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Conference Call Transcript

SNN - Preliminary 2008 Smith & Nephew Earnings Conference Call

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PRESENTATION

Operator

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Ladies and gentlemen, you are now connected to the auditorium. You will hear silence until the conference begins. Thank you.

John Buchanan - *Smith & Nephew - Chairman*

Good morning, everybody. My name is John Buchanan, I'm the Chairman of Smith & Nephew. Welcome to our preliminary 2008 results presentation. Dave Illingworth and Adrian Hennah will be taking you through the fourth quarter and the year in a moment. But before they speak, I thought I'd make a few introductory comments, offering you a broad perspective of the business.

2008 was a challenging year for Smith & Nephew. We had a number of issues to face and the management team performed well. We believe the team is well placed to handle the challenges and opportunities of 2009 and beyond.

The outcome for 2008 was good, with progress made on many fronts. As you would expect, the Board has been keeping a close eye on the financial strategy of the business. We continue to manage our financial resources carefully, keeping our gearing conservative. We have excellent financial resources and strong cash flow. As you've seen, we've altered our distribution policy, suspending the buy-back but again increasing the dividend by 10%. And on a parochial point, a dollar-based dividend has attractions for sterling shareholders.

Before I hand over to Dave Illingworth I would like to comment on the Board's view of Smith & Nephew. The Company operates in resilient markets with strong underlying demand. These are good markets to be in at any time, but particularly in times of economic uncertainty. We see this as a good business, one with innovative products and excellent opportunities for sustained growth in the future. It's being run by a motivated management team who are focused on executing their plans. There may be tougher times ahead, but Smith & Nephew is in good shape to continue its growth path.

And on that note, Dave, over to you.

David Illingworth - *Smith & Nephew - CEO*

Thank you, John. Good morning, everyone. Welcome to our fourth quarter results presentation. I am going to take you through the business first and then let Adrian talk about the numbers. And then we'll summarize in the normal course of events, and then we'll take some questions.

So starting with an overview of the business. As John said, 2008 has been a very good year for us and we achieved 6% overall revenue growth, which is 8% growth excluding the impact of Plus. After a tough first quarter we took some clear management actions. And we finished the year with a stronger business as a result. In Orthopedics we achieved better alignment in both Reconstruction and Trauma, creating better focus of our business with our customers. Although Europe was held back by Plus somewhat, our US Reconstruction business had a strong finish to the year.

I'm pleased that we've settled with the Plus vendors. We achieved a significantly earlier settlement than we expected. And we achieved better revenues than we anticipated. And now we can concentrate on achieving the full benefits of this acquisition.

In Endoscopy we enhanced the US sales force management and are investing in our US sales force. In both Orthopedics and Endoscopy we've made progress during the year and have ended the year with stronger, better motivated sales teams in both of these businesses.

Advanced Wound Management. They had their best year of revenue growth for five years. And it was led by strong performance in Europe. We have more work to do in the US and on Negative Pressure Wound Therapy specifically, to deliver the full potential of this business going forward.

We merged our Biologics capability into one business unit to achieve critical mass under central leadership. And this is clearly one of our investments for our long-term future.

As far as EIP is concerned, we've made some excellent progress this year, and our earnings improvement program has given us a head start in adopting the mindset that I think we need to win and weather the difficult economic conditions and meet our margin targets for 2010. We're nearly two years into the earnings improvement program now, and we have many ongoing projects to re-engineer our business processes for sustainable, profitable growth. We've started to combine many of the back office functions so that we can leverage our scale while maintaining entirely customer-focused sales and marketing teams. And we're calling this our 'One Company Program'.

Now moving on to look at each of our businesses in turn. In Orthopedics revenues grew 6% in the quarter and double digit growth in the US. In Europe the impact of Plus continued to be evident in our revenue growth rates. In Reconstruction we achieved growth from our Hip and Knee businesses and achieved good operating leverage across the business. Our Knee business had a real benefit this quarter, and the year, from both Journey and Legion ranges, which are being very well received by surgeons. Our Hip revenues grew 5% globally, benefiting from early growth from the R3 Acetabular Cup, and sales of our Anthology and Synergy stems. We estimate that BHR has captured about 3% of the Hip market share.

Europe continued to be impacted by Plus in the quarter although at a slower rate than we had envisioned in early 2008. With more certainty around the numbers we're changing our guidance on the lost revenues from Plus to \$80m from the original \$100m.

The work in our US Trauma sales force has paid off and can be seen in the 13% US growth for the quarter, although it should be noted that a large military order was taken in the quarter. Our nailing systems, particularly Intertan, continued to perform very well for our businesses.

Clinical therapies had flat revenue growth as continued pricing pressure contained the growth in that business. Durolane performed well outside the US and we continue to work towards FDA approval on the single injection product.

The EIP work in Orthopedics has been broad-based and includes new distribution centers in the US and Europe. The actions we took have achieved significant margin improvements from the centralization of services which have been temporarily masked this year by Plus and compliance costs.

Compliance has been a big feature for us in our business, especially in Reconstruction. And it's been led by Joe DeVivo. And he's done a great job in making sure we are and continue to be a compliant business. We've invested heavily in compliance this year and expect these costs to continue. We do believe that compliance produces a level playing field, and that Smith & Nephew will benefit from this in the longer term.

Now if we look at Orthopedics for 2009, to date we have not seen a noticeable fall-off in demand of our Orthopedic business. Clearly the baby boomers will continue to wear out their joints and accidents will continue to happen, underpinning the long-term growth in demand for our products, which enable our patients to return to their active lifestyles. We will continue to get benefits from recent product launches. And we're very excited about the wider launch of R3, our universal Acetabular cup and the continued growth from Journey and Journey Deuce.

In Europe, we expect now to fully realize the benefits available to us from Plus, from both increased revenues and reduced costs. We are rationalizing costs and products, and we'll drive growth from the combined product bag and sales forces. As a separate note, those of you attending the AAOS, Plus needs will be featured at AAOS this year. The anniversary of the Plus issues in Q1 and Q2 will see the start of return to growth for Plus revenues.

Turning to Trauma, we expect revenue growth from our strong product offering and the changes we made in the US and in Europe as a result of not having the Plus effect. We expect to be able to increasingly leverage our management structure and invest in the talent of our sales force during the year.

Earnings improvement program for Orthopedics in 2009 is focused on executing our plans and laying a base for continued improvements through 2010. This will include operations. It will include manufacturing benefits and process efficiencies as well as gaining operational leverage from the merger of the Reconstruction and Trauma business teams.

Turning to Endoscopy. Endoscopy had a good quarter as Arthroscopy performed well, driven by Repair, which grew some 21% in the quarter, and an improvement in Resection. We've recently launched a new resection product, bringing further innovation to the segment, a product called the bone cutter electroblade, we believe has benefits for the surgeon in reducing procedure time and for the patient in faster healing. Visualization revenues grew more slowly in the quarter. Mike Frazzette and his team have achieved good margin drop through from operational leverage in the quarter. Product and geographic mix made a significant contribution to the expanded margin in the year, dampened by some one-off costs in both litigation and IP protection.

Now the business drivers for Endoscopy were really an extension of the activities of 2008. The changes we made in our US sales force will continue to drive growth in 2009. The management team have done a lot of work on alignment and motivation of the sales force which we expect to benefit from this year. This work on alignment is a good example of our Group-wide work as part of EIP.

Outside the US we are investing in training and development of the sales force to drive continued growth in these high potential markets, and markets that we have historically performed very well in. Endoscopy has the most exposure to elective procedures in the Group and we expect

some weakening of demand during 2009. As market leader, we expect to be able to continue to grow the business and are investing in 2009 to enable this growth. We expect capital equipment revenues to continue to be impacted by the weak economic conditions.

Innovation and product development will continue to drive revenue growth for Arthroscopy, particularly in the Repair segment.

And now let me turn to Advanced Wound Management for some comments. In the year Advanced Wound Management had its best growth in revenues for five years as the business grew globally. The leadership team, led by Joe Woody since 2006 is performing well for us. In the fourth quarter Europe and the rest of the world had strong growth. In the US some destocking by distributors pushed the growth down somewhat.

