SMITH & NEPHEW PLC
Form 20-F
March 03, 2011

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 20-F

(Mark One)

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

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2010

or

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

¨ **SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
Commission file number 1-14978

Smith & Nephew plc

(Exact name of Registrant as specified in its charter)

England and Wales

(Jurisdiction of incorporation or organization)

15 Adam Street, London WC2N 6LA

(Address of principal executive offices)

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

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

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

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

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

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

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

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

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

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

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

Large Accelerated Filer x Accelerated Filer ¨ Non-accelerated filer ¨

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

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

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

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

INTRODUCTION AND FINANCIAL SUMMARY

The Smith & Nephew Group (the Group) is a global medical devices business operating in the markets for orthopaedic reconstruction and trauma, endoscopy (which includes arthroscopic procedures referred to as sports medicine) and advanced wound management, with revenue of approximately $4 billion in 2010. 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 2010. 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 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 page 152. The product names referred to in this document are identified by use of capital letters and are trademarks owned by or licensed to members of the Group.

Financial Summary

	2010	2009	2008
Financial Highlights (i) (iii)	**$ million**	**$ million**	**$ million**
Revenue	3,962	3,772	3,801
Underlying growth in revenue (%)	*4%*	*2%*	*6%*
Trading profit	*969*	*857*	*776*
Underlying growth in trading profit (%)	*11%*	*15%*	*6%*
Trading profit margin (%)	*24.5%*	*22.7%*	*20.4%*
Operating profit	920	723	630
Attributable profit for the year	615	472	377
Adjusted attributable profit	*654*	*580*	*493*
Basic earnings per Ordinary Share	69.3¢	53.4¢	42.6¢
EPSA	*73.6¢*	*65.6¢*	*55.6¢*
Growth in EPSA (%)	*12%*	*18%*	*7%*
Dividends per Ordinary Share (ii)	15.82¢	14.39¢	13.08¢
Cash generated from operations	1,111	1,030	815
Trading cash flow	*825*	*771*	*612*
Trading profit to cash conversion (%)	*85%*	*90%*	*79%*

(i) Items shown in italics are non-GAAP measures. Reconciliations to reported figures are on pages 24 to 27.

(ii)

The Board has proposed a final dividend of 9.82 US cents per share which together with the first interim dividend of 6.00 US cents makes a total for 2010 of 15.82 US cents. The final dividend is expected to be paid, subject to shareholder approval, on 19 May 2011 to shareholders on the Register of Members at the close of business on 3 May 2011.

(iii) All items are $ million unless otherwise indicated.

Key Performance Indicators

The Directors Report includes a number of measures that management use as key performance indicators including those financial performance indicators set out in the Financial Summary above. A discussion of the reasons for, calculation and limitations of the key financial performance indicators is set out below.

The Group is focused on continued delivery of sustainable profitable growth through four strategic pillars Customer led , Efficient , Investing for growth and Aligned as explained on page 4 of this document.

From these four strategic pillars, a scorecard has been developed which identifies the specific functional strategic imperatives for each part of the Group. The performance against the scorecard is evaluated against a series of financial and non-financial indicators and measures.

The principal key financial performance indicators used in the scorecard, which measure performance against the Group s strategic pillars, are:

(i) Underlying growth in revenue

Underlying growth in revenue is used to compare the revenue in a given year to the previous year on a like-for-like basis. This is achieved by adjusting for the impact of sales of products acquired in material business combinations and for movements in exchange rates. Underlying growth in revenue is not presented in the accounts prepared in accordance with International Financial Reporting Standards (IFRS) and is therefore not a Generally Accepted Accounting Principle (a non-GAAP measure). An explanation of how this non-GAAP measure is calculated is presented in the Business Overview on page 24.

The Group believes that the tabular presentation and reconciliation of reported revenue growth to underlying revenue growth assists investors in their assessment of the Group s performance in each business segment and for the Group as a whole.

Underlying growth in revenue is considered by the Group to be an important measure of performance in terms of local functional currency since it excludes those items considered to be outside the influence of local management. The Group s management uses this non-GAAP measure in its internal financial reporting, budgeting and planning to assess performance on both a business segment and a consolidated Group basis. Revenue growth at constant currency is important in measuring business performance compared to competitors and compared to the growth of the market itself.

The Group considers that revenue from sales of products acquired in material business combinations results in a step-up in growth in revenue in the year of acquisition that cannot be wholly attributed to local management s efforts with respect to the business in the year of acquisition. Depending on the timing of the acquisition, there will usually be a further step change in the following year. A measure of growth excluding the effects of business combinations also allows senior management to evaluate the performance and relative impact of growth from the existing business and growth from acquisitions. The process of making business acquisitions is directed, approved and funded from the Group corporate centre in line with strategic objectives.

The material limitation of the underlying growth in revenue measure is that it excludes certain factors, described above, which ultimately have a significant impact on total revenues. The Group compensates for this limitation by taking into account relative movements in exchange rates in its investment, strategic planning and resource allocation. In addition, as the evaluation and assessment of business acquisitions is not within the control of local management, performance of acquisitions is monitored centrally until the business is integrated. The Group s management considers that the non-GAAP measure of underlying growth in revenue and the GAAP measure of growth in revenue are complementary measures, neither of which management uses exclusively.

(ii) Trading profit and trading profit margin

Growth in trading profit and trading profit margin (trading profit expressed as a percentage of revenue) are measures which present the growth trend in the long-term profitability of the Group excluding the impact of specific transactions or events that management considers affect the Group s short-term profitability. The Group presents these measures to assist investors in their understanding of trends. The Group s internal financial reporting (budgets, monthly reporting, forecasts, long-term planning and incentive plans), focuses primarily on profit and earnings before these items. Trading profit and trading profit margin are not recognised measures under IFRS and are therefore non-GAAP financial measures.

The Group has identified the following items, where material, as those to be adjusted and identified separately: acquisition and disposal related items including amortisation of acquisition intangible assets and impairments; significant restructuring events; gains and losses arising from legal disputes and uninsured losses; and taxation thereon. An explanation of how trading profit is calculated is presented in Business Overview on page 25.

The material limitation of these measures is that they exclude significant income and costs that have a direct impact on current and prior years profit attributable to shareholders. They do not, therefore, measure the overall performance of the Group presented by the GAAP measures of earnings per share and operating profit. The Group considers that no single measure enables it to assess overall performance and therefore it compensates for the limitation of the adjusted earnings per share and trading profit measures by considering them in conjunction with their GAAP equivalents. The gains or losses which are identified separately arise from irregular events or transactions. Such events or transactions are authorised centrally and require a strategic assessment which includes consideration of financial returns and generation of shareholder value. Amortisation of acquisition intangibles will occur each year, whilst other excluded items arise irregularly depending on the events that give rise to such items.

(iii) Adjusted earnings per ordinary share

Growth in adjusted earnings per ordinary shares (EPSA) is another measure which presents the trend growth in the long-term profitability of the Group. EPSA is not a recognised measure under IFRS and is therefore a non-GAAP financial measure.

EPSA excludes the same impact of specific transactions or events that management considers affect the Group s short-term profitability as set out and discussed in the section on trading profit above, including the material limitations of such measures. A reconciliation of adjusted attributable profit, which represents the numerator used in the EPSA calculation, to attributable profit is presented in Business Overview on page 26.

(iv) Trading cash flow and trading profit to cash conversion ratio

Growth in trading cash flow and improvement in the trading profit to cash conversion ratio are measures which present the trend growth in the long-term cash generation of the Group excluding the impact of specific transactions or events that management considers affect the Group s short-term performance.

Trading cash flow is defined as cash generated from operations less net capital expenditure but before acquisition related cash flows, restructuring and rationalisation cash flows and cash flows arising from legal disputes and uninsured losses. Trading profit to cash conversion ratio is trading cash flow expressed as a percentage of trading profit. The nature and material limitations of these adjusting items are discussed in the sections above.

The Group presents these measures to assist investors in their understanding of trends. The Group s internal financial reporting (budgets, monthly reporting, forecasts, long-term planning and incentive plans) focuses on cash generation before these items. Trading cash flow and trading profit to cash conversion ratio are not recognised measures under IFRS and are therefore considered non-GAAP financial measures. A reconciliation of trading cash flow to cash generated from operations is presented in Business Overview on page 27.

The material limitation of this measure is that it could exclude significant cash flows that have had a direct impact on the current and prior years financial performance of the Group. It does not, therefore, measure the financial performance of the Group presented by the GAAP measure of cash generated from operations. The Group considers that no single measure enables it to assess financial performance and therefore it compensates for the limitation of the trading cash flow measure by considering it in conjunction with the GAAP equivalents. Cash flows excluded relate to irregular events or transactions including acquisition related costs, restructuring and rationalisation costs and cash flows arising from legal disputes and uninsured losses.

Presentation

The Group s fiscal year end is 31 December. References in this Annual Report to a particular year 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 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 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. Except as where stated otherwise, the translation of US Dollars and cents to Sterling and pence appearing in this Annual Report has been made at the Bank of England exchange rate on the date indicated. On 23 February 2011, the Bank of England rate was US$1.6238 per £1.

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. In particular, statements regarding expected revenue growth and trading margins discussed under Outlook and Trend Information , 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-lookin 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, payors 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 integrating acquired businesses; and numerous other matters that affect us or our markets, including those of a political, economic, business or competitive nature. Specific risks faced by the Group are described under Risk Factors on page 18 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.

Market Data

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

Documents on Display

It is possible to read and copy documents referred to in this Annual Report at the Registered Office of the Company. Documents referred to in this Annual Report that have been filed with the Securities and Exchange Commission in the US may be read and copied at the SEC s public reference room located at 450 Fifth Street, NW, Washington DC 20549. Please call the SEC at 1-800-SEC-0330 for further information on the public reference rooms and their copy charges. The SEC also maintains a web site at www.sec.gov 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.

Description of the Group

Business Review, Liquidity and Prospects

Corporate Governance Statement

Directors Remuneration Report

Group Accounts

Company Accounts

Investor Information

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DESCRIPTION OF THE GROUP

This section discusses the activities, resources and operating environment of the business under the following headings:

Discussion of the Group s operating and financial performance, liquidity and financial resources for 2010 and 2009 is given in the Business Review, Liquidity and Prospects section (pages 23 to 44).

Discussion of the Group s management structure and corporate governance procedures is set out in the Corporate Governance Statement section (pages 45 to 57).

The Directors Remuneration Report gives details of the Group s policies on senior management s remuneration in 2010 (pages 59 to 71).

Details of the structure of the Company s share capital and securities, persons with significant shareholdings in the Company and a summary of the articles of association are incorporated into the Directors Report and are given in Investor Information (pages 135 to 149).

THE BUSINESS

HISTORY AND DEVELOPMENT

Group Strategy

Smith & Nephew s overall vision is to help improve people's lives by repairing and healing the human body. To achieve this, the Group is focused on continued delivery of sustainable profitable growth, through four strategic pillars:

Customer led : outperforming our served markets by focusing on our customers; anticipating and innovating to deliver on their needs.

Efficient : delivering operating margin improvement and freeing up resources to invest in the business, through streamlining process and systems re-engineering.

Investing for growth : driving additional sales from new opportunities such as emerging markets, biologics and adjacent technologies.

Aligned : aligning objectives across the business and developing our talent and organisation for consistent execution, through leveraging core functions and sharing best practices.

Group History

The Group has a history dating back over 150 years to the family enterprise of Thomas James Smith who opened a small pharmacy in Hull, England in 1856. On 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, including various medical devices, personal care products and traditional and advanced woundcare 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.

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.

Recent Developments

On 10 February 2011, the Group announced that David Illingworth will retire from the Board and as Chief Executive, at the Annual General Meeting on 14 April 2011. It was also announced that Olivier Bohuon will join the Board as an executive director on 1 April 2011. He will offer himself for re-election by the shareholders at the Annual General Meeting and, subject to his re-appointment, shall assume the position of Chief Executive Officer at the conclusion of the Annual General Meeting on 14 April 2011.

In December 2010, the Group reviewed and replaced its principal banking facilities ahead of their maturity in May 2012. The Group has reduced its $1 billion 5 year term loan to $500 million with effect from 20 December 2010. Smith & Nephew has also cancelled its $1.5 billion multi-currency revolving loan facility and replaced it with a new 5-year $1 billion multi-currency revolving loan facility.

BUSINESS DESCRIPTION

Organisation

Smith & Nephew is organised into three primary Global Business Units (GBUs), which are also our reporting segments: Orthopaedics, Endoscopy and Advanced Wound Management. Included within the Orthopaedics segment are our biologics activities, which comprise research and development projects under the direction of a Committee representing all GBUs.

Smith & Nephew operates on a worldwide basis and has distribution channels in over 90 countries. In the more established countries by revenue, the Group s business operations are organised by GBU. In the majority of the remaining markets, operations are managed by country managers who are responsible for sales and distribution of the Group s product range. These comprise the emerging markets unit.

A head office team in London, England directs the overall business and supports the business units, primarily in the areas of business development, legal, company secretarial, finance, human resources and investor relations.

Orthopaedics

Overview

Orthopaedics comprises reconstruction, trauma and clinical therapies products.

The Orthopaedics business is managed worldwide from Memphis, Tennessee, the site of its main development and manufacturing facility, with a European headquarters in Baar, Switzerland. Products are also manufactured at smaller facilities in Switzerland, Germany, and the UK as well as by third-party manufacturers. A new facility has been constructed in Beijing, China.

Products

Orthopaedic reconstruction implants include hip, knee and shoulder joints as well as ancillary products such as bone cement. Orthopaedic trauma fixation products consist of internal and external devices and other products, including shoulder fixation and orthobiological materials used in the stabilisation of severe fractures and deformity correction procedures. Clinical therapies products are those that are applied in an orthopaedic office or a clinic setting and include bone growth stimulation and joint fluid therapies.

Knee Implant Systems The Orthopaedics business offers a range of products for specialised knee procedures. The LEGION/GENESIS II Total Knee System is a comprehensive system designed to allow surgeons to address a wide range of knee procedures from primary to revision. LEGION TKS features VERILAST Technology, an advanced bearing surface. The JOURNEY Active Knee Solutions, a family of advanced, customised products designed to treat early to mid-stage osteoarthritis patients, provides more normal feeling and motion through bone ligament preservation and anatomic replication. Other knee systems include the PLUS Solution Knee Family and PROFIX Knee. Our LEGION/GENESIS II and JOURNEY also utilise VISONAIRE Patient-Matched Instrumentation, a new technology platform of patient-matched cutting blocks for total knee procedures.

