
Net movement in post-retirement benefit obligations		(85)	(57)	(81)
Increase in inventories		(47)	(83)	(168)
Increase in trade and other receivables		(74)	(26)	(76)
(Decrease)/increase in trade and other payables and provisions		(49)	216	86
Cash generated from operations[1]		1,035	1,203	961
Interest received		3	8	3
Interest paid		(48)	(44)	(36)
Income taxes paid		(141)	(137)	(245)
Net cash inflow from operating activities		849	1,030	683
Cash flows from investing activities				
Acquisitions, net of cash acquired	21	(214)	(44)	(1,572)
Capital expenditure	2	(392)	(358)	(375)
Investment in associate	11	–	(25)	(2)
Purchase of investments	10	(2)	(2)	(4)
Proceeds from associate loan redemption		–	–	188
Proceeds on disposal of manufacturing facility	21	–	–	20
Proceeds on disposal of business	21	343	–	–
Tax on disposal of business		(118)	–	–
Net cash used in investing activities		(383)	(429)	(1,745)
Cash flows from financing activities				
Proceeds from issue of ordinary share capital		10	16	40
Purchase of own shares		(368)	(77)	(75)
Proceeds from borrowings due within one year	20	34	42	30
Settlement of borrowings due within one year	20	(38)	(26)	(52)
Proceeds from borrowings due after one year	20	890	831	3,390
Settlement of borrowings due after one year	20	(759)	(1,062)	(2,068)
Proceeds from own shares		6	5	4
Settlement of currency swaps	20	(25)	(15)	(11)
Equity dividends paid	19	(279)	(272)	(250)
Net cash (used in)/from financing activities		(529)	(558)	1,008
Net (decrease)/increase in cash and cash equivalents		(63)	43	(54)
Cash and cash equivalents at beginning of year	20	102	65	126
Exchange adjustments	20	(1)	(6)	(7)
Cash and cash equivalents at end of year[2]		38	102	65

1 Includes $62m (2015: $52m, 2014: $60m) of outgoings on restructuring and rationalisation expenses, $24m (2015: $36m, 2014: $112m) of acquisition-related costs and $36m (2015: $3m, 2014: $23m) of legal and other costs.
2 Cash and cash equivalents is net of bank overdrafts of $62m (2015: $18m, 2014: $28m).

THE NOTES ON PAGES 116 TO 164 ARE
AN INTEGRAL PART OF THESE ACCOUNTS.

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 2016 of $1,035m (2015: $1,203m, 2014: $961m) is after paying out $24m (2015: $36m, 2014: $112m) of acquisition-related costs, $62m (2015: $52m, 2014: $60m) of restructuring and rationalisation expenses and $36m (2015: $3m, 2014: $23m) relating to legal and other costs.

Inventory turn improved slightly supported by the benefits from the Global inventory transformation program. For trade receivables there was a slight deterioration in days of sales outstanding. Movements in trade and other payables and provisions were impacted in 2015 by the recognition of a $185m provision relating to the estimated costs to resolve all known and anticipated metal-on-metal hip claims.

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 2016, capital expenditure on tangible and intangible assets represented approximately 8% of continuing Group revenue (2015: 8%, 2014: 8%).

In 2016, capital expenditure amounted to $392m (2015: $358m, 2014: $375m). 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 2016, $64m (2015: $24m, 2014: $34m) of capital expenditure had been contracted but not provided for which will be funded from future cash inflows.

ACQUISITIONS AND DISPOSALS

During the year ended 31 December 2016, the Group acquired Blue Belt Technologies Inc. and BST-CarGel for consideration, net of cash acquired, of $214m. The Gynaecology business was disposed of for proceeds of $350m less expenses of $7m and taxes of $118m.

During the year ended 31 December 2015, the Group acquired businesses in Colombia and Russia for consideration, net of cash acquired, of $44m. In November 2015, the Group invested $25m in its associate, Bioventus.

SHARE BUY-BACKS

During the year ended 31 December 2016, the Group purchased a total of 24.0m (2015: 4.4m) ordinary shares at a cost of $368m (2015: $77m), which in 2016 included a $300m share buy-back announced following the disposal of the Gynaecology business.

DIVIDENDS

The 2015 final dividend of 19.0 US cents per ordinary share totalling $170m was paid on 11 May 2016. The 2016 interim dividend of 12.3 US cents per ordinary share totalling $109m was paid on 25 October 2016.

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 2016, the Group held $38m (2015: $102m, 2014: $65m) in cash net of bank overdrafts. The Group had committed facilities available of $2,425m at 31 December 2016 of which $1,560m 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 $7m (2015: $10m).

The principal variations in the Group's borrowing requirements result from the timing of dividend payments, acquisitions and disposals of businesses, timing of capital expenditure and working capital fluctuations. Smith & Nephew believes that its capital expenditure needs and its working capital funding for 2017, as well as its other known or expected commitments or liabilities, can be met from its existing resources and facilities. The Group's net debt increased from $1,361m at the beginning of 2016 to $1,550m at the end of 2016, representing an overall increase of $189m.

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 178 TO 179 FOR COMMENTARY ON THE 2015 FINANCIAL YEAR.

GROUP STATEMENT OF CHANGES IN EQUITY

	Share capital $ million	Share premium $ million	Capital redemption reserve $ million	Treasury shares[2] $ million	Other reserves[3] $ million	Retained earnings $ million	Total equity $ million
At 31 December 2013	184	535	10	(322)	120	3,520	4,047
Attributable profit for the year[1]	–	–	–	–	–	501	501
Other comprehensive expense	–	–	–	–	(184)	(75)	(259)
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[4]	1	39	–	–	–	–	40
At 31 December 2014	184	574	11	(315)	(64)	3,650	4,040
Attributable profit for the year[1]	–	–	–	–	–	410	410
Other comprehensive (expense)/income	–	–	–	–	(192)	2	(190)
Equity dividends declared and paid	–	–	–	–	–	(272)	(272)
Share-based payments recognised	–	–	–	–	–	29	29
Taxation on share-based payments	–	–	–	–	–	5	5
Purchase of own shares	–	–	–	(77)	–	–	(77)
Cost of shares transferred to beneficiaries	–	–	–	38	–	(33)	5
Cancellation of treasury shares	(1)	–	1	60	–	(60)	–
Issue of ordinary share capital[4]	–	16	–	–	–	–	16
At 31 December 2015	183	590	12	(294)	(256)	3,731	3,966
Attributable profit for the year[1]	–	–	–	–	–	784	784
Other comprehensive expense	–	–	–	–	(119)	(71)	(190)
Equity dividends declared and paid	–	–	–	–	–	(279)	(279)
Share-based payments recognised	–	–	–	–	–	27	27
Taxation on share-based payments	–	–	–	–	–	2	2
Purchase of own shares	–	–	–	(368)	–	–	(368)
Cost of shares transferred to beneficiaries	–	–	–	40	–	(34)	6
Cancellation of treasury shares	(3)	–	3	190	–	(190)	–
Issue of ordinary share capital[4]	–	10	–	–	–	–	10
At 31 December 2016	180	600	15	(432)	(375)	3,970	3,958

1 Attributable to equity holders of the Company and wholly derived from continuing operations.
2 Refer to Note 19.2 for further information.
3 Other reserves comprises gains and losses on cash flow hedges, foreign exchange differences on translation of foreign operations and net changes on fair value of trading investments. The cumulative translation loss within other reserves at 31 December 2016 was $388m (2015: $254m loss, 2014: $78m loss).
4 Issue of ordinary share capital as a result of options being exercised.

1 BASIS OF PREPARATION

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

As required by the European Union's IAS Regulation and the Companies Act 2006, the Group has prepared its accounts in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU) effective as at 31 December 2016. 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 2016. 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 year. 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 108. 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.

As described in Note 15, the Group meets its funding requirements through a mixture of shareholders' funds, bank borrowings and private placement notes. At 31 December 2016, the Group had committed borrowing facilities of $2.4bn and total liquidity of $0.9bn, including net cash and cash equivalents of $38m and undrawn committed borrowing facilities of $0.9bn. The earliest expiry date of the Group's committed borrowing facilities is in respect of a $300m bilateral term loan facility due to expire in April 2019.

The Group's forecasts and projections, taking into account reasonably possible changes in trading performance, show that the Group has sufficient financial resources. The Directors have reasonable expectation that the Company and the Group are well placed to manage their business risks and to continue in operational existence for a period of at least three years from the date of the approval of the financial statements. Accordingly, the Directors continue to adopt the going concern basis (in accordance with the guidance 'Going Concern and Liquidity Risk: Guidance for Directors of UK Companies 2009' issued by the FRC) in preparing the consolidated financial statements.

There have been no new accounting pronouncements impacting the Group in 2016.

A number of new standards, amendments to standards and interpretations are effective for the Group's annual periods beginning on or after 1 January 2017, and have not been applied in preparing these consolidated accounts. The new leasing standard IFRS 16 *Leases* will become effective from 1 January 2019 and is expected to have a significant effect on the consolidated accounts of Group. The impact of these new standards is still being determined.

1.1 Consolidation

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

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

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

1.2 Foreign currencies

Functional and presentation currency

The Group accounts are presented in US Dollars, 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 as at the exchange rate at the reporting date. Non-monetary items are not retranslated.

Foreign operations

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

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

Foreign operations continued

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

	2016	2015	2014
Average rates			
Sterling	1.35	1.53	1.65
Euro	1.11	1.11	1.33
Swiss Franc	1.02	1.04	1.09
Renminbi	0.15	0.16	0.16
Year end rates			
Sterling	1.23	1.48	1.56
Euro	1.05	1.09	1.21
Swiss Franc	0.98	1.00	1.01
Renminbi	0.14	0.15	0.16

2 BUSINESS SEGMENT INFORMATION

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

In making decisions about the allocation of the Group's resources, the ExCo review financial information on an integrated basis for the Group as a whole and determines the best allocation of resources to group-wide projects. This information is prepared substantially on the same basis as the Group's IFRS financial statements aside from the adjustments described in Note 2.2.

In assessing performance, the ExCo also consider financial information presented on a geographical selling region and product franchise basis for revenue. Financial information for corporate and functional costs is presented on a group-wide basis. When applying the requirements of IFRS 8, the Group considers that the allocation of resources by the ExCo being determined at Group level on a project by project basis determines that the Group has one operating segment.

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

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

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

The segment profit measure reported to the Chief Executive Officer and his Commercial and Operations Committee team for the purposes of resource allocation and assessment is trading profit before interest, and related income tax expense and excludes the effects of non-recurring income and expenditure from one-off items as discussed in Note 2.2. Group financing (including interest receivable and payable) is managed on a net basis outside of the business segment. In 2015, the Group changed its operating segments following its transition to a new commercial organisational structure. Consequently the 2014 comparatives presented were restated in 2015 to conform to the one global segment view.

The results and other information as required of the single segment are shown in Note 2.

2 BUSINESS SEGMENT INFORMATION continued

2.1 Revenue by business segment and geography

ACCOUNTING POLICY

Revenue comprises sales of products and services to third parties at amounts invoiced net of trade discounts and rebates, excluding taxes on revenue. Revenue from the sale of products is recognised upon transfer to the customer of the significant risks and rewards of ownership. This is generally when goods are delivered to customers. There is no significant revenue associated with the provision of discrete services. Sales of inventory located at customer premises and available for customers' immediate use are recognised when notification is received that the product has been implanted or used. Appropriate provisions for returns, trade discounts and rebates are deducted from revenue. Rebates comprise retrospective volume discounts granted to certain customers on attainment of certain levels of purchases from the Group. These are accrued over the course of the arrangement based on estimates of the level of business expected and adjusted at the end of the arrangement to reflect actual volumes.

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

	2016 $ million	2015 $ million	2014 $ million
Reportable segment revenue			
Revenue from external customers	4,669	4,634	4,617

The table below shows revenue by product type from continuing operations. Included within the 2015 and 2014 analyses are reclassifications of $58m and $54m respectively of product sales formerly included in the Sports Medicine Joint Repair franchise which have now been included in the Arthroscopic Enabling Technologies franchise in order to present analysis in line with 2016 management reporting on a consistent basis.

	2016 $ million	2015 $ million	2014 $ million
Revenue by product from continuing operations			
Sports Medicine Joint Repair	587	548	522
Arthroscopic Enabling Technologies	631	631	596
Trauma & Extremities	475	497	506
Other Surgical Businesses	214	205	147
Knee Implants	932	883	873
Hip Implants	597	604	654
Advanced Wound Care	719	755	805
Advanced Wound Bioactives	342	344	322
Advanced Wound Devices	172	167	192
Consolidated revenue from continuing operations	4,669	4,634	4,617

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

	2016 $ million	2015 $ million	2014 $ million
Geographical segment revenue			
United Kingdom	266	301	299
United States of America	2,299	2,217	2,012
Other[1]	2,104	2,116	2,306
Consolidated revenue from continuing operations	4,669	4,634	4,617

1 No other country represents more than 5% of consolidated sales revenue from continuing operations.

Major customers

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

2.2 Trading and operating profit by business segment

Trading profit is a trend measure which presents the long-term profitability of the Group excluding the impact of specific transactions that management considers affects the Group's short-term profitability. The Group presents this measure to assist investors in their understanding of trends. The Group has identified the following items, where material, as those to be excluded from operating profit when arriving at trading profit: acquisition and disposal-related items including amortisation and impairment of acquisition intangibles; significant restructuring programmes; gains and losses arising from legal disputes; and other significant items. Further detail is provided in Notes 3.3, 3.4 and 3.5. Trading profit reconciles to operating profit as follows:

	2016 $ million	2015 $ million	2014 $ million
Trading profit of the business segment	1,020	1,099	1,055
Acquisition-related costs	(9)	(12)	(118)
Restructuring and rationalisation expenses	(62)	(65)	(61)
Amortisation of acquisition intangibles and impairments	(178)	(204)	(129)
Legal and other	30	(190)	2
Operating profit of the business segment	801	628	749
Net interest expense	(46)	(38)	(22)
Other finance costs	(16)	(15)	(11)
Share of results of associates	(3)	(16)	(2)
Profit on disposal of business	326	–	–
Taxation	(278)	(149)	(213)
Attributable profit for the year of the business segment	784	410	501

2.3 Assets and liabilities by business segment and geography

	2016 $ million	2015 $ million	2014 $ million
Reconciliation of assets of the business segment to the consolidated group			
Assets of the business segment	7,147	6,929	7,129
Unallocated corporate assets:			
– Deferred tax assets	97	105	77
– Retirement benefit assets	–	13	7
– Cash at bank	100	120	93
Total assets of the consolidated group	7,344	7,167	7,306

Segment assets are based on the location of the assets:

	2016 $ million	2015 $ million	2014 $ million
United Kingdom	335	366	379
United States of America	3,145	2,982	3,104
Other	1,238	1,226	1,299
Non-current assets by geographical location[1]	4,718	4,574	4,782

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

2 BUSINESS SEGMENT INFORMATION continued

	2016 $ million	2015 $ million	2014 $ million
Reconciliation of liabilities of the business segment to the consolidated group			
Liabilities of the business segment	1,247	1,197	1,012
Unallocated corporate liabilities:			
– Long-term borrowings	1,564	1,434	1,666
– Retirement benefit obligations	164	184	233
– Deferred tax liabilities	94	77	98
– Bank overdrafts and loans due within one year	86	46	39
– Current tax payable	231	263	218
Total liabilities of the consolidated group	3,386	3,201	3,266
Depreciation, amortisation and impairment of the business segment			
Depreciation of property, plant and equipment	224	226	222
Amortisation of acquired intangibles	130	153	129
Amortisation of other intangible assets	61	66	62
Total depreciation and amortisation	415	445	413
Impairment losses on property, plant and equipment[1]	–	–	14
Impairment losses on acquired intangibles[1]	48	51	–
Impairment reversal on trade investments[1]	–	(3)	–
Total non-cash items	463	493	427

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

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

	2016 $ million	2015 $ million	2014 $ million
Additions to property, plant and equipment	320	303	298
Additions to intangibles	72	55	77
Capital expenditure (excluding business combinations)	392	358	375
Trade investments	2	2	4
Acquisitions – Goodwill	211	34	844
Acquisitions – Intangible assets	85	19	833
Acquisitions – Property, plant and equipment	2	6	62
Capital and acquisition expenditure	692	419	2,118

3 OPERATING PROFIT

ACCOUNTING POLICIES

Research and development

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

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

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

Advertising costs

Advertising costs are expensed as incurred.

	2016 $ million	2015 $ million	2014 $ million
Revenue	4,669	4,634	4,617
Cost of goods sold[1,2]	(1,272)	(1,143)	(1,162)
Gross profit	3,397	3,491	3,455
Research and development expenses	(230)	(222)	(235)
Selling, general and administrative expenses:			
Marketing, selling and distribution expenses	(1,712)	(1,735)	(1,670)
Administrative expenses[3,4,5,6]	(654)	(906)	(801)
	(2,366)	(2,641)	(2,471)
Operating profit	801	628	749

1 2016 includes $nil of restructuring and rationalisation expenses (2015: $nil, 2014: $12m).
2 2016 includes $nil of acquisition-related costs (2015: $nil, 2014: $23m).
3 2016 includes $61m of amortisation of software and other intangible assets (2015: $66m, 2014: $62m).
4 2016 includes $62m of restructuring and rationalisation expenses and $178m of amortisation and impairment of acquisition intangibles (2015: $65m of restructuring and rationalisation expenses and $204m of amortisation of acquisition intangibles, 2014: $49m of restructuring and rationalisation expenses and $129m of amortisation of acquisition intangibles).
5 2016 includes $30m credit relating to legal and other exceptionals (2015: $190m charge, 2014: $2m credit).
6 2016 includes $9m of acquisition-related costs (2015: $12m, 2014: $95m).