Exudate Management, mainly the Allewyn products ranges, grew globally by 2% with outside the US generating double digit growth. The Infection Management segment grew by 13% in the quarter, driven by Allewyn AG. Negative Pressure Wound Therapy is still very much in the early adoption phase of the product lifecycle, but it grew its billing accounts by 17% in the quarter. We're making excellent progress and we're building a strong base of pump rental income as well as disposable sales.

Advanced Wound Management has a big agenda for 2009. The management team are very focused in the US in building a substantial business in this continued under-penetrated market for us. In Europe we will continue to build on our market leading position. We're very excited about the big opportunity that Negative Pressure Wound Therapy is for us, as you are as well. But just to remind you it is small in the context of this business as a whole. The margin improvements planned for Advanced Wound Management include manufacturing savings. And in November last year I showed you some photos of essentially some walls and a dirt floor and a roof, the shell of our new factory in China. And as you can see from these recent photographs taken a few weeks ago that we have made some very, very good progress. This is moving along very well. We have machinery in place and our project teams are there and are making very, very good progress.

So turning to the outlook for the business. We expect that the long-term demand for our products will continue to be strong, even in the weaker economic circumstances, although there will continue to be quarterly variations at times. Pricing may well become tougher, although it is hard to determine to what extent and when this might happen. Some things are unchanged. Demand for our products will continue and is in many of our business segments resilient. Innovation that delivers a customer benefit will be rewarded. And that's something we're very good at.

Our strategy is to be at the -- or close to the market leadership in all of our business segments and to use that market leadership to deliver sustainable, profitable growth. Our key objectives for 2009 are to maintain market growth in Reconstruction, drive for sustainable above market growth in Trauma, in Endoscopy continue to increase our focus on our US revenue growth, and in Advanced Wound Management to deliver on improved revenue growth in the United States where we are relatively under-penetrated versus where we are in other parts of the world and continue to build the market presence for Negative Pressure Wound Therapy. And also continue to improve our margins towards our 2010 targets.

Our EIP work, our earnings improvement work, has already put us ahead of the curve in developing the mindset I think we need in order to win in this economic climate. We've had a very tough look at our cost structures. We have volume-based contingency plans in place. And we're ready to go if we find that economic conditions are harder for us than we currently anticipate. That's why we're confident about our overall profitability targets.

And with that, I'd like to turn it over to Adrian Hennah to take you through the numbers. Adrian.

Adrian Hennah - Smith & Nephew - CFO

Thank you, Dave. And good morning, ladies and gentlemen.

So turning to the next slide, which is number 16, and the income statement. Revenue in the quarter was \$960m. This represents underlying growth after adjusting for exchange rates of 7% on the comparable period last year, a reported decline of 1% given the strength of the dollar. We estimate the loss of Plus sales reduced revenue growth by about 2% in quarter four. We estimate that sales of \$17m were lost in the quarter, giving a total of \$64m in 2008.

There were two more selling days in quarter four 2008 compared to quarter four 2007. Excluding the impact of lost Plus sales and the impact of the extra selling days, we estimate that sales grew at constant currency by about 7%. On the same basis sales in the full year grew by 8%.

Trading profit in the quarter was \$222m, representing an underlying growth of 8%. The underlying trading margin grew slightly in the quarter on quarter four last year. We estimate that trading profit was reduced by about \$9m as the result of lost Plus sales and related costs. But for this effect quarter four trading margin would have increased by 50 basis points, mostly due to the slightly lower R&D spend.

In the full year, adjusting for the consolidation of Plus and for the impact of the lost Plus sales, was an underlying margin improvement of 50 basis points.

Included in the GBP21m -- excuse me, \$21m charge for the amortization and impairment of acquisition intangibles is a \$14m impairment charge in respect of the OBI acquisition which we made in 2006 at a cost of \$72m. The impairment arises as we now expect it to take longer to get approval for one of the indications of one of the products acquired.

R&D was 3.9% of sales in quarter four, a decrease of 0.4% on quarter four last year. For the full year it was 4%, a decrease of 0.2% on '07. We've begun to focus more on Biologics, but this has been more than offset in terms of spend by delays in development efforts as we have focused on putting the full processes in place required under the deferred prosecution agreement in the United States.

Moving to the next slide, and further down the income statement. The tax charge in quarter four before exceptionals and amortization, is 28.3%, lower than the rate we expected for the full year due to a couple of settlements. The rate for the full year is 30.6%.

We announced two weeks ago that we had reached agreement with the vendors of Plus on an adjustment to the price paid for the company and a release of most warranties. This agreement is not reflected in the 2008 numbers as it was not reached until after the year end. We will account for the transaction in the quarter one numbers. We expect that the CHF159m cash received will be reflected principally in a reduction in the goodwill attributed to the transaction, partly in a provision for certain tax liabilities for which we are now liable.

Part of the monies received compensate us for costs incurred in investigating and resolving the issues. We're charging about \$15m of such expenses through exceptional costs associated with the integration. Accounting rules do not allow us to credit the recovery of these expenses through exceptionals. As a consequence, total cash costs of integrating Plus are likely to be slightly higher than the range of \$60m to \$80m that we gave at the time of the acquisition.

Adjusted attributable profit for quarter four was \$147m. Adjusted earnings per share were the same as quarter four last year. This occurs despite an underlying 8% growth in underlying trading profit, due to the strength of the dollar. The dollar was 9% stronger than the euro in quarter four this year and quarter four last year, and 23% stronger than the pound sterling.

Turning to the next slide, slide 18 in the pack and an analysis of revenue by business segment. You've heard from Dave on the progress of each business. On this schedule you can see the growth rates in the quarter to which Dave referred for each of our business segments.

And turning to the next slide, which is an analysis of revenue growth rates by segment and by geography. Constant currency growth rate in our Orthopedics business in the quarter was 6% before adjustment for the sales practices that affect all the extra sales days. Hips grew at 5%, Knees at 9%, Trauma Fixation at 6% and Clinical Therapy was flat. In the United States overall growth was 10%, including of course the benefit of the extra sales days. Growth in the Knee business was 15%, benefiting again from good growth in the newer products. Hip growth was 8%. Trauma Fixation growth in the US improved again to 13%. This is we expect slightly ahead of the Trauma growth rate in the USA in quarter four which was our target when we brought the Recon and Trauma sales forces together in quarter two. However, growth did benefit from both the extra sales days and, as Dave has already mentioned, from a significant military order in the quarter. Clinical therapy sales grew by 3%, impacted again by pricing pressures on Supartz and also by a strong comparatives.

In Europe, Ortho sales decreased by 2%. Adjusting for the \$17m lost Plus sales Ortho achieved a sales growth of 7%. In the rest of the world Ortho sales grew at 11%. Like-for-like pricing in our Orthopedic business in the USA and outside the USA was again slightly negative in the quarter.

The Endoscopy growth rate was 9%. Within this Arthroscopy grew by 10% and Visualization related sales grew by 7%. Sales grew in the United States at 5%, in Europe at 12% and rest of the world at 16%. Visualization capital sales in the USA within these numbers fell by 7%, impacted by a marked contraction in hospital capital spending. The small level of sales of a capital nature within Arthroscopy were also weak in the quarter. We expect this weakness to continue until market conditions change.

Wound sales grew at 7% in the quarter, including a contribution from NPWT sales, for a total growth of 2%. Total Wound sales fell by 3% in the United States, grew 9% in Europe and by 11% in the rest of the world. Sales in the United States were impacted by decline in wholesale inventory levels, which may in part be a response to macro-economic and market conditions.

Turning to the next slide, this shows the usual analysis of revenue and trading profit by business segment. As we have already noted, the underlying trading margin for the Group was up slightly in the quarter, and would have increased by about 50 basis points but for the lost Plus sales.

As mentioned earlier adjusting for the effect of consolidating Plus and for the impact of the lost Plus sales, the full year also shows an underlying margin improvement of 50 basis points. This is less of course than the average 100 basis points per annum that we are targeting until the end of 2010. We have made good progress with our EIP, as Dave has already mentioned. And we've also invested materially in the NPWT launch and incurred additional compliance costs.

