

FINAL TRANSCRIPT

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PRESENTATION

Operator

Good morning ladies and gentlemen and welcome to the Smith & Nephew 2009 Q1 results conference call, hosted by Mr. David Illingworth. My name is Phil and I will be your co-coordinator for today's conference. For the duration of this call you will be on listen only, however at the end of the call you will have the opportunity to ask questions. (Operator Instructions).

I am now handing you over to Mr. David Illingworth to begin today's conference call.

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David Illingworth - *Smith & Nephew - Chief Executive*

Thank you. Good morning everyone and welcome to our first quarter results. I'm going to start today's meeting with an overview of our Businesses and then hand over to Adrian, who is with me here today, who will take you through the numbers. Then I'll come back and summarize before we take questions in the usual manner.

Starting with the highlights for the quarter, we generated \$865m in revenues which we see as a good performance against a backdrop of difficult global economic conditions and a slowing of demand in some of our markets. Our focus on costs and our continued work on our earnings improvement program resulted in 120 basis point improvement in margin over the same quarter last year.

In light of the current economic conditions there is a further shift in emphasis in the Business as a whole, from the top line towards cost effectiveness. We have had a head start with our EIP which gives us some flexibility for the future.

Orthopaedics was impacted by market conditions but grew particularly well in Asia Pacific and the emerging markets. Endoscopy had flat revenues, as the expected impact of the weaker capital products market continued.

Advanced Wound Management performed well, with consistent global growth and demonstrated the resilience we have been expecting of this Business.

The completion of the Deferred Prosecution Agreement is a very positive step forward for us after many months of excellent work by a lot of people in our US and global teams. And let me then move on to looking at each of the businesses in a little bit more detail.

In Orthopaedics we had a solid quarter. We saw good outcomes in many parts of our Business, growing in the US by 3% and by 16% in the rest of the world outside Europe. Our Business in Japan generated good revenues from OXINIUM following approval on that market and we benefited from strong growth in Australia and in the emerging markets.

As Adrian is going to highlight later, our Asia Pacific and emerging markets business has performed very well in all three of our businesses this quarter.

In Reconstruction we grew at near the market rate. Global Hips grew by 2%, Knees by 5%, reflecting some quarterly variations against our long-term trend and softer market conditions in the US. And to a lesser extent Europe.

We are very pleased with the completion of the Deferred Prosecution Agreement at the end of the quarter and many of our employees worked extremely hard and particularly in the last few months, with the monitor to achieve this successful outcome. Our thanks to all of our employees who were involved.

We now have a global compliance program that is beneficial to many people. Our customers, our employees, the patients, the payers. We take ethics very seriously and we are a better Company for having this structure in place.

BHR had slower sales in the US this quarter as the development of the market slowed somewhat. We've also launched VISIONAIRE, our custom cutting block instrument, which as well as giving patients a precisely aligned implant, eliminates about 20 steps and four of the seven instrument trays for a total knee replacement procedure.

The launch of R3, our Universal Acetabular Cup at AAOS has gone very well for us and surgeon feedback is very positive. We now have full approval for this product in the US.

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Our Trauma business continues to make progress with improving its approach to the market in both the US and in Europe and in Clinical Therapies revenue grew by 2% a quarter. We've seen the impact of the weak economy and some competitive pressure in the marketplace in this segment.

During the quarter, as part of our earnings improvement program work, we rationalized the administration of our European Business and announced the closure of a facility in Switzerland.

If I turn to the Endoscopy business, Endoscopy had a good quarter in difficult conditions. In the US we're seeing some procedural volumes reduction but this is not true in all parts of the country or in all other geographies.

Market demand overall is softer, as we expected, while growth rates remain at double digits for the repair part of this business.

Our Arthroscopy business has performed well in these conditions with good growth in our Knee and Shoulder Repair business and also from a small base, our Hip business. At the launch of our Bioabsorbable OSTEORAPTOR Anchor helped drive Hip and Shoulder revenues and our ENDOBUTTON Ultra and Ultra FASTEX also performed very well.

Our Capital Equipment businesses have been, certainly have been impacted, as we expected by the economic conditions, with the US the hardest hit. Endoscopy's margin improved by 70 basis points in the quarter, benefiting mainly from product mix.

As part of our EIP initiatives, Endoscopy has been reviewing its facility needs and has announced the closure of our facility in San Antonio, Texas, by the end of 2009. The facility in Warsaw, Indiana was closed at the end of 2008, as you may recall.

Now turning to the Advanced Wound Management business to take a look at that. Advanced Wound Management had a good quarter, with revenues in both Advanced Wound Care and Negative Pressure Wound Therapy growing well. Market conditions continue, as anticipated, to be relatively good for us across the Advanced Wound Care market.

In NPWT we are gaining traction. We launched two new Pumps this quarter. RENASYS for the hospital market and RENASYS GO for the home market. We've also had some good outcomes on the legal side and patent cases this quarter and we continue to expand the number of accounts we're billing and are very focused on increasing the penetration of these accounts.