Hip Implant Systems The Orthopaedics business offers a broad range of hip replacement systems. In particular, the R3 Acetabular System includes a modular acetabular cup that provides a variety of advanced bearings within a single system. The BIRMINGHAM HIP Resurfacing System is a system for hip resurfacing, a bone conserving approach, which utilises proven low wear metal-on-metal bearing surface technology. Other hip systems include the SYNERGY Hip System, ANTHOLOGY Hip System and the SL-PLUS Hip Family System.

Bearing surfaces The Orthopaedics business utilises a range of bearing surfaces in its implant systems, including its proprietary OXINIUM Technology. Oxidised zirconium, branded OXINIUM, combines the enhanced wear resistance of a ceramic bearing with the superior durability of a metallic bearing. When combined with highly cross-linked polyethylene (XLPE) it results in our VERILAST Technology. LEGION Primary Knee, with VERILAST Technology, is the only knee system with a 30 year wear performance claim approved by the United States Food and Drug Administration (FDA) more than double the performance expectation for wear compared to conventional technologies.

Trauma Implant Systems The principal fixation products are the TRIGEN Intramedullary Nailing system, TRIGEN Meta Nail with expanded fixation and technique options, TRIGEN INTERTAN Intertrochanteric Antegrade nails for hip fractures, TRIGEN SURESHOT Distal Targeting System for Intramedullary Nailing and PERI-LOC Periarticular Locked Plating system which offers a comprehensive family of fracture specific plate and screw products for the upper and lower extremity.

For external fixation and limb restoration, Orthopaedics offers the TAYLOR SPATIAL FRAME Circular Fixation System and JET-X Unilateral Fixator.

Clinical therapies The principal clinical therapies products offered include the EXOGEN Ultrasound Bone Healing System which utilises low-intensity pulsed ultrasound to accelerate the healing of fresh fractures and to heal non unions. DUROLANE Joint Fluid Therapy and SUPARTZ Joint Fluid Therapy are non-surgical, non-pharmacological pain-relieving therapies for osteoarthritis of the knee.

Strategy

Orthopaedics maintains its commitment to being customer-led by focusing on product innovation, sales excellence and physician education. Whether through extending the life of implants, improving operating room efficiency, or promoting faster healing, Smith & Nephew s innovations differentiate it and provide solutions to active patients seeking to regain quality of life while enhancing economic value for customers. Orthopaedics provides peer-to-peer medical education, through KLEOS, tailored to individual surgeon needs utilising the world s top orthopaedic specialists and key opinion leaders. KLEOS is a medical education platform which offers seminars, fellowships, instructional videos and literature reviews.

The Orthopaedics business efficiency programmes continue to deliver savings to the business. The current programmes are focused on improving inventory utilisation, reducing sourcing costs, improving manufacturing efficiency, reducing overhead costs and ensuring continual efficiency improvement.

The emerging markets continue to be an important component of investing for growth, China in particular remains a focus with several milestones achieved in 2010 including opening a new manufacturing facility near Beijing, integration of product development teams into the franchises, and opening of three surgical training centres. Outside China, Orthopaedics is investing in sales teams in other emerging markets, extending physician training via KLEOS, developing tailored products to meet local needs and improving local infrastructure and logistics.

The Orthopaedics business aligns its organisation and develops its talent for consistent execution on the Group s plans. Compensation for executives, managers and staff are carefully aligned to the execution of their objectives.

New Products

In Trauma, Orthopaedics launched the TRIGEN SURESHOT Distal Targeting System for Intramedullary Nailing which simplifies the surgical technique, reducing surgery time and fluoroscopic X-ray exposure. The VLP Foot and Ankle plating system, a comprehensive plate and screw system to manage fractures in the foot and ankle was also launched in the year bringing the advantages of variable angle plating to a rapidly growing segment of the market.

Reconstructive Orthopaedics continued the commercialisation of its VISIONAIRE Patient-Matched Instrumentation. With VISIONAIRE, the patient s MRI and X-rays are used to create customised cutting blocks that allow the surgeon to achieve optimal mechanical axis alignment as well as saving time and reducing instruments in the operating room.

Regulatory Approvals

In 2010, several significant regulatory product and claims approvals were obtained around the globe.

In the US the SURESHOT Distal Targeting System for TAN Intramedullary Nails and accessories was approved. In Japan, the LEGION TKS Posterior Stabilized and Revision Systems, 12/14 Taper OXINIUM Femoral Heads, the PERI-LOC Titanium Plating System, and ECHELON Titanium Hip Stems were all approved. In the EU, we also received approval for the SURESHOT Distal Targeting System and VISIONAIRE Patient Matched Cutting Blocks. Also, in the EU, DUROLANE was approved for treatment of mild to moderate osteoarthritis in a broader range of joints and following joint arthroscopy.

In the US, the Orthopaedics business received 510(k) clearance from the FDA for VERILAST Technology wear claims for an estimated 30 years of normal use for the LEGION Primary Knee system.

Around the globe, 20 additional approvals and clearances were obtained, including amongst others: BHR instrument upgrades, R3 Acetabular system additions, VLP FOOT Plating Screw System and accessories, the JOURNEY Select Knee System and LEGION Porous Plus HA primary Femoral Components.

In Europe, regulatory approval was secured for EXOGEN for use on all osseous defects and DUROLANE for osteoarthritis pain relief in all synovial joints and for pain relief post arthroscopic surgery.

Seasonality

Orthopaedic reconstruction revenues are lower in the third quarter of any year due to fewer elective surgeries in the summer and higher in the fourth quarter as elective surgeries increase. Reconstructive trauma revenues are generally highest in the fourth quarter caused to a large extent by the relatively high number of accidents and sports related injuries which occur in the autumn and winter seasons in North America and Europe.

Market and Competition

Smith & Nephew estimates that the worldwide orthopaedic market, excluding clinical therapies, served by the Group grew by approximately 4% in 2010 and is currently worth approximately $17 billion per annum worldwide. Management believes that the Smith & Nephew Orthopaedics business holds an 11% share of this market by value. Principal global competitors in orthopaedics are Zimmer, Stryker, DePuy/Johnson & Johnson, Synthes and Biomet.

In 2010, weaker economic conditions worldwide continued to create several challenges for the overall orthopaedic market, including increased deferrals of joint replacement procedures and heightened pricing pressures. These factors contributed to the lower overall growth of the worldwide orthopaedic market compared to historic comparables. However, over the medium-term, several catalysts are expected to continue to drive sustainable growth in orthopaedic device sales, including the growing, ageing population, rising rates of co-morbidities such as obesity and diabetes, technology improvements allowing surgeons to treat younger, more active patients, and the increasing

strength of the demand for healthcare in emerging markets. Both the orthopaedic trauma and clinical therapies markets are expected to continue to grow due to a global population increasingly at risk from fractures due to age, osteoporosis, obesity and diabetes and also due to continuous advancements in the surgical treatment of fractures, and the need to manage pain in younger, more active patients.

Management estimates that the worldwide market for clinical therapies increased by 6% in 2010 and is currently worth more than $1.7 billion per annum. Smith & Nephew s primary market for clinical therapies is in the US. In the US long bone stimulation market management estimates Smith & Nephew s share to be 40%. Principal competitors are Biomet, DJ Ortho and Orthofix. In the US joint fluid therapies market, management estimates that Smith & Nephew maintains a share of 14%. The principal competitors are Genzyme, Sanofi Aventis, DePuy/Johnson & Johnson and Ferring Pharmaceuticals.

Endoscopy

Overview

Smith & Nephew s Endoscopy business develops and commercialises endoscopic (minimally invasive surgery) techniques, educational programmes and value-added services for surgeons to treat and repair soft tissue and articulating joints. The business focuses on the arthroscopy or sports medicine sector of the endoscopy market. Arthroscopy is the minimally invasive surgery of joints, in particular the knee, shoulder and hip.

The Endoscopy business is headquartered in Andover, Massachusetts and manufacturing facilities are currently located in Mansfield, Massachusetts, and Oklahoma City, Oklahoma. Major service centres are located in the US, the UK, Germany, Japan and Australia.

Products

The Endoscopy business offers surgeons endoscopic technologies for surgery of the joints and ligament repair, including: specialised devices and fixation systems to repair damaged tissue; fluid management equipment for surgical access; digital cameras, digital image capture, scopes, light sources and monitors to assist with visualisation; radiofrequency wands, electromechanical and mechanical blades, and hand instruments for resecting damaged tissue.

Key products in repair are FAST-FIX for meniscal repair, ENDOBUTTON for cruciate fixation, and the FOOTPRINT Suture Anchor for rotator cuff repair. Key products in resection are the wide range of DYONICS shaver blades, ACUFEX handheld instruments, and a range of radiofrequency probes. The key product in Visualisation is the DYONICS 560 HD camera.

Strategy

Smith & Nephew s strategic intent is to grow the business as the leading provider of endoscopic techniques and technologies for joint and ligament repair. Management believes that the business capitalises on the growing acceptance of endoscopy as a preferred surgical choice among physicians, patients and payors, enhanced by a customer-led approach to growing the arthroscopy market.

To sustain growth and enhance its market position, the Endoscopy business supports its strategy with investment in surgeon education programmes, global fellowship support initiatives, partnerships with professional associations and surgeon advisory boards. The emerging markets, especially China, are expected to be a major driver of growth in future, and the business is also investing funds to accelerate this growth.

The business has a commitment to, and track record of, driving efficiencies, through a formal operational excellence programme as well as a culture of continuous process improvement.

The Endoscopy business aligns its organisation to ensure all employees are working on common objectives, and to ensure consistent execution against the Group s wider objectives.

New Products

In 2010, Smith & Nephew continued to expand its arthroscopic sports medicine portfolio with the launch of several new repair and resection products.

The BIORAPTOR Knotless Suture Anchor is a device used to repair a torn labrum in the hip and shoulder. The ease of use provided by this knotless arthroscopic device provides surgeons with full control over suture tension a critical element in the procedure.

BIOSURE SYNC Tibial Fixation System is designed to address the need for strong fixation on the tibial side of ACL reconstruction. It employs a sheath and screw to achieve a 360° graft-to-bone contact throughout the tibial tunnel and can accommodate a variety of arthroscopic ligament reconstruction techniques.

The TWINFIX and FOOTPRINT suture anchor product lines were enhanced through the incorporation of ULTRABRAID suture, which provides stronger knot strength and a low profile knot stack. Both are designed to provide easy, secure and strong repairs with precise control over final tensioning and are available in a wide variety of materials and sizes.

Recent Regulatory Approvals

During 2010, the Endoscopy business obtained regulatory clearances for the following products in most major markets, except Japan where the approval process is more lengthy: FOOTPRINT Ultra PK, BIOSURE SYNC, TWINFIX Ultra HA, and TWINFIX Ultra Ti, all designed for the reattachment of ligaments, tendons or soft tissues to bone in knees, shoulders or other articulating joints; and various other arthroscopy instruments, devices and sterilisation trays. In Japan, regulatory approvals included ENDOBUTTON CL Ultra, Ultra FAST-FIX KINSA RC and various TWINFIX suture anchors.

Seasonality

Smith & Nephew s Endoscopy revenues are generally at their highest in the fourth quarter of any year. This is caused to a large extent by the relatively high number of accidents and sports related injuries which occur in the autumn and winter seasons in North America and Europe.

Market and Competition

Management estimates that the global arthroscopy market in which the business principally participates is worth more than $3 billion a year and has recently been growing between 8% and 12% annually. Arthroscopy growth rates are driven by increasing numbers of sports injuries, longer and more active lifestyles, patient desire for minimally invasive procedures, innovative technological developments and a need for cost-effective procedures. The arthroscopy market has a particular focus on arthroscopic repair of the knee and shoulder using a broad range of technology. The Group also expects to benefit from the demand for less invasive approaches to arthroscopic hip repair.

Management believes that Smith & Nephew has a 22% share of the global arthroscopy market as at 31 December 2010. Smith & Nephew s main competitors in the global arthroscopy market in 2010 were Arthrex, Mitek/Johnson & Johnson, Stryker, Arthrocare and Linvatec/Conmed.

Advanced Wound Management

Overview

Smith & Nephew s Advanced Wound Management business offers a range of products from initial wound bed preparation through to full wound closure. These products are targeted at chronic wounds associated with the older population, such as pressure sores and venous leg ulcers. There are also products for the treatment of wounds such as burns and invasive surgery that impact the wider population.

The Advanced Wound Management business has its global headquarters in Hull, England and its North American headquarters in St Petersburg, Florida. The products are manufactured at facilities in Hull and Gilberdyke, England, Suzhou in China, and also by third party manufacturers around the world.

Products

The main products within the Advanced Wound Management business are for exudate management, predominantly the ALLEVYN brand, infection management, including the ACTICOAT brand and Negative Pressure Wound Therapy (NPWT).

The ALLEVYN hydrocellular dressings range has been considerably enhanced by new versions, introduced in recent years, which management believes provide efficient fluid management and an optimal moist wound environment that promotes faster healing of the wound, reduced risk of maceration and protection from infection. The range includes ALLEVYN Ag, a range of dressings combining the infection management capabilities of silver with ALLEVYN.

The ACTICOAT range incorporates the smallest crystallised silver used in the treatment of wounds and burns. The silver reduces the risk of bacterial colonisation and acts to kill micro-organisms that can cause infection and prevent or delay healing.

NPWT delivers vacuum-assisted pressure to help promote healing. NPWT consists of a wound dressing, a drainage tube, and a transparent film that is connected to a suction device. Smith & Nephew offers the RENASYS EZ and RENASYS GO pump systems together with a range of foam and gauze dressing kits.

Advanced Wound Management also offers a range of other advanced products including films, such as OPSITE and IV3000, skin care treatments and gels.

Strategy

Advanced Wound Management s strategy is to be customer-led and invest for growth by focusing on high growth, high value segments, in particular exudate and infection management, through improved wound bed preparation, moist and active healing and penetration of the NPWT market.

There has been a continued focus on operational efficiency and excellence. Since 2007, efficiency improvements have been delivered through various projects including support function consolidation, outsourcing of manufacturing to low cost suppliers, distribution rationalisation projects and the start of manufacturing in Suzhou, China.

An aligned approach across the GBU is designed to ensure that our employees are developed and work on common objectives to deliver consistent execution of the Group s plan.

New Products

During 2010, the ALLEVYN hydrocellular dressings range was extended further, reinforcing our position as the company offering what we believe is the most comprehensive foam dressing solutions with the addition of ALLEVYN Lite. This new addition has the efficient fluid management properties of the existing ALLEVYN dressings and reduces pain on dressing removal for the patient, whilst improving comfort and wear through anatomical design.