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

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

	2016 $ million	2015 $ million	2014 $ million
Other operating income	(25)	(41)	(9)
Amortisation of intangibles	191	219	191
Impairment of intangible assets	48	51	–
Depreciation of property, plant and equipment	224	226	222
Loss on disposal of property, plant and equipment and intangible assets	15	15	11
Operating lease payments for land and buildings	39	37	38
Operating lease payments for other assets	19	20	18
Advertising costs	88	91	96

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

3 OPERATING PROFIT continued

3.1 Staff costs and employee numbers

Staff costs during the year amounted to:

	Notes	2016 $ million	2015 $ million	2014 $ million
Wages and salaries		1,227	1,193	1,237
Social security costs		129	135	127
Pension costs (including retirement healthcare)[1]	18	23	58	17
Share-based payments	23	27	30	32
		1,406	1,416	1,413

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

During the year ended 31 December 2016, the average number of employees was 15,584 (2015: 14,686, 2014: 13,469).

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

	2016 $ million	2015 $ million	2014 $ million
Audit services:			
Group accounts	2	2	2
Local statutory audit pursuant to legislation	2	2	1
Other services:			
Non-audit services	1	1	–
Taxation services:			
Compliance services	–	–	1
Advisory services	–	–	1
Total auditor's remuneration	5	5	5
Arising:			
In the UK	2	2	3
Outside the UK	3	3	2
	5	5	5

Audit fees for the current year and 2015 are those relating to KPMG LLP, the Group's auditor. In 2014, fees relate to Ernst & Young LLP, the Group's former auditor.

3.3 Acquisition-related costs

Acquisition-related costs of $9m (2015: $12m, 2014: $118m) were incurred within operating profit in 2016. These costs relate to the costs associated with the purchase and integration of Blue Belt Technologies and other acquisitions.

3.4 Restructuring and rationalisation expenses

Restructuring and rationalisation costs of $62m (2015: $65m, 2014: $61m) were incurred in 2016. These costs primarily related to the ongoing implementation of the Group Optimisation Plan that was announced in May 2014 and has now completed.

3.5 Legal and other

The legal and other credit within operating profit of $30m (2015: $190m charge, 2014: $2m credit) recognised primarily related to a $44m curtailment gain arising on UK post-retirement benefits. Also included is a net $1m gain in respect of insurance recoveries of $24m and legal expenses of $23m, relating to the ongoing metal-on-metal hip claims. This was partially offset by legal expenses relating to patent litigation.

4 INTEREST AND OTHER FINANCE COSTS

4.1 Interest income/(expense)

	2016 $ million	2015 $ million	2014 $ million
Interest income	6	11	13
Interest expense:			
Bank borrowings	(9)	(9)	(19)
Private placement notes	(37)	(37)	(14)
Other	(6)	(3)	(2)
	(52)	(49)	(35)
Net interest expense	(46)	(38)	(22)

4.2 Other finance costs

	Notes	2016 $ million	2015 $ million	2014 $ million
Retirement benefit net interest expense	18	(7)	(11)	(10)
Unwinding of discount		(9)	(3)	–
Other		–	(1)	(1)
Other finance costs		(16)	(15)	(11)

Foreign exchange gains or losses arose primarily on the translation of intercompany and third party borrowings and amounted to a net $22m gain in 2016 (2015: net $11m gain, 2014: net $21m gain). These amounts were matched by the fair value gains or losses on currency swaps held to manage this currency risk.

5 TAXATION

ACCOUNTING POLICY

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

The Group operates in 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 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.

5 TAXATION continued

5.1 Taxation charge attributable to the Group

	2016 $ million	2015 $ million	2014 $ million
Current taxation:			
UK corporation tax at 20% (2015: 20.3%, 2014: 21.5%)	23	31	39
Overseas tax	261	219	235
Current income tax charge	284	250	274
Adjustments in respect of prior periods	(53)	(56)	(6)
Total current taxation	231	194	268
Deferred taxation:			
Origination and reversal of temporary differences	24	(73)	(52)
Changes in tax rates	–	(3)	–
Adjustments to estimated amounts arising in prior periods	23	31	(3)
Total deferred taxation	47	(45)	(55)
Total taxation as per the income statement	278	149	213
Taxation in other comprehensive income	(10)	(10)	(19)
Taxation in equity	(2)	(5)	–
Taxation attributable to the Group	266	134	194

The 2016 net prior period adjustment benefit of $30m (current tax credit of $53m offset by a deferred tax charge of $23m) mainly relates to a provision release following agreement reached with the IRS on a US tax matter, other provision releases on the expiry of statute of limitations and tax accrual to tax return adjustments offset by an increase in certain other tax provisions. The 2015 net prior period adjustment benefit of $25m (current tax credit of $56m offset by a deferred tax charge of $31m) mainly relates to provision releases after settlement with tax authorities or the expiry of statute of limitations and tax accrual to tax return adjustments.

Total taxation as per the income statement increased by $48m (2015: $130m reduction and 2014: $71m reduction) as a consequence of acquisition and disposals, restructuring and rationalisation costs, amortisation and impairment of acquisition intangibles and legal and other (see Note 6).

Factors affecting future tax charges

The Group operates in numerous tax jurisdictions around the world and is subject to factors that may affect future tax charges including potential US tax reform, implementation of the OECD's BEPS actions, tax rate changes, tax legislation changes and resolution of tax audits and disputes. At any given time the Group has unagreed years outstanding in various countries and is involved in tax audits and disputes, some of which may take several years to resolve. The ultimate tax liability may differ from the amount provided depending on interpretations of tax law, settlement negotiations or changes in legislation. The Group believes that it has made adequate provision in respect of additional tax liabilities that may arise from these unagreed years, tax audits and disputes, the majority of which relate to transfer pricing matters as would be expected for a Group operating internationally. However, the actual liability for any particular issue may be higher or lower than the amount provided resulting in a negative or positive effect on the tax charge in any given year.

In December 2016, the Group appealed to the First-Tier Tribunal in the UK against a decision by HM Revenue and Customs (HMRC) relating to the tax deductibility of certain historical foreign exchange losses. The decision of the Tribunal was released on 8 February 2017 and it upheld the Group's appeal. HMRC has 56 days from 8 February 2017 to decide whether to appeal this decision. No tax benefit has been recognised to date in respect of these foreign exchange losses. In the event that HMRC decide not to appeal or if they do and the Group is ultimately successful in the Courts following an appeal, then the Group's tax charge would be reduced, in the year of success, as a result.

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

The UK standard rate of corporation tax for 2016 is 20% (2015: 20.3%; 2014: 21.5%). Overseas taxation is calculated at the rates prevailing in the respective jurisdictions. The table below reconciles the expected tax charge at the UK statutory rate with the actual tax charge:

	2016 $ million	2015 $ million	2014 $ million
Profit before taxation	1,062	559	714
Expected taxation at UK statutory rate of 20% (2015: 20.3%, 2014: 21.5%)	212	113	154
Differences in overseas taxation rates[1]	52	61	63
Disposal of the Gynaecology business (mainly at the US tax rate)	56	–	–
Benefit of US Manufacturing deduction	(7)	(7)	(10)
R&D credits	(3)	(6)	(5)
Tax losses not recognised	1	11	11
Utilisation of previously unrecognised tax losses	(9)	–	–
Expenses not deductible for tax purposes[2]	6	2	9
Adjustments in respect of prior years[3]	(30)	(25)	(9)
Total taxation as per the income statement	278	149	213

1 Mainly relates to profits taxed in the US at a rate higher than the UK statutory rate.
2 Includes the impact of intra-group loans provided to finance US acquisitions and business operations.
3 The 2016 and 2015 credits of $30m and $25m respectively are explained above.

5.2 Deferred taxation

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

	Accelerated tax depreciation $ million	Intangibles $ million	Retirement benefit obligation $ million	Macrotexture $ million	Inventory, provisions and other differences $ million	Total $ million
At 1 January 2015	(70)	(226)	70	52	153	(21)
Exchange adjustment	(1)	7	(1)	–	(7)	(2)
Reclassifications	(1)	(53)	(19)	–	73	–
Movement in income statement – current year	4	41	(19)	–	47	73
Movement in income statement – prior years	6	9	(1)	–	(45)	(31)
Movement in other comprehensive income	–	–	9	–	1	10
Movement in equity	–	–	–	–	(1)	(1)
Changes in tax rate	–	2	–	–	1	3
Acquisitions	–	(3)	–	–	–	(3)
At 31 December 2015	(62)	(223)	39	52	222	28
Exchange adjustment	–	2	–	–	(3)	(1)
Movement in income statement – current year	–	34	(16)	–	(42)	(24)
Movement in income statement – prior years	(11)	6	(2)	–	(16)	(23)
Movement in other comprehensive income	–	–	7	–	(1)	6
Movement in equity	–	–	–	–	2	2
Changes in tax rate	–	1	–	–	(1)	–
Acquisitions	–	(29)	–	–	44	15
At 31 December 2016	(73)	(209)	28	52	205	3

Represented by:

	2016 $ million	2015 $ million
Deferred tax assets	97	105
Deferred tax liabilities	(94)	(77)
Net position at 31 December	3	28

The Group has unused gross trading tax losses of $146m (2015: $103m) and gross unused capital losses of $122m (2015: $196m) available for offset against future profits. A deferred tax asset has been recognised in respect of $94m (2015: $29m) of the trading tax losses. No deferred tax asset has been recognised on the remaining unused tax losses as they are not expected to be realised in the foreseeable future.

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 $483m (2015: $467m).

6 EARNINGS PER ORDINARY SHARE

ACCOUNTING POLICIES

Earnings per share

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

Diluted earnings per share

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

Adjusted earnings per share

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

	2016 $ million	2015 $ million	2014 $ million
Earnings			
Attributable profit for the year	784	410	501
Adjusted attributable profit (see below)	735	761	743

Attributable profit is reconciled to adjusted attributable profit as follows:

	Notes	2016 $ million	2015 $ million	2014 $ million
Attributable profit for the year		784	410	501
Acquisition-related costs		9	25	125
Restructuring and rationalisation expenses	3	62	65	61
Amortisation and impairment of acquisition intangibles	9	178	204	129
Legal and other[1]		(20)	187	(2)
Profit on disposal of business	21	(326)	–	–
Taxation on excluded items	5	48	(130)	(71)
Adjusted attributable profit		735	761	743

1 Legal and other credit includes $30m within operating profits (refer to Note 3.5), a $5m charge within other finance costs for unwinding of the discount on the provision for known, anticipated and settled metal-on-metal hip claims, and a $5m charge within share of results of associates for expenses incurred by Bioventus for an aborted initial public offering of shares.

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:

	2016	2015	2014
Number of shares (millions)			
Basic weighted number of shares	890	894	893
Dilutive impact of share options outstanding	3	5	6
Diluted weighted average number of shares	893	899	899
Earnings per ordinary share			
Basic	88.1¢	45.9¢	56.1¢
Diluted	87.8¢	45.6¢	55.7¢
Adjusted[2]	82.6¢	85.1¢	83.2¢

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

7 PROPERTY, PLANT AND EQUIPMENT

ACCOUNTING POLICIES

Property, plant and equipment

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

Depreciation is calculated to write off the cost of items of property, plant and equipment less their estimated residual values using the straight-line method over their estimated useful lives, and is 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 assessment of the time value of money and the risks specific to the asset.

7 PROPERTY, PLANT AND EQUIPMENT continued

		Land and buildings		Plant and equipment		Assets in course of construction	
	Notes	Freehold $ million	Leasehold $ million	Instruments $ million	Other $ million	$ million	Total $ million
Cost							
At 1 January 2015		149	54	1,060	963	134	2,360
Exchange adjustment		(3)	(1)	(63)	(26)	(1)	(94)
Acquisitions	21	–	–	6	–	–	6
Additions		4	1	152	78	68	303
Disposals		(1)	(1)	(113)	(47)	–	(162)
Transfers		5	5	–	35	(45)	–
At 31 December 2015		154	58	1,042	1,003	156	2,413
Exchange adjustment		(6)	–	(22)	(46)	(5)	(79)
Acquisitions	21	–	–	2	–	–	2
Additions		1	1	166	72	80	320
Disposals	21	–	–	(76)	(39)	(3)	(118)
Transfers		16	60	4	33	(113)	–
At 31 December 2016		165	119	1,116	1,023	115	2,538
Depreciation and impairment							
At 1 January 2015		45	32	744	637	11	1,469
Exchange adjustment		(1)	–	(43)	(19)	–	(63)
Charge for the year		5	4	137	80	–	226
Disposals		(1)	(1)	(106)	(43)	–	(151)
At 31 December 2015		48	35	732	655	11	1,481
Exchange adjustment		(3)	–	(15)	(34)	–	(52)
Charge for the year		5	7	131	81	–	224
Disposals		–	–	(67)	(30)	–	(97)
At 31 December 2016		50	42	781	672	11	1,556
Net book amounts							
At 31 December 2016		115	77	335	351	104	982
At 31 December 2015		106	23	310	348	145	932

Land and buildings includes land with a cost of $19m (2015: $19m) that is not subject to depreciation. Assets held under finance leases with a net book value of $5m (2015: $6m) are included within land and buildings.

Group capital expenditure relating to property, plant and equipment contracted but not provided for amounted to $55m (2015: $20m).

The amount of borrowing costs capitalised in 2016 and 2015 was minimal.

8 GOODWILL

ACCOUNTING POLICY

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

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

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

	Notes	2016 $ million	2015 $ million
Cost			
At 1 January		2,012	2,027
Exchange adjustment		(35)	(49)
Acquisitions	21	211	34
At 31 December		2,188	2,012
Impairment			
At 1 January and 31 December		–	–
Net book amounts		2,188	2,012

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

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

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

	2016 $ million
Reconstruction	551
Other Surgical Devices	1,351
Advanced Wound Management	286
	2,188

Impairment reviews were performed in September 2016 and September 2015 by comparing the recoverable amount of each CGU with its carrying amount, including goodwill. These were updated during December, taking into account any significant events that occurred between September and December.

For each CGU, the recoverable amounts are based on value-in-use which is calculated from pre-tax cash flow projections for five years using data from the Group's budget and strategic planning process, the results of which are reviewed and approved by the Board. These projections exclude any estimated future cash inflows or outflows expected to arise from future restructurings. The five-year period is in-line with the Group's strategic planning process.

In determining the growth rates used in the calculations of the value-in-use, management considered annual revenue growth. Projections are based on anticipated volume and value growth in the markets served by the Group and assumptions as to market share movements. Each year the projections for the previous year are compared to actual results and variances are factored into the assumptions used in the current year. The discount rates used in the value-in-use calculations reflect management's assessment of risks specific to the assets of each CGU.

8.1 Reconstruction CGU

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

Revenue growth rates for the five-year period ranged from 1.0% to 2.45% for the various components of the Reconstruction CGU. The weighted average growth rate used to extrapolate the cash flows beyond the five-year period in calculating the terminal value is 1.9%. The pre-tax discount rate used in the Reconstruction CGU value-in-use calculation is 10.5%.

8 GOODWILL continued

8.2 Other Surgical Devices CGU

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

Revenue growth rates for the five-year period ranged from 1.0% to 8.1% for the various components of the Other Surgical Devices CGU. The weighted average growth rate used to extrapolate the cash flows beyond the five-year period in calculating the terminal value is 5.0%. The pre-tax discount rate used in the Other Surgical Devices CGU value-in-use calculation is 10.5%.

8.3 Advanced Wound Management CGU

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

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

Revenue growth rates for the five-year period ranged from 1.0% to 14.5% for the various components of the Advanced Wound Management CGU. The weighted average growth rate used to extrapolate the cash flows beyond the five-year period in calculating the terminal value is 4.3%. The pre-tax discount rate used in the Advanced Wound Management CGU value-in-use calculation is 10.5%.

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

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

- Growth of market and market share – management has considered the impact of a variance in market growth and market share. The value-in-use calculations shows that if the assumed long-term growth rates were reduced to nil, the recoverable amount of each CGU would still be greater than its carrying value.
- Discount rate – management has considered the impact of an increase in the discount rate applied to the value-in-use calculations. This sensitivity analysis shows that for the recoverable amount of each CGU to be less than its carrying value, the discount rate would have to be increased to 13.2% for the Reconstruction CGU, 17.2% for the Other Surgical Devices CGU and 21.6% for the Advanced Wound Products CGU.

9 INTANGIBLE ASSETS

ACCOUNTING POLICIES

Intangible assets

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

Contingent consideration

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

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

Impairment of intangible assets

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

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

	Technology $ million	Product-related $ million	Customer and distribution related $ million	Software $ million	Total $ million
Cost					
At 1 January 2015	244	1,884	113	267	2,508
Exchange adjustment	(9)	(31)	(13)	(8)	(61)
Acquisitions[1]	–	–	19	–	19
Additions	–	17	–	38	55
Disposals	–	(6)	–	(8)	(14)
At 31 December 2015	235	1,864	119	289	2,507
Exchange adjustment	(2)	(20)	2	(8)	(28)
Acquisitions[1]	68	17	–	–	85
Additions	–	24	–	48	72
Disposals	–	(36)	–	–	(36)
At 31 December 2016	301	1,849	121	329	2,600
Amortisation and impairment					
At 1 January 2015	10	564	57	130	761
Exchange adjustment	–	(11)	(3)	(2)	(16)
Charge for the year – amortisation	11	159	15	34	219
Charge for the year – impairment	–	51	–	–	51
Disposals	–	(4)	–	(6)	(10)
At 31 December 2015	21	759	69	156	1,005
Exchange adjustment	–	(16)	1	(4)	(19)
Charge for the year – amortisation	48	98	10	35	191
Charge for the year – impairment	–	48	–	–	48
Disposals	–	(36)	–	–	(36)
At 31 December 2016	69	853	80	187	1,189
Net book amounts					
At 31 December 2016	232	996	41	142	1,411
At 31 December 2015	214	1,105	50	133	1,502

1 In 2016 this relates to technology and product related intangibles acquired with the purchase of Blue Belt Technologies Inc. and BST-CarGel. In 2015 this balance relates to customer relationships acquired with the purchase of distributors in Colombia and Russia.