The Ortho margin fell by 50 basis points in quarter four. As we signaled last quarter, we incurred around \$30m in incremental compliance costs in the full year, with about a third of this sum in quarter four. The Endo margin increased by 150 basis points in quarter four on the prior year. We did not see the legal and business development costs, which has held back margin in earlier quarters.

Margin in Wound was 30 basis points higher in quarter four as the year-on-year drag from the NPWT investment begins to fall away. NPWT was, as expected, again loss-making in quarter four.

Turning to the next slide and summary cash flow statement. We generated \$82m of free cash flow in the quarter. After the payment of the interim dividend of \$44m and a small net exchange movement, this led to net debt of about \$1.33b at the end of the year. Capital expenditure in the full year was \$289m, with the largest part investment in instruments. Restructuring spend on EIP program and on the Plus integration were in line with expectations.

As mentioned, net debt as at December 31 was \$1.332b. Since the year end we have received CHF159m from the vendors of Plus. And having suspended our share buy-back we will of course be using the free cash flow to repay borrowing.

You will see also from the balance sheet that the retirement benefit obligation or pension deficit has increased from \$184m at end 2007 and \$183m at the end of quarter three this year, or Q3 2008, I should say -- to \$350m at the year end. The main reason for the movement since the last year end is a fall in the value of assets in line with falling share prices. About 55% of the assets of the UK fund are held in shares, and about 70% in US funds.

At end quarter three this reduction was compensated by a fall in the value of the liabilities due to a significant increase in the AA corporate bond rate. At year end we have used a lower rate than quarter three of 6.1% in the UK. This is of course still higher than the 5.8% of the last year end.

Turning to slide 22 and the outlook for 2009. Dave has made some comments on this, and on our views on the overall market growth. I will therefore confine my remarks to performance compared to market. In this regard we see no significant change in the trends of the last few months.

In the Orthopedic Reconstructive area we believe that underlying global market growth declined slightly to around 6% in quarter four. We expect our Recon growth to be around market growth in 2009.

Within Orthopedic Trauma we estimate that global market growth continued at about 10% in quarter four, although Synthes is yet to report. We exceeded our goal to return to market growth rates in the USA by end 2008, but as mentioned, with the help of some extra sales days and a specific large order. We expect to achieve a sustainable market growth rate as the year progresses.

Within Orthopedic Clinical Therapies, we expect continued good growth from Exogen. The sales progression of our hyaluronic acid products will likely be impacted by the timing of approvals in the USA for our one injection product and for competitor one injection products.

We previously signaled that as a direct result of the Plus sales practice changes, we expected a reduction in revenues in a full 12-month period of about \$100m across our Orthopedics business, and that the impact on 2008 revenues to be somewhat lower than this. The direct impact in 2008 was a reduction in revenue of about \$64m. We now expect the effect in a full year period to be less than \$100m, perhaps \$80m.

Within Endo we are looking for ways to improve on the slightly below market growth in 2008 in the 80% of the business addressing the Repair and Resection markets. But we do not expect to achieve full market growth in 2009. We expect to see continued strong performance relative to the market in Repair, with a strong portfolio of products and a strong sales and service infrastructure.

Within Wounds we expect to grow as in 2008 at or slightly ahead of market growth in areas excluding NPWT.

As far as margins are concerned, we remain focused on achieving our earnings improvement program target with a margin of 24.5% as the annualized exit rate from 2010. As signaled in previous quarters, we expect a further small short-term impact on margins from the lost Plus sales and the NPWT launch. We expect to have ended the margin impact of the lost Plus sales through cost reductions by towards the end of 2009. We continue to expect breakeven on our NPWT sales to be a few quarters away and that they will be materially profitable thereafter.

A quick comment on some directly financial items. We expect a tax rate in 2009 of 31% to 32%, very slightly higher than the 30.6% in 2008, which as I've mentioned, benefited from some favorable settlements in quarter four.

We also expect an effective interest rate on our net debt slightly lower than this year's effective rate at around 4%. We expect other finance costs which are principally the notional funding costs associated with the defined benefit pension funds of around \$8m. This is higher than the 2008 income of \$2m due to the larger pension deficit and the slightly higher discount rate used in the future pension liabilities.

We expect a charge for amortization on acquisition intangibles of about \$40m in the full year. We expect capital expenditure be slightly higher in 2009 than 7.6% of sales in 2008, with investment in the IT systems and the second China factory as part of the EIP as well as the usual investment in instrumentation, all featuring prominently.

A quick comment also on the impact of currency movements, given the significant movements there have been recently. Clearly those recent substantial movements in the value of the dollar against most other currencies will continue to have a significant impact on translational exchange movements during the year. We've again included in the appendices to this presentation the main exchange rates in past quarters and the principal geographic sales split for your ease of reference.

We have also as you know some, but limited, transactional or economic currency exposure. Across the Group as a whole the currency of our SG&A and R&D spend broadly matches that of our revenue with a slight US dollar and sterling, and a slight Swiss franc orientation from the location of our development activities and business unit headquarters.

We do have a dollar orientation to our cost of sales in Ortho and Endo with around three quarters of cost of sales in dollars. We also have a sterling orientation to our Wound cost of sales with around half Wound cost of sales in sterling. Given that only around 50% of our revenue in Ortho and Endo is in dollars, and only 15% of our Wound revenue in sterling, we do have some transactional currency exposure, although the effect is muted as cost of sales accounts for less than 30% of sales across the Group. And the impact is also delayed by the inventory cycle and by foreign exchange cover, which together give rise to a lag of around nine months before impact on the P&L.

Finally a comment on phasing. We've again included in the appendices a schedule showing the number of business days in each quarter with the same number of business days in 2009 and the year as a whole as in 2008, but one fewer in each of quarter one and quarter two, and two extra again in quarter four.

And with that outlook for 2009, I'll hand back to Dave.

David Illingworth - Smith & Nephew - CEO

Thanks, Adrian. 2008 was a year that we faced some considerable challenges, many of which I'm confident that we've put behind us. We've also faced some costs to make sure that we continue to be a fully compliant business. And I'm confident that we've achieved that goal. Compliance is a very strong focus for our business. And we have a comprehensive program to deliver this. A level playing field is going to be good for Smith & Nephew.

Overall we've achieved a good outcome for 2008 and we've built a base with our earnings improvement work, and have additional plans in place to deal with tougher times in our market if they arise.

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We don't see our business as immune to economic conditions. But we do believe that the benefits that we provide to patients and health providers in enabling people to return to an active, productive lifestyle, will enable us to be resilient in this difficult macro-economic environment. Our market positions in our resilient markets are strong. Our product bag is world-class. And we're excited about the products we're going to bring to the market. And we have a management team clearly focused on the execution and delivery of our plans.

We look forward to 2009 with confidence that we can deliver revenue performance at or around market growth rates across our businesses and continue to improve our margins through our earnings improvement work to deliver our 2010 target.

So with that, I am happy to take questions. We'll use our usual system of taking questions. And again, I would ask if you would please limit your number of questions to a couple, or two, to allow as many people as possible the opportunity to participate. Can we have our first questions from the caller, please?

QUESTION AND ANSWER

Operator

Thank you. (Operator Instructions). The first question comes through from the line of Michael Junging. Michael, your question, please.

Michael Junging - Merrill Lynch - Analyst

Good morning, everyone. I have a couple of questions. The first one is, can you please give us an indication when you feel that Negative Pressure Wound Therapy will break even?

The second question I have is in relation to compliance costs and the DoJ settlement. With the agreement expiring in Q1 of 2009, could you give us an indication of how this will impact your monitoring costs that you've incurred in 2008?

And then the third question is, can I just get a sense whether the additional compliance cost that you've incurred, the \$30m, did that peak on an absolute basis in the fourth quarter of 2008? Thank you.

David Illingworth - Smith & Nephew - CEO

Alright, we'll take a shot at those three questions.

