

## Smith & Nephew Reports Q3 Results

2 November 2006

Smith & Nephew plc (LSE: SN, NYSE: SNN), the global medical technology business, announces its results for the third quarter ended 30 September 2006.

| Q3 highlights   | Year to date highlights   |
|---|---|
| <ul style="list-style-type: none"><li>• Q3 revenue up 10%* to \$679 million, driven by new product success</li><li>• Trading profit up 15% to \$134 million</li><li>• Q3 EPSA** up by 6% to 10.3¢**</li><li>• Good performances across all Smith &amp; Nephew divisions<ul style="list-style-type: none"><li>- Orthopaedic Reconstruction revenue up 13%, significantly outperforming the market</li><li>- Orthopaedic Trauma revenue grows at an improved 15%</li><li>- Endoscopy achieves increased revenue growth of 13%</li><li>- Advanced Wound Management revenue grows at 1%, but up 5% after adjusting for the dilutive effect of DERMAGRAFT®</li></ul></li></ul> | <ul style="list-style-type: none"><li>• Group revenue up 7% to \$2,008 million*</li><li>• EPSA increased to 30.8¢**</li></ul> |

Commenting on the third quarter, Sir Christopher O'Donnell, Chief Executive of Smith & Nephew, said:

"The third quarter results reflect stronger revenue growth across our business. The US market has shown signs of strengthening, and we were particularly encouraged to see a modest recovery in the US orthopaedic reconstruction market in the last quarter. However, a number of European countries remain challenging as a result of healthcare spending constraints.

"We again exceeded market growth in orthopaedics and, as expected, the strong new product launch programme has contributed to revenue growth across all our businesses during Q3, with BHR<sup>®</sup> and the LEGION<sup>®</sup> and JOURNEY<sup>®</sup> knees leading the improvement. With the positive market reception given to these new products, we expect them to drive revenue growth through the fourth quarter, into 2007 and beyond."

An analyst conference call to discuss the Company's third quarter results will be held at 12.00 noon GMT / 7.00am EST today, Thursday 2 November. The conference call will be broadcast live on the web and will be available on demand shortly following the close of the call at <http://www.smith-nephew.com/Q306>. If interested parties are unable to connect to the web, a listen-only service is available by calling +44 (0)20 7806 1956 in the UK or +1 (718) 354 1389 in the US. Analysts should contact Samantha Hardy on +44 (0)20 7960 2257 or by email at [samantha.hardy@smith-nephew.com](mailto:samantha.hardy@smith-nephew.com) for conference call details.

\* Unless otherwise specified as 'reported', all revenue increases throughout this document are underlying increases after adjusting for the effects of currency translation. See note 3 for a reconciliation of these measures to results reported under IFRS.

\*\* EPSA is stated before the restructuring and rationalisation costs, the fair value loss made on hedging the proceeds from the disposal of the joint venture, taxation thereon, amortisation of acquisition intangibles and the gain on the disposal of the joint venture. See note 2.

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## Introduction

The third quarter results reflect stronger revenue growth across our business. The US market has shown signs of strengthening, and we were particularly encouraged to see a modest recovery in the US orthopaedic reconstruction market in the last quarter. However, a number of European countries remain challenging as a result of healthcare spending constraints.

We again exceeded market growth in orthopaedics and, as expected, the strong new product launch programme has contributed to revenue growth across all our businesses during Q3, with BHR<sup>®</sup> and the LEGION<sup>®</sup> and JOURNEY<sup>®</sup> knees leading the improvement. With the positive market reception given to these new products, we expect them to drive revenue growth through the fourth quarter, into 2007 and beyond.

During the last twelve months we have invested substantially in several important product launches. Now these new products have been successfully introduced, we are increasing our focus on margin enhancement with a systematic review to identify areas for improvement across our businesses.

## Third Quarter Results

Revenue in the quarter was \$679 million. This represents growth of 11% as reported and an underlying growth of 10% after adjusting for movements in currency when compared to the same period last year.

Trading profit in the quarter was \$134 million, representing growth of 15% as reported. Trading margin increased to 19.7%, and interest and finance income was \$3 million. A tax charge of \$40 million at the estimated rate for the year of 29.5% resulted in an attributable profit of \$97 million before amortisation of acquisition intangibles of \$4 million.

Earnings per share before the amortisation of acquisition intangibles were 10.3¢ (51.5¢ per American Depositary Share, "ADS"), which was 6% higher than in the prior year.

## Orthopaedic Reconstruction

Reconstruction revenues at \$219 million grew by 13% compared to the third quarter last year, well ahead of the global market. We had another improved quarter in the US with revenues growing at 14%, benefiting from the strong new product introductions. Outside the US, despite the continuation of difficult market conditions in Europe, growth at 11% signalled a return to double-digit growth through stronger results in most markets.

Knee revenue growth improved to 15% with the success of our LEGION Revision Knee System and JOURNEY Bi-Cruciate Stabilised Knee System introduced earlier this year. Within the US, revenue growth increased to 16% and outside the US revenues grew 13%.

