

## Chair's introduction

We are making progress implementing the 2018 UK Corporate Governance Code.



### DEAR SHAREHOLDER,

I am pleased to present the governance section of our Annual Report, which includes details about the Board and an explanation of our individual roles and responsibilities. We also summarise the activities of the Board during the year and the Chair of each Board Committee discusses the activities of that Committee during the past year.

The publication by the Financial Reporting Council in 2018 of the new UK Corporate Governance Code (the 'Code') and the Guidance on Board Effectiveness has caused us to reconsider some aspects of how we will operate as a Board going forward. We are in the process of reorganising the composition and the responsibilities of some of the Board Committees to reflect the new emphasis in the Code on listening to the employee voice and having regard to the views of all our key stakeholders. We explain our intended approach in the reports from the Nomination & Governance Committee and the Ethics & Compliance Committee, which will become the expanded Compliance & Culture Committee. The scope of the Remuneration Committee has also been broadened and this is discussed in the Remuneration Report. These changes are reflected in revised terms of reference, which are available on our website and in revised Committee memberships, explained further in the individual Committee reports.

We have also included a section explaining how the Board has fulfilled its duties towards our key stakeholders – our employees, our customers and suppliers, our investors and governments and regulators – in 2018, and how we plan to build on this in 2019.

In particular, we have considered how we can listen better to the employee voice. We feel that as a unitary Board, this is very much the responsibility of the Board as a whole and that this responsibility should not fall to any one designated director or to an employee representative. We are a global company operating out of multiple locations, with employees coming from many different perspectives. Elsewhere in this report, you will have read about the work Namal and the executive team have done in the past year, developing the new purpose, strategic imperatives and culture pillars. This work included engagement with a large number of our employees across the world at all levels of the organisation. The Board intends to build on these now established means of engagement, so that we too can listen effectively and respond to the employee voice. This programme will be developed for us by the expanded Compliance & Culture Committee and will be in addition to the engagement we currently have with employees when we undertake site visits as part of our Board programme.

### CHANGES TO THE BOARD IN 2018

During the year to 31 December 2018, there were the following changes to the Board:

1. Namal Nawana joined the Board as Chief Executive Officer on 7 May 2018.
2. Olivier Bohuon retired from the Board as Chief Executive Officer on 7 May 2018.
3. Roland Diggelmann joined the Board as a Non-Executive Director and Member of the Audit Committee on 1 March 2018.
4. Joseph Papa retired from the Board on 12 April 2018.

At the Annual General Meeting to be held on 11 April 2019 there will be some additional Board changes. Ian Barlow, our Senior Independent Director and former Chair of the Audit Committee will be retiring after nine years' service to the Company. Michael Friedman, Chair of our Compliance & Culture Committee will also be retiring after six years' service.

We would like to thank both Ian and Michael for their outstanding contribution to the Company through periods of change. Michael has given us deeper insight into regulatory matters and Ian has been a valuable support to me on many matters, most recently in finding Namal Nawana, our new Chief Executive Officer.

Robin Freestone will succeed Ian as Senior Independent Director and Marc Owen will succeed Michael as Chair of the expanded Compliance & Culture Committee. Over the course of the coming months, we shall be undertaking a search for a new Non-Executive Director with recent and relevant financial experience to be our financial expert and in time take over from Robin as Chair of the Audit Committee.

**Roberto Quarta**  
Chair

## Leadership

### Our Board of Directors



#### ROBERTO QUARTA (69)

##### Chair

Joined the Board in December 2013 and appointed Chair following election by shareholders at the 2014 Annual General Meeting. He was also appointed Chair of the Nomination & Governance Committee and a Member of the Remuneration Committee on that day.

##### Career and experience

Roberto is a graduate and a former Trustee of the College of the Holy Cross, Worcester (MA), US. He started his career as a manager trainee at David Gessner Ltd, before moving on to Worcester Controls Corporation and then BTR plc, where he was a divisional Chief Executive. Between 1985 and 1989 he was Executive VP of Hitchiner Manufacturing Co., Inc. He returned to BTR plc in 1989 as Divisional Chief Executive, where he was appointed to the main board. From here he moved to BBA Aviation plc, as CEO and then as Chair, until 2007.

He has held several board positions, including Non-Executive Director of Powergen plc, Equant N.V., BAE Systems plc and Foster Wheeler AG. His previous Chairmanships include Italtel SpA, Rexel S.A., IMI plc and SPIE SA. He is currently Chair of WPP plc. He is a partner at Clayton Dubilier & Rice and a former member of the Investment Committee of Fondo Strategico Italiano S.p.A.

##### Skills and competencies

Roberto's career in private equity brings valuable experience to Smith & Nephew, particularly when evaluating acquisitions and new business opportunities. He has an in-depth understanding of differing global governance requirements having served as a director and chairman of a number of UK and international companies.

Since his appointment as Chair in April 2014, he has conducted a comprehensive review into the composition of the Board and its Committees, and conducted the search for new Non-Executive Directors, resulting in the appointment of Vinita Bali in 2014, Erik Engstrom and Robin Freestone in 2015, Angie Risley and Marc Owen during 2017, and Roland Diggelmann in 2018. Roberto also conducted the search resulting in the appointment of Namal Nawana as our CEO in 2018.

##### Nationality

 American/Italian



#### NAMAL NAWANA (48)

##### Chief Executive Officer

Joined the Board and was appointed Chief Executive Officer on 7 May 2018. He will stand for election by shareholders at the AGM on 11 April 2019. He is based in Andover, US.

##### Career and experience

Prior to Smith & Nephew Namal was Chief Executive Officer and a member of the Board of Medical Diagnostics Company Alere Inc, until its \$8 billion acquisition by Abbott in 2017. Before joining Alere, Namal spent more than 15 years at Johnson & Johnson in progressively senior leadership roles globally including the role of Worldwide President of Johnson & Johnson's multi-billion dollar spine franchise, DePuy Synthes Spine. In addition to his role as CEO of Smith & Nephew, Namal is also a member of the Board of Directors of Hologic, Inc. a Nasdaq listed company and Advamed (Advanced Medical Technology Association).

##### Skills and competencies

Namal holds an undergraduate degree in Mechanical Engineering and a Masters degree in Medical Science from the University of Adelaide, South Australia, as well as an MBA from Henley Management College. He is a global leader with broad experience in healthcare and medical technology.

##### Nationality

 Australian/French



#### GRAHAM BAKER (50)

##### Chief Financial Officer

Joined the Board as Chief Financial Officer in March 2017. He is based in London, UK.

##### Career and experience

Graham holds an MA degree in Economics from Cambridge University and qualified as a Chartered Accountant and Chartered Tax Adviser with Arthur Andersen. In 1995, he joined AstraZeneca PLC where he worked for 20 years, holding multiple senior roles, including Vice President Finance & Chief Financial Officer, North America (2008–2010), Vice President, Global Financial Services (2010–2013) and Vice President, Finance, International (2013–2015) with responsibility for all emerging markets.

Most recently, Graham was Chief Financial Officer of generic pharmaceuticals company Alvogen.

##### Skills and competencies

Graham has deep sector knowledge and has had extensive exposure to established and emerging markets which is extremely relevant to his role at Smith & Nephew. He has a strong track record of delivering operational excellence and has relevant experience across major finance roles and geographic markets, leading large teams responsible for significant budgets.

##### Nationality

 British



### VINITA BALI (63)

#### Independent Non-Executive Director

Appointed Independent Non-Executive Director in December 2014 and Member of the Remuneration Committee and Compliance & Culture Committee.

#### Career and experience

Vinita holds an MBA from the Jamnalal Bajaj Institute of Management Studies, University of Bombay and a BA in Economics from the University of Delhi. She commenced her career in India with a Tata Group Company, and then joined Cadbury India, subsequently working with Cadbury Schweppes plc in the UK, Nigeria and South Africa. She has held a number of senior global positions in marketing and general management at The Coca-Cola Company based in the US and South America, becoming President of the Andean Division in 1999 and VP, Corporate Strategy in 2001. In 2003, she joined Zyman Group, LLC, a US-based consultancy, as Managing Principal. Vinita was MD and CEO of Britannia Industries Limited, a leading Indian publicly listed food company from 2005 to 2014. Currently, Vinita is NED of Syngene International Limited, Bunge Limited and CRISIL India (a Standard & Poor Company). She is also a member of the Advisory Board of PwC India.

#### Skills and competencies

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

#### Nationality

Indian



### THE RT. HON BARONESS VIRGINIA BOTTOMLEY OF NETTLESTONE DL (70)

#### Independent Non-Executive Director

Appointed Independent Non-Executive Director in April 2012 and Member of the Remuneration Committee and Nomination & Governance Committee in April 2014 and will join the Compliance & Culture Committee in April 2019.

#### Career and experience

Virginia gained her MSc in Social Administration from the London School of Economics following her first degree. She was appointed a Life Peer in 2005 following her career as a Member of Parliament between 1984 and 2005. She served successively as Secretary of State for Health and then Culture, Media and Sport. Virginia was formerly a Director of Bupa and AkzoNobel NV. She is currently a Director of International Resources Group Limited, where she is Chair of Board & CEO Practice at Odgers Berndtson. She is a member of the International Advisory Council of Chugai Pharmaceutical Co., Chancellor of University of Hull and Sheriff of Kingston upon Hull. She is a Trustee of The Economist Newspaper.

#### Skills and competencies

Virginia's extensive experience within Government, particularly as Secretary of State for Health, brings a unique insight into the healthcare system both in the UK and globally, whilst her experience on the board of Bupa brings an understanding of the private healthcare sector and an insight into the needs of our customers. Her experience running the board practice at a search firm gives her a valuable skillset as a member of the Nomination & Governance Committee and Remuneration Committee. Her long association with Hull, the home of many of our UK employees, also brings an added perspective.

#### Nationality

British



### ROLAND DIGGELMANN (51)

#### Independent Non-Executive Director

Appointed Independent Non-Executive Director and Member of the Audit Committee on 1 March 2018. He was elected by shareholders at the AGM on 12 April 2018. He will join the Compliance & Culture Committee in April 2019.

#### Career and experience

Roland studied Business Administration at the University of Berne. In 1995, he joined Sulzer AG as Manager Strategic Planning and progressed into further senior roles over the years until his appointment as Executive Vice President, Sales Europe and Asia Pacific from 2002 to 2004 for Sulzer Medica (later known as Centerpulse).

Roland joined Zimmer Group in 2004, in the role of Managing Director of Zimmer Japan and then later in 2006 as Senior Vice President, EMEA until 2008. Roland joined Roche Diagnostics in 2008 starting as president of Asia Pacific before assuming the role of Chief Executive Officer of the Diagnostics Division of F. Hoffmann-La Roche Ltd from 2012 until September 2018.

#### Skills and competencies

Having spent his whole career in medical devices, with 12 years at Sulzer and Zimmer, Roland brings an in-depth knowledge of the medical device industry and healthcare environment which is of great value to Smith & Nephew.

#### Nationality

Swiss

## Leadership

### Our Board of Directors continued



#### ERIK ENGSTROM (55)

##### Independent Non-Executive Director

Appointed Independent Non-Executive Director in January 2015 and Member of the Audit Committee. He will join the Nomination & Governance Committee in April 2019.

##### Career and experience

Erik is a graduate of the Stockholm School of Economics (BSc) and of the Royal Institute of Technology in Stockholm (MSc). In 1988, he graduated with an MBA from Harvard Business School as a Fulbright Scholar. Erik commenced his career at McKinsey & Company and then worked in publishing, latterly as President and COO of Random House Inc. and as President and CEO of Bantam Doubleday Dell, North America. In 2001, he moved on to be a partner at General Atlantic Partners, a private equity investment firm. Between 2004 and 2009, he was CEO of Elsevier, the division specialising in scientific and medical information and then from 2009 CEO of RELX Group.

##### Skills and competencies

Erik has successfully reshaped RELX Group's business in terms of portfolio and geographies.

He brings a deep understanding of how technology can be used to transform a business and insight into the development of new commercial models that deliver attractive economics. His experience as a CEO of a global company gives him valuable insights as a member of our Audit and Nomination & Governance Committees.

##### Nationality

 Swedish



#### ROBIN FREESTONE (60)

##### Independent Non-Executive Director

Appointed Independent Non-Executive Director and Member of the Audit Committee and the Remuneration Committee in September 2015 and Chair of the Audit Committee in April 2017. Robin will succeed Ian Barlow as Senior Independent Director following the AGM on 11 April 2019 and join the Nomination & Governance Committee.

##### Career and experience

Robin graduated with a BA in Economics from The University of Manchester and later qualified and commenced his career as a Chartered Accountant at Deloitte. He has held a number of senior financial positions throughout his career, including at ICI plc, Henkel Ltd and at Amersham plc. Robin was the Deputy CFO and then later the CFO of Pearson plc between 2006 and August 2015, where he was heavily involved with the transformation and diversification of Pearson. He was previously NED at eChem Ltd, Chair of the 100 Group and Senior Independent Director and Chair of the Audit Committee of Cable & Wireless Communications plc. Robin is NED and Chair of the Audit Committee at Capri Holdings Ltd, (formerly Michael Kors Holdings Ltd). Robin became Chair of the ICAEW Corporate Governance Committee in 2017 and is currently a NED and Chair of the Audit Committee at MoneySupermarket.com plc. Robin will be appointed as Chair of their Board with effect from the conclusion of its Annual General Meeting on 9 May 2019.

##### Skills and competencies

Robin has been a well-regarded FTSE 100 CFO who has not only been heavily involved with transformation and diversification, but also the healthcare industry at Amersham, where his acquisition experience is of value to Smith & Nephew as it continues to grow globally and in different markets. He brings financial expertise and insight as Chair of the Audit Committee and an understanding of how to attract and retain talent in a global business as a member of the Remuneration Committee.

##### Nationality

 British



#### MARC OWEN (59)

##### Independent Non-Executive Director

Appointed Independent Non-Executive Director and Member of the Audit Committee in October 2017 and Member of the Compliance & Culture Committee in March 2018. He will be appointed chair of the Compliance & Culture Committee in April 2019.

##### Career and experience

Marc graduated from Oxford University with a BA and BCL in Law. In 1984 he was called to the Bar, following four years at Corpus Christi College Cambridge as a fellow and director of studies in law. He decided upon a corporate career and undertook an MBA at Stanford University. Marc commenced his healthcare and technology career at McKinsey & Company where he progressed to senior partner and eventually a founding partner of McKinsey's Business Technology Office. In September 2001, Marc joined McKesson Corporation and served as Executive Vice President and member of the Executive Committee. He delivered strategic objectives and led over 40 acquisitions and divestments over a 10-year period. In late 2011 he headed McKesson Speciality Health, which operates over 130 cancer centres across the US and provides services including market intelligence, supply chain services, patient access to therapy, provider and patient engagement and clinical trial support. His final executive role came in 2014 where he was appointed Chair of the European Management Board at Celesio AG. He retired in March 2017 once he had improved operations, set the strategy and recruited his successor.

##### Skills and competencies

Marc is a proven leader with an astute, strategic vision, capable of building significant international healthcare businesses. He has strong commercial healthcare expertise which the Board values deeply and makes him ideally placed to Chair the Compliance & Culture Committee.

##### Nationality

 British





### ANGIE RISLEY (60)

#### Independent Non-Executive Director

Appointed Independent Non-Executive Director in September 2017 and appointed Chair of the Remuneration Committee on 12 April 2018.

#### Career and experience

After graduating from Exeter University, and completing a 1-year personnel management programme, Angie joined the United Biscuits graduate scheme. After working in various different HR roles she joined Pizza Hut (UK) Ltd as Human Resources Director, a joint venture between PepsiCo and Whitbread plc. After five years she joined Whitbread, becoming Executive Director on the plc board responsible for HR and Corporate Social Responsibility in 2004. Between 2007–2013 she was the Group HR Director for Lloyds Banking Group, joining J Sainsbury plc as Group HRD in January 2013. Over the years, Angie has been a member of the Low Pay Commission and has held a number of Non-Executive Directorships with Biffa plc, Arriva and Serco Group plc, and now Smith & Nephew. At Serco she was the Chair of the Remuneration Committee. Previously she has attended Remuneration Committees of Whitbread, Lloyds Banking Group, Arriva and attends Sainsbury's today. She is also a Non-Executive Director on the Sainsbury's Bank Board.

#### Skills and competencies

Angie is a well-regarded FTSE 100 Human Resources Director, proven Non-Executive Director and Remuneration Committee Chair. She has gained experience in a wide range of sectors, including a regulated environment. This diversity of experience is welcomed by the Board and the Remuneration Committee. Angie is also an additional resource and sounding board for Smith & Nephew's own internal Human Resources function.

#### Nationality

 British

### DIRECTORS WHO SERVED DURING 2018 RETIRING AT ANNUAL GENERAL MEETING

### IAN BARLOW (67)

#### Independent Non-Executive Director

Appointed Independent Non-Executive Director in March 2010, Chairman (now Member) of the Audit Committee in May 2010, Member of the Compliance & Culture Committee in October 2014 and Senior Independent Director and Member of the Nomination & Governance Committee on 6 April 2017. Ian will retire from the Board at the Annual General Meeting on 11 April 2019 and will not stand for re-election.

#### Career and experience

Ian is a Chartered Accountant with considerable financial experience both internationally and in the UK. He was a Partner at KPMG, latterly Senior Partner, London, until 2008. At KPMG, he was Head of UK tax and legal operations. Previously he was Chairman of WSP Group plc, and is currently NED and Chairman of the Audit Committees of The Brunner Investment Trust PLC, Foxtons Group plc and Urban&Civic plc.

### MICHAEL FRIEDMAN (75)

#### Independent Non-Executive Director

Appointed Independent Non-Executive Director in April 2013 and Chairman of the Compliance & Culture Committee in August 2014. Michael will be retiring from the Board at the Annual General Meeting on 11 April 2019 and will not stand for re-election.

#### Career and experience

Michael is medically trained, specialising in Internal Medicine and Medical Oncology. He was formerly CEO of City of Hope in California, and also served as Director of the institution's cancer centre. He was formerly Senior VP of research, medical and public policy for Pharmacia Corporation and also Deputy Commissioner and Acting Commissioner at the US Food and Drug Administration (FDA). He has served on a number of boards in a non-executive capacity and is currently a NED of Celgene Corporation, MannKind Corporation and Intuitive Surgical, Inc.



### SUSAN SWABEY (57)

#### Company Secretary

Joined Smith & Nephew in May 2009 as Company Secretary with responsibility for Board support and corporate governance, employee and executive share plans and subsidiary governance. In 2016, she also assumed responsibility for leading the group's risk management programme. She is based in Watford.

#### Career and experience

Susan has over 30 years' experience as a Company Secretary in a wide range of companies including Prudential plc, Amersham plc and RMC Group plc. Her work has covered board support, corporate governance, remuneration, corporate transactions, group risk management, share registration, listing obligations, corporate social responsibility, pensions, insurance and employee and executive share plans.

Susan holds an MA from Corpus Christi College Oxford in Literae Humaniores and is a Fellow of the Institution of Chartered Secretaries: The Governance Institute. She is also Chair of ShareGift, the share donation charity, a member of the Financial Reporting Council Lab Steering Group and a frequent speaker on corporate governance and related matters.

## Leadership

### Executive team

Namal Nawana is supported in the day-to-day management of the Group by Graham Baker, Chief Financial Officer, and a strong team of Executive Officers.



#### RODRIGO BIANCHI (58)

##### Interim President, Asia Pacific

Joined Smith & Nephew in July 2013 with responsibility for Greater China, India, Russia, Asia, Middle East and Africa, focusing on continuing our strong momentum in these regions. With effect from 1 January 2016, Rodrigo also became responsible for the Latin American, Australian, New Zealand and Japanese markets. His role was further expanded in May 2017, when he became responsible for oversight of the markets in Europe and Canada. He is now President of Asia Pacific. He is based in Dubai, UAE.

##### Skills and experience

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

##### Nationality



#### BRAD CANNON (50)

##### President, Sports Medicine & ENT

Joined Smith & Nephew in 2012 and has since been the President of Smith & Nephew's Europe and Canada business, the Company's Chief Marketing Officer, and now serves as the President of the Global Sports Medicine and Ear, Nose and Throat business. He is based in Andover, US.

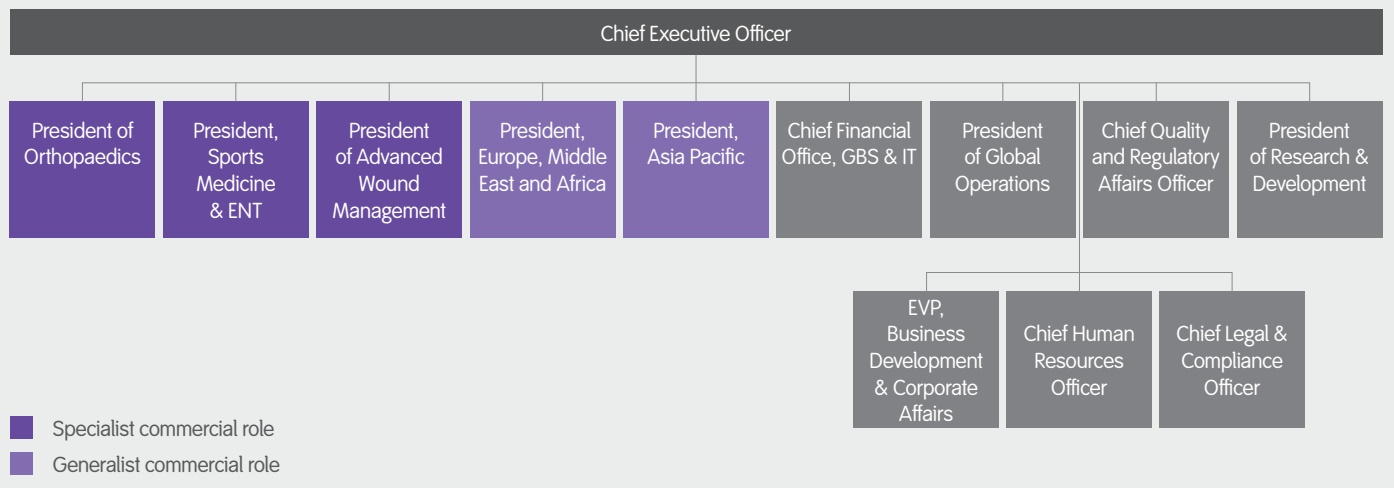
##### Skills and experience

Brad was most recently the Chief Marketing Officer and prior to that the President of Europe and Canada, where he successfully led the commercial business in those regions. He has also served as the President of Global Orthopaedic Franchises, leading Smith & Nephew's Reconstruction, Endoscopy, Trauma and Extremities businesses. Prior to Smith & Nephew, Brad worked in Medtronic's Spine and Biologics division. From 2009, he was responsible for Medtronic's Spine International division and held positions heading US sales and global commercial operations. Brad is a graduate of Washington and Lee University, and the Wharton School of Business at the University of Pennsylvania.

##### Nationality



### NEW COMMERCIAL MODEL: CREATION OF GLOBAL FRANCHISES





**MASSIMILIANO COLELLA (50)**  
**President, Europe, Middle East and Africa**

Joined Smith & Nephew in 2013 as Senior Vice President for Mid-Tier Business based in Dubai, Massimiliano (Max to his colleagues and friends), afterwards took over the role of SVP Smith & Nephew AsiaPac in Singapore. Promoted to President Europe and Canada, he moved back to Europe in 2017. He is now President of Europe, Middle East and Africa. Massimiliano is based in Baar, Switzerland.

**Skills and experience**

Over his 26 years spent in the medical device industry, Massimiliano has held a number of national and international roles in Europe, Middle-East and Asia. Before joining Smith & Nephew, Max worked for 21 years in Johnson & Johnson, leading a number of different businesses in Ethicon and DePuy Synthes franchises.

**Nationality**

Italian



**PHIL COWDY (51)**  
**Executive Vice President, Business Development & Corporate Affairs**

Joined Smith & Nephew in 2008 as Director of Investor Relations. From 2010 his responsibility expanded as Head of Corporate Affairs, including media, investor relations, global brand and government affairs, together with Strategic Planning. Between 2015 and 2018 he was also responsible for IT. In 2018 he took on additional responsibility for Business Development. He is based in London, UK.

**Skills and experience**

Prior to joining Smith & Nephew, Phil served as a senior Director at Deutsche Bank for 13 years, providing corporate finance and equity capital markets advice to a variety of UK-based companies. He qualified as a chartered accountant with EY.

**Nationality**

British



**SIMON FRASER (51)**  
**President of Advanced Wound Management**

Joined Smith & Nephew in January 2019 with commercial leadership responsibility for Advanced Wound Management in the US and global upstream marketing for the Advanced Wound Management Franchise. As part of his executive responsibilities Simon will also provide leadership for Healthcare Systems. Simon is based in Fort Worth, US.

**Skills and Experience**

Simon brings to this role more than 25 years of experience across medical devices, pharmaceuticals and diagnostics, including wound management. Importantly, he is a purpose-driven and accomplished business leader who has successfully managed large, global commercial organisations with full P&L responsibility while growing business and earning market share.

Prior to joining Smith & Nephew Simon was Group Vice President of Dentsply-Sirona's Dental Implant Global Business Unit. Prior to this Simon was Vice President, US Commercial Infectious Diseases including corporate accounts at Abbott Laboratories. Simon joined Abbott following the acquisition of Alere where he had three successful years as the President of Latin America. Prior to these roles, Simon had a 15-year career with Johnson & Johnson, where he held increasingly senior commercial roles spanning surgical devices, wound management, implants and pharmaceuticals including both global strategic marketing and P&L responsibilities.

**Nationality**

American/Canadian

## Leadership

### Executive team continued



#### MARK GLADWELL (43)

##### President of Global Operations

Joined Smith & Nephew in August 2018 with responsibility for Global Manufacturing, Global Supply Chain, Global Procurement, Global Engineering and Global Operational Excellence, and all Operational Strategy and programmes including APEX projects related to Global Operations. Mark is based in Watford, UK.