First of all, in terms of Negative Pressure breakeven, we haven't given any definite dates for breakeven. But what we have said, what we said last time still holds true, that we expect Negative Pressure, if we continue to make good progress on revenue growth progressions that we're seeing, that it will take a few quarters. And we'll leave it to your interpretation of what a few quarters mean. But it's -- it really is a few quarters.

I think if we get into the predicting game there, it's certainly not useful for us, because we want to have the flexibility to do the right things. We think there's some long-term value in this business and real long-term value in this business for us as a Company. And I think the reason why the Group keeps asking a lot of questions about Negative Pressure is because I think you also recognize this as something that has real long-term value for the Company.

As such we need to have the flexibility to invest it in a way that we think is going to be best for the long-term success. And that's what we've been doing. So we see it over the next couple of -- next few quarters to reach a point where we can get to a breakeven point on that.

In terms of compliance costs, there are a couple of questions in there, Michael. We haven't -- what we've said is, we've spent \$30m last year. We wanted to give some transparency. We thought it was important so you could make some sense of some of the margin impact. I would think that those costs have peaked in the fourth quarter. I don't think that's much of a stretch. So I think I can go out on a limb on that. I do think they have peaked.

We're not giving any kind of firm guidance on what we might spend on an absolute basis in 2009. Because essentially we're spending what we need to spend in order to make sure that we have systems and processes in place to have a fully compliant business. It's not just the Department of Justice actions in the US that we're concerned with. We want to make sure that we take the learnings from the deferred prosecution agreement in the US that all medical device -- all the orthopedic companies have gone through, and apply it to our global businesses so that we have strong assurances that we have high predictability in a compliant business on a global basis and we've been putting a lot of effort into that.

Adrian Hennah - Smith & Nephew - CFO

I think that David, certainly within quarter -- within 2008 quarter four was the peak. About a third of that \$30m was in fact in quarter four. But as we said at quarter three, it would be inappropriate to think there's going to be a big unwinding of that \$30m level as we go forward. This nature might change as the monitor falls away, but it would not be right to think there's going to be a significant fall in aggregate for compliance spend.

Michael Junging - Merrill Lynch - Analyst

Adrian, the market does expect in general for the industry to have some savings as a result of the ceasing of those monitoring costs. Is it fair to assume that you will have some benefit to margins as a result of the expiry of the agreement?

Adrian Hennah - Smith & Nephew - CFO

I think we'll repeat what we said last quarter, Michael, and that is that yes, the specific costs associated with the monitor may well go down. Well, it will if there's not a monitor. But that is not the only cost. We, and we suspect frankly that there are other companies in the industry (inaudible). We are for example rolling out globally what we're calling an enhanced global compliance program which has another sets of costs associated with it. So in the round the guidance we gave last quarter and would repeat now, is do not expect in aggregate from the incremental compliance costs a significant boost to margin from their reduction.

Michael Junging - Merrill Lynch - Analyst

Great, thank you.

David Illingworth - Smith & Nephew - CEO

Thanks, Michael.

Operator

The next question comes through from the line of Julien Dormois. Julien, your question, please.

Julien Dormois - Exane BNP Paribas - Analyst

Good morning, gentlemen, can you hear me?

David Illingworth - Smith & Nephew - CEO

Yes, we can.

Julien Dormois - Exane BNP Paribas - Analyst

Yes, okay. My first question would be actually on the share buy-back. You've not signaled anything on that front. Should we expect it to restart in the course of 2009?

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And the second related question is depending -- is on the cash flow used. Do you plan, are you still in a mood of acquiring companies in 2009? So what is your policy on external growth for the year to come?

And the last question would be on the next significant product launches in 2009. We've not had the slide in the presentation, the usual slide in which you present your launches. So can you give us a bit more flavor about that? Thank you.

David Illingworth - Smith & Nephew - CEO

Do you want to launch into the -- launch into the first two parts of that?

Adrian Hennah - Smith & Nephew - CFO

Sure. Yes, in terms of the share buyback, when we said we were suspending it a couple of quarters ago, I think we said until -- we would review it when markets become more normal. I'm not quite sure they've reached that state yet. So we're keeping it under review. It's not imminent or high on our agenda. At some point in the future we'll look at it again. But I don't think there's going to be any change in the near term on that.

In terms of the use of cash flow, yes, we are focused on using the cash flow to pay down the debt. We are very much focused on the operational effectiveness of the business at the moment as Dave just said and that is our priority. We will not rule out bolt-on acquisitions as they come along and they're attractive. That may be a use of it. But it's not high on our mind at the moment.

David Illingworth - Smith & Nephew - CEO

Yes, in terms of the product launches, actually we're very consistent with what we've done this time. We typically don't go into that at this meeting because it's so close to the Academy meeting, the American Academy of Orthopedic Surgeon meeting where we will be rolling out products in just a few weeks.

So you're right to observe that we don't have that chart that is in there three times a year, three out of the four times. But we will clearly be rolling out our new products at the Academy meeting in a few weeks' time in Las Vegas. I hope to see many of you there.

Julien Dormois - Exane BNP Paribas - Analyst

Thank you.

David Illingworth - Smith & Nephew - CEO

We're going to take some questions in here? Okay. I think we'll wait for a microphone [Hans] so we can --

Hans Bostrom - Goldman Sachs - Analyst

A few questions as well. First of all with regards to cash conversion which made a substantial improvement in 2007 that seems to have fallen back and increasingly so in 2008. Could you give us some explanation for that and how you see that developing in 2009?

And secondly, I sense that you are somewhat more conservative with regards to the Reconstructive business in 2009, given that you are coming from a pretty strong growth rate in 2008. Can you give us a sense of what is the potential challenge that you are facing in 2009 that we haven't had this year?

And if I may, a third quick question is really the margin difference between the capital and the consumable business in Endoscopy, is it fair to assume that actually you have a product mix improvement helping your margins in Q4 as well? That could be helpful for future forecasting, to get a sense of the difference in margins. Thank you.

David Illingworth - Smith & Nephew - CEO

Okay. Thanks, Hans. Let me take the one about the growth rates in Reconstructive. Then I'll turn it over to you to talk about the cash conversion and while you're at it you can talk about the margin in '09 also. I'm not sure we're going to be able to give you a lot of information there.

Clearly there was some product mix shift, just due to the fact that our capital side of our business was weaker and our Repair side was stronger. So you can figure that one out pretty quickly by what we've said in the announcement that we grew our Repair business by over 20%. And so we were pretty happy with what was going on in the bulk of that business. And we also saw a return to growth in the Resection business which actually neutralizes that somewhat because our Resection margins are typically a little bit lower.

The -- but the capital equipment side was weaker. I think that's probably about as much as is helpful to pass along to you. There was a lot of activities in the fourth quarter due to the fact that we were uncertain about what was going to happen with capital equipment. So we took a lot of action to make sure we controlled our costs, spending, discretionary spending, travel, things like that. We were -- we used a lot of good judgment on trying to make sure that we could impact our margins favorably if we were faced with some softening in that business. And we told you right up front that we felt like the Endoscopy business was probably the business that we'd have a leading indicator on in terms of any kind of softness in the market due to the elective procedures.

In terms of the Orthopedic growth rates, I think it's a nuance, it's a subtlety, what we're doing. We've always -- we've pretty consistently said that we're going to grow at or slightly above market growth rates over the last couple of years in that segment, and we were going to focus on execution and making sure that we did what we needed to do to drive the margins in the business because we felt like the time was right to do that. We're still investing in that business in a big way

You may be detecting a little bit of conservatism, due to the fact that we are still trying to figure out what exactly might happen in the market itself in terms of any deferral procedures, and trying to understand what the market growth rates are going to be.

I'll let you comment on the cash convergence piece.

Adrian Hennah - Smith & Nephew - CFO

Sure. Yes, cash generation really is slightly higher in 2008 than 2008. I am not sure there's a dramatic difference year-on-year albeit profitability was also up too.

The main reason the relatively -- relative to profit it's down slightly is, of course, capital was higher, and within that it was mainly instrumentation that was up. That does tend to be slightly lumpy year-on-year. So I'm not sure there has been a dramatic year on year change to be honest Hans, when you look at the numbers.

