SMITH & NEPHEW PLC
Form 20-F
March 01, 2012
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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, 2011

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

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Every day each one of us at **smith&nephew**

helps improve the life of someone, somewhere

in the world. That s something to be proud of.

Front Cover:

Smith & Nephew is a world leader in sports medicine and joint

replacement technology to relieve pain and heal the body.

Important information on Smith & Nephew, Presentation,

Special note regarding forward-looking statements, Segment data and Documents on

display are set out on page 156.

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For over 150 years, Smith & Nephew has developed advanced medical devices for healthcare professionals around the world. Our pioneering technologies enable nurses, surgeons and other medical practitioners to provide effective treatment more quickly and economically.

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Overview

Smith & Nephew at a glance

Smith & Nephew is a global medical technology business dedicated to helping improve people s lives. With leadership positions in Orthopaedic Reconstruction and Trauma, Advanced Wound Management and Endoscopy (sometimes referred to as Arthroscopy or sports medicine).

Our strategic priorities Read more about our strategic priorities on page 10.

Established Markets
Emerging Markets
Innovate for value
Simplify and improve our operating model
Supplement the organic growth through acquisitions

Our performance

[1] Explanations of these non-GAAP financial measures are provided on pages 20 to 22.

[2] Underlying increase/decrease after adjusting for the effect of currency translation.

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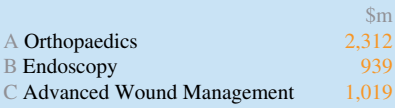
In August 2011, the Group announced its new strategic priorities. Part of this framework was the implementation of an organisational change. Smith & Nephew has brought together the Orthopaedics and Endoscopy business segments, creating the Advanced Surgical Devices division, which will sit alongside the Advanced Wound Management division. These two divisions will serve the Established Markets and will support our newly created Emerging Markets (focusing on China, India, Brazil and Russia) and International Markets organisations. For reporting purposes, the two division structure will replace the three business segment structure during 2012.

Our business segments in 2011

Revenue by business **$4.3bn**



Orthopaedics

The Orthopaedics business segment comprises reconstruction (primarily implants including hip, knee and shoulder joints), trauma (internal and external fixation devices) and Clinical Therapies (bone growth stimulation and joint fluid therapies).

Global segment size[3]	Revenue
$17.8bn	$2.3bn
Global segment growth[2,3]	Revenue growth[2]
+2%	+2%
Trading profit	Trading profit margin
$492m	21.3%
Operating profit	Operating profit margin

Endoscopy

The Endoscopy business segment develops and commercialises arthroscopy (minimally invasive surgery) techniques, educational programmes and value-added services for surgeons to treat and repair soft tissue and articulating joints.

Global segment size[3]	Revenue
$3.8bn	$0.9bn
Global segment growth[2,3,4]	Revenue growth[2]
+8%	+6%
Trading profit	Trading profit margin
$222m	23.6%
Operating profit	Operating profit margin

Advanced Wound Management

The Advanced Wound Management business segment offers a range of products from initial wound bed preparation through to full wound closure and Negative Pressure Wound Therapy. These products are targeted at chronic wounds associated with the older population and for the treatment of wounds such as burns and from invasive surgery.

Global segment size[3]	Revenue
$5.5bn	$1.0bn
Global segment growth[2,3]	Revenue growth[2]
+3%	+7%
Trading profit	Trading profit margin
$247m	24.3%
Operating profit	Operating profit margin

$415m	17.9%	$215m	22.9%	$232m	22.8%
Segment share[3]		Segment share[3]		Segment share[3]	
11%		21%		18%	

VERILAST s use of OXINIUM, oxidized Zirconium, results in a knee which has been proven to last 30 years, twice the current industry standard of 15 years.

The FAST-FIX 360 Meniscal Repair System offers exceptional fixation strength and enhanced control to optimise the chances of a successful meniscus repair.

PICO is a small portable pump, providing 7 days effective Negative Pressure Wound Therapy yet is small enough to fit discreetly into a pocket.

Read more about our Orthopaedics business on page 31.

Read more about our Endoscopy business on page 35.

Read more about our Advanced Wound Management business on page 38.

[3] These are estimates generated by Smith & Nephew based upon public sources and internal analysis.

[4] Global segment data represents the Arthroscopy market which is a combination of repair and resection products. The Endoscopy business includes additional product categories.

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Where we operate

Smith & Nephew has nearly 11,000 employees and a presence in more than 90 countries.

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Overview

Chairman s statement

Sir John Buchanan

Chairman

We are striving to build a successful, sustainable business

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Dear shareholder,

Smith & Nephew is in a transition phase. The external environment is a challenge for all businesses. With CEO succession we have taken the opportunity to review the fundamentals of what we do.

Led by our new CEO, Olivier Bohuon, the Group is embracing a new set of strategic priorities which build on established strengths, recent successes and emerging opportunities. To stimulate sales growth we are enhancing our innovation processes in both established and new markets.

The Group focuses both on what we do to create long-term sustainable value, and on how we do it. Matters of health, safety, environment, compliance, ethics and the treatment of employees, customers, suppliers and the communities in which we operate are all important to Smith & Nephew.

Financial & business review

We are building from a strong and stable financial base, a foundation that has strengthened despite the challenges of the last three years.

In 2011, we increased revenue by 4% on an underlying basis to $4,270m and delivered a trading profit of $961m. Free cash flow, a key indicator of the health of any business, was good and we increased our adjusted earnings per share. The Board is pleased to recommend a proposed final dividend for the year of 10.8 cents per share, up 10% on 2010.

All of our businesses contributed to the revenue uplift. In Orthopaedics we led the market in knee growth amongst our major competitors, Endoscopy generated double-digit growth in our sports medicine repair franchise and Advanced Wound Management grew at more than double the market rate and exceeded $1 billion in revenue for the first time.

We don t assume that the external environment will be easier in the year ahead. Nor do we expect competitive pressures to diminish. We are well positioned to deal with these challenges, building upon our performance in 2011, and we continue to seek ways to further enhance our competitive positions.

Board changes

We were very pleased to welcome our new CEO, Olivier Bohuon, in April 2011, following the retirement of David Illingworth.

David s numerous contributions, from putting the customer-relationship at the heart of the business to the earnings and margin achievements, leave a good platform for the next stage of our journey. I am sure you will join the Board in thanking David for his important contribution.

Olivier, with his healthcare background, leadership skills and notable record, is well placed to take the Group forward. The Board is confident that we will evolve as a fitter, more focused business, ready to tackle new opportunities and challenges.

We were also delighted to welcome Ajay Piramal to the Board in January 2012. He is one of India s most respected businessmen. Ajay s global healthcare experience and emerging markets expertise will further strengthen the Board.

Thank you

With so much change there can be unsettling effects. The Board has been constantly impressed by the passion to serve customers and the determination to compete which our management and employees continue to exhibit wherever they are in the world.

We recognise that change can also engender uncertainties for shareholders. We will continue to enhance our record of long-term value creation and thank you for your support over recent times. I have had the opportunity to meet many of our institutional and private shareholders and have appreciated greatly their ideas and input. We are your Group, and we strive to build a sustainable, successful business.