Amortisation and impairment of acquired intangibles is set out below:

	2016 $ million	2015 $ million
Technology	48	11
Product-related	126	188
Customer and distribution related	4	5
Total	178	204

Group capital expenditure relating to software contracted but not provided for amounted to $9m (2015: $4m).

Two product-related intangible assets were determined to have a value in use below their carrying value, resulting in an impairment charge being recognised. The impairment charge primarily relates to $32m from Oasis, calculated using a discount rate of 10.3% (2015: 11.2%), a product right acquired with the Healthpoint acquisition in 2012. During the year, continued reimbursement pressure has resulted in revenues not increasing at the previously expected rate. The remaining carrying value of $9m is supported by the present value of anticipated future cash flows. The second product-related intangible asset has no residual carrying value.

10 INVESTMENTS

ACCOUNTING POLICY

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

	2016 $ million	2015 $ million
At 1 January	13	5
Additions	2	2
Fair value remeasurement	10	3
Transfer from investments in associates	–	6
Distributions	–	(3)
At 31 December	25	13

11 INVESTMENTS IN ASSOCIATES

ACCOUNTING POLICY

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

At 31 December 2016 and 31 December 2015, the Group holds 49% of Bioventus LLC (Bioventus). Bioventus is a limited liability company operating as a partnership. The Company's headquarters is located in Durham, North Carolina, US. Bioventus focuses its medical product development around its core competencies of orthobiologic therapies and orthopaedic diagnostics from which it develops and markets clinically proven orthopaedic therapies and diagnostic tools, including osteoarthritis pain treatments, bone growth stimulators and ultrasound devices. Bioventus sells bone healing stimulation devices and is a provider of osteoarthritis injection therapies. The Group's ability to recover the value of its investment is dependent upon the ongoing clinical and commercial success of these products. The loss after taxation recognised in the income statement relating to Bioventus was $3m (2015: loss after taxation $18m).

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

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

	2016 $ million	2015 $ million
Balance sheet	112	115
Income statement loss	(3)	(16)

Summarised financial information for significant associates

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

	2016 $ million	2015 $ million
Summarised balance sheet		
Non-current assets	364	389
Current assets	105	93
Non-current liabilities	(258)	(235)
Current liabilities	(53)	(80)
Net assets	158	167
Group's share of net assets at 49%	77	82
Group adjustments[1]	32	30
Group's carrying amount of investment at 49%	109	112

	2016 $ million	2015 $ million
Summarised statement of comprehensive income		
Revenue	282	256
Attributable loss for the year	(21)	(41)
Group adjustments[1]	15	5
Total comprehensive loss	(6)	(36)
Group share of loss for the year at 49%	(3)	(18)

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

At December 2016, the Group held an equity investment in one other associate (2015: one) with a carrying value of $3m (2015: $3m).

12 INVENTORIES

ACCOUNTING POLICY

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

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

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

	2016 $ million	2015 $ million	2014 $ million
Raw materials and consumables	213	205	214
Work-in-progress	55	84	82
Finished goods and goods for resale	976	928	885
	1,244	1,217	1,181

Reserves for excess and obsolete inventories were $303m (2015: $322m, 2014: $317m). The decrease in reserves of $19m in the year comprised $12m credited to the reserve on the write-off of inventory and foreign exchange movements of $7m.

The cost of inventories recognised as an expense and included in cost of goods sold amounted to $1,131m (2015: $961m, 2014: $1,013m). In addition, $85m was recognised as an expense within cost of goods sold resulting from inventory write-offs (2015: $73m, 2014: $55m).

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

13 TRADE AND OTHER RECEIVABLES

ACCOUNTING POLICY

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

The 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.

	2016 $ million	2015 $ million	2014 $ million
Trade receivables	1,042	1,003	1,015
Less: provision for bad and doubtful debts	(54)	(64)	(47)
Trade receivables – net	988	939	968
Derivatives – forward foreign exchange, currency swaps and interest rate contracts	48	33	49
Other receivables	76	83	51
Prepayments and accrued income	73	83	98
	1,185	1,138	1,166

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

The provision for bad and doubtful debts is based on specific assessments of risk and reference to past default experience. The bad debt expense for the year was $7m (2015: $25m expense, 2014: $4m credit). Amounts due from insurers in respect of the macrotextured claim of $144m (2015: $144m, 2014: $143m) are included within other receivables and have been provided in full.

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

	2016 $ million	2015 $ million	2014 $ million
Past due not more than three months	142	154	181
Past due more than three months and not more than six months	51	45	49
Past due more than six months and not more than one year	70	57	51
Past due more than one year	54	53	42
	317	309	323
Neither past due nor impaired	725	694	692
Provision for bad and doubtful debts	(54)	(64)	(47)
Trade receivables – net	988	939	968

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

	2016 $ million	2015 $ million	2014 $ million
At 1 January	64	47	57
Exchange adjustment	(3)	(3)	(4)
Net receivables provided/(provision released) during the year	7	25	(4)
Utilisation of provision	(14)	(5)	(2)
At 31 December	54	64	47

Trade receivables include amounts denominated in the following major currencies:

	2016 $ million	2015 $ million	2014 $ million
US Dollar	416	362	353
Sterling	57	58	92
Euro	193	192	225
Other	322	327	298
Trade receivables – net	988	939	968

14 TRADE AND OTHER PAYABLES

	2016 $ million	2015 $ million
Trade and other payables due within one year		
Trade and other payables	807	808
Derivatives – forward foreign exchange, currency and interest swaps	39	26
Acquisition consideration	38	8
	884	842
Other payables due after one year		
Acquisition consideration	82	19
Other payables	–	10
	82	29

The acquisition consideration includes $56m contingent upon future events.

The acquisition consideration due after more than one year is expected to be payable as follows: $29m in 2018, $8m in 2019, $20m in 2020, $11m in 2021, and $14m due in over five years (2015: $7m in 2017, $7m in 2018 and $5m in 2019).

15 CASH AND BORROWINGS

15.1 Net debt

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

	2016 $ million	2015 $ million
Bank overdrafts and loans due within one year	86	46
Long-term bank borrowings and finance leases	440	308
Private placement notes	1,124	1,126
Borrowings	1,650	1,480
Cash at bank	(100)	(120)
Credit balance on derivatives – currency swaps	1	2
Debit balance on derivatives – interest rate swaps	(1)	(1)
Net debt	1,550	1,361

Borrowings are repayable as follows:

	Within one year or on demand $ million	Between one and two years $ million	Between two and three years $ million	Between three and four years $ million	Between four and five years $ million	After five years $ million	Total $ million
At 31 December 2016:							
Bank loans	22	–	300	–	135	–	457
Bank overdrafts	62	–	–	–	–	–	62
Finance lease liabilities	2	2	3	–	–	–	7
Private placement notes	–	–	125	–	264	735	1,124
	86	2	428	–	399	735	1,650
At 31 December 2015:							
Bank loans	26	–	300	–	–	–	326
Bank overdrafts	18	–	–	–	–	–	18
Finance lease liabilities	2	2	3	3	–	–	10
Private placement notes	–	–	–	125	–	1,001	1,126
	46	2	303	128	–	1,001	1,480

15 CASH AND BORROWINGS continued

15.2 Assets pledged as security

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

	2016 $ million	2015 $ million
Finance lease liabilities – due within one year	2	2
Finance lease liabilities – due after one year	5	8
Total amount of secured borrowings	7	10
Total net book value of assets pledged as security:		
Property, plant and equipment	5	6
	5	6

15.3 Liquidity risk exposures

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

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

The Group has available committed facilities of $2.4bn (2015: $2.4bn). The interest payable on borrowings under committed facilities is either at fixed or floating rates. Floating rates are typically based on the LIBOR (or other reference rate) relevant to the term and currency concerned.

The Company is subject to restrictive covenants under its principal facility agreements. These financial covenants are tested at the end of each half year for the 12 months ending on the last day of the testing period. As of 31 December 2016, the Company was in compliance with these covenants. The facilities are also subject to customary events of default, none of which are currently anticipated to occur.

The Group's committed facilities are:

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

15.4 Year end financial liabilities by contractual maturity

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

	Within one year or on demand $ million	Between one and two years $ million	Between two and five years $ million	After five years $ million	Total $ million
At 31 December 2016					
Non-derivative financial liabilities:					
Bank overdrafts and loans	86	–	435	–	521
Trade and other payables	807	–	–	–	807
Finance lease liabilities	3	3	3	–	9
Private placement notes	36	36	491	800	1,363
Acquisition consideration	38	30	46	16	130
Derivative financial liabilities:					
Currency swaps/forward foreign exchange contracts – outflow	2,284	–	–	–	2,284
Currency swaps/forward foreign exchange contracts – inflow	(2,285)	–	–	–	(2,285)
	969	69	975	816	2,829
At 31 December 2015					
Non-derivative financial liabilities:					
Bank overdrafts and loans	45	–	300	–	345
Trade and other payables	808	10	–	–	818
Finance lease liabilities	3	3	6	–	12
Private placement notes	36	36	230	1,098	1,400
Acquisition consideration	8	7	12	–	27
Derivative financial liabilities:					
Currency swaps/forward foreign exchange contracts – outflow	2,279	–	–	–	2,279
Currency swaps/forward foreign exchange contracts – inflow	(2,277)	–	–	–	(2,277)
	902	56	548	1,098	2,604

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.

15.5 Finance leases

ACCOUNTING POLICY

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

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

15 CASH AND BORROWINGS continued

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

	2016 $ million	2015 $ million
Within one year	3	3
After one and within two years	3	3
After two and within three years	3	3
After three and within four years	–	3
After four and within five years	–	–
After five years	–	–
Total minimum lease payments	9	12
Discounted by imputed interest	(2)	(2)
Present value of minimum lease payments	7	10

Present value of minimum lease payments can be split out as: $2m (2015: $2m) due within one year, $5m (2015: $8m) due between one to five years and $nil (2015: $nil) due after five years.

Liquidity and capital resources

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

At 31 December 2016, the Group held $38m (2015: $102m, 2014: $65m) in cash net of bank overdrafts. The Group had committed facilities available of $2,425m at 31 December 2016 of which $1,560m was drawn. Smith & Nephew intends to repay the amounts due within one year using available cash and drawing down on the longer-term facilities. In addition, the Group has finance lease commitments of $7m.

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 2016, 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 $1,361m at the beginning of 2016 to $1,550m at the end of 2016, representing an overall increase of $189m, due primarily to the acquisition of Blue Belt Technologies.

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

16 FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

ACCOUNTING POLICY

Derivative financial instruments

Derivative financial instruments are initially recognised at fair value on the date a derivative contract is entered into and are subsequently 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.

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

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

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

16.1 Foreign exchange exposures

The Group operates in 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 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 2016, the Group had contracted to exchange within one year the equivalent of $1.8bn (2015: $1.9bn). Based on the Group's net borrowings as at 31 December 2016, if the US Dollar were to weaken against all currencies by 10%, the Group's net borrowings would decrease by $1m (2015: decrease by $1m) as the Group held a higher amount of foreign denominated cash than foreign denominated borrowings.

If the US Dollar were to weaken by 10% against all other currencies, then the fair value of the forward foreign exchange contracts as at 31 December 2016 would have been $51m lower (2015: $42m lower). Similarly, if the Euro were to weaken by 10% against all other currencies, then the fair value of the forward foreign exchange contracts as at 31 December 2016 would have been $17m higher (2015: $16m higher). Movements in the fair value of forward foreign exchange contracts would be recognised in other comprehensive income and accumulated in the hedging reserve.

A 10% strengthening of the US Dollar or Euro against all other currencies at 31 December 2016 would have had the equal but opposite effect to the amounts shown above, on the basis that all other variables remain constant.

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

16.2 Interest rate exposures

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

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

Based on the Group's gross borrowings as at 31 December 2016, if interest rates were to increase by 100 basis points in all currencies then the annual net interest charge would increase by $7m (2015: $6m). A decrease in interest rates by 100 basis points in all currencies would have an equal but opposite effect to the amounts shown above.

16.3 Credit risk exposures

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

The maximum credit risk exposure on derivatives at 31 December 2016 was $48m (2015: $33m), 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 2016 was $100m (2015: $120m). The Group's exposure to credit risk is not material as the amounts are held in a wide number of banks in a number of different countries.

Credit risk on trade receivables is detailed in Note 13.

16 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:

							Fixed rate liabilities	
	Gross borrowings $ million	Currency swaps $ million	Interest rate swaps $million	Total liabilities $ million	Floating rate liabilities $ million	Fixed rate liabilities $ million	Weighted average interest rate %	Weighted average time for which rate is fixed Years
At 31 December 2016								
US Dollar	(1,588)	(367)	(1)	(1,956)	(1,108)	(862)	3.5	6.8
Other	(62)	(81)	–	(143)	(129)	–	–	–
Total interest bearing liabilities	(1,650)	(448)	(1)	(2,099)	(1,237)	(862)		
At 31 December 2015								
US Dollar	(1,439)	(310)	–	(1,749)	(884)	(865)	3.5	7.8
Other	(41)	(60)	–	(101)	(101)	–	–	–
Total interest bearing liabilities	(1,480)	(370)	–	(1,850)	(985)	(865)		

At 31 December 2016, $7m (2015: $10m) of fixed rate liabilities related to finance leases. In 2016, the Group also had liabilities due for deferred acquisition consideration (denominated in US Dollars, Euros, Turkish Lira and Russian Rubles) totalling $120m (2015: $27m, 2014: $33m) on which no interest was payable (see Note 14). There were no other significant interest bearing financial liabilities.

Floating rates on liabilities are typically based on the one, three or six-month LIBOR (or other reference rate) relevant to the currency concerned. The weighted average interest rate on floating rate borrowings as at 31 December 2016 was 2% (2015: 2%).

Currency and interest rate profile of interest bearing assets:

	Interest rate swaps $ million	Cash at bank $ million	Currency swaps $ million	Total assets $ million	Floating rate assets $ million	Fixed rate assets $ million
At 31 December 2016						
US Dollars	–	29	83	112	112	–
Other	–	71	366	437	437	–
Total interest bearing assets	–	100	449	549	549	–
At 31 December 2015						
US Dollars	1	72	55	128	127	1
Other	–	48	313	361	361	–
Total interest bearing assets	1	120	368	489	488	1

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

16.5 Fair value of financial assets and liabilities

ACCOUNTING POLICY

Measurement of fair values

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

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

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

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

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

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

16 FINANCIAL INSTRUMENTS AND RISK MANAGEMENT continued

						Carrying amount			Fair value
At 31 December 2015	Designated at fair value $ million	Fair value – hedging instruments $ million	Loans and receivables $ million	Available for sale $ million	Other financial liabilities $ million	Total $ million	Level 2 $ million	Level 3 $ million	Total $ million
Financial assets measured at fair value									
Forward foreign exchange contracts	–	31	–	–	–	31	31	–	31
Investments	–	–	–	13	–	13	–	13	13
Currency swaps	1	–	–	–	–	1	1	–	1
Interest rate swaps	–	1	–	–	–	1	1	–	1
	1	32	–	13	–	46			
Financial liabilities measured at fair value									
Acquisition consideration	(27)	–	–	–	–	(27)	–	(27)	(27)
Forward foreign exchange contracts	–	(23)	–	–	–	(23)	(23)	–	(23)
Currency swaps	(3)	–	–	–	–	(3)	(3)	–	(3)
Private placement debt	–	–	(201)	–	–	(201)	(201)	–	(201)
	(30)	(23)	(201)	–	–	(254)			
Financial assets not measured at fair value									
Trade and other receivables	–	–	1,022	–	–	1,022			
Cash at bank	–	–	120	–	–	120			
	–	–	1,142	–	–	1,142			
Financial liabilities not measured at fair value									
Bank overdrafts	–	–	–	–	(18)	(18)			
Bank loans	–	–	–	–	(326)	(326)			
Private placement debt	–	–	–	–	(925)	(925)	(949)	–	(949)
Finance lease liabilities	–	–	–	–	(10)	(10)			
Trade and other payables	–	–	–	–	(818)	(818)			
	–	–	–	–	(2,097)	(2,097)			

There has been no change in the classification of financial assets and liabilities, the method and assumptions used in determining fair value and the categorisation of financial assets and liabilities within the fair value hierarchy from those disclosed in the Annual Report for the year ended 31 December 2015.

The Group enters into derivative financial instruments with financial institutions with investment grade credit ratings. The fair value of forward foreign exchange contracts is calculated by reference to quoted market forward exchange rates for contracts with similar maturity profiles. The fair value of currency swaps is determined by reference to quoted market spot rates. As a result, foreign forward exchange contracts and currency swaps are classified as Level 2 within the fair value hierarchy.

The changes in counterparty credit risk had no material effect on the hedge effectiveness for derivatives designated in hedge relationships and other financial instruments recognised at fair value.

The fair value of 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.

The fair value of investments is based upon third party pricing models for share issues. As a result, investments are considered Level 3 in the fair value hierarchy.

There were no transfers between Levels 1, 2 and 3 during 2016 and 2015.

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.