Hip revenues grew by 11%, a significant improvement on the mid-single digit growth in the first half of 2006. Outside the US growth was 13%, within the US hip revenues grew 10%. The controlled introduction of the BHR system in the US is in line with our expectations, with 150 surgeons having been trained to date. We launched the EMPERION<sup>®</sup> Modular Hip System ahead of schedule during the quarter and initial interest in the product has been encouraging.

There is nothing more to report on the subpoena Smith & Nephew received from the United States Department of Justice, Antitrust Division on 30 June this year. We continue to co-operate fully with any requests we receive.

## Orthopaedic Trauma

Trauma revenue growth improved this quarter to 15% relative to the same period last year at \$125 million. Growth in the US was 13% and growth outside the US was 18%, with particularly strong growth in Europe.

Fixation products grew in the US by 10% and outside the US by 16%. The quarter's revenue growth in the US again benefited from the continued success of our PERI-LOC<sup>®</sup> Periarticular Locked Plating System for lower extremity indications and the launch of the upper extremity version took place in late Q3. In July, we launched the TRIGEN<sup>®</sup> INTERTAN<sup>®</sup> nail for femoral fractures and sales are progressing to plan. We were pleased with the further strengthening of our internal fixation portfolio by the launch of the TRIGEN Meta Nail and the recent favourable US court ruling against Synthes.

Clinical Therapies growth remained strong at 20% against the same period last year. Following the worldwide licensing agreement with Q-Med AB in Sweden that we signed in June, we have integrated the DUROLANE<sup>®</sup> single injection joint fluid therapy into the direct Smith & Nephew distribution network in parts of Europe and Canada. Smith & Nephew and Q-Med have also begun to work together toward a pre-market approval of the DUROLANE product in the US. The improved EXOGEN<sup>®</sup> 4000+ low frequency ultrasound bone-healing device was successfully rolled-out during the quarter following FDA approval in Q2.

## Endoscopy

Endoscopy revenue grew by an improved 13% to \$161 million, with growth in the US of 14% and outside the US of 12%, compared with a year ago. Digital Operating Room sales were strong in the third quarter and, with an improved performance for our visualisation products, these two sectors combined grew by 20%.

Repair revenues continued to grow strongly at 22% helped by the successful introduction of the CALAXO<sup>®</sup> Osteoconductive Interference Screw and the BIORAPTOR<sup>®</sup> Suture Anchor for the hip launched earlier in the year. More progress was made with our hip arthroscopy range during the quarter in this small but rapidly expanding new market sector. Recently the repair product range was further strengthened by the launch of the KINSA<sup>®</sup> Self-locking Suture Anchor for treating instability of the shoulder.

Smith & Nephew's view that single-use shaver blades should not be reprocessed was reinforced by the publication of a peer-reviewed study conducted by Loma Linda University in California in the October issue of *Arthroscopy: The Journal of Arthroscopic and Related Surgery*. This study indicated that shaver blades cannot be cleaned effectively and reprocessed single-use only blades may pose health and safety risks to patients.

The integration of OsteoBiologics, Inc ("OBI"), acquired in July, is proceeding to plan. It is a powerful addition to our comprehensive arthroscopy knee product offering in the area of treating cartilage defects.

## Advanced Wound Management

Advanced Wound Management revenues grew to \$174 million, up 1% relative to the third quarter of last year. This was after a 4% dilution effect as a result of the exit from DERMAGRAFT<sup>®</sup> and its related products. After adjusting for this dilution, which principally affects US sales, we are pleased with the strong consecutive quarterly US growth achieved during the year. This quarter's growth of 14% was again offset by slower growth of 2% outside the US, principally due to continuing healthcare cost pressures in the UK and Germany.

ALLEVYN<sup>®</sup> dressings had another strong quarter. Revenue increased by 10% with the contribution of European product launches in the last quarter of improved versions of ALLEVYN Adhesive and ALLEVYN Sacrum Dressing. Wound bed preparations, which includes our ACTICOAT<sup>®</sup> antimicrobial silver dressings, grew by 12%, although increased low price competition adversely affected sales of ACTICOAT dressings. Our VERSAJET<sup>®</sup> hydrosurgical wound debrider benefited from the Q2 US FDA approval of expanded labelling to include burns indications and continues to grow rapidly.

### **Year to Date Results**

Reported revenues increased by 7% to \$2,008 million compared to the same period last year, with underlying growth at 7%.

Trading profit year to date was up 8% to \$399 million. Trading margin was slightly ahead of the comparable period last year at 19.9%. Interest and finance income was \$12 million. A tax charge of \$120 million at the estimated rate for the year of 29.5% resulted in an adjusted attributable profit of \$290 million before fair value loss, taxation thereon, the amortisation of acquisition intangibles of \$8 million, and the gain on the disposal of the joint venture.

Earnings per share before the restructuring and rationalisation costs, the gain on disposal of the joint venture, fair value loss, taxation thereon, and the amortisation of acquisition intangibles was 30.8¢ (154.0¢ per American Depository Share "ADS"), marginally higher than last year's comparator having been negatively impacted by the disposal of our joint venture with BSN and by the loss of net interest income deriving from the dollar/sterling interest rate differences. The total impact on EPSA growth of these one-off items was 7% to 8% year to date. Reported basic earnings per share were 65.1¢ (325.5¢ per ADS). A reconciliation of EPSA to reported earnings per share is provided in note 2 to the accounts.