The infection management portfolio was expanded in Japan in 2010, with further improvements to the already successful CADEX product and our first silver dressing entry in the market with ALGISITE Ag, giving a strong portfolio for future growth in the region.

Recent Regulatory Approvals

During 2010, Advanced Wound Management secured approval for a new formulation of No Sting SKIN PREP, ALGISITE Ag in Japan, OPSITE Visible Drain dressing and NPWT dressing kits with ports in the EU and US. A new more conformable version of ALLEVYN Gentle Border, ALLEVYN Gentle Border Lite, was also approved in the EU and the US.

Approval was obtained in the EU and US for the manufacture of the complete range of ACTICOAT dressings at Advanced Wound Management s Hull facility following transfer of conversion and packaging from Alberta and for the manufacture of OPSITE Post Op Visible in Suzhou.

We secured our first licence to sell domestically manufactured products in China following the transfer of ALLEVYN Adhesive manufacture to the Suzhou facility.

Seasonality

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

Market and Competition

Management estimates that the sales value of the advanced wound management market worldwide was $5.2 billion in 2010, an underlying increase of just under 4% from 2009. During 2010, the market growth rate slowed slightly due to the weaker economic conditions. The advanced wound management market is focused on the treatment of chronic wounds of the older population and other hard-to-heal wounds such as burns and certain surgical wounds and is therefore also expected to benefit from demographic trends. Growth is driven by an ageing population and by a steady advance in technology and products that are more clinically efficient and cost effective than their conventional counterparts. The market for advanced wound treatments is relatively unpenetrated and it is estimated that the potential market is significantly larger than the current market. Management believes that the market will continue the trend towards advanced wound products with its ability to accelerate healing rates, reduce hospital stay times and cut the cost of clinician and nursing time as well as aftercare in the home.

Management estimates that Smith & Nephew had a 18% share of the advanced wound management market as at 31 December 2010. Worldwide competitors in advanced wound management in 2010 include Convatec, Mölnlycke, Systagenix and Kinetic Concepts, who are active exclusively in the NPWT market.

OPERATING ACTIVITIES

SALES AND MARKETING

Smith & Nephew s customers are the providers of medical and surgical services worldwide. In certain parts of the world, including the UK, much of Continental Europe, Canada and Japan, these are largely government organisations funded by tax revenues. In the US, the Group s major customers are public and private hospitals, which receive revenue from private health insurance and government reimbursement programmes. Medicare is the major source of reimbursement in the US, for knee and hip reconstruction procedures and for wound healing treatment regimes.

Competition exists among healthcare providers to gain patients on the basis of quality, service and price. Providers are under pressure to reduce the total cost of healthcare delivery. There has been some consolidation in the Group s customer base, as well as amongst the Group s competitors, and these trends are expected to continue in the long term. Smith & Nephew competes against both specialised and multinational corporations, including some with greater financial, marketing and other resources.

The Group s customers reflect the wide range of distribution channels, purchasing agents and buying entities in over 90 countries worldwide. The largest single customers worldwide are the National Health Service in the UK and the Heath Trust Purchasing Group in the US. These represented 6% and 5% respectively of the Group s worldwide revenue in 2010.

In the US, the Group s products are marketed directly to care givers, hospitals and other healthcare facilities with each business unit operating a separate specialised sales force. The US sales forces consist of a mixture of independent commissioned sales agents and direct employees. The independent agents are contractually not permitted to sell products that compete with Smith & Nephew s. Orthopaedics and Endoscopy products are principally shipped and invoiced directly to the ultimate customer. Advanced Wound Management products are marketed directly to the ultimate customer. The products are shipped and invoiced to a number of wholesale distributors. In most other direct markets, the business units typically manage employee sales forces directly, and also ship and invoice products both directly to the ultimate customer and to wholesale distributors.

The emerging markets unit comprises direct selling and marketing operations, directly and through distributors, in India, China, Hong Kong, South Korea, Malaysia, Singapore, Thailand, the United Arab Emirates and South Africa. In these markets, Orthopaedics and Endoscopy frequently share sales resources. The Advanced Wound Management sales force may be separate where it calls on different customers. In countries not covered by the emerging markets unit, Smith & Nephew typically sells to third party distributors which market the Group s products locally.

MANUFACTURING, SUPPLY AND DISTRIBUTION

The Group has a central Global Operations function which continues to implement Lean manufacturing throughout the factories and the supply chain which is designed to improve and sustain higher levels of productivity, quality, service and efficiency. Core competencies include: materials technology; high precision machining in Orthopaedics and Endoscopy; and high-volume, automated manufacturing in Advanced Wound Management.

Each business unit purchases raw materials, components, finished products and packaging materials from certain key suppliers. These principally include metal forgings and stampings for Orthopaedics, optical and electronic sub-components and finished goods for Endoscopy, active ingredients and finished goods for Advanced Wound Management and packaging materials across all businesses. Suppliers are selected, and contracts negotiated, by a centralised Group procurement team wherever possible, with a view to ensure value for money based on the total spending across the Group.

The Group outsources manufacturing where necessary to obtain specialised expertise or where it is possible to gain lower cost without risk to intellectual property. Suppliers of outsourced products and services are selected based on their ability to deliver products and services to specification, and establish and maintain a quality system. Suppliers are trained and are monitored through on-site assessments and performance audits that include quality, service and delivery. Finished goods purchased for resale include SUPARTZ and DUROLANE joint fluid therapy products in the Orthopaedics business and screen displays, optical and electrical devices in the Endoscopy business.

The Group operates a number of central distribution facilities in the key geographical areas in which it operates. Orthopaedics and Endoscopy operate a facility in Baar, Switzerland which acts as the main holding and consolidation point for markets in Europe. Hubs serving the US are located in Memphis, US for Orthopaedics and Oklahoma City, US for Endoscopy. Products are shipped to Group companies who hold small amounts of inventory locally for immediate or urgent customer requirements. Advanced Wound Management distribution hubs include: Neunkirchen, Germany; Nottingham, England; and Atlanta, US.

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, England	15
Group research facility in York, England	83
Orthopaedics headquarters and manufacturing facilities in Memphis, Tennessee, US	1,052
Orthopaedics distribution facility in Memphis, Tennessee, US	210
Orthopaedics manufacturing facility in Aarau, Switzerland	117
Orthopaedics manufacturing facility in Beijing, China (Linhe)	21
Orthopaedics manufacturing facility in Beijing, China	192
Orthopaedics manufacturing and warehouse facility in Warwick, England	90
Orthopaedics manufacturing and warehouse facility in Tüttlingen, Germany	63
Orthopaedics and Endoscopy distribution facility and Orthopaedics European headquarters in Baar, Switzerland	63
Orthopaedics Biologics/ Global Operations headquarters in Durham, North Carolina, US	27
Endoscopy headquarters in Andover, Massachusetts, US	144
Endoscopy manufacturing facility in Mansfield, Massachusetts, US	98
Endoscopy manufacturing and distribution facility in Oklahoma City, Oklahoma, US	155
Advanced Wound Management headquarters and manufacturing facility in Hull, England	439
Advanced Wound Management manufacturing facility in Gilberdyke, England	70
Advanced Wound Management manufacturing facility in Suzhou, China	144
Advanced Wound Management manufacturing facility in Alberta, Canada	76
Advanced Wound Management US headquarters in St. Petersburg, Florida, US	44

The Group Global Operations strategy includes ongoing assessment of the optimal facility footprint. The Orthopaedics headquarters and manufacturing facilities in Memphis, Tennessee are largely freehold, a portion of Tuttlingen and the Advanced Wound Management facilities in Hull and Gilberdyke 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.

In 2010, Orthopaedics purchased a building in Cordova, Tennessee which will be its new headquarters and sales training building, and is exiting a smaller leasehold office facility in 2011. The Group closed the manufacturing facility in Largo, Florida during 2009 and outsourced or relocated its manufacturing output the building was sold in 2010. The Orthopaedics business has opened the new factory in Beijing, China, and the facility in Linhe is expected to close at the end of 2011. The Beijing factory will supply implants to the local market and orthopaedic instruments for export.

RESEARCH AND DEVELOPMENT

The global business units each manage a portfolio of short and long-term product development projects designed to meet the future needs of customers and continue to provide growth opportunities for the business. The Group s research and development is directed towards all three operating segments. Expenditure on research and development amounted to $151m in 2010 (2009 $155m, 2008 $152m), representing approximately 4% of Group revenue (2009 4%, 2008 4%).

The Group continues to invest in future technology opportunities for clinical needs identified from across the Smith & Nephew businesses.

The Group s principal research facility located in York, England is now managed in conjunction with the Group s research facility in Durham, North Carolina, to provide research programmes that seek to underpin the longer-term technology requirements for its businesses and to provide a flow of innovative products. In-house research is supplemented by work performed by academic institutions and other external research organisations in Europe, America and Asia.

Product development is primarily carried out at the Group s principal locations, notably in Memphis, Tennessee and Aarau, Switzerland (Orthopaedics), Mansfield, Massachusetts (Endoscopy) and Hull, England (Advanced Wound Management).

INTELLECTUAL PROPERTY

Smith & Nephew has a policy of protecting, with patents, the results of research and development carried out by the Group. Patents have been obtained in a wide range of fields, including Orthopaedic reconstruction and trauma, clinical therapies, Endoscopy and Advanced Wound Management. Patent protection for Group products is sought routinely in the Group s principal markets. Currently, the Group s patent portfolio stands at approximately 4,000 patents in force and patent applications pending.

Smith & Nephew also has a policy of protecting the Group s products by registering trademarks under local laws of markets in which such products are sold. The Group vigorously protects its trademarks against infringement. Currently, the Group s trademark portfolio consists of approximately 4,000 trademarks, trademark applications and design rights.

For each major product, Smith & Nephew s goal is to provide a collection of intellectual property, which may include patents, trade secrets and licences, that reduces the risk associated with failure of any individual piece of intellectual property. Most individual pieces of intellectual property protect a relatively small proportion of the Group s annual revenue. As a result, the Group tries to ensure that its overall business is not sensitive to the loss (however caused) of any single piece of intellectual property.

In addition to protecting its market position by filing and enforcing patents and trademarks, Smith & Nephew may oppose third party patents and trademark filings where appropriate in those areas that might conflict with the Group s business interests.

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

REGULATION

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 and the State Food and Drug Administration in China.

The trend is towards more effective regulation and higher standards of technical appraisal. In the US, many of the Group s products are brought to market following pre-market notification to the FDA under Section 510(k) of the Food, Drug and Cosmetic Act, with a request that FDA clear the product as being substantially equivalent in terms of safety and effectiveness to a previously approved device. The FDA is considering changes in the 510(k) clearance process that might delay or modify the path to clearance in some circumstances. 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 audit for compliance with national and Group medical device regulation and policies.

Payment for medical devices is governed by reimbursement tariff agencies in various 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.

Management believes that the Group s operations currently comply in all material respects with applicable environmental laws and regulations. Although the Group continues to make capital expenditures for environmental compliance, it is not currently aware of any significant expenditure that would be required as a result of such laws and regulations that would have a material adverse impact upon the Group s financial position.

THE BUSINESS AND THE COMMUNITY

OUR COMMITMENT TO SUSTAINABILITY

Approach

Smith & Nephew recognises that companies have a wide responsibility to the community, the environment and the quality of life enjoyed by society at large. As a leader in its markets, Smith & Nephew believes it should also be a leader in setting and meeting standards of sustainable development. The Group monitors progress and views sustainable development as an integral part of the way the Group does business. We believe this because:

- It reinforces our commitment to meeting regulatory obligations and reduces our risks.
- It helps us to retain and recruit talented employees by demonstrating that we care about our people and our planet.
- It enhances our reputation as a partner with our health care customers, collaboratively developing innovative solutions in the form of products and services.
- It enables us to improve our operational efficiencies, thereby reducing costs as well as improving environmental outcomes.
- It enables us to anticipate and prepare for over the horizon issues that will affect our customers and society at large.
- It reinforces our role as a strong corporate citizen in the communities where we work and live.
- It provides real value to our shareholders.

To further advance its commitment to sustainability, Smith & Nephew created a new executive position in 2010, the Senior Vice-President of Corporate Sustainability.

Smith & Nephew s approach to sustainability is governed by the policies and principles it has developed to cover four key areas of corporate and social responsibility, namely: corporate governance and business integrity; health, safety and environment; social responsibility and economic contribution. These policies and principles are available at www.smith-nephew.com.

2010 Highlights

Continued strong ranking in the Dow Jones Sustainability Index (DJSI) and membership of FTSE4Good.

Commenced registration for the UK Carbon Reduction Commitment.

Became an invited member of the World Environment Center as the first representative of the Health Care and Technology industry.

The Group has published a Sustainability Report since 2001. The 2011 Sustainability Report, which provides more comprehensive information on the actions and performance in the four key reporting areas during the last year, will be published on the Group s website in mid 2011 at www.smith-nephew.com.

Corporate Governance and Business Integrity

See the Corporate Governance Statement section on pages 45 to 57 for a discussion of Smith & Nephew s governance structures and procedures.

Smith & Nephew aims to be honest and fair in all aspects of its business and expects the same from those with whom it does business. The Group s Code of Conduct and Business Principles governs the way it operates so that it respects stakeholders and seeks to build open, honest and constructive relationships. The Group takes account of ethical, social, environmental, legal and financial considerations as part of its operating methods. The Group has an independently operated whistle-blowing service in all jurisdictions in which the Group operates where such service is allowed.

Our Environment

The Group s health, safety and environmental (HSE) commitment is to:

give due regard to the effects of its operations on the environment and community to create a sustainable business;

provide and maintain a safe and healthy work environment for employees, contractors and visitors;

require each of the Group s businesses to achieve the HSE standards specified by the HSE policy;

seek to improve HSE performance through continuous evaluation and development of measures to control risk, conserve resources and minimise waste; and

recognise, promote and reinforce the responsibility of employees, contractors and visitors to work safely and follow procedures.

Smith & Nephew recognises the importance of minimising the environmental impact arising from all aspects of the business and places emphasis on controlling its waste streams, use of energy and overall carbon emissions. Activities at a local and Group level remain key to ensuring our overall HSE performance. Annual targets are set and initiatives put in place to meet these performance goals.

Throughout 2010, operations continued to develop in China and Canada. Results associated with these locations are included for the first time this year.

While we report absolute performance data, we also provide data normalised for changes related to cost of production (using 2010 as the base year) to facilitate better year-on-year comparisons. Performance against the published targets for the key HSE parameters is also shown in the table below.