17 PROVISIONS AND CONTINGENCIES

ACCOUNTING POLICY

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

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

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

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

17.1 Provisions

	Rationalisation provisions $ million	Metal-on-metal $ million	Legal and other provisions $ million	Total $ million
At 1 January 2015	12	–	118	130
Charge to income statement	23	185	18	226
Utilised	(11)	–	(31)	(42)
Transfers	–	–	15	15
Exchange adjustment	(1)	–	(2)	(3)
At 31 December 2015	23	185	118	326
Net charge to income statement	12	–	(1)	11
Acquisitions	–	–	10	10
Unwinding of discount	–	5	–	5
Utilised	(14)	(27)	(30)	(71)
Exchange adjustment	(1)	–	1	–
At 31 December 2016	20	163	98	281
Provisions – due within one year	20	43	84	147
Provisions – due after one year	–	120	14	134
At 31 December 2016	20	163	98	281
Provisions – due within one year	23	63	107	193
Provisions – due after one year	–	122	11	133
At 31 December 2015	23	185	118	326

The principal elements 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.

Following the settlement of the majority of US metal-on-metal hip claims (discussed below) the Group has estimated a provision of $163m (2015: $185m) relating to the present value at 31 December 2016 of the estimated costs to resolve all other known and anticipated metal-on-metal hip claims. The estimated value of the provision has been determined using an actuarial model. Given the inherent uncertainty in assumptions relating to factors such as the number of claims and outcome the actual costs may differ significantly from this estimate. The provision does not include any possible insurance recoveries on these claims or legal fees associated with defending claims. The Group carries considerable product liability insurance, and will continue to defend claims vigorously.

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

All provisions are expected to be substantially utilised within five years of 31 December 2016 and none are treated as financial instruments.

17 PROVISIONS AND CONTINGENCIES continued

17.2 Contingencies

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

In August 2003, the Group withdrew voluntarily from all markets the macrotextured versions of its OXINIUM femoral knee components. A charge of $154m was recorded in 2004 for anticipated expenses in connection with macrotexture claims. Most of that amount has since been applied to settlements of such claims, and all claims have now been resolved. The aggregate cost at 31 December 2016 related to this matter is approximately $205m. The Group has sought recovery from its primary and excess insurers for costs of resolving the claims. The primary insurance carrier has paid $60m in full settlement of its policy liability. However, the excess carriers have denied coverage, citing defences relating to the wording of the insurance policies and other matters. In December 2004, the Group brought suit against them in the US district court for the Western District of Tennessee, for which a trial has not yet begun. An additional $22m was received during 2007 from a successful settlement with a third party.

17.3 Legal proceedings

Product liability claims

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

In recent years, there has been heightened concern about possible adverse effects of hip implant products with metal-on-metal bearing surfaces, and the Group has incurred, and will continue to incur expenses to defend claims in this area. As of February 2017, and giving effect to the US settlements described below, approximately 770 such claims were pending with the Group around the world, of which approximately 320 had given rise to pending legal proceedings. Most claims relate to the Group's Birmingham Hip Resurfacing (BHR) product and its two modular metal-on-metal components: the Birmingham Hip Modular Head (BHMH) and the optional metal liner component of the R3 Acetabular System (R3ML). The BHMH and R3ML are no longer on the market: the R3ML was withdrawn in 2012 and the BHMH was phased out in 2014. In 2015, the Group ceased offering smaller sizes of the BHR and restricted instructions for BHR use in female patients. These actions were taken to ensure that the BHR is only used in those patient groups where it continues to demonstrate strong performance.

In 2015 and 2016, the Group's US subsidiary settled the majority of its US metal-on-metal hip lawsuits in two group settlements, without admitting liability. Insurance receipts covered most of the amounts paid, with the net cash cost being $25m. These cases had been consolidated in a state court in Memphis, Tennessee and principally related to the Group's modular metal-on-metal hip components, which are no longer on the market. In February 2017, certain plaintiffs asked the US Judicial Panel on Multidistrict Litigation to transfer 31 cases pending in federal courts to the US District Court for the District of Maryland. In England and Wales, metal-on-metal hip implant claims against various companies have been consolidated for trials under group litigation orders in the High Court in London. The BHR and other claims pending against the Group have been stayed and will not be reactivated until the outcome of those trials is known.

The Group has requested indemnity from its product liability insurers for most of these metal-on-metal hip implant claims. Each insurer makes its own decision as to coverage issues, and the liability of some insurers depends on exhaustion of lower levels of coverage. The Group is working with all of the insurers to address any defences to coverage they have raised.

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

Intellectual property disputes

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

The Group prosecuted and defended a series of patent infringement suits against Arthrex in US federal courts in Oregon and Texas starting in 2004, principally relating to suture anchors for use in shoulder surgery. Arthrex paid $99m in June 2015 in connection with the Oregon litigation, and most of that award (net of various expenses) was recognised in the Group's operating profit at that time. The Group asserted the same patent against additional Arthrex products in a follow-up suit that was scheduled for trial in February 2017 in the Oregon court. Arthrex asserted its own suture anchor patents against Smith & Nephew in 2014 and 2015 in the US District Court for the Eastern District of Texas. In December 2016, the jury in that case decided that two of the Group's US subsidiaries infringed two asserted Arthrex patents and awarded Arthrex $17.4m. In February 2017, the parties reached a settlement resulting in the dismissal of all patent litigation in Oregon and Texas. Smith & Nephew agreed to pay Arthrex $8m, and each party agreed to additional payments contingent on the outcome of patent validity proceedings currently pending at the US Patent & Trademark Office relating to the asserted patents. The Group has fully provided for any possible additional payment relating to its historical sales.

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

17.4 Tax Matters

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

18 RETIREMENT BENEFIT OBLIGATIONS

ACCOUNTING POLICY

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

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

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

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

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

18.1 Retirement benefit net (assets)/obligations

The Group's retirement benefit obligations comprise:

	2016 $ million	2015 $ million
Funded plans:		
UK Plan	4	(7)
US Plan	27	56
Other plans	52	48
	83	97
Unfunded plans:		
Other plans	55	44
Retirement healthcare	26	30
	164	171
Amount recognised on the balance sheet – liability	164	184
Amount recognised on the balance sheet – asset	–	(13)

The Group sponsors defined benefit 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 years of service of the employee.

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

The UK Plan operates under trust law and responsibility for its governance lies with a Board of Trustees. This Board is composed of representatives of the Group, plan participants and an independent trustee, who act on behalf of members in accordance with the terms of the Trust Deed and Rules and relevant legislation. The UK Plan's assets are held by the trust. Annual increases on benefits in payment are dependent on inflation. There is no legislative minimum funding requirement in the UK, however the Group has agreed with the Board of Trustees to pay a schedule of supplementary payments (see Note 18.8). The Trust Deed of the UK Plan states that any surplus is ultimately accessible by the Group as a refund.

18 RETIREMENT BENEFIT OBLIGATIONS continued

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

18.2 Reconciliation of benefit obligations and pension assets

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

	2016			2015		
	Obligation $ million	Asset $ million	Total $ million	Obligation $ million	Asset $ million	Total $ million
Amounts recognised on the balance sheet at beginning of the period	(1,521)	1,350	(171)	(1,637)	1,411	(226)
Income statement expense:						
Current service cost	(19)	–	(19)	(20)	–	(20)
Past service credit	51	–	51	22	–	22
Settlements	7	(7)	–	30	(32)	(2)
Interest (expense)/income	(52)	48	(4)	(56)	50	(6)
Administration costs and taxes	(3)	–	(3)	(3)	–	(3)
Costs recognised in Income statement	(16)	41	25	(27)	18	(9)
Re-measurements:						
Actuarial gain due to liability experience	7	–	7	17	–	17
Actuarial (loss)/gain due to financial assumptions change	(301)	–	(301)	20	–	20
Actuarial gain due to demographic assumptions	33	–	33	–	–	–
Return on plan assets greater than/(less than) discount rate	–	180	180	–	(45)	(45)
Re-measurements recognised in OCI	(261)	180	(81)	37	(45)	(8)
Cash:						
Employer contributions	–	60	60	–	66	66
Employee contributions	(4)	4	–	(5)	5	–
Benefits paid directly by the Group, taxes and administration costs paid from scheme assets	3	–	3	3	–	3
Benefits paid	61	(64)	(3)	52	(55)	(3)
Net cash	60	–	60	50	16	66
Exchange rates	161	(158)	3	56	(50)	6
Amount recognised on the balance sheet	(1,577)	1,413	(164)	(1,521)	1,350	(171)
Amount recognised on the balance sheet – liability	(1,577)	1,413	(164)	(691)	507	(184)
Amount recognised on the balance sheet – asset	–	–	–	(830)	843	13

Represented by:

	2016			2015		
	Obligation $ million	Asset $ million	Total $ million	Obligation $ million	Asset $ million	Total $ million
UK Plan	(844)	840	(4)	(804)	811	7
US Plan	(461)	434	(27)	(460)	404	(56)
Other Plans	(272)	139	(133)	(257)	135	(122)
Total	(1,577)	1,413	(164)	(1,521)	1,350	(171)

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 22 years and 12 years for the UK and US Plans respectively.

18.3 Plan assets

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

	2016 $ million	2015 $ million	2014 $ million
UK Plan:			
Assets with a quoted market price:			
Cash and cash equivalents	6	5	6
Equity securities	213	234	237
Other Bonds	38	43	–
Liability driven investments	239	171	227
Diversified growth funds	130	144	155
	626	597	625
Other assets:			
Insurance contract	214	214	238
Market value of assets	840	811	863
US Plan:			
Assets with a quoted market price:			
Cash and cash equivalents	–	–	–
Equity securities	178	166	167
Government bonds – fixed interest	128	119	121
Corporate bonds	128	119	120
Market value of assets	434	404	408
Other Plans:			
Assets with a quoted market price:			
Cash and cash equivalents	4	9	6
Equity securities	35	35	33
Government bonds – fixed interest	3	5	7
– index linked	3	9	13
Corporate and other bonds	11	13	12
Insurance contracts	34	28	31
Property	12	8	6
Other quoted securities	2	1	3
	104	108	111
Other assets:			
Insurance contracts	35	27	29
Market value of assets	139	135	140
Total market value of assets	1,413	1,350	1,411

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). 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.

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 $23m (2015: $58m, 2014: $17m). Of this cost recognised for the year, $48m (2015: $49m, 2014: $32m) relates to defined contributions and $25m net credit (2015: $9m net expense, 2014: $15m net credit) relates to defined benefit plans.

The cost charged in respect of the Group's defined contribution plans represents contributions payable to these plans by the Group at rates specified in the rules of the plans. These were charged to operating profit in selling, general and administrative expenses. There were $nil outstanding payments as at 31 December 2016 due to be paid over to the plans (2015: $nil, 2014: $nil).

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

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

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

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

	2016		2015		2014	
	UK Plan $ million	US Plan $ million	UK Plan $ million	US Plan $ million	UK Plan $ million	US Plan $ million
Service cost	7	–	9	–	10	2
Past service credit	(49)	–	(7)	–	–	(35)
Settlement loss/(gain)	1	–	2	–	–	(11)
Net interest cost, administration and taxes	–	3	3	4	3	3
	(41)	3	7	4	13	(41)

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.

	2016 % per annum	2015 % per annum	2014 % per annum
UK Plan:			
Discount rate	2.6	3.8	3.7
Future salary increases	3.8	3.6	3.5
Future pension increases	3.3	3.1	3.0
Inflation (RPI)	3.3	3.1	3.0
Inflation (CPI)	2.3	2.1	2.0
US Plan:			
Discount rate	4.0	4.3	4.0
Future salary increases	n/a	n/a	n/a
Inflation	n/a	n/a	n/a

Actuarial assumptions regarding future mortality are based on mortality tables. The UK uses the S1NA with projections in line with the CMI 2011 table and the US uses the RP2014 table with MP2016 scale. The current longevities underlying the values of the obligations in the defined benefit plans are as follows:

	2016 years	2015 years	2014 years
Life expectancy at age 60			
UK Plan:			
Males	29.7	29.6	29.4
Females	31.1	31.3	31.2
US Plan:			
Males	25.1	25.8	26.0
Females	27.4	28.2	28.5
Life expectancy at age 60 in 20 years' time			
UK Plan:			
Males	32.5	32.6	32.4
Females	33.0	33.4	33.3
US Plan:			
Males	25.4	27.6	27.8
Females	27.9	29.9	30.2

18.6 Sensitivity analysis

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

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

	Increase in pension obligation		Increase in pension cost	
$ million	+50bps/+1yr	-50bps/-1yr	+50bps/+1 yr	-50bps/-1yr
UK Plan:				
Discount rate	-84.4	97.5	-2	+2
Inflation	88.1	-79.4	+2	-2
Mortality	33.3	-32.8	+1	-1
US Plan:				
Discount rate	-24.9	26.7	-1	+1
Inflation	n/a	n/a	n/a	n/a
Mortality	10.9	-10.9	–	–

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

18.8 Funding

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

UK Plan

The most recent full actuarial valuation of the UK Plan was undertaken as at 30 September 2015. Contributions to the UK Plan in 2016 were $32m (2015: $37m, 2014: $33m). This included supplementary payments of $26m (2015: $29m, 2014: $23m).

The Group has currently agreed to pay supplementary payments until 2021 and the agreed supplementary contribution for 2017 is $23m.

US Plan

A full actuarial valuation for the US Plan was last undertaken as at 20 September 2013 before the closure of the Plan to future accrual. Contributions to the US Plan were $20m (2015: $20m, 2014: $22m) which included supplementary payments of $20m.

The planned supplementary contribution for 2017 is $20m.

19 EQUITY

ACCOUNTING POLICY

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

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

19.1 Share capital

	Ordinary shares (20¢)		Deferred shares (£1.00)		Total
	Thousand	$ million	Thousand	$ million	$ million
Authorised					
At 31 December 2014	1,223,591	245	50	–	245
At 31 December 2015	1,223,591	245	50	–	245
At 31 December 2016	1,223,591	245	50	–	245
Allotted, issued and fully paid					
At 1 January 2014	918,167	184	50	–	184
Share options	4,180	1	–	–	1
Shares cancelled	(4,405)	(1)	–	–	(1)
At 31 December 2014	917,942	184	50	–	184
Share options	1,855	–	–	–	–
Shares cancelled	(4,350)	(1)	–	–	(1)
At 31 December 2015	915,447	183	50	–	183
Share options	1,283	–	–	–	–
Shares cancelled	(13,007)	(3)	–	–	(3)
At 31 December 2016	903,723	180	50	–	180

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

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

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

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

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

	2016 $ million	2015 $ million	2014 $ million
Share capital	180	183	184
Share premium	600	590	574
Capital redemption reserve	15	12	11
Treasury shares	(432)	(294)	(315)
Retained earnings and other reserves	3,595	3,475	3,586
	3,958	3,966	4,040

19 EQUITY continued

19.2 Treasury shares

Treasury shares represents the holding of the Company's own shares in respect of the Smith & Nephew Employees' Share Trust and shares bought back as part of the share buy-back programme. On 8 August 2016 the Group commenced a new $300m share buy-back programme following the sale of its Gynaecology business. The share buy-back programme was completed in December 2016. During 2016, a total of 24.0m (2.7%) ordinary shares were purchased at a cost of $368m and 13.0m (1.5%) ordinary shares were cancelled. During 2015, a total of 4.4m ordinary shares (0.5%) had been purchased at a cost of $77m and 4.4m (0.5%) had been cancelled.

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

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

	Treasury $ million	Employees' Share Trust $ million	Total $ million
At 1 January 2015	314	1	315
Shares purchased	77	–	77
Shares transferred from treasury	(58)	58	–
Shares transferred to Group beneficiaries	(9)	(29)	(38)
Shares cancelled	(60)	–	(60)
At 31 December 2015	264	30	294
Shares purchased	368	–	368
Shares transferred from treasury	(18)	18	–
Shares transferred to Group beneficiaries	(13)	(27)	(40)
Shares cancelled	(190)	–	(190)
At 31 December 2016	411	21	432

	Number of shares million	Number of shares million	Number of shares million
At 1 January 2015	24.0	0.1	24.1
Shares purchased	4.4	–	4.4
Shares transferred from treasury	(4.4)	4.4	–
Shares transferred to Group beneficiaries	(0.7)	(2.2)	(2.9)
Shares cancelled	(4.4)	–	(4.4)
At 31 December 2015	18.9	2.3	21.2
Shares purchased	24.0	–	24.0
Shares transferred from treasury	(1.2)	1.2	–
Shares transferred to Group beneficiaries	(0.9)	(2.0)	(2.9)
Shares cancelled	(13.0)	–	(13.0)
At 31 December 2016	27.8	1.5	29.3

19.3 Dividends

	2016 $ million	2015 $ million	2014 $ million
The following dividends were declared and paid in the year:			
Ordinary final of 19.0¢ for 2015 (2014: 18.6¢, 2013: 17.0¢) paid 11 May 2016	170	166	152
Ordinary interim of 12.3¢ for 2016 (2015: 11.8¢, 2014: 11.0¢) paid 25 October 2016	109	106	98
	279	272	250

A final dividend for 2016 of 18.5¢ per ordinary share was proposed by the Board on 8 February 2017 and will be paid, subject to shareholder approval, on 10 May 2017 to shareholders on the Register of Members on 31 March 2017. The estimated amount of this dividend is $162m.