Operating cash flow, defined as cash generated from operations less capital expenditure, was \$145 million after \$30 million of pension payments to reduce pension plan deficits. This is a trading profit to cash conversion ratio of 47%, before rationalisation and integration expenditure of \$17 million and \$24 million of funding of settlement payments to patients in respect of macrotexture revisions which are not being reimbursed by insurers, and compares with 48% a year ago.

### **Outlook**

We reaffirm our guidance for the full year given at our interim results in July.

We are encouraged by the modest improvement in the US market growth rate in Orthopaedic Reconstruction, but European market conditions remain challenging. We are encouraged by the positive market reception and growth of our new products in the year to date and expect this to continue in the coming quarter and into 2007 and beyond.

### **About us**

Smith & Nephew is a global medical technology business, specialising in Orthopaedic Reconstruction, Orthopaedic Trauma, Endoscopy and Advanced Wound Management products. Smith & Nephew is a global leader in arthroscopy and advanced wound management and is one of the leading global orthopaedics companies.

Smith & Nephew is dedicated to helping improve people's lives. The Company prides itself on the strength of its relationships with its surgeons and professional healthcare customers, with whom its name is

synonymous with high standards of performance, innovation and trust. The Company has over 8,500 employees and operates in 33 countries around the world generating annual sales in excess of \$2.6 billion.

### **Forward-Looking Statements**

*This press release contains certain "forward-looking statements" within the meaning of the US Private Securities Litigation Reform Act of 1995. In particular, statements regarding expected revenue growth and trading margins discussed under "Outlook" are forward-looking statements as are discussions of our product pipeline. These statements, as well as the phrases "aim", "plan", "intend", "anticipate", "well-placed", "believe", "estimate", "expect", "target", "consider" and similar expressions, are generally intended to identify forward-looking statements. Such forward-looking statements involve known and unknown risks, uncertainties and other important factors (including, but not limited to, the outcome of litigation, claims and regulatory approvals) that could cause the actual results, performance or achievements of Smith & Nephew, or industry results, to differ materially from any future results, performance or achievements expressed or implied by such forward-looking statements. Please refer to the documents that Smith & Nephew has filed with the U.S. Securities and Exchange Commission under the U.S. Securities Exchange Act of 1934, as amended, including Smith & Nephew's most recent annual report on Form 20F, for a discussion of certain of these factors.*

*All forward-looking statements in this press release are based on information available to Smith & Nephew as of the date hereof. All written or oral forward-looking statements attributable to Smith & Nephew or any person acting on behalf of Smith & Nephew are expressly qualified in their entirety by the foregoing. Smith & Nephew does not undertake any obligation to update or revise any forward-looking statement contained herein to reflect any change in Smith & Nephew's expectation with regard thereto or any change in events, conditions or circumstances on which any such statement is based.*

◇ Trademark of Smith & Nephew. Certain names registered at the US Patent and Trademark Office.

DUROLANE<sup>®</sup> is a trademark of Q-Med AB.

DERMAGRAFT<sup>®</sup> is a trademark of Advanced BioHealing Inc.

## SMITH &amp; NEPHEW plc

## 2006 QUARTER THREE RESULTS

**Unaudited Group Income Statement for the 3 months and 9 months to 30 September 2006**

| 3 Months<br>2005 <sup>A</sup><br>\$m | 3 Months<br>2006<br>\$m |   | Notes | 9 Months<br>2006<br>\$m | 9 Months<br>2005 <sup>A</sup><br>\$m |
|--------------------------------------|-------------------------|---|-------|-------------------------|--------------------------------------|
| 612                                  | 679                     | Revenue   | 3     | 2,008                   | 1,882                                |
| (161)                                | (173)                   | Cost of goods sold                                      |       | (509)                   | (484)                                |
| (307)                                | (342)                   | Selling, general and administrative expenses            |       | (1,011)                 | (941)                                |
| (27)                                 | (30)                    | Research and development expenses                       |       | (89)                    | (87)                                 |
| 117                                  | 134                     | <b>Trading profit</b>                                   | 4     | 399                     | 370                                  |
| (44)                                 | -                       | Restructuring and rationalisation costs                 | 5     | -                       | (44)                                 |
| (2)                                  | (4)                     | Amortisation of acquisition intangibles                 |       | (8)                     | (8)                                  |
| 71                                   | 130                     | <b>Operating profit</b>                                 | 4     | 391                     | 318                                  |
| 10                                   | 4                       | Interest receivable                                     |       | 15                      | 25                                   |
| (8)                                  | (2)                     | Interest payable  |       | (7)                     | (18)                                 |
| (2)                                  | 1                       | Other finance income/(costs)                            |       | 4                       | (2)                                  |
| -                                    | -                       | Loss on hedge of the sale proceeds of the joint venture |       | (3)                     | -                                    |
| 71                                   | 133                     | <b>Profit before taxation</b>                           |       | 400                     | 323                                  |
| (18)                                 | (40)                    | Taxation  | 8     | (120)                   | (95)                                 |
| 53                                   | 93                      | <b>Profit from continuing operations</b>                |       | 280                     | 228                                  |
|                                      |                         | Discontinued operations:                                |       |                         |                                      |
| -                                    | -                       | Net profit on disposal of the joint venture             | 9     | 332                     | -                                    |
| 9                                    | -                       | Share of results of the joint venture                   | 9     | -                       | 24                                   |
| <u>62</u>                            | <u>93</u>               | <b>Attributable profit</b>                              |       | <u>612</u>              | <u>252</u>                           |
|                                      |                         | <b>Earnings per share</b>                               |       |                         |                                      |
|                                      |                         | Including discontinued operations:                      |       |                         |                                      |
| 6.6¢                                 | 9.9¢                    | Basic   |       | 65.1¢                   | 26.9¢                                |
| 6.6¢                                 | 9.9¢                    | Diluted   |       | 64.8¢                   | 26.7¢                                |
|                                      |                         | Excluding discontinued operations:                      |       |                         |                                      |
| 5.6¢                                 | 9.9¢                    | Basic   |       | 29.8¢                   | 24.3¢                                |
| 5.6¢                                 | 9.9¢                    | Diluted   |       | 29.7¢                   | 24.1¢                                |