Sir John Buchanan

Chairman

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Strategy, KPIs & Risk management

Chief Executive Officer s statement

Olivier Bohuon

Chief Executive Officer

We are building a business that is stronger, growing faster, better balanced and is fit and effective for

the future

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Dear shareholder,

Smith & Nephew delivered strong results in 2011, despite the prevailing difficult macro-economic climate. The market is not getting any easier, and we are not resting on the successes of the past. We have great ambitions for the future and are taking active measures to transform your Group.

I believe that many growth opportunities exist; that we can secure greater market-share in our Established Markets and be market leaders in the Emerging Markets. Our success will be built through innovation and efficiency, driving permanent improvements across the Group. These principles are at the heart of our new strategic priorities, announced in August 2011, which we are working tirelessly to embed across the Group.

New strategic priorities

First, in our **Established Markets**, we believe we can build upon existing strong positions and win market share. We will do this through greater innovation and being more efficient, liberating resources for investment in those areas that will maximise both revenue and margins.

Second, in **Emerging Markets**, we will build upon our initial success in China and expand to create sustainable businesses in India, Brazil and Russia. These Emerging Markets are enjoying good GDP growth and there is an increasing demand for high quality medical products from amongst the population and an expanding surgical infrastructure to deliver these safely, the key features required to make a new market attractive to Smith & Nephew.

Our performance in the Established and Emerging Markets will be driven by an unremitting focus to **Innovate for Value**, our third strategic priority. Our future success depends upon offering new technologies designed for each market where we operate. We are accelerating our rate of innovation by increasing the research & development budget and prioritising projects that will deliver maximum value.

Next, we will **Simplify and Improve our Operating Model**, streamlining the business and reducing our cost of goods through actions such as optimising our manufacturing footprint.

Finally, we will **Augment our Organic Growth through Acquisitions**. We will continue with our successful strategy of adding complementary technologies. We will also now seek to support our Emerging Markets ambitions by acquiring local manufacturing and/or distribution businesses and we remain alert to larger opportunities to support our ambitions in advanced woundcare, minimally invasive surgery and extremities.

Sustainability

Through our new strategic priorities we are seeking to maximise growth and revenue through building a sustainable business. We embrace the wider responsibilities this brings, and will work to protect the environment, our employees and the communities in which we work, as well as to meet our customers high expectations and global compliance obligations, as we deliver on our action plans.

Progress in delivery

We have made considerable progress reshaping the business in line with these priorities.

Our management teams in our Advanced Surgical Devices and Advanced Wound Management divisions are now focused exclusively on meeting the needs of our customers in the Established Markets.

We have strong leadership to drive us into the Emerging and other International Markets. We are investing an additional $300m over the next five years into R&D to drive our innovation agenda. And our programmes to realise efficiencies, liberate resources and reduce the cost of goods are well underway.

We are building momentum every day and I am confident that the result will be a business that is stronger, growing faster, better balanced and is fit and effective for the future.

Olivier Bohuon

Chief Executive Officer

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Strategy, KPIs & Risk management

Our strategic priorities and key performance indicators (KPIs)

Smith & Nephew use a range of measures to monitor progress against our five strategic priorities and against our overall financial goal. While their relative importance changes as market conditions evolve, progress against all five priorities continues to drive our growth.

Financial goal	
To deliver a higher return to shareholders than our peer group over the longer term.	
Strategic priorities	
Established Markets	In Established Markets (US, Europe, Australia, New Zealand, Canada and Japan), Smith & Nephew sees opportunities to build upon existing strong positions, to win market share through greater innovation and drive efficiencies to liberate resources. Through these actions the Group seeks to meet the challenges of subdued markets and maximise both revenue growth and profit margins.
Emerging Markets	Smith & Nephew believes it can secure market leadership in the Emerging Markets, building upon its initial success in China and expanding to create sustainable businesses in India, Brazil and Russia. In particular, the Group sees significant opportunities to build value through augmenting its existing portfolio with new products specifically designed for and manufactured in these markets.
Innovate for value	The Group s future success depends upon continuing to offer new technologies to customers around the world. Smith & Nephew is accelerating its rate of innovation by increasing the research & development budget and identifying and investing in the projects that will deliver maximum value.

Simplify and improve our operating model

Smith & Nephew will work to ensure the business structure and processes support our innovation agenda and the Group seeks to maximise efficiency in everything it does. There are opportunities to streamline the Group s operations and manufacturing processes and to remove duplication. Smith & Nephew is building strong global functions human capital, regulatory, quality, sustainability and legal affairs to support its management teams in their quest to better serve the Group s markets and customers.

Supplement organic growth through acquisitions

The Group aims to augment its organic growth through acquisitions. Smith & Nephew will continue with its successful strategy of acquiring complementary technologies, seek to support our Emerging Markets ambitions by acquiring local manufacturing and distribution businesses and remain alert to larger opportunities to support expansion in the advanced woundcare, extremities or minimally invasive surgery sectors.

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What we will measure (KPIs)	Why we will measure
Total Shareholder Return	Monitor the value created for shareholders over the longer term
Growth in statutory and adjusted earnings per share	Demonstrate the improvement in underlying earnings per share for our shareholders
Trading cash flow	Measure 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
Growth in the Established Markets versus the market	Track the relative strength of our market positions
Emerging Markets % of Group revenue	Track underlying growth of Emerging Markets to global growth
Growth of individual Emerging Markets versus the market	Monitor progress in key market segments
% of Group revenue from products launched in the last 36 months	Monitor impact from innovation

R&D expense as % of Group revenue	Monitor underlying investment in R&D
Trading profit growth	Track our underlying trading profit growth
Trading profit margin	Monitor underlying trading profitability
Waste/Recycling normalised metric	Reduce amount of waste for the Group, our customers, and the environment
Energy use normalised metric	Total energy consumption (volumetrically)
Return on cash invested	Monitor value created for shareholders

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Strategy, KPIs & Risk management

Risk management

Smith & Nephew is focused on managing the principal risks facing the Group.

As an integral part of planning and review, Group management and management of each of the business segments 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 business segment 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

Risk	Context	Specific risks we face
Disruptive technologies	The medical devices industry has a rapid rate of new product introduction. The Group must be adept at monitoring the landscape for technological advances, make good investment/acquisition choices, have an efficient and valuable product development pipeline and secure protection for its intellectual property.	Competitors may introduce a disruptive technology, or obtain patents or other intellectual property rights, that affect the Group s competitive position Lack of innovation due to low R&D investment, R&D skills gap or poor product development execution Failure to successfully commercialise a pipeline product, failure to receive regulatory approval, or changes in consumer demand
Government action, pricing and reimbursement	In most markets throughout the world, expenditure on medical devices is controlled to a large extent by governments, many of which are facing increasingly intense budgetary constraints. Funds may be made available or withdrawn from healthcare budgets depending	Reduced reimbursement levels and increasing pricing pressures

pressure	on government policy budgetary and other considerations. The Group is therefore largely dependent on governments providing increased funds commensurate with the increased demand arising from demographic trends. Reimbursement rates may be set in response to perceived economic value of the devices, based on clinical and other data relating to cost, patient outcomes and comparative effectiveness.	Reduced demand for elective surgery Increased focus on health economics Changes in medical device tax policy
Supply, system and site disruption	Unexpected events could disrupt the business by affecting either a key facility or system or a large number of employees. The business is also reliant on certain key suppliers of raw materials, components, finished products and packaging materials.	Competitors with higher market share and lower costs Catastrophe could render one of the Group s production facilities out of action A significant event could impact key leadership or a large number of employees Issues with a single source supplier of a key component and failure to secure critical supply A severe IT fault could disable critical systems
Product regulation, compliance and litigation	The medical device industry is highly regulated. 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. Such controls have become increasingly stringent and costly to comply with and the Group believe this trend will continue. They also review data supporting the safety and efficacy of such products and regulatory requirements may entail inspections for compliance with appropriate standards, including those relating to Quality Management Systems (QMS) or Good Manufacturing Practice (GMP) regulations.	Non-compliance with regulatory policies and standards could result in fines, penalties, and prosecutions. Product recalls, lost sales and inventory write-offs Third party liability claims Damage to reputation
Compliance with laws and regulations	Business practices in the healthcare industry are subject to increasing regulation and review by various government authorities. In general, the trend in many countries is towards higher expectations and increased enforcement activity by governmental authorities. The Group is also subject to increased regulation of personal information. Expansion into emerging	Violation of healthcare, data privacy or anti-corruption laws could result in fines, loss of reimbursement and impact reputation.

markets could also pose additional compliance risks.	Serious breaches could potentially prevent the Group from doing business.