##### Skills and experience

Mark joined Smith & Nephew from QIAGEN, a provider of sample and assay technologies for molecular diagnostics, applied testing, academic and pharmaceutical research. There he was Senior Vice President of Global Operations responsible for global manufacturing, supply chain, quality assurance and control, regulatory affairs, and global customer service.

Mark is a seasoned operational leader bringing more than 20 years of experience in progressively senior operations roles across global organisations including DuPont, AGFA Medical Imaging, Johnson & Johnson, and Alere Inc. Mark has experience of working and living in Europe and the US and operating global manufacturing and supply chain organisations with a significant focus and track record in delivering operational excellence transformation programmes.

##### Nationality

 British



#### MELISSA GUERDAN (44)

##### Chief Quality and Regulatory Affairs Officer

Joined Smith & Nephew in July 2018 with responsibility for Quality and Regulatory Affairs and is based in Andover, US.

##### Skills and Experience

Melissa brings more than 20 years of leadership experience in Quality and Regulatory Affairs spanning the pharmaceutical, medical device and biologics industries. Melissa has deep compliance and operations knowledge and has progressed through senior leadership roles in global organisations including Pfizer, Baxter, Covidien and Alere. Most recently, Melissa was Senior Vice President, Quality and Regulatory for Alere where she had executive responsibility for establishing enterprise vision, strategy and direction for all aspects of quality, compliance and regulatory affairs. Melissa is adept at inspiring diverse global organisations to achieve common goals and has consistently delivered material value at the enterprise level through transformational quality and regulatory improvement programmes.

Melissa holds a BA degree in Biology and Psychology, and holds an MBA from DePaul University.

##### Nationality

 American



#### SKIP KIIL (44)

##### President of Orthopaedics

Joined Smith & Nephew in November 2018 with global responsibility for the Orthopaedics franchise, which includes Reconstruction, Trauma, Extremities and Robotics. Skip is based in Memphis, US.

##### Skills and Experience

Skip is a seasoned leader who brings a wealth of global experience from diverse medical technology companies, and importantly, significant global experience in Orthopaedics markets over an extended period. Prior to joining Smith & Nephew, Skip was most recently responsible for all Global Commercial Operations at NuVasive and member of the senior executive leadership team. Prior to this, Skip spent three years with Alcon, a division of Novartis Corporation, based in Geneva, Switzerland, where he served as Surgical Head, Europe, Middle East, Africa and Russia. While at Alcon, Skip led the successful commercial transformation of its \$1.1bn surgical business across both developed and emerging growth markets.

Before joining Alcon, Skip had a successful 12-year career with Stryker Corporation, beginning in sales and holding progressively senior positions in commercial leadership in the US as well as in global marketing. Skip also had general management experience in Japan, as well as group leadership responsibilities in Europe where he held the role of Vice President and General Manager of its Medical Surgical Group.

##### Nationality

 American





**ELGA LOHLER (51)**

**Chief Human Resources Officer**

Joined Smith & Nephew in January 2002 as Director of HR and has since held progressively senior positions in Wound Management, Operations, Corporate Functions and Group. Elga became Chief Human Resources Officer in December 2015 and leads the Global Human Resources, Internal Communication and Sustainability Functions. Elga is based in Fort Worth, US.

**Skills and Experience**

Elga has more than 25 years' Human Resources experience. Prior to joining Smith & Nephew, Elga held Human Resources roles at Transnet, Sensomatic (now Tyco) and Advanced Tissue Sciences, which was acquired by Smith & Nephew in 2002. Through these roles, Elga has developed deep expertise in strategy planning and development, organisational design and effectiveness, restructuring and integration and transformational change in support of business objectives. In her current roles, Elga is responsible for driving Smith & Nephew's human capital strategy across the enterprise in support of the company's overall business plan and strategic direction.

Elga holds an undergraduate degree in Psychology and a Master's degree in Organizational Psychology, both from the University of Witwatersrand in South Africa.

**Nationality**

American/South African



**CATHY O'ROURKE (46)**

**Chief Legal and Compliance Officer**

Cathy joined Smith & Nephew in February 2013 and became Chief Legal Officer in May 2017 and Chief Legal and Compliance Officer in July 2018. Cathy heads up the Global Legal and Compliance functions and is based in Andover, US.

**Skills and Experience**

Prior to being appointed Chief Legal Officer, Cathy had various responsibilities within Legal as Assistant General Counsel – Litigation and Investigations. Prior to joining Smith & Nephew, Cathy spent 11 years of her career with Davis Polk & Wardwell LLP.

Cathy earned her Juris Doctorate in Law from Harvard University.

**Nationality**

American



**VASANT PADMANABHAN (52)**

**President of Research & Development**

Vasant joined Smith & Nephew in August 2016 and is responsible for Research and Innovation, New Product Development, Safety Affairs, Clinical Affairs, Medical device/Pharmacovigilance and Clinical Operations. He is based in Andover, US.

**Skills and Experience**

Vasant brings extensive experience in R&D and technology. Prior to Smith & Nephew, Vasant was Senior Vice President of Technical Operations at Thoratec Corporation, a leader in mechanical circulatory support solutions for the treatment of heart failure. In this role, he provided leadership to a 600 member team, with responsibility for global R&D, Programme Management, Operations and Quality. Prior to Thoratec, Vasant had an 18-year career at Medtronic, starting as a Staff Scientist and, progressing through more senior roles, ultimately becoming Vice President of Product Development for the Implantable Defibrillator Business. Vasant holds a Ph.D degree in Biomedical Engineering from Rutgers University, US and an MBA degree from the Carlson School of Management, Minnesota.

**Nationality**

American

# Leadership

## Roles and composition

Whilst we all share collective responsibility for the activities of the Board, some of our roles have been defined in greater detail below.

### CHAIR

- Building a well-balanced Board.
- Chairing Board meetings and setting Board agendas.
- Ensuring effectiveness of the Board and enabling the annual review of effectiveness.
- Encouraging constructive challenge and facilitating effective communication between Board members.
- Promoting effective Board relationships.
- Ensuring appropriate induction and development programmes.
- Ensuring effective two-way communication and debate with shareholders and stakeholders.
- Promoting high standards of corporate governance.
- Maintaining appropriate balance between stakeholders.

### CHIEF FINANCIAL OFFICER

- Supporting the Chief Executive Officer in developing and implementing the Group strategy.
- Leading the global finance function, developing key finance talent and planning for succession.
- Ensuring effective financial reporting, processes and controls are in place.
- Recommending the annual budget and long-term strategic and financial plan.
- Maintaining relationships with shareholders.

### CHIEF EXECUTIVE OFFICER

- Developing and implementing Group strategy.
- Recommending the annual budget and three-year strategic and financial plan.
- Ensuring coherent leadership of the Group.
- Managing the Group's risk profile and establishing effective internal controls.
- Regularly reviewing organisational structure, developing executive team and planning for succession.
- Ensuring the Chair and Board are kept advised and updated regarding key matters.
- Maintaining relationships with shareholders and advising the Board accordingly.
- Setting the tone at the top with regard to compliance and sustainability matters.
- Day-to-day running of the business.

### SENIOR INDEPENDENT DIRECTOR

- Chairing meetings in the absence of the Chair.
- Acting as a sounding board for the Chair on Board-related matters.
- Acting as an intermediary for the other Directors where necessary.
- Available to shareholders and stakeholders on matters which cannot otherwise be resolved.
- Leading the annual evaluation into the Board's effectiveness.
- Leading the search for a new Chair, if necessary.

### COMPANY SECRETARY

- Advising the Board on matters of corporate governance.
- Supporting the Chair and Non-Executive Directors.
- Point of contact for investors on matters of corporate governance.
- Ensuring good governance practices at Board level and throughout the Group.

## Corporate governance framework

The Board is responsible to shareholders for approving the strategy of the Group, for overseeing the performance of the Group and evaluating and monitoring the management of risk. Each member of the Board has access, collectively and individually, to the Company Secretary and is also entitled to obtain independent professional advice at the Company’s expense, should they decide it is necessary in order to fulfil their responsibilities as Directors.

The Board delegates certain matters, as follows, to Board Committees, consisting of members of the Board:

| BOARD  |  |  |   |  |
|--|--|--|---|--|
| <p><b>Audit Committee</b><br/>Provides independent assessment of the financial affairs of the Company, reviews financial statements and controls oversight of the risk management process and key risks, such as cyber security. Manages use of internal and external auditors.</p> <p>⇒ PAGE 76</p> | <p><b>Remuneration Committee</b><br/>Determines Remuneration Policy and packages for Executive Directors and Executive Officers, having regard to pay across the Group.</p> <p>⇒ PAGE 84</p> | <p><b>Nomination &amp; Governance Committee</b><br/>Reviews size and composition of the Board, succession planning, diversity and governance matters.</p> <p>⇒ PAGE 71</p> | <p><b>Compliance &amp; Culture Committee</b><br/>Reviews and monitors ethics and compliance, quality and regulatory matters across the Group. Role to be expanded in 2019 to include oversight of culture, sustainability and stakeholder relationships.</p> <p>⇒ PAGE 74</p> | <p><b>Ad hoc committees</b><br/>Ad hoc committees may be established to review and approve specific matters or projects.</p> |

The Board delegates the day-to-day running of the business to Namal Nawana, Chief Executive Officer, who is assisted in his role by the Executive Committee comprising the Executive team shown on pages 58-61. The governance framework below outlines the Executive Committee arrangements as follows:

| EXECUTIVE COMMITTEE  |  |  |  |
|--|--|--|--|
| <p>The Executive Committee meets regularly and makes decisions collectively. It recommends and implements strategy, recommends budget and three-year plan to the Board for approval, ensures liaison between commercial and corporate functions, receives regular reports from sub-committees, reviews major investments, divestment and capital expenditure proposals and approves business development projects.</p> |  |  |  |
| <p><b>Monthly Operating Review</b><br/>Wider group of senior commercial and financial leaders reviews monthly commercial and marketing and operating results against budget, identifying gaps and agreeing remedial actions.</p>   | <p><b>Franchise, Functional and Regional Leadership Meetings</b><br/>Senior management meetings to drive performance across each franchise, function and region.</p> | <p><b>Portfolio Innovation Board</b><br/>Defines portfolio allocation principles, reviewing and challenging current shape of portfolio, identifying gaps and opportunities and re-prioritising segments and geographies.</p> | <p><b>Group Ethics &amp; Compliance Committee</b><br/>Reviews compliance matters and country business unit or function compliance reports.</p> |
| <p><b>Finance &amp; Banking Committee</b><br/>Approves banking and treasury matters, guarantees, Group structure changes relating to mergers, acquisitions and disposals.</p>  | <p><b>Disclosures Committee</b><br/>Approves release of communications to investors and Stock Exchanges.</p>   | <p><b>Mergers &amp; Acquisitions Investment Committee</b><br/>Oversees Corporate Development Strategy, monitors status of transactions and approves various stages in merger, acquisition and disposal process.</p>          | <p><b>IT Governance Board</b><br/>Oversees IT and cyber security.</p>  |
| <p><b>Diversity &amp; Inclusion Council</b><br/>Implements strategies to promote diversity and inclusion.</p>  | <p><b>Global Benefits Committee</b><br/>Oversees all policies and processes relating to pensions and employee benefit plans.</p>                                     | <p><b>Health, Safety &amp; Environment Committee</b><br/>Oversees health, safety and environmental matters.</p>  |  |

# Leadership

## Responsibilities of the Board

## 1 Board timetable 2018

|  | January  | Early February  |
|--|--|---|
|  |  | 2017 Preliminary Results  |
| <b>STRATEGY</b>  |  |   |
| <ul style="list-style-type: none"> <li>– Approving the Group strategy including major changes to corporate and management structure.</li> <li>– Approving acquisitions, mergers, disposals, capital transactions in excess of \$50 million.</li> <li>– Setting priorities for capital investment across the Group.</li> <li>– Approving annual budget, financial plan, three-year business plan.</li> <li>– Approving major borrowings and finance and banking arrangements.</li> <li>– Approving changes to the size and structure of the Board and the appointment and removal of Directors and the Company Secretary.</li> <li>– Approving Group policies relating to sustainability, health and safety, Code of Conduct and Code of Share Dealing and other matters.</li> <li>– Approving the appointment and removal of key professional advisers.</li> </ul> | <p>Approved Strategic Plan for 2018–2020</p> <p>Approved 2018 Budget</p> | <p>Reviewed capital allocation policies</p> <p>Reviewed report on post acquisitions reviews</p> |
| <b>PERFORMANCE</b>   |  |   |
| <ul style="list-style-type: none"> <li>– Reviewing performance against strategy, budgets and financial and business plans.</li> <li>– Overseeing Group operations and maintaining a sound system of internal control.</li> <li>– Determining the dividend policy and dividend recommendations.</li> <li>– Approving the appointment and removal of the external auditor on the recommendation of the Audit Committee.</li> <li>– Approving significant changes to accounting policies or practices.</li> <li>– Overseeing succession planning at Board and Executive Officer level.</li> <li>– Approving the use of the Company's shares in relation to employee and executive share incentive plans on the recommendation of the Remuneration Committee.</li> </ul>   |  | <p>Reviewed financial performance</p> <p>Received update on European business</p>               |
| <b>SHAREHOLDER COMMUNICATIONS</b>  |  |   |
| <ul style="list-style-type: none"> <li>– Approving preliminary announcement of annual results, the publication of the Annual Report, the half-yearly report, the quarterly Trading Reports, the release of price sensitive announcements and any listing particulars, circulars or prospectuses.</li> <li>– Approving the Sustainability Report.</li> <li>– Maintaining relationships and continued engagement with shareholders.</li> </ul>   |  | <p>Approved Preliminary Announcement 2017</p> <p>Considered payment of final dividend</p>       |
| <b>RISK</b>  |  |   |
| <ul style="list-style-type: none"> <li>– Overseeing the Group's risk management programme.</li> <li>– Regularly reviewing the risk register.</li> <li>– Overseeing risk management processes (see pages 41-49 for further details).</li> </ul>   |  | <p>Approved Annual Risk Management Report</p>   |
| <b>PROVIDING ADVICE</b>  |  |   |
| <ul style="list-style-type: none"> <li>– Using experience gained within other companies and organisations to advise management both within and between Board meetings on an ad hoc basis.</li> </ul>   |  |   |
| <b>OTHER MATTERS</b>   |  |   |
|  | <p>Reviewed Non-Executive Director Fees</p>                              |   |



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

| Late February  | April   | May                             | June  | July   | September  | October  | December   |
|--|---|---------------------------------|---|--|--|--|--|
| 2017 Financial Statements  | Annual General Meeting  | Q1 2018                         |   | H1 2018  | Site visit to Berlin   | Q3 Trading Report  | Strategic Planning   |
|  |   |                                 | Approved re-financing of the revolving credit facility                | Considered the Company's organisational design<br>Considered the Company's strategic focus | Update on organisational change  |  | Approved the strategic plan for 2019-2021<br>Approved the budget for 2019            |
|  | Reviewed financial performance<br>Received updates on global operations |                                 | Received report from new Chief Executive Officer on first impressions | Reviewed financial performance, operating review and scorecards                            | Reviewed financial performance and global operations                   | Reviewed financial performance<br>Received update on Medical Devices global market |  |
| Approved the: Annual Report for 2017<br>Notice of the Annual General Meeting<br>Sustainability Report 2017 | Prepared for the Annual General Meeting to be held later that day       | Approved Q1 2018 Trading Report |   | Approved H1 2018 Results Announcement  | Considered report on investor and media perspectives                   | Approved Q3 2018 Trading Report  |  |
|  | Reviewed update on Brexit   |                                 |   |  |  |  | Reviewed risk management programme as part of strategy review                        |
|  |   |                                 |   |  | Approved the terms of the Directors' and Officers' Liability Insurance |  | Reviewed results of external board effectiveness review and agreed follow up actions |

## Leadership

### Our approach to stakeholders

#### EMPLOYEES

The Board regularly takes the opportunity to meet with staff at all levels in the organisation when making site visits across our operations. Regular staff surveys are undertaken, which the Board reviews and follows up on outcomes. The Compliance & Culture Committee reviews certain workplace policies and whistle-blowing incidents, ensuring that appropriate follow up is implemented as necessary. We ensure that when making strategic decisions the impact upon our employees is fully considered.

##### Actions during 2018

- The Board reviewed and discussed the results of the Culture Survey and focus forums initiated by Namal Nawana, Chief Executive Officer on joining the Company. See page 24–25.
- We actively debated and approved the culture pillars of Care, Collaboration and Courage, which will underpin our purpose and corporate strategy.
- We met with key employees on our site visit to Berlin in September and some of us have undertaken additional site visits and spent time on the road with our sales representatives.
- The Ethics & Compliance Committee reviewed our policies on sexual harassment.
- In making decisions regarding organisational change and the APEX programme, we have considered the impact on employees, ensuring that all are treated fairly and with respect.
- The Chief Executive Officer and senior management hold quarterly webcasts for the workforce, which encourage employee engagement and dialogue.

##### Actions planned for 2019

- The Board will continue to consider the impact on employees when making strategic decisions.
- We will continue to take opportunities to meet staff at all levels across the organisation when conducting site visits. We plan to visit our Memphis facility in 2019.
- The Compliance & Culture Committee (formerly Ethics & Compliance Committee) will assume responsibility for overseeing our corporate culture and workplace policies and will report back regularly to the Board.
- In listening to the employee voice, we have decided not to appoint an employee director or to nominate a single designated Non-Executive Director. Instead, we have designated our Compliance & Culture Committee as a whole with the responsibility for engaging with employees. This programme of employee engagement will be developed and implemented during 2019.
- The Board will continue to monitor the outcomes from employee surveys and forums.

#### CUSTOMERS AND SUPPLIERS

The Board receives regular updates at Board meetings from the management team on relationships with our key customers and suppliers and how these relationships are evolving as we respond to different market conditions and environments. We also take the opportunity to meet with key customers during our site visits.

##### Actions during 2018

- As part of our country visit to Germany, we visited La Charité Hospital in Berlin, which is the largest University hospital in Germany. We met with surgeons who used our products and also the Chief Executive who outlined some of the challenges in the German market.
- A number of us accompanied sales representatives in the UK, US and Switzerland as they met with customers and surgeons who used our products.
- During the course of the year, we received management updates on different areas of the business. These included presentations on the management of our supply chain, and the changing market environment and expectations from our customers.

##### Actions planned for 2019

- The Board will continue to receive management updates on our customers and suppliers.
- We will meet with customers and surgeons when we visit our Memphis facility.
- The Compliance & Culture Committee will assume responsibility for overseeing relationships with our key stakeholders including customers and suppliers.

## INVESTORS

The Board meets with retail investors at the Annual General Meeting and responds to letters and emails from shareholders throughout the year. Members of the Board are always happy to engage with investors, if they have matters they wish to raise with the non-executive team. The Chair and other Board members report back to the Board following their meetings with investors. A short report on our major shareholders and any significant changes in their holdings since the previous meeting is reviewed at each Board meeting. Copies of the analyst reports on the Company and its peers are also circulated to Directors.

### Actions during 2018

- The Executive Directors held 124 meetings with investors representing 43.8% of the Company's share capital. They discussed a range of topics including strategy, performance and organisational structure.
- The Chair, Roberto Quarta, held 7 meetings and telephone calls with investors holding approximately 12.6% of the Company's share capital. They discussed a range of topics including the performance of the Company, the appointment of Namal Nawana as our new Chief Executive Officer, our Strategy, the structure of the Board and succession planning at Board and Executive level.
- The Chair of the Remuneration Committee, Angie Risley reached out to our top 20 shareholders holding 44% of the company's shares and received responses from 9 shareholders collectively holding 17.1% of the company's share capital in connection with Graham Baker's pay following his increased responsibility for IT and Global Business Services. See page 85 for further details.

### Actions planned for 2019

- The Board will continue to receive regular updates at Board meetings on management and Chair meetings with investors and will review regular analyst reports.
- The management team and the Chair and Non-Executive Directors will continue to engage with shareholders. If you have matters to raise with the non-executive team, please contact the Company Secretary.

## GOVERNMENTS AND REGULATORS

In many countries, our principal customers are governments, who purchase our products for their national health systems. It is important that we maintain good relationships with governments so that we continue to develop cost efficient solutions to their national healthcare issues. We operate in a heavily regulated industry and our businesses across the world are regulated by many different authorities in different jurisdictions. Our Compliance & Culture Committee has for a number of years overseen our relationships with our key regulators, particularly in areas of ethics, compliance and quality.

### Actions during 2018

- The Compliance & Culture Committee received regular reports from the Quality and Regulatory function on regulatory activities and the results of regulatory inspections.
- The Compliance & Culture Committee received regular reports from the Legal & Compliance function on the activities of key agencies relating to ethics and compliance matters.
- The Board received regular updates from the business areas on the pricing challenges faced by the business when dealing with governments operating with limited financial resources.
- The Board and the Audit Committee received regular updates relating to the progress towards Brexit and management plans to manage the transition as smoothly as possible.

### Actions planned for 2019

- The Compliance & Culture Committee will continue to oversee relationships between the Company and our regulators.
- The Board and the Audit Committee will continue to monitor management preparations for Brexit.

# Leadership

## Responsibilities of the Board

### BOARD AND COMMITTEE ATTENDANCE

|                                | Board          |           | Committee |              |                          |                      |
|--------------------------------|----------------|-----------|-----------|--------------|--------------------------|----------------------|
|                                |                |           | Audit     | Remuneration | Nominations & Governance | Compliance & Culture |
| Total meetings                 |                | <b>10</b> | <b>8</b>  | <b>5</b>     | <b>4</b>                 | <b>4</b>             |
| <b>Appointed</b>               |                |           |           |              |                          |                      |
| Roberto Quarta <sup>1</sup>    | December 2013  | 10/10     | –         | 5/5          | 3/4                      | –                    |
| Olivier Bohuon <sup>2</sup>    | April 2011     | 5/5       | –         | –            | –                        | –                    |
| Graham Baker                   | March 2017     | 10/10     | –         | –            | –                        | –                    |
| Vinita Bali                    | December 2014  | 10/10     | –         | 5/5          | –                        | 4/4                  |
| Ian Barlow <sup>3</sup>        | March 2010     | 10/10     | 7/8       | –            | 4/4                      | 4/4                  |
| Virginia Bottomley             | April 2012     | 10/10     | –         | 5/5          | 4/4                      | –                    |
| Roland Diggelmann <sup>4</sup> | 1 March 2018   | 7/7       | 5/6       | –            | –                        | –                    |
| Erik Engstrom                  | January 2015   | 10/10     | 8/8       | –            | –                        | –                    |
| Robin Freestone                | September 2015 | 10/10     | 8/8       | 5/5          | –                        | 2/2                  |
| Michael Friedman               | April 2013     | 10/10     | –         | –            | –                        | 4/4                  |
| Namal Nawana <sup>5</sup>      | 7 May 2018     | 5/5       | –         | –            | –                        | –                    |
| Marc Owen                      | October 2017   | 10/10     | 8/8       | –            | –                        | 3/3                  |
| Joseph Papa <sup>6</sup>       | August 2008    | 4/4       | 3/3       | 2/2          | –                        | 2/2                  |
| Angie Risley                   | September 2017 | 10/10     | –         | 5/5          | –                        | –                    |

1 Roberto Quarta missed one Nomination & Governance Committee meeting on 11 April 2018 because of another commitment.

2 Olivier Bohuon retired from the Board on 7 May 2018.

3 Ian Barlow missed one Audit Committee meeting on 11 April 2018 in order to attend a funeral.

4 Roland Diggelmann was appointed on 1 March 2018. He missed one Audit Committee meeting on 24 July 2018 because of another commitment scheduled before his appointment.

5 Namal Nawana was appointed on 7 May 2018 and attended all his scheduled meetings to 31 December 2018.

6 Joseph Papa retired from the Board at the Annual General Meeting on 12 April 2018.

### INDEPENDENCE OF DIRECTORS

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

### MANAGEMENT OF CONFLICTS OF INTEREST

None of our Directors or their connected persons, has any family relationship with any other Director or Officer, nor has a material interest in any contract to which the Company or any of its subsidiaries are, or were, a party during the year or up to 15 February 2019.

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

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

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

### OUTSIDE DIRECTORSHIPS

We encourage our Executive Directors to serve as Non-Executive Directors of external companies. We believe that the work they do as Non-Executive Directors of other companies has benefits for their executive roles with the Company, giving them a fresh insight into the role of a Non-Executive Director. Namal Nawana is an independent Director of Hologic Inc. Namal discussed his external role with the Chair prior to his appointment and the Chair was satisfied that he had the capacity for the time commitment required. Suitable arrangements were put in place when reaching a settlement with Hologic related to historical intellectual property litigation to ensure that Namal was not party to any of the negotiations or discussions, which could have given rise to an actual conflict.

### RE-APPOINTMENT OF DIRECTORS

In accordance with the Code, all Directors offer themselves to shareholders for re-election annually, except those who are retiring immediately after the Annual General Meeting. Each Director may be removed at any time by the Board or the shareholders.

### DIRECTOR INDEMNITY ARRANGEMENTS

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

### PURCHASE OF ORDINARY SHARES

In order to avoid shareholder dilution, shares allotted to employees through employee share schemes are bought back on a quarterly basis and subsequently cancelled as stated in Note 19.2 of the accounts on page 172.



## Board effectiveness review

The Board effectiveness review in 2018 was externally facilitated by Dr Tracy Long of Boardroom Review. Dr Long interviewed each member of the Board and the Company Secretary, reviewed minutes, Board papers and other Board documents, and attended and observed the Board and Committee meetings held in October 2018. She then prepared a report summarising her findings, which she presented to the Board for discussion in December.

### FINDINGS

Overall she observed that the Board had many strengths, was effective with a diversity of perspectives and was an open supportive environment. It was led by a strong Chair, the Chief Executive Officer and Chief Financial Officer were both highly regarded and recent appointments had strengthened the Board's domain knowledge. Finance, risk and governance controls were working well and corporate culture was openly discussed at Board level.

### RECOMMENDATIONS

She did note however that there were challenges ahead, given the number of initiatives underway across the Company to lift performance, the recent appointment of a new Chief Executive Officer, a refreshed management team and the development of new Strategic Imperatives, Purpose and Culture Pillars. There would be additional work for the Board in coming months to get behind the new strategy and develop a shared perspective on the future strategy and appetite for risk.