I'm pleased to be able to tell you that we've started making test product in our new factory in China and expect production to start up more fully late this year. We also expect our Largo facility to close as scheduled later this year and to see a contribution to our margins next year.

In addition, as part of our Earnings Improvement Program in the UK, we've made some substantial changes to the number of our distributors, which will begin to generate savings shortly.

We've announced today the appointment of a new President for this Business, Roger Teesdale, as Joe Woody is leaving to return to the US. Roger has in depth knowledge of this Business, having led a major portion of it including the US in the last three years and I'm sure Roger will take full advantage of the strong platform for growth in this Business and build on it.

With that I'm going to hand it over to Adrian to take you through the numbers.

Adrian Hennah - *Smith & Nephew - CFO*

Thank you Dave and good morning ladies and gentlemen. Turning firstly to the income statement slide. Revenue in the quarter was \$865m. This represents underlying growth after adjusting for exchange rate, 4% on the comparable period last year. A reported decline of 5% given the strength of the dollar.

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There was one fewer selling day in quarter one 2009 compared to quarter one 2008. Adjusting for this, we estimate that sales grew at constant currency by about 5%.

Trading profit in the quarter was \$183m and underlying growth of 12%.

Trading margin was 120 basis points higher than quarter one last year.

Moving to the next slide and a little further down the income statement. The tax charge in quarter one, before exceptionals and amortization, was 31.8%, the rate we expect for the full year. Adjusted attributable profit for quarter one was \$116m. Adjusted earnings per share were \$0.131 which is 2% higher than quarter one last year.

EPSA growth is significantly lower than the underlying 12% growth in trading profit due to the strength of the Dollar. The Dollar was 13% stronger against the Euro in quarter one this year and quarter one last year and 28% stronger against the Pound Sterling.

Turning to the next slide, the 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 quarters which Dave referred for each of our business segments. You can see that reported sales in the Wound business were particularly impacted by the strength of the dollar. Wound has as you know a larger proportions of its sales in Euro and Sterling than the Group average.

Turning to the next slide, the analysis of revenue growth rates by segment and by geography. The constant currency growth rate in our Orthopaedics business in the quarter was 4%. Hips grew at 2%, Knees at 5%, Trauma Fixation at 6% and Clinical Therapies at 2%.

In the United States overall growth was 3%. As Dave has mentioned we, like other companies, saw some softening in market demand. There were also a number of developments specific to Smith & Nephew. Growth in the Knee business of 5% saw solid contributions from the newer products. Hip growth was 2%. After an excellent launch we are now experiencing some decline, year on year, in BHR sales in the USA. Progress with our other Hip products has been encouraging, the solid launch of the R3 Acetabular Cup in particular.

Trauma Fixation growth in the United States was 7%. CT sales in the USA grew by 1%. EXOGEN sales have been materially impacted by the weakening in the economy.

In Europe, Ortho sales fell by 2%. We have seen some impact from softening market demand in these Europe numbers. Growth was also lowered by very strong comparity in the UK where we saw large orders by the NHS in Recon and in Trauma quarter one last year.

In the rest of the world Ortho sales grew at a solid 16%. As in the USA and Europe we do not expect, we do expect, excuse me, we do expect some impact from the macro economic challenges in these markets, especially in Japan and Australia. We expect these, however, to continue to be outweighed by positive underlying trends in the emerging markets.

Endoscopy growth rate is flat. As similar with last year's quarter three and quarter four numbers, we have seen a material impact from the macro economy in a capital sales within this business. As with the Ortho business, we have seen a slight softening in procedure related demand.

Within Endo, Arthroscopy sales, including both repair and [resection] grew by 3% and visualization related sales fell by 12%. Sales in the United States fell by 4%, grew in Europe at 2% and the rest of the world at 8%.

Capital sales account for about 25% of total Endo sales. We expect the weakness in capital sales to continue until market conditions improve.

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Wound sales grew at 9% in the quarter. This included a contribution from NPWT sales to total growth of 2%. Total Wound sales grew by 8% in the USA, by 6% in Europe and by 15% in the rest of the world.

Following a negative impact in quarter four last year, sales in the USA were increased by a rise in wholesale inventory levels. Sales in Europe in particular also benefited from the timing of Easter, which fell in quarter one last year but quarter two this year.

Adjusting for the increase in growth of NPWT, increase in USA wholesaler inventory and the Easter effect, growth was about 5%. This is around the level it has been for several quarters.

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 120 basis in the quarter on quarter one last year. The Ortho margin decreased by 30 basis points in the quarter. The Endo margin increased by 70 basis points in the quarter. You've heard from Dave some of the EIP projects that have specific deliverables in the quarter, including a significant office rationalization in Switzerland and two small factory rationalizations in the United States.

Margin in Wound was 560 basis points higher in the quarter. NPWT was, as expected, again loss making in quarter one. Although at quarter one last year saw the launch of our NPWT products with the associated investment, the improvement in the Wound margin was not materially driven by NPWT losses. The improvement was due to EIP programs and cost control efforts.