20 CASH FLOW STATEMENT

ACCOUNTING POLICY

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

Analysis of net debt

			Borrowings				
	Cash $ million	Overdrafts $ million	Due within one year $ million	Due after one year $ million	Net currency swaps $ million	Net interest swaps $ million	Total $ million
At 1 January 2014	137	(11)	(33)	(347)	1	–	(253)
Net cash flow impact	(35)	(19)	22	(1,322)	11	–	(1,343)
Exchange adjustment	(9)	2	–	3	(13)	–	(17)
At 31 December 2014	93	(28)	(11)	(1,666)	(1)	–	(1,613)
Net cash flow impact	34	9	(17)	231	15	1	273
Exchange adjustment	(7)	1	–	1	(16)	–	(21)
At 31 December 2015	120	(18)	(28)	(1,434)	(2)	1	(1,361)
Net cash flow impact	(18)	(45)	4	(129)	25	(2)	(165)
Exchange adjustment	(2)	1	–	(1)	(22)	–	(24)
At 31 December 2016	100	(62)	(24)	(1,564)	1	(1)	(1,550)

Reconciliation of net cash flow to movement in net debt

	2016 $ million	2015 $ million	2014 $ million
Net cash flow from cash net of overdrafts	(63)	43	(54)
Settlement of currency swaps	25	15	11
Net cash flow from borrowings	(127)	215	(1,300)
Change in net debt from net cash flow	(165)	273	(1,343)
Exchange adjustment	(24)	(21)	(17)
Change in net debt in the year	(189)	252	(1,360)
Opening net debt	(1,361)	(1,613)	(253)
Closing net debt	(1,550)	(1,361)	(1,613)

Cash and cash equivalents

For the purposes of the Group cash flow statement cash and cash equivalents at 31 December 2016 comprise cash at bank net of bank overdrafts.

	2016 $ million	2015 $ million	2014 $ million
Cash at bank	100	120	93
Bank overdrafts	(62)	(18)	(28)
Cash and cash equivalents	38	102	65

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

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 2016

During the year ended 31 December 2016, the Group acquired two medical technology businesses deemed to be business combinations within the scope of IFRS 3 *Business Combinations*.

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

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

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

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

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

Year ended 31 December 2015

During the year ended 31 December 2015, the Group acquired its distributor in Colombia and its distributor and a manufacturer in Russia. The acquisitions are deemed to be business combinations within the scope of IFRS 3 *Business Combinations*.

The aggregated total fair value of the consideration was $68m and included $23m of contingent consideration and $13m through the settlement of working capital commitments. The acquisition accounting was completed during 2016 with no measurement adjustments being made.

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

	$ million
Aggregate identifiable assets acquired and liabilities assumed	
Intangible assets	19
Other assets[1]	29
Liabilities	(14)
Net assets	34
Goodwill	34
Cost of acquisition	68

1 Including net cash of $1m.

The aggregated estimate of goodwill arising on the acquisitions is $34m. This is attributable to the additional economic benefits expected from the transactions, including the assembled workforces, which have been transferred as part of the acquisitions. The goodwill recognised is not expected to be deductible for tax purposes.

The contribution to revenue and attributable profit from these acquisitions for the year ended 31 December 2015 was immaterial. If the acquisitions had occurred at the beginning of the year, their contributions to revenue and attributable profit for the year ended 31 December 2015 would also have been immaterial.

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 $1bn revolving credit facility and a new two-year $1.4bn 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 acquisition accounting was completed during 2015. The fair values shown below include measurement period adjustments recognised during the period. 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
Identifiable assets acquired and liabilities assumed	
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

For the year ended 31 December 2014, ArthroCare's contribution to Group revenue was $207m 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 for 2014 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 was 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 of 2014.

The acquisition accounting was completed during 2015. As at the acquisition date, the fair value of the net assets acquired, which includes measurement period adjustments recognised during the period, was $16m. This includes 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 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 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.

21 ACQUISITIONS AND DISPOSALS continued

21.2 Disposal of business

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

For the year ended 31 December 2015, the Group did not dispose of any businesses.

During 2014, the Group disposed of a manufacturing facility in the UK for cash consideration of $20m, resulting in a pre-tax gain on disposal of $9m. 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:

	2016 $ million	2015 $ million
Land and buildings:		
Within one year	33	29
After one and within two years	27	20
After two and within three years	23	14
After three and within four years	16	11
After four and within five years	13	8
After five years	41	9
	153	91
Other assets:		
Within one year	15	16
After one and within two years	11	9
After two and within three years	6	5
After three and within four years	2	2
	34	32

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 on plans up to 2014 and £500 per month from 2015 onwards 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, Costa Rica, Denmark, Finland, France, Germany, Hong Kong, India, Ireland, Italy, Japan, Malaysia, South Korea, Mexico, the Netherlands, New Zealand, Norway, Poland, Portugal, Singapore, South Africa, Spain, Sweden, Switzerland and the United Arab Emirates. Employees in Turkey became eligible to join the plan in 2016. Puerto Rico participants were eligible to receive options under the International Plans up to 2011 and are 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.

23 OTHER NOTES TO THE ACCOUNTS continued

At 31 December 2016, 5,779,861 (2015: 7,235,070, 2014: 8,708,000) options were outstanding under share option plans as follows:

	Number of shares thousand	Range of option exercise prices pence	Weighted average exercise price pence
Employee Plans:			
Outstanding at 1 January 2014	3,287	380.0 – 625.0	530.5
Granted	799	831.0	831.0
Forfeited	(289)	380.0 – 831.0	533.8
Exercised	(743)	380.0 – 625.0	436.2
Expired	(18)	461.0 – 556.0	465.7
Outstanding at 31 December 2014	3,036	380.0 – 831.0	632.7
Granted	1,622	949.0	949.0
Forfeited	(275)	380.0 – 949.0	683.6
Exercised	(744)	380.0 – 831.0	514.6
Expired	(45)	461.0 – 535.0	533.0
Outstanding at 31 December 2015	3,594	452.0 – 949.0	797.3
Granted	1,168	1,026.0	1,025.4
Forfeited	(295)	452.0 – 1,026.0	848.8
Exercised	(865)	452.0 – 949.0	599.1
Expired	(73)	452.0 – 625.0	616.2
Outstanding at 31 December 2016	3,529	452.0 – 1,026.0	920.9
Options exercisable at 31 December 2016	120	452.0 – 625.0	606.2
Options exercisable at 31 December 2015	82	461.0 – 556.0	521.4
Options exercisable at 31 December 2014	94	380.0 – 585.0	439.6
Executive Plans:			
Outstanding at 1 January 2014	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
Outstanding at 31 December 2014	5,672	470.0 – 680.5	596.2
Forfeited	(8)	622.0 – 650.0	630.2
Exercised	(1,841)	479.0 – 680.5	602.2
Expired	(182)	479.0 – 650.0	604.2
Outstanding at 31 December 2015	3,641	470.0 – 650.0	592.7
Exercised	(1,311)	470.0 – 650.0	570.6
Expired	(79)	479.0 – 650.0	599.1
Outstanding at 31 December 2016	2,251	479.0 – 650.0	605.4
Options exercisable at 31 December 2016	2,251	479.0 – 650.0	605.4
Options exercisable at 31 December 2015	3,641	470.0 – 650.0	592.7
Options exercisable at 31 December 2014	4,713	470.0 – 680.5	585.3

The weighted average remaining contractual life of options outstanding at 31 December 2016 was 4.8 years (2015: 5.1 years, 2014: 5.8 years) for Executive Plans and 2.7 years (2015: 2.7 years, 2014: 2.5 years) for Employee Plans.

	2016 pence	2015 pence	2014 pence
Weighted average share price	1,181.8	1,144.4	994.4

Options granted during the year were as follows:

	Options granted thousand	Weighted average fair value per option at grant date pence	Weighted average share price at grant date pence	Weighted average exercise price pence	Weighted average option life years
Employee Plans	1,168	301.2	1,217.0	1,026.0	3.8

The weighted average fair value of options granted under Employee Plans during 2015 was 293.9p (2014: 255.8p) and those under Executive Plans during 2015 was nil (2014: nil).

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:

	Employee Plans		
	2016	2015	2014
Dividend yield %	2.0	2.0	2.0
Expected volatility %[1]	25.0	25.0	20.0
Risk free interest rate %[2]	1.3	1.3	1.3
Expected life in years	3.8	3.8	3.9

1 Volatility is assessed on a historic basis primarily based on past share price movements over the expected life of the options.
2 The risk free interest rate reflects the yields available on zero coupon government bonds over the option term and currency.

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 (i.e. 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 (i.e. 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 35% (2015: 35%, 2014: 40%) 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.

23 OTHER NOTES TO THE ACCOUNTS continued

At 31 December 2016, the maximum number of shares that could be awarded under the Group's long-term incentive plans was:

	Number of shares in thousands				
	Other Awards	EIA	PSP	Deferred Bonus Plan	Total
Outstanding at January 2014	1,449	1,284	5,197	44	7,974
Awarded	751	642	1,510	–	2,903
Vested	(583)	(751)	–	(44)	(1,378)
Forfeited	(96)	(24)	(2,188)	–	(2,308)
Outstanding at 31 December 2014	1,521	1,151	4,519	–	7,191
Awarded	661	592	1,393	–	2,646
Vested	(678)	(648)	(1,794)	–	(3,120)
Forfeited	(93)	(84)	(138)	–	(315)
Outstanding at 31 December 2015	1,411	1,011	3,980	–	6,402
Awarded	790	633	1,324	–	2,747
Vested	(800)	(608)	(1,035)	–	(2,443)
Forfeited	(88)	(38)	(773)	–	(899)
Outstanding at 31 December 2016	1,313	998	3,496	–	5,807

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 2016 was 1.2 years (2015: 1.1 years, 2014: 1.1 years) for the PSP, 1.7 years (2015: 1.6 years, 2014: 1.5 years) for the EIA and 2.0 years (2015: 1.9 years, 2014: 2.0 years) for the other awards.

Share-based payments – charge to income statement

The expense charged to the income statement for share-based payments is as follows:

	2016 $ million	2015 $ million	2014 $ million
Granted in current year	9	11	9
Granted in prior years	18	19	23
Total share-based payments expense for the year[1]	27	30	32

1 The total share-based payments expense in 2015 comprised $29m taken through reserves as well as $1m cash settlements during the year.

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 $nil (2015: $nil, 2014: $1m).

Key management personnel

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

	2016 $ million	2015 $ million	2014 $ million
Short-term employee benefits	15	16	14
Share-based payments expense	7	8	8
Pension and post-employment benefit entitlements	1	1	1
Other benefits	–	–	3
	23	25	26

Directors' remuneration disclosures are included on pages 90 and 96.

23.3 Group Companies

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

Company name[1]	Country of operation and incorporation	Registered Office
UK[1]		
Blue Belt Technologies UK Limited	England & Wales	London
Michelson Diagnostic Limited [5] (13.4%)	England & Wales	Kent
Neotherix Limited[5] (24.9%)	England & Wales	London
Plus Orthopedics (UK) Limited[4]	England & Wales	London
Smith & Nephew (Overseas) Limited[2,3]	England & Wales	London
Smith & Nephew ARTC Limited	England & Wales	London
Smith & Nephew Beta Limited[4]	England & Wales	London
Smith & Nephew China Holdings UK Limited[3]	England & Wales	London
Smith & Nephew Collagenase Limited[4]	England & Wales	Hull
Smith & Nephew Employees Trustees Limited[4]	England & Wales	London
Smith & Nephew ESN Limited[4]	England & Wales	London
Smith & Nephew Extruded Films Limited[4]	England & Wales	Hull
Smith & Nephew Finance[4]	England & Wales	London
Smith & Nephew Finance Oratec[4]	England & Wales	London
Smith & Nephew Healthcare Limited[4]	England & Wales	Hull
Smith & Nephew Investment Holdings Limited[3]	England & Wales	London
Smith & Nephew Medical Fabrics Limited[4]	England & Wales	London
Smith & Nephew Medical Limited[4]	England & Wales	Hull
Smith & Nephew Nominee Company Limited[4]	England & Wales	London
Smith & Nephew Nominee Services Limited[4]	England & Wales	London
Smith & Nephew Orthopaedics Limited[4]	England & Wales	London
Smith & Nephew Pensions Nominees Limited[4]	England & Wales	London
Smith & Nephew Pharmaceuticals Limited[4]	England & Wales	Hull
Smith & Nephew Raisegrade Limited[3,4]	England & Wales	London
Smith & Nephew Rareletter Limited[4]	England & Wales	London
Smith & Nephew Trading Group Limited[3]	England & Wales	London
Smith & Nephew UK Executive Pension Scheme Trustee Limited[4]	England & Wales	London
Smith & Nephew UK Limited[2,3]	England & Wales	London
Smith & Nephew UK Pension Fund Trustee Limited[4]	England & Wales	London
Smith & Nephew USD Limited[3]	England & Wales	London
Smith & Nephew USD One Limited[3]	England & Wales	London
T.J.Smith and Nephew, Limited[3]	England & Wales	Hull
The Albion Soap Company Limited[4]	England & Wales	London
TP Limited[3]	Scotland	Edinburgh
Rest of Europe[1]		
Smith & Nephew GmbH	Austria	Vienna
ArthroCare Belgium SPRL[4]	Belgium	Zaventem
Smith & Nephew S.A.-N.V	Belgium	Zaventem
Smith & Nephew A/S	Denmark	Hoersholm
Smith & Nephew France SAS[3]	France	Le Mans
Smith & Nephew S.A.S.	France	Le Mans
A2 Surgical	France	Le Mans
Smith & Nephew Oy	Finland	Helsinki

Company name[1]	Country of operation and incorporation	Registered Office
Smith & Nephew Business Services GmbH & Co. KG[3]	Germany	Hamburg
Smith & Nephew Business Services Verwaltungs GmbH[3]	Germany	Hamburg
Smith & Nephew Deutschland (Holding) GmbH[3]	Germany	Hamburg
Smith & Nephew GmbH	Germany	Hamburg
Smith & Nephew Orthopaedics GmbH	Germany	Tuttlingen
Plus Orthopedics Hellas SA	Greece	Athens
Smith & Nephew Hellas S.A.	Greece	Athens
Smith & Nephew Limited	Ireland	Dublin 2
Smith & Nephew Finance Ireland Limited	Ireland	Dublin 1
Smith & Nephew S.r.l.[3]	Italy	Milan
ArthroCare Luxembourg Sarl[3 4]	Luxembourg	Luxembourg
Smith & Nephew Finance S.a.r.l.[3]	Luxembourg	Luxembourg
Smith & Nephew International S.A.[3]	Luxembourg	Luxembourg
Smith & Nephew (Europe) B.V.[3]	Netherlands	Amsterdam
Smith & Nephew B.V.[3]	Netherlands	Amsterdam
Smith & Nephew Management B.V.[3]	Netherlands	Amsterdam
Smith & Nephew Nederland CV	Netherlands	Amsterdam
Smith & Nephew Optics B.V.[4]	Netherlands	Amsterdam
Smith & Nephew A/S	Norway	Oslo
Smith & Nephew sp. z.o.o.	Poland	Warsaw
Smith & Nephew Lda	Portugal	Lisbon
D-Orthopaedics LLC	Russian Federation	Moscow
LLC DC	Russian Federation	Puschino
LLC Smith & Nephew	Russian Federation	Moscow
Smith & Nephew S.A.U	Spain	Barcelona
Smith & Nephew Atkiebolag[3]	Sweden	Molndal
Lumina Adhesives AB[5] (11%)	Sweden	Gothenberg
Plus Orthopedics Holding AG[3]	Switzerland	Baar
Smith & Nephew Manufacturing AG	Switzerland	Aarau
Smith & Nephew Orthopaedics AG[3]	Switzerland	Baar
Smith & Nephew Schweiz AG	Switzerland	Baar
Smith & Nephew AG	Switzerland	Baar
US[1]		
Arthrocare Corporation[3]	United States	San Jose
Bioventus LLC[5] (49%)	United States	Wilmington
Blue Belt Holdings, Inc.[3]	United States	Minneapolis
Blue Belt Technologies, Inc.[3]	United States	Pittsburgh
Blue Sky Medical Group, Inc.	United States	Wilmington
Delphi Ventures V, L.P.[5] (6.9%)	United States	Menlo Park
Healicoil, Inc.	United States	Wilmington
Hipco, Inc.	United States	Wilmington
Kalypto Medical, Inc.	United States	Wilmington
LifeModeler, Inc.	United States	Tustin
Memphis Biomed Ventures I, LP[5] (4.61%)	United States	Delaware
Oratec Interventions, Inc.	United States	Concord
Orthopaedic Biosystems Ltd., Inc.	United States	Phoenix
OsteoBiologics, Inc.	United States	Dallas
Plus Orthopedics LLC	United States	Andover

23 OTHER NOTES TO THE ACCOUNTS continued

Company name[1]	Country of operation and incorporation	Registered Office
Sinopsys Surgical, Inc.[5] (11.3%)	United States	Boulder
Smith & Nephew AHP, Inc.[4]	United States	Wilmington
Smith & Nephew Consolidated, Inc.	United States	Amsterdam
Smith & Nephew OUS, Inc.[3]	United States	Wilmington
Smith & Nephew, Inc.[3]	United States	Wilmington
Surgical Frontiers Series I, LLC[5] (32%)	United States	Dover

Africa, Asia, Australasia and Other America[1]