The Board accepted the recommendations and an action plan is being developed to address them.

#### RECOMMENDATION 1

- The Board will need to ensure that it continually reviews and ensures alignment of its appetite for risk against the changing landscape and revised Strategic Imperatives, particularly as the Company continued to evolve. This will require continued monitoring of Board composition and succession planning.

#### RECOMMENDATION 2

- Performance management will need to evolve to monitor alignment with the new strategy, with an increased emphasis on a globally consistent culture and purpose.

#### RECOMMENDATION 3

- The workload, composition and support for the Board Committees will be reviewed to ensure a more even balance of workload and greater diversity on each Committee.

#### RECOMMENDATION 4

- The Chair and Chief Executive Officer will agree shared priorities for Board site visits at the beginning of each year, so that individual and group site visits could be arranged within these agreed parameters rather than on an ad hoc basis.

The areas for attention identified in the 2017 review have been addressed as follows:

| Actions identified   | Action taken   |
|--|--|
| Changes could be made to the Board calendar to spread our work more efficiently and effectively throughout the year, with an even greater focus on people issues, R&D and commercial execution.  | During the year, the Board and Committee calendar for the year has been reviewed and updated and a revised rolling calendar has been prepared for 2019, aligned to the new Group strategy and the updated Strategic Imperatives.   |
| We would like to spend more time on our site visits meeting the local teams, their staff, our customers and local hospitals to give us a deeper understanding of our markets, our customers and competition, and to assist in assessing bench strength further down the Company. | The Board site visit to Berlin in September 2018 incorporated meetings with the German management team and a visit to La Charite, the largest university hospital in Germany to meet with surgeons and hospital staff. This helped us gain a deeper understanding of the views and needs of our customers. |
| Further improvements could be made to how we monitor performance against our strategic objectives, tracking development and implementation of our strategy, and lessons learned from our successes and shortfalls.   | During the year, we have evolved the way reports on performance are presented to the Board. Going forward, performance reports will be aligned with the new Strategy and Strategic Imperatives.  |

The reviews in 2019 and 2020 will be facilitated internally and led by the Senior Independent Director and the Company Secretary. The 2021 review will also be facilitated externally.

## Leadership

### Board development

#### BOARD DEVELOPMENT PROGRAMME

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

operate around the world helps us to make effective investment and strategic decisions. Meeting our local managers also helps us when making succession planning decisions below Board level.

All Non-Executive Directors are encouraged to visit our overseas businesses, if they happen to be travelling for other purposes. Our local management teams enjoy welcoming Non-Executive Directors to their business and it emphasises the interest the Board takes in all our operations. The Chair regularly reviews the development needs of individual Directors and the Board as a whole.

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

| June   | September  | October   | December  |
|--|--|---|---|
| <b>2018 PROGRAMME</b>  |  |   |   |
| <p>The Board received an overview from the new Chief Executive Officer on his first impressions of the Company and his proposals for a new organisational structure.</p> | <p>Visit to Germany to meet with our local management team and to visit La Charité, the largest university hospital in Germany and one of our significant customers. The Board received presentations from local surgeons and members of the hospital's executive team about the challenges faced in the German healthcare market and role played by Smith &amp; Nephew.</p> <p>The Board received updates from new members of the Executive team on their first impressions on joining the Company and their plans for the EMEA business, Global Operations and Quality and Regulatory Assurance.</p> <p>The Board received updates from the Executive team on Investor and Media coverage, and the results of the culture survey and focus groups carried out earlier in the summer.</p> | <p>Presentation from Deloitte LLP to the Remuneration Committee on the changes to be made to the role of the Committee in light of the new UK Corporate Governance Code.</p> <p>Presentation by the Company Secretary to the Audit Committee/ Nomination &amp; Governance Committee on the changes required by the UK Corporate Governance Code to the roles and structure of the Board and its Committees.</p> <p>Presentation to the Board by McKinsey on the current environment and trends in the Medical Devices industry.</p> | <p>Presentations from the entire Executive team as part of the Board's annual Strategy Review, covering the whole business.</p> |

#### INDUCTION PROGRAMME FOR NEW DIRECTORS

During 2018, Roland Diggelmann joined the Board. He and Angie Risley and Marc Owen continued to receive tailored induction programmes relevant to their skills and experiences and their roles on the Board. These induction programmes included:

- One-to-one meetings with senior executives to understand the roles played by our senior employees and specifically how we do things at Smith & Nephew;

- Visits to our sites local to the Director in UK, US and Switzerland to get a feel of how our research and manufacturing operations are run;
- Opportunities to accompany our sales representatives in the US on the road to better understand the daily challenges they face; and
- Meetings with our external advisers for example Freshfields, our Corporate lawyers, KPMG, our Auditor, and Deloitte LLP, our Remuneration Committee adviser to explain the legal and regulatory background to their role on our Board and how these issues are approached at Smith & Nephew.

# Nomination & Governance Committee report



Ensuring the Board evolves to align with the new Strategic Imperatives and with the developing external regulatory environment.

## MEMBERSHIP

|                                     | Member from | Meetings attended |
|-------------------------------------|-------------|-------------------|
| Roberto Quarta (Chair) <sup>1</sup> | April 2014  | 3/4               |
| Ian Barlow <sup>2</sup>             | April 2014  | 4/4               |
| Erik Engstrom <sup>3</sup>          | April 2019  | N/A               |
| Robin Freestone <sup>3</sup>        | April 2019  | N/A               |
| Virginia Bottomley                  | April 2014  | 4/4               |

- 1 Roberto Quarta missed the meeting in April because of a conflicting commitment.
- 2 Ian Barlow will be retiring from the Board and the Committee at the Annual General Meeting to be held on 11 April 2019, having completed nine years' service.
- 3 Erik Engstrom and Robin Freestone will join the Nomination & Governance Committee on 11 April 2019.

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

| Early February | March | April | October |
|----------------|-------|-------|---------|
|----------------|-------|-------|---------|

### BOARD COMPOSITION

|   |  |  |   |
|---|--|--|---|
| <ul style="list-style-type: none"> <li>- Reviewing the size and composition of the Board.</li> <li>- Overseeing Board succession plans.</li> <li>- Recommending the appointment of Directors.</li> <li>- Monitoring Board diversity.</li> </ul> | <p>Approved the re-appointment of Directors who had completed three or six years' service and the annual appointment of Directors serving in excess of six years.</p> <p>Discussed progress on search for a new Chief Executive Officer.</p> | <p>Considered candidates for the role of Chief Executive Officer and agreed to recommend to the Board the appointment of Namal Nawana.</p> | <p>Reviewed the composition of the Board and agreed to appoint Robin Freestone as Senior Independent Director to replace Ian Barlow who would be retiring from the Board at the Annual General Meeting in 2019.</p> |
|---|--|--|---|

### CORPORATE GOVERNANCE

|   |  |   |  |
|---|--|---|--|
| <ul style="list-style-type: none"> <li>- Overseeing governance aspects of the Board and its Committees.</li> <li>- Overseeing the review into the effectiveness of the Board.</li> <li>- Considering and updating the Schedule of Matters Reserved to the Board and the terms of reference of the Board Committees.</li> <li>- Monitoring external corporate governance activities and keeping the Board updated.</li> <li>- Overseeing the Board Development Programme and the induction process for new Directors.</li> </ul> | <p>Reviewed and approved the Schedule of Matters Reserved to the Board and the terms of reference of the Board Committees.</p> | <p>Reviewed current governance trends in the UK and particularly the changes likely to be proposed in the UK Corporate Governance Code.</p> | <p>Reviewed the annual cadence of Board and committee meetings. Considered the implications of the UK Corporate Governance Code 2018 and in particular the expanded role of the Board relating to corporate culture and relationships with stakeholders and agreed that the remit of the Ethics &amp; Compliance Committee be expanded to undertake some of these responsibilities on behalf of the Board.</p> |
|---|--|---|--|

## NOMINATION &amp; GOVERNANCE COMMITTEE REPORT continued

In 2018, we held four meetings. In addition to members of the Committee, the Company Secretary, Chief Executive Officer and Chief Human Resources Officer also attended all or some of the meetings. Other Non-Executive Directors were invited to join the meetings to discuss the search for a new Chief Executive Officer.

Further matters were resolved by written resolution including the appointment of Roland Diggelmann.

Since the year end, we have also discussed the future structure of the Board and its Committees and completed our year end governance processes.

### APPOINTMENT OF CHIEF EXECUTIVE OFFICER

During the early part of the year, the Committee continued its search for a new Chief Executive Officer to replace Olivier Bohuon who had announced his intention to retire by the end of 2018. The Committee recommended the appointment of Namal Nawana, who joined the Company as Chief Executive Officer in May 2018. Namal brings a wealth of experience of the international medical devices industry to his role. The Nomination & Governance Committee was advised by Russell Reynolds on this appointment. Russell Reynolds also advises the Company on other executive recruitment and appointments.

### NON-EXECUTIVE DIRECTORS

The Committee has reviewed the composition of the Board and its Committees to ensure that it evolves to align with the new Strategic Imperatives and with the developing external regulatory environment.

The Committee also recommended the appointment of Roland Diggelmann as an additional Non-Executive Director who joined the Board in March 2018. Roland has many years' experience in the Medical Devices industry. Russell Reynolds advised the Committee on this appointment.

Ian Barlow will be retiring from the Board and from his position as Senior Independent Director at the Annual General Meeting to be held on 11 April 2019, following completion of nine years' service as Non-Executive Director and until 2017 as Chairman of the Audit Committee and then latterly as Senior Independent Director. The Committee recommended to the Board that Robin Freestone be appointed Senior Independent Director in Ian's place at the conclusion of the Annual General Meeting, subject to his re-appointment by shareholders.

Robin will continue to Chair the Audit Committee, but the Committee will undertake a search for an additional Non-Executive Director with recent and relevant financial experience who could in time succeed Robin as Chair of the Audit Committee. When considering candidates for this role, the Committee will be mindful of building a diverse Board and will aim to ensure an appropriate balance of genders, ethnicity, backgrounds, skills and experience.

Michael Friedman will also be retiring from the Board and from his position as Chair of the Compliance & Culture Committee at the Annual General Meeting, following the completion of six years' service. He will be succeeded as Chair of the expanded Compliance & Culture Committee by Marc Owen.

Erik Engstrom and Robin Freestone will be joining the Nomination & Governance Committee as additional members in April 2019 after the Annual General Meeting and Virginia Bottomley and Roland Diggelmann will be joining the Compliance & Culture Committee at the same time.

### DIVERSITY

We aim to have a Board which represents a wide range of backgrounds, skills and experiences. We also value a diversity of outlook, approach and style in our Board members. We believe that a balanced Board is better equipped to consider matters from a broader perspective, understanding the views of our stakeholders as well as our shareholders and therefore come to decisions that have considered a wider range of issues and perspectives than would be the case in a more homogeneous Board. Diversity is not simply a matter of gender, ethnicity or other easily measurable characteristics. Diversity of outlook and approach is harder to measure than gender or ethnicity but is equally important. A Board needs a range of skills from technical adherence to governance or regulatory matters to understanding the business in which we operate. It needs some members with a long corporate memory and others who bring new insights from other fields.

There needs to be both support and challenge on the Board as well as a balance of gender and commercial and international experience. When selecting new members for the Board, we take these considerations into account, as well as professional background. A new Board member needs to fit in with their fellow Board members, but also needs to provide a new way of looking at things.

During 2018, 25% of our Board were female. With the retirement of Ian Barlow and Michael Friedman in April 2019, this percentage rises to 30%. Looking forward, we are working towards a Board with 33% female representation in line with the Hampton-Alexander Review. From 7 May 2018, 17% of our Board were of non-white ethnicity. This rises to 20% after the Annual General Meeting in April 2019.

We will also look to increase ethnic diversity on the Board following the Parker Review as appropriate. We will continue to appoint our Directors on merit, valuing the unique contribution that they will bring to the Board, regardless of gender, ethnicity or any other diversity measure.

### SUCCESSION PLANNING

Since the appointment of Namal Nawana as Chief Executive Officer in May 2018, we have initiated substantial changes to our structure to move to a franchise-led model, as described on page 14. Throughout the year, the Board and Nomination & Governance Committee have monitored the consequent changes to the organisational structure and approved appointments to key leadership positions. Individual Directors have acted as a sounding board for the executive team when considering succession plans in key areas. Given the level of change during 2018, this will be a continued focus of the Nomination & Governance Committee during 2019.



We believe the Board's composition gives us the necessary balance of diversity, skills experience, independence and knowledge to ensure we continue to run the business effectively and deliver sustainable growth. In order to ensure that our Board remains diverse, we analyse the skills and experiences we require against the skills and experiences on our Board using the following matrix. We review this matrix regularly to ensure that it is refreshed to meet the changing needs of the Company.

| CEO  | Financial   | International  | Healthcare/<br>Medical Devices  | Emerging market  |
|--|---|--|---|--|
| Four members of the Board are either current or recent CEOs  | Two members of the Board have recent and relevant financial experience                      | Seven members of the Board have international experience | Six members of the Board have different levels of experience within the Healthcare industry | Two members of the Board have Emerging Market experience   |
| UK Governance  | Remuneration  | Gender   | Ethnic  | Other  |
| Six members of the Board have considerable experience of working in a UK listed environment and four members of the Board have experience of the US listed environment | Five members of the Board have Remuneration Committee experience within a UK listed context | Nine members of the Board are male and three are female  | Ten members of the Board are white and two are of Asian ethnicity                           | Various Board members bring experiences in a variety of fields including customer focus, investment markets, government affairs, digital and corporate social responsibility |

## GOVERNANCE

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

We also took the opportunity of reviewing whether the annual cadence of our Board and Committee meetings was appropriate for the work we need to undertake. As a result of this review, we have changed the physical October meeting to approve the third quarter trading figures to a half day Board telephone call. We have also introduced additional monthly Board update calls for those months when we do not meet physically and will be introducing separate site visits for Non-Executive Directors to meet employees and customers.

We also considered how we would implement the requirements of the 2018 UK Corporate Governance Code and agreed that the Remuneration Committee would retain responsibility for provisions relating to executive pay and pay matters generally. This is discussed further on pages 84–85. We also agreed that the remit of the new Compliance & Culture Committee would be expanded to cover responsibility for overseeing corporate culture and relationships with stakeholders on behalf of the Board. The revised remit of the Compliance & Culture Committee is discussed on pages 74–75 and our approach to listening to the voice of our employees and other stakeholders is discussed on pages 66–67. We have noted the three options set out in the 2018 UK Corporate Governance Code for listening to the Employee Voice and have determined that this will be the responsibility of the Compliance & Culture Committee as this is too important an issue to fall to one Non-Executive Director.

## LOOKING FORWARD

During 2019 our focus will include:

> Search for an additional Non-Executive Director with recent and relevant financial experience to serve on the Audit Committee.

> Monitoring the implementation of the revised Board and Committee structure to ensure that the Company complies with the UK Corporate Governance Code or explains why not.



**Roberto Quarta**  
Chairman of the Nomination & Governance Committee

## Compliance & Culture Committee report (formerly Ethics & Compliance Committee)



Broadening our scope to oversee culture in addition to our focus on compliance and quality.

### MEMBERSHIP

|                                       | Member from  | Meetings attended |
|---------------------------------------|--------------|-------------------|
| Michael Friedman (Chair) <sup>1</sup> | August 2014  | 4/4               |
| Vinita Bali                           | April 2015   | 4/4               |
| Virginia Bottomley <sup>2</sup>       | April 2019   | N/A               |
| Ian Barlow <sup>3</sup>               | October 2014 | 4/4               |
| Roland Diggelmann <sup>4</sup>        | April 2019   | N/A               |
| Marc Owen <sup>5</sup>                | 1 March 2018 | 3/3               |
| Joseph Papa <sup>6</sup>              | August 2008  | 2/2               |
| Robin Freestone                       | 24 July 2018 | 2/2               |

1 Michael Friedman will retire from the Board and the Committee at the Annual General Meeting on 11 April 2019.

2 Virginia Bottomley will join the Committee on 11 April 2019.

3 Ian Barlow will retire from the Board and the Committee on 11 April 2019.

4 Roland Diggelmann will join the Committee on 11 April 2019.

5 Marc Owen joined the Committee on 1 March 2018.

6 Joseph Papa retired from the Board and the Committee on 12 April 2018.

### February

### April

### July

### October

#### ETHICS & COMPLIANCE

- Overseeing ethics and compliance programmes, strategies and plans.
- Monitoring ethics and compliance process improvements and enhancements.
- Assessing compliance performance based on monitoring, auditing and internal and external investigations data.
- Reviewing allegations of significant potential compliance issues.
- Receiving reports from the Group's Ethics & Compliance Committee meetings and from the Chief Legal and Compliance Officer.

Noted the progress made on the Global Compliance Programme Plan for 2017 and noted the plan of action for 2018.

Reviewed the ethics and compliance training programmes in place across the Group. Reviewed significant findings from monitoring, auditing and progress on Corrective and Preventative Actions.

Noted progress on the 2018 Global Compliance Plan of Action. Reviewed significant findings from monitoring auditing, and progress on Corrective and Preventative Actions.

Received Ethics & Compliance update in new format and noted insights from various aspects of Global Compliance Programme.

#### QUALITY ASSURANCE AND REGULATORY AFFAIRS (QARA)

- Overseeing the processes by which regulatory and quality risks relating to the Company and its operations are identified and managed.
- Receiving and assessing regular functional reports and presentations from the Chief Quality and Regulatory Affairs Officer, or the SVP Quality Assurance.

Reviewed various quality metrics. Noted the plans to address the potential impact on the Group of both the EU Medical Device Regulations (EU MDR) and Brexit.

Reviewed various quality metrics and approved the Global Quality Plan for 2018, noting the additional work to be done to implement the EU MDR.

Reviewed various quality metrics including the results of inspections by the FDA and Notified Bodies, progress on handling complaints and in preparing for the EU MDR.

Received Quality and Regulatory report in updated format from newly appointed Chief Quality and Regulatory Affairs Officer, noting status of various Quality and Regulatory metrics and initiatives.

#### OTHER MATTERS

#### February

Reviewed the sexual harassment policies and procedures in place across the Group.

As a follow up to the February meeting, reviewed the circumstances and actions taken to address the sexual harassment allegations made in the year.

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

In 2018, we held four physical meetings. Each meeting was attended by all members of the Committee. The Company Secretary, the Chief Legal and Compliance Officer and the Chief Quality and Regulatory Affairs Officer or SVP, Quality Assurance also attended all or part of the meetings by invitation.

At each meeting we noted and considered the activities of compliance and enforcement agencies and investigation of possible improprieties. At every meeting a report on the Quality Assurance Regulatory Assurance (QARA) function was provided along with updates of product complaint trends. We also reviewed a report on the activities of the Group's Ethics & Compliance Committee and reviewed the progress of the Global Compliance Programme.

### OVERSIGHT OF QUALITY & REGULATORY

Product safety is at the heart of our business. Regulatory authorities across the world enforce a complex series of laws and regulations that govern the design, development, approval, manufacture, labelling, marketing and sale of healthcare products. During the year, we oversaw the quality and regulatory activities of our business. At each meeting, we received a report on quality and regulatory matters from the Chief Quality and Regulatory Affairs Officer, or the SVP Quality Assurance.

We reviewed the results of inspections carried out by the FDA and other regulators and monitored the progress of improvements following some of these inspections. We also monitored the work being undertaken to help our manufacturing sites to prepare for future inspections.

We reviewed the results of quality audits undertaken during the year, noted follow up actions and monitored progress made to address these actions.

### OVERSIGHT OF ETHICS & COMPLIANCE

'Doing the right thing' is part of our licence to operate. During the year, we oversaw the ethics and compliance activities of our business. At each meeting we received a report on ethics and compliance matters from the Chief Legal and Compliance Officer.

We regularly review our compliance programme as it relates to healthcare professionals and third party sellers (such as distributors and sales agents), particularly in higher risk markets. For healthcare professionals, this includes policies, training and certification for employees and sales agents, as well as pre-approval of consulting services and grants and fellowships. For third parties, our programme includes due diligence, contracts with compliance terms, compliance training and certification, and site assessments to check compliance controls and monitoring visits to review books and records.

We ensure that comprehensive due diligence is carried out prior to an acquisition and we ensure that following acquisitions new businesses are integrated rapidly into the Smith & Nephew compliance programme.

We oversee the employee compliance training programme, ensuring that all new employees are trained on our Code of Conduct, which sets out our basic legal and ethical principles for conducting business. We are updated on significant calls made to our whistle-blower line, which enables employees and members of the public to contact us anonymously through an independent provider (where allowed by local law) and are updated on allegations of potentially significant improprieties and the Company's response.

During the year, we expanded our remit and reviewed the policies and procedures we have in place to handle claims of sexual harassment.

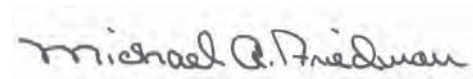
### LOOKING FORWARD

The Board and the Committee have considered the UK Corporate Governance Code 2018 and have decided to expand the role of the Committee to cover a broader focus. Whilst oversight of our Ethics & Compliance programme will continue to remain a key focus for us and we will monitor and assess quality and regulatory issues, we will also oversee culture across the organisation and relationships with our key stakeholders. We will develop the mechanism for ensuring that the Board listens to the employee voice and will oversee the Sustainability Programme.

#### Our focus for 2019 will include:

- > Develop a programme to enable the Board to monitor and assess the corporate culture.
- > Develop a programme to enable the Board to engage with employees, building on existing processes within the Company.
- > Ensure oversight of the Company's Sustainability programme and relationships with key stakeholders.

This will be my final report as Chair of this Committee, as I shall be retiring from the Board at the Annual General Meeting. I should like to thank my colleagues on the Committee and particularly Marc Owen who will be succeeding me as Chair of the Committee and overseeing its expanded focus on culture, the employee voice and stakeholders.



**Michael Friedman**  
Chair of the Compliance & Culture Committee

## Audit Committee report



2018 was my first full year as Chair of the Audit Committee. I have overseen a busy schedule – with the Committee meeting eight times during the year.

### MEMBERSHIP

|                                      | Member from    | Meetings attended |
|--------------------------------------|----------------|-------------------|
| Robin Freestone (Chair) <sup>1</sup> | September 2015 | 8/8               |
| Ian Barlow <sup>1,2</sup>            | May 2010       | 7/8               |
| Roland Diggelmann <sup>3,4</sup>     | March 2018     | 5/6               |
| Erik Engstrom                        | January 2015   | 8/8               |
| Mark Owen                            | October 2017   | 8/8               |
| Joseph Papa <sup>5</sup>             | February 2011  | 3/3               |

- 1 Designated financial experts under the SEC Regulations or recent and relevant financial experience under the UK Corporate Governance Code.
- 2 Ian Barlow missed one Audit Committee meeting on 11 April 2018.
- 3 Roland Diggelmann joined the Audit Committee on 1 March 2018.
- 4 Roland Diggelmann missed one Audit Committee meeting on 24 July 2018.
- 5 Joseph Papa retired from the Board and Audit Committee at the Annual General Meeting on 12 April 2018.

In addition to discharging its role in accordance with its terms of reference, the Committee has met its commitments to provide assurance in respect of various non-routine matters. Areas of scrutiny for the Committee in 2018 have included: the progression of NAPO, (our SAP Enterprise Resource Planning migration in North America); top risks identified in the 2017 Annual Report such as Cyber Security; Brexit readiness; and the Accelerating Performance and Execution (APEX) programme.

In 2018 the Committee oversaw the adoption of two accounting standards, IFRS 15 *Revenue from contracts with customers* and IFRS 9 *Financial Instruments*. A detailed impact assessment of the application of IFRS 15 was undertaken with the conclusion being that there was no significant impact on the timing and recognition of revenue. The main impact on adoption of IFRS 9 has been the implementation of the expected credit loss methodology for the calculation of the loss allowance for trade receivables. This resulted in an additional loss allowance of \$14 million being recognised on 1 January 2018. With regard to IFRS 16 *Leases*, the Committee considered the application of exemptions, estimated impact, transition preparations (including the implementation of a new lease accounting software solution) and transition readiness. IFRS 16 will be adopted on 1 January 2019 with no restatement of comparatives.

In May 2018 we welcomed our new Chief Executive Officer, Namal Nawana. Under Namal's leadership, Smith & Nephew has established its new strategy and organisational structure. That will provide the context for our focus of activity for 2019 – particularly as it will form the backdrop for our risk assessment.

Roland Diggelmann joined the Audit Committee in March 2018 where his experience and expertise enables him to provide appropriate challenge to information presented at meetings by the Executive.

Ian Barlow will be standing down as a member of the Board after the AGM on 11 April. He has served as member of the Committee since 2010 (including seven years as Chair) and has been the Senior Independent Director since 2017. I should like to take this opportunity to thank Ian for his valuable contribution and wise counsel during his tenure.

KPMG have now completed their fourth year's audit and continue to provide robust challenge. We have negotiated fees that will continue to be reviewed for good market practice. We have also agreed arrangements for rotation of the senior partner in accordance with recommendations set out in the Financial Reporting Council's (FRC) Guidance for Audit Committees 2016 and as required by the Securities Exchange Commission (SEC). Finally, we note the positive comments received from the FRC following its review of KPMG's audit of Smith & Nephew's financial statements for 2017.

### Our focus for 2019 will include:

- > The next phase of the APEX programme.
- > Ensuring compliance with new leasing standard IFRS 16.
- > Risk management process – aligned to the new strategy and organisational structure.
- > Continuing to provide assurance on the effectiveness of managing the risks associated with Cyber Security.
- > Ensuring that we are compliant with additional governance and reporting requirements coming into effect for 2019 – such as the revised UK Corporate Governance Code.

**Robin Freestone**  
Chair of the Audit Committee

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

## SIGNIFICANT MATTERS RELATED TO THE FINANCIAL STATEMENTS

We considered the following key areas of judgement in relation to the 2018 accounts and at each half-year and quarterly trading report, which we discussed in all cases with management and the external auditor:

### Valuation of inventories

A feature of the Orthopaedic Reconstruction and Trauma & Extremities franchises (whose inventory makes up approximately 60% of the Group total inventory) is the high level of product inventory required, some of which is located at customer premises and is available for customers' immediate use.