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management who have primary responsibility for managing each of these risks along with selected actions they have put in place to mitigate such risks. In addition, the Board considers risk as part of the development of strategy.

There are known and unknown risks and uncertainties relating to Smith & Nephew s business. The table below provides an overview of what the Board considers to be the most significant risks that could cause the Group s business, financial position

and results of operations to differ materially and adversely from expected and historical levels, and how these risks relate to the Group s strategic priorities. A more detailed discussion of the Group s risks and uncertainties can be found in the Risk factors section on pages 16 to 18. 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.

	Possible impacts include	Mitigation	Link to strategic priority
	Loss of market share, profit and long-term growth	R&D Model: increasing productivity, prioritisation and allocation of funds	**Innovate for value**
		Increasing R&D investment in order to enhance clinical capability, invest in biomaterials, stregthen intellectual property rights and support an Emerging Market portfolio	**Simplify and improve our operating model**
		Business development to augment the portfolio	**Supplement the organic growth through acquisitions**
		Speed to market of new products	

Loss of revenue, profit and cash flows	Enhanced expertise supporting reimbursement strategy and guidance	**Simplify and improve our operating model**
	Develop innovative economic product and service solutions for both Established and Emerging Markets	**Established Markets**
	Incorporate health economic component into design and development of new products	
	Optimise cost to serve to protect margins and liberate funds for investment	
	Streamline cost of goods sold and inventory	
Loss of revenue, profit and cash flows	Ensure crisis response/business continuity plans at all major facilities and for key products	**Simplify and improve our operating model**
	Audit programme for critical suppliers and second sources for critical components	**Established Markets**
	Regular review of supply contracts with supplier consolidation and vertical integration where beneficial	
	IT disaster and data recovery plans are in place and support overall business continuity plans	
Loss of revenue, reduction	Enhanced leadership and resources	**Simplify and improve our operating model**

in share price and negative impact on brand/reputation	Standardise the Group s management review practice	**Innovate for value**
	Maintain internal auditing programmes to assure compliance	
	Group-wide robust validation practices to drive true production line performance and dependability	
	Group-wide objectives for quality, operational and process yield improvements	
Loss of profit and reduction in share price	Board and Executive oversight committees supported by Compliance experts and infrastructure	**Simplify and improve our operating model**
	Code of Conduct/Global Policies and Procedures (GPPs) providing controls for significant compliance risks	**Emerging Markets**
	Training and e-resources to guide employees and third parties with compliance responsibilities	**Established Markets**
	Monitoring and auditing programmes to verify implementation and compliance	
	Independent reporting channels for employees and third parties to report concerns with confidentiality	

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Our business, marketplace and other factors that could affect us

We look at our business in relation to issues

in the wider marketplace in which we operate.

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 local and multinational corporations, including some with greater financial, marketing and other resources.

The Group s business reflects a wide range of distribution channels, purchasing agents and buying entities in over 90 countries worldwide. The largest single customers worldwide are purchasing groups in the US and the UK that represented 6% and 5% respectively of the Group s worldwide revenue in 2011.

In the US, the Group s products are marketed directly to healthcare providers, hospitals and other healthcare facilities with each business segment operating dedicated sales forces. The US sales forces consist of a mixture of independent contract workers and employees. Sales agents are contractually prohibited from selling products that compete with Smith & Nephew products. Orthopaedics and Endoscopy products are principally shipped and invoiced to healthcare providers, hospitals and other healthcare facilities. Certain Advanced Wound Management products are shipped and invoiced to wholesale distributors, others are consigned to distributors that lease the devices to healthcare providers, hospitals and other healthcare facilities and end-users. In most other Established Markets, each business segment typically manages employee sales forces directly, and also ships and invoices products both directly to healthcare providers, hospitals and other healthcare facilities and to wholesale distributors.

In Emerging Markets and International Markets the Group operates through direct selling and marketing operations, and through distributors. 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.

Sales trends

Smith & Nephew s business segments participate in the global medical devices market and share a common focus on the repair of the human body. Smith & Nephew s principal geographic markets are in the established healthcare economies of the US, Europe, Japan, Canada, Australia and New Zealand.

These markets are characterised by increased longevity, more active lifestyles, obesity, increased affluence and an increase in the average age of the population caused by the immediate post-World War II baby boomer generation approaching retirement. 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 patient awareness of available healthcare treatments through the internet and direct-to-customer advertising has led to some increased patient influence over product purchasing decisions.

For a description of the impact on each business segment refer to the Market and competition sections under Business segment reviews on pages 30 to 40.

Manufacturing, supply & 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 segment 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.

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The Group outsources manufacturing where necessary to obtain specialised expertise or where it is possible to gain lower cost without undue 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 screen displays, optical and electrical devices in the Endoscopy business and skincare products in the Advance Wound Management 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 for Orthopaedics and Oklahoma City 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, UK; and Atlanta, US.

Research and development

Smith & Nephew 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 each business segment. Expenditure on research and development amounted to $167m in 2011 (2010 $151m, 2009 $155m), representing approximately 3.9% of Group revenue (2010 3.8%, 2009 4.1%).

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

Research and development is primarily carried out at the Group s principal locations, notably in Memphis, US (Orthopaedics), Mansfield, US (Endoscopy) and Hull, UK (Advanced Wound Management). There are a number of other smaller research and developments units situated at other locations around the Group. In-house research is supplemented by work performed by academic institutions and other external research organisations in Europe, America and Asia.

Intellectual property

Smith & Nephew has a policy of protecting 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, 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.

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.

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 16 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 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.

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Our business, marketplace and other factors that could affect us continued

Risk factors

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

Highly competitive markets

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

There is a possibility of further consolidation of competitors, which could adversely affect the Group s ability to compete with larger companies due to insufficient financial resources. If any of the Group s businesses were to lose market share or achieve lower than expected 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 segments must continue to develop innovative products that satisfy customer needs and preferences or provide cost or other advantages. Developing new products is a costly, lengthy and uncertain process. A potential product may not be brought to market or not succeed in the market for any number of reasons, including failure to work optimally, failure to receive regulatory approval, failure to be cost-competitive, infringement of patents or other intellectual property rights and changes in consumer demand. The Group s products and technologies are also subject to marketing attack by competitors. Furthermore, new products that are developed and marketed by the Group s competitors may affect price levels in the various markets in which the Group s business segments operate. If the Group s new

products do not remain competitive with those of competitors, the Group s revenue could decline.