<sup>A</sup> As restated for the change in reporting currency from Sterling to US Dollars on 1 January 2006 – see Note 1.

**Unaudited Group Statement of Recognised Income & Expense  
for the 3 months and 9 months to 30 September 2006**

| 3 Months<br>2005 <sup>A</sup><br>\$m | 3 Months<br>2006<br>\$m |  | 9 months<br>2006<br>\$m | 9 months<br>2005 <sup>A</sup><br>\$m |
|--------------------------------------|-------------------------|--|-------------------------|--------------------------------------|
| (12)                                 | (2)                     | Translation differences on foreign currency net investments        | 43                      | (106)                                |
| -                                    | -                       | Cumulative translation adjustment on disposal of the joint venture | (14)                    | -                                    |
| (3)                                  | 3                       | (Losses)/gains on cash flow hedges                                 | (3)                     | 16                                   |
| 37                                   | (3)                     | Actuarial gains/(losses) on defined benefit pension plans          | 40                      | (3)                                  |
| (12)                                 | -                       | Taxation on items taken directly to equity                         | (13)                    | 1                                    |
| 10                                   | (2)                     | Net income/(expense) recognised directly in equity                 | 53                      | (92)                                 |
| 62                                   | 93                      | <b>Attributable profit</b>   | 612                     | 252                                  |
| <u>72</u>                            | <u>91</u>               | <b>Total recognised income and expense</b>                         | <u>665</u>              | <u>160</u>                           |

## SMITH &amp; NEPHEW plc

## 2006 QUARTER THREE RESULTS continued

Unaudited Group Balance Sheet as at 30 September 2006

| 31 Dec<br>2005 <sup>A</sup><br>\$m |  | Notes | 30 Sep<br>2006<br>\$m | 1 Oct<br>2005 <sup>A</sup><br>\$m |
|------------------------------------|--|-------|-----------------------|-----------------------------------|
|                                    | <b>ASSETS</b>  |       |                       |                                   |
|                                    | <b>Non-current assets</b>                                  |       |                       |                                   |
| 589                                | Property, plant and equipment                              |       | 630                   | 579                               |
| 673                                | Intangible assets  |       | 813                   | 673                               |
| 10                                 | Investments  |       | 10                    | 10                                |
| -                                  | Investment in joint venture                                |       | -                     | 228                               |
| -                                  | Non-current receivables                                    |       | -                     | 1                                 |
| <u>131</u>                         | Deferred tax assets  |       | <u>104</u>            | <u>138</u>                        |
| 1,403                              |  |       | 1,557                 | 1,629                             |
|                                    | <b>Current assets</b>                                      |       |                       |                                   |
| 610                                | Inventories  |       | 703                   | 633                               |
| 620                                | Trade and other receivables                                |       | 636                   | 572                               |
| 10                                 | Current asset derivatives                                  |       | 2                     | 24                                |
| <u>151</u>                         | Cash and bank  |       | <u>304</u>            | <u>120</u>                        |
| 1,391                              |  |       | 1,645                 | 1,349                             |
| <u>218</u>                         | Held for sale – investment in joint venture                |       | <u>-</u>              | <u>-</u>                          |
| <u>3,012</u>                       | <b>TOTAL ASSETS</b>  |       | <u>3,202</u>          | <u>2,978</u>                      |
|                                    | <b>EQUITY AND LIABILITIES</b>                              |       |                       |                                   |
|                                    | <b>Equity attributable to equity holders of the parent</b> |       |                       |                                   |
| 203                                | Called up equity share capital                             |       | 189                   | 203                               |
| 299                                | Share premium account                                      |       | 321                   | 292                               |
| (4)                                | Own shares   |       | (1)                   | (3)                               |
| <u>984</u>                         | Accumulated profits and other reserves                     |       | <u>1,563</u>          | <u>937</u>                        |
| 1,482                              | Total equity   | 11    | 2,072                 | 1,429                             |
|                                    | <b>Non-current liabilities</b>                             |       |                       |                                   |
| 211                                | Long-term borrowings                                       |       | 16                    | 186                               |
| 190                                | Retirement benefit obligation                              |       | 123                   | 256                               |
| 16                                 | Other payables due after one year                          |       | 4                     | 6                                 |
| 48                                 | Provisions – due after one year                            |       | 43                    | 50                                |
| <u>53</u>                          | Deferred tax liabilities                                   |       | <u>45</u>             | <u>57</u>                         |
| 518                                |  |       | 231                   | 555                               |
|                                    | <b>Current liabilities</b>                                 |       |                       |                                   |
| 227                                | Bank overdrafts and loans due within one year              |       | 137                   | 208                               |
| 452                                | Trade and other payables                                   |       | 447                   | 471                               |
| 91                                 | Provisions – due within one year                           |       | 56                    | 67                                |
| 29                                 | Current liability derivatives                              |       | -                     | 22                                |
| <u>213</u>                         | Current tax payable  |       | <u>259</u>            | <u>226</u>                        |
| 1,012                              |  |       | 899                   | 994                               |
| <u>1,530</u>                       | <b>Total liabilities</b>                                   |       | <u>1,130</u>          | <u>1,549</u>                      |
| <u>3,012</u>                       | <b>TOTAL EQUITY AND LIABILITIES</b>                        |       | <u>3,202</u>          | <u>2,978</u>                      |