	2010 actual	2009 actual	2010 target change	2010 actual change (normalised) (iv)	Change over last 5 years (normalised) (iv)
Energy Consumption (GWh)	168.9	157.4	-5%	6.5%	-1.9%
Carbon Emissions (tonnes)	76,638	74,603	No target	1.1%	-10.9%
Non-hazardous waste (tonnes)	3,297	4,917	(i)	-33.3%	-42.0%
Hazardous waste (tonnes)	481	517	(i)	-9.7%	61.5%
Recycled waste (tonnes)	3,081	2,334	(i)	-	-
Total waste incl. recycled (tonnes)	6,859	7,768	-5%	-11.2%	-5.8%
Water (1,000m^3)	629	621	No target	-0.2%	-13.7%
Lost time accidents incident rate (ii)	0.53	0.57	-5%	-7.0%	6.0%
OSHA recordable incident rate (iii)	0.89	1.20	-10%	-26.0%	-36.0%

(i) There was no target for the reduction of specific waste streams. The Group target was for a 5% reduction in total waste.

(ii) Lost Time Accident Frequency Rate is measured as the number of accidents resulting in the loss of a day or more per 200,000 hours worked.

(iii) Occupational Safety & Health Administration (OSHA) definition measured as the number of incidents resulting in lost time, medical treatment (other than simple first aid), or modification to the persons work, per 200,000 hours worked.

(iv) Normalisation is based on Cost of Production which is defined as the Cost of Goods Sold adjusted for opening and closing inventory levels.

Energy consumption for the Group increased by over 6% in 2010, but this was largely attributable to 2010 representing the first full year of energy use reporting for the major global distribution centre in Memphis and the newly acquired facility in Alberta, Canada. Energy efficiency initiatives were effected at a number of locations, with particularly notable accomplishments at the Hull Advanced Wound Management site and Endo operations in Massachusetts and Oklahoma.

The Group emission of carbon dioxide was 76,638 tonnes. This figure is calculated from both direct emissions from the combustion of fossil fuels on Smith & Nephew s sites and secondary emissions from utility company power generation for Smith & Nephew s electricity needs. While carbon dioxide emissions increased

by approximately 1% in 2010, this was almost entirely related to the addition of the Memphis distribution facility and Alberta, Canada operations as noted above.

The business generated 3,297 tonnes of non-hazardous waste in 2010. While this represented a substantial decline (33%) from 2009 levels, 2009 represented an anomaly related to increased waste production associated with new construction and closure of a facility.

Over the last year, the amount of hazardous waste has reduced by 10% to 481 tonnes. The largest percentage reductions were achieved at the Advanced Wound Management site in Hull and the Research Centre in York.

Smith & Nephew continues to demonstrate a commitment to recycling; in 2010, our percentage of total waste that was recycled increased to 45% relative to 30% in the previous year. While these recycling initiatives were evident at many sites, the Memphis Orthopaedic facilities were noteworthy for their focus on scrap metals that resulted in diminished landfill costs and improved recycling revenue generation.

Water consumption throughout the Group remained largely unchanged relative to 2009. All sites continue to explore opportunities to minimise water use.

Workplace accidents decreased in 2010. Improvements were notable both in terms of lost time accident frequency rate (-7%) and the number of lost time accidents (46 relative to 58 in 2009). The OSHA recordable rate for the Group also continued to improve (26%). Both indicators of occupational accidents are below published industry average levels. The local HSE training plans continue to drive and promote safe working practices at all sites.

HSE audits were undertaken at six locations in 2010. These audits are a continuation of our protocol of assessing each of our facilities on a bi-annual schedule.

A full analysis of these measurements and key health and safety performance measures will be included in the 2011 Sustainability Report on the Group s website when it is published in mid 2011.

Social Responsibility

Our People

The Group's employment policies are based on equality of opportunity regardless of colour, creed, race, national origin, sex, age, marital status, sexual orientation, or mental or physical disability unrelated to the ability of the person to perform the essential functions of the job.

Smith & Nephew is committed to providing a healthy and safe working environment and operates a set of policies that ensure flexible, family-friendly practices and non-discrimination. It aims to provide an open environment based on constructive relationships and regular and timely dissemination of Group information and encourages feedback and ideas. Smith & Nephew carries out employee opinion surveys across the business. The aim of the surveys is to assess how aligned staff are to the Group s, and local GBU s strategy, to determine what we, as a business, do well and identify what could be improved. We also take the opportunity to test the effectiveness of Performance, Innovation and Trust as the declared company values.

The Human Resources (HR) Policy Framework provides a framework of key HR policies, values, behaviours and management principles that provide the structure within which the business units and global functions plan and deliver successful results. There is also an HR strategy which provides direction on how the Group intends to attract, retain and develop the right talent to meet business needs and create a culture that is aligned to Smith & Nephew values and deliver the Group s long term strategic plans.

Other employee engagement indicators

In 2010, the Group continued to assess indicators of employee engagement. These measurements are a useful monitoring tool and alert mechanism for action as well as giving trend indicators of improved performance. The data below relates to the Group s US and UK population (approximately 60% of the total employees) as these regions have the most established and robust data collection processes in place.

Positions filled by internal candidates through promotions This measure is an indicator of how well the Group believes it is developing its employees and the success of the Group s internal recruitment policy. In 2010, the percentage of vacancies filled by internal applicants averaged 32% (2009 32%). The total for non-management positions was 29% (2009 29%) and for management positions was 52% (2009 51%). The Group target for all employees continues to be 40% (including management positions), which management believes is challenging but achievable. The Group has a policy of open advertising and providing opportunities for existing employees wherever possible, while recognising the need to bring in new ideas and approaches that external recruitment brings.

Labour turnover The Group measures various labour turnover rates. The average voluntary labour turnover rate during 2010 was 7.2%, a slight increase from the 2009 equivalent rate of 6.5%. The average involuntary labour turnover rate was 5.1% (2009 10.7%), which management believe is indicative of the Group s continuing management programme of efficiency improvements. This is aligned to continued investment in new markets and skills. An indicator of this is that the Group s headcount remained broadly unchanged on the prior year. In addition, the Group measures labour turnover relating specifically to employees who have been with the business for less than two years. This measure is an indication of how well the Group recruits and then retains its employees so that they can make a contribution to the business. The average voluntary turnover for employees leaving the Group within two years of joining was 10.9%, compared to 10.1% in 2009.

The Group is committed to providing training and information so that all employees can make the best contribution possible. To ensure that the Group continues to improve in this important area, the central global organisational development team continued their programmes to lead talent management, performance management and learning and development across the whole of the Group. Learning and development programmes are used to attract, retain and develop employees. These programmes are linked to formal performance appraisal and development planning. The Group operates training programmes under the banner of Management Excellence . These provide the key management skills required to be successful managers and leaders, covering the requirements of both new and experienced individuals. Additionally the Group has rolled out a global on-line learning resource and in 2011 will be expanding the programmes available to all employees.

The legal frameworks governing employee relations vary from country to country, as does custom and practice. Relations with trade unions are nationally determined and managed locally in line with the applicable legal framework and standards of good practice. The well-developed arrangements for interactions with trade union and worker councils provide the forum for productive discussion and collaborations with regard to collective bargaining agreements and other employment issues. It is the Group s policy to conform to the nationally determined arrangements. The Group does not use any form of forced, compulsory or child labour.

Our Communities

Smith & Nephew values community involvement; it is an active member of its local communities and supports employees who undertake community work. The Group s principles for charitable giving are based on criteria relevant to its business, with priority given to medical education. Individual company sites support their local communities in a range of charitable causes giving donations of money, gifts in kind and employee time.

The Group realises that its technologies and products do not reach everyone. Project Apollo is a charitable and humanitarian service programme of the Orthopaedics business. This links up with physicians and non-profit groups engaged in medical philanthropy that receive donations of Smith & Nephew products through sponsorship and help from the Group s employees. By working in collaboration with these individuals and organisations, Smith & Nephew considers that this is a way of increasing the impact of its charitable giving and work it undertakes.

More examples of community support programmes supported by the Group are given in the Sustainability Report.

In 2010, direct donations to charitable and community activities totalled $5,644,000 comprised of $1,736,000 in cash and $3,908,000 in product donations, primarily for Haiti earthquake relief efforts. This compares with $1,866,000 of cash donations in 2009 and $1,498,000 in 2008. As a matter of policy, Smith & Nephew makes no political contributions.

Smith & Nephew is committed to establishing mutually beneficial relationships with its suppliers, customers and business partners. The Group works only with partners it believes adhere to business principles and health, safety, social and environmental standards consistent with its own. Additional work continues each year to improve the monitoring of supplier standards for service quality and activities relevant to their corporate responsibility including a diversity programme to promote long-term relationships with local or small business enterprises and minority-owned and women-owned business enterprises.

Economic Contribution

Sustainability by definition includes economic success. The Group is committed to providing innovative, cost-effective healthcare solutions benefiting patients, healthcare professionals, reimbursement agencies and their patients through improved treatment, ease and speed of product use and reduced healthcare costs. The Group s business policies are designed to achieve long-term growth and profits which in turn bring continued economic benefits to shareholders, employees, suppliers and local communities. Highlights for 2010 included:

- Our net sales in 2010 amounted to $4.0 billion (2009 $3.8 billion);
- Smith & Nephew s employment of over 10,000 people globally is a substantial economic generator; our total wages and salaries in 2010 amounted to $817m (2009 $768m); and

We invested $151m (2009 $155m) in Research and Development to develop improved products and services.

Looking Ahead

The Group is fulfilling an important role in the healthcare sector. Increased demands are being placed on healthcare systems by the demographic trends of an ageing population and as the problems with obesity become more widespread. More active lifestyles and the increased incidence of diabetes and other diseases also increase the demand for Smith & Nephew s products. In addition, developing and newly industrialised countries are increasing their demands for advanced products driven by similar demographic and health issues as developed nations.

Smith & Nephew s vision is to be the best in helping people regain their lives by improving and healing the human body. The Group believes that it can achieve this by setting and meeting ambitious performance targets, by constant innovation in products and services and by earning the trust of its stakeholders. The Group considers sustainability a journey, not an end point and is committed to that journey as an essential part of its long-term strategy.

EMPLOYEES

The average number of full-time equivalent employees in 2010 was 10,172, of whom 1,625 were located in the UK, 4,247 were located in the US and 4,300 were located in other countries. The Group does not employ a significant number of temporary employees.

The average number of employees for the past three years by business segment:

	2010	2009	2008
Orthopaedics	5,045	4,853	4,840
Endoscopy	2,134	1,888	1,849
Advanced Wound Management	2,993	3,023	3,068
	10,172	9,764	9,757

Where the Group has collective bargaining arrangements in place with labour unions, these reflect local market circumstances.

Smith & Nephew operates share option plans that are available to the majority of employees (for further information see Note 25 of the Notes to the Group Accounts). The Group has no share plans in which shares have rights with regard to control of the Company that are not exercisable directly by employees.

RISK

Management of Risk

As an integral part of planning and review, Group management and management of each of the GBUs seek to identify the risks involved in the business, the probability of those risks materialising, the impact if they do materialise and the actions being taken, and to be taken, to manage and mitigate those risks. Internal audit reviews and reports on the effectiveness of the operation of the risk management process. The Group Risk Committee meets twice a year to review the major risks identified by the GBUs and Group management and any mitigating actions being taken. As appropriate, the Risk Committee may re-categorise risks or require further information or mitigating action to be undertaken. The Risk Committee reports to the Board on an annual basis detailing all principal risks categorised by potential financial impact on profit and share price. In addition, the risks considered to be most significant to the Group are reported to the Board on a regular basis. These reports include details of new, key or significantly increased risks, the senior management who have primary responsibility for managing each of these risks along with actions they have put in place to mitigate such risks.

RISK FACTORS

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

Strategic Risk

Highly Competitive Markets

The Group s business units compete across a diverse range of geographic and product markets. Each market in which the business units operate contains a number of different competitors, including specialised and international corporations. Significant product innovations, technical advances or the intensification of price competition by competitors could adversely affect the Group s operating results. Some of these competitors may have greater financial, marketing and other resources than Smith & Nephew. These competitors may be able to initiate technological advances in the field, deliver products on more attractive terms, more aggressively market their products or invest larger amounts of capital and research and development into their businesses.

There is a possibility of further consolidation of companies, 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 sales 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. Increased competition and unanticipated actions by competitors or customers could lead to downward pressure on prices and/or a decline in market share in any of the Group s business areas, which could adversely affect Smith & Nephew s results of operations and hinder its growth potential.

Continual Development and Introduction of New Products

The medical devices industry has a rapid rate of new product introduction. In order to remain competitive, each of the Group s business units 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. A potential product may not be brought to market for any number of reasons, including failure to work optimally, failure to receive regulatory approval, failure to be cost-competitive, infringement of patents or other intellectual property rights and changes in consumer demand. The Group s products and technologies are also subject to marketing attack by competitors. Furthermore, new products that are developed and marketed by the Group s competitors may affect price levels in the various markets in which the Group s business units operate. If the Group s new products do not remain competitive with those of competitors, the Group s sales revenue could decline.

There is a risk that a major disruptive technology could be introduced into one or more of the Group s markets and adversely affect its ability to achieve business plans and targets.

External Risk

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 governed in most major markets largely 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 changes in reimbursement policy, tax policy and pricing which may have an adverse impact on sales and operating profit. In particular, recent changes to the health care legislation in the US are due to impose significant taxes on medical device manufacturers from 2013. There may be an increased risk of adverse changes to government funding policies arising from the deterioration in macro-economic conditions in some of the Group s markets.

The Group must adhere to the rules laid down by government agencies that fund or regulate health care, 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 2010, economic conditions worldwide continued to create several challenges for the Group, including deferrals of joint replacement procedures, heightened pricing pressures and significant declines in capital equipment expenditures at hospitals. 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 90 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 import quotas, taxation or other matters could adversely affect the Group s turnover and operating profit. War, terrorist activities or

other conflict could also adversely impact the Group.

Currency Fluctuations

The Group uses the US Dollar as its reporting currency and the US Dollar is the functional currency of Smith & Nephew plc. In 2010, 43% (2009 44%) of Group revenue arose in the US, 26% (2009 27%) in Continental Europe, 24% (2009 21%) in Africa, Asia, Australia, Canada, New Zealand and Latin America, and 7% (2009 8%) in the UK.

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 currencies 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.