Complete sets of products, including large and small sizes, have to be made available in this way. These sizes are used less frequently than standard sizes and towards the end of the product life cycle are inevitably in excess of requirements. Adjustments to carrying value are therefore required to be made to orthopaedic inventory to anticipate this situation. These adjustments are calculated in accordance with a formula based on levels of inventory compared with historical usage. This formula is applied on an individual product line basis and is first applied when a product group has been on the market for two years. This method of calculation is considered appropriate based on experience, but it does involve management estimation of customer demand, effectiveness of inventory deployment, length of product lives, phase-out of old products and efficiency of manufacturing planning systems.

#### Our action

At each quarter end, we received reports from, and discussed with, management the level of provisioning and material areas at risk. The provisioning level was 18% at 31 December 2018 (19% as at 31 December 2017). We challenged the basis of the provisions and concluded that the proposed levels were appropriate and have been consistently estimated.

### Liability provisioning

The recognition of provisions for legal disputes is subject to a significant degree of estimation. Provision is made for loss contingencies when it is considered probable that an adverse outcome will occur and the amount of the loss can be reasonably estimated. In making its estimates, management takes into account the advice of internal and external legal counsel and uses third party actuarial modelling where appropriate. 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.

#### Our action

As members of the Board, we receive regular updates from the Chief Legal and Compliance Officer. These updates form the basis for the level of provisioning.

The Group carries a provision relating to potential liabilities arising on its portfolio of metal-on-metal hip products of \$192 million as of 31 December 2018. We received detailed reports from management on this position, including the actuarial model used to estimate the provision, and challenged the key assumptions, including the number of claimants and projected value of each claim. The provisions for legal matters have increased by \$27 million during the year, primarily due to an increase in the metal-on-metal provision. There have been some smaller movements from other cases having been resolved. We have determined that the proposed levels of provisioning at year end of \$217 million included within 'provisions' in Note 17.1 in 2018 (\$190 million in 2017) were appropriate in the circumstances.

### Impairment

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

#### Our action

We reviewed management's reports on the key assumptions with respect to acquisition intangible assets – particularly the forecast future cash flows and discount rates used to make these calculations. We concluded that the carrying value of these assets is appropriately supported by the cash flow projections. We have also considered the disclosure surrounding these reviews, and concluded that the review and disclosure were appropriate.

### Taxation

The Group operates in numerous tax jurisdictions around the world and it is Group policy to submit its tax returns to the relevant tax authorities as promptly as possible. At any given time, the Group is involved in disputes and tax audits and will have a number of tax returns potentially subject to audit. Significant issues may take several years to resolve. In estimating the probability and amount of any tax charge, management takes into account the views of internal and external advisers and updates the amount of tax provision whenever necessary. The ultimate tax liability may differ from the amount provided depending on factors including interpretations of tax law, settlement negotiations or changes in legislation.

#### Our action

We annually review our processes and approve the principles for management of tax risks. We review quarterly reports from management evaluating existing risks and tax provisions. Based on a thorough report from management of tax liabilities and our challenge of the basis of any tax provisions recorded, we concluded that the levels of provisions and disclosures were appropriate.



## AUDIT COMMITTEE REPORT continued

|  | Early February  | Late February   |
|--|---|---|
|  | Preliminary Announcement  | Financial Statements  |
| <b>FINANCIAL ACCOUNTING AND REPORTING</b>  |   |   |
| <ul style="list-style-type: none"> <li>– Reviewing significant financial reporting judgements and accounting policies and compliance with accounting standards.</li> <li>– Ensuring the integrity of the financial statements and their compliance with UK and US statutory requirements.</li> <li>– Ensuring the Annual Report and Accounts are fair, balanced and understandable and recommending their adoption by the Board.</li> <li>– Monitoring announcements relating to the Group's financial performance.</li> </ul>   | <p>Endorsed 2017 results and Preliminary announcement Report from KPMG on 2017 results</p> <p>Reviewed draft 2017 Annual Report including report of the Audit Committee</p> <p>Assessed compliance with UK and US governance requirements</p> | <p>Approved the Annual Report and Accounts for 2017 including report of the Audit Committee – confirming fair, balanced and understandable</p> <p>Report from KPMG on 2017 statements – Unqualified Opinion</p> <p>Approved letter of representation for 2017</p> <p>Reviewed S302 and S906 certifications</p> <p>Confirmed Going Concern and Viability Statement</p> |
| <b>INTERNAL AUDIT</b>  |   |   |
| <ul style="list-style-type: none"> <li>– Agreeing Internal Audit plans and reviewing reports of Internal Audit work.</li> <li>– Monitoring the effectiveness of the Internal Audit function.</li> <li>– Reviewing the control observations made by the Internal Auditor, the adequacy of management's response to recommendations and the status of any unremediated actions.</li> </ul>   | Reviewed year end Report  | Reviewed effectiveness of Internal Audit  |
| <b>RISK MANAGEMENT</b>   |   |   |
| <ul style="list-style-type: none"> <li>– On behalf of the Board, reviewing and ensuring oversight of the processes by which risks are managed, through regular functional reports and presentations, and reporting any issues arising out of such reviews to the Board.</li> <li>– Reviewing the process undertaken and deep-dive work required to complete the Viability Statement and recommending its adoption to the Board.</li> <li>– Reviewing the impact of risk management and internal controls and working closely with the Ethics &amp; Compliance Committee.</li> <li>– Overseeing risk management processes (see pages 40 – 49 for further details).</li> <li>– Regularly reviewing the risk register.</li> </ul> | Risk Management Update  | Confirmed effective system of risk management in place and approved the Viability Statement   |
| <b>INTERNAL CONTROLS</b>   |   |   |
| <ul style="list-style-type: none"> <li>– Monitoring the effectiveness of internal controls and compliance with the UK Corporate Governance Code 2016 and the Sarbanes-Oxley Act, specifically sections 302 and 404.</li> <li>– Reviewing the operation of the Group's risk mitigation processes and the control environment over financial risk.</li> </ul>  | Considered Sarbanes-Oxley (Sox) and MAPs Update   | Reviewed effectiveness of Internal Controls over financial reporting  |
| <b>FRAUD &amp; WHISTLE-BLOWING</b>   |   |   |
| <ul style="list-style-type: none"> <li>– Receiving reports on the processes in place to prevent fraud and to enable whistle-blowing.</li> <li>– If significant, receive and review reports of potential fraud or whistle-blowing incidents.</li> <li>– Reviewed Internal Audit Report on Fraud.</li> </ul>   | Reviewed Internal Audit Report on Fraud and Whistle-blowing   |   |
| <b>EXTERNAL AUDITOR</b>  |   |   |
| <ul style="list-style-type: none"> <li>– Overseeing the Board's relationship with the external auditor.</li> <li>– Monitoring and reviewing the independence and performance of the external auditor and evaluating their effectiveness.</li> <li>– Making recommendations to the Board for the appointment or re-appointment of the external auditor.</li> <li>– Monitoring and approving the external auditor's fees.</li> </ul>   | Confirmed independence of KPMG  | Reviewed effectiveness and independence and concluded their effectiveness   |
|  |   | Approved external auditor fees for 2017   |
| <b>OTHER MATTERS</b>   |   |   |
|  | Endorsed NAPO processing and scheduling plan  | Approved consultancy fees to external advisors  |
|  | Approved Audit Committee's TOR  |   |

| April  | May   | July   | September   | October  | December  |
|--|---|--|---|--|---|
|  | 2018 Q1 Trading Report  | 2018 H1 Results  |   | 2018 Q3 Trading Report   |   |
| Debrief of Annual Report process and timetable for 2018<br>Approved Senior Finance Officers Code of Ethics<br>Reviewed summary of Company audits | Reviewed and endorsed 2018 Q1 Trading Report and announcement<br>Approved the Company's policy and report on Conflict Minerals for submission to NYSE | Reviewed and endorsed H1 results and announcement<br>Report from KPMG on H1 results<br>Approved letter of representation for H1 2018 |   | Reviewed and endorsed Q3 Trading Report and announcement<br>Clarified MDR policy<br>New reporting and regulatory requirements update | Reviewed accounting matters for 2018<br>Considered and approved critical accounting policies and judgements in advance of 2018 year end<br>Reviewed preparation work for adoption of IFRS 16<br>Approved plans for delivery of the Annual Report 2018 |
| Reviewed progress  |   |  | Reviewed progress   |  | Reviewed Progress and approved Charter and 2019 Plan  |
|  |   | Risk Management Update   |   | Risk Management Update   | Risk Management Update  |
| Considered Sarbanes-Oxley (Sox) and MAPs Planning 2018   |   |  | Considered Sarbanes-Oxley (Sox) and MAPs progress   |  | Considered Sarbanes-Oxley (Sox) and MAPs progress   |
|  |   | Reviewed Internal Audit Report on Fraud  |   |  | Reviewed Internal Audit Report on Fraud and Whistle-blowing   |
| Endorsed External Audit Plan   | Approved 2017 fee overruns  | Approved Engagement letter for 2018<br>Noted partner rotation arrangements   | KPMG Fee Schedule 2018  | Results of FRC Review of KPMG  |   |
| Treasury Update<br>Cyber Security<br>Project reports including Apex<br>China Channel Management  |   | Cyber Security Update  | Update on NAPO<br>Project reports including APEX<br>Tax Update/Strategy<br>Cyber Security |  | Tax Update<br>Cyber Update<br>APEX Update   |

## AUDIT COMMITTEE REPORT continued

## OTHER MATTERS RELATED TO THE FINANCIAL STATEMENTS

Regular private meetings have taken place between the Audit Committee and the External auditor (KPMG) and the Audit Committee and the Group Head of Internal Audit.

As well as the identified significant matters, other matters that the Audit Committee considered during 2018 were:

### Business combinations

During 2018, we considered and concurred with management that there had been no changes to the provisional fair values recognised in the 2017 acquisition of Rotation Medical, Inc.

### Post Retirement Benefits

The Group has post retirement defined benefit pension schemes, which require estimation in setting the assumptions. We received a report from management setting out their proposed assumptions for the UK and US schemes and concurred with management that these assumptions were appropriate.

### Since the year end

Since the year end we have also reviewed the results for the full year 2018, the preliminary announcement, Annual Report and Accounts, for 2018 and have concluded that they are fair, balanced and understandable. In coming to this conclusion, we have considered the description of the Group's strategy and key risks, the key elements of the business model, which is set out on pages 12–13, risks and the key performance indicators and their link to the strategy.

## EXTERNAL AUDITOR

### Independence of external auditor

Following a competitive tender in 2014, KPMG was appointed external auditor of the Company in 2015. We are satisfied that KPMG are fully independent from the Company's management and free from conflicts of interest. Our Auditor Independence Policy, which ensures that this independence is maintained, is available on the Company's website.

We believe that the implementation of this policy helps ensure that auditor objectivity and independence is safeguarded. The policy also governs our approach when we require our external auditor to carry out non-audit services, and all such services are strictly governed by this policy.

The Auditor Independence Policy also governs the policy regarding audit partner rotation with the expectation that the audit partner will rotate at least every five years. Stephen Oxley has been in tenure for four years as our Audit Partner. The Audit Committee confirms it has complied with the provision of the Competition and Markets Authority Order.

### Effectiveness of external auditor(s)

We conducted a review into the effectiveness of the external audit as part of the 2018 year end process, in line with previous years. We sought the views of key members of the finance management team, considered the feedback from this process and shared it with management.

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

The Audit Committee regularly receives feedback from KPMG, including at each meeting where management present their summary of critical accounting estimates as at each quarter end.

Overall therefore, we concluded that KPMG had carried out their audit for 2018 effectively.

The Audit Committee continues to review not only the effectiveness of the external auditor, KPMG, but also its market competitiveness.

### Appointment of external auditor at Annual General Meeting

Resolutions will be put to the Annual General Meeting to be held on 11 April 2019 proposing the re-appointment of KPMG as the Company's auditor and authorising the Board to determine its remuneration, on the recommendation of the Audit Committee in accordance with the Competition and Markets Authority (CMA) Order 2014.

### Disclosure of Information to the auditor

In accordance with Section 418 of the Companies Act 2006, the Directors serving at the time of approving the Directors' Report confirm that, to the best of their knowledge and belief, there is no relevant audit information of which the Auditor, KPMG, is unaware and the Directors also confirm that they have taken reasonable steps to be aware of any relevant audit information and, accordingly, to establish that the Auditor is aware of such information.

### Non-Audit Fees Paid to the auditor

Non-audit fees are subject to approval in line with the Auditor Independence Policy which is reviewed annually and forms part of the terms of reference of the Audit Committee.

The Audit Committee recognises the importance of the independence of the external auditor and ensures that the Auditor's independence should not be breached. The Audit Committee ensures that the Auditor does not receive a fee from the Company or its subsidiaries that would be deemed large enough to impact its independence or be deemed a contingent fee. The total fees for permitted non-audit services shall be no more than 70% of the average of the fees paid in the last three consecutive financial years for the statutory audits of the Company and its subsidiaries.

Any pre-approved aggregate, individual amounts up to \$25,000 may be authorised by the Group Treasurer and Senior Vice-President Group Finance respectively and amounts up to \$50,000 by the Chief Financial Officer. Any individual amount over \$50,000 must be pre-approved by the Chairman of the Audit Committee. If unforeseen additional permitted services are required, or any which exceed the amounts approved, again pre-approval by the Chairman of the Audit Committee is required.

The following reflects the non-audit fees incurred with KPMG in 2018, which were approved by the Chairman of the Audit Committee:

|                                  |  | 2018<br>\$ million | 2017<br>\$ million |
|----------------------------------|--|--------------------|--------------------|
| Tax fees and compliance services | Assistance with tax compliance in Singapore only | –                  | 0.1                |

Tax compliance services conducted by KPMG in 2017 only took place in countries where it is required by law for the auditor to conduct these services.

The ratio of non-audit fees to audit fees for the year ended 31 December 2018 is 0.00. The ratio of non-audit fees to audit fees for the year ended 31 December 2017 was 0.02.

Full details are shown in Note 3.2 of the Notes to the Group accounts.

### Audit Fees paid to the auditor

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

|                    | 2018<br>\$ million | 2017<br>\$ million |
|--------------------|--------------------|--------------------|
| Audit fees         | 6.0                | 4.4                |
| Audit-related fees | –                  | –                  |
| Total              | 6.0                | 4.4                |

### INTERNAL AUDIT

The Internal Audit team, which reports functionally to the Audit Committee, carries out risk-based reviews across the Group. These reviews examine the management of risks and controls over financial, operational, IT and transformation programme activities.

The audit team, led by the Group Head of Internal Audit, consists of appropriately qualified and experienced employees. Third parties may be engaged to support audit work as appropriate.

The Group Head of Internal Audit has direct access to, and has regular meetings with, the Audit Committee Chair and prepares formal reports for Audit Committee meetings on the activities and key findings of the function, together with the status of management's implementation of recommendations. The Audit Committee has unrestricted access to all internal audit reports, should it wish to review them.

During the year, the team completed 53 risk based audits and reviews across the Group. These included Financial and Operational Market based reviews covering the EMEA, APAC, US and Latam Regions; Global Operations, including manufacturing and supply chain; IT and various Programme Assurance reviews ranging from the implementation of SAP across the North American Business to MDR preparedness. Key issues noted during reviews included the need to better control user access to some systems, also the need to improve internal controls in a number of smaller markets. Management has taken swift action to implement Internal Audit's recommendations.

A periodic review of the Internal Audit function is undertaken by an independent external consultant, in accordance with the guidelines of the Institute of Internal Auditors. In 2018 KPMG completed an ISA 610 review of the function and this concluded satisfactorily. Finally, the performance of the function is assessed using a structured questionnaire, allowing Non-Executive and Executive and senior management, plus the external auditor, to comment on key aspects of the function's performance. The Audit Committee, which re-approved the function's charter in December 2018, has satisfied itself that adequate, objective internal audit standards and procedures exist within the Group and that the Internal Audit function is effective.

### RISK MANAGEMENT PROGRAMME

Whilst the Board is responsible for ensuring oversight of strategic risks relating to the Company, determining an appropriate level of risk appetite, and monitoring risks through a range of Board and Board Committee processes, the Audit Committee is responsible for ensuring oversight of the processes by which operational risks, relating to the Company and its operations are managed and for reviewing financial risks and the operating effectiveness of the Group's Risk Management process.

During the year, we reviewed our Risk Management processes and progress was discussed at our meetings in February, July, September and December. We approved the Risk Management Programme for 2018 and monitored performance against that plan specifically reviewing the work undertaken by the risk champions across the Group, identifying the risks which could impact their areas of our business.

The Risk Management programme in 2018 followed the new risk management policy and manual rolled out across the Company in 2017. This programme combines a 'bottom up' approach (whereby risks are identified within business areas by local risk champions working with their leadership teams), with a top-down approach (when the Executive Committee meets as the Risk Committee to consider the risks facing the Group at an enterprise level).

Throughout the year, the Audit Committee maintained oversight of this programme. We reviewed the principal risks identified and the heat maps prepared by management showing how these risks were being managed. We considered those risks where the risk profile was changing particularly political and economic risks as a consequence of Brexit. We also reviewed the deep dives undertaken by the Group Risk team, which looked more closely at the risks impacting certain business areas.

## AUDIT COMMITTEE REPORT continued

Since the year end, we have reviewed a report from the Group Head of Internal Audit into the effectiveness of the Risk Management Programme throughout the year. We considered the principal risks, the actions taken by management to review those risks and the Board risk appetite in respect of each risk.

We concluded that the Risk Management process during 2018 and up to the date of approval of this Annual Report was effective. Work will continue in 2019 and beyond to continue to enhance the process.

See pages 40–49 for further information on our Risk Management Process.

## VIABILITY STATEMENT

We also reviewed management's work in conducting a robust assessment of those risks which would threaten our business model and the future performance or liquidity of the Company, including its resilience to the threats of viability posed by those risks in severe but plausible scenarios. This assessment included stress and sensitivity analyses of these risks to enable us to evaluate the impact of a severe but plausible combination of risks. We then considered whether additional financing would be required in such eventualities. Based on this analysis, we recommended to the Board that it could approve and make the Viability Statement on page 50–51.

## GOING CONCERN

The Group's business activities, together with the factors likely to affect its future development, performance and position are set out in the 'Financial review and principal risks' section on pages 42–47.

The financial position of the Group, its cash flows, liquidity position and borrowing facilities are described on page 38–39.

In addition, the Notes to the Group accounts include the Group's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments and hedging activities; and its exposure to credit risk and liquidity risk.

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

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

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

## EVALUATION OF INTERNAL CONTROLS

Management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a–15(f) and 15d–15(f) under the US Securities Exchange Act of 1934.

There is an established system of internal control throughout the Group and our country business units. The main elements of the internal control framework are:

- The management of each country and group function is responsible for the establishment, maintenance and review of effective financial controls within their business unit or function.
- The Group's IT organisation is responsible for the establishment of effective IT controls within the core financial systems and underlying IT infrastructure.
- The Financial Controls & Compliance Group has responsibility for the review of the effectiveness of controls operating in the countries, functions and IT organisation, either by performing testing directly or reviewing testing performed in-country.
- The Group Finance Manual sets out financial and accounting policies. The Group's Minimum Acceptable Practices (MAPs) have been further enhanced during 2018 by simplifying and clarifying the requirements as well as broadening their scope and incorporating the core financial controls. The business is required to self-assess their level of compliance with the MAPs twice a year and remediate any gaps. MAPs compliance is validated through spot-checks conducted by the Financial Controls & Compliance Group and during both Internal Audit and external audit visits.
- There are clearly defined lines of accountability and delegations of authority.
- During the year, there has been further progress in standardising our core financial controls globally and merging with the MAPs. In 2019, there will be a focus on implementing a technology solution to facilitate the operation and testing of controls.
- The Internal Audit function executes a risk-based annual work plan, as approved by the Audit Committee.
- The Audit Committee reviews reports from Internal Audit on their findings on internal financial controls, including compliance with MAPs and from the SVP Group Finance and the heads of the Financial Controls & Compliance, Taxation and Treasury functions.
- The Audit Committee reviews regular reports from the Financial Controls & Compliance Group with regard to compliance with the Sarbanes-Oxley Act including the scope and results of management's testing and progress regarding any remediation, as well as the aggregated results of MAPs self-assessments performed by the business.
- Business continuity planning, including preventative and contingency measures, back-up capabilities and the purchase of insurance.
- Risk management policies and procedures including segregation of duties, transaction authorisation, monitoring, financial and managerial review and comprehensive reporting and analysis against approved standards and budgets.



- A treasury operating framework and Group treasury team, accountable for all treasury activities, which establishes policies and manages liquidity and financial risks, including foreign exchange, interest rate and counterparty exposures. Treasury policies, risk limits and monitoring procedures are reviewed regularly by the Audit Committee, or the Finance and Banking Committee, on behalf of the Board.
- Our published Group tax strategy which details our approach to tax risk management and governance, tax compliance, tax planning, the level of tax risk we are prepared to accept and how we deal with tax authorities, which is reviewed by the Audit Committee on behalf of the Board.
- The Audit Committee reviews the Group whistle-blower procedures to ensure they are effective.
- The Audit Committee received and reviewed a report on the progress of the Finance Transformation during 2018 and the mitigation of the associated risks.

This system of internal control has been designed to manage rather than eliminate material risks to the achievement of our strategic and business objectives and can provide only reasonable, and not absolute, assurance against material misstatement or loss. Because of inherent limitation, our internal controls over financial reporting may not prevent or detect all misstatements. In addition, our projections of any evaluation of effectiveness in future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. Entities where the Company does not hold a controlling interest have their own processes of internal controls similar to those of the Company.

We have reviewed the system of internal financial control and satisfied ourselves that we are meeting the required standards both for the year ended 31 December 2018 and up to the date of approval of this Annual Report. No concerns were raised with us in 2018 regarding possible imperfections in matters of financial reporting.

This process complies with the Financial Reporting Council's 'Guidance on Risk Management, Internal Control and Related Financial and Business Reporting' on the UK Corporate Governance Code and additionally contributes to our compliance with the obligations under the Sarbanes-Oxley Act and other internal assurance activities. There has been no change during the period covered by this Annual Report that has materially affected, or is reasonably likely to materially affect, the Group's internal control over financial reporting.

The Board is responsible overall for reviewing and approving the adequacy and effectiveness of the risk management framework and the system of internal controls over financial, operational (including quality management and ethical compliance) processes operated by the Group. The Board has delegated responsibility for this review to the Audit Committee. The Audit Committee, through its Internal Audit function, reviews the adequacy and effectiveness of internal control procedures and identifies any significant weaknesses and ensures these are remediated within agreed timelines. The latest review covered the financial year to 31 December 2018 and included the period up to the approval of this Annual Report. The main elements of this review are as follows:

- The Chief Executive Officer and the Chief Financial Officer evaluated the effectiveness of the design and operation of the Group's disclosure controls and procedures as at 31 December 2018.
- Management is responsible for establishing and maintaining adequate internal control over financial reporting. Management assessed the effectiveness of the Group's internal control over financial reporting as at 31 December 2018 in accordance with the requirements in the US under section 404 of the Sarbanes-Oxley Act. In making that assessment, they used the criteria set forth by the Committee of Sponsoring Organisations of the Treadway Commission in Internal Control-Integrated Framework (2013). Based on their assessment, management concluded and reported that, as at 31 December 2018, the Group's internal control over financial reporting was effective based on those criteria. Having received the report from management, the Audit Committee reports to the Board on the effectiveness of controls. KPMG, an independent registered public accounting firm issued an audit report on the Group's internal control over financial reporting as at 31 December 2018.

### CODE OF ETHICS FOR SENIOR FINANCIAL OFFICERS

We have adopted a Code of Ethics for Senior Financial Officers, which applies to the Chief Executive Officer, the Chief Financial Officer, the SVP Group Finance and the Group's senior financial officers. There have been no waivers to any of the Code's provisions nor have there been any substantive amendments to the Code during 2018 or up until 15 February 2019. A copy of the Code of Ethics for Senior Financial Officers can be found on our website at [www.smith-nephew.com](http://www.smith-nephew.com).

In addition, every individual in the finance function certifies to the Chief Financial Officer that they have complied with the Finance Code of Conduct.

### EVALUATION OF COMPOSITION, PERFORMANCE AND EFFECTIVENESS OF THE AUDIT COMMITTEE

The composition, performance and effectiveness of the Audit Committee was evaluated this year in accordance with the EU Audit Reform. Its effectiveness is also reviewed in conjunction with the annual Board evaluation, conducted by Boardroom Review.

The review by the Audit Committee found the following and the below action will be taken during 2019:

|                             |  |
|-----------------------------|--|
| Composition                 | Following retirement of Ian Barlow an additional member with recent and relevant financial experience will be required |
| Performance & Effectiveness | The Audit Committee is well chaired, with a clear role, an efficient use of time and high quality information          |

## Directors' Remuneration Report

### Remuneration Committee report



Our focus in 2019 will be on aligning our remuneration arrangements to the new Strategic Imperatives of the Company

#### MEMBERSHIP

|  | Member from    | Meetings attended |
|--|----------------|-------------------|
| Angie Risley <sup>1</sup> (Chair)          | September 2017 | 5/5               |
| Vinita Bali                                | April 2015     | 5/5               |
| Virginia Bottomley                         | April 2014     | 5/5               |
| Robin Freestone                            | September 2015 | 5/5               |
| Joseph Papa <sup>1</sup><br>(Former Chair) | April 2011     | 2/2               |
| Roberto Quarta                             | April 2014     | 5/5               |

<sup>1</sup> Angie Risley was appointed Chair of the Committee on 12 April 2018 replacing Joseph Papa, on his retirement from the Board.

#### DEAR SHAREHOLDER,

It is a great pleasure to be writing to you for the first time as Chair of the Remuneration Committee. I should like to take the opportunity of thanking my predecessor, Joseph Papa, who was a great support to me during our handover process. The recruitment of Namal Nawana as our new Chief Executive Officer and the consequent changes to his leadership team have given the Committee a full programme during the year. We have also considered the expansion of the role of the Remuneration Committee in the light of revised remuneration regulations and corporate governance reforms. At all times, we have sought to ensure that our pay arrangements support and drive delivery of the strategic aims set out by the Company, while making careful decisions to align pay outcomes with the performance delivered during the period.