<sup>A</sup> As restated for the change in reporting currency from Sterling to US Dollars on 1 January – see Note 1.

## SMITH &amp; NEPHEW plc

## 2006 QUARTER THREE RESULTS continued

**Unaudited Condensed Group Cash Flow Statement for the 3 months and 9 months to 30 September 2006**

| <b>3 Months</b><br><b>2005</b> <sup>A</sup><br><b>\$m</b> | <b>3 Months</b><br><b>2006</b><br><b>\$m</b> |   | <b>9 Months</b><br><b>2006</b><br><b>\$m</b> | <b>9 Months</b><br><b>2005</b> <sup>A</sup><br><b>\$m</b> |
|---|--|---|--|---|
|   |  | <b>Net cash inflow from operating activities</b>                |  |   |
| 71  | 130  | Operating profit  | 391  | 318   |
| 70  | 44   | Depreciation, amortisation and impairment                       | 121  | 142   |
| 4   | 4  | Share based payment expense                                     | 13   | 11  |
| <u>(35)</u>   | <u>(78)</u>                                  | Movement in working capital and provisions <sup>B</sup>         | <u>(195)</u>                                 | <u>(180)</u>  |
| 110   | 100  | Cash generated from operations                                  | 330  | 291   |
| 2   | 2  | Net interest received   | 8  | 7   |
| <u>(19)</u>   | <u>(33)</u>                                  | Income taxes paid   | <u>(96)</u>                                  | <u>(79)</u>   |
| 93  | 69   | Net cash inflow from operating activities                       | 242  | 219   |
|   |  | <b>Cash flows from investing activities</b>                     |  |   |
| (1)   | (75)   | Acquisitions (net of Loan Notes issued of \$18 million in 2006) | (82)   | (18)  |
| -   | 2  | Cash acquired with acquisitions                                 | 2  | -   |
| -   | (2)  | Disposal of joint venture <sup>C</sup>                          | 541  | -   |
| 1   | -  | Dividends received from the joint venture <sup>C</sup>          | -  | 12  |
| <u>(44)</u>   | <u>(55)</u>                                  | Capital expenditure   | <u>(185)</u>                                 | <u>(153)</u>  |
| (44)  | (130)  | Net cash used in investing activities                           | 276  | (159)   |
| 49  | (61)   | <b>Cash flows before financing activities</b>                   | 518  | 60  |
|   |  | <b>Cash flows from financing activities</b>                     |  |   |
| 2   | 3  | Proceeds from issue of ordinary share capital                   | 8  | 11  |
| -   | -  | Equity dividends paid   | (57)   | (56)  |
| (21)  | (12)   | Cash movements in borrowings                                    | (275)  | (8)   |
| <u>(10)</u>   | <u>(2)</u>                                   | Settlement of currency swaps                                    | <u>(5)</u>                                   | <u>(5)</u>  |
| (29)  | (11)   | Net cash used in financing activities                           | (329)  | (58)  |
| 20  | (72)   | <b>Net increase/(decrease) in cash and cash equivalents</b>     | 189  | 2   |
| 21  | 329  | Cash and cash equivalents at beginning of period                | 65   | 44  |
| -   | -  | Exchange adjustments  | <u>3</u>                                     | <u>(5)</u>  |
| <u>41</u>   | <u>257</u>                                   | <b>Cash and cash equivalents at end of period</b> <sup>D</sup>  | <u>257</u>                                   | <u>41</u>   |

<sup>A</sup> As restated for the change in reporting currency from Sterling to US Dollars on 1 January – see Note 1.