Company name[1]	Country of operation and incorporation	Registered Office
Smith & Nephew Argentina S.R.L.[4]	Argentina	Buenos Aires
ArthroCare (Australasia) Pty Ltd[4]	Australia	North Ryde
Smith & Nephew Pty Limited	Australia	North Ryde
Smith & Nephew Surgical Holdings Pty Limited[3,4]	Australia	North Ryde
Smith & Nephew Surgical Pty Limited[3,4]	Australia	North Ryde
Smith & Nephew Comercio de Produtos Medicos LTDA	Brazil	São Paulo
Smith & Nephew do Brasil Participacoes S.A.[3]	Brazil	São Paulo
Smith & Nephew (Alberta) Inc.	Canada	Calgary
Smith & Nephew Inc.[3]	Canada	Toronto
Tenet Medical Engineering, Inc.	Canada	Calgary
Smith & Nephew Finance Holdings Limited	Cayman Islands	South Church Street, George Town
Smith & Nephew Medical (Shanghai) Limited[3]	China	Shanghai Free Trade Test Zone
Smith & Nephew Medical (Suzhou) Limited	China	Suzhou City
Smith & Nephew Orthopaedics (Beijing) Co., Ltd	China	Beijing Economic and Technical Development Area
S&N Holdings SAS[3]	Colombia	Bogota
Smith & Nephew Colombia S.A.S	Colombia	Bogota
ArthroCare Costa Rica Srl	Costa Rica	Costa Rica
Smith & Nephew Curaçao N.V.	Curaçao	Willemstad
Smith & Nephew Beijing Holdings Limited[3]	Hong Kong	Delta House, Hong Kong
Smith & Nephew Limited[3]	Hong Kong	Delta House, Hong Kong
Smith & Nephew Suzhou Holdings Limited[3]	Hong Kong	Delta House, Hong Kong
Adler Mediequip Private Limited	India	Pune
Smith & Nephew Healthcare Private Limited	India	Mumbai-59
Ortho-Space Ltd.[5] (16.8%)	Israel	Caesarea
Smith & Nephew Endoscopy KK	Japan	Tokyo
Smith & Nephew KK	Japan	Tokyo
Smith & Nephew Orthopaedics KK[3]	Japan	Tokyo
Smith & Nephew Wound Management KK	Japan	Tokyo
Smith & Nephew Chusik Hoesia	Korea, Republic of	Seoul
Smith & Nephew Healthcare Sdn Berhad	Malaysia	Kuala Lumpur
Smith & Nephew S.A. de C.V.	Mexico	Mexico City
Smith & Nephew Limited	New Zealand	Auckland
Smith & Nephew, Inc.	Puerto Rico	San Juan
Smith & Nephew Pte Limited[3]	Singapore	Singapore
ICEMBE Medical (pty) Ltd[5] (10%)	South Africa	Pinetown
Smith & Nephew (Pty) Limited[3]	South Africa	Westville
Smith & Nephew Pharmaceuticals (Proprietary) Limited	South Africa	Westville
Smith & Nephew Limited	Thailand	Huai Khwang District, Bangkok
Sri Siam Medical Limited[3,5] (48.9%)	Thailand	Lumpini Phatumwan, Bangkok
Smith ve Nephew Medikal Cihazlar Ticaret Limited Sirketi	Turkey	Sariyer, Istanbul
Smith & Nephew FZE	United Arab Emirates	Jebel Ali, Dubai

1 The activity of all companies listed above is the provision of medical devices, unless indicated otherwise.
2 Directly owned by Smith & Nephew plc.
3 Holding company.
4 Dormant company.
5 Not 100% owned by Smith & Nephew Group.

Registered Office addresses

UK

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

Rest of Europe

Vienna	Concorde Business Park, 1/C/3 2320, Schwechat, Austria
Zaventem	Hector Heenneaulaan 366, 1930 Zaventem, Belgium
Hoersholm	Slotsmarken 14, Hoersholm, DK-2970, Denmark
Le Mans	25 Boulevard Marie et Alexandre, Oyon, 72100, Le Mans, France
Helsinki	Ayritie 12 C, 01510, Vantaa, Finland
Hamburg	Friesenweg 4, Haus 21, 22763, Hamburg, Germany
Tuttlingen	Alemannenstrasse 14, 78532, Tuttlingen, Germany
Athens	Protopappa Street 43, GR 16346, Ilioupoli, Athens, Greece
Dublin 1	3rd Floor, Kilmore House, Park Lane, Spencer Dock, Dublin 1, Ireland
Dublin 2	Molyneux House, Bride Street, Dublin 2, Ireland
Milan	Via de Capitani 2A, 20864, Agrate Brianza (MI), Italy
Luxembourg	163, Rue de Kiem, L-8030 Strassen, Luxembourg
Amsterdam	Kruisweg 637, 2132 NB Hoofddorp, The Netherlands
Oslo	Nye Vakas vei 64, 1395, Hvalsted, Norway
Warsaw	Ul Osmanska 12, 02-823, Warsaw, Poland
Lisbon	Estrada Nacional no 10 ao Km. 131, Parque Tejo – Bloco C, 2625-445 Forte de Casa, Vila Franca de Xira, Portugal
Moscow	9a, Bld, 10, 2nd Sinichkina Street, Moscow 111020, Russian Federation
Puschino	8/1 Stroiteley Street, 142290, City of Puschino, Moscow Region, Russian Federation
Barcelona	Edificio Conata I, c/ Fructuos Gelabert 2 y 4, San Joan Despi – 08970, Barcelona, Spain
Molndal	PO Box 143, S-431 22 Molndal, Sweden
Baar	Oberneuhofstr 10d, Baar, 6340
Aarau	Schachenallee 29, 5000, Aarau, Switzerland
Gothenburg	Varbergsgatan 2A / 412 65 Göteborg / Sweden

US

San Jose	595 North Pastoria Avenue, Sunnyvale, California, 94086, USA
Minneapolis	2905 Northwest Blvd, Suite 40, Plymouth MN 55441, United States
Pittsburgh	2828 Liberty Ave, Suite 100, Pittsburgh PA 15222, United States

Registered Office addresses

Boulder	5480 Valmont Road, Suite 215, Boulder, Colorado, 90301
Wilmington	CT Corporation, 1209 Orange Street, Wilmington DE 19801, United States
Concord	C T Corporation, 9 Capitol Street, Concord, New Hampshire, 03301, USA
Phoenix	CT Corporation System, 3225 North Central Avenue, Phoenix AZ 85012, United States
Dallas	CT Corporation System, 350 North St. Paul Street, Dallas TX 75201, United States
Andover	150 Minuteman Road, Andover, MA, 01810, United States
Menlo Park	3000 Sand Hill Road, Building 1, Suite 135, Melo Park, California, 94025
Memphis	6075 Poplar Avenue, Suite 335, Memphis, Tennessee, 38119
Tustin	3002 Dow Avenue, Building 100, Unit 138, Tustin, California, 92780
Dover	160 Greentree Drive, Suite 101, Dover, Delaware, 19904

Africa, Asia, Australasia and Other America

Buenos Aires	Maipu 1300, 13th Floor, City of Buenos Aires, Argentina
North Ryde	85 Waterloo Road, North Ryde NSW 2113, Australia
São Paulo	Avenida do Cafe, 277, Centro Empresarial do Aco, Centro Empresarial do Aco, Torre B, 4 andar, conjuto, CEP 04311-000, São Paulo 403, Jabaquara, Brazil
Calgary	3500-855-2 Street SW, Calgary AB AB T2P 4J8, Canada
Toronto	199, Bay Street, 4000, Toronto, Ontario M5L 1A9, Canada
Shedden Road, Georgetown	Chartered Trust Services Limited, One Capital Place, Shedden Road, PO Box 1034 GT, Grand Cayman, Cayman Islands
South Church Street, Georgetown	c/o M&C Corporate Services Limited, Ugland House, South Church Street, P.O. Box 309, George Town, Grand Cayman, Cayman Islands
Chao Yang District, Beijing	Room 17-021, Internal B17 floor, B3-24th floor, No 3 Xin Yuan South Rd, Chao Yang District, Beijing, China
Shunyi District, Beijing	22 Linhe Avenue, Linhe Economic Development Zone, Shunyi District, Beijing, 101300, China
East City, Beijing	No. B-D, Floor 2, A Building, Beijing East Gate Plaza, No. 9, Dong Zhong Street, East City, Beijing, China
Guangzhou	Room 2502 No 33, 6th Jian She Rd, Yue Xiu District, Guangzhou, China
Shanghai	Room 1208-1209, No 168 Middle Xi Zang Rd, Shanghai, China
Shanghai Free Trade Test Zone	Part B, 4th Floor, Tong Yong Building, No 188 Ao Na Rd, Shanghai Free Trade Test Zone, Shanghai, China
Dong Cheng District, Beijing	Unit B1, 2/F, Tower A, East Gate Plaza No.9, Dongshong Street, Dong Cheng District, Beijing, China
Chengdu	No 5. 15th Floor, Unit 1, Building, 1 Li Bao Building, No 62 North Ke Hua Rd, Wu Hou District, Chengdu, China

23 OTHER NOTES TO THE ACCOUNTS continued

Registered Office addresses	
Middle Xi Zang Rd, Shanghai	Room 1201-1207, No168 Middle Xi Zang Rd, Shanghai, China
Suzhou City	12, Wuxiang Road, West Area of Comprehensive Bonded Zone, Suzhou Industrial Park, Suzhou City, SIP, Jiangsu Province, China
Beijing Economic and Technical Development Area	No. 98 Kechuang Dongliujie, Beijing Economic and Technical Development Area, Beijing, China
Bogota	Calle 100 No. 7 – 33 to 1 P3, Bogota D.C., 0, Colombia
Costa Rica	Heredia-Heredia Aurora, Free Zone Global Park, Building 200, Costa Rica
Willemstad	Pietermaai 15, PO Box 4905, Curaçao
Delta House, Hong Kong	Unit 813 – 816, 8/F, Delta House, 3 On Yiu Street, Shatin, New Territories, Hong Kong
Pune	Sushrut House, Survey no.288, Phase II next to MIDC, Hinjewadi, at Mann, Taluka Mulshi, Pune, 411057, India
Mumbai	5A, Bakhtawar, 5th Floor, behind The Oberoi, Nariman Point, Mumbai, Maharashtra, 400021, India
Mumbai-59	501-B – 509-B Dynasty Business Park, Andheri Kurla Road, Andheri East, Mumbai-59, Maharashtra, India
Caesarea	7 Halamarish, Caesarea, 3088900, Israel
Tokyo	2-4-1, Shiba -Koen, Minato-Ku, Tokyo 105-0011, Japan
Seoul	13th Floor, ASEM Tower, Gangnam-gu 13th Floor, ASEM Tower, 159-1 Samsung-dong, Seoul, Korea
Kuala Lumpur	Suite 11.01 B & 11.02 Level 11, Menara AmFIRST, No 1 Jalan 19/3 46300 Petaling Jaya, Selangor, Malaysia

Registered Office addresses	
Mexico City	Av. Insurgentes Sur, numero 1602, Piso No.7, Oficina 702, Colonia Credito, Constructor, Delegacion Benito Juarez, C.P. 03940, Mexico
Auckland	621 Rosebank Road, Avondale, Auckland 6, New Zealand
San Juan	Edificio Cesar Castillo, Calle Angel Buonomo #361, Hato Rey, 00917, Puerto Rico
Singapore	50 Raffles Place, #32-01 Singapore Land Tower, 048623, Singapore
Pinetown	30 Gillitts Road, Pinetown, 3600, South Africa
Westville	30 The Boulevard, Westway Office Park, Westville, 3629, South Africa
Huai Khwang District, Bangkok	16th Floor Building A, 9th Tower Grand Rama 9, 33/4 Rama 9 Road, Huai Khwang District, Bangkok, 10310, Thailand
Lumpini Phatumwan, Bangkok	16th Floor, GPF Witthayu Tower A, 93/1 Wireless Road, Lumpini, Phatumwan, Bangkok, 10330, Thailand
Ankara	Mebusevleri Mah. Ergin Sk. No:24, 2 Çankaya, Ankara, Turkey
Sariyer, Istanbul	Bahcekoy Mah., Orkide Sok., No:8/E Bahcekoy, Sariyer Istanbil, Turkey
Bagcilar, Istanbul	Mahmutbey Mah. 16 Yol Sok., No: 127/1 DPL+ASM Bagcilar, Istanbul, Turkey
Jebel Ali, Dubai	PO Box 16993 LB02016, Jebel Ali, Dubai, United Arab Emirates
Dubai Health Centre, Dubai	401-404 & 406-407, Floor 4, B-47 Dubai Health Centre, Dubai, United Arab Emirates

COMPANY BALANCE SHEET

	Notes	At 31 December 2016 $ million	At 31 December 2015 $ million
Fixed assets:			
Investments	3	5,322	5,322
Current assets:			
Debtors	4	824	2,234
Cash and bank	6	14	47
		838	2,281
Creditors: amounts falling due within one year:			
Borrowings	6	(41)	(3)
Other creditors	5	(814)	(1,881)
		(855)	(1,884)
Net current (liabilities)/assets		(17)	397
Total assets less current liabilities		5,305	5,719
Creditors: amounts falling due after one year:			
Borrowings	6	(1,559)	(1,425)
Total assets less total liabilities		3,746	4,294
Equity shareholders' funds:			
Called up equity share capital		180	183
Share premium account		600	590
Capital redemption reserve		15	12
Capital reserve		2,266	2,266
Treasury shares		(432)	(294)
Exchange reserve		(52)	(52)
Profit and loss account		1,169	1,589
Shareholders' funds		3,746	4,294

The accounts were approved by the Board and authorised for issue on 22 February 2017 and signed on its behalf by:

Roberto Quarta
Chairman

Olivier Bohuon
Chief Executive Officer

STATEMENT OF CHANGES IN EQUITY

								2016	2015
	Share capital $ million	Share premium $ million	Capital redemption reserve $ million	Capital reserves $ million	Treasury shares $ million	Exchange reserves $ million	Profit and loss account $ million	Total shareholders' funds $ million	Total shareholders' funds $ million
At 1 January	183	590	12	2,266	(294)	(52)	1,589	4,294	4,484
Attributable profit for the year	–	–	–	–	–	–	58	58	107
Net gain on cash flow hedges	–	–	–	–	–	–	1	1	1
Exchange adjustments	–	–	–	–	–	–	(3)	(3)	1
Equity dividends paid in the year	–	–	–	–	–	–	(279)	(279)	(272)
Share-based payments recognised	–	–	–	–	–	–	27	27	29
Cost of shares transferred to beneficiaries	–	–	–	–	40	–	(34)	6	5
New shares issued on exercise of share options	–	10	–	–	–	–	–	10	16
Cancellation of treasury shares	(3)	–	3	–	190	–	(190)	–	–
Treasury shares purchased	–	–	–	–	(368)	–	–	(368)	(77)
At 31 December	180	600	15	2,266	(432)	(52)	1,169	3,746	4,294

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 $685m (2015: $1,243m). 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 $58m (2015: $107m).

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

NOTES TO THE COMPANY ACCOUNTS

1 BASIS OF PREPARATION

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

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

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

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

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

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

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

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

2 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 $58m (2015: $107m).

3 INVESTMENTS

ACCOUNTING POLICY

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

	2016 $ million	2015 $ million
At 1 January and 31 December	5,322	5,322

Investments represent holdings in subsidiary undertakings.

In accordance with Section 409 of the Companies Act 2006, a listing of all entities invested in by the consolidated Group is provided in Note 23.3 of the Notes to the Group Accounts. Entities directly owned by Smith & Nephew plc are highlighted in that section.

4 DEBTORS

	2016 $ million	2015 $ million
Amounts falling due within one year:		
Amounts owed by subsidiary undertakings	735	2,169
Prepayments and accrued income	3	5
Current asset derivatives – forward foreign exchange contracts	45	30
Current asset derivatives – forward foreign exchange contracts – subsidiary undertakings	36	21
Current asset derivatives – currency swaps	1	–
Current taxation	4	9
	824	2,234

5 OTHER CREDITORS

	2016 $ million	2015 $ million
Amounts falling due within one year:		
Amounts owed to subsidiary undertakings	715	1,813
Other creditors	17	15
Current liability derivatives – forward foreign exchange contracts	36	21
Current liability derivatives – forward foreign exchange contracts – subsidiary undertakings	45	30
Current liability derivatives – currency swaps	–	2
Current liability derivatives – interest rate swaps	1	–
	814	1,881

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.

	2016 $ million	2015 $ million
Bank loans and overdrafts due within one year or on demand	41	3
Bank loans due after one year	1,559	1,425
Borrowings	1,600	1,428
Cash and bank	(14)	(47)
Credit balance on derivatives – forward exchange contracts and currency swaps	1	2
Interest rate swaps	(1)	–
Net debt	1,586	1,383

All currency swaps are stated at fair value. Gross US Dollar equivalents of $449m (2015: $368m) receivable and $448m (2015: $370m) payable have been netted. Currency swaps comprise foreign exchange swaps and were used in 2016 and 2015 to hedge intra-group loans.

7 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.

8 CONTINGENCIES

	2016 $ million	2015 $ million
Guarantees in respect of subsidiary undertakings	–	–

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

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

GROUP INFORMATION

BUSINESS OVERVIEW AND GROUP HISTORY

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

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

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

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

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

PROPERTY, PLANT AND EQUIPMENT

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

	Approximate area (square feet 000's)
Group head office in London, UK	22
Office and surgical training facility in Croxley Park, Watford, UK	60
Regional headquarters in Andover, Massachusetts, US	144
Manufacturing, research and office facility in Hull, UK	473
Manufacturing and office facilities in Memphis, Tennessee, US	968
Distribution facility in Memphis, Tennessee, US	248
Manufacturing facility in Aarau, Switzerland	121
Manufacturing facility in Beijing, China	192
Manufacturing facility in Tuttlingen, Germany	50
Distribution facility and regional headquarters in Baar, Switzerland	71
Manufacturing facility in Mansfield, Massachusetts, US	98
Manufacturing facility in Oklahoma City, Oklahoma, US	155
Manufacturing, research and office facility in Austin, Texas, US	157
Manufacturing facilities in La Aurora and Alajuela, Costa Rica	292
Research facility in Irvine, California, US	23
Manufacturing facility in Devrukh, India	74
Manufacturing facility in Suzhou, China	288
Bioactives headquarters and laboratory space in Fort Worth, Texas, US	165
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.