#### Review of 2018 performance

During the year, the Group delivered underlying revenue growth of 2% and a 90bps improvement in trading profit margin, in line with guidance. Performance improved over the course of the year, with 1% underlying revenue growth in the first half and 3% in the second half. Highlights included our continued strength in the Emerging Markets, with China delivering double-digit growth. At a franchise level, our Knee Implants franchise continued to deliver market-beating growth and Hip Implants improved markedly in the second half. In Sports Medicine REGENETEN for shoulder repair, acquired in December 2017, had an outstanding year as we more than doubled sales and the acquisition of Ceterix, completed in early 2019, offers exciting opportunities in knee repair. Our performance in Advanced Wound Care and Advanced Wound Devices in the US also stood out across 2018. The team delivered these successes whilst controlling costs. This contributed to the margin growth, which also included a gain from a one-off legal settlement. Most impressively, the significant change in structure and leadership in the second half did not detract from delivery and the stronger finish to the year.

Pay for performance is important to us and therefore members of the Audit Committee joined us to consider our results and determine the extent to which performance against the targets in our incentive plans were met. Taking into account this financial performance along with consideration of how our Executive Directors performed against

their business performance objectives, the Remuneration Committee determined that Namal Nawana would receive a cash incentive payment of 67.7% of his full year's salary and an Equity Incentive award of 35.9% of his full year's salary (prorated to reflect his joining date in May 2018) and that Graham Baker would receive a cash incentive payment of 95.5% of his salary and an Equity Incentive award of 50% of his salary (pro-rated to reflect his increase in salary from July 2018 to reflect increased responsibilities). The Committee also determined that Olivier Bohuon would receive a cash incentive payment of 94% of his salary in respect of the period worked as Chief Executive Officer to May 2018, when he retired from the Board. Reviewing the performance of the Company, the Committee was confident that these outcomes appropriately reflected our underlying performance over the year as a whole.

The Committee also reviewed performance over the past three years and determined that 93% of the target Performance Share Plan awards made in 2016 to Olivier Bohuon would vest reflecting the performance of the Company as a whole. Namal Nawana and Graham Baker were not employed by the Company at the time these awards were made.

The total remuneration paid to Namal Nawana, Olivier Bohuon and Graham Baker in 2018 is detailed further on page 89.

#### Looking forward – remuneration arrangements for 2019

As explained on pages 8–11, the Board approved a new strategy during 2018 and Namal articulated his vision for the business externally earlier in 2019. During the course of 2019 our focus will be on developing remuneration arrangements to align with this strategy and to drive the performance and behaviours to deliver that strategy. We shall engage with shareholders during the course of 2019 to ensure firstly that shareholders understand our business strategy and secondly how we intend to align our remuneration arrangements to that strategy. We shall ensure that shareholder views are appropriately reflected in the Remuneration Policy we submit at the 2020 Annual General Meeting.

## Looking forward – UK corporate governance code

We are mindful of the corporate governance changes which have come into effect at the beginning of 2019. During 2018, we discussed how we would be addressing these changes. We have updated our Terms of Reference to expand our remit to consider pay and benefits across the Company in more depth and breadth than before. The review of our Remuneration Policy in 2019 will also consider the new provisions of the UK Corporate Governance Code.

Although we are not required to report on the CEO pay ratio until next year, we have compared the pay of our outgoing Chief Executive Officer, Olivier Bohuon and our new Chief Executive Officer, Namal Nawana to the median pay in the UK and determined that our CEO pay ratio is 95:1. Further details are given on page 102.

## Appointment of Namal Nawana

We determined the remuneration arrangements for Namal Nawana, our incoming Chief Executive Officer, having regard both to the remuneration policy approved by shareholders in 2017 and also to the competitive market environment for Medical Devices Chief Executives of Namal's calibre and experience, most of whom are based in the US. We are very grateful for the support and guidance we received from the shareholders we spoke to when we were considering appropriate remuneration arrangements.

His remuneration arrangements are described more fully in the following pages. Namal is employed on a standard US executive contract. He receives a base salary of \$1,540,000 and participates in the Annual Incentive Plan (cash and equity) and the Performance Share Plan. He also participates in the retirement plans available to our US Executives: Executive Plus Plan, 401k and 401k plus. The Company contribution to these plans is: 20% of base salary to the Executive Plus Plan, standard company match for 401k and standard 401k plus contribution up to the IRS maximum. He will be required to give six months' notice and the notice period from the Company is 12 months. He received no sign-on or buy-out award on joining the Company.

## Executive officer remuneration

We also considered and approved remuneration arrangements for a number of Executive Officers who have moved into new roles or joined the Company as part of Namal's review of the leadership team and organisational structure. In particular, we consulted shareholders over the summer with regard to increasing our Chief Financial Officer, Graham Baker's base salary by 5% to reflect his increased responsibilities for our IT and Global Business Services functions. We are grateful to those shareholders who responded to this consultation and were overwhelmingly supportive. We reached out to the holders of over 40% of our share capital and received responses from nearly half of these shareholders, all of whom were supportive.

## Retirement of Olivier Bohuon

We also determined the retirement arrangements for Olivier Bohuon, our former Chief Executive Officer, in line with the Remuneration Policy approved by our shareholders in 2017.

Olivier stepped down from the Board on Namal's appointment in May 2018 and remained employed in an advisory capacity supporting the transition for a period of six months, during which time he continued to receive the same salary and benefits as in 2017. He participated in the Annual Incentive Plan for the period worked as Chief Executive Officer in 2018, but did not receive a 2018 award under the Performance Share Plan. As a good leaver, his Equity Incentive Awards vested on his retirement date on 7 November 2018, and his Performance Share Awards have been pro-rated for length of time served since the date of award and will vest subject to the original performance conditions on their original vesting dates in 2019 and 2020. Additionally, his 2017 award remains subject to a two-year post vesting holding period.

## 2018 Annual general meeting

We were pleased that our Remuneration Report received over 97% of votes in favour at the 2018 Smith & Nephew plc AGM. This demonstrates the strong support from our shareholders for our remuneration arrangements.

I should like to thank the shareholders who have engaged with us and supported us during the year and particularly those I met as part of my induction programme.

I should also like to thank my fellow Committee members for their support during the year and to welcome Deloitte as our new remuneration advisors.

## LOOKING FORWARD

In summary, our focus for 2019 includes:

- > Developing a new Remuneration Policy to align with the new strategy to deliver the performance and behaviours required to deliver the results.
- > Engaging with key shareholders whilst developing a new Remuneration Policy to ensure alignment of views.
- > Continuing to develop our understanding and oversight of pay arrangements across the Group focusing particularly on the CEO pay ratio and the gender pay ratio.



**Angie Risley**  
Chair of the Remuneration Committee

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

DIRECTORS' REMUNERATION REPORT continued

## Remuneration Committee report continued

### MEASURES IN OUR VARIABLE PAY PLANS

#### FINANCIAL MEASURES IN ANNUAL INCENTIVE PLAN

|                                    |  |
|------------------------------------|--|
| <b>Revenue (35%)</b>               | Revenue is a key driver of profit growth.  |
| <b>Trading Profit Margin (25%)</b> | Trading profit margin is a critical measure both for the business and our shareholders and delivering margin improvements is a core commitment under our strategy. |
| <b>Trading Cash Flow (15%)</b>     | Cash flow from our Established Markets is necessary in order to fund growth in Emerging Markets, innovation, organic growth and acquisitions.                      |

#### BUSINESS OBJECTIVES IN ANNUAL INCENTIVE PLAN

|                                |  |
|--------------------------------|--|
| <b>Growth (8.3%)</b>           | Revenue growth through achieving the full potential of our portfolio transforming our business through enabling technologies and expanding in high growth segments is fundamental to our future success.                                     |
| <b>Business Process (8.3%)</b> | We need to release resources from the businesses through improved structures, efficiencies and business processes in order to re-invest in our higher growth areas, including Emerging Markets, innovation, organic growth and acquisitions. |
| <b>People (8.3%)</b>           | We need to attract and retain the right people to achieve our strategy through improving our operating model and drive the right behaviours for all of our people globally.  |

#### PERFORMANCE MEASURES IN OUR PERFORMANCE SHARE PLAN

|   |  |
|---|--|
| <b>Relative TSR (25%)</b>               | If we execute our strategy successfully, this will lead to an increased return for our shareholders, whether you invest in the healthcare sector or in the FTSE. |
| <b>Cumulative Free Cash Flow (25%)</b>  | Cash flow from our Established Markets is necessary in order to fund growth in Emerging Markets, innovation, organic growth and acquisitions.                    |
| <b>Sales Growth (25%)</b>               | Sales growth is a key driver of profit growth.   |
| <b>Return on Invested Capital (25%)</b> | Return on invested capital is a high priority for our shareholders which will drive better financial discipline and enhanced operating performance.              |

### COMPLIANCE STATEMENT

We have prepared this Directors' Remuneration Report (the Report) in accordance with The Enterprise and Regulatory Reform Act 2012-2013 (clauses 81-84) and The Large and Medium-Sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013 (the Regulations). The Report also meets the relevant requirements of the Financial Conduct Authority (FCA) Listing Rules.

The first part of the Report (pages 89 to 105) is the annual report on remuneration (the Implementation Report). The Implementation Report will be put to shareholders for approval as an advisory vote at the Annual General Meeting on 11 April 2019. The Implementation Report explains how the Remuneration Policy was implemented during 2018 and also how it is currently being implemented in 2019.

The second part of the Report (pages 106 to 114) is the Directors' Remuneration Policy Report (the Policy Report) which was approved by shareholders at the Annual General Meeting held in April 2017. The Policy Report describes our Remuneration Policy as it relates to the Directors of the Company. All payments we make to any Director of the Company will be in accordance with this Remuneration Policy. This Policy remains unchanged in 2019 and it is intended that it will next be put to shareholder vote at the Annual General Meeting to be held in 2020.

The financial tables and narrative reporting on pages 89 to 100, (including the Directors' interests tables on page 101, the table of historic data on page 104 and the senior management remuneration table on page 105), have been audited by KPMG LLP.

The Remuneration Committee presents the Annual Report on remuneration (the Implementation Report), which will be put to shareholders for an advisory vote at the Annual General Meeting to be held on 11 April 2019.

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

### WORK OF THE REMUNERATION COMMITTEE IN 2018

In 2018, we held five meetings and determined ten matters by written resolution, mainly relating to Executive Officer Remuneration and termination packages and the appointment of Deloitte LLP as new Remuneration Committee advisors. Each meeting was attended by all members of the Committee. The Chief Executive Officer, the Chief Human Resources Officer and the SVP Global Reward, key members of the finance function and the Company Secretary also attended all or part of some of the meetings, except when their own remuneration was being discussed. We also met with the independent Remuneration Consultants, Willis Towers Watson, in the first part of the year and Deloitte in the second half of the year without management present. Our programme of work in 2018 can be found in the table on the next page.

Since year end, we have also reviewed the financial results for 2018 against the targets under the short-term and long-term incentive arrangements jointly with the Audit Committee, and have agreed the targets for the short-term and long-term incentive plans for 2019. We have also approved increases to the salaries of Executive Directors and Executive Officers and determined cash payments under the Annual Incentive Plan, awards under the Equity Incentive Programme and the Performance Share Programme, and the vesting of awards under the Performance Share Programme granted in 2016. Finally, we approved the wording of this Directors' Remuneration Report.

### INDEPENDENT REMUNERATION COMMITTEE ADVISORS

During the year, the Remuneration Committee received information and advice from both Willis Towers Watson and Deloitte LLP. Both firms are independent executive remuneration consultancy firms appointed by the Remuneration Committee following a full tender process in 2011 and 2018 respectively. Deloitte LLP replaced Willis Towers Watson as our primary Remuneration advisors in July 2018, although Willis Towers Watson continue to provide market benchmark data on compensation design and levels for our Executive Director and Executive Officer positions. During the year, both firms provided advice on market trends and remuneration issues in general, attended Remuneration Committee meetings, assisted in the review of the Directors' Remuneration Report, undertook calculations relating to the TSR performance conditions, advised on Executive Director and Officer pay and investor views and engagement.

The fees paid to Deloitte LLP for Remuneration Committee advice during 2018, charged on a time and expense basis, were £68,200 and the fees paid to Willis Towers Watson were £91,000. Deloitte LLP also provided other tax and consultancy services to the Company. Willis Towers Watson also provided other human resources and compensation advice to the Company for the level below the Board. Both Deloitte LLP and Willis Towers Watson comply with the Code of Conduct in relation to Executive Remuneration Consulting in the United Kingdom and the Remuneration Committee is satisfied that their advice is objective and independent.



DIRECTORS' REMUNERATION REPORT continued

## Remuneration Committee report continued

| Late January                                     | Early February   | July   | September                         | October                         |
|--|--|--|-----------------------------------|---------------------------------|
| Approval of salaries, awards and payouts in 2018 | Approval of targets and Remuneration strategy for 2018 | Mid-year Review of Remuneration Arrangements | Review of Graham Baker's base pay | Review of Remuneration Strategy |

### DETERMINATION OF REMUNERATION POLICY AND PACKAGES

|  |   |   |   |   |
|--|---|---|---|---|
| <ul style="list-style-type: none"> <li>Determination of Remuneration Policy for Executive Directors and senior executives.</li> <li>Approval of individual remuneration packages for Executive Directors and Executive Officers, at least annually, and any major changes to individual packages throughout the year.</li> <li>Consideration of remuneration policies and practices across the Group in particular relating to CEO Pay ratio and Gender Pay.</li> <li>Approval of appropriate performance measures for short-term and long-term incentive plans for Executive Directors and senior executives.</li> <li>Determination of pay-outs under short-term and long-term incentive plans for Executive Directors and senior executives.</li> </ul> | <p>Approved quantum of cash payments and awards to Executive Directors and Officers under the Annual Incentive Plan, the Equity Incentive Programme and Performance Share Programme, (in the context of 2017 financial performance). Reviewed the fees for the Chair, Executive Directors and Officers.</p> | <p>Agreed the targets for the short-term and long-term incentive plans for 2018. Approved the remuneration strategy for 2018 against the proposed business plan.</p> <p>Considered appropriate remuneration package for new Chief Executive Officer.</p> <p>Reviewed Chair's pay.</p> | <p>Report from Deloitte on current market trends in remuneration matters and an analysis of how the Company's remuneration arrangements aligned with current practices elsewhere.</p> <p>Reviewed the performance of long-term awards granted in 2016, 2017 and 2018.</p> | <p>Approved 5% base salary increase for Graham Baker to reflect his increased responsibilities for the IT and Global Business Services functions following consultation programme with the holders of 40% of the Company's shares.</p> <p>Agreed to update the Company's Remuneration Policy to align with the new corporate strategy during 2019 to put to shareholders for approval in 2020.</p> <p>Agreed to make minor adjustments to certain targets and measures in 2019 in line with the existing remuneration Policy.</p> <p>Reviewed benchmarking data for the Executive Directors and Executive officers prepared in accordance with agreed methodology.</p> <p>Considered reports on Gender Pay Gap.</p> |
|--|---|---|---|---|

### OVERSIGHT OF ALL COMPANY SHARE PLANS

|   |   |
|---|---|
| <ul style="list-style-type: none"> <li>Determination of the use of long-term incentive plans and overseeing the use of shares in executive and all-employee plans.</li> </ul> | <p>Reviewed adherence to shareholding guidelines for Directors and Senior Management.</p> <p>Monitored dilution limits and the number of shares available for use in respect of Executive and all-employee share plans.</p> <p>Approved amendments to various share plan rules to reflect regulatory changes.</p> |
|---|---|

### REPORTING AND ENGAGEMENT WITH SHAREHOLDERS ON REMUNERATION MATTERS

|  |  |  |  |
|--|--|--|--|
| <ul style="list-style-type: none"> <li>Approval of the Directors' Remuneration Report ensuring compliance with related governance provisions.</li> <li>Continuation of constructive engagement on remuneration matters with shareholders.</li> </ul> | <p>Approved the Remuneration Report.</p> | <p>Reviewed the shareholder response to the Remuneration Report at the AGM and noted feedback.</p> | <p>Reviewed the shareholder response to the Remuneration Report at the AGM and noted feedback.</p> |
|--|--|--|--|

### OTHER MATTERS

|  |  |  |
|--|--|--|
| <p>Audit Committee in attendance to answer questions related to audited numbers and provide assurance.</p> | <p>Confirmed the appointment of Deloitte LLP as the new independent advisors to the Committee.</p> | <p>Discussed recent corporate governance changes and the impact they would have on the Remuneration Committee.</p> |
|--|--|--|

## Remuneration implementation report

### SINGLE TOTAL FIGURE ON REMUNERATION

The amounts for 2018 have been converted into US\$ for ease of comparability using the exchange rates of £ to US\$1.334 and € to US\$1.180 (2017: £ to US\$1.2877 and € to US\$1.1279).

|                                | Namal Nawana<br>Appointed 7 May 2018 |      | Olivier Bohuon<br>Appointed 1 April 2011<br>(resigned from Board<br>7 May 2018) |                    | Graham Baker<br>Appointed 1 March 2017 |                    | Julie Brown<br>Appointed 4 February 2013<br>(resigned with effect from<br>11 January 2017) |                 |
|--------------------------------|--------------------------------------|------|---|--------------------|--|--------------------|--|-----------------|
|                                | 2018                                 | 2017 | 2018  | 2017               | 2018                                   | 2017               | 2018   | 2017            |
| <b>FIXED PAY</b>               |                                      |      |   |                    |  |                    |  |                 |
| Base salary                    | \$1,006,923                          | –    | \$490,615   | \$1,330,347        | \$707,628                              | \$547,273          | –  | \$21,606        |
| Pension payments               | \$222,010                            | –    | \$147,184   | \$399,104          | \$212,302                              | \$164,182          | –  | \$6,482         |
| Taxable benefits               | \$59,754                             | –    | \$44,322  | \$177,433          | \$26,758                               | \$22,308           | –  | \$637           |
| <b>ANNUAL VARIABLE PAY</b>     |                                      |      |   |                    |  |                    |  |                 |
| Annual Incentive Plan – cash   | \$1,042,655                          | –    | \$455,345   | \$1,208,911        | \$676,025                              | \$683,797          | –  | –               |
| <b>HYBRID</b>                  |                                      |      |   |                    |  |                    |  |                 |
| Annual Incentive Plan – equity | \$552,290                            | –    | –   | \$665,173          | \$353,817                              | \$361,200          | –  | –               |
| <b>LONG-TERM VARIABLE PAY</b>  |                                      |      |   |                    |  |                    |  |                 |
| Performance Share Plan         | –                                    | –    | \$1,193,678   | \$1,335,721        | –                                      | –                  | –  | –               |
| <b>Total</b>                   | <b>\$2,883,632</b>                   |      | <b>\$2,331,144</b>  | <b>\$5,116,689</b> | <b>\$1,976,530</b>                     | <b>\$1,778,760</b> | <b>–</b>   | <b>\$28,725</b> |

|                                       |  |
|---------------------------------------|--|
| <b>Base salary</b>                    | the actual salary receivable for the year.   |
| <b>Pension payments</b>               | the value of the salary supplement in lieu of pension or contribution to any pension scheme made by the Company.   |
| <b>Taxable benefits</b>               | the gross value of all taxable benefits (or benefits that would be taxable in the UK) received in the year.  |
| <b>Annual Incentive Plan – cash</b>   | the value of the cash incentive payable for performance in respect of the relevant financial year.   |
| <b>Annual Incentive Plan – equity</b> | the value of the equity element awarded in respect of performance in the relevant financial year, but subject to an ongoing performance test as described on pages 94–95 of this report.   |
| <b>Performance Share Plan</b>         | the value of shares vesting that were subject to performance over the three-year period ending on 31 December in the relevant financial year. For awards vesting in early 2019 this is based on an estimated share price of 1,380.98p per share, which was the average price of a share over the last quarter of 2018. The value of the 2015 share awards that vested in 2018 have now been restated with the share price on the date of actual vesting being 1,325.65p per share on 9 March 2018. |
| <b>Total</b>                          | the sum of the above elements.   |

All data is presented in our reporting currency of US\$. Amounts for Olivier Bohuon have been converted from EURO and amounts for Julie Brown and Graham Baker from GBP using average exchange rates. Given currency volatility in 2018, this may give the impression of changes that are misleading. Data is presented in local currency in the subsequent sections in the interests of full transparency.

DIRECTORS' REMUNERATION REPORT continued

## Remuneration implementation report continued

### FIXED PAY

#### Base salary

In February 2018, it was agreed that with effect from 1 April 2018, Executive Directors would be paid the following base salaries per annum.

|   | 2018       | 2017       |
|---|------------|------------|
| Olivier Bohuon (retired from Board on 7 May 2018 and from Company on 7 November 2018) | €1,179,490 | €1,179,490 |
| Graham Baker  | £520,000   | £510,000   |

Namal Nawana was appointed Chief Executive Officer on 7 May 2018 and paid a base salary of \$1,540,000 per annum.

After a period of consultation with shareholders, Graham Baker's salary was increased by 5% to £546,210 to take effect from 1 July 2018, when he assumed additional responsibilities for the IT and Global Business Services functions.

In February 2019, we reviewed the base salaries of the Executive Directors, having considered general economic conditions and average salary increases across the rest of the Group, which have averaged at 2.9% in the UK and 3% in the US. The Remuneration Committee has agreed that Namal Nawana's salary will increase by 2.5% and Graham Baker's salary will increase by 2% to \$1,578,500 and £557,134 respectively with effect from 1 April 2019.

#### Pension payments

In 2018, Graham Baker and Olivier Bohuon, until his retirement from the Company on 7 November 2018, received a salary supplement of 30% of their basic salary to apply towards their retirement savings, in lieu of membership of one of the Company's pension schemes.

Namal Nawana participates in the retirement plans available to our US Executives: Executive Plus Plan, 401k and 401k plus. During 2018, total Company Pension and 401k contributions for Mr Nawana amounted to \$222,010 which on an annualised basis is equivalent to 21.34% of salary. Due to the fact that Mr Nawana reached the annual cap on 401k contributions in the period from joining on 7 May 2018, the actual percentage for 2018 equated to 22.05%. For 2019, the combined pension and 401k Company contribution is expected to be less than 21.47% of his base salary.

#### Benefits

In 2018, our UK based Executive Directors (Olivier Bohuon and Graham Baker) received death in service cover of seven-times basic salary, of which four-times salary is payable as a lump sum, with the balance used to provide for any spouse and dependent persons. Namal Nawana participated in the US Life Assurance Program, which in total is capped at \$2 million. They also received health cover for themselves and their families, a car allowance and financial consultancy advice. Olivier Bohuon also received assistance with travel costs between London and Paris. The same arrangements will apply in 2019 for Namal Nawana and for Graham Baker. The following table summarises the value of benefits in respect of 2017 and 2018. Olivier Bohuon and Julie Brown received these benefits until they retired from the Board on 7 May 2018 and 11 January 2017 respectively.

|                              | Namal Nawana |      | Olivier Bohuon |         | Graham Baker |         | Julie Brown |      |
|------------------------------|--------------|------|----------------|---------|--------------|---------|-------------|------|
|                              | 2018         | 2017 | 2018           | 2017    | 2018         | 2017    | 2018        | 2017 |
| Health cover                 | \$6,635      | –    | £2,915         | £17,807 | £1,369       | £1,217  | –           | £44  |
| Car and fuel allowance       | \$8,467      | –    | £5,288         | £15,000 | £17,676      | £14,182 | –           | £451 |
| Financial consultancy advice | £33,485      | –    | £15,733        | £34,204 | £1,020       | £1,925  | –           | –    |
|                              | –            | –    | –              | €37,736 | –            | –       | –           | –    |
| Travel costs                 | –            | –    | £7,056         | £33,703 | –            | –       | –           | –    |
| Subscriptions                | –            | –    | £2,245         | £4,023  | –            | –       | –           | –    |

## ANNUAL VARIABLE PAY

### Annual Incentive Plan 2018 – cash element

The performance measures and weightings which apply to the cash element of the Annual Incentive Plan are set out in the Remuneration Policy approved by shareholders in 2017 and detailed on page 108.

The weightings of the performance measures and the figures for threshold, target and maximum relating to the financial objectives of the cash element can be summarised as follows:

|                       | Weighting | Threshold | Target   | Maximum  | Actual                |
|-----------------------|-----------|-----------|----------|----------|-----------------------|
| Revenue               | 35%       | \$4,887m  | \$5,039m | \$5,190m | \$4,960m <sup>1</sup> |
| Trading profit margin | 25%       | 22.0%     | 22.5%    | 22.9%    | 22.7% <sup>1</sup>    |
| Trading cash flow     | 15%       | \$886m    | \$985m   | \$1,083m | \$951m                |

<sup>1</sup> At constant exchange rates. See page 131.

The Committee determined that this performance fairly reflected the overall performance of the Company during 2018 and therefore resulted in a bonus achievement of 71% of salary in respect of the financial objectives.

|                       | Weight | Achieved % of target | Award % of salary |
|-----------------------|--------|----------------------|-------------------|
| Revenue               | 35%    | 74%                  | 25.9%             |
| Trading profit margin | 25%    | 129%                 | 32.3%             |
| Trading cash flow     | 15%    | 83%                  | 12.5%             |

Accordingly, the following amounts have been earned by Namal Nawana and Graham Baker under the cash element of the Annual Incentive Plan in respect of their financial objectives.

|  |           |
|--|-----------|
| Namal Nawana (pro-rated to reflect date of joining Company 7 May 2018) | \$708,268 |
| Graham Baker (pro-rated to reflect change to salary from 1 July 2018)  | £374,287  |

The same measures and weightings will apply to the financial measurements of the cash element of the Annual Incentive Plan 2019. For reasons of commercial sensitivity, we are unable to disclose the precise targets now, but they will be disclosed in full in the 2019 Remuneration Report at the time of vesting.