<sup>B</sup> After \$24 million (2005 – \$34 million) unreimbursed by insurers relating to macrot textured knee revisions, \$17 million (2005 – \$4 million) of outgoings on rationalisation, acquisition and divestment costs and payments to reduce pension plan deficits in 2006 of \$30 million.

<sup>C</sup> Discontinued operations accounted for \$541 million (2005 – \$12 million) of net cash flow from investing activities.

<sup>D</sup> Cash and cash equivalents at the end of the period are net of overdrafts of \$47 million (2005 – \$79 million).

**SMITH & NEPHEW plc****2006 QUARTER THREE RESULTS continued****NOTES**

1. Except as detailed below, the financial information for the three months and nine months has been prepared on the basis of the accounting policies set out in the full annual accounts of the Group for the year ended 31 December 2005.

As the Group's principal assets and operations are in the US and the majority of its operations are conducted in US Dollars, the Group changed its reporting currency from Pounds Sterling to US Dollars with effect from 1 January 2006. This lowers the Group's exposure to currency translation risk on its revenue, profits and equity. The Company redenominated its share capital into US Dollars on 23 January 2006 and will retain distributable reserves and declare dividends in US Dollars. Consequently, its functional currency became the US Dollar. Financial information for prior periods has been restated from Pounds Sterling into US Dollars in accordance with IAS 21.

The financial information contained in this document does not constitute statutory accounts as defined in section 240 of the Companies Act 1985. The auditors have issued an unqualified opinion on the Group's statutory financial statements for the year ended 31 December 2005, which have been delivered to the Registrar of Companies.

2. In order to provide a trend measure of underlying performance, attributable profit is adjusted to exclude items which management consider may distort comparability. Such items arise from events or transactions that fall within the ordinary activities of the Group but which management believes should be separately identified to help explain trends as they are exceptional in nature or derive from specific accounting treatments.

Adjusted earnings per share ("EPSA") has been calculated by dividing adjusted attributable profit by the weighted (basic) average number of ordinary shares in issue of 941 million (2005 – 938 million). The diluted weighted average number of ordinary shares in issue is 944 million (2005 – 944 million).

| <b>3 Months</b> | <b>3 Months</b> |   | <b>9 Months</b> | <b>9 Months</b> |
|-----------------|-----------------|---|-----------------|-----------------|
| <b>2005</b>     | <b>2006</b>     |   | <b>2006</b>     | <b>2005</b>     |
| <b>\$m</b>      | <b>\$m</b>      |   | <b>\$m</b>      | <b>\$m</b>      |
| 62              | 93              | Attributable profit                                     | 612             | 252             |
|                 |                 | Adjustments:  |                 |                 |
| 2               | 4               | Amortisation of acquisition intangibles                 | 8               | 8               |
| 44              | -               | Restructuring and rationalisation costs                 | -               | 44              |
| -               | -               | Net profit on disposal of the joint venture             | (332)           | -               |
| -               | -               | Loss on hedge of the sale proceeds of the joint venture | 3               | -               |
| (17)            | -               | Taxation on excluded items                              | (1)             | (17)            |
| <u>91</u>       | <u>97</u>       | Adjusted attributable profit                            | <u>290</u>      | <u>287</u>      |
| 9.7¢            | 10.3¢           | Adjusted earnings per share                             | 30.8¢           | 30.6¢           |
| 9.6¢            | 10.3¢           | Adjusted diluted earnings per share                     | 30.7¢           | 30.4¢           |

## SMITH &amp; NEPHEW plc

## 2006 QUARTER THREE RESULTS continued

## NOTES

3. Revenue by segment for the three months and nine months to 30 September 2006 was as follows:

| 3 Months<br>2005<br>\$m             | 3 Months<br>2006<br>\$m |   | 9 Months<br>2006<br>\$m | 9 Months<br>2005<br>\$m | Underlying growth<br>in revenue<br>% |           |
|-------------------------------------|-------------------------|---|-------------------------|-------------------------|--------------------------------------|-----------|
|                                     |                         |   |                         |                         | 3 Months                             | 9 Months  |
| <b>Revenue by business segment</b>  |                         |   |                         |                         |                                      |           |
| 193                                 | 219                     | Orthopaedic Reconstruction                | 668                     | 616                     | 13                                   | 9         |
| 109                                 | 125                     | Orthopaedic Trauma                        | 356                     | 319                     | 15                                   | 12        |
| 141                                 | 161                     | Endoscopy                                 | 478                     | 442                     | 13                                   | 9         |
| <u>169</u>                          | <u>174</u>              | Advanced Wound Management                 | <u>506</u>              | <u>505</u>              | <u>1</u>                             | <u>1</u>  |
| <u>612</u>                          | <u>679</u>              |   | <u>2,008</u>            | <u>1,882</u>            | <u>10</u>                            | <u>7</u>  |
| <b>Revenue by geographic market</b> |                         |   |                         |                         |                                      |           |
| 302                                 | 337                     | United States                             | 991                     | 920                     | 12                                   | 8         |
| 185                                 | 204                     | Europe <sup>E</sup>                       | 624                     | 597                     | 6                                    | 5         |
| <u>125</u>                          | <u>138</u>              | Africa, Asia, Australasia & Other America | <u>393</u>              | <u>365</u>              | <u>11</u>                            | <u>10</u> |
| <u>612</u>                          | <u>679</u>              |   | <u>2,008</u>            | <u>1,882</u>            | <u>10</u>                            | <u>7</u>  |

<sup>E</sup> Includes United Kingdom nine months revenue of \$183 million (2005 - \$178 million) and three months revenue of \$65 million (2005 - \$58 million).