The Group maintains reserves for excess and obsolete inventory resulting from the potential inability to sell its products at prices in excess of current carrying costs. Marketplace changes resulting from the introduction of new products or surgical procedures may cause some of the Group s products to become obsolete. The Group makes estimates regarding the future recoverability of the costs of these products and records a

provision for excess and obsolete inventories based on historical experience, expiration of sterilisation dates and expected future trends. If actual product life cycles, product demand or acceptance of new product introductions are less favourable than projected by management, additional inventory write-downs may be required.

Dependence on government and other funding

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

Pricing of the Group s products is largely governed in most established markets by governmental reimbursement authorities. Initiatives sponsored by government agencies, legislative bodies and the private sector to limit the growth of healthcare costs, including price regulation, excise taxes and competitive pricing, are on-going 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, changes to the healthcare 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 healthcare, including extensive and complex rules in the US. Failure to do so could result in fines or loss of future funding.

World economic conditions

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

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During 2011, economic conditions worldwide continued to create several challenges for the Group, including deferrals of joint replacement procedures, heightened pricing pressure, significant declines in capital equipment expenditures at hospitals and increased uncertainty over the collectability of European government debt, particularly those in certain parts of southern Europe. These factors tempered the overall growth of the Group s global markets and could have an increased impact on growth in the future.

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

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

The Group manages the impact of exchange rate movements on 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 uses the US Dollar as its reporting currency and the US Dollar is the functional currency of Smith & Nephew plc. The Group s revenues, profits and earnings are also affected by exchange rate movements on the translation of results of operations in foreign subsidiaries for financial reporting purposes. See Financial position, liquidity and capital resources on page 25.

Manufacturing and supply

The Group s manufacturing production is concentrated at 11 main facilities in Memphis, Mansfield and Oklahoma City 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 segments 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 and other 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.

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 passed in 2010 and became effective in 2011, increasing the risk 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 on page 28. 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 approval

The international medical device industry is highly regulated. Regulatory requirements are a major factor in determining whether substances and materials can be developed into marketable products and the amount of time and expense that should be allotted to such development.

National regulatory authorities administer and enforce a complex series of laws and regulations that govern the design, development, approval, manufacture, labelling, marketing and sale of healthcare products. They also review data supporting the safety and efficacy of such products. Of

particular importance is the requirement in many countries that products be authorised or registered prior to manufacture, marketing or sale and that such authorisation or registration be subsequently maintained. The major regulatory agencies for Smith & Nephew s products include the Food and Drug Administration (FDA) in the US, the Medicines and Healthcare products Regulatory Agency in the UK, the Ministry of Health, Labour and Welfare in Japan and the State Food and Drug Administration in China. At any time, the Group is awaiting a number of regulatory approvals which, if not received, could adversely affect results of operations.

The trend is towards more stringent regulation and higher standards of technical appraisal. Such controls have become increasingly demanding to comply with and management believes that this trend will continue. 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 lengthen 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 and external audit for compliance with national and Group medical device regulation and policies.

Payment for medical devices may be governed by reimbursement tariff agencies in a number of countries. Reimbursement rates may be set in response to perceived economic value of the devices, based on clinical and other data relating to cost, patient outcomes and comparative effectiveness. They may also be affected by overall government budgetary considerations. The Group believes that its emphasis on innovative products and services should contribute to success in this environment.

Failure to comply with these regulatory requirements could have a number of adverse consequences, including withdrawal of approval to sell a product in a country, temporary closure of a manufacturing facility, fines and potential damage to company reputation.

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.

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Financial review

Adrian Hennah

Chief Financial Officer

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Financial review continued

Chief Financial Officer highlights

Group revenue was $4,270m for the year ended 31 December 2011, representing an 8% growth compared to 2010. This comprised of underlying revenue growth of 4% and favourable currency translation of 4%.

Profit before taxation was $848m in 2011, compared with $895m in 2010. Attributable profit in 2011 was $582m compared to $615m in 2010. Adjusted attributable profit (calculated as set out in Selected financial data on pages 145 to 146) rose 2% to $664m in 2011, from $654m in 2010.

Basic earnings per Ordinary Share were 65.3¢, compared to 69.3¢ for 2010. EPSA (as set out in Selected financial data) was 74.5¢ in 2011 compared to 73.6¢ for 2010, representing a 1% increase.

	2011 $ million	2010 $ million	2009 $ million
Financial highlights (i) (iii)			
Revenue	**4,270**	3,962	3,772
Underlying growth in revenue (%)	***4%***	*4%*	*2%*
Trading profit	***961***	*969*	*857*
Underlying growth in trading profit (%)	***(4)%***	*11%*	*15%*
Trading profit margin (%)	***22.5%***	*24.5%*	*22.7%*
Operating profit	**862**	920	723
Attributable profit for the year	**582**	615	472
Adjusted attributable profit	***664***	*654*	*580*
Basic earnings per Ordinary Share	**65.3¢**	69.3¢	53.4¢
EPSA	**74.5¢**	73.6¢	65.6¢
Growth in EPSA (%)	***1%***	*12%*	*18%*
Dividends per Ordinary Share (ii)	**17.40¢**	15.82¢	14.39¢
Cash generated from operations	**1,135**	1,111	1,030
Trading cash flow	***838***	*825*	*771*
Trading profit to cash conversion (%)	***87%***	*85%*	*90%*

(i) Items shown in italics are non-GAAP measures. Reconciliations to reported figures are on pages 21 to 22.

(ii) The Board has proposed a final dividend of 10.80 US cents per share which together with the first interim dividend of 6.60 US cents makes a total for 2011 of 17.40 US cents. The final dividend is expected to be paid, subject to shareholder approval, on 9 May 2012 to shareholders on the Register of Members at the close of business on 20 April 2012.

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

Measuring performance

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 a measure not in accordance with Generally Accepted Accounting Principles (a non-GAAP measure).

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

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

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

The material limitation of the underlying growth in revenue measure is that it excludes certain factors, described above, which ultimately have a significant impact on total revenues. The Group compensates for this limitation by taking into account relative movements in exchange rates in its investment. strategic planning and resource allocation. in addition, as the evaluation and assessment of business acquisitions is not within the control of local management. performance of acquisitions is monitored centrally until the business is integrated.

The Group s management considers that the non-GAAP measure of underlying growth in revenue and the GAAP measure of growth in revenue are complementary measures, neither of which management uses exclusively.

Underlying growth in revenue reconciles to growth in revenue reported, the most directly comparable financial measure calculated in accordance with IFRS by making two adjustments, the constant currency exchange effect and the acquisitions effect , described below.

The constant currency exchange effect is a measure of the increase/decrease in revenue resulting from currency movements on non-US Dollar sales. 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.

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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.

Reported revenue growth, the most directly comparable financial measure calculated in accordance with IFRS, reconciles to underlying growth in revenue as follows:

	2011	2010	2009
	%	%	%
Reported revenue growth	8	5	(1)
Constant currency exchange effect	(4)	(1)	3
Underlying revenue growth	4	4	2

A reconciliation of reported revenue growth to underlying revenue growth, by business segment, can be found on pages 30 to 40.