#### Business Objectives

When setting business objectives for the upcoming year, the Board looks not only at the expected financial performance for the year, but also at the actions it expects the Executive Director to carry out in the year to build a solid foundation for financial performance over the longer term. In reviewing performance against these objectives at the end of the year, the Board is mindful that there is not always a necessary correlation between financial performance and the achievement of business objectives.

The table on page 92 overleaf sets out how Namal Nawana and Graham Baker have performed against the business objectives of People, Business Process and Customers.

## DIRECTORS' REMUNERATION REPORT continued

## Remuneration implementation report continued

## Namal Nawana

## Graham Baker

## People

- Assessed and took action at the senior leadership level designing a new operating model and attracting four new Executive Committee leaders to Smith & Nephew as well as numerous vice presidents. Improved diversity and aligned team in support of the new purpose, culture pillars and strategic imperatives.
- Successfully launched new brand purpose – Life Unlimited – culture pillars and winning behaviours. Engaged organisation with more than 40% of employees actively participating in the process.
- Implemented an employee engagement platform through the introduction of Company-wide live, interactive broadcast meetings and extended face-to-face engagement opportunities with >20% of global employee base through face-to-face Town Halls, factory and other site meetings.

- Key accomplishments in 2018 included strengthening Finance leadership team and improving diversity, as well as successfully integrating Global Business Services and IT following transfer of additional responsibilities mid-year. Supported successful CEO transition including assessment of the overall Company and design of the new organisational operating model.

## Business Process

- Completed a robust market and internal organisational assessment as well as external benchmarking to inform the development of a clear strategy resulting in a newly designed operating model including a flatter, franchise-led organisational design with global supporting functions.
- Introduced new Company strategy with five imperatives to drive medium and long-term value creation for shareholders with detailed and robust KPIs put in place internally for continuous measurement throughout the relevant period.
- Engaged with R&D organisations in all business areas and reprioritised programmes to align with strategy. Personally led robotic programme acceleration and the team exceeded overall target of 80% key product launches delivered to plan.

- Strong delivery of APEX restructuring programme, at both Group level, with around \$60 million of benefits realised and tight control of operating expenditure, and in Finance function with successful insourcing of transaction processing and IT upgrades. Delivered a significantly improved full year trading margin and built robust plans for further multi-year expansion. Additionally, delivered meaningful reduction in trading tax rate for 2018, down to 16.1%.

## Customers

- Demonstrated strong customer focus meeting with hundreds of customers in aggregate including through hospital visits and attending medical education events and industry conferences.
- Engaged regularly with key shareholders and investors through face-to-face meetings built around the financial calendar and key investor conferences in London and the United States.
- Delivered significant shareholder returns through strong stock out-performance of FTSE 100 index and improved dividend distribution.

- Regular engagement with shareholders, supporting financial calendar reporting and key investor conferences, as well as management of debt provider and other key financial stakeholders. Delivered significant shareholder returns through strong stock out-performance of FTSE 100 index and improved dividend distribution.

This resulted in a bonus achievement of 33.2% of salary in respect of the business objectives.

|                  | Weight | Achieved % of target | Award % of salary |
|------------------|--------|----------------------|-------------------|
| People           | 8.33%  | 133%                 | 11.1%             |
| Business Process | 8.33%  | 116%                 | 9.7%              |
| Customers        | 8.33%  | 150%                 | 12.5%             |

Accordingly, the following amount has been earned by Namal Nawana under the cash element of the Annual Incentive Plan in respect of his business objectives.

|  |           |
|--|-----------|
| Namal Nawana (pro-rated to reflect date of joining Company 7 May 2018) | \$334,387 |
|--|-----------|

This resulted in a bonus achievement of 25% of salary in respect of the business objectives.

|                  | Weight | Achieved % of target | Award % of salary |
|------------------|--------|----------------------|-------------------|
| People           | 8.33%  | 100%                 | 8.33%             |
| Business Process | 8.33%  | 100%                 | 8.33%             |
| Customers        | 8.33%  | 100%                 | 8.33%             |

Accordingly, the following amount has been earned by Graham Baker under the cash element of the Annual Incentive Plan in respect of his business objectives.

|   |          |
|---|----------|
| Graham Baker (pro-rated to reflect 5% salary increase with effect from 1 July 2018) | £132,664 |
|---|----------|



As well as considering the monetary outcome of the formulaic calculation of these awards, the Committee considered whether discretion should be applied to override these formulaic outcomes and concluded that the monetary outcomes were aligned with the financial performance of the Company, individual performance during 2018 and the intention of the Remuneration Policy.

For 2019, the business objectives for the Executive Directors will be; Growth, People, and Business Processes to align with the new Strategic Imperatives. These business objectives will be equally weighted.

The Committee also considered the level of Cash Incentive Payment to be made to Olivier Bohuon who retired as Chief Executive Officer on 7 May 2018. 75% of his Cash Incentive Payment was based on the Financial Objectives, which resulted in a payout of 94% of target as described on page 91. 25% of his Cash Incentive Payment was based on his performance against his Business Objectives: People, Business Process and Customers. In 2018, these objectives were all aligned to ensuring an orderly transition to the new Chief Executive Officer. The Committee considered his performance as Chief Executive Officer against these business objectives for the period up to 7 May 2018 and concluded that he had broadly met these objectives and that therefore the payout in respect of his Business Objectives should be in line with the payout in respect of the overall financial objectives at 94% as follows:

|                                     | Amount          | Award %<br>of target |
|-------------------------------------|-----------------|----------------------|
| Financial Objectives (75% of award) | €289,463        | 94                   |
| Business Objectives (25% of award)  | €96,488         | 94                   |
| <b>Total Cash Incentive Payment</b> | <b>€385,951</b> |                      |

<sup>1</sup> These non-IFRS financial measures are explained and reconciled to the most directly comparable financial measure prepared in accordance with IFRS on pages 194–198.

## DIRECTORS' REMUNERATION REPORT continued

## Remuneration implementation report continued

### Annual Incentive Plan – equity element

The individual performance of all employees in the Group is assessed on two bases. The first looks at what has been achieved, namely the extent to which the employee has performed against the financial and business objectives set at the beginning of the year. The second looks at how this performance has been achieved, reflecting the right culture and values in accordance with our critical enablers. Against each, the employee is rated as having performed below, in-line or above expectations.

| Assessment of what has been achieved | Assessment of how Executive Directors have achieved |                           |                        |  |
|--------------------------------------|---|---------------------------|------------------------|--|
|                                      | Below expectations                                  | In-line with expectations | Above expectations     |  |
| Below expectations                   | No Award  | No Award                  | No Award               |  |
| In-line with expectations            | No Award  | Award of 50% of Salary    | Award of 55% of Salary |  |
| Above expectations                   | No Award  | Award of 55% of Salary    | Award of 65% of Salary |  |

The Remuneration Committee has considered the performance of Namal Nawana and Graham Baker in exactly the same way as other employees in the Group when determining the level of Equity Incentive Award to be made to them. In assessing their performance against the same financial and business objectives used to determine the level of their cash award, the Remuneration Committee has determined that on the first criterion (assessing what they have achieved) Namal Nawana and Graham Baker have both performed in line with expectations throughout the year. On the second criterion (assessing how they have achieved), the Remuneration Committee has determined that Namal Nawana has exceeded expectations and Graham Baker has performed in line with expectations. These ratings result in an Equity Incentive Award of 55% of salary (pro-rated to 35.9% to reflect his appointment on 7 May 2018) for Namal Nawana and 50% of salary for Graham Baker. In summary, as a result of the financial performance described on page 91 and the individual performance described in the table on page 92, the Remuneration Committee determined that the following awards be made under the Annual Incentive Plan in respect of performance in 2018:

| Executive Director | Cash Component |             | Equity Component |           |
|--------------------|----------------|-------------|------------------|-----------|
|                    | % of salary    | Amount      | % of salary      | Amount    |
| Namal Nawana       | 67.7%          | \$1,042,655 | 35.9%            | \$552,290 |
| Graham Baker       | 95.5%          | £506,951    | 50.0%            | £265,328  |

These figures are converted into dollars and included under Annual Incentive Plan (cash) and (equity) in the single figure table on page 89.

The precise awards granted in 2019 to Namal Nawana and Graham Baker in respect of service in 2018 will be announced when the awards are made and will be disclosed in the 2019 Annual Report. The Committee also determined that no Equity Incentive Award would be made to Olivier Bohuon who had retired as Chief Executive Officer during the year. As a result of the 2018 performance assessment for Graham Baker, the first tranche of the Equity Incentive Award made in 2018 will vest. Both the grant and vesting of these awards are subject to Graham's performance discussed on page 92. Namal Nawana was not employed during 2017 and therefore received no Equity Incentive award in 2018.

| Director     | Date of Grant | Number of shares under award vesting | Number of shares to vest from each grant subject to performance |
|--------------|---------------|--------------------------------------|---|
| Graham Baker | 7 March 2018  | 7,242                                | 14,485  |

### EQUITY INCENTIVE AWARD FROM PRIOR YEARS

The following Equity Incentive awards held by Olivier Bohuon vested in their entirety on his retirement from the Company on 7 November 2018 in accordance with the plan rules:

| Director       | Date of Grant | Number of shares under award vested on 7 November 2018 |
|----------------|---------------|--|
| Olivier Bohuon | 7 March 2018  | 41,587   |
|                | 7 March 2017  | 28,787   |
|                | 7 March 2016  | 17,608   |

### EQUITY INCENTIVE AWARDS IN 2019

The Equity Incentive Award element will operate in 2019 in exactly the same way as in 2018 and previous years. The Remuneration Committee will assess what has been achieved by the Executive Directors against the same financial and business objectives used to determine the level of their cash awards. The Remuneration Committee will assess how the Executive Directors have achieved their objectives by considering the role played by the Executive Directors in establishing an appropriate culture and set of values throughout the organisation. The level of Equity Incentive Award to be made will be determined according to the matrix above.

## LONG-TERM VARIABLE PAY

### Performance Share Plan

#### Performance Share Programme – 2018 grants

Performance share awards granted in 2018 were made to Graham Baker and to Namal Nawana on his appointment under the Global Share Plan 2010 to a maximum value of 190% of salary (95% for target performance). As Olivier Bohuon had already indicated his intention to retire at the time the awards were made in 2018, no award was made to him. The four equally weighted performance measures are relative TSR, return on invested capital, sales growth and cumulative free cash flow. These measures are aligned with our financial priorities and strategies. Performance will be measured over the three financial years from 1 January 2018 and awards will vest subject to performance and continued employment in 2021. Sufficient shares will be sold to cover taxation obligations and the Executive Directors will be required to hold the net shares for a further period of two years.

The two equally weighted peer groups against which the Company's TSR performance will be measured are defined at the start of each performance period based on constituents of the following:

- A sector-based peer group based on those companies classified as the S&P 1200 Global Healthcare subset comprising Medical Devices, equipment and supplies companies (official industry classifications of 'Health Care Equipment and Supplies, Life Sciences Tools & Services and Health Care Technology'). This is a broader sector-based peer group than in previous years, so that we maintain a focus on outperforming our broad sector without being impacted by the volatility of a smaller group.
- FTSE 100 constituents excluding financial services and commodities companies. This is in response to shareholders who assess our performance not based on sector, but instead based on the index we operate in.

The Group's TSR performance and its performance relative to the comparator groups is independently monitored and reported to the Remuneration Committee by Deloitte LLP.

Total Shareholder Return (TSR) performance is relative to two separate indices as follows:

| Relative TSR ranking    | Award vesting as % of salary at date of grant |                     |
|-------------------------|---|---------------------|
|                         | Sector Based Peer Group                       | FTSE 100 Peer Group |
| Below median            | Nil   | Nil                 |
| Median                  | 5.9375%                                       | 5.9375%             |
| Upper quartile or above | 23.75%  | 23.75%              |

Awards will vest on a straight-line basis between these points. If the Company's TSR performance is below median against both indices, none of this part of the award will vest.

DIRECTORS' REMUNERATION REPORT continued

## Remuneration implementation report continued

**Return on invested capital (ROIC)**, adds focus on enhancing operating performance and reducing the under-performing asset base.

25% of the award will vest subject to ROIC:

ROIC will be defined as:

$$\frac{\text{Net Operating Profit}^1 \text{ less Adjusted Taxes}^2}{(\text{Opening Net Operating Assets} + \text{Closing Net Operating Assets})^3 \div 2}$$

ROIC will be measured each year of the three-year performance period and a simple average of the three years will be compared to the targets below (precise numbers will be included in the Remuneration Report prospectively). The Remuneration Committee will have the discretion to adjust ROIC targets in the case of significant events such as material mergers, acquisitions and disposals and that such adjustment will be consistent with the deal model and approved by the Board at the time of the transaction.

1 Operating profit is as disclosed in the Group income statement in the Annual Report.

2 Adjusted taxes represents our taxation charge per the Group income statement adjusted for the impact of tax on items not included in Operating Profit notably interest income and expense, other finance costs and share of results of associates.

3 Net Operating Assets comprises net assets from the Group balance sheet (Total assets less Total liabilities) excluding the following items: Investments, Investments in associates, Retirement benefit assets and liabilities, Long-term borrowings, Bank overdrafts, borrowings and loans, and Cash at bank.

The awards subject to ROIC will vest as follows:

| Return on Invested Capital                        | Award vesting as % of salary |
|---|------------------------------|
| Below Threshold 11.6%                             | Nil                          |
| Threshold 11.6% (-1.25% of target)                | 11.875%                      |
| Target 12.9% (as derived from the Strategic Plan) | 23.75%                       |
| Maximum or above 14.1% (+1.25% of target)         | 47.5%                        |

Awards will vest on a straight-line basis between these points.

**Sales growth** focuses on growth in both Established Markets and Emerging Markets. 25% of the award will be subject to sales growth and will vest as follows:

| Sales growth over three-year period commencing 1 January 2018 | Award vesting as % of salary |
|---|------------------------------|
| Below Threshold   | Nil                          |
| Threshold (-2.7% of target)                                   | 11.875%                      |
| Target  | 23.75%                       |
| Maximum or above (+2.7% of target)                            | 47.5%                        |

It is not possible to disclose precise targets for sales growth as this will give commercially sensitive information to our competitors concerning our growth plans and is potentially price sensitive information. This target however will be disclosed in the 2020 Annual Report, when the Committee will discuss performance against the target.

**Cumulative free cash flow** is defined as net cash inflow from operating activities, less capital expenditure, less the cash flow input of certain adjusted items. Free cash flow is the most appropriate measure of cash flow performance because it relates to cash generated to finance additional investments in business opportunities, debt repayments and distribution to shareholders. This measure includes significant elements of operational financial performance and helps to align Executive Director awards with shareholder value creation.

It is important as it is derived from increased revenues and healthy trading profits. Having a healthy cash flow will enable us to continue to grow and invest. 25% of the award will be subject to cumulative free cash flow performance and will vest as follows:

| Cumulative free cash flow         | Award vesting as % of salary |
|-----------------------------------|------------------------------|
| Below \$1,575m                    | Nil                          |
| \$1,575m (-13% of target)         | 11.875%                      |
| \$1,810m                          | 23.75%                       |
| \$2,046m or more (+13% of target) | 47.5%                        |

### Performance Share Programme 2019

Performance share awards will be made in 2019 to the Executive Directors under the Global Share Plan 2010 to a maximum value of 190% of salary (95% for target performance). Performance will be measured over the three financial years commencing 1 January 2019 against the same four equally weighted performance measures as in 2018: relative TSR, return on invested capital, sales growth and cumulative free cash flow. On vesting, sufficient shares will be sold to cover taxation obligations and the Executive Directors will be required to hold the net shares for a further period of two years.

**TSR performance** will be measured in the same way as in 2018 as described on page 95 against the same two peer groups.

**Return on invested capital (ROIC)** will be measured in the same way as in 2018, as described on page 96.

The targets will be as follows:

| Return on Invested Capital                        | Award vesting as % of salary |
|---|------------------------------|
| Below Threshold 11.8%                             | Nil                          |
| Threshold 11.8% (-1.25% of target)                | 11.875%                      |
| Target 13.1% (as derived from the Strategic Plan) | 23.75%                       |
| Maximum or above 14.3% (+1.25% of target)         | 47.5%                        |

Awards will vest on a straight-line basis between these points.

**Sales growth** will be measured in the same way as in 2018, as described on page 96. The targets will be as follows:

| Sales growth over three-year period commencing 1 January 2019 | Award vesting as % of salary |
|---|------------------------------|
| Below Threshold   | Nil                          |
| Threshold (-2.7% of target)                                   | 11.875%                      |
| Target  | 23.75%                       |
| Maximum or above (+2.7% of target)                            | 47.5%                        |

It is not possible to disclose precise targets for sales growth as this will give commercially sensitive information to our competitors concerning our growth plans and is potentially price sensitive information. This target however will be disclosed in the 2021 Annual Report, when the Committee will discuss performance against the target.

**Cumulative free cash flow** will be measured in the same way as in 2018, as described on page 96. The targets will be as follows:

| Cumulative free cash flow         | Award vesting as % of salary |
|-----------------------------------|------------------------------|
| Below \$1,923m                    | Nil                          |
| \$1,923m (-13% of target)         | 11.875%                      |
| \$2,210m                          | 23.75%                       |
| \$2,497m or more (+13% of target) | 47.5%                        |



## DIRECTORS' REMUNERATION REPORT continued

## Remuneration implementation report continued

### Performance Share Programme 2016

Since the end of the year, the Remuneration Committee has reviewed the vesting of conditional awards made to Executive Directors under the Global Share Plan 2010 in 2016. Vesting of the conditional awards made in 2016 was subject to performance conditions based on TSR, revenue in Emerging Markets and cumulative free cash flow measured over a three-year period commencing 1 January 2016.

25% of the award was based on the Company's TSR relative to a bespoke group of 15 Medical Devices companies. This group comprised the following companies; Baxter, Becton Dickinson, Boston Scientific, Coloplast, Conmed, Edwards Life Sciences, Essilor Luxottica, Getinge B, GN Store Nord, Medtronic, Shire, Sonova N, Stryker, William Demant Holding, and Zimmer. The following companies delisted during the period and were therefore removed; C R Bard and St Jude Medical. Against this peer group, the Company's TSR performance ranked below median meaning that this part of the award therefore vested at 0%.

25% of the award was based on revenues in Emerging Markets. The threshold set in 2016 was \$2,316 million with a target of \$2,725 million. Over the three-year period, the adjusted revenues in Emerging Markets were \$2,560 million. These adjustments include translational foreign exchange. This part of the award therefore vested at 20% out of the 25% target.

50% of the award was based on cumulative free cash flow performance. Over the three-year period, the adjusted cumulative free cash flow was \$1,929 million which is between target and maximum. These adjustments include items such as Board-approved M&A, including the acquisition of Rotation Medical and the disposal of the Gynaecological business and Board-approved Business Plans such as the APEX programme, the commercial restructuring programme and exceptional expenditure to comply with the EU Medical Devices Regulations. This part of the award therefore vested at 73%.

|                           | Threshold | Target   | Maximum        | Actual       | Percentage Vesting |
|---------------------------|-----------|----------|----------------|--------------|--------------------|
| TSR                       | Median    | –        | Upper Quartile | Below Median | 0%                 |
| Emerging Markets Sales    | \$2,316m  | \$2,725m | \$3,133m       | \$2,560m     | 20%                |
| Cumulative Free Cash Flow | \$1,585m  | \$1,822m | \$2,059m       | \$1,929m     | 73%                |

Overall therefore, the conditional awards made in 2016 will vest at 93% of target (46.5% of maximum) on 7 March 2019 as follows:

| Director       | Date of grant | Number of shares under award at maximum  | Number vesting |
|----------------|---------------|--|----------------|
| Olivier Bohuon | 7 March 2016  | 139,396<br>Pro-rated for length of time held prior to retirement from the Company on 7 November 2018 | 64,819         |

As well as considering the monetary outcome of the formulaic calculation of these awards, the Committee considered whether discretion should be applied to override these formulaic outcomes and concluded that the monetary outcomes were aligned with the financial performance of the Company during the performance period and the intention of the Remuneration Policy.

Neither Namal Nawana nor Graham Baker were employed by the Company in 2016 and therefore have no Performance Share Awards to vest on 7 March 2019.

### DETAILS OF OUTSTANDING AWARDS MADE UNDER THE PERFORMANCE SHARE PROGRAMME

Details of conditional awards over shares granted to Executive Directors subject to performance conditions are shown below. These awards were granted under the Global Share Plan 2010. The performance conditions and performance periods applying to these awards are detailed on page 95–97.

|                | Date granted | Number of ordinary shares under award at maximum | Date of vesting |
|----------------|--------------|--|-----------------|
| Olivier Bohuon | 7 March 2016 | 139,396 <sup>1,2</sup>                           | 7 March 2019    |
|                | 7 March 2017 | 97,744 <sup>1,2</sup>                            | 7 March 2020    |
| Graham Baker   | 7 March 2017 | 79,166   | 7 March 2020    |
|                | 7 March 2018 | 75,058   | 9 March 2021    |
| Namal Nawana   | 9 May 2018   | 108,800  | 9 May 2021      |

1 Pro-rated to reflect Olivier Bohuon's retirement from the Company on 7 November 2018.

2 On 5 February 2019, 53.5% of the award granted at maximum to Olivier Bohuon lapsed following completion of the performance period.

## SUMMARY OF SCHEME INTERESTS AWARDED DURING THE FINANCIAL YEAR

|  | Namal Nawana <sup>1</sup> |            | Olivier Bohuon <sup>2</sup> |            |                  | Graham Baker <sup>3</sup> |  |
|--|---------------------------|------------|-----------------------------|------------|------------------|---------------------------|--|
|  | Number of shares          | Face value | Number of shares            | Face value | Number of shares | Face value                |  |
| Annual Equity Incentive Award (see page 94)      | –                         | –          | 40,801                      | €589,745   | 21,727           | £280,500                  |  |
| Performance Share Award at maximum (see page 98) | 108,800                   | £1,419,311 | –                           | –          | 75,058           | £969,000                  |  |

1 Annual Equity Incentive Awards for 2018 were based on performance for 2017, hence Namal Nawana received no award.

2 Olivier Bohuon did not receive a Performance Share Award in 2018, as he had announced his intention to retire.

Please see Policy Table on pages 108 and 109 for details of how the above plans operate. The number of shares is calculated using the closing share price on the day before the grant, which for the awards granted on 7 March 2018 was 1291p, and for the awards granted on 9 May 2018 was 1304.5p.

## SINGLE TOTAL FIGURE ON REMUNERATION

### Chair and Non-Executive Directors

| Director                       | Basic annual fee <sup>1</sup> |           | Committee Chair/Senior Independent Director fee |          | Intercontinental travel fee |          | Total     |           |
|--------------------------------|-------------------------------|-----------|---|----------|-----------------------------|----------|-----------|-----------|
|                                | 2018                          | 2017      | 2018  | 2017     | 2018                        | 2017     | 2018      | 2017      |
| Roberto Quarta                 | £418,695                      | £412,000  | –   | –        | –                           | £7,000   | £418,695  | £419,000  |
| Vinita Bali <sup>2</sup>       | –                             | £36,750   | –   | –        | –                           | £7,000   | –         | £43,750   |
|                                | \$129,780                     | \$59,780  | –   | –        | \$42,000                    | \$21,000 | \$171,780 | \$80,780  |
| Ian Barlow                     | £69,500                       | £68,135   | £20,000   | £20,000  | –                           | £7,000   | £89,500   | £95,135   |
| Virginia Bottomley             | £69,500                       | £68,135   | –   | –        | –                           | £7,000   | £69,500   | £75,135   |
| Roland Diggelmann <sup>3</sup> | £59,000                       | –         | –   | –        | –                           | –        | £59,000   | –         |
| Erik Engstrom                  | £69,500                       | £68,135   | –   | –        | –                           | £7,000   | £69,500   | £75,135   |
| Robin Freestone                | £69,500                       | £68,135   | £20,000   | £16,667  | –                           | £7,000   | £89,500   | £91,802   |
| Michael Friedman               | \$129,780                     | \$129,780 | \$35,000  | \$35,000 | \$42,000                    | \$42,000 | \$206,780 | \$206,780 |
| Brian Larcombe <sup>4</sup>    | –                             | £20,750   | –   | £1,277   | –                           | –        | –         | £22,027   |
| Marc Owen <sup>5</sup>         | \$129,780                     | \$30,000  | –   | –        | \$42,000                    | \$14,000 | \$171,780 | \$44,000  |
| Joseph Papa <sup>6</sup>       | \$44,115                      | \$129,780 | –   | \$35,000 | \$14,000                    | \$35,000 | \$58,115  | \$199,780 |
| Angie Risley <sup>7</sup>      | £69,500                       | £18,173   | £14,172   | –        | –                           | £7,000   | £83,672   | £25,173   |

1 The basic annual fee includes shares purchased for the Chairman and Non-Executive Directors in lieu of part of the annual fee, details of which can be found on the table on page 100.

2 Vinita Bali elected to receive the payment of her fee in US\$ in August 2017 having previously been in GBP.

3 Roland Diggelmann was appointed to the Board on 1 March 2018.

4 Brian Larcombe retired from the Board with effect from 6 April 2017.

5 Marc Owen was appointed to the Board with effect from 1 October 2017.

6 Joseph Papa retired from the Board with effect from 12 April 2018.

7 Angie Risley was appointed to the Board with effect from 18 September 2017.

DIRECTORS' REMUNERATION REPORT continued

## Remuneration implementation report continued

### Chair and Non-Executive Director Fees

In February 2019, the Remuneration Committee reviewed the fees paid to the Chairman and determined that with effect from 1 April 2019 the fees paid would remain unchanged. The Board reviewed the fees paid to the Non-Executive Directors and determined that with effect from 1 April 2019, the fees would remain unchanged as follows:

|  |   |
|--|---|
| Annual fee paid to the Chair                               | £420,240 of which £105,060 paid in shares   |
| Annual fee paid to Non-Executive Directors                 | £69,500 of which £6,500 paid in shares or \$129,780 of which \$9,780 paid in shares |
| Intercontinental travel fee (per meeting)                  | £3,500 or \$7,000   |
| Fee for Senior Independent Director and Committee Chairman | £20,000 or \$35,000   |

### Payments made to past Directors

Olivier Bohuon retired as Chief Executive Officer of the Board on 7 May 2018 and as an employee of the Company on 7 November 2018 and was paid in accordance with the Remuneration Policy approved by shareholders in 2017 as an employee and the terms of his service agreement. In respect of the transition period, (from 7 May to 7 November 2018) he received salary (€612,427), benefits (£39,472) and a payment in lieu of pension (€176,924). In accordance with the Plan Rules, on his retirement from the Company all unvested Equity Incentive Awards vested in their entirety and the outstanding Performance Share Plan awards were pro-rated for service to 7 November 2018 and will, subject to the performance conditions being satisfactorily met at the end of the three-year performance period, vest on the original vesting dates on the third anniversary of the respective dates of grant. He will be required to retain any vested shares, net of tax, in relation to the 2017 award for a further two-year period after the vesting date. In light of his anticipated retirement, no Performance Share Plan award was made in 2018.