RISK FACTORS

There are known and unknown risks and uncertainties relating to Smith & Nephew's business. The factors listed on pages 170 to 172 could cause the Group's business, financial position and results of operations to differ materially and adversely from expected and historical levels. In addition, other factors not listed here that Smith & Nephew cannot presently identify or does not believe to be equally significant could also materially adversely affect Smith & Nephew's business, financial position or results of operations.

Highly competitive markets

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

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

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

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

Continual development and introduction of new products

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

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

Dependence on government and other funding

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

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

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

World economic conditions

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

During 2016, 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 (notably in China) and increased uncertainty over the collectability of government debt, particularly those in the Emerging Markets and the oil-dependent Gulf States. These factors tempered the overall growth of the Group's global markets and could have an increased impact on growth in the future.

Political uncertainties

The Group operates on a worldwide basis and has distribution channels, purchasing agents and buying entities in over 100 countries. Political upheaval in some of those countries or in surrounding regions may impact the Group's results of operations. Political changes in a country could prevent the Group from receiving remittances of profit from a member of the Group located in that country or from selling its products or investments in that country. Furthermore, changes in government policy regarding preference for local suppliers, import quotas, taxation or other matters could adversely affect the Group's revenue and operating profit. War, economic sanctions, terrorist activities or other conflict could also adversely impact the Group. These risks may be greater in Emerging Markets, which account for an increasing portion of the Group's business. During 2016, the outcome of the UK referendum regarding the EU and the pending change in administration in the United States have added to political uncertainty.

Currency fluctuations

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

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

The Group uses the US Dollar as its reporting currency 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 114.

Manufacturing and supply

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

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

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

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

The Group will, from time to time, 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. During 2015, developments in the Group's metal-on-metal hip implant claims led to a $203m charge being recognised relating to known and future claims.

Regulatory standards and compliance in the healthcare industry

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

International regulation

The Group operates across the world and is subject to extensive legislation, including anti-bribery and corruption and data protection, in each country in which we operate. Our international operations are governed in part 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 government officials and other persons 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 16 to 17, 'Financial review' on pages 39 to 41 and 'Taxation information for shareholders' on pages 187 to 188.

OTHER FINANCIAL INFORMATION

SELECTED FINANCIAL DATA

	2016 $ million	2015 $ million	2014 $ million	2013 $ million	2012 $ million
Income statement					
Revenue	4,669	4,634	4,617	4,351	4,137
Cost of goods sold	(1,272)	(1,143)	(1,162)	(1,100)	(1,070)
Gross profit	3,397	3,491	3,455	3,251	3,067
Selling, general and administrative expenses	(2,366)	(2,641)	(2,471)	(2,210)	(2,050)
Research and development expenses	(230)	(222)	(235)	(231)	(171)
Operating profit[1]	801	628	749	810	846
Net interest (payable)/receivable	(46)	(38)	(22)	4	2
Other finance (costs)/income	(16)	(15)	(11)	(11)	(11)
Share of results of associates	(3)	(16)	(2)	(1)	4
Profit on disposal of business and net assets held for sale	326	–	–	–	251
Profit before taxation	1,062	559	714	802	1,092
Taxation	(278)	(149)	(213)	(246)	(371)
Attributable profit for the year	784	410	501	556	721
Earnings per ordinary share					
Basic	88.1¢	45.9¢	56.1¢	61.7¢	80.4¢
Diluted	87.8¢	45.6¢	55.7¢	61.4¢	80.0¢
Adjusted attributable profit					
Attributable profit for the year	784	410	501	556	721
Acquisition related costs	9	25	125	31	11
Restructuring and rationalisation expenses	62	65	61	58	65
Legal and other	(20)	187	(2)	–	–
Amortisation and impairment of acquisition intangibles	178	204	129	88	43
Profit on disposal of business and net assets held for sale	(326)	–	–	–	(251)
Taxation on excluded items	48	(130)	(71)	(40)	82
Adjusted attributable profit	735	761	743	693	671
Adjusted earnings per ordinary share (EPSA)[2]	82.6¢	85.1¢	83.2¢	76.9¢	74.8¢

1 Reconciliation of operating to trading profit is presented below.
2 Adjusted earnings per ordinary share is calculated by dividing adjusted attributable profit by the basic weighted number of shares.

	2016 $ million	2015 $ million	2014 $ million	2013 $ million	2012 $ million
Operating profit	801	628	749	810	846
Acquisition related costs	9	12	118	31	11
Restructuring and rationalisation costs	62	65	61	58	65
Amortisation and impairment of acquisition intangibles	178	204	129	88	43
Legal and other	(30)	190	(2)	–	–
Trading profit	1,020	1,099	1,055	987	965

OTHER FINANCIAL INFORMATION

SELECTED FINANCIAL DATA continued

	2016 $ million	2015 $ million	2014 $ million	2013 $ million	2012 $ million
Group balance sheet					
Non-current assets	4,815	4,692	4,866	3,563	3,498
Current assets	2,529	2,475	2,440	2,256	2,144
Total assets	7,344	7,167	7,306	5,819	5,642
Share capital	180	183	184	184	193
Share premium	600	590	574	535	488
Capital redemption reserve	15	12	11	10	–
Treasury shares	(432)	(294)	(315)	(322)	(735)
Retained earnings and other reserves	3,595	3,475	3,586	3,640	3,938
Total equity	3,958	3,966	4,040	4,047	3,884
Non-current liabilities	2,038	1,857	2,104	699	828
Current liabilities	1,348	1,344	1,162	1,073	930
Total liabilities	3,386	3,201	3,266	1,772	1,758
Total equity and liabilities	7,344	7,167	7,306	5,819	5,642
Group cash flow statement					
Cash generated from operations	1,035	1,203	961	1,138	1,184
Net interest paid	(45)	(36)	(33)	(6)	(4)
Income taxes paid	(141)	(137)	(245)	(265)	(278)
Net cash inflow from operating activities	849	1,030	683	867	902
Capital expenditure (including trade investments and net of disposals of property, plant and equipment)	(394)	(360)	(379)	(340)	(265)
Acquisitions and disposals	(214)	(44)	(1,552)	(67)	(782)
Proceeds on disposal of business (net of tax)	225	–	–	–	103
Investment in associate	–	(25)	(2)	–	(10)
Proceeds from associate loan redemption	–	–	188	–	–
Proceeds from own shares	6	5	4	3	6
Equity dividends paid	(279)	(272)	(250)	(239)	(186)
Issue of ordinary capital and treasury shares purchased	(358)	(61)	(35)	(183)	77
Net cash flow from financing and investing activities	(165)	273	(1,343)	41	(155)
Exchange adjustments	(24)	(21)	(17)	(6)	5
Opening net debt	(1,361)	(1,613)	(253)	(288)	(138)
Closing net debt	(1,550)	(1,361)	(1,613)	(253)	(288)
Selected financial ratios					
Gearing (closing net debt as a percentage of total equity)	39%	34%	40%	6%	7%
Dividends per ordinary share[1]	30.8¢	30.8¢	29.60¢	27.40¢	26.10¢
Research and development costs to revenue	4.9%	4.8%	5.1%	5.3%	4.1%
Capital expenditure (including intangibles but excluding goodwill) to revenue	8.4%	7.7%	8.1%	7.8%	6.4%

1 The Board has proposed a final dividend of 18.5 US cents per share which together with the first interim dividend of 12.3 US cents makes a total for 2016 of 30.8 US cents.

NON-GAAP FINANCIAL INFORMATION – ADJUSTED MEASURES

These Financial Statements include financial measures that are not prepared in accordance with International Financial Reporting Standards (IFRS). These measures, which include trading profit, trading profit margin, trading cash flow, 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 segment and the consolidated Group on a consistent basis, similar to the way in which the Group's management evaluates performance, that is not otherwise apparent on an IFRS basis, given that certain non-recurring, infrequent 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.

Underlying revenue growth

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

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 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:

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

			Reconciling items	
2015 **Consolidated revenue**	Reported growth %	Underlying growth %	Acquisitions/disposals %	Currency impact %
Total	–	4	4	(8)

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.

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).

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

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

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

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

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

	Revenue $ million	Operating profit[1] $ million	Taxation[2] $ million	Attributable profit[3] $ million	Cash generated from operating activities[4] $ million	Earnings per share[5] ¢
2015 Reported	4,634	628	(149)	410	1,203	45.9
Acquisition-related costs	–	12	(9)	16	36	1.8
Restructuring and rationalisation costs	–	65	(18)	47	52	5.3
Amortisation and impairment of acquisition intangibles	–	204	(66)	138	–	15.4
Legal and other	–	190	(37)	150	3	16.7
Capital expenditure	–	–	–	–	(358)	–
2015 Adjusted	4,634	1,099	(279)	761	936	85.1

Acquisition-related costs and cash flows: For the year to 31 December 2015, these costs primarily relate to ongoing ArthroCare integration and deferred consideration for an acquisition made by an associate.

Restructuring and rationalisation costs: For the year to 31 December 2015, these costs primarily relate to the ongoing implementation of the Group Optimisation plan that was announced in May 2014.

Amortisation and impairment of acquisition intangibles: For the year ended 31 December 2015, these charges relate to the amortisation of intangible assets acquired in material business combinations and a total impairment of $51m including $40m relating to Oasis, a product acquired with the Healthpoint acquisition in 2013.

Legal and other: For the year to 31 December 2015, the net charge primarily relates to $203m for known, anticipated and settled metal-on-metal hip claims and associated legal expenses of $21m. This was offset by a net gain of $33m relating to patent litigation with Arthrex and past service and curtailment gains of $19m arising on US and UK post-retirement benefits.

In addition, a total of $18m charge primarily relates to final costs relating to RENASYS distribution hold and redundancies from the decision to cease development of HP802.

1 Represents a reconciliation of operating profit to trading profit.
2 Represents a reconciliation of reported tax to trading tax.
3 Represents a reconciliation of reported attributable profit to adjusted attributable profit.
4 Represents a reconciliation of cash generated from operations to trading cash flow.
5 Represents a reconciliation of basic earnings per ordinary share to adjusted earnings per ordinary share (EPSA).

2015 FINANCIAL HIGHLIGHTS

REVENUE

Group revenue increased by $17m, flat on a reported basis, from $4,617m in 2014 to $4,634m in 2015.

The underlying increase is 4%, after adjusting for the 4% impact of acquisitions and the 8% attributable to the unfavourable impact of currency movements.

Established Markets had an underlying growth of 3% and Emerging Markets had an underlying growth of 11%, both of which contributed to the Group increase of 4%.

COST OF GOODS SOLD

Cost of goods sold decreased by $19m, 2% on a reported basis, from $1,162m in 2014 to $1,143m in 2015. The movement is primarily due to the strengthening of the US Dollar which more than offsets the increase in volume from acquisitions and underlying trading.

During 2015, no restructuring and rationalisation expenses (2014: $12m) and acquisition related costs (2014: $23m) were charged to cost of goods sold.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses increased by $170m (7% on a reported basis) from $2,471m in 2014 to $2,641m in 2015. The underlying movement is 7% after adjusting for net impact of 7% from acquisitions and unfavourable currency movements of 7%.

In 2015, administrative expenses included amortisation of software and other intangible assets of $66m (2014: $62m), $65m of restructuring and rationalisation expenses (2014: $49m), an amount of $204m relating to amortisation and impairment of acquired intangibles (2014: $129m), $12m of acquisition related costs (2014: $95m) and $203m relating to anticipated and settled metal-on-metal hip claims and additional expenses primarily relating to the RENASYS distribution hold in the US. These expenses were offset by a net gain of $33m relating to a patent litigation and past service and curtailment gains of $19m (2014: $46m) arising on US and UK post-retirement benefits.

RESEARCH AND DEVELOPMENT EXPENSES

Research and development expenditure as a percentage of revenue remained broadly consistent at 4.8% in 2015 (2014: 5.1%). Actual expenditure was $222m in 2015 compared to $235m in 2014. The Group continues to invest in innovative technologies and products to differentiate it from competitors.

OPERATING PROFIT

Operating profit decreased by $121m from $749m in 2014 to $628m in 2015.

This movement was primarily driven by the benefits of the Group Optimisation programme and synergies from the ArthroCare acquisition in 2014, offset by the costs relating to anticipated and settled metal-on-metal hip claims.

INTEREST INCOME/(EXPENSE)

Net interest expense increased by $16m from a net $22m expense in 2014 to a net $38m expense in 2015. This movement is primarily due to an increase in interest expense due to the financing of the ArthroCare acquisition in 2014.

OTHER FINANCE COSTS

Other finance costs in 2015 increased by $4m and principally relates to costs associated with the Group's retirement benefit schemes.

TAXATION

The taxation charge decreased by $64m to $149m from $213m in 2014.

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 on trading profit was 26.8% (2014: 27.7%).

COMMENTARY ON THE GROUP BALANCE SHEET

Non-current assets

Non-current assets decreased by $174m to $4,692m in 2015 from $4,866m in 2014. This is principally attributable to the following:

- Property, plant and equipment increased by $41m from $891m in 2014 to $932m in 2015. There were $303m of additions together with $6m acquired with the Colombia and Russia acquisitions which were offset by $11m of assets disposed. Depreciation of $226m was charged during 2015 and there were unfavourable currency movements of $31m.
- Goodwill decreased by $15m from $2,027m in 2014 to $2,012 in 2015. This movement relates to additions of $10m from the acquisition in Colombia and $24m from the acquisition in Russia. This was offset by unfavourable currency movements of $49m which decreased the overall goodwill balance.
- Intangible assets decreased by $245m from $1,747m in 2014 to $1,502m in 2015. There were additions of $55m in 2015 relating to intellectual property, distribution rights and software acquired together with $19m acquired with the Colombia and Russia acquisitions. Amortisation and impairment during 2015 was $270m and there were unfavourable currency movements of $45m.
- Investments in associates increased to $115m from $112m in 2014. The increase was attributable to a capital contribution to Bioventus of $25m and other investment gains of $2m, offset by an investment loss in Bioventus of $18m and a reclassification of an associate to investments of $6m due to a change in shareholding.
- Deferred tax assets increased by $28m in the year from $77m in 2014 to $105m in 2015. The net deferred tax position has changed from a liability of $21m in 2014 to an asset of $28m in 2015. The net movement of $49m is mainly due to the creation of the metal-on-metal hip claim provision and amortisation of certain acquired intangibles, offset by a reduction in retirement benefit obligations.

Current assets

Current assets increased by $35m to $2,475m from $2,440m in 2014. The movement relates to the following:

- Inventories rose by $36m to $1,217m in 2015 from $1,181m in 2014. This movement is driven by inventory acquired with the Colombia and Russia acquisitions and a general increase across the Emerging Markets. This was offset by unfavourable currency movements of $63m.
- The level of trade and other receivables decreased by $28m to $1,138m in 2015 from $1,166m in 2014. The movement primarily relates to the $17m increase in the bad debt provision as well as unfavourable currency movements.
- Cash at bank has increased by $27m from $93m in 2014 to $120m in 2015.

Non-current liabilities

Non-current liabilities decreased by $247m from $2,104m in 2014 to $1,857m in 2015. This movement principally relates to:

- Long-term borrowing decreased from $1,666m in 2014 to $1,434m in 2015 principally due to repayments of bank debt.
- The retirement benefit obligation decreased from $233m in 2014 to $184m in 2015 due to past cost adjustments arising from plan amendments in the UK and US, increases in discount rates and supplementary cash contributions.
- Deferred tax liabilities decreased by $21m from $98m in 2014 to $77m in 2015. Refer to commentary within non-current assets for explanation of the net deferred tax position movement.
- The impact of the above was partly offset by an increase in non-current provisions, primarily relating to the estimated costs to resolve all future known and anticipated metal-on-metal hip claims.

Current liabilities

Current liabilities increased by $182m from $1,162m in 2014 and $1,344m in 2015. This movement is attributable to:

- Bank overdrafts and loans increased by $7m from $39m in 2014 to $46m in 2015.
- Provisions increased by $126m from $67m in 2014 to $193m in 2015 primarily due to an increase in legal provision for known and anticipated metal-on-metal hip claims.
- Current tax payables increased by $45m from $218m in 2014 to $263m, mainly attributable to differences in the timing of cash tax payments year-on-year.

TOTAL EQUITY

Total equity decreased by $74m from $4,040m in 2014 to $3,966m in 2015. The principal movements were:

	Total equity $ million
1 January 2015	4,040
Attributable profit	410
Currency translation gains	(176)
Hedging reserves	(16)
Actuarial losses on retirement benefit obligations	(8)
Dividends paid during the year	(272)
Purchase of own shares	(77)
Taxation on other comprehensive income and equity items	15
Net share-based transactions	50
31 December 2015	3,966

CONTRACTUAL OBLIGATIONS

Contractual obligations at 31 December 2016 were as follows:

	Payments due by period			
	Less than one year $ million	One to three years $ million	Three to five years $ million	More than five years $ million
Debt obligations	86	300	135	–
Private placement notes	36	197	330	800
Finance lease obligations	3	6	–	–
Operating lease obligations	48	67	31	41
Retirement benefit obligation	43	–	–	–
Purchase obligations	27	24	10	–
Capital expenditure	64	–	–	–
Other	74	42	34	16
	381	636	540	857

Other contractual obligations represent $36m of foreign exchange contracts and $130m of acquisition consideration. Provisions that do not relate to contractual obligations are not included in the above table.

The agreed contributions for 2017 in respect of the Group's defined benefits plans are: $23m for the UK and $20m for the US Plan. 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 84.