Stock Market Valuations

Changing market conditions, both within the medical devices sector and in stock prices in general, may lead to volatility in the share price, or a stock market valuation of the Group which is materially less than the Group s intrinsic value. This may lead to difficulties in making acquisitions, an increased vulnerability to takeovers at below intrinsic value, and loss of value for our shareholders.

Operational Risk

Manufacturing and Supply

The Group s manufacturing production is concentrated at 11 main facilities in Memphis, Tennessee, Mansfield, Massachusetts and Oklahoma City, Oklahoma in the US, Hull, Warwick and Gilberdyke in the UK, Aarau in Switzerland, Tüttlingen in Germany, Alberta in Canada and Suzhou and Beijing in China. If major physical disruption took place at any of these sites, it could adversely affect the results of operations. Physical loss and consequential loss insurance is carried to cover such risks but is subject to limits and deductibles and may not be sufficient to cover catastrophic loss.

Management of orthopaedic inventory is complex, particularly forecasting and production planning. There is a risk that failures in operational execution could lead to excess inventory or individual product shortages.

Each of the business units is reliant on certain key suppliers of raw materials, components, finished products and packaging materials. These suppliers must provide the materials and perform the activities to the Group s standard of quality requirements. If any of these suppliers is unable to meet the Group s needs, compromises on standards of quality or substantially increases its prices, Smith & Nephew would need to seek alternative suppliers. There can be no assurance that alternative suppliers would provide the necessary raw materials on favourable or cost-effective terms at the desired quality. Consequently, the Group may be forced to pay higher prices to obtain raw materials, which it may not be able to pass on to its customers in the form of increased prices for its finished products. In addition, some of the raw materials used may become unavailable, and there can be no assurance that the Group will be able to obtain suitable and cost-effective substitutes. Any interruption of supply caused by these or other factors could negatively impact Smith & Nephew s revenue and operating profit.

The Group uses a variety of information systems to conduct its manufacturing, supply and selling operations. An unrecoverable fault in one of these systems could disrupt trading in certain markets and locations.

The Group is in the process of outsourcing to third parties or relocating to lower cost countries certain of its manufacturing processes. As a result of 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 sales 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.

Compliance and Reporting Risk

Regulatory 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. In the UK, a new Bribery Act was adopted in 2010 that will increase risks for companies that allow improper conduct on their behalf. While the Group is committed to doing business with integrity and welcomes the trend to higher standards in the healthcare industry, the Group and other companies in the industry have been subject to investigations and other enforcement activity that have incurred and may continue to incur significant expense. See Legal Proceedings . 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.

Regulatory Approvals and Controls

The 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. The Group is required to comply with a wide range of regulatory controls over the manufacturing, testing, distribution, marketing and sale of its products, particularly in the US, Europe and China. Such controls have become increasingly demanding and costly to comply with and management believes that this trend will continue. At any time, the Group is awaiting a number of regulatory approvals which, if not received, could adversely affect results of operations. Regulatory approval of new products and new materials is required in most countries in which the Group operates, although a single approval may be obtained for all countries within the European Union. Regulatory approval of new products may entail a lengthy process, particularly if materials are employed which have not previously been used in similar products. In the US, the 510(k) process by which many of the Group s products are cleared for sale may be revised in ways that could lead to delays or increased costs. See Regulation .

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.

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.

EXCHANGE AND INTEREST RATE RISK AND FINANCIAL INSTRUMENTS

The Board of directors of the Company has established a set of policies to manage funding, currency and interest rate risks. Derivative financial instruments are used only to manage the financial risks associated with underlying business activities and their financing. See Note 20 of the Notes to the Group accounts for further details of these risks.

The Group s financial instruments are subject to changes in fair values as a result of changes in market rates of exchange and forward interest rates. Financial instruments entered into to hedge sales and purchase transactions in foreign currency and interest rate exposures are accounted for as hedges. Changes in fair values of effective financial instruments would not affect the Group s income statement immediately. The movements in the fair value of financial instruments that are not accounted for as hedges offset movements in the values of assets and liabilities and are recognised through the income statement. The net impact of these changes in fair value on the Group s income statement is not significant.

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BUSINESS REVIEW, LIQUIDITY AND PROSPECTS

The Business Review, Liquidity and Prospects discusses the operating and financial performance of the Group, including the financial outlook and the financial resources of the Group, under the following headings:

The results for each year are compared primarily with the results for the preceding year.

BUSINESS OVERVIEW

Smith & Nephew s operations are organised into three primary business units that operate globally: Orthopaedics, Endoscopy and Advanced Wound Management. Smith & Nephew believes that its businesses have opportunities for strong growth due to its markets benefiting from an ageing population, an increase in active lifestyles, trends toward less invasive medical procedures and the increasing demand in emerging markets.

Revenue by business segment as a percentage of total revenue was as follows:

	2010 %	2009 %	2008 %
Orthopaedics	55	57	57
Endoscopy	22	21	21
Advanced Wound Management	23	22	22
Total revenue	100	100	100

Revenue by geographic market as a percentage of total revenue was as follows:

	2010 %	2009 %	2008 %
United States	43	44	44
Europe (Continental Europe and United Kingdom)	33	35	36
Africa, Asia and Australia and Other America	24	21	20
Total revenue	100	100	100

Underlying Growth in Revenue

Underlying growth in revenue is a non-GAAP financial measure which is a key performance indicator used by the Group s management in order to compare the revenue in a given year to that of the previous year on a like-for-like basis. This is achieved by adjusting for the impact both of sales of products acquired in material business combinations and for movements in exchange rates. The Group s management uses this non-GAAP measure in its internal financial reporting, budgeting and planning to assess performance on both a business segment and a consolidated Group basis.

Underlying growth in revenue reconciles to growth in revenue reported in accordance with IFRS by making two adjustments, the constant currency exchange effect and the acquisitions effect , described below. The material limitation of the underlying growth in revenue measure is that it excludes certain factors, described above, which do ultimately have a significant impact on total revenues. The Group measures the performance of local managers using underlying growth in revenue whilst the Group s management additionally considers GAAP revenue each quarter and further assesses the excluded items by monitoring against internal budget amounts.

The constant currency exchange effect is a measure of the increase/decrease in revenue resulting from currency movements on non-US Dollar sales. This is measured as the difference between the increase in revenue translated into US Dollars on a GAAP basis (i.e. current year revenue translated at the current year average rate, prior year revenue translated at the prior year average rate) and the increase measured by translating current and prior year revenue into US Dollars

using the prior year closing rate.

The acquisitions effect is the measure of the impact on revenue from newly acquired business combinations. This is calculated by excluding the revenue from sales of products acquired as a result of a business combination consummated in the current year, with non-US Dollar sales translated at the prior year average rate. Additionally, prior year revenue is adjusted to include a full year of revenue from the sales of products acquired in those business combinations consummated in the previous year, calculated by adding back revenue from sales of products in the period prior to the Group s ownership. These sales are separately tracked in the Group s internal reporting systems and are readily identifiable.

Underlying growth in revenue in 2010 by business segment reconciles to reported growth, the most directly comparable financial measure calculated in accordance with IFRS, as follows:

	Reported growth %	Constant currency exchange effect %	Underlying growth %
Orthopaedics	3	(1)	2
Endoscopy	8	(1)	7
Advanced Wound Management	8	(1)	7
Total revenue	5	(1)	4

Underlying growth in revenue by business segment reconciles to reported growth in 2009 as follows:

	Reported growth %	Constant currency exchange effect %	Underlying growth %
Orthopaedics	(1)	2	1
Endoscopy	(1)	2	1
Advanced Wound Management	-	6	6
Total revenue	(1)	3	2

Trading Profit

Trading profit is a trend measure which presents the long-term profitability of the Group excluding the impact of specific transactions that management considers affect the Group s short-term profitability. The Group presents this measure to assist investors in their understanding of trends. The Group has identified the following items, where material, as those to be excluded from operating profit when arriving at trading profit: acquisition and disposal related items including amortisation of acquisition intangible assets and impairments; significant restructuring events; and gains and losses resulting from legal disputes and uninsured losses.

Trading profit in 2010 reconciles to operating profit, the most directly comparable financial measure calculated in accordance with IFRS, as follows:

	Operating profit $ million	Restructuring and rationalisation costs $ million	Amortisation of acquisition intangibles and impairments $ million	Trading profit $ million
Orthopaedics	503	8	25	536
Endoscopy	197	2	1	200
Advanced Wound Management	220	5	8	233
Total	920	15	34	969

Trading profit reconciles to operating profit in 2009 as follows:

	Operating profit $ million	Acquisition related costs $ million	Restructuring and rationalisation costs $ million	Amortisation of acquisition intangibles and impairments $ million	Trading profit $ million
Orthopaedics	410	26	26	46	508
Endoscopy	169	-	5	15	189
Advanced Wound Management	144	-	11	5	160
Total	723	26	42	66	857

Trading profit by business segment as a percentage of total trading profit was as follows:

	2010 %	2009 %	2008 %
Orthopaedics	55	59	62
Endoscopy	21	22	21
Advanced Wound Management	24	19	17
Total trading profit	100	100	100

Operating profit by business segment as a percentage of total operating profit was as follows.

	2010 %	2009 %	2008 %
Orthopaedics	55	57	61
Endoscopy	21	23	23
Advanced Wound Management	24	20	16
Total operating profit	100	100	100

Adjusted Earnings per Ordinary Share

Adjusted earnings per Ordinary Share is a trend measure which presents the long-term profitability of the Group excluding the impact of specific transactions that management considers affect the Group s short-term profitability. The most comparable financial measure calculated in accordance with IFRS is earnings per Ordinary share. The Group presents this measure to assist investors in their understanding of trends. Adjusted attributable profit is the numerator used for this measure.

Adjusted attributable profit is reconciled to attributable profit as follows:

	2010 $ million	2009 $ million	2008 $ million
Attributable profit for the year	615	472	377
Acquisition related costs	-	26	61
Restructuring and rationalisation expenses	15	42	34
Amortisation of acquisition intangibles and impairments	34	66	51
Taxation on excluded items	(10)	(26)	(30)
Adjusted attributable profit	654	580	493

Earnings per Ordinary share			
Basic	69.3¢	53.4¢	42.6¢
Diluted	69.2¢	53.3¢	42.4¢
Adjusted: Basic	73.6¢	65.6¢	55.6¢
Adjusted: Diluted	73.6¢	65.5¢	55.4¢

Trading Cash Flow and Trading Profit to Cash Conversion Ratio

Growth in trading cash flow and improvement in the trading profit to cash conversion ratio are measures which present the trend growth in the long-term cash generation of the Group excluding the impact of specific transactions or events that management considers affect the Group s short-term performance.

Trading cash flow is defined as cash generated from operations less net capital expenditure but before acquisition related cash flows, restructuring and rationalisation cash flows and cash flows arising from legal disputes and uninsured losses. Trading profit to cash conversion ratio is trading cash flow expressed as a percentage of trading profit.

The Group presents those measures to assist investors in their understanding of trends. The Group s internal financial reporting (budgets, monthly reporting, forecasts, long-term planning and incentive plans) focuses on cash generation before these items. Trading cash flow and trading profit to cash conversion ratio are non-GAAP financial measures.

Trading cash flow reconciles to cash generated from operations, the most directly comparable financial measure calculated in accordance with IFRS, as follows:

	2010 $ million	2009 $ million	2008 $ million
Cash generated from operations	1,111	1,030	815
Less: Capital expenditure	(315)	(318)	(292)
Add: Cash received on disposal of fixed assets	8	-	3
Add: Acquisition related expenditure	-	22	48
Add: Restructuring and rationalisation related expenditure	16	32	28
Add: Macrotexture expenditure	5	5	10
Trading cash flow	825	771	612
Trading Profit	969	857	776
Trading profit to cash conversion ratio (%)	85%	90%	79%

Factors Affecting Smith & Nephew s Results of Operations

Sales Trends

Smith & Nephew s business units participate in the global medical devices market and share a common focus on the repair of human tissue. Smith & Nephew s principal geographic markets are in the well-developed healthcare economies of the US, Europe, Japan and Australia.

These markets are characterised by an increase in the average age of the population caused by the immediate post-World War II baby boomer generation approaching retirement, increased longevity, more active lifestyles, obesity and increased affluence. Together these factors have created significant demand for more effective healthcare products which deliver improved outcomes through technology advances. Furthermore, pressure to resist increases in overall healthcare

spending has led healthcare providers to demand products which minimise the length of hospital stays and use of surgeon and nursing resources.

Increasing consumer awareness of available healthcare treatments through the Internet and direct-to-customer advertising has led to increased consumer influence over product purchasing decisions.

For a description of the impact on each business unit refer to the Market and Competition sections under Business Description on pages 4 to 9.

Innovation

The Group must continually develop its existing and new technologies and bring new products to its customers to drive sales growth. Expenditure on research and development in 2010 represented approximately 4% (2009 4%) of Group revenue. The focus of Smith & Nephew s innovation is to create new products and surgical techniques with distinct advantages in clinical performance and cost-effectiveness benefits for clinicians, patients and healthcare providers.

Currency Movements

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 manages the impact of exchange rate movements on sales and cost of goods sold by a policy of transacting forward foreign currency commitments when firm purchase orders are placed. In addition, the Group s policy is for forecast transactions to be covered between 50% and 90% for up to one year.

The Group 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. This exposure is offset partly because the Group incurs interest in currencies other than US Dollars on its indebtedness denominated in currencies other than US Dollars. See Financial Position, Liquidity and Capital Resources on page 39.

Governmental economic, fiscal, monetary and political policies and factors that materially affect the Group s operations or investments of shareholders are discussed in Regulation, External Risk , Compliance and Reporting Risk , Taxation information for shareholders on pages 12, 19, 21 and 145-146, respectively, and elsewhere in this Annual Report.

Critical Accounting Policies

The Group s significant accounting policies are set out in Note 2 of the Notes to the Group Accounts. Of those, the policies which require the most use of management s judgment are as follows:

Inventories

A feature of the Orthopaedics business (whose finished goods inventory makes up approximately 78% of the Group total finished goods inventory) is the high level of product inventory required, some of which is located at customer premises and is available for customers immediate use. Complete sets of product, including large and small sizes, have to be made available in this way. These sizes are used less frequently than standard sizes and towards the end of the product life cycle are inevitably in excess of requirements. Adjustments to carrying value are therefore required to be made to orthopaedic inventory to anticipate this situation. These adjustments are calculated in accordance with a formula based on levels of inventory compared with historical usage. This formula is applied on an individual product line basis and is first applied when a product group has been on the market for two years. This method of calculation is considered appropriate based on experience, but it does involve management judgements on 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, 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.