No other payments were made to former Directors in the year.

### Payments for loss of office

No payments were made in respect of a Director's loss of office in 2018.

### Service contracts

Executive Directors are employed on rolling service contracts with notice periods of up to 12 months from the Company and six months from the Executive Director. Further information can be found on page 111 of the Policy Report.

### Outside directorships

Olivier Bohuon was a Non-Executive Director of Virbac SA and received £7,269 in respect of this appointment up to 7 May 2018. He was also a Non-Executive Director of Shire Plc and received £48,348 in respect of this appointment up to 7 May 2018.

Namal Nawana is a Non-Executive Director of Hologic, Inc. and received \$56,231 in respect of this appointment from 7 May 2018 to 31 December 2018.

### Directors' interests in ordinary shares

Beneficial interests of the Executive Directors in the ordinary shares of the Company are as follows:

|                                       | Namal Nawana            |                  |                               | Graham Baker   |                  |                               | Olivier Bohuon |                         |
|---------------------------------------|-------------------------|------------------|-------------------------------|----------------|------------------|-------------------------------|----------------|-------------------------|
|                                       | 7 May 2018 <sup>1</sup> | 31 December 2018 | 15 February 2019 <sup>2</sup> | 1 January 2018 | 31 December 2018 | 15 February 2019 <sup>2</sup> | 1 January 2018 | 7 May 2018 <sup>3</sup> |
| Ordinary shares                       | –                       | 224,214          | 224,214 <sup>4</sup>          | –              | 10,076           | 10,076 <sup>4</sup>           | 467,811        | 531,470                 |
| Share options                         | –                       | –                | –                             | –              | 2,734            | 2,734                         | –              | –                       |
| Performance share awards <sup>5</sup> | –                       | 108,800          | 108,800                       | 79,166         | 154,224          | 154,224                       | 423,680        | 304,948                 |
| Equity Incentive awards               | –                       | –                | –                             | –              | 21,727           | 21,727                        | 87,956         | 85,305                  |

1 Namal Nawana was appointed to the Board on 7 May 2018.

2 The latest practicable date for this Annual Report.

3 Olivier Bohuon retired from the Board on 7 May 2018.

4 The ordinary shares held by Namal Nawana on 15 February 2019 represent 276.41% of his base annual salary and for Graham Baker 28.67% of his base salary.

5 These share awards are subject to further performance conditions before they may vest, as detailed on pages 95 to 97.

The beneficial interest of each Executive Director is less than 1% of the ordinary share capital of the Company.

Beneficial interests of the Chair and Non-Executive Directors in the ordinary shares of the Company are as follows:

| Director                       | 1 January 2018 (or date of appointment if later) | 31 December 2018 (or date of retirement if earlier) | 15 February 2019 <sup>1</sup> | Shareholding as % of annual fee <sup>2</sup> |
|--------------------------------|--|---|-------------------------------|--|
| Roberto Quarta                 | 28,261   | 32,449  | 32,449                        | 112.04                                       |
| Vinita Bali <sup>4</sup>       | 6,836  | 7,154   | 7,154                         | 152.12                                       |
| Ian Barlow                     | 19,009   | 19,291  | 19,291                        | 402.75                                       |
| Virginia Bottomley             | 18,714   | 19,024  | 19,024                        | 397.18                                       |
| Roland Diggelmann <sup>5</sup> | –  | 4,867   | 4,867                         | 101.61                                       |
| Erik Engstrom                  | 15,547   | 15,796  | 15,796                        | 329.78                                       |
| Robin Freestone                | 15,525   | 15,774  | 15,774                        | 329.32                                       |
| Michael Friedman <sup>4</sup>  | 9,910  | 10,212  | 10,212                        | 149.26                                       |
| Marc Owen                      | –  | 7,290   | 7,290                         | 213.29                                       |
| Joseph Papa <sup>6</sup>       | 13,860   | 13,860  | N/A                           | N/A  |
| Angie Risley                   | –  | 1,960   | 1,960                         | 40.92  |

1 The latest practicable date for this Annual Report.

2 Calculated using the closing share price of 1,451p per ordinary share and \$37.97 per ADS on 15 February 2019, and an exchange rate of £1/\$1.284687.

3 All Non-Executive Directors in office since 1 January 2018 held the required shareholding during the year except Angie Risley.

4 Vinita Bali, Michael Friedman and Marc Owen hold some of their shares in the form of ADS.

5 Roland Diggelmann was appointed to the Board on 1 March 2018.

6 Joseph Papa retired from the Board on 12 April 2018.

The beneficial interest of each Non-Executive Director is less than 1% of the ordinary share capital of the Company.

#### Chief Executive Officer remuneration compared to employees generally

The percentage change in the remuneration of the Chief Executive Officer between 2017 and 2018 compared to that of employees generally was as follows:

|                                      | Base salary<br>% change 2018 | Benefits<br>% change 2018 | Annual cash bonus<br>% change 2018 |
|--------------------------------------|------------------------------|---------------------------|------------------------------------|
| Chief Executive Officer <sup>1</sup> | 12.6%                        | -41.3%                    | 23.9%                              |
| Average for all employees            | 2.6%                         | N/A                       | N/A                                |

1 Amounts paid to Olivier Bohuon up to his retirement on 7 May 2018 and to Namal Nawana after his appointment on the same date.

The average cost of wages and salaries for employees generally increased by 6% in 2018 (see Note 3.1 to the Group accounts). Figures for annual cash bonuses are included in the numbers.

When considering remuneration arrangements for our Executive Directors, the Remuneration Committee takes into account pay across the Group in the following ways:

Salary levels and increases for all employees including Executive Directors take account of the scope and responsibility of position, the skills, experience and performance of the individual and general economic conditions within the relevant geographical market. When considering increases to Executive Director base salaries, the Committee considers the average pay increases in the market where the Executive Director is based.

All employees including the Executive Directors have performance objectives determined at the beginning of the year which cascade down from the Strategic Imperatives for the Group. The level of variable pay determined for all employees, whether in the form of shares or cash is dependent on performance against these imperatives, both financially and personally.

Executive Directors participate in benefits plans and arrangements comparable to benefits paid to other senior executives in the relevant geography.

The Remuneration Committee is keeping under review the level of pension benefits and cash payments in lieu of pensions paid to our Executive Directors, which for historical reasons are currently higher than paid to most employees.

Executive Directors participate in the same senior executive incentive plans (currently the Annual Incentive Programme and the Performance Share Programme) as other Executive Officers and senior executives. The level of award reflect the differing seniority of participants but the same performance conditions apply for all.

DIRECTORS' REMUNERATION REPORT continued

## Remuneration implementation report continued

### Chief Executive Officer Pay Ratio

The Committee has chosen to provide our CEO pay ratio data for 2018, despite the requirement not coming into force until 2019, as we consider that it is important to take a lead in this area.

Our calculations are based on actual pay data for 2018, (in accordance with Option A as set out in the Companies (Miscellaneous Reporting) Regulations 2018) using a combined figure for CEO pay comprising: pay for Olivier Bohuon (Chief Executive Officer until 7 May 2018); and pay for Namal Nawana (Chief Executive Officer from 7 May 2018).

Comparisons have been made with employees at median (P50), lower (P25) and upper (P75) quartiles. The Committee is satisfied that the individuals identified in the employee comparison group appropriately reflect the employee pay profile at those quartiles, and that the overall picture presented by the ratios is consistent with our pay, reward and progression policies for UK employees.

The table below sets out the ratio at the median, lower and upper quartiles:

| Year | P25 (lower quartile) | P50 (median) | P75 (upper quartile) |
|------|----------------------|--------------|----------------------|
| 2018 | 142:1                | 95:1         | 59:1                 |

The table below provides the total pay figure used for each quartile employee, and the salary component within this.

| Component | CEO (combined) | P25 (lower quartile) | P50 (median) | P75 (upper quartile) |
|-----------|----------------|----------------------|--------------|----------------------|
| Salary    | \$1,497,538    | \$32,976             | \$51,434     | \$83,011             |
| Total pay | \$5,214,776    | \$36,597             | \$54,923     | \$87,956             |

In assessing our pay ratio, the Committee would like to highlight that 2018 reflects a year of change for the CEO role at Smith & Nephew, with the transition from Olivier Bohuon to Namal Nawana in May. Next year we expect the figures to relate solely to remuneration for Namal Nawana.

### Relative importance of spend on pay

When considering remuneration arrangements for our Executive Directors and employees as a whole, the Remuneration Committee also takes into account the overall profitability of the Company and the amounts spent elsewhere, particularly in returning profits to shareholders in the form of dividends and share buy backs.

The following table sets out the total amounts spent in 2018 and 2017 on remuneration, the attributable profit for each year and the dividends declared and paid in each year.

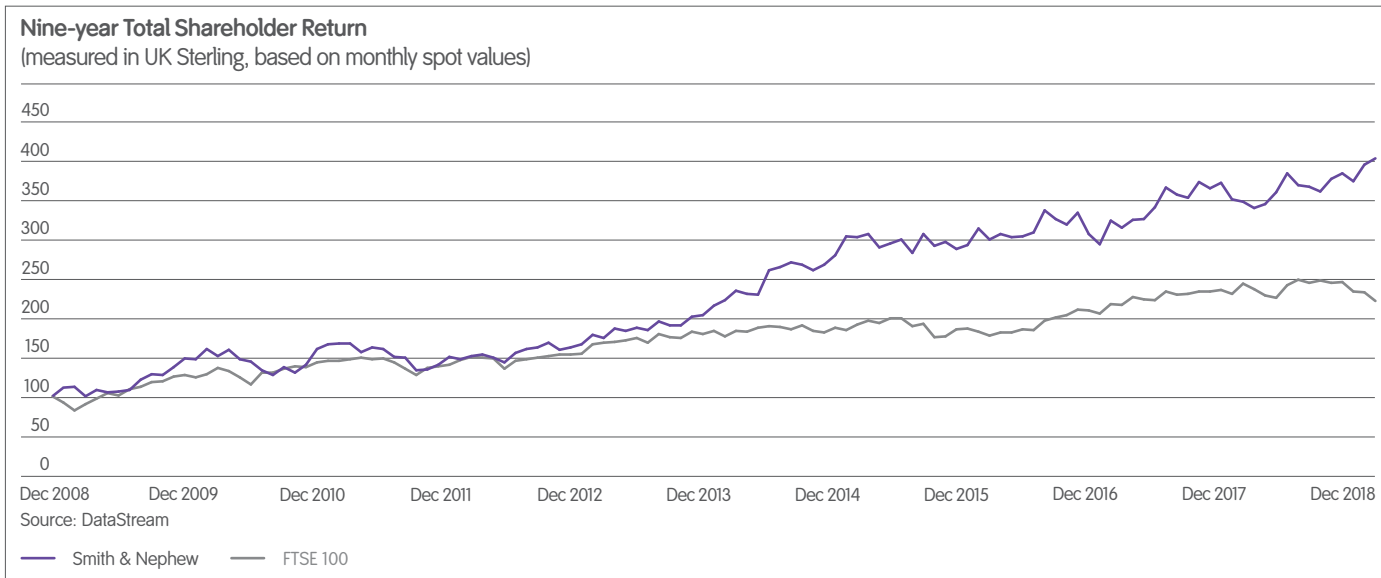
|                                   | For the year to<br>31 December 2018 | For the year to<br>31 December 2017 | % change |
|-----------------------------------|-------------------------------------|-------------------------------------|----------|
| Attributable profit for the year  | \$663m                              | \$767m                              | -14%     |
| Dividends paid during the year    | \$321m                              | \$269m                              | 19%      |
| Share buyback                     | \$48m <sup>1</sup>                  | \$52m <sup>1</sup>                  | -8%      |
| Total Group spend on remuneration | \$1,330m                            | \$1,231m                            | 8%       |

<sup>1</sup> Shares are bought in the market in respect of shares issued as part of the executive and employee share plans.

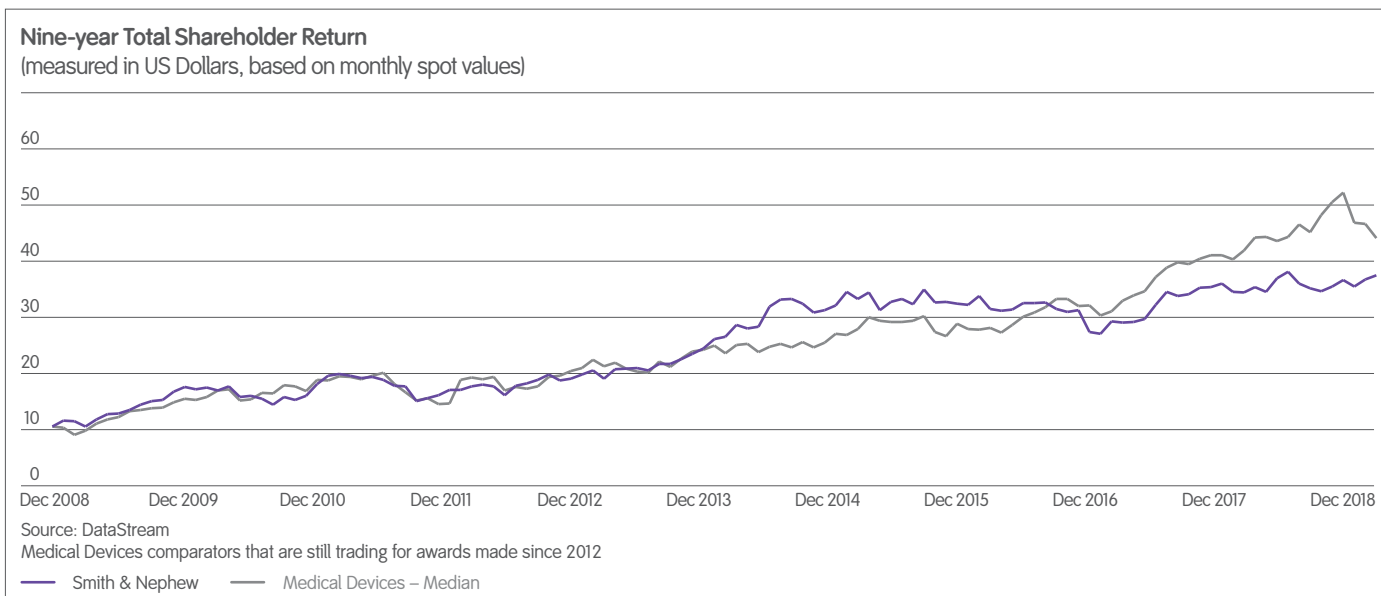


**Total Shareholder Return**

A graph of the Company's TSR performance compared to that of the FTSE 100 index is shown below in accordance with Schedule 8 to the Regulations.



However, as we compare the Company's performance to a tailored sector peer group of medical devices companies (see page 95), when considering TSR performance in the context of the Global Share Plan 2010, we feel that the following graph showing the TSR performance of this peer group is also of interest.



## DIRECTORS' REMUNERATION REPORT continued

## Remuneration implementation report continued

### Table of historic data

The following table details information about the pay of the Chief Executive Officer in the previous ten years:

| Year | Chief Executive Officer        | Single figure of total remuneration \$ | Long-term incentive vesting rates against maximum opportunity |                      |           |
|------|--------------------------------|--|---|----------------------|-----------|
|      |                                |  | Annual Cash Incentive payout against maximum %                | Performance shares % | Options % |
| 2018 | Namal Nawana <sup>1</sup>      | \$2,883,632                            | 69 <sup>7</sup>   | N/A                  | –         |
| 2018 | Olivier Bohuon <sup>2</sup>    | \$2,331,144                            | 63 <sup>7</sup>   | 46.5                 | –         |
| 2017 | Olivier Bohuon                 | \$5,116,689 <sup>6</sup>               | 61  | 54                   | –         |
| 2016 | Olivier Bohuon                 | \$3,332,850                            | 30  | 8                    | –         |
| 2015 | Olivier Bohuon                 | \$5,342,377                            | 75  | 33.5                 | –         |
| 2014 | Olivier Bohuon                 | \$6,785,121                            | 43  | 57                   | –         |
| 2013 | Olivier Bohuon                 | \$4,692,858                            | 84  | –                    | –         |
| 2012 | Olivier Bohuon                 | \$4,956,771                            | 84  | N/A                  | –         |
| 2011 | Olivier Bohuon <sup>3,4</sup>  | \$7,442,191                            | 68  | N/A                  | –         |
| 2011 | David Illingworth <sup>5</sup> | \$3,595,787                            | 37  | 27                   | 27        |
| 2010 | David Illingworth              | \$4,060,707                            | 57  | 70                   | 61        |

1 Appointed Chief Executive Officer on 7 May 2018.

2 Retired as Chief Executive Officer on 7 May 2018.

3 Appointed Chief Executive Officer on 1 April 2011.

4 Includes recruitment award of €1,400,000 cash and a share award over 200,000 ordinary shares with a value of €1,410,000 on grant.

5 Resigned as Chief Executive Officer on 1 April 2011.

6 Prior years are restated to reflect amounts not known at the date of signing the previous Annual Report.

7 Calculated as 103.8% for Namal Nawana and 94% for Olivier Bohuon, (disclosed on pages 92-93), divided by the maximum potential payout of 150%.

### Gender Pay Ratio

In 2018, the Remuneration Committee reviewed our UK Gender Pay ratio. It was noted that the average pay gap had increased from 29% (in 2017) to 31% (in 2018) and the median pay gap from 15% to 21% for the same period. We recognised that the reasons for this increase were a higher level of female attrition with more males being promoted or recruited during the year into senior positions, as well as the move of one senior female executive from UK to US. We shall continue to review these figures and the actions being taken by management to address these gaps across our global business.

A number of initiatives were established in 2018 including: Developing our female leaders – though a programme we call Elevate (280 female professionals participated in the programme); Training our managers and Human Resource professionals in areas such as increasing awareness of unconscious biases; Conducting a masterclass for the Talent Acquisition Team – to further drive diversity and inclusion in our approach to recruitment; and Procuring Talent – widening recruitment channels to improve diversity and inclusion in our candidate pipeline.

From 2019 a programme of activity is planned, under the sponsorship of the Chief Executive Officer and Executive Committee and in line with our new purpose and culture pillars. It includes plans to: leverage a new spirit of inclusion at the Executive level to drive change at a global level; sponsor female talent and leveraging role models to increase diversity in senior roles; pro-actively map the market for female talent, launch a female acceleration programme to drive development of talented women; and train our leaders and managers on how to lead inclusively beyond recruitment.

### Shareholding Requirements

The Chief Executive Officer is required to hold three times his salary in the form of shares and the Chief Financial Officer is required to hold two times his salary. Our current remuneration arrangements also require Executive Directors to retain any shares received in respect of Performance Share Awards made in or after 2017 for a period of two years after vesting. The Remuneration Committee will be considering these requirements further as part of our review of Remuneration Policy in 2019 and in particular, we will be looking to introduce some form of post-cessation shareholding requirement for our Executive Directors.

### Statement of voting at Annual General Meeting held in 2018

At the Annual General Meeting held on 12 April 2018, votes cast by proxy and at the meeting and votes withheld in respect of the votes on the Directors' Remuneration Report were as follows:

| Resolution  | Votes for   | % for | Votes against | % against | Total votes validly cast | Votes withheld |
|---|-------------|-------|---------------|-----------|--------------------------|----------------|
| Approval of the Directors' Remuneration Report (excluding policy) | 581,091,881 | 97.29 | 16,160,313    | 2.71      | 597,252,194              | 407,092        |

### Senior management remuneration

The Group's administrative, supervisory and management body (senior management) is comprised for US reporting purposes, of Executive Directors and Executive Officers. Details of the current Executive Directors and Executive Officers are given on pages 54 and 58–61.

Compensation paid to senior management in respect of 2016, 2017 and 2018 was as follows:

|  | 2018         | 2017         | 2016         |
|--|--------------|--------------|--------------|
| Total compensation (excluding pension emoluments, but including cash payments under the performance-related incentive plans) | \$15,935,000 | \$13,573,000 | \$12,874,000 |
| Total compensation for loss of office  | \$433,000    | \$2,711,000  | –            |
| Aggregate increase in accrued pension scheme benefits  | –            | –            | –            |
| Aggregate amounts provided for under supplementary schemes   | \$1,570,000  | \$872,000    | \$1,112,000  |

As at 15 February 2019, senior management owned 306,666 shares and 112,107 ADSs, constituting less than 0.1% of the share capital of the Company. For this purpose, the Group is defined as the Executive Directors, members of the Executive Committee, including the Company Secretary and their Persons Closely Associated. Details of share awards granted during the year and held as at 15 February 2019 by members of senior management are as follows:

|   | Share awards granted during the year | Total share awards held as at 15 February 2019 |
|---|--------------------------------------|--|
| Equity Incentive awards                                   | 218,794                              | 257,530  |
| Performance Share awards at maximum                       | 510,358                              | 987,432  |
| Conditional share awards under the Global Share Plan 2010 | 95,890                               | 244,056  |
| Options under Employee ShareSave plans                    | 6,504                                | 9,041  |

### Dilution headroom

The Remuneration Committee ensures that at all times the number of new shares which may be issued under any share-based plans, including all-employee plans, does not exceed 10% of the Company's issued share capital over any rolling 10-year period (of which up to 5% may be issued to satisfy awards under the Company's discretionary plans). The Company monitors headroom closely when granting awards over shares taking into account the number of options or shares that might be expected to lapse or be forfeited before vesting or exercise. In the event that insufficient new shares are available, there are processes in place to purchase shares in the market to satisfy vesting awards and to net-settle option exercises.

Over the previous 10 years (2009 to 2018), the number of new shares issued under our share plans has been as follows:

|                               |   |
|-------------------------------|---|
| All-employee share plans 2019 | 7,567,286 (0.86% of issued share capital as at 15 February 2019)  |
| Discretionary share plans     | 31,010,812 (3.54% of issued share capital as at 15 February 2019) |

By order of the Board, on 21 February 2019



**Angie Risley**  
Chair of the Remuneration Committee

DIRECTORS' REMUNERATION REPORT continued

## The Policy Report

### FUTURE POLICY TABLE – EXECUTIVE DIRECTORS

The following table and accompanying notes explain the different elements of remuneration we pay to our Executive Directors. It was approved by shareholders at the 2017 Annual General Meeting on 6 April 2017.

#### BASE SALARY AND BENEFITS

##### Base salary

We are a FTSE 50 listed company, operating in over 100 countries around the world. Our strategy to generate cash from Established Markets in order to invest for growth in higher growth geographies and franchises means that we are competing for international talent and our base salaries therefore need to reflect what our Executive Directors would receive if they were to work in another international company of a similar size, complexity and geographical scope.

| How the component operates   | Maximum levels of payment   | Framework in which performance is assessed  |
|--|---|---|
| <p>Salaries are normally reviewed annually, with any increase applying from 1 April.</p> <ul style="list-style-type: none"> <li>– Salary levels and increases take account of:</li> <li>– Market movements within a peer group of similarly sized UK listed companies;</li> <li>– Scope and responsibility of the position;</li> <li>– Skill/experience and performance of the individual Director;</li> <li>– General economic conditions in the relevant geographic market; and</li> <li>– Average increases awarded across the Company, with particular regard to increases in the market in which the Executive is based.</li> </ul> | <p>The base salary of the Executive Directors with effect from 1 April 2017 will be as follows:</p> <ul style="list-style-type: none"> <li>– Olivier Bohuon €1,179,490.</li> <li>– Graham Baker £510,000.</li> </ul> <p>The factors noted in the previous column will be taken into consideration when making increases to base salary and when appointing a new Director.</p> <p>In normal circumstances, base salary increases for Executive Directors will relate to the geographic market and peer group. In addition, the average increases for employees across the Group will be taken into account. The Remuneration Committee retains the right to approve higher increases when there is a substantial change in the scope of the Executive Director's role. A full explanation will be provided in the Implementation Report should higher increases be approved in exceptional cases.</p> | <p>Performance in the prior year is one of the factors taken into account and poor performance is likely to lead to a zero salary increase.</p> |

##### Payment in lieu of pension

In order to attract and retain Executive Directors with the capability of driving our corporate strategy, we need to provide market-competitive retirement benefits similar to the benefits they would receive if they were to work for one of our competitors.

At the same time, we seek to avoid exposing the Company to defined benefit pension risks, and where possible will make payments in lieu of providing a pension.

| How the component operates  | Maximum levels of payment        | Framework in which performance is assessed  |
|---|----------------------------------|---|
| <p>Current Executive Directors receive an allowance in lieu of membership of a Company-run pension scheme.</p> <p>Base salary is the only component of remuneration which is pensionable.</p> | <p>Up to 30% of base salary.</p> | <p>The level of payment in lieu of a pension paid to Executive Directors is not dependent on performance.</p> |

## Benefits

In order to attract and retain Executive Directors with the capability of driving our corporate strategy, we need to provide a range of market-competitive benefits similar to the benefits they would receive if they were to work for one of our competitors.