Looking forward we will see fluctuations in capital expenditure. We do actually expect capital might be slightly higher in this year than it was last year. Not driven so much by instrumentation, but driven by the fact that we are -- we have this factory spend peaking under EIP for our Chinese factories.

And we do also expect a reasonable amount of IT spend, because we are very much focused on improving processes and systems and that does need an IT underpinning. Not signaling anything dramatic here, but just in terms of slight tendency.

The area of use of capital, which probably is getting our closest attention, is inventory. We have \$900m odd of inventory which people come from other industries and they say, excuse me, that's 80% of cost of sales, isn't that rather high?

Now in our industry obviously it's a hugely important part of the business model. Notwithstanding that we are paying close attention to how to -- or will be paying closer attention to how to improve on that. So it is subject to attention, we will -- we'll look at it.

Hans Bostrom - Goldman Sachs - Analyst

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Can I just briefly follow up on Dave's comments on the Reconstructive business? Should we read your statement that you expect to grow in line with the market as an interpret -- well as your view that you don't really know if the market is likely to hold up at this rate? And you are happy with a mid-single digit growth rate?

David Illingworth - Smith & Nephew - CEO

No, actually Hans I think you should take it as a comment that is extremely consistent with what we've said for years now. For the last several years what we've giving guidance on in our Orthopedics Reconstruction business is that we expect -- once we started the margin improvement programs that we expect to grow at or slightly above market growth rates. And anything more -- I think if anything it's a signal that we continue to provide that same level of guidance.

We do have some uncertainty as to what the market will be. We are not -- we haven't seen anything that would raise our eyebrows in terms of -- for our own business. But we are reading the same -- we are reading your reports from other companies.

And some of the other companies are detecting that there might be a slight softness in the fourth quarter in the Orthopedics revenues and procedures. So, we're watching it. I wouldn't read too much into it Hans.

I think it is a reaffirmation that we believe that we have a strong Orthopedic Reconstruction business as we always have. And that we'll, even with the profit improvement initiatives we have, that will continue to grow at market rate or slightly above.

Hans Bostrom - Goldman Sachs - Analyst

Okay, thanks.

David Illingworth - Smith & Nephew - CEO

Yi-Dan, let's get the microphone over here.

Yi-Dan Wang - Deutsche Bank - Analyst

Thank you very much. I've got a couple of questions, first of all on Negative Pressure Wound Therapy. How should we think about your go-to-market approach there in terms of the penetration that you expect to, I suppose, reach? Just in terms of how -- what percentage of the customers you've targeted already, and how that would change in 2009.

And then in terms of the absolute cost base of that business, should we expect that to be relatively stable compared to 2008? Or should we expect a further pick up in the cost there as you roll out some of these additional new products, and perhaps target new accounts?

The second question is the relocation savings of your Wound factory. Can you give us some sense of how significant that would be? Clearly there is a big difference between where you are going make those products and where you are making those now. Thank you.

David Illingworth - Smith & Nephew - CEO

Okay thanks. Okay, before I get to your second question let me hit your first four. The -- on Negative Pressure Wound Therapy what I would take is the same answers and guidance we've given you in the past on our go-to-market plan.

We are -- we started from zero. We started from having no sales people, no products managers, no development folks, no partners for logistics, no service ability, nothing. And it's -- we have to transport ourselves back in time, not very far, to where we started.

So we're on a pretty steep curve in terms of investing in that business to get the infrastructure. And we're trying to do it in a way that our investment matches our growth rates. In a perfect world that's what we want to do Yi-Dan.

And we are sort of paying and playing as we go. We have had a couple of areas in 2008 that -- opportunities that presented themselves that we felt like we wanted to take advantage of. We took advantage of the fact that we were getting very early acceptance of us being in the marketplace, and getting good signs. So we decided to invest at a slightly higher level than we originally planned, and we had the resolve and commitment to do that.

We also felt like we had an opportunity to aggressively defend some intellectual property rights that we had in terms -- in the US with some of our products, specifically the gauze products.

And we now also believe that we have the opportunity to offer our customers an even wider choice, not unlike what we've done in our advanced bearing surfaces in Reconstructive, where we have the widest range of advanced bearings of any company in the world. Our feeling is give the customer the choice if we can.

So we're going to take those opportunities as they come, and make -- hopefully make good long term business decisions about what we should be doing in that business.

I don't believe our plan has changed significantly. We've learnt a lot along the way. It is a steep learning curve for us. And we have an entrenched competitor and they are fighting very hard. And they have a lot to lose and we have a lot to gain.

So, it's a good old fashioned -- we have a good old fashioned fight on our hands. But we feel very good about the progress we are making. And we'll continue to invest in that business commensurate with our ability to compete and win in the marketplace.

In terms of the percentage of customers targeted, well, ultimately we want to target them all. But that's not practical when you start from ground zero with zero, and that's where we started. So actually the percentage of our customers that we target changes all the time. We continually are -- have the ability to target more customers.

Our strategy might change a little bit and has. And I am not going to give you a lot of details on what our strategy is. But we went after a certain type of customer early on in the process and we've adjusted our strategy and our tactics, so that we believe that we can be more successful going forward.

And I think you are seeing it being -- it paying off. We continually increase our revenue and our base. We -- every day we get another report of another big win. Every day we launch another big fight and battle with the market leader. We are in it for the long term.

Cost base, I don't think you should see it as stable at all. I just made the comment. I think that it's going to be commensurate with what the opportunity is. And our judgment as a management team about how we should be investing in this business versus all the other choices for investment that we have at Smith & Nephew. So I don't -- I think it would be wrong to think of it as stable.

Adrian Hennah - Smith & Nephew - CFO

I think that's right. But I suspect behind Yi-Dan's question is as the sales go up are we going -- is there going to be a gearing to profitability? Yes there is. Clearly there is. We don't expect costs to grow except cost of sales -- in line with sales. There'll be some increase in costs but nothing like -- not a step increase in [position].

David Illingworth - Smith & Nephew - CEO

The Wound factory, we are making great progress. I am not sure what was behind your question there. We've built up some inventories to make sure that we do this properly. And it doesn't have an impact on our business or our customers. So you're probably seeing a little bit of that going on in terms of the inventory levels in that business.

I don't know the exact time we're supposed to be on line but it's a matter (technical difficulty). I'm having some real issues with this thing today. It is -- I got it. The -- it's pretty close to being on line. We are making -- we are right on schedule with the factory. We expect it to decrease our cost of goods.

It's not the lowest -- we didn't go into China because we felt it would be the lowest cost alternative for us to manufacture. It was a -- it was both a lower cost manufacturing move but also a highly strategic move, because we believe that the economy and the market in China over the next decade is going to be significant, and they will be a significant player.

And we believe that given the choice of entering that marketplace, that having a base there, having people there, having skills, expertise, relationships with the government officials, would only service us well to penetrate that market in the future, so it's part of a wider strategy to actually penetrate Asia over time.

Yi-Dan Wang - Deutsche Bank - Analyst

Okay. I have a couple of follow ups. First of all on the Negative Pressure Wound Therapy business, clearly through 2008 the revenues came in slower than we had originally anticipated, and the costs went in.

So going forward, in 2009, should we expect the investments to be sort of close -- more closely matched to your revenue development now? Or should we expect -- obviously we don't know how well those products will be received, but if you could comment on how you're thinking about those investments.

David Illingworth - Smith & Nephew - CEO

Sure.

Yi-Dan Wang - Deutsche Bank - Analyst

That would be great. And a follow up on the relocation question was basically while -- you were making those products in the US. Those came at a cost. How will those costs change once you start to make them in China?

David Illingworth - Smith & Nephew - CEO

Alright, well let me try the first follow up question myself. I think one of the difficulties is a lot of people want to see Negative Pressure as a steady state business. And it is for KCI. It's not for Smith & Nephew. We are building this business.

The reason that we are making these investments, and the reason we're willing to make investments that are higher than potentially what our current monthly revenue might support, is because we believe there's long term value.