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

FINANCIAL CALENDAR

Annual General Meeting	6 April 2017
First quarter trading report	5 May 2017
Payment of 2016 final dividend	10 May 2017
Half year results announced	27 July 2017[1]
Third quarter trading report	3 November 2017
Payment of 2017 interim dividend	November 2017
Full year results announced	February 2018[1]
Annual Report available	February/March 2018
Annual General Meeting	April 2018

1 Dividend declaration dates.

Annual General Meeting

The Company's Annual General Meeting (AGM) will be held on 6 April 2017 at 2:00pm 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

ORDINARY SHAREHOLDERS

Registrar

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

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

Tel: 0370 703 0047
Tel: +44 (0) 117 240 2532 from outside the UK
Website: www.investorcentre.co.uk

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

Shareholder facilities

Investor Centre

You can now manage your holdings online by registering on Computershare's secure shareholder website Investor Centre. Once registered, Investor Centre makes it easy for you to sign up for electronic communications, update your address details and add a payment instruction. Visit www.investorcentre.co.uk for a fast and convenient way to manage your holdings.

E-communications

We encourage you to elect to receive communications via e-mail as this has significant environmental and cost benefits. If you would like to receive email notifications when your shareholder communications are available online, please submit your email address and SRN by visiting www.investorcentre.co.uk/ecomms

Payment of dividends direct to your bank or building society account

If you 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 Global Payment Service. For more information, please contact Computershare.

Dividend Re-Investment 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 Computershare.

Duplicate accounts

If you have more than one account due to inconsistency in account details, you may avoid duplicate mailings by writing to Computershare and requesting an amalgamation of your share accounts.

Keep your personal details up to date

Please remember to tell Computershare if you move house or change bank details or there is any other change in your account information. If you have already registered with Investor Centre, you can update your address online. Alternatively, you will need to complete a Change of Address form and send it to Computershare. You can access a Change of Address form via investor centre by visiting http://www.computershare.com/uk/SNPforms

You can also change your address or update your bank details quickly and easily over the phone, using the contact number above.

Individual savings account (ISA)

Shareholders who are UK resident may hold Smith & Nephew plc shares in an ISA, which is administered by the Company's registrar. For information about this service please contact Computershare.

SHAREHOLDER COMMUNICATIONS

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

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

INVESTOR COMMUNICATIONS

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

UK CAPITAL GAINS TAX

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

SMITH & NEPHEW SHARE PRICE

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

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 no. 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 Computershare at the address given on page 181.

Further information about ShareGift is available at 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/

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

More detailed information can be found on the FCA website at 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 or Form 20-F.

twitter.com/SmithNephewPLC facebook.com/SmithNephewPlc 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 6201 15th Avenue
Brooklyn, New York
NY 11219

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

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

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.

SMITH & NEPHEW ADS PRICE

The Company's ADS price can be obtained from the official New York Stock Exchange website at www.nyse.com, the Smith & Nephew website 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 2016 in accordance with the Securities and Exchange Commission rules 12.D.3 and 12.D.4 relating to Form 20-F filings by foreign private issuers. The depositary collects its fees for delivery and surrender of ADSs directly from investors depositing shares or surrendering ADSs for the purpose of withdrawal or from intermediaries acting for them. The depositary collects fees for making distributions to investors, including payment of dividends by the Company by deducting those fees from the amounts distributed or by selling a portion of distributable property to pay the fees. The depositary may collect its annual fee for depositary services by deductions from cash distributions or by directly billing investors or by charging the book-entry system accounts of participants acting for them. The depositary may generally refuse to provide fee-attracting services until its fee for those services are paid.

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

During 2016, a fee of one US cent per ADS was collected on the 2015 final dividend paid in May and a fee of one US cent per ADS was collected on the 2016 interim dividend paid in October. In the period 1 January 2016 to 17 February 2017, the total program payments made by Deutsche Bank Trust Company Americas were $515,910.

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				
	2016	2015	2014	2013	2012
Pence per share:					
Interim	10.080	8.533	7.578	7.211	6.811
Final[1]	14.883	13.496	13.711	11.233	11.778
Total	24.963	22.029	21.289	18.444	18.589
US cents per share:					
Interim	12.300	13.111	12.222	11.556	11.000
Final	18.500	19.000	20.667	18.889	18.000
Total	30.800	32.111	32.889	30.445	29.000

1 Translated at the Bank of England rate on 17 February 2017.

Dividends above include the associated UK tax credit of 10%, but exclude the deduction of withholding taxes, up to and including the interim dividend for 2015. From 6 April 2016, please note that dividends below £5,000 per tax year will be tax free and dividends above £5,000 per tax year will be subject to personal income tax at the rate of 7.5% for basic rate taxpayers, 32.5% for higher rate taxpayers and 38.1% for additional rate taxpayers. A self-assessment form will therefore be required. This will apply to both cash and DRIP dividends, although dividends paid on shares held within pensions and ISAs will be unaffected, remaining tax free.

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

The 2016 final dividend will be payable on 10 May 2017, subject to shareholder approval.

In respect of the proposed final dividend for the year ended 31 December 2016 of 18.5 US cents per ordinary share, the record date will be 31 March 2017 and the payment date will be 10 May 2017. 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 21 April 2017. The ordinary shares will trade ex-dividend on both the London and New York Stock Exchanges from 30 March 2017.

The proposed final dividend of 18.5 US cents per ordinary share, which together with the interim dividend of 12.3 US cents, makes a total for 2016 of 30.8 US cents.

SHARE PRICES

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

	Ordinary shares		ADSs	
	High £	Low £	High US$	Low US$
Year ended 31 December:				
2012	6.93	5.80	56.13	45.13
2013	8.68	6.80	71.85	52.90
2014[1]	11.93	8.57	97.27	29.39
2015	12.12	10.60	37.78	32.48
2016	13.10	10.51	35.06	27.11
Quarters in the year ended 31 December:				
2015:				
1st Quarter	12.00	11.13	36.85	33.44
2nd Quarter	11.95	10.72	35.80	33.68
3rd Quarter	12.03	10.68	37.78	33.24
4th Quarter	12.12	10.60	35.88	32.48
2016:				
1st Quarter	11.79	10.51	34.80	30.55
2nd Quarter	12.67	11.12	34.97	31.43
3rd Quarter	13.10	12.11	35.06	32.37
4th Quarter	12.81	10.67	32.97	27.11
2017:				
1st Quarter (to 17 February 2017)	12.37	10.51	30.78	29.90
Last six months:				
August 2016	13.00	12.24	33.81	32.73
September 2016	12.67	12.11	33.70	32.37
October 2016	12.81	11.83	32.97	29.25
November 2016	11.56	10.67	28.75	27.11
December 2016	12.21	11.06	30.08	28.07
January 2017	12.37	11.70	30.74	29.90
February 2017 (to 17 February 2017)	12.07	10.51	30.78	30.19

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

SHARE CAPITAL

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

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

Shareholdings

As at 17 February 2017, to the knowledge of the Group, there were 15,167 registered holders of ordinary shares, of whom 92 had registered addresses in the USA and held a total of 207,127 ordinary shares (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.

As at 17 February 2017, 31,428,045 ADSs equivalent to 62,856,090 ordinary shares or approximately 7.2% of the total ordinary shares in issue, were outstanding and were held by 88 registered ADS holders.

SHARE CAPITAL continued

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 17 February 2017, 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		
	17 February 2017 %	2016 %	2015 %	2014 %
BlackRock, Inc.	5.2	5.2	5.2	5.5
Invesco	4.9	4.8	5.7	5.3

		As at 31 December		
	17 February 2017 '000	2016 '000	2015 '000	2014 '000
BlackRock, Inc.	46,427	46,427	46,427	49,008
Invesco	42,635	42,034	51,539	47,508

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

Purchase of ordinary shares on behalf of the Company

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

In addition, the Company engaged in a share buy-back as a result of the divestiture of its Gynaecology business to Medtronic plc in August 2016. This buy-back programme ran from August to December 2016.

From 1 January 2016 to 17 February 2017, in the months listed below, the Company has purchased 24,832,000 ordinary shares at a cost of US$381m.

	Total shares purchased '000s	Average price paid per share pence	Approximate US$ value of shares purchased under the plan
9-19 February 2016	1,264	1,090.26	$19,956,603
24 May – 3 June 2016	1,570	1,176.15	$27,030,952
2-3 August 2016	425	1,240.85	$7,055,627
8 August – 12 December 2016	19,886	1,176.07	$301,802,068
14-19 December 2016	887	1,177.17	$13,049,081
14-16 February 2017	800	1,196.75	$11,992,307

The shares were purchased in the open market by JP Morgan Cazenove Limited and Merrill Lynch International on behalf of the Company.

Exchange controls and other limitations affecting security holders

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

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

TAXATION INFORMATION FOR SHAREHOLDERS

The comments below are of a general and summary nature and are based on the Group's understanding of certain aspects of current UK and US federal income tax law and practice relevant to the ADSs and ordinary shares not in ADS form. The comments address the material US and UK tax consequences generally applicable to a person who is the beneficial owner of ADSs or ordinary shares and who, for US federal income tax purposes, is a citizen or resident of the USA, a corporation (or other entity taxable as a corporation) created or organised in or under the laws of the USA (or any State therein or the District of Columbia), or an estate or trust the income of which is included in gross income for US federal income tax purposes regardless of its source (each a US Holder). The comments set out below do not purport to address all tax consequences of the ownership of ADSs or ordinary shares that may be material to a particular holder and in particular do not deal with the position of shareholders who directly or indirectly own 10% or more of the Company's issued ordinary shares. This discussion does not apply to (i) persons whose holding of ADSs or ordinary shares is effectively connected with or pertains to either a permanent establishment in the UK through which a US Holder carries on a business in the UK or a fixed base from which a US Holder performs independent personal services in the UK, or (ii) persons whose registered address is inside the UK. This discussion does not apply to certain investors subject to special rules, such as certain financial institutions, tax-exempt entities, insurance companies, broker-dealers and traders in securities that elect to use the mark-to-market method of tax accounting, partnerships or other entities treated as partnerships for US federal income tax purposes, US Holders holding ADSs or ordinary shares as part of a hedging, conversion or other integrated transaction or US Holders whose functional currency for US federal income tax purposes is other than the US Dollar. In addition, the comments below do not address the potential application of the provisions of the United States Internal Revenue Code, known as the Medicare contribution tax, any alternative minimum tax consequences 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 2016.

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.

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.

SHARE PRICES continued

Taxation of capital gains

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

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

Inheritance and estate taxes

The HM Revenue & Customs imposes inheritance tax on capital transfers which occur on death, and in the seven years preceding death. The HM Revenue & Customs considers that the US/UK Double Taxation Convention on Estate and Gift Tax applies to inheritance tax. Consequently, a US citizen who is domiciled in the USA and is not a UK national or domiciled in the UK will not be subject to UK inheritance tax in respect of ADSs and ordinary shares. A UK national who is domiciled in the USA will be subject to 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

Payments of dividends on, or proceeds from the sale of, ADSs or ordinary shares that are made within the USA or through certain US-related financial intermediaries generally will be subject to US information reporting, and may be subject to backup withholding, unless a US Holder is an exempt recipient or, in the case of backup withholding, provides a correct US taxpayer identification number and certain other conditions are met. 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 or closely-held entities held by individuals 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 ½% of the consideration given for the transfer with the duty rounded up to the nearest £5.

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

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

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

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

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 2016.

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.

ARTICLES OF ASSOCIATION continued

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.

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.

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GLOSSARY OF TERMS

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

Term	Meaning
ACL	The anterior cruciate ligament (ACL) is one of the four major ligaments in the human knee.
ADR	In the US, the Company's ordinary shares are traded in the form of ADSs evidenced by American Depositary Receipts (ADRs).
ADS	In the US, the Company's ordinary shares are traded in the form of American Depositary Shares (ADSs).
Advanced Surgical Devices	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.
Advanced Wound Management	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.
AGM	Annual General Meeting of the Company.
Arthroscopy	Endoscopy of the joints is termed 'arthroscopy', with the principal applications being the knee and shoulder.
ASD	Advanced Surgical Devices.
AWM	Advanced Wound Management.
Basis Point	One hundredth of one percentage point.
Chronic wounds	Chronic wounds are those with long or unknown healing times including leg ulcers, pressure sores and diabetic foot ulcers.
Company	Smith & Nephew plc or, where appropriate, the Company's Board of Directors, unless the context otherwise requires.
Companies Act	Companies Act 2006, as amended, of England and Wales.
EBITA	Earnings before interest, tax and amortisation.
EBITDA	Earnings before interest, tax, depreciation and amortisation.
Emerging Markets	Emerging Markets include Greater China, India, Brazil and Russia.
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.
Endoscopy	Through a small incision, surgeons are able to see inside the body using a monitor and identify and repair defects.
ERP	Enterprise Resource Planning: a software system which integrates internal and external management information, facilitating the flow of information across an organisation.
Established Markets	Established Markets include United States of America, Europe, Australia, New Zealand, Canada and Japan.
Euro or €	References to the common currency used in the majority of the countries of the European Union.
External fixation	The use of wires or pins transfixed through bone to hold a frame to the position of a fracture.
FDA	US Food and Drug Administration.
Financial statements	Refers to the consolidated Group Accounts of Smith & Nephew plc.
FTSE 100	Index of the largest 100 listed companies on the London Stock Exchange by market capitalisation.
GMP	Good manufacturing practice or 'GMP' is the guidance that outlines the aspects of production and testing that can impact the quality of a product.
Group or Smith & Nephew	Used for convenience to refer to the Company and its consolidated subsidiaries, unless the context otherwise requires.

GLOSSARY OF TERMS continued

Term	Meaning
Health economics	A branch of economics concerned with issues related to efficiency, effectiveness, value and behaviour in the production and consumption of health and healthcare.
IFRIC	International Financial Reporting Interpretations as adopted by the EU and as issued by the International Accounting Standards Board.
IFRS	International Financial Reporting Standards as adopted by the EU and as issued by the International Accounting Standards Board.
International Markets	International Markets include Middle East, North Africa, Southern Africa, Latin America, ASEAN, South Korea and Eastern Europe.
LSE	London Stock Exchange.
Metal-on-metal hip resurfacing	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.
Negative Pressure Wound Therapy	A technology used to treat chronic wounds such as diabetic ulcers, pressure sores and post-operative wounds through the application of sub-atmospheric pressure to an open wound.
NYSE	New York Stock Exchange.
Orthobiologics products	Any product that is primarily intended to act as a scaffold and/or actively stimulates bone growth.
Orthopaedic products	Orthopaedic reconstruction products include joint replacement systems for knees, hips and shoulders and support products such as computer-assisted surgery and minimally invasive surgery techniques. Orthopaedic trauma devices are used in the treatment of bone fractures including rods, pins, screws, plates and external frames. Clinical therapies products include joint fluid therapy for pain reduction of the knee and an ultrasound treatment to accelerate the healing of bone fractures.
OXINIUM	OXINIUM material is an advanced load bearing technology. It is created through a proprietary manufacturing process that enables zirconium to absorb oxygen and transform to a ceramic on the surface, resulting in a material that incorporates the features of ceramic and metal. Management believes that OXINIUM material used in the production of components of knee and hip implants exhibits unique performance characteristics due to its hardness, low-friction and resistance to roughening and abrasion.
Parent Company	Smith & Nephew plc.
Pound Sterling, Sterling, £, pence or p	References to UK currency. 1p is equivalent to one hundredth of £1.
Repair	A product group within ASD comprising specialised devices, fixation systems and bio-absorbable materials to repair joints and associated tissue.
Resection	Products that cut or ablate tissue within ASD comprising mechanical blades, radio frequency wands, electromechanical and hand instruments for resecting tissue.
SEC	US Securities and Exchange Commission.
Trading results	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	United Kingdom of Great Britain and Northern Ireland.
UK GAAP	Accounting principles generally accepted in the United Kingdom.
Underlying growth	Growth after adjusting for the effects of currency translation and the inclusion of the comparative impact of acquisitions and exclusion of disposals.
US	United States of America.
US Dollars, $ or cents or ¢	References to US currency. 1 cent is equivalent to one hundredth of US$1.
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.

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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 $4.7bn in 2016. 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 2016. It comprises, in a single document, the Annual Report and Accounts of the Company in accordance with UK requirements and the Annual Report on Form 20-F in accordance with the regulations of the United States Securities and Exchange Commission (SEC).

Smith & Nephew operates on a worldwide basis and has distribution channels in over 100 countries. The Group is structured as three geographical selling regions responsible for the commercial view of that region. Research & Development, Manufacturing, Supply Chain and Central functions are managed globally for the Group as a whole.

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

For the convenience of the reader, a Glossary of technical and financial terms used in this document is included on pages 193 and 194. The product names referred to in this document are identified by use of capital letters and the ◊ symbol (on first occurrence) and are trademarks owned by or licensed to members of the Group.

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 17 February 2017, the Bank of England rate was US$1.243 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', 'estimate', 'expect', 'target', 'consider' and similar expressions are generally intended to identify forward-looking statements. Forward-looking statements involve known and unknown risks, uncertainties and other important factors that could cause actual results, to differ materially from what is expressed or implied by the statements.

For Smith & Nephew, these factors include: economic and financial conditions in the markets we serve, especially those affecting 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 169 to 172 of this Annual Report. Any forward-looking statement is based on information available to Smith & Nephew as of the date of the statement. All written or oral forward-looking statements attributable to Smith & Nephew are qualified by this caution. Smith & Nephew does not undertake any obligation to update or revise any forward-looking statement to reflect any change in circumstances or in Smith & Nephew's expectations.

PRODUCT DATA

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

DOCUMENTS ON DISPLAY

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

The inks used are renewable, biodegradable and emit fewer Volatile Organic Compounds (VOCs) than mineral-oil inks. They are based on high levels of renewable raw materials such as vegetable oils and naturally occurring resin. The inks do not contain any toxic heavy metals and therefore, do not pose a problem if placed in landfill.

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