It is important that our Executive Directors are free to focus on the Company's business without being diverted by concerns about medical provision, risk benefit cover or, if required, relocation issues.

| How the component operates   | Maximum levels of payment  | Framework in which performance is assessed  |
|--|--|---|
| <p>A wide range of benefits may be provided depending on the benefits provided for comparable roles in the location in which the Executive Director is based. These benefits will include, as a minimum, healthcare cover, life assurance, long-term disability, annual medical examinations, company car or car allowance. The Committee retains the discretion to provide additional benefits where necessary or relevant in the context of the Executive's location.</p> <p>Where applicable, relocation costs may be provided in-line with the Company's relocation policy for employees, which may include removal costs, assistance with accommodation, living expenses for self and family and financial consultancy advice. In some cases such payments may be grossed up.</p> | <p>The policy is framed by the nature of the benefits that the Remuneration Committee is willing to provide to Executive Directors. The maximum amount payable will depend on the cost of providing such benefits to an employee in the location at which the Executive Director is based. Shareholders should note that the cost of providing comparable benefits in different jurisdictions may vary widely.</p> <p>As an indication, the cost of such benefits provided in 2016 was as follows:</p> <ul style="list-style-type: none"> <li>– Olivier Bohuon €150,511.</li> <li>– Julie Brown £22,244.</li> </ul> <p>The maximum amount payable in benefits to an Executive Director, in normal circumstances, will not be significantly more than amounts paid in 2016 (or equivalent in local currency). The Remuneration Committee retains the right to pay more than this should the cost of providing the same underlying benefits increase or in the event of a relocation. A full explanation will be provided in the Implementation Report should the cost of benefits provided be significantly higher.</p> | <p>The level and cost of benefits provided to Executive Directors is not dependent on performance but on the package of benefits provided to comparable roles within the relevant location.</p> |

## ALL-EMPLOYEE ARRANGEMENTS

### All-employee share plans

To enable Executive Directors to participate in all-employee share plans on the same basis as other employees.

| How the component operates  | Maximum levels of payment  | Framework in which performance is assessed   |
|---|--|--|
| <p>ShareSave Plans are operated in the UK and 31 other countries internationally. In the US, an Employee Stock Purchase Plan is operated. These plans enable employees to save on a regular basis and then buy shares in the Company. Executive Directors are able to participate in such plans on a similar basis to other employees, depending on where they are located.</p> | <p>Executive Directors may currently invest up to £500 per month in the UK ShareSave Plan. The Remuneration Committee may exercise its discretion to increase this amount up to the maximum permitted by the HM Revenue &amp; Customs. Similar limits will apply in different locations.</p> | <p>The potential gains from all-employee plans are not based on performance but are linked to growth in the share price.</p> |



DIRECTORS' REMUNERATION REPORT continued

## The Policy Report continued

### ANNUAL INCENTIVES

#### Annual Incentive Plan – cash incentive

To motivate and reward the achievement of specific annual financial and business objectives related to the Company's strategy and sustained through a clawback mechanism explained more fully in the notes.

The objectives which determine the payment of the annual cash incentive and the level of the annual equity award are linked closely to the Group strategy.

The financial measures of Revenue, Trading Profit Margin and Trading Cash Flow underline our strategy for growth.

The business objectives are also linked to the Group strategy. These change from year to year to reflect the evolving strategy, but will typically be linked to the Strategic Priorities set out in this Annual Report. The Implementation Report each year will explain how each objective is linked to a specific strategic priority.

| How the component operates  | Maximum levels of payment  | Framework in which performance is assessed  |
|---|--|---|
| <p>The Annual Incentive Plan comprises a cash and an equity component, both based on the achievement of financial and business objectives set at the start of the year.</p> <p>The cash component is paid in full after the end of the performance year.</p> <p>At the end of the year, the Remuneration Committee determines the extent to which performance against these has been achieved and sets the award level.</p> | <p>The total maximum payable under the Annual Incentive Plan is 215% of base salary (150% Cash Incentive and 65% Equity Incentive).</p> <p>In respect of the Cash Incentive:</p> <ul style="list-style-type: none"> <li>– 150% salary awarded for maximum performance.</li> <li>– 100% salary awarded for target performance.</li> <li>– 50% salary awarded for threshold performance.</li> <li>– Performance assessed against individual objectives and Group financial targets.</li> </ul> | <p>The cash and share awards are subject to malus and clawback as detailed in the notes following this table.</p> <p>75% of the cash component is based on financial performance measures, which currently include Revenue (35%), Trading Profit Margin (25%) and Trading Cash Flow (15%).</p> <p>25% of the cash component is based on other business goals linked to the Company's strategy, which could include financial and non-financial measures.</p> <p>The Remuneration Committee retains the discretion to adjust the relative weightings of the financial and business components, and to adopt any performance measure that is relevant to the Company.</p> |

#### Annual Incentive Plan – equity incentive

To drive share ownership and encourage sustained high standards through the application of a 'malus' provision over three years, explained more fully in the notes.

| How the component operates  | Maximum levels of payment  | Framework in which performance is assessed  |
|---|--|---|
| <p>The equity award component comprises conditional share awards (made at the time of the cash award), with vesting phased over the following three years.</p> <p>The equity component vests <math>\frac{1}{3}</math>, <math>\frac{1}{3}</math>, <math>\frac{1}{3}</math> on successive award anniversaries, only if performance remains satisfactory over each of these three years; otherwise the award will lapse.</p> <p>Participants will receive an additional number of shares equivalent to the amount of dividend payable per vested share during the relevant performance period.</p> | <p>In respect of the Equity Incentive:</p> <ul style="list-style-type: none"> <li>– Performance is assessed against individual performance, which includes an element of Group financial targets.</li> <li>– 65% of salary awarded for maximum performance.</li> <li>– 50% of salary awarded for target performance.</li> <li>– 0% of salary awarded for performance assessed to be below target.</li> </ul> | <p>The Remuneration Committee will use its judgement of the individual's performance based both on what has been achieved during the year and how it has been achieved in determining the level of equity award that may be awarded within the range of 0% to 65% of salary.</p> <p>The equity component will vest in three equal tranches over a three-year period, provided that satisfactory performance is sustained.</p> |

## LONG-TERM INCENTIVES (AWARDS ACTIVELY BEING MADE)

### Performance Share Programme

To motivate and reward longer-term performance linked to the long-term strategy and share price of the Company.

The performance measures which determine the level of vesting of the Performance Share Awards are linked to our corporate strategy.

| How the component operates  | Maximum levels of payment  | Framework in which performance is assessed   |
|---|--|--|
| <p>The Performance Share Programme comprises conditional share awards which vest after three years, subject to the achievement of stretching performance targets linked to the Company's strategy.</p> <p>Awards may be subject to clawback in the event of material financial misstatement or misconduct.</p> <p>Participants will receive an additional number of shares equivalent to the amount of dividend payable per vested share during the relevant performance period.</p> <p>On vesting, a number of shares are sold to cover the tax liability. The remaining shares are required to be held by the Executive Director for a further two-year holding period.</p> | <p>Annual awards:</p> <ul style="list-style-type: none"> <li>- 190% of salary for maximum performance.</li> <li>- 95% of salary for target performance.</li> <li>- 47.5% of salary for threshold performance.</li> </ul> | <p>Currently:</p> <ul style="list-style-type: none"> <li>- 25% of the award vests on achievement of a three-year cumulative free cash flow target.</li> <li>- 25% of the award vests subject to three-year Total Shareholder Return (TSR) at median performance relative to Global Healthcare companies and to FTSE 100 companies.</li> <li>- 25% of the award vests subject to the achievement of return on invested capital targets.</li> <li>- 25% of the award vests subject to total sales growth.</li> <li>- These measures, the targets and performance against them are described more fully in the Implementation Report.</li> <li>- The Performance Share Award will vest on the third anniversary of the date of grant, depending on the extent to which the performance conditions are met over the three-year period commencing in the year the award was made.</li> <li>- The Remuneration Committee retains the discretion to change the measures and their respective weightings to ensure continuing alignment with the Company's strategy.</li> <li>- The cash and share awards are subject to malus and clawback as detailed in the notes following this table.</li> </ul> <p>Awards made prior to 2017 were subject to TSR against a sector peer group, cash flow and revenue in Emerging Markets targets.</p> |

DIRECTORS' REMUNERATION REPORT continued

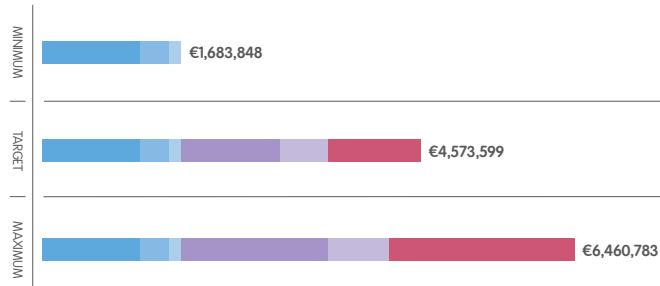
# The Policy Report continued

## ILLUSTRATIONS OF THE APPLICATION OF THE REMUNERATION POLICY 2017

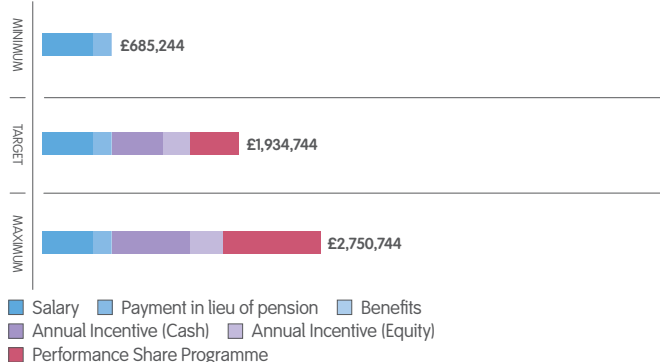
The following charts show the potential split between the different elements of the Executive Directors' remuneration under three different performance scenarios.

Figures as at salary levels in 2017, when the Policy Report was approved by shareholders

### CHIEF EXECUTIVE OFFICER



### CHIEF FINANCIAL OFFICER



## MALUS AND CLAWBACK

The Remuneration Committee may determine that an unvested award or part of an award may not vest (regardless of whether or not the performance conditions have been met) or may determine that any cash bonus, vested shares, or their equivalent value in cash be returned to the Company in the event that any of the following matters is discovered:

- A material misstatement of the Company's financial results; or
- A material error in determining the extent to which any performance condition has been satisfied; or
- A significant adverse change in the financial performance of the Company, or a significant loss at a general level or at the country business unit or function in which a participant worked; or
- Inappropriate conduct (for example reputational issues), capability or performance by a participant, or within a team business area or profit centre.

These provisions apply to share awards under the Global Share Plan 2010 and cash amounts under the Annual Cash Incentive Plan.

## POLICY ON RECRUITMENT ARRANGEMENTS

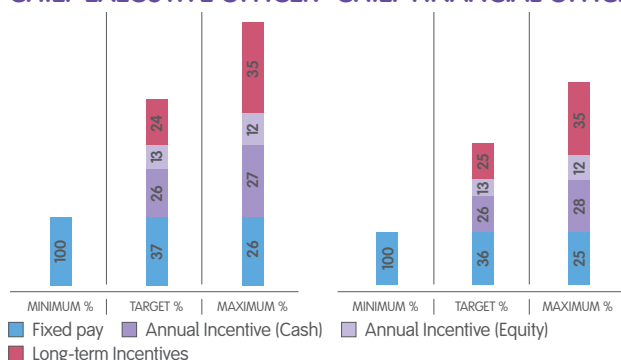
Our policy on the recruitment of Executive Directors is to pay a fair remuneration package for the role being undertaken and the experience of the Executive Director appointed. In terms of base salary, we will seek to pay a salary comparable, in the opinion of the Committee, to that which would be paid for an equivalent position elsewhere. The Remuneration Committee will determine a base salary in-line with the policy and having regard to the parameters set out on in the future policy table. Incoming Executive Directors will be entitled to pension, benefit and incentive arrangements which are the same as provided to existing Executive Directors. On that basis, incentive awards would not exceed 405% of base salary.

We recognise that in the event that we require a new Executive Director to relocate to take up a position with the Company, we will also pay relocation and related costs as described in the future policy table, which is in-line with the relocation arrangements we operate across the Group.

We also recognise that in many cases, an external appointee may forfeit sizeable cash bonuses and share awards if they choose to leave their former employer and join us. The Remuneration Committee therefore believes that we need the ability to compensate new hires for incentive awards they give up on joining us. The Committee will use its judgement in determining any such compensation, which will be decided on a case-by-case basis. We will only provide compensation which is no more beneficial than that given up by the new appointee and we will seek evidence from the previous employer to confirm the full details of bonus or share awards being forfeited. As far as possible, we will seek to replicate forfeited share awards using Smith & Nephew incentive plans or through reliance on Rule 9.4.2 in the Listing Rules, whilst at the same time aiming for simplicity.

### Total Remuneration by Performance Scenario for 2017 Financial Year (percentage split)

#### CHIEF EXECUTIVE OFFICER CHIEF FINANCIAL OFFICER



Data for the Chief Executive Officer assumes an exchange rate of €1 = £0.820.

If we appoint an existing employee as an Executive Director of the Company, pre-existing obligations with respect to remuneration, such as pension, benefits and legacy share awards, will be honoured. Should these differ materially from current arrangements, these will be disclosed in the next Implementation Report.

We will supply details via an announcement to the London Stock Exchange of an incoming Executive Director's remuneration arrangements at the time of their appointment.

## SERVICE CONTRACTS

We employ Executive Directors on rolling service contracts with notice periods of up to 12 months from the Company and six months from the Executive Director. On termination of the contract, we may require the Executive Director not to work their notice period and pay them an amount equivalent to the base salary and payment in lieu of pension and benefits they would have received if they had been required to work their notice period.

Under the terms of the Executive Director's service contract, Executive Directors are restricted for a period of 12 months after leaving the employment of the Company from working for a competitor, soliciting orders from customers and offering employment to employees of Smith & Nephew. The Company retains the right to waive these provisions in certain circumstances. In the event that these provisions are waived or the former Executive Director commences employment earlier than at the end of the notice period, no further payments shall be made in respect of the portion of notice period not worked. Directors' service contracts are available for inspection at the Company's registered office: 15 Adam Street, London WC2N 6LA.

## POLICY ON PAYMENT FOR LOSS OF OFFICE

Our policy regarding termination payments to departing Executive Directors is to limit severance payments to pre-established contractual arrangements. In the event that the employment of an Executive Director is terminated, any compensation payable will be determined in accordance with the terms of the service contract between the Company and the Executive Director, as well as the rules of any incentive plans.

Under normal circumstances (excluding termination for gross misconduct) all leavers are entitled to receive termination payments in lieu of notice equal to base salary, payment in lieu of pension, and benefits. In some circumstances additional benefits may become payable to cover reimbursement of untaken holiday leave, repatriation and outplacement fees, legal and financial advice.

In addition, we may also in exceptional circumstances exercise our discretion to pay the Executive Director a proportion of the annual cash incentive they would have received had they been required to work their notice period. Any entitlement or discretionary payment may be reduced in-line with the Executive Director's duty to mitigate losses, subject to applying our non-compete clause.

We will supply details via an announcement to the London Stock Exchange of a departing Executive Director's termination arrangements at the time of departure.

In the case of a change of control which results in the termination of an Executive Director or a material alteration to their responsibilities or duties, within 12 months of the event, the Executive Director would be entitled to receive 12 months' base salary plus payment in lieu of pension and benefits. In addition, the Remuneration Committee has discretion to pay an Executive Director in these circumstances an annual cash incentive. For Directors appointed prior to 1 November 2012, an automatic annual cash incentive is payable at target.

In the event that an Executive Director leaves for reasons of ill-health, death, redundancy or retirement in agreement with the Company, then the vesting of any outstanding annual cash incentive and equity incentive awards will generally depend on the Remuneration Committee's assessment of performance to date. Performance share awards will be pro-rated for the time worked during the relevant performance period, and will remain subject to performance over the full performance period.

For all other leavers, the annual cash incentive will generally be forfeited and outstanding equity incentive awards and performance share awards will lapse.

One-off awards granted on appointment will normally lapse on leaving except in cases of death, retirement, redundancy, or ill-health. The Remuneration Committee has discretion to permit such awards to vest in other circumstances and will be subject to satisfactorily meeting performance conditions if applicable.

The Remuneration Committee retains discretion to alter these provisions on a case-by-case basis following a review of circumstances and to ensure fairness for both shareholders and Executive Directors.

We will supply details via an announcement to the London Stock Exchange of an out-going Executive Director's remuneration arrangements around the time of leaving.

DIRECTORS' REMUNERATION REPORT continued

## The Policy Report continued

### CHANGES TO POLICY

The 2017 Remuneration Policy makes the following changes to the 2014 Remuneration policy:

- Introduction of a two-year holding period for vested Performance shares;
- Flexibility to change measures;
- Increased emphasis on financial objectives in the Annual Incentive Plan, increases from 70% to 75%; and
- Increased shareholding requirement to 300% of salary for the Chief Executive Officer.

Further details can be found in the letter from the Chairman of the Remuneration Committee on page 79 of the 2017 Annual Report.

### POLICY ON SHAREHOLDING REQUIREMENTS

The Remuneration Committee believes that one of the best ways our Executive Directors can have a greater alignment with shareholders is for them to hold a significant number of shares in the Company. The Chief Executive Officer is therefore expected to build up a holding of Smith & Nephew shares worth three times their base salary and the Chief Financial Officer is expected to build up a holding of two times their basic salary. In order to reinforce this expectation, we require them to retain 50% of the shares (after tax) vesting under the equity incentive programmes until this holding has been met, recognising that differing international tax regimes affect the pace at which an Executive Director may fulfil the shareholding requirement. When calculating whether or not this requirement has been met, we will include ordinary shares or ADRs held by the Executive Director and their immediate family. Ordinarily, we would expect this required shareholding to have been built up within a period of five years from the date of appointment.

Furthermore, from awards made in 2017, we require our Executive Directors to retain all the shares (after tax) vesting under the Performance Share Programme for a period of two years after vesting.

### STATEMENT OF CONSIDERATION OF EMPLOYMENT CONDITIONS ELSEWHERE IN THE COMPANY AND DIFFERENCES TO THE EXECUTIVE DIRECTOR POLICY

All employees across the Group have performance-based pay linked to objectives derived from the strategic priorities, which underpin the performance metrics in the Executive Director Incentive Plans.

Executive Director base salaries will generally increase at a rate in-line with the average salary increases awarded across the Company. Given the diverse geographic markets within which the Company operates, the Committee will generally be informed by the average salary increase in both the market local to the Executive and the UK, recognising the Company's place of listing, and will also consider market data periodically.

A range of different pension arrangements operate across the Group depending on location and/or length of service. Executive Directors and Executive Officers either participate in the legacy pension arrangements relevant to their local market or receive a cash payment of 30% of salary in lieu of a pension. Senior executives who do not participate in a local Company pension plan receive a cash payment of 20% of salary in lieu of pension. Differing amounts apply for lower levels within the Company.

The Company has established a benefits framework under which the nature of benefits varies by geography. Executive Directors participate in benefit arrangements similar to those applied for employees within the applicable location.

All employees are set objectives at the beginning of each year, which link through to the objectives set for the Executive Directors. Annual cash incentives payable to employees across the Company depend on the satisfactory completion of these objectives as well as performance against relevant Group and country business unit financial targets relating to revenue, trading profit and trading cash, similar to the financial targets set for the Executive Directors.

Executive Officers and senior executives (61 as at 2017) participate in the annual Equity Incentive Programme and the Performance Share Programme. The maximum amounts payable are lower, but the performance conditions are the same as those that apply to the Executive Directors.

No specific consultation with employees has been undertaken relating to Director remuneration. However, regular employee surveys are conducted across the Group, which cover a wide range of issues relating to local employment conditions and an understanding of Group-wide strategic matters. As at 2017, around 5,000 employees in 63 countries participate in one or more of our global share plans.



## FUTURE POLICY TABLE – CHAIRMAN AND NON-EXECUTIVE DIRECTORS

The following table and accompanying notes explain the different elements of remuneration we pay to our Chairman and Non-Executive Directors. No element of their remuneration is subject to performance. All payments made to the Chairman are determined by the Remuneration Committee, whilst payments made to the Non-Executive Directors are determined by the Directors who are not themselves Non-Executive Directors, currently the Chairman, the Chief Executive Officer and the Chief Financial Officer.

### Annual fees

#### Basic annual fee

To attract and retain Directors by setting fees at rates comparable to what would be paid in an equivalent position elsewhere.

A proportion of the fees are paid in shares in the third quarter of each year in order to align Non-Executive Directors' fees with the interests of shareholders.

| How the component operates   | Maximum levels of payment   |
|--|---|
| <p>Fees will be reviewed periodically. In future, any increase will be paid in shares until 25% of the total fee is paid in shares.</p> <p>Fees are set in-line with market practice for fees paid by similarly sized UK listed companies.</p> <p>Annual fees are set and paid in UK Sterling or US Dollars depending on the location of the Non-Executive Director. If appropriate, fees may be set and paid in alternative currencies.</p> | <p>Annual fees are currently as follows:</p> <ul style="list-style-type: none"> <li>– £63,000 in cash plus £5,135 in shares; or</li> <li>– \$120,000 in cash plus \$9,780 in shares.</li> </ul> <p>Chairman fee:</p> <ul style="list-style-type: none"> <li>– £309,000 plus £103,000 in shares.</li> </ul> <p>Whilst it is not expected to increase the fees paid to the Non-Executive Directors and the Chairman by more than the increases paid to employees generally, in exceptional circumstances higher fees might become payable.</p> <p>The total maximum aggregate fees payable to the Non-Executive Directors will not exceed £1.5 million as set out in the Company's Articles of Association.</p> |

#### Fee for Senior Independent Director and Committee Chairmen

To compensate Non-Executive Directors for the additional time spent as Committee Chairmen or as the Senior Independent Director.

| How the component operates                                  | Maximum levels of payment  |
|---|--|
| <p>A fixed fee is paid, which is reviewed periodically.</p> | <ul style="list-style-type: none"> <li>– £20,000 in cash; or</li> <li>– \$35,000 in cash.</li> </ul> <p>Whilst it is not expected that the fees paid to the Senior Independent Director or Committee Chairmen will exceed the increases paid to employees generally, in exceptional circumstances, higher fees might become payable.</p> |

#### Intercontinental travel

To compensate Non-Executive Directors for the time spent travelling to attend meetings in another continent.

| How the component operates                                  | Maximum levels of payment  |
|---|--|
| <p>A fixed fee is paid, which is reviewed periodically.</p> | <ul style="list-style-type: none"> <li>– £3,500 in cash; or</li> <li>– \$7,000 in cash.</li> </ul> <p>Whilst it is not expected to increase these fees by more than the increases paid to employees generally, in exceptional circumstances, higher fees might become payable.</p> |

DIRECTORS' REMUNERATION REPORT continued

## The Policy Report continued

### NOTES TO FUTURE POLICY TABLE – NON-EXECUTIVE DIRECTORS

#### Changes to Remuneration Policy

There have been no changes to our Remuneration Policy as it applies to Non-Executive Directors, since the Policy was initially approved by shareholders in April 2014.

#### Additional duties undertaken by Non-Executive Directors

In the event that the Chairman or a Non-Executive Director is required to undertake significant additional executive duties in order to support the Executive Directors during a period of absence due to illness or a gap prior to the appointment of a permanent Executive Director, the Remuneration Committee is authorised to determine an appropriate level of fees which shall be payable. These fees will not exceed the amounts which would normally be paid to a permanent Executive Director undertaking such duties and shall not include participation in short- or long-term incentive arrangements or benefit plans.

#### Policy on recruitment arrangements

Any new Non-Executive Director shall be paid in accordance with the current fee levels on appointment, in line with the Policy set out above. With respect to the appointment of a new Chairman, fee levels will take into account market rates, the individual's profile and experience, the time required to undertake the role and general business conditions. In addition, the Remuneration Committee retains the right to authorise the payment of relocation assistance or an accommodation allowance in the event of the appointment of a Chairman not based within the UK.

#### Letters of appointment

The Chairman and Non-Executive Directors have letters of appointment which set out the terms under which they provide their services to the Company and are available for inspection at the Company's registered office: 15 Adam Street, London WC2N 6LA. The appointment of Non-Executive Directors is not subject to a notice period, nor is there any compensation payable on loss of office, for example, should they not be re-elected at an Annual General Meeting. The appointment of the Chairman is subject to a notice period of six months.

The Chairman and Non-Executive Directors are required to acquire a shareholding in the Company equivalent in value to one times their basic fee within two years of their appointment to the Board.

### STATEMENT OF CONSIDERATION OF SHAREHOLDER VIEWS

The broad outline of our remuneration arrangements have remained largely unchanged since 2012. As our strategy has evolved, we have altered some of the measures we use in our short- and long-term incentive plans, but the overall structure of our remuneration arrangements has remained the same. Shareholders formally approved the Remuneration Policy in respect of our Executive Directors at the Annual General Meeting in 2014. Joseph Papa, Chairman of the Remuneration Committee, has met with shareholders before the policy was approved and every year since, in order to ascertain shareholder views on our remuneration arrangements.

Ahead of the Annual General Meeting in 2016, Mr Papa held meetings and calls with 28 shareholders holding approximately 33% of the Company's Share Capital. Although the holders of 53% of our shares voted against the Remuneration Report in 2016, our engagement ahead of the 2016 Annual General Meeting had shown us that shareholders were broadly supportive of our Remuneration Policy and those who opposed the Remuneration Report were primarily voting against the use of discretion rather than any aspect of the Remuneration Policy.

During 2016, following the Annual General Meeting, Mr Papa continued to engage extensively with shareholders. In Autumn 2016, he met with or held telephone calls with 28 shareholders holding around 41% of the Company's shares. The shareholders he met ranged from some of our top 20 shareholders down to smaller active and engaged shareholders holding fewer than one million shares. He discussed our proposals to continue with the same overall remuneration arrangements, whilst altering the performance measures used in the short- and long-term incentive plans. We found the discussions with shareholders at this time useful in helping to understand the measures and targets which were important to our shareholders, and those which shareholders did not support. As a result of these discussions, some updated performance measures have been incorporated into our incentive plans for 2017 and a two-year holding period will now apply on the vesting of performance shares for our Executive Directors.