Part of the -- a big piece of our job is to make those types of tough decisions about how do we get real long term value in this business and have some resolve to make the tough decision to do it. And I think we did that in 2008 with Negative Pressure.

And it really is going to be a matter of what we think the long term value -- we are not in this for the next quarter in Negative Pressure, we are in this for the next 10 years. We think it's going to be a real growth driver of this business for the next decade.

And if we start looking at it at a quarter by quarter basis and how do we get to profitability as quickly as we can, we are just not going to have a very strong business when it's all said and done, especially when you are competing against a multi-billion dollar monopolistic company in the form of KCI. So I think that's the nature of the decisions we are making. In terms of --

Adrian Hennah - Smith & Nephew - CFO

Yes Yi-Dan, it's not appropriate for us to give you a precise number of the different costs between Largo and a Chinese, our US factory and our Chinese factory.

I can tell you it is material. The lower labor costs, the lower overhead costs are unsurprisingly quite material between Florida and Suzhou. And both labor and overheads are material parts of the total cost of production. So we are expecting it to be material.

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Probably just in terms of timing, as Dave said, we will -- stuff will be coming out of this factory next quarter. But it won't be fully -- a high level of utilization and completely checked and everything until towards the end of the year. And during the course of the year we have offsetting the early benefits, the double running costs, because we'll still have costs in Largo.

So in terms of getting a clean full benefit from this you should be thinking the following year we'll be getting bits coming through, as I say offset by some double costs where we still have some part of Largo open in this course of this year.

David Illingworth - Smith & Nephew - CEO

Thank you. Well we --

Yi-Dan Wang - Deutsche Bank - Analyst

I need to clarify this.

David Illingworth - Smith & Nephew - CEO

Okay.

Yi-Dan Wang - Deutsche Bank - Analyst

Well some of your peers have done similar relocations and they indicate that the cost differential is about 50%. Is that something that we should think of for your relocations?

David Illingworth - Smith & Nephew - CEO

Well I --

Adrian Hennah - Smith & Nephew - CFO

I don't think we want to be drawn on (multiple speakers) Yi-Dan.

David Illingworth - Smith & Nephew - CEO

Yes I don't -- we are not going to -- we don't know what our peers are saying. We'll stand on the original answer Yi-Dan, but thank you. I think we are going to go right here.

Justin Smith - MF Global - Analyst

It's Justin Smith from MF Global, just a quick question for Adrian. If financial market conditions don't improve, and we see the de-leveraging coming through this year, and there aren't really enough external growth opportunities there, how should we be thinking about use of cash? Can the dividend go up, just a bit of color there?

Adrian Hennah - Smith & Nephew - CFO

I think in the short term we will just be using it to pay down debt. Our dividend policy of 10% growth in dollars has been established for some time now, and we haven't got imminent plans to review that. So I think you should just see it as paying down debt.

David Illingworth - Smith & Nephew - CEO

Okay, we are going to go to the callers.

Operator

The next question comes through from the line of Scott Bardo. Scott your question please.

Scott Bardo - Credit Suisse - Analyst

Hi, thank you. Good morning. Just two questions if I may, firstly on Wound I just wondered if you could give us an update on where you are with your US launch in foam. And also could you clarify how important your foam launch is to your profitability predictions for this year?

And secondly also I wondered if you can quantify what percentage of your Ortho margin improvement over the coming years will come from instrument manufacture in China, from general [efficacy] gains, and also from margin improvements you expect from roll out of your premium price products?

David Illingworth - Smith & Nephew - CEO

Okay, thanks for that. Let me take the second question first. I am not sure we know what those percentages are off the top of our heads for what's going to come from where. We are looking at earnings and margin expansion wherever we can get it. And we are looking at it fairly holistically.

Clearly we believe that manufacturing products in lower cost settings are going to give us some benefits. And I am not sure off the top of my head what exactly those are.

Adrian Hennah - Smith & Nephew - CFO

Well, I was going to say on the very specific question of what proportion will come from savings from lower cost instruments in the next two years, very little. Because we are -- this factory is going to be on line in 2010, and then you capitalize instruments and depreciate it. So on that very technical question, not a lot.

David Illingworth - Smith & Nephew - CEO

Yes, and just for clarification the factory that I showed you the pictures of was a wound care factory. It was dedicated to wound care. We have another factory that we have purchased the land and we've started the construction, but it's about a year behind where we are with the wound care, by design.

And it's going to be in the Beijing area, so it's actually even going to be in a different location. So Adrian is right, over the next couple of years the answer to the question is very little.

In terms of the US launch in foam, I think you should look at it as having little impact on our -- what we're saying about profitability and how long it will take us to get there.

This is another -- it's another product extension for us. We think we have the ability to offer our customers a choice. If it takes us a little bit longer I don't think it's going to make a big difference in that area.

So I would have to say that the US launch in foam is really dependent on the court battles that we are going to be getting into with KCI. And I think those are well documented and talked about. And hopefully they'll come to a conclusion pretty quickly, and we'll get it behind us and move on.

Scott Bardo - Credit Suisse - Analyst

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Thank you. Just one quick follow up if I may? Do you expect to be enjoined for wound for other European countries? I just wondered if you'd give some commentary about how we should expect to read through from the UK patent case to the ongoing US trial.

David Illingworth - Smith & Nephew - CEO

We don't think there is any connection really. We've been told there is very little connection. No, we never expect to be enjoined. We believe that we have a strong intellectual property position, as I am sure our competition does. And we are very pleased that we've been able to get a very quick hearing date in the UK, and we are looking forward to it.

Adrian Hennah - Smith & Nephew - CFO

Maybe one bit of clarification, clearly if you want to know about injunctions you've got to ask KCI not us. But in terms of just understanding the UK one where -- which is the only place there is an injunction, it was, as we understand it, from the judge an injunction based on convenience, on the basis that we hadn't launched this product. And the judge wanted a quick hearing, which we were very keen on too.

So the hearing was set for March. And, therefore, on the balance of convenience they said, well you haven't launched this thing, don't launch it and we'll have a quick hearing in March, which suits us. So that was why we have an injunction in the UK, as for [elsewhere].

David Illingworth - Smith & Nephew - CEO

As we are told.

Adrian Hennah - Smith & Nephew - CFO

As does KCI, yes.

Scott Bardo - Credit Suisse - Analyst

Thank you.

David Illingworth - Smith & Nephew - CEO

Thank you.

Operator

The next question comes through from the line of Tom Jones. Tom your question please.

Tom Jones - JP Morgan Securities - Analyst

Good morning gentlemen. I was just wondering if you might be able to give us some color on your ex-US Orthopedic Reconstruction business. Maybe be so kind as to give us the actual growth rates in Hips and Knees. I think backing out from the numbers you gave us it looks like Hips was in the low single digits, and Knees was about flat. It would be nice if you could confirm that.

And then secondly, very quickly, on the Negative Pressure business, you mentioned that your billable accounts was up 17% quarter-on-quarter. I was just wondering if you could give us some idea of what your average bill per account is quarter-on-quarter, and how that's developed?

And then lastly just on the earnings improvement program, given that you delivered an operating or trading profit margin of just over 20% in 2008, and you are aiming to get to 24.5% by the end of 2010, you've got the best part of 400 basis points of lifting to do between now and then.

It would be useful to know how much of that 400 basis points is going to come from things that you can very clearly point at and you've got a very definite and firm control over such as the Wound relocation -- relocation of the manufacturing and other things. And how of it is -- depends on things that are perhaps less within your grasp such as pricing, and the success of product introductions.

And then just sort of following on from that if you look like you are going to start falling short of the 24.5% target by the end of 2010, will you just engage in some outright cost reductions to hit that target? Because as the management, you're pretty much now -- your [color is to the mast] on getting to that 24.5% target.

David Illingworth - Smith & Nephew - CEO

Okay thanks for that. Let me take the last question first and then I'll turn it over to Adrian. You can -- you've got the number sheet out, and you can talk through a couple of the specific numbers on the geographic segments.