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 affects the Group s short-term profitability. The Group presents this measure to assist investors in their understanding of trends. The Group has identified the following items, where material, as those to be excluded from operating profit when arriving at trading profit: acquisition and disposal related items including amortisation of acquisition intangible assets and impairments; significant restructuring events; and gains and losses resulting from legal disputes and uninsured losses.

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 the trends. The Group s international financial reporting (budgets, monthly reporting, forecasts, long-term planning and incentive plans) focusses 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 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 financial measure of operating profit. The Group considers that no single measure enables it to assess overall performance and therefore it compensates for the limitation of the trading profit measure by considering it in conjunction with its GAAP equivalent. 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.

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

	2011	2010	2009
	$ million	$ million	$ million
Operating profit	**862**	920	723
Acquisition related costs			26
Restructuring and rationalisation costs	**40**	15	42

Amortisation of acquisition intangibles and impairments	**36**	34	66
Legal provision (see page 29)	**23**		
Trading profit	**961**	**969**	**857**

A reconciliation of operating profit to trading profit, by business segment, can be found on pages 30 to 40.

Adjusted earnings per Ordinary Share

Growth in adjusted earnings per Ordinary Share (EPSA) is another measure which presents the trend in the long-term profitability of the Group. EPSA is not a recognised measure under IFRS and is therefore a non-GAAP financial measure. The most directly comparable financial measure calculated in accordance with IFRS is earnings per Ordinary Share.

EPSA excludes the same impact of specific transactions or events that management considers affect the Group s short-term profitability, is used by the Group for similar purposes, and is subject to the same material limitations, as set out and discussed in the above section on trading profit.

Adjusted attributable profit represents the numerator used in the EPSA calculation. Adjusted attributable profit is reconciled to attributable profit, the most directly comparable financial measure in accordance with IFRS, as follows:

	2011	2010	2009
	$ million	$ million	$ million
Attributable profit for the year	**582**	615	472
Acquisition related costs			26
Restructuring and rationalisation expenses	**40**	15	42
Amortisation of acquisition intangibles and impairments	**36**	34	66
Legal provision (see page 29)	**23**		
Taxation on excluded items	**(17)**	(10)	(26)
Adjusted attributable profit	**664**	654	580
Earnings per Ordinary share			
Basic	**65.3¢**	69.3¢	53.4¢
Diluted	**65.0¢**	69.2¢	53.3¢
Adjusted: Basic	**74.5¢**	73.6¢	65.6¢
Adjusted: Diluted	**74.2¢**	73.6¢	65.5¢

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Financial review continued

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 adjusted items are discussed above.

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 not recognised measures under IFRS and are therefore considered non-GAAP financial measures.

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.

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

	2011 $ million	2010 $ million	2009 $ million
Cash generated from operations	**1,135**	1,111	1,030
Less: Capital expenditure	**(321)**	(315)	(318)
Add: Cash received on disposal of fixed assets		8	
Add: Acquisition related expenditure	**1**		22
Add: Restructuring and rationalisation related expenditure	**20**	16	32
Add: Macrotexture expenditure	**3**	5	5
Trading cash flow	**838**	825	771
Trading Profit	**961**	969	857
Trading profit to cash conversion ratio	**87%**	85%	90%

Recent developments

On 4 January 2012, the Group announced it had entered into an agreement with Essex Woodlands for the disposal of the Group s Clinical Therapies business. After disposal, the Group will retain a 49% investment in the newly formed company, Bioventus LLC, which will be reported as an associate. At 31 December 2011, the assets and liabilities of the Clinical Therapies business, $125m and $19m respectively, are disclosed as held for sale. In 2011, the Clinical Therapies business contributed $237m to revenue and $48m to trading profit. The Group expects to recognise a profit before tax in excess of $250m on the transaction on completion.

2011 Financial highlights

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

	2011	2010
	$ million	$ million
Revenue (i)	**4,270**	3,962
Cost of goods sold (ii)	**(1,140)**	(1,031)
Gross profit	**3,130**	2.931
Marketing, selling and distribution expenses (iii)	**(1,526)**	(1,414)
Administrative expenses (iv, v, vi)	**(575)**	(446)
Research and development expenses	**(167)**	(151)
Operating profit (i)	**862**	920
Net interest payable	**(8)**	(15)
Other finance costs	**(6)**	(10)
Profit before taxation	**848**	895
Taxation	**(266)**	(280)
Attributable profit for the year	**582**	615

(i) Group revenue and operating profit are derived wholly from continuing operations and discussed on a segment basis on pages 30 to 40.

(ii) In 2011, $7m of restructuring and rationalisation expenses were charged to cost of goods sold (2010 $nil).

(iii) In 2011, no restructuring and rationalisation expenses were charged to marketing, selling and distribution expenses (2010 $3m).

(iv) 2011 includes $42m of amortisation of other intangible assets (2010 $34m).

(v) 2011 includes $23m relating to legal provision (2010 $nil).

(vi) 2011 includes $33m of restructuring and rationalisation expenses and $36m relating to amortisation of acquisition intangibles (2010 $12m of restructuring and rationalisation expenses and $34m relating to amortisation of acquisition intangibles).

Revenue

Group revenue increased by $308m (8%) from $3,962m in 2010 to $4,270m in 2011. Underlying revenue growth was 4% and 4% growth was attributable to favourable currency translation.

Orthopaedics revenues increased by $117m (5%), of which 2% was attributable to underlying growth, and 3% due to favourable currency translation. Endoscopy revenues increased by $84m (10%), of which 6% was attributable to underlying growth, and 4% due to favourable currency translation. Advanced Wound Management revenues increased by $107m (12%), of which 7% was attributable to underlying growth and 5% due to favourable currency translation.

A more detailed analysis is included within the Revenue sections of the individual business segments that follow on pages 30 and 40.

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Cost of goods sold

Cost of goods sold increased by $109m to $1,140m from $1,031m in 2010 which represents an 11% increase. Of this movement, 4% is due to adverse translation movements leaving an underlying movement of 7% compared to an increase in underlying revenue of 4%. The residual movement is largely attributable to continued pricing pressure across all of the Group s markets which Smith & Nephew was not able to pass on to suppliers and an adverse movement in the mix of products sold, towards lower gross margin product.

Further margin analysis is included within the Trading profit sections of the individual business segments that follow on pages 30 to 40.

Marketing, selling and distribution expenses

Marketing, selling and distribution expenses increased by $112m (8%) to $1,526m from $1,414m in 2010. After adjusting for an unfavourable currency movement of 3% the underlying movement of 5% is broadly in line with increased Group revenues.

Administrative expenses

Administrative expenses increased by $129m (29%) to $575m from $446m in 2010. Unfavourable currency movements contributed towards 5% of this increase. The factors contributing to the underlying movement of 24% were; the non-recurrence of the one-off benefit of $25m arising from the BlueSky settlement in 2010, a charge of $23m relating to legal provision, an increase of $21m in restructuring and rationalisation expenses, an increase of $12m in the bad debt expense and an $8m increase in the amortisation charge on intangible assets. Other factors contributing to this increase included the additional investment in China and Emerging Markets during the year.

Research and development expenses

Expenditure as a percentage of revenue increased by 0.1% to 3.9% in 2011 (2010 3.8%). Actual expenditure was $167m in 2011 compared to $151m in 2010. The Group continues to invest in innovative technologies and products to differentiate it from competitors.

Operating profit

Operating profit decreased by $58m to $862m from $920m in 2010 comprising a decrease of $88m in Orthopaedics, offset by increases of $18m in Endoscopy and $12m in Advanced Wound Management.