Retirement Benefits

A number of key judgements have to be made in calculating the fair value of the Group s defined benefit pension plans. These assumptions impact the Balance Sheet liability, operating profit and other finance income/costs. The most critical assumptions are the discount rate and mortality assumptions to be applied to future pension plan liabilities. For example as of 31 December 2010, a 0.5% increase in discount rate would have reduced the combined UK and US pension plan deficit by $84m whilst a 0.5% decrease would have increased the combined deficit by $93m. A 0.5% increase in discount rate would have decreased profit before taxation by $2m whilst a 0.5% decrease would have increased it by $2m. A one year increase in the assumed life expectancy of the average 60 year old male pension plan member in both the UK and US would have increased the combined deficit by $33m. In making these judgements, management takes into account the advice of professional external actuaries and benchmarks its assumptions against external data.

The discount rate is determined by reference to market yields on high quality corporate bonds, with currency and term consistent with those of the liabilities. In particular for the UK and US, the discount rate is derived by reference to a AA yield curve derived by the Group s actuarial advisers.

See Note 33 of the Notes to the Group Accounts for a summary of how the assumptions selected in the last five years have compared with actual results.

Contingencies and Provisions

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.

The Group operates in numerous tax jurisdictions around the world. Although it is Group policy to submit its tax returns to the relevant tax authorities as promptly as possible, at any given time the Group has unagreed years outstanding and is involved in disputes and tax audits. Significant issues may take several years to resolve. In estimating the probability and amount of any tax charge, management takes into account the views of internal and external advisors 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.

2010 YEAR

The following discussion and analysis is based upon, and should be read in conjunction with, the Group Accounts of Smith & Nephew included elsewhere in this Annual Report.

Financial Highlights of 2010

Group revenue was $3,962m for the year ended 31 December 2010, representing a 5% growth compared to 2009. This comprised of underlying revenue growth of 4% and favourable currency translation of 1%.

Profit before taxation was $895m in 2010, compared with $670m in 2009. Attributable profit was $615m compared to $472m in 2009. Adjusted attributable profit (calculated as set out in Selected Financial Data) rose 13% to $654m in 2010, from $580m in 2009.

Basic earnings per Ordinary Share were 69.3¢, compared to 53.4¢ for 2009. EPSA (as set out in Selected Financial Data) was 73.6¢ in 2010 compared to 65.6¢ for 2009, representing a 12% increase.

Fiscal 2010 Compared with Fiscal 2009

The following table sets out certain income statement data for the periods indicated:

	2010	2009
	$ million	$ million
Revenue (i)	3,962	3,772
Cost of goods sold (ii)	(1,031)	(1,030)
Gross profit	2.931	2,742
Marketing, selling and distribution expenses (iii)	(1,414)	(1,351)
Administrative expenses (iv)	(446)	(513)
Research and development expenses	(151)	(155)
Operating profit (i)	920	723
Net interest payable	(15)	(40)
Other finance costs	(10)	(15)
Share of results of associates	-	2
Profit before taxation	895	670
Taxation	(280)	(198)
Attributable profit for the year	615	472

(i) Group revenue and operating profit are derived wholly from Continuing Operations and discussed on a segment basis on pages 32 to 34.

(ii) In 2010 no restructuring and rationalisation expenses and no acquisition related costs were charged to cost of goods sold (2009 $15m of restructuring and rationalisation expenses and $12m of acquisition related costs).

(iii) 2010 includes $3m of restructuring and rationalisation expenses. No acquisition related costs were charged to Marketing, selling and distribution in 2010. (2009 $7m of acquisition related costs and $10m of restructuring and rationalisation expenses).

(iv) 2010 includes $12m of restructuring and rationalisation expenses and $34m relating to amortisation of acquisition intangibles and impairments (2009 $7m of acquisition related costs, $17m of restructuring and rationalisation expenses and $66m relating to amortisation of acquisition intangibles and impairments).

Transactional and Translational Exchange

The Group s principal markets outside the US are, in order of significance, Continental Europe, UK, Australia and Japan. Revenues in these markets fluctuate when translated into US Dollars on consolidation. During the year, the average rates of exchange against the US Dollar used to translate revenues and profits arising in these markets changed compared to the previous year as follows: the Euro decreased from $1.39 to $1.32 (5%), Sterling decreased from $1.56 to $1.54 (1%), the Swiss Franc increased from $0.92 to $0.96 (4%), the Australian Dollar increased from $0.78 to $0.92 (18%) and the Japanese Yen increased from ¥94 to ¥88 (6%).

The Group s principal manufacturing locations are in the US (Orthopaedics and Endoscopy), Switzerland (Orthopaedics), UK (Advanced Wound Management and Orthopaedics) and China (Orthopaedics and Advanced Wound Management). The majority of the Group s selling and distribution subsidiaries around the world purchase finished products from these locations. As a result of currency movements compared with the previous year, purchases from the US became relatively more expensive for Europe and the UK and relatively less expensive for Australia, Japan and Switzerland. The Group s policy of purchasing forward a proportion of its currency requirements mitigated the impact of these movements.

Revenue

Group revenue increased by $190m (5%) from $3,772m in 2009 to $3,962m in 2010. Underlying revenue growth was 4%, and a further 1% growth was attributable to favourable currency translation.

Orthopaedics revenues increased by $60m (3%), of which 2% was attributable to underlying growth, and 1% due to favourable currency translation. Endoscopy revenues increased by $64m (8%), of which 7% was attributable to underlying growth, and 1% due to favourable currency translation. Advanced Wound Management revenues increased by $66m (8%), of which 7% was attributable to underlying growth and 1% due to favourable currency translation.

A more detailed analysis is included within the Revenue sections of the individual business segments that follow on pages 32 and 34.

Cost of goods sold

Cost of goods sold increased by $1m to $1,031m from $1,030m in 2009. This represents 26% of revenue compared to 27% in 2009. During 2010, the Group has continued to deliver on its efficiency commitments, including our new Advanced Wound Management manufacturing facility in China and improved inventory management in Orthopaedics. Other factors contributing to the movement were the decrease of $15m in restructuring and rationalisation expenses and decrease of $12m in other acquisition related costs. Currency had little impact on the year on year movement.

Further margin analysis is included within the Trading profit sections of the individual business segments that follow on pages 32 to 34.

Marketing, selling and distribution expenses

These expenses increased by $63m (5%) to $1,414m from $1,351m in 2009. In line with increased revenue there has been a 4% underlying increase in advertising, marketing and selling costs. Unfavourable currency movements have contributed to the remaining 1% movement.

Administrative expenses

Administrative expenses decreased by $67m (-13%) to $446m from $513m in 2009. The principal factors contributing to the underlying movement of -14% were a $32m reduction in the amortisation and impairment charge of intangible assets, a $7m reduction in acquisition related costs and a decrease of $5m in restructuring and rationalisation expenses. This was partially offset by a 1% unfavourable movement in currency.

Research and development expenses

Expenditure as a percentage of revenue decreased by 0.3% to 3.8% in 2010 (2009 4.1%). The Group continues to invest in innovative technologies and products to differentiate itself from competitors.

Operating profit

Operating profit increased by $197m to $920m from $723m in 2009 comprising increases of $93m in Orthopaedics, $28m in Endoscopy and $76m in Advanced Wound Management.

Net interest payable

Net interest payable reduced by $25m from $40m in 2009 to $15m in 2010. This is a consequence of the overall reduction of borrowings within the Group and a reduction in the applicable interest rates.

Other finance cost

Other finance costs in 2010 were $10m compared to $15m in 2009. This decrease is attributable to an increase in the expected return on pension plan assets.

Taxation

The taxation charge increased by $82m to $280m from $198m in 2009. The effective rate of tax was 31.3%, compared with 29.6% in 2009.

The tax charge was reduced by $10m in 2010 (2009 $26m) as a consequence of restructuring and rationalisation expenses, acquisition related costs, amortisation of acquisition intangibles and impairments. The effective tax rate was 30.8% (2009 27.9%) after adjusting for these items and the tax thereon.

Group Balance Sheet

The following table sets out certain balance sheet data as at 31 December of the years indicated:

	2010 $million	**2009 $million**
Non-current assets	2,579	2,480
Current assets	2,154	2,071
Assets held for sale	-	14
Total assets	4,733	4,565
Non-current liabilities	1,046	1,523
Current liabilities	914	863
Total liabilities	1,960	2,386
Total equity	2,773	2,179
Total equity and liabilities	4,733	4,565

Non-current assets increased by $99m to $2,579m from $2,480 in 2009. Intangible assets and goodwill increased by $22m of which $65m related to additions of intangibles, $28m related to favourable currency translation and $2m of transfers. These were partially offset by $68m of amortisation and a $4m adjustment to contingent consideration. Property, plant and equipment increased by $34m comprising $250m of additions and $3m of favourable currency translation, partially offset by $203m of depreciation charge, $14m of disposals and $2m of transfers. Deferred tax assets and other non-current assets increased by $43m in the year.

Current assets increased by $83m to $2,154m from $2,071m in 2009. This was due to an increase in trade and other receivables of $78m and an increase in cash at bank of $15m. These increases were partially offset by a reduction in inventories of $10m.

Non-current liabilities decreased by $477m from $1,523m in 2009 to $1,046m in 2010. $448m of this decrease was due to the reduction of long-term borrowings. The net retirement benefit obligation decreased by $60m. This was largely due to the excess of pension contributions totalling $65m over the charge to the income statement in the year of $35m which gave rise to a net $30m reduction in the liability. In addition, there were actuarial gains totalling $26m. Other movements in non-current liabilities related to a reduction in deferred acquisition consideration of $27m due to settlement of the BlueSky Medical Group, Inc (BlueSky) deferred consideration, an increase of $38m in the deferred tax liability and an increase in provisions of $20m due to a change in the expected time frame to settlement which has resulted in a reclassification from current liabilities.

Current liabilities increased by $51m from $863m in 2009 to $914m in 2010. This was due to an increase in bank overdrafts and current borrowings of $12m, an increase in trade and other payables of $21m and an increase in current tax payable of $36m, offset by a decrease in provisions of $18m.

Total equity increased by $594m from $2,179m in 2009 to $2,773m in 2010. The principal movements were an increase of $615m due to attributable profit, currency translation and hedging gains of $53m, an increase of $26m relating to actuarial gains on retirement benefit obligations, offset by a decrease of $7m relating to deferred taxation and a decrease of $132m due to dividends paid during the year.

Business Segment Analysis

Revenue by business segment and geographic market and trading and operating profit by business segment are set out below:

	2010 $ million	2009 $ million
Revenue by business segment		
Orthopaedics	2,195	2,135
Endoscopy	855	791
Advanced Wound Management	912	846
Total revenue	3,962	3,772
Revenue by geographic market		
United States	1,707	1,664
Europe (Continental Europe and United Kingdom)	1,315	1,313
Africa, Asia, Australasia and other America	940	795
Total revenue	3,962	3,772
Trading profit by business segment		
Orthopaedics	536	508
Endoscopy	200	189
Advanced Wound Management	233	160
Total trading profit	969	857
Operating profit by business segment		
Orthopaedics	503	410
Endoscopy	197	169
Advanced Wound Management	220	144
Total operating profit	920	723

Orthopaedics

Revenue

Orthopaedics revenue increased by 3% to $2,195m from $2,135m in 2009. Of this increase, 2% is attributable to underlying growth and 1% is due to favourable currency movements.

In the US, revenue increased by $22m to $1,176m (2%), all of which was due to underlying growth. The main factors were the continued growth of products launched in the year including VERILAST and VISIONAIRE.

Outside the US, revenue increased by $38m to $1,019m (4%). This movement is attributable to underlying growth of 2% and favourable foreign currency translation of 2%.

Global knee revenue increased by $45m to $806m (6%), representing underlying revenue growth of 5% and favourable foreign currency translation of 1%. There has been continued pressure from the challenging environment on higher specification and early intervention hip and knee implant systems. Nevertheless, our knee

franchise and in particular our LEGION Knee Systems delivered strong growth. This was driven by the FDA clearance to claim that VERILAST bearing technology for knee replacement provides wear performance sufficient for 30 years of actual use under typical conditions and by our VISIONAIRE Patient Matched Instrumentation sets.

Global hip revenue increased by $7m to $688m (1%), all of which was due to favourable foreign currency translation. In our hip franchise, both our traditional and new products have continued to perform well, led by the R3 Acetabular System. Sales of BIRMINGHAM HIP Resurfacing Systems have been weaker, but we are confident that our programme of reinforcing the superior clinical data with surgeons and patients will be effective.

Global trauma revenue increased by $20m to $434m (5%), representing underlying revenue growth of 3% and 2% favourable foreign currency translation. This improvement is attributable to management s actions to provide additional support and training to the sales force.

In Clinical Therapies, EXOGEN Ultrasound Bone Healing System achieved double digit revenue growth for the year. Our joint fluid therapies franchise continues to perform well despite the increased competitive environment in the US. Early in 2010 we sold our niche pain management business and terminated our small spine distribution business in Germany, which reduced our Orthopaedics revenue growth by approximately 1%.

Trading profit

Trading profit increased by $28m (6%) to $536m from $508m in 2009. Trading profit margin increased from 23.8% to 24.4%. This increase is due to cost management and further investment in improving the efficiency and effectiveness of the main processes, primarily in the cost of sales area.

Operating profit

Operating profit increased by $93m to $503m. This comprises the increase in trading profit of $28m discussed above, a $26m reduction in acquisition related costs, a reduction of $21m in the amortisation of acquisition intangibles and impairments and an $18m reduction in costs associated with the Earnings Improvement Programme (EIP).

Endoscopy

Revenue

Endoscopy revenue increased by $64m, or 8%, to $855m from $791m in 2009, comprising 1% favourable currency translation and 7% underlying growth.

In the US, revenue increased by $4m to $353m (1%), all of which represents underlying growth.

Outside the US, revenue increased by $60m to $502m (14%), of which 11% was underlying growth and 3% was due to favourable foreign currency translation.

Global revenue of knee and shoulder repair products increased by $46m to $391m (13%), of which 11% was underlying growth and 2% favourable foreign currency translation.

Revenue in the global resection products sector increased by $17m to $282m (7%), of which 6% represents underlying revenue growth and 1% of favourable foreign currency translation. The resection franchise benefited from the introduction of a new range of radio-frequency ablation probes early in the year.

Global Visualisation revenue reduced by $9m to $112m (-7%), of which -9% represents negative underlying growth, partially offset by 2% of favourable foreign currency translation. This decrease reflects the Group s strategy to only focus on those capital items which are closely aligned with our core resection and repair businesses.