Turning to the next slide and the cash flow statement. We generated \$53m of free cash flow in the quarter. After the receipt of the monies from the Plus vendors and small inflatable net exchange movement, this led to net debt of about \$1.1b at the end of quarter one, down from \$1.33b at December 31.

Capital expenditure in quarter one was \$42m, the largest part investment instruments. Restructuring spends on the EIP program and on the Plus integration were in line with expectations. As mentioned with our full year numbers, the agreement we reached with the vendors of Plus on an adjustment to the price paid for the Company and the release of most warranties is reflected in the Q1 numbers.

The CHF159m or \$137m cash received is reflected in a reduction in the good will attributed to the transaction of \$112m and in a provision of \$25m for various tax liabilities, for which we could now be potentially liable. There is no impact of these adjustments on the profit and loss account.

As also mentioned at the full year numbers, part of the monies received compensated us for costs incurred in investigating and resolving the Plus issues. They have charged about \$15m for such expenses, through exceptional costs associated with the integration. Accounting rules do not allow us to credit the recovery of these expenses for exceptionals. As a consequence, total cash costs of integrating Plus is slightly higher than the range of \$60m to \$80m that we gave at the time of the acquisition.

Turning to the next slide and the outlook for 2009, Dave has commented on our view of overall market growth. In the Orthopaedic Reconstructive area we believe that underlying global market growth declined to around 4% to 5% in quarter one. We expect our Recon growth to be approaching the market rate in 2009.

In Orthopaedic Trauma, we expect to move towards a sustainable market growth rate over time. Within Orthopaedic Clinical Therapies, we expect EXOGEN to continue, excuse me we expect EXOGEN growth to continue to be impacted by the macro economy. The sales progression of our Hyaluronic Acid products will likely be impacted by the timing of approvals in the United States for our One Injection product.

Within Endo we continue to expect to achieve something below market growth in 2009. In the 80% of the business addressing the Repair and Resection markets. Within Visualization we expect growth to continue to be materially impacted by market weakness until the economy improves.

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Within Wound, we continue to expect to grow at or slightly ahead of market growth in areas excluding NPWT. Subject to unexpected legal developments, we anticipate good progress with NPWT sales.

In the face of the tougher economic climate, we remain very focused on improving our operational efficiency and specifically looking further toward a target margin of 24.5%, the annualized exit rate from 2010.

The caveat that we have always given remains, that the target assumes constant like for like pricing and no material reduction in volume growth trend. There is no doubt, however, that we do see very material scope for margin improvement and are committed to achieving it.

We continue to expect to break even on our NPWT sales, excuse me, we continue to expect break even on our NPWT sales to be a few quarters away and that they will be materially profitable thereafter. We expect an effective interest rate on net debt of around 3.5% for the full year, as in quarter one.

Finally a couple of comments on phasing. We've again included in the Appendices a schedule showing the number of business days in each quarter. There is one fewer business day in quarter two this year and one extra in quarter four, a total of one fewer in the full year. We also expect in Wound in quarter two a reduction of sales in the order of perhaps \$5m to \$10m and we announced consolidation of Wound wholesalers in the UK, which takes effect from June 1st.

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

David Illingworth - *Smith & Nephew - Chief Executive*

Well thanks Adrian. In summary -- the first quarter's been a solid quarter for us. We've seen good growth in many parts, most parts of our business. We've used tight cost control, together with our earnings improvement program to deliver good margin growth.

Adrian has explained our view of the outlook and the numbers. I do want to take a moment to summarize on how I see our Business progressing in these tougher times. We have a very strong track record in delivering above market revenue growth, particularly in Reconstruction. That's clearly how I see the Business in the long-term. There will be quarterly variations but I remain confident in the fundamental growth drivers in all our business areas.

We continue to look for new ways of making our business more productive, more efficient and more innovate, so that we can service our customers better. And we are building a one Company culture to achieve our margin goals.

We have great products, we have great people. We are in great markets and we'll continue to use all these assets to deliver value for our shareholders.

Now we are happy to take questions. We are going to use the usual system of taking questions, I presume. Can each person please limit their number of questions to two to allow as many people as possible the opportunity to participate. Phil can we have our first questions from the callers please?

QUESTIONS AND ANSWERS

Operator

Yes, that's me, thank you. (Operator Instructions). The first question comes through from the line of Matt Miksic from Piper Jaffray. Your question please.

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Matt Miksic - Piper Jaffray - Analyst

Good morning. Can you hear me okay?

David Illingworth - Smith & Nephew - Chief Executive

Yes Matt. How are you doing?

Matt Miksic - Piper Jaffray - Analyst

Good thanks. Thanks for taking the questions. So one year on to the Orthopaedic side, you mentioned BHR a little bit slower in the quarter. I'm wondering if you could talk first about how much of that pressure, how much of that pressure do you see as