Well first of all I think your question about earnings improvement program and our margin expansion is a good one. We -- look, our -- the end of 2010 target of 24.5% is still very much our focus. We believe we are going to achieve it. There are lots of programs that are going on internally and more to come.

We had significant progress in our earnings improvement program in 2008 that are clearly masked by the unusual cost that we were faced with, not only in terms of compliance costs but also in terms of some of the Plus issues that we were dealing with.

And clearly the economic backdrop gives us a -- certainly makes it more of a challenge. It might even be argued that there might even be a little bit higher risk than when we set out to target in February 2007.

And we believe we can achieve it. And we believe we can achieve it because we have real programs that we track every day, in our program office, that show us when and where we're going to get the benefits of the programs that are already in place.

We achieved 130 basis points of improvement in the first year in 2007. And if you adjust for consolidating the Plus lower margins and the lost sales and the cost of the Plus issues that we dealt with, we had 50 basis points improvement in 2008.

So, we feel like we're still on a trajectory to get there. It's not lost on us that we have a bulk of the commitment to deliver. And if we did not have a set of active programs and a highly motivated group of people, clearly focused on this goal, we wouldn't be telling you that we have some confidence that we are going to make it.

So that's probably the best way for me to give you a summary about what we are doing in the earnings.

Tom Jones - JP Morgan Securities - Analyst

Well, maybe I can ask it a slightly different way. If you look like you are going to fall short of that target what's your preferred choice, just to fall short or to engage in just some outright cost cutting measures to hit the target?

David Illingworth - Smith & Nephew - CEO

Well I don't think we are going to be faced with that decision. And there was another part of your question which I didn't answer, which was concerning price and product mix and new introductions.

The majority, the vast majority of the 400 basis points that we committed to in February 2007 and had plans to deliver on were from efficiency gains. They were not from getting higher prices. They were not from new products introductions etc, etc. They really, truly came from efficiency gains.

But we were very careful to say that this was not just a cost cutting program. The reason we called it earnings improvement program is we believe that you can improve your earnings by increasing your sales as well, and being more competitive in the marketplace.

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And we wanted to send the signal that it wasn't just about taking cost. It wasn't just about taking draconian measures and tightening down the hatch on cost in the business, and potentially sacrificing our competitiveness in the future.

There is nothing in -- that could not be further from what we are doing in our earnings improvement program. So I don't think we are going to be faced with it. So it's a theoretical question, a hypothetical question that I would like to stay away from.

I believe we have plans in front of us and visibility to plans and actions that are going to get us to this goal. And that's where we are.

Tom Jones - JP Morgan Securities - Analyst

Okay.

Adrian Hennah - Smith & Nephew - CFO

Good. And in terms of mechanical question you asked Tom. Just let me run through these numbers. Global growth in Hips for us was 5%, which was 8% in the United States. These are quarter four numbers, 8% in the United States, 3% outside the United States.

In Knees 9% global, 15% in the United States, 4% is outside the United States, which gives a total Recon of 7% global, 12% United States, 4% outside the United States. And Trauma was 6% overall, 13% in the United States and a 2% fall outside the United States.

And on your other question of the average dollars per account in NPWT, we are not going to give you that Tom. It's clearly, as you can see from the sort of rough numbers we have put in the public domain, a relatively modest number, which is what you would expect, what we would expect anyway at this stage of the introduction of a product.

We do typically break into a hospital and don't take the whole account. You then have to prove yourself in the round to sort of get a greater share from the hospital. So it is a relatively small number, and certainly on our agenda, it is increasing the dollars per account as much as it increasing the number of accounts.

David Illingworth - Smith & Nephew - CEO

Okay. We'll take some questions here.

Ilan Chaitowitz - Redburn Partners - Analyst

Good morning, Ilan Chaitowitz from Redburn Partners, just a couple of questions. You note that the Recon market exited at a growth rate of about 6%. Is that number also flattered by a 2% boost from the extra trading days?

Notwithstanding that, there was still a noticeable step down in the growth in the recon market in the final quarter. Can you give some indication of what the main drivers are of that in terms of pricing versus volume, and how you see those trends continuing over the course of this year?

David Illingworth - Smith & Nephew - CEO

Well we can't -- we are still processing the information in terms of looking at the market, because the market data is just now coming in for us. We'll have a better view of what we think the dynamics were in the market itself once we process all of your reports, quite frankly, and all the competitive data that comes in. So I am not sure we can be overly helpful on that.

Adrian Hennah - Smith & Nephew - CFO

Well what we can say is we had two extra trading days. It doesn't mean everyone had two extra trading days, because we have different account period ends for various reasons. So I think the overall market number, if you track everyone, is probably less affected. Ours is affected.

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And as we've tried to signal we have a -- we are flattered if you like by those two extra days, two extra trading days in quarter four. Equally we have the Plus effect that goes the other way. So we tend to think that those two just about net off for the quarter.

David Illingworth - Smith & Nephew - CEO

Yes that's right.

Adrian Hennah - Smith & Nephew - CFO

So actually you are looking at an underlying number for us when you take those two things off.

David Illingworth; Yes, so it's pretty close.

Adrian Hennah - Smith & Nephew - CFO

And I actually -- I can't bring -- I don't know the trading days for every one of the competitors, but certain at least a couple did not have two extra trading days.

Ilan Chaitowitz - Redburn Partners - Analyst

Thank you.

David Illingworth - Smith & Nephew - CEO

We'll get the mike over to you here.

Unidentified Audience Member

Just following up on the trading day -- on the Orthopedic market. It sounded as though the military order was slightly exceptional. So excluding that what would the growth have been from the Orthopedic division?

And also on the EIP program are you pulling any additional levers at the moment? And are there any cost implications of that?

David Illingworth - Smith & Nephew - CEO

I don't know if we -- I'll see if we can figure out the first number for you.

Adrian Hennah - Smith & Nephew - CFO

It would be about a 1% less, just under a 1%.

David Illingworth - Smith & Nephew - CEO

In Trauma or --

Adrian Hennah - Smith & Nephew - CFO

Total Orthopedics.

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David Illingworth - Smith & Nephew - CEO

Total Orthopedics right.

Adrian Hennah - Smith & Nephew - CFO

No it's less than that, it's 0.5% less. Sorry I was looking at the US. So for the total Orthopedics it's about 0.5% less.

David Illingworth - Smith & Nephew - CEO

And the other question, I'm sorry I missed it.

Unidentified Audience Member

With the EIP program are you pulling any additional levers, and are there any cost implications of that?

Adrian Hennah - Smith & Nephew - CFO

The guidance we gave for the EIP program at the outset in terms of the cost is unchanged. So we said up to \$120m costs for the full program, that's unchanged and that remains the case. Cash costs that is. There are write-offs, not huge but there are write-offs on top of that. But that cash cost number is firm.

David Illingworth - Smith & Nephew - CEO

But we are pulling plenty of levers.

Adrian Hennah - Smith & Nephew - CFO

Yes.

David Illingworth - Smith & Nephew - CEO

I don't know what additional means, but we are pulling plenty of them. But I understand what your question was, thanks. Over here.

Unidentified Audience Member

Thanks.

Firstly on Negative Pressure Wound Therapy, I think you'd indicated Adrian that about 7% growth in a -- in Advanced Wound Management in the quarter 2% came from Negative Pressure, which gave you sort of \$4m or \$5m number if I do my maths correctly in the quarter, which is similar to Q3. So I am slightly struggling to square that with the 17% growth in billing incomes. Can you help me at all?

Adrian Hennah - Smith & Nephew - CFO

Well you are quite right Martin. We did say that 2% points of the growth in Wound is attributable to NPWT. You can -- you get to it -- your calculation is in the round there. And I am not going to confirm or deny them. But they are -- depending on exactly how the rounding goes it will affect it a little bit. But your broad conclusion about there wasn't a massive mammoth increase wouldn't be a wrong one.

Unidentified Audience Member

Okay. And a much broader question that maybe David wants to take. What, if any, impact do you think the change in administration in the United States will have on your business?