Trading profit

Trading profit increased by $11m (6%) to $200m from $189m in 2009. Trading profit margin decreased from 23.9% to 23.3%. This reflects the increased investment in product development and in the sales force, particularly in the US.

Operating profit

Operating profit increased by $28m to $197m from $169m in 2009. This comprises the $11m increase in trading profit set out above, a reduction of $14m in amortisation of acquisition intangibles and impairments and a $3m reduction in restructuring costs.

Advanced Wound Management

Revenue

Revenue increased by $66m, or 8%, to $912m from $846m in 2009, comprising 1% favourable currency translation and 7% underlying growth. A significant portion of the growth came from our Negative Pressure Wound Therapy (NPWT) product range, which we have continued to expand to offer customers a wide range of clinical options. Our Exudate and Infection Management franchises continue to benefit from new products and line extensions.

In the US, revenue increased by $17m to $178m (11%), all of which is attributable to underlying revenue growth.

Outside the US, revenue increased by $49m to $734m (7%). This is represented by an underlying growth of 6% and 1% of favourable foreign currency translation. European revenue increased by $6m to $454m (1%) of which 5% was underlying growth partially offset by 4% of unfavourable currency translation.

Trading profit

Trading profit increased by $73m (46%) to $233m from $160m in 2009 and trading profit margin increased from 18.9% to 25.6%. The settlement in the year with the vendors of BlueSky Medical Group, Inc with regard to legal expenses in defending our NPWT intellectual property position increased trading profit by $25m. During the year, Advanced Wound Management also benefited from a full year s production at the new manufacturing facility in China, reducing manufacturing costs.

Operating profit

Operating profit increased by $76m to $220m. This comprises the increase in trading profit of $73m and a reduction of $6m in restructuring and rationalisation costs partially offset by an increase of $3m in the amortisation of acquisition intangibles following the acquisition of Nucryst in December 2009.

2009 YEAR

The following discussion and analysis is based upon, and should be read in conjunction with, the Group Accounts of Smith & Nephew included elsewhere in this Annual Report.

Financial Highlights of 2009

Group revenue was $3,772m for the year ended 31 December 2009, representing a 1% decline compared to 2008. Unfavourable currency translation of -3% was partly offset by underlying revenue growth of 2%.

Profit before taxation was $670m in 2009, compared with $564m in 2008. Attributable profit was $472m compared with $377m in 2008. Adjusted attributable profit (calculated as set out in Selected Financial Data), rose 18% to $580m in 2009, from $493m in 2008.

Basic earnings per Ordinary Share were 53.4¢, compared to 42.6¢ for 2008. EPSA (as set out in Selected Financial Data) was 65.6¢ in 2009 compared, to 55.6¢ for 2008, representing an 18% increase.

Fiscal 2009 Compared with Fiscal 2008

The following table sets out certain income statement data for the periods indicated:

	2009 $ million	2008 $ million
Revenue (i)	3,772	3,801
Cost of goods sold (ii)	(1,030)	(1,077)
Gross profit	2,742	2,724
Marketing, selling and distribution expenses (iii)	(1,351)	(1,416)
Administrative expenses (iv)	(513)	(526)
Research and development expenses	(155)	(152)
Operating profit (i)	723	630
Net interest payable	(40)	(66)
Other finance costs	(15)	(1)
Share of results of associates	2	1
Profit before taxation	670	564
Taxation	(198)	(187)
Attributable profit for the year	472	377

(i) Group revenue and operating profit are derived wholly from Continuing Operations and discussed on a segment basis on pages 37 to 38.
(ii) 2009 includes $15m of restructuring and rationalisation expenses and $12m of acquisition related costs (2008 $15m in respect of the utilisation of Plus inventory stepped-up to fair value on acquisition, $18m of restructuring and rationalisation expenses and $8m of acquisition related costs).
(iii) 2009 includes $7m of acquisition related costs and $10m of restructuring and rationalisation expenses (2008 $7m of acquisition related costs and $3m of restructuring and rationalisation expenses).
(iv) 2009 includes $7m of acquisition related costs, $17m of restructuring and rationalisation expenses and $66m relating to amortisation of acquisition intangibles and impairments (2008 $31m of acquisition related costs, $13m of restructuring and rationalisation expenses and $51m amortisation of acquisition intangibles and impairments).

Transactional and Translational Exchange

The Group s principal markets outside the US are, in order of significance, Continental Europe, UK, Australia and Japan. Revenues in these markets fluctuate when translated into US Dollars on consolidation. During the year, the average rates of exchange against the US Dollar used to translate revenues and profits arising in these markets changed compared to the previous year as follows: the Euro weakened from $1.46 to $1.39 (-5%), Sterling weakened from $1.84 to $1.56 (-15%), the Swiss Franc remained flat at $0.92, the Australian Dollar weakened from $0.84 to $0.78 (-7%) and the Japanese Yen strengthened from ¥103 to ¥94 (+9%).

The Group s principal manufacturing locations are in the US (Orthopaedics and Endoscopy), Switzerland (Orthopaedics) and UK (Advanced Wound Management and Orthopaedics). The majority of the Group s selling and distribution subsidiaries around the world purchase finished products from these locations. As a result of currency movements compared with the previous year, purchases from the US became relatively more expensive. The Group s policy of purchasing forward a proportion of its currency requirements mitigates the impact of these movements.

Revenue

Group revenue decreased by $29m (-1%) from $3,801m in 2008 to $3,772m in 2009. Underlying revenue growth was 2%, offset by -3% attributable to unfavourable currency translation.

Orthopaedics revenues decreased by $23m (-1%), of which 1% was attributable to underlying growth, offset by -2% due to unfavourable currency translation. Endoscopy revenues decreased by $9m (-1%), of which 1% was attributable to underlying growth, offset by -2% due to unfavourable currency translation. Advanced Wound Management revenues increased by $3m (nil%), of which 6% was attributable to underlying growth, offset by -6% due to unfavourable currency translation.

A more detailed analysis is included within the Revenue sections of the individual business segments that follow on pages 37 and 38.

Cost of goods sold

Cost of goods sold decreased by $47m to $1,030m from $1,077m in 2008. The main drivers of this decrease are continuing focus on cost efficiency, cost effectiveness and the impact of currency. Other factors contributing to the movement were the decrease of $15m in utilisation of the Plus inventory stepped up to fair value on the acquisition, a decrease of $3m in restructuring and rationalisation expenses, offset by an increase of $4m in other acquisition related costs.

Further margin analysis is included within the Trading profit sections of the individual business segments that follow on pages 37 to 38.

Marketing, selling and distribution expenses

These expenses decreased by $65m to $1,351m from $1,416m in 2008. The decrease was largely driven by continuing focus on cost management, efficiencies achieved through the Earnings Improvement Programme and the impact of currency. These were partly offset by an increase in restructuring and rationalisation expenses of $7m.

Administrative expenses

Administrative expenses decreased by $13m to $513m from $526m in 2008, largely as a result of the focus on cost management and efficiency and the impact of currency. Other factors contributing to the movement were the decrease of $24m in other acquisition related costs, offset by an increase in the amortisation and impairment charge of intangible assets by $15m and an increase of $4m in restructuring and rationalisation expenses.

Research and development expenses

Expenditure as a percentage of revenue increased by 0.1% to 4.1% in 2009 (2008 4.0%). The Group continues to invest in innovative technologies and products to differentiate itself from competitors.

Operating profit

Operating profit increased by $93m to $723m from $630m in 2008 comprising, increase of $28m in Orthopaedics, $23m in Endoscopy and $42m in Advanced Wound Management.

Net interest payable

Net interest payable decreased by $26m from $66m in 2008 to $40m in 2009. This is a consequence of the overall reduction of borrowings within the Group and a reduction in the applicable interest rates.

Other finance cost

Other finance costs in 2009 were $15m compared to $1m in 2008. This increase is attributable to a decrease in the expected return on pension plan assets.

Taxation

The taxation charge increased by $11m to $198m from $187m in 2008. The effective rate of tax was 29.6%, compared with 33.2% in 2008.

The tax charge was reduced by $26m in 2009 (2008 $30m) as a consequence of restructuring and rationalisation expenses, acquisition related costs, amortisation of acquisition intangibles and impairments. The effective tax rate was 27.9% (2008 30.6%) after adjusting for these items and the tax thereon. This is a lower rate than expected due to favourable progress in, and resolution of, certain historic issues.

Group Balance Sheet

The following table sets out certain balance sheet data for the years ended indicated:

	2009 $ million	**2008 $ million**
Non-current assets	2,480	2,523
Current assets	2,071	1,985
Assets held for sale	14	-
Total assets	4,565	4,508
Non-current liabilities	1,523	1,841
Current liabilities	863	968
Total liabilities	2,386	2,809
Total equity	2,179	1,699
Total equity and liabilities	4,565	4,508

Non-current assets decreased by $43m to $2,480m from $2,523 in 2008. Intangible assets and goodwill decreased by $60m of which $112m related to the Plus settlement, $92m to amortisation and impairments and $4m to disposals. These were offset by $102m of additions, $15m relating to the acquisition of Nucryst and $31m relating to favourable currency translation. Property, plant and equipment increased by $28m comprising $216m of additions, $30m of favourable currency

translation and $6m relating to the acquisition of Nucryst. This was offset by $206m of depreciation charge, $10m of disposals and $8m of assets transferred to held for sale. Deferred tax assets decreased by $12m in the year, primarily due to the decrease in post retirement obligations.

Current assets increased by $86m to $2,071m from $1,985m in 2008. This was due to an increase in inventory of $54m and an increase in cash at bank of $47m. These increases were partially offset by a reduction in trade and other receivables of $15m.

Non-current liabilities decreased by $318m from $1,841m in 2008 to $1,523m in 2009. $268m of this decrease was due to the reduction of long-term borrowings. The net retirement benefit obligation decreased by $28m. This was due to experience gains on plan assets and liabilities totalling $88m. These gains were offset by a $47m increase in the defined obligation attributable to changes in actuarial assumptions and $16m of unfavourable currency movements.

Current liabilities decreased by $105m from $968m in 2008 to $863m in 2009. This was due to a decrease in bank overdrafts and current borrowings of $70m, a decrease in trade and other payables of $11m and decrease in current tax payable of $25m.

Total equity increased by $480m from $1,699m in 2008 to $2,179m in 2009. The principal movements were an increase of $472m due to attributable profit, an increase in currency translation and hedging gains of $62m, an increase of $41m relating to actuarial gains on retirement benefit obligations, offset by $10m relating to deferred taxation and $120m due to dividends paid during the year.

Business Segment Analysis

Revenue by business segment and geographic market and trading and operating profit by business segment are set out below:

	2009 $ million	2008 $ million
Revenue by business segment		
Orthopaedics	2,135	2,158
Endoscopy	791	800
Advanced Wound Management	846	843
Total revenue	3,772	3,801
Revenue by geographic market		
Europe (Continental Europe and United Kingdom)	1,313	1,398
United States	1,664	1,657
Africa, Asia, Australasia and other America	795	746
Total revenue	3,772	3,801
Trading profit by business segment		
Orthopaedics	508	481
Endoscopy	189	166
Advanced Wound Management	160	129
Total trading profit	857	776
Operating profit by business segment		
Orthopaedics	410	382
Endoscopy	169	146
Advanced Wound Management	144	102
Total operating profit	723	630

Orthopaedics

Revenue

Orthopaedics revenue decreased by 1% to $2,135m from $2,158m in 2008. Of this decrease, 1% is attributable to underlying growth and -2% is due to unfavourable currency movements. The principal factors in the underlying growth in revenue were the continuing expansion in global orthopaedic markets and the growth of recently launched products.

In the US, revenue increased by $27m to $1,154m (2%), all of which was due to underlying growth. The main factors were the continued growth of products launched in recent years including the LEGION and JOURNEY knees.

Outside the US, revenue decreased by $50m to $981m (-5%), attributable to unfavourable foreign currency translation of -5% and flat underlying revenue growth.

Global knee revenue increased by $3m to $761m (nil%), representing underlying revenue growth of 3% offset by -3% of unfavourable foreign currency translation.

Global hip revenue decreased by $7m to $681m (-1%) of which 1% was due to underlying revenue growth offset by -2% unfavourable foreign currency translation.

Trading profit

Trading profit increased by $27m (6%) to $508m from $481m in 2008. Trading profit margin increased from 22.3% to 23.8%. This increase is due to good cost management and further investment in improving the efficiency and effectiveness of the main processes, primarily in the cost of sales area.

Operating profit

Operating profit increased by $28m to $410m. This largely comprises the increases in trading profit of $27m. A decrease in acquisition related costs of $35m were offset by increases of $17m in costs associated with Earnings Improvement Programme (EIP) and $17m in the amortisation of acquisition intangibles and impairments.

Endoscopy

Revenue

Endoscopy revenue decreased by $9m, or 1%, to $791m from $800m in 2008, comprising -2% unfavourable currency translation and 1% underlying growth.

In the US, revenue decreased by $23m to $349m (-6%), all of which represents negative underlying growth. This is largely attributable to the decrease in demand for capital equipment due to the current economic market conditions.

Outside the US, revenue increased by $14m to $442m (3%), of which 9% was underlying growth offset by -6% of unfavourable foreign currency translation.

Global revenue of knee and shoulder repair products increased by $13m to $325m (4%), of which 12% was underlying growth offset by -8% unfavourable foreign currency translation.

Revenue in the global resection products sector decreased by $29m to $248m (-11%), of which -2% represents negative underlying revenue growth in addition to -9% of unfavourable foreign currency translation.

Global Visualisation revenue decreased by $29m to $121m (-19%), of which -20% represents negative underlying growth offset by 1% of favourable foreign currency translation.

Trading profit

Trading profit increased by $23m (14%) to $189m from $166m in 2008 resulting in a trading profit margin increase from 20.8% to 23.9%. This improvement was mainly due to a greater focus on managing costs and a favourable product mix benefit.

Operating profit

Operating profit increased by $23m to $169m from $146m in 2008. This comprises the $23m increase in trading profit.

Advanced Wound Management

Revenue

Revenue increased by $3m, or nil%, to $846m from $843m in 2008, comprising -6% unfavourable currency translation and 6% underlying growth. Within the infection management and exudate management markets, growth was driven by the extension of the Group s ALLEVYN brand to new products.

In the US, revenue increased by $3m to $161m (2%), all of which is attributable to underlying revenue growth.

Outside the US, revenue remained constant at $685m. This is represented by an underlying growth of 7% offset by -7% of unfavourable foreign currency translation. European revenue decreased by 2% of which -8% was unfavourable currency translation and 6% was underlying growth.