Net interest payable

Net interest payable reduced by $7m from $15m in 2010 to $8m in 2011. 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 2011 were $6m compared to $10m in 2010. This decrease is attributable to an increase in the expected return on pension plan assets.

Taxation

The taxation charge decreased by $14m to $266m from $280m in 2010. The effective rate of tax was 31.4%, compared with 31.3% in 2010.

The tax charge was reduced by $17m in 2011 (2010 $10m) as a consequence of restructuring and rationalisation expenses, amortisation of acquisition intangibles and legal provision. The effective tax rate was 29.9% (2010 30.8%) 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:

	2011	2010
	$ million	$ million
Non-current assets	**2,542**	2,579
Current assets	**2,080**	2,154
Assets held for sale	**125**	
Total assets	**4,747**	4,733
Non-current liabilities	**422**	1,046
Current liabilities	**1,119**	914
Liabilities directly associated with assets held for sale	**19**	
Total liabilities	**1,560**	1,960
Total equity	**3,187**	2,773
Total equity and liabilities	**4,747**	4,733

Non-current assets

Non-current assets decreased by $37m to $2,542m in 2011 from $2,579m in 2010. This is attributable to the following:

Goodwill decreased by $5m from $1,101m in 2010 to $1,096m in 2011. Goodwill totalling $37m was transferred to assets held for sale. Following the acquisition of Tenet Medical Engineering during 2011, an amount of $44m was capitalised as goodwill. The balance relates to unfavourable currency movements totalling $12m.

Intangible assets decreased by $3m from $426m in 2010 to $423m in 2011. Intangible assets totalling $14m were transferred to assets held for sale. Amortisation of $78m was charged during the year and assets with a net book value of $2m were written-off. A total of $92m relates to the addition of intellectual property and software. The balance relates to unfavourable currency movements totalling $1m.

Property, plant and equipment decreased by $4m from $787m in 2010 to $783m in 2011. Property, plant and equipment totalling $3m were transferred to assets held for sale. Depreciation of $217m was charged during 2011 and assets with a net book value of $7m were written-off. These movements were largely offset by $229m of additions relating primarily to instruments and other plant & machinery. The balance relates to unfavourable currency movements totalling $6m.

Trade and other receivables decreased by $22m to $nil in 2011 from $22m in 2010 due to non-current receivables switching to current receivables during the year.

Deferred tax assets and other non-current assets decreased by $3m in the year.

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Financial review continued

Current assets

Current assets decreased by $74m to $2,080m from $2,154m in 2010. The movement relates to the following:

- Inventories fell by $64m to $859m in 2011 from $923m in 2010. Inventories totalling $15m were transferred to assets held for sale. Of the remaining movement, $10m related to unfavourable currency movements.
- The level of trade and other receivables increased by $13m to $1,037m in 2011 from $1,024m in 2010. Trade and other receivables totalling $49m were transferred to assets held for sale. Of the movement in the year, $18m related to unfavourable currency movements.
- Cash and bank has fallen by $23m to $184m from $207m in 2010. Of the movement, $2m related to unfavourable currency movements.

Assets held for sale

Assets held for sale totalling $125m relate to the underlying assets of Clinical Therapies business, the proposed sale of which was announced on 4 January 2012.

Non-current liabilities

Non-current liabilities decreased by $624m from $1,046m in 2010 to $422m in 2011. This movement relates to the following items:

- Long-term borrowings have fallen from $642m in 2010 to $16m in 2011. This decrease of $626m is mainly attributable to the long-term loan repayable in May 2012 switching to a current liability.
- The net retirement benefit obligation increased by $25m to $287m in 2011 from $262m in 2010. This was largely due to actuarial losses of $70m which were only partly offset by pension contributions.
- Deferred acquisition consideration was $8m at the end of 2011, an increase of $8m from $nil at the end of 2010 as a result of the acquisition of Tenet Medical Engineering during the year.
- Provisions decreased from $73m in 2010 to $45m in 2011 which is largely due to a number of settlements during the year.

Deferred tax liabilities decreased by $3m in the year.

Current liabilities

Current liabilities increased by $205m from $914m in 2010 to $1,119m in 2011. This movement is attributable to:

Bank overdrafts and current borrowings have increased by $249m from $57m in 2010 to $306m in 2011 mainly as a result of the long-term loan repayable in May 2012 switching to a current liability.

Trade and other payables have decreased by $53m to $564m in 2011 from $617m in 2010. Trade and other payables totalling $19m were transferred to liabilities directly associated with assets held for sale. An amount of $8m is attributable to favourable currency movements.

Provisions have increased by $41m from $37m in 2010 to $78m in 2011. The most significant item contributing to this increase is the $23m legal provision (see Note 3).

Current tax payable is $171m at the end of 2011 compared to $203m in 2010. Of the $32m reduction, $1m is attributable to favourable currency movements.

Liabilities directly associated with assets held for sale

Liabilities held for sale totalling $19m relate to the underlying liabilities of the Clinical Therapies business, the proposed sale of which was announced on 4 January 2012.

Total equity

Total equity increased by $414m from $2,773m in 2010 to $3,187m in 2011. The principal movements were:

	Total equity $ million
1 January 2011	2,773
Attributable profit	582
Currency translation losses	(36)
Hedging reserves	14
Actuarial loss on retirement benefit obligations	(70)
Dividends paid during the year	(146)
Taxation benefits on Other Comprehensive Income and equity items	22
Net share based transactions	48
31 December 2011	3,187

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 strengthened from $1.32 to $1.39 (5%), Sterling strengthened from $1.54 to $1.60 (4%), the Swiss Franc strengthened from $0.96 to $1.13 (18%), the Australian Dollar strengthened from $0.92 to $1.03 (12%) and the Japanese Yen strengthened from ¥88 to ¥80 (9%).

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, sales from the US became relatively less profitable to all of these countries. The Group s policy of purchasing forward a proportion of its currency requirements and the existence of an inventory pipeline reduce the short-term impact of currency movements.

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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:

	2011 $ million	2010 $ million	2009 $ million
Cash generated from operations	**1,135**	1,111	1,030
Net interest paid	**(8)**	(17)	(41)
Income taxes paid	**(285)**	(235)	(270)
Net cash inflow from operating activities	**842**	859	719
Capital expenditure (net of disposal of property, plant and equipment)	**(321)**	(307)	(318)
Acquisitions (net of cash acquired)	**(33)**		(25)
Plus Orthopedics settlement			137
Equity dividends paid	**(146)**	(132)	(120)
Proceeds from own shares	**7**	8	10
Issue of ordinary share capital	**17**	15	7
Treasury shares purchased	**(6)**	(5)	
Change in net debt from net cash flow (see Note 21 of the Notes to the Group accounts)	**360**	438	410
Exchange adjustment	**(6)**	13	(21)
Opening net debt	**(492)**	(943)	(1,332)
Closing net debt	**(138)**	(492)	(943)

The Group s net debt decreased from $1,332m at the beginning of 2009 to $138m at the end of 2011, representing an overall decrease of $1,194m. 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 2011.

Net cash inflow from operating activities

Cash generated from operations in 2011 of $1,135m (2010 $1,111m, 2009 $1,030m) is after paying out $3m (2010 $5m, 2009 $5m) of macrotextured claim settlements unreimbursed by insurers, $1m (2010 $nil, 2009 $22m) of acquisition related costs and $20m (2010 $16m, 2009 $32m) of restructuring and rationalisation expenses.