David Illingworth - Smith & Nephew - CEO

Wow. Well let me speak for 2009 for a second, because I guess that's what we all have our minds focused around, because that's the year we're in.

I don't think its going to have a lot of impact in 2009 quite frankly. I think it's going to take a significant amount of time. I think there is a lot of lag in the system. And it's a huge bureaucratic machine.

There's -- they've already had -- the administration has already had some setbacks in terms of healthcare policy advocates and people that they've identified to pick up the mantle. I think that's going to set them back a little bit.

There's really two sides of the story in terms of the debate. One side focuses on an expansion of the healthcare, and access for more people in the US. And the other side focuses the debate around a contraction of healthcare spending as -- on a per capita basis and thus overtaking the expansion and having a bit of a negative effect.

And there is very informed and thoughtful debate and arguments on both sides of that question. And I choose to follow the thought leaders and try to see what's going to happen as it develops.

But I think we are long way off. I don't think we are going to see any impact at all in 2009. And I have a question as to whether or not we'll really see an impact in 2010. So that's about as good as I can do.

Unidentified Audience Member

Let me ask the question a slightly different way and try and extract some numbers.

David Illingworth - Smith & Nephew - CEO

How do you get numbers from I don't know?

Unidentified Audience Member

Well that's what I'm going to try and find out. How many people do you think -- I'll rephrase that. If there was universal coverage in your business areas, what sort of volume uplift do you -- could you anticipate from that?

David Illingworth - Smith & Nephew - CEO

Well what is the number?

Unidentified Audience Member

I don't know that's why I am asking.

David Illingworth - Smith & Nephew - CEO

You folks probably know. What's the number of uninsured --

Unidentified Audience Member

46m or something like that.

David Illingworth - Smith & Nephew - CEO

46m, there's the number.

Unidentified Audience Member

But how much of that directly impacts your business, because clearly that's not necessarily going to be spread in the areas that you operate in? I am guessing that obviously most over 65's have some coverage through Medicare or all have coverage through Medicare. So it's less of an impact --

David Illingworth - Smith & Nephew - CEO

You know it's a really good question that you're starting to head -- it's a good path that you are heading down. We personally haven't headed down that path, because we don't think we are going to see an impact in the short term, and in 2009. And we don't know which side of the debate this thing is going to end up on.

But I think you are on the right path, what percentage of the 46m are going to be impacted for Orthopedics and Wound care. But I am not sure I know -- have much of an opinion on that at this point.

Unidentified Audience Member

And the other -- I suppose the question would be what happens if there was a price transparency bill brought in across all orthopedic devices, or all medical devices. What impact would that have?

David Illingworth - Smith & Nephew - CEO

Yes, I think that's a question that I can give you an opinion on. I actually think it will help us. We -- from what we've seen about the transparency, the language and the bills that are being proposed, I think they are going to reward companies that have -- that can bring products to the market with real economic value associated with them.

And we believe we're pretty good at that. It's one of the reasons why we focused on the younger more active patient, because we believe that, that segment has the ability to sell the argument about economic and clinical value with products.

And when we develop products we think about that. We honestly do think about that. And so -- I don't think the transparency laws or bills are going to be anything but a neutral or a positive for us as a company.

Unidentified Audience Member

Thanks a lot.

David Illingworth - Smith & Nephew - CEO

You're welcome. Okay this -- I think is going to have to be the last question, given the time. Got one more on your end, okay. Maybe not, okay.

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Operator

The last question on the phone?

David Illingworth - Smith & Nephew - CEO

Yes please.

Operator

Okay, the next question is from Matt Miksic, Matt your question please.

Matt Miksic - Piper Jaffray - Analyst

Hi, its Matt Miksic from Piper, can you hear me?

David Illingworth - Smith & Nephew - CEO

Yes, thanks Matt.

Matt Miksic - Piper Jaffray - Analyst

So just a few questions and some of them are follow ups to some of the things you've talked about here, but just to get a clarification.

And Dave, I think you said that we may see -- be seeing a touch of conservatism in your outlook for 2009 around Recon tracking the market instead of maybe tracking or growing slightly faster than the market as you talked about in prior years.

What -- I guess if you are conservative, are you conservative that -- do you feel like the 6% of market growth is conservative? Or do you think that tracking the market growth is the conservative part?

David Illingworth - Smith & Nephew - CEO

Well I think we're kind of splitting hairs on the words here. But let me try to clear it up the best I can. The only thing that we know is that when we look retrospectively we know what the market growth rates are. Everything else is a prediction going forward.

We do believe that we have a difficult macroeconomic environment that we are in. We don't believe that this industry is going to be completely immune to it. And as such we are keeping a watchful eye on what's happening in the market itself.

I would -- we have not predicted what the market growth rate is going to be. We pegged a number that we believe that we -- is prudent for us to budget to. Those are internal numbers obviously.

And we've done some very careful volume-based contingency plans that if the market changes significantly that we will be prepared to react to. So, that's sort of the given in what we are doing.

I think it's a real nuance to say that we are more conservative. And maybe I said it without saying it's a nuance. But we've always said that we're going to grow at or slightly above market growth rates. And what we are saying now is we believe we're going to be able to grow at market growth rates in Orthopedic Reconstruction. It is a slight nuance, but it's slight.

And it is mainly because we're still trying to figure out exactly what impact this economic environment may have on the overall market growth rates, and how that impacts our own growth rates. So that's as really straightforward as I can be with that Matt.

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Matt Miksic - Piper Jaffray - Analyst

Okay. Maybe -- and I guess what I am trying to get at is, is there anything that's changed in your -- is it mix, because mix and price are what's generally absent -

David Illingworth - Smith & Nephew - CEO

No the only thing that --

Matt Miksic - Piper Jaffray - Analyst

(Multiple speakers) [share gains].

David Illingworth - Smith & Nephew - CEO

No the only thing that changed was the greatest global economic meltdown in the last 100 years. Other than that everything else is the same.

Matt Miksic - Piper Jaffray - Analyst

Right. I guess I am talking about the deltas of the market. So nobody can predict, nobody knows. I think that your estimate is as good as anybody's and probably better than most. But in terms of whether -- or [aftermarket] I guess the delta that I see is the ability to get mix (inaudible) I guess. Is there anything that you are seeing that changes your view on your ability to drive mix?

David Illingworth - Smith & Nephew - CEO

Yes that's a good question. And I think the answer to that is no. There is nothing of note that significantly changes our opinion on our ability to perform in the marketplace. Leave it at that.

Matt Miksic - Piper Jaffray - Analyst

Okay. The second question here is just again there's been a lot of talk too on the earnings improvement program. But if you think about the investments in Negative Pressure Wound and the benefit that come from some of the unwinding of the post DoJ monitoring expenses, should we be thinking about those as offsetting one another or should we still be thinking about an improvement this year?

David Illingworth - Smith & Nephew - CEO

Are you talking about in aggregate or margins or just those two elements?

Matt Miksic - Piper Jaffray - Analyst

Those two elements.

David Illingworth - Smith & Nephew - CEO

I don't know how --

Adrian Hennah - Smith & Nephew - CFO

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Well I think on the compliance cost, I think we covered that earlier. And we're basically saying do not take into account -- do not assume significant reduction total compliance cost. There may be a change in the mix as regards the monitor. But in terms of total compliance cost I think we should say again do not assume a significant change, a significant reduction in that.

In terms of NPWT investments, and I think we just have to go back to the guidance, which was we expect to breakeven in a few quarters, and after that to be materially profitable. Now we haven't -- a few quarters is deliberately a little vague for the reasons Dave explained. And I am afraid that's the way it is in reality.

Matt Miksic - Piper Jaffray - Analyst

Okay.

David Illingworth - Smith & Nephew - CEO

Thanks Matt.

Matt Miksic - Piper Jaffray - Analyst

Sure.

David Illingworth - Smith & Nephew - CEO

Alright thank you very much. Well I'd like to thank everybody for your attendance today and also for your thoughtful questions. And we'll see you soon I am sure. Thank you very much.

Operator

Ladies and gentlemen thank you for attending today's conference call. You may now replace your handsets.

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