The Orthopaedics segment, that was reported in the full annual accounts of the Group for the year ended 31 December 2005, has been split into two segments: Orthopaedic Reconstruction and Orthopaedic Trauma.

Underlying revenue growth is calculated by eliminating the effects of translational currency. Reported growth reconciles to underlying growth as follows:

|                            | Reported<br>growth in<br>revenue<br>% | Foreign<br>currency<br>translation<br>effect<br>% | Underlying<br>growth in<br>revenue<br>% |
|----------------------------|---------------------------------------|---|---|
| <b>9 Months</b>            |                                       |   |   |
| Orthopaedic Reconstruction | 8                                     | 1   | 9                                       |
| Orthopaedic Trauma         | 12                                    | -   | 12                                      |
| Endoscopy                  | 8                                     | 1   | 9                                       |
| Advanced Wound Management  | -                                     | <u>1</u>  | <u>1</u>                                |
|                            | <u>7</u>                              | =   | <u>7</u>                                |
| <b>3 Months</b>            |                                       |   |   |
| Orthopaedic Reconstruction | 13                                    | -   | 13                                      |
| Orthopaedic Trauma         | 15                                    | -   | 15                                      |
| Endoscopy                  | 14                                    | (1)   | 13                                      |
| Advanced Wound Management  | <u>3</u>                              | <u>(2)</u>  | <u>1</u>                                |
|                            | <u>11</u>                             | <u>(1)</u>  | <u>10</u>                               |

## SMITH &amp; NEPHEW plc

## 2006 QUARTER THREE RESULTS continued

## NOTES

4. Trading and operating profit by segment for the three months and nine months to 30 September 2006 was as follows:

| 3 Months<br>2005<br>\$m | 3 Months<br>2006<br>\$m |   | 9 Months<br>2006<br>\$m | 9 Months<br>2005<br>\$m |
|-------------------------|-------------------------|---|-------------------------|-------------------------|
|                         |                         | <b>Trading Profit by business segment</b>   |                         |                         |
| 44                      | 52                      | Orthopaedic Reconstruction                  | 170                     | 155                     |
| 22                      | 24                      | Orthopaedic Trauma                          | 67                      | 63                      |
| 25                      | 28                      | Endoscopy                                   | 86                      | 85                      |
| <u>26</u>               | <u>30</u>               | Advanced Wound Management                   | <u>76</u>               | <u>67</u>               |
| <u>117</u>              | <u>134</u>              |   | <u>399</u>              | <u>370</u>              |
|                         |                         | <b>Operating Profit by business segment</b> |                         |                         |
| 42                      | 49                      | Orthopaedic Reconstruction                  | 163                     | 148                     |
| 22                      | 24                      | Orthopaedic Trauma                          | 67                      | 63                      |
| 9                       | 27                      | Endoscopy                                   | 85                      | 68                      |
| <u>(2)</u>              | <u>30</u>               | Advanced Wound Management                   | <u>76</u>               | <u>39</u>               |
| <u>71</u>               | <u>130</u>              |   | <u>391</u>              | <u>318</u>              |

5. Restructuring and rationalisation costs in 2005 comprise a charge against Advanced Wound Management of \$28 million relating to the decision to exit DERMAGRAFT<sup>®</sup> and related products and \$16 million for the rationalisation of Endoscopy manufacturing facilities.
6. On 10 July 2006, the Group acquired all of the share capital in OsteoBiologics, Inc., for a net consideration of \$73 million (including \$1 million of acquisition costs). The cost of the acquisition has been allocated provisionally as \$45 million intangible fixed assets, \$37 million goodwill, \$11 million net deferred tax liability and other net assets of \$2 million. The final fair value allocation will be determined by 31 December 2006.
7. The cumulative number of revisions of the macrotextured knee product was 987 on 30 September 2006 compared with 978 at the end of Quarter Two 2006. This represents 33% of the total implanted. Settlements with patients have been achieved in respect of 888 revisions (Quarter Two 2006 – 843 settlements). Costs of \$103 million are in dispute with insurers and are provided for in full. \$51 million of provision remains to cover future settlement costs.
8. Taxation of \$121 million (2005 – \$112 million) for the nine months on the profit before restructuring and rationalisation costs, amortisation of acquisition intangibles, the loss on hedge of the sale proceeds of the joint venture and discontinued operations is based on the full year estimated effective rate. In 2005, a taxation benefit of \$17 million arose on the restructuring and rationalisation costs. Of the \$120 million (2005 – \$95 million) taxation charge for the nine months \$96 million (2005 – \$68 million) relates to overseas taxation.
9. On 23 February 2006 the Group sold its 50% interest in the BSN joint venture for cash consideration of \$562 million. The net profit of \$332 million on the disposal of the joint venture is after a credit of \$14 million for cumulative translation adjustments and \$26 million of transaction costs. In 2005 the share of results of the joint venture for the nine months is after interest payable of \$2 million and taxation of \$11 million. The Group's discontinued operations earnings per share for the nine months is: basic 35.3¢ (2005 – 2.6¢) and diluted 35.1¢ (2005 – 2.6¢).
10. The 2005 second interim dividend of \$57 million was paid on 12 May 2006. The first interim dividend for 2006 of 4.10 US cents per ordinary share was declared by the Board on 27 July 2006. UK shareholders will receive 2.21 pence per ordinary share. This is payable on 10 November 2006 to shareholders whose names appear on the register at the close of business on 20 October 2006. Shareholders may participate in the dividend re-investment plan.