Capital expenditure

The Group s on-going 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 2011, gross capital expenditure amounted to $321m (2010 $315m, 2009 $318m). 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 2011, $9m (2010 $15m, 2009 $7m) 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 2011, $58m was spent on acquisitions, funded from net debt and cash inflows. This comprised, $33m for Tenet Medical Engineering during 2011 and $25m for Nucryst in 2009. 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 a 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 the maturity in May 2012. The Group reduced its $1,000m 5 year term loan to $500m with effect from 20 December 2010. As at 31 December 2011 the balance outstanding was $245m. Smith & Nephew 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 2011, the Group held $184m (2010 $207m, 2009 $192m) in cash and balances at bank. The Group has committed and uncommitted facilities of $1.3bn and $0.3bn respectively. The undrawn committed facilities totalling $1.0bn expires 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 $18m (of which $8m 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, timing of capital expenditure and working capital fluctuations.

Smith & Nephew believes that its capital expenditure needs and its working capital funding for 2012, 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 underfunded position in the Group s defined benefit plans.

Further disclosure regarding borrowings, related covenants and the liquidity risk exposures is set out in Note 15 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.

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Financial review continued

2010 Financial highlights

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

	2010 $ million	2009 $ 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 30 to 40.

(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 expenses 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).

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 30 and 40.

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 the 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 30 to 40.

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.

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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

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

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

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

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

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.

	Total equity $ million
1 January 2010	2,179
Attributable profit	615
Currency translation gains	52
Hedging gains	1
Actuarial gain on retirement benefit obligations	26
Dividends paid during the year	(132)
Taxation on Other Comprehensive Income and equity items	(7)
Net share based transactions	39
31 December 2010	2,773

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 Business Review section on pages 30 to 40. The financial position of the Group, its cash flows, liquidity position and borrowing facilities are described under Financial position, liquidity and capital resources within the Business Review section set out on page 25. 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 on-going uncertain economic outlook.

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

Management also believes that the Group has sufficient working capital for its present requirements.

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.

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Financial review continued

Factors affecting Smith & Nephew s results of operations

Government economic, fiscal, monetary and political policies are all factors that materially affect the Group s operation or investments of shareholders. Other factors include sales trends, currency fluctuations and innovation. Each of these factors is discussed in further in Our business, marketplace and other factors that could affect us on pages 14 to 18 and Taxation information for shareholders on pages 147 to 148.

Critical accounting policies

The Group s significant accounting policies are set out in Notes 1 to 24 of the Notes to the Group accounts. Of those, the policies which require the most use of management s judgement are as follows:

Inventories

A feature of the Orthopaedics business segment (whose finished goods inventory makes up approximately 74% 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 customer demand, effectiveness of inventory deployment, length of product lives, phase-out of old products and efficiency of manufacturing planning systems.

Impairment

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

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 2011, a 0.5% increase in discount rate would have reduced the combined UK and US pension plan deficit by $96m whilst a 0.5% decrease would have increased the combined deficit by $109m. A 0.5% increase in discount rate would have decreased profit before taxation by $5m whilst a 0.5% decrease would have increased it by $5m. 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 $36m. 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 an AA yield curve derived by the Group s actuarial advisers.

See Note 19 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.

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 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 at 31 December 2011 related to this matter is approximately $214m. The Group has sought recovery from its primary and excess insurers for costs of resolving the claims. The primary insurance carrier has paid $60m in full settlement of its policy liability. However, the excess carriers have denied coverage, citing defences relating to the wording of the insurance policies and other matters. In December 2004, the Group brought suit against them in the US District Court for the Western District of Tennessee, and trial is expected to commence in 2013. An additional $22m was received from a successful settlement with a third party.

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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 $17m 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 segments.

In September 2007, the SEC notified the Group that it was conducting an informal investigation of companies in the medical devices industry, including the Group, regarding possible violations of the Foreign Corrupt Practices Act (FCPA) in connection with the sale of products in certain countries outside of the US. The US Department of Justice (DOJ) subsequently joined the SEC s request.

During quarter four of 2011, the Group established a provision of $23m in relation to this investigation.

On 6 February 2012, Smith & Nephew announced that it had reached settlement with the SEC and DOJ in connection with this matter. Smith & Nephew has committed to pay slightly less than $23m in fines and profit disgorgement, and committed to maintain an enhanced compliance programme and appoint an independent monitor for at least 18 months to review and report on its compliance programme to both the SEC and DOJ. The settlement agreements impose detailed reporting, compliance and other requirements on Smith & Nephew for a three-year term. Failure to comply with these requirements, or any other violation of law, could have severe consequences for the Group.

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 and settlements 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 patents exclusively licensed to KCI by Wake Forest University (Wake Forest) 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 asserted Wake Forest patents were valid and infringed. But the court determined the relevant patent claims were invalid and entered judgement in favour of the Group. Wake Forest has appealed the court s judgement. If Wake Forest 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 Texas case was reversed on appeal with judgement entered in favour of Arthrex. The Oregon decision was reversed on appeal and remanded to the District Court for a new trial. The Group secured a jury verdict in its favour that was subsequently reversed by the Oregon court post-trial. The Group plans to proceed with an appeal of the Oregon court s ruling.

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 a 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 Defence 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 Smith & Nephew s initial voluntary disclosure, a whistleblower suit was filed in the US District Court for the Western District of Tennessee alleging these violations. Smith & Nephew s motion to dismiss the suit was denied in November 2010.

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Business segment reviews

In August 2011, the Group announced its new strategic priorities. Part of this framework was the implementation of an organisational change. Smith & Nephew has brought together the Orthopaedics and Endoscopy business segments, creating the Advanced Surgical Devices division (ASD), which will sit alongside the Advanced Wound Management division (AWM). These two divisions will serve the Established Markets and will support our newly created Emerging Markets (focusing on China, India, Brazil and Russia) and International Markets organisations. For reporting purposes, the two division structure will replace the current three business segment structure during 2012.

Business segment analysis

Organisation

During 2011, internally the Group has reported as three business segments: Orthopaedics, Endoscopy and Advanced Wound Management. Included within the Orthopaedics business segment are biologics activities, which comprise research and development projects under the direction of a committee representing all operating segments.

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

	2011 $m	2010 $m	2009 $m
Revenue by business segment			
Orthopaedics	**2,312**	2,195	2,135
Endoscopy	**939**	855	791
Advanced Wound Management	**1,019**	912	846
Total revenue	**4,270**	**3,962**	**3,772**
Revenue by geographic market			
United States	**1,756**	1,707	1,664
Europe (Continental Europe and United Kingdom)	**1,409**	1,315	1,313
Africa, Asia, Australasia and other America	**1,105**	940	795
Total revenue	**4,270**	**3,962**	**3,772**
Trading profit by business segment			
Orthopaedics	**492**	536	508
Endoscopy	**222**	200	189
Advanced Wound Management	**247**	233	160

Total trading profit	**961**	**969**	**857**
Operating profit by business segment			
Orthopaedics	**415**	503	410
Endoscopy	**215**	197	169
Advanced Wound Management	**232**	220	144
Total operating profit	**862**	**920**	**723**

Business segment revenue

	$m
A Orthopaedics	2,312
B Endoscopy	939
C Advanced wound management	1,019

Geographic revenue

	$m
A US	1,756
B Europe	1,409
C Rest of World	1,105

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

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VERILAST s use of OXINIUM, oxidized Zirconium, results in a knee

which has been proven to last 30 years, twice the current industry

standard of 15 years.