Trading profit

Trading profit increased by $31m (24%) to $160m from $129m in 2008 and trading profit margin increased from 15.3% to 18.9%. This improvement was mainly due to a greater focus on cost management and overall process improvement.

Operating profit

Operating profit increased by $42m to $144m. This largely comprises the increase in trading profit of $31m and a reduction of $10m in restructuring and rationalisation costs.

FINANCIAL POSITION, LIQUIDITY AND CAPITAL RESOURCES

Cash Flow and Net Debt

The main elements of Group cash flow and movements in net debt can be summarised as follows:

	2010	2009	2008
	$ million	$ million	$ million
Cash generated from operations	1,111	1,030	815
Net interest paid	(17)	(41)	(63)
Income taxes paid	(235)	(270)	(186)
Net cash inflow from operating activities	859	719	566
Capital expenditure (net of disposal of property, plant and equipment)	(307)	(318)	(289)
Acquisitions (net of cash acquired)	-	(25)	(16)
Plus settlement	-	137	-
Equity dividends paid	(132)	(120)	(109)
Proceeds from own shares	8	10	4
Issue of ordinary share capital	15	7	19
Treasury shares purchased	(5)	-	(193)
Change in net debt from net cash flow (see Note 27 of the Notes to the Group Accounts)	438	410	(18)
Facility fee	-	-	2
Exchange adjustment	13	(21)	(6)
Opening net debt	(943)	(1,332)	(1,310)
Closing net debt	(492)	(943)	(1,332)

The Group s net debt decreased from $1,310m at the beginning of 2008 to $492m at the end of 2010, representing an overall decrease of $818m. Translation of foreign currency net debt into US Dollars had the effect of increasing net debt by $14m in the three-year period ended 31 December 2010. Closing net debt includes no currency swap liabilities (2009 nil, 2008 $4m).

Net Cash Inflow from Operating Activities

Cash generated from operations in 2010 of $1,111m (2009 $1,030m, 2008 $815m) is after paying out $5m (2009 $5m, 2008 $10m) of macrotextured claim settlements unreimbursed by insurers, $nil (2009 $22m, 2008 $48m) of acquisition related costs and $16m (2009 $32m, 2008 $28m) of restructuring and rationalisation expenses.

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 recent years, capital expenditure on tangible and intangible fixed assets represented approximately 8% of continuing Group revenue.

In 2010, gross capital expenditure amounted to $315m (2009 $318m, 2008 $292m). 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 2010, $15m (2009 $7m, 2008 $27m) of capital expenditure had been contracted but not provided for which will be funded from cash inflows.

Acquisitions and Disposals

In the three-year period ended 31 December 2010, $41m was spent on acquisitions, funded from net debt and cash inflows. This comprised $25m for Nucryst, $14m for BlueSky and $2m for Plus. During 2009, the Group reached an agreement with the vendors of Plus Orthopedics Holdings AG to reduce the total original purchase price to CHF927m. This resulted in an additional cash inflow of $137m.

Liquidity

The Group s policy is to ensure that it has sufficient funding and facilities in place to meet foreseeable borrowing requirements. In December 2010 the Group reviewed and replaced its principal banking facilities ahead of their maturity in May 2012. The Group has reduced its $1,000m 5 year term loan to $500m with effect from 20 December 2010. Smith & Nephew has also cancelled its $1,500m multi-currency revolving loan facility and replaced it with a new 5 year $1,000m multi-currency revolving loan facility.

At 31 December 2010, the Group held $207m (2009 $192m, 2008 $145m) in cash and balances at bank. The Group has committed and uncommitted facilities of $1,511m and $332m respectively. Of the undrawn committed facilities totalling $884m, $7m expires in 2011 and $877m after two but within five years. 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 $22m (of which $10m extends beyond five years).

The principal variations in the Group s borrowing requirements result from the timing of dividend payments, acquisitions and disposals of businesses, the share buy-back programme (announced as suspended in November 2008), timing of capital expenditure and working capital fluctuations.

Smith & Nephew believes that its capital expenditure needs and its working capital funding for 2011, as well as its other known or expected commitments or liabilities, can be met from its existing resources and facilities.

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

Further disclosure regarding borrowings, related covenants and the liquidity risk exposures is set out in Note 19 of the Notes to the Group Accounts. The Group believes that its borrowing facilities do not contain restrictions that would have significant impact on its funding or investment policy for the foreseeable future.

Going Concern

The Group s business activities, together with the factors likely to affect its future development, performance and position are set out in the Description of the Group section on pages 3 to 21. The financial position of the Group, its cash flows, liquidity position and borrowing facilities are described in the Business Review, Liquidity and Prospects section set out on pages 23 to 40. In addition, the notes to the financial statements include the Group s objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments and hedging activities; and its exposure to credit risk and liquidity risk.

The Group has considerable financial resources and its customers and suppliers are diversified across different geographic areas. As a consequence, the directors believe that the Group is well placed to manage its business risk successfully despite the ongoing uncertain economic outlook.

The directors have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. Thus they continue to adopt the going concern basis for accounting in preparing the annual financial statements.

Payment Policies

It is the Group s and Company s policy to ensure that suppliers are paid within agreed terms. At the year-end the Company had no trade creditors.

LEGAL PROCEEDINGS

The Company and its subsidiaries are parties to various legal proceedings, some of which include claims for substantial damages. The outcome of these proceedings cannot readily be foreseen, but with the possible exception of those detailed below, management believes none of them will 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 the provision or will not have a significant impact on the Group s results of operations or financial condition in the period in which they are realised.

Product Liability Claims

In August 2003, the Group withdrew voluntarily from all markets the macrotextured versions of its OXINIUM femoral knee components. A number of related claims have been filed, most of which have been settled. The aggregate cost to date related to this matter is approximately $212m. The Group has sought recovery from its insurers.

To date the primary insurance carrier has paid $60m in full settlement of its policy liability. An additional $22m was received from a successful legal settlement. At 31 December 2010, at least $133m remains due, and the Group has sought coverage from five excess insurance carriers. However, these 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, and trial is expected to commence in 2012.

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. Management believes that the $20m provision remaining is adequate to cover remaining claims. Given the uncertainty inherent in such matters, there can be no assurance on this point.

The Group faces other claims from time to time for alleged defects in its products and has on occasion recalled products to minimise risk of harm or claims. The Group maintains product liability insurance subject to limits and deductibles that management believes are reasonable.

Business Practice Investigations

In March 2005 the US Attorney s Office in Newark, New Jersey issued subpoenas to the five largest sellers of hip and knee implants to US orthopaedic surgeons, including the Group s Orthopaedic business, asking for information regarding arrangements with orthopaedic reconstructive surgeons. In September 2007, the Group (and the other four companies involved) settled the charges that could have resulted from this investigation, without admitting any wrongdoing as part of the settlement. At the same time, the Group entered into a Corporate Integrity Agreement with the Office of the Inspector General (OIG) of the US Department of Health and Human Services which requires certain compliance efforts. This agreement is in effect for five years, until September 2012. If the Group meets its terms, the OIG will not attempt to exclude it from receiving Medicare payments for its products. The Group has devoted substantial effort to comply with this agreement and to enhance its compliance programme across all of its business units.

In September 2007, the SEC notified the Group that it was conducting an informal investigation of companies in the medical devices industry, including the Group, regarding possible violations of the Foreign Corrupt Practices Act (FCPA) in connection with the sale of products in certain foreign countries. The US Department of Justice subsequently joined the SEC s request. The Group is cooperating fully with the US Department of Justice and the SEC regarding these matters, has conducted a broader review on its own initiative, and has disclosed to them information indicating that at least one independent distributor of its products may have made payments that could have FCPA implications. The Group is engaged in discussions to resolve these matters which might include a settlement by which the Group would pay certain amounts and submit to compliance reporting and oversight obligations. There is no assurance that a settlement will be reached, however.

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, in some cases, breach of licence agreement. These disputes are being heard in courts in the United States and other jurisdictions and also before agencies that examine patents. Outcomes are rarely certain and costs are often significant.

Since the Group s entry into the negative pressure wound therapy business in 2007, Kinetic Concepts, Inc. (KCI) has pursued claims of patent infringement against the Group in the US, UK, Germany and other jurisdictions. In one case in the US District Court for the Western District of Texas a jury found that KCI s patents were valid but not infringed by the Group. That ruling was upheld on appeal in February 2009. In a subsequent case in the same court, relating to the Group s foam product, a jury concluded in March 2010 that KCI s asserted patents were valid and infringed. But the court determined the relevant patent claims were invalid and entered judgement in favour of the

Group. KCI has appealed the court s judgement. If KCI were to prevail, the Group could be prevented from selling that foam product in the US until patent expiration in 2014. KCI has also pursued patent infringement claims in certain countries relating to pumps, canisters and other negative pressure wound therapy accessories.

The Group has won jury verdicts against Arthrex Inc., (Arthrex) for infringement of the Group s patents relating to suture anchors (in the US District Court for Oregon) and femoral fixation devices for ACL reconstruction (in the US District Court for the Eastern District of Texas). Arthrex appealed both decisions. The Oregon decision was reversed on appeal and remanded to the District Court for a new trial, scheduled to begin in June 2011.

In a case filed in September 2008 in the US District Court for the Western District of Tennessee against the Group's US subsidiary, three individuals are seeking substantial royalty and other damages in connection with sales of certain products within the Group s Orthopaedics business based on various legal theories including alleged breach of contracts entered into in 1988-1999 and patent infringement. The Group disputes these claims. Trial is expected to commence in 2012.

Other Matters

In April 2009, the Group was served with a subpoena by the US Department of Justice in Massachusetts requiring the production of documents from 1995 to 2009 associated with the marketing and sale of the Group s EXOGEN bone growth stimulator. Similar subpoenas have been served on a number of competitors in the bone growth stimulator market. Around the same time a qui tam or whistleblower complaint concerning the industry s sales and marketing of those products, originally filed in 2005 against the primary manufacturers of bone growth stimulation products (including Smith & Nephew), was unsealed in federal court in Boston, Massachusetts. A motion to dismiss that complaint was denied in December 2010.

In June 2010 the Group was served with another subpoena by the US Department of Justice in Massachusetts requiring the production of documents relating to the distribution of samples of the Group s SUPARTZ joint fluid therapy product.

The Group is subject to country of origin requirements under the US Buy American and Trade Agreements Acts with regard to sales to certain US government customers. The Group has voluntarily disclosed to the US Veterans Administration and the US Department of Defense that a small percentage of the products sold to the US government in the past, primarily from the Orthopaedics business, may have originated from countries that are not eligible for such sales except with government consent. Government auditors subsequently conducted an on-site visit at the Group s Orthopaedics business. In December 2008, three months after our initial voluntary disclosure, a whistleblower suit was filed in the US District Court for Massachusetts alleging these violations. Smith & Nephew s motion to dismiss the suit was denied in November 2010.

OUTLOOK AND TREND INFORMATION

The discussion below contains certain forward-looking statements that may or may not prove accurate. For example, statements regarding expected revenue growth and trading margins, market trends and our product pipeline are forward looking statements. Phrases such as aim , plan , intend , anticipate , well placed , believe , estimate , target , consider , and similar expressions are generally intended to identify forward looking statements. Forward-looking statements involve known and unknown risks and uncertainties and other important factors that could cause actual results to differ materially from those projected in forward-looking statements. For Smith & Nephew, these factors include: economic and financial conditions in the markets we serve, especially those affecting health care providers, payors and customers; price levels for established and innovative medical devices; developments in medical technology; regulatory approvals; reimbursement decisions or other government actions; products 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 depositions and our success in integrating acquired businesses; and numerous other matters which affect us or our markets, including those of a political, economic business or competitive nature.

For additional information on factors that could cause the Group s actual results to differ from estimates reflected in these forward-looking statements, can be found under Risk Factors within this document.

Information regarding the recent and longer term market growth trends is given for each of the Group s global business units in the relevant Market and Competition sections under Business Description on pages 4 to 9.

The Group has delivered another strong performance, with the majority of businesses outperforming their respective markets. The current market challenges are well understood. The Group is meeting them by supplying innovative products which offer clinical and cost benefit for our customers and continuing to execute efficiency programmes across our businesses. The long-term growth drivers underpinning the Group s industry including demographics, emerging markets and patients desire to return to an active life remain strong.

During 2011, the Group expects Orthopaedic Reconstruction to grow at above the market rate, as the momentum in our knee franchise is expected to continue. In Orthopaedic Trauma the Group made substantial improvements in 2010 and are committed to sustaining this performance. In Endoscopy the Group expects to achieve above market growth in Arthroscopy (sports medicine), driven by the repair product segment. In Advanced Wound Management the Group believes it will continue to grow at above the market rate.

The Group made further trading margin progress during 2010, achieving a trading profit margin of 23.9% (before the benefit of the BlueSky settlement), and continues to see many areas in our businesses which offer further efficiencies. The Group also sees an increasing number of investment opportunities to drive top line growth, both geographically and in new products. The Group is taking advantage of these opportunities and anticipates that in the short to medium term the cost of these investments will broadly offset our further efficiency savings.

The Group believes it has a clear, balanced, plan for the future, based on the same strategic pillars which have maintained growth and investment during the recent global cyclical downturn, while delivering significant margin improvement. We are confident that, by offering our customers the right product, at the right time with the right value proposition, we are positioned to continue to deliver long term growth.

CONTRACTUAL OBLIGATIONS

Contractual obligations at 31 December 2010 were as follows:

		Payments due by period			
	Total $ million	Less than 1 year $ million	1-3 years $ million	3-5 years $ million	More than 5 years $ million
Debt obligations	677	53	498	126	-
Finance lease obligations	22	4	4	4	10
Operating lease obligations	166	53	59	33	21
Retirement benefit obligation	75	75	-	-	-
Purchase obligations	-	-	-	-	-
Capital expenditure	15	15	-	-	-
Other	33	33	-	-	-
	988	233	561	163	31

Other contractual obligations represent $33m of foreign exchange contracts. Provisions that do not relate to contractual obligations are not included in the above table.

The agreed contributions for 2011 in respect of the Group s defined benefits plans are: $38m for the UK (including $29m of supplementary payments), $30m for the US plan and $7m for other funded defined benefit plans. The table above does not include amounts payable in respect of 2012 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 on page 66.

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

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 34 of Notes to the Group Accounts), no other related party had material transactions or loans with Smith & Nephew over the last three financial years.

CORPORATE GOVERNANCE STATEMENT

This section discusses Smith & Nephew s structures and governance procedures.