**SMITH & NEPHEW plc****2006 QUARTER THREE RESULTS continued****NOTES**

11. The movement in total equity for the nine months to 30 September 2006 was as follows:

|   | <b>2006</b>  | <b>2005</b>  |
|---|--------------|--------------|
|   | <b>\$m</b>   | <b>\$m</b>   |
| Opening equity as at 1 January                            | 1,482        | 1,338        |
| Attributable profit                                       | 612          | 252          |
| Equity dividends paid or accrued                          | (96)         | (91)         |
| Exchange adjustments                                      | 29           | (106)        |
| (Losses)/gains on cash flow hedges                        | (3)          | 16           |
| Actuarial gains/(losses) on defined benefit pension plans | 40           | (3)          |
| Share based payment recognised in the income statement    | 13           | 11           |
| Taxation on items taken directly to equity                | (13)         | 1            |
| Issue of ordinary share capital                           | <u>8</u>     | <u>11</u>    |
| Closing equity  | <u>2,072</u> | <u>1,429</u> |

12. Net cash/(net debt) as at 30 September 2006 comprises:

|   | <b>2006</b> | <b>2005</b>  |
|---|-------------|--------------|
|   | <b>\$m</b>  | <b>\$m</b>   |
| Cash and bank                                 | 304         | 120          |
| Long-term borrowings                          | (16)        | (186)        |
| Bank overdrafts and loans due within one year | (137)       | (208)        |
| Net currency swap assets                      | <u>2</u>    | <u>2</u>     |
|   | <u>153</u>  | <u>(272)</u> |

The movements in the nine months were as follows:

|   |            |              |
|---|------------|--------------|
| Opening net debt as at 1 January              | (306)      | (232)        |
| Cash flows before financing activities        | 518        | 60           |
| Loan Notes issued on acquisition              | (18)       | -            |
| Proceeds from issue of ordinary share capital | 8          | 11           |
| Equity dividends paid                         | (57)       | (56)         |
| Exchange adjustments                          | <u>8</u>   | <u>(55)</u>  |
| Closing net cash/(net debt)                   | <u>153</u> | <u>(272)</u> |

**INDEPENDENT REVIEW REPORT TO SMITH & NEPHEW plc*****Introduction***

We have been instructed by the company to review the financial information for the three months and nine months ended 30 September 2006 which comprises Group Income Statement, Group Statement of Recognised Income and Expense, Group Balance Sheet, Condensed Group Cash Flow Statement and the related notes 1 to 12. We have read the other information contained in the interim report for quarter three and considered whether it contains any apparent misstatements or material inconsistencies with the financial information.

This report is made solely to the company in accordance with guidance contained in Bulletin 1999/4 'Review of interim financial information' issued by the Auditing Practices Board. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company, for our work, for this report, or for the conclusions we have formed.

***Directors' Responsibilities***

The interim report for quarter three, including the financial information contained therein, is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the interim report for quarter three in accordance with the Listing Rules of the Financial Services Authority which require that the accounting policies and presentation applied to the interim figures should be consistent with those applied in preparing the preceding annual accounts except where any changes, and the reasons for them, are disclosed. The accounting policies are consistent with those that the directors intend to use in the next annual accounts.

***Review Work Performed***

We conducted our review in accordance with guidance contained in Bulletin 1999/4 'Review of interim financial information' issued by the Auditing Practices Board for use in the United Kingdom. A review consists principally of making enquiries of group management and applying analytical procedures to the financial information and underlying financial data, and based thereon assessing whether the accounting policies and presentation have been consistently applied, unless otherwise disclosed. A review excludes audit procedures such as tests of controls and verification of assets, liabilities and transactions. It is substantially less in scope than an audit performed in accordance with International Standards on Auditing (UK and Ireland) and therefore provides a lower level of assurance than an audit. Accordingly we do not express an audit opinion on the financial information.

***Review Conclusion***

On the basis of our review we are not aware of any material modifications that should be made to the financial information as presented for the three months and nine months ended 30 September 2006.

Ernst & Young LLP  
London

2 November 2006