Orthopaedics

Overview

During 2011, the Orthopaedics business was 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, China and the UK as well as by third-party manufacturers.

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 various 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, in particular 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. LEGION/GENESIS II and JOURNEY also utilise VISIONAIRE Patient-Matched Instrumentation, a 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. Oxidized 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 the Group s VERILAST Technology. The 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 extremities.

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

Under the new ASD structure, the Group will continue to focus on product innovation, sales excellence and physician education. Whether through extending the life of implants, improving operating room efficiency, or promoting faster healing and other clinical outcomes, Smith & Nephew s innovations differentiate it and provide solutions to active patients seeking to regain quality of life while enhancing economic value for customers. For its ASD products, Smith & Nephew provides peer-to-peer medical education, through KLEOS, tailored to individual surgeon needs utilising the world s top orthopaedic specialists and key opinion leaders.

The emerging markets continue to be an important growth opportunity. China remains a focus, with further progress and growth achieved during 2011. Outside China, ASD 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.

Under the ASD structure, the 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.

On 4 January 2012, the Group announced it had entered into an agreement with Essex Woodlands for the disposal of the Group s Clinical Therapies business. After disposal, the Group will retain a 49% investment in the newly formed company, Bioventus LLC, which will be reported as an associate. At 31 December 2011, the assets and liabilities of the Clinical Therapies business, $125m and $19m respectively, are disclosed as held for sale. In 2011, the Clinical Therapies business contributed $237m to revenue and $48m to trading profit. The Group expects to recognise a profit before tax in excess of $250m on the transaction on completion.

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Business segment reviews continued

Orthopaedics continued

New products

In Trauma, Orthopaedics launched STRUCSURE CP, an advanced injectable, hard-setting bone graft substitute designed to gradually resorb while being replaced by natural bone.

Reconstructive Orthopaedics continued the extension of its VISIONAIRE Patient-Matched Instrumentation into its knee portfolio, with its roll-out of VISIONAIRE for the TC-PLUS knee system. 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. Also launched was the SMF Short Modular Femoral Hip System, a primary hip stem that is substantially shorter than traditional length stems, yet maintains optimal fixation and stability. The SMF Hip complements the newly launched Direct Anterior retractor set, an instrument set and technique that allows orthopaedic surgeons to enter the hip socket through the front, or anterior, which results in far less soft tissue disruption and post-operative pain than traditional techniques.

Regulatory approvals

During 2011, the Orthopaedics business obtained regulatory clearances/approvals for several key products.

In the US, 510(k) clearance was obtained for the TAYLOR SPATIAL FRAME V4.1 Software, TRIGEN SURESHOT Distal Targeting System V2.1, and the SMF Hip Stem Line Additions.

Several products were approved in Japan, which included the 10/12 TAPER OXINIUM Femoral Heads, LARGE COCR Femoral Heads, REFLECTION XLPE Acetabular Liners, BHR Resurfacing Hip System, BHR Modular Head System with 10/12 Taper Sleeves, SL-PLUS Hip Stems, SLR-PLUS Hip Stems, and SL-PLUS Mia Hip Stems.

Seasonality

Orthopaedic reconstruction and trauma procedures tend to be higher in the winter months (quarter one and quarter four) where accidents and sports related injuries are highest. Conversely, elective procedures tend to slow down in the summer months due to holidays.

Market and competition

Smith & Nephew estimates that the global orthopaedic segment, excluding clinical therapies, served by the Group grew by approximately 2% in 2011 and is currently worth approximately $17.8 billion per annum. Management believes that the Smith & Nephew Orthopaedics business holds an 11% share of this segment by value. Principal global competitors in orthopaedics are Zimmer, Stryker, Johnson & Johnson and Biomet.

Global orthopaedics competitor share (i) (ii)

	%
A Smith & Nephew	11

B Zimmer	19
C Stryker	18
D DePuy/Johnson & Johnson (iii)	17
E Synthes (iii)	12
F Biomet	9
G Others	14

(i) The global orthopaedics segment served by the Group consists of orthopaedic reconstruction and orthopaedic trauma.

(ii) Competitor shares are based on estimates for selected segments and competitors, and may not be comprehensive.

(iii) Synthes is the subject of a takeover from Johnson & Johnson which is expected to complete in 2012.
In 2011, weaker economic conditions worldwide continued to create several challenges for the overall orthopaedic market, including continued 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 and 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.

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Orthopaedics financial performance

Revenue

Orthopaedics revenue

	$m
A Orthopaedic Reconstruction	1,618
B Orthopaedic Trauma	457
C Clinical Therapies	237

2011

Orthopaedics revenue increased by 5% to $2,312m from $2,195m in 2010. Of this increase, 2% is attributable to underlying growth and 3% is due to favourable currency movements.

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

	2011 **%**	**2010** %
Reported growth	**5**	3
Constant currency exchange effect	**(3)**	(1)
Underlying growth	**2**	2

In the US, revenue increased by $28m to $1,204m (2%), all of which was due to underlying growth. The main factor was the continued growth of the Group s knee products including VERILAST and VISIONAIRE.

Outside the US, revenue increased by $89m to $1,108m (9%). This movement is attributable to underlying growth of 2% and favourable foreign currency translation of 7%.

Global knee revenue increased by $63m to $869m (8%), representing underlying revenue growth of 5% and favourable foreign currency translation of 3%. There has been continued pressure from the challenging environment on higher specification and early intervention hip and knee implant systems. Nevertheless, the Group s knee franchise and in particular the LEGION Knee Systems delivered strong growth. This was driven by VERILAST and by VISIONAIRE Patient Matched Instrumentation sets.

Global hip revenue increased by $16m to $704m (2%), representing a 1% underlying revenue decline and 3% due to favourable foreign currency translation. Both traditional and new products have continued to perform well, led by the R3 Acetabular System. Sales of BIRMINGHAM HIP Resurfacing System have continued to decline.

Global trauma revenue increased by $23m to $457m (5%), representing underlying revenue growth of 3% and 2% favourable foreign currency translation. Trauma underperformed in the second half of the year and the Group has taken actions to address this. The expiry of an agreement under which Smith & Nephew received royalties in the US has also had a negative impact on Trauma revenue in the second half of the year.

In Clinical Therapies, revenue grew from $223m to $237m (7%) which was represented by underlying growth of 6% and favourable currency movements of 1%.

Underlying revenue growth for key product lines is:

	2011	**2010**
	%	%
Reconstruction		
Knees	**5**	5
Hips	**(1)**	
Trauma	**3**	3
Clinical therapies	**6**	(5)

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Business segment reviews continued

Orthopaedics continued

2010

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 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 was continued pressure from the challenging environment on higher specification and early intervention hip and knee implant systems. Nevertheless, the Group s knee franchise and in particular the 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 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 the Group s hip franchise, both traditional and new products continued to perform well, led by the R3 Acetabular System. Sales of BIRMINGHAM HIP Resurfacing Systems were weaker.

Global trauma revenue increased by $20m to $434m (5%), representing underlying revenue growth of 3% and 2% favourable foreign currency translation. This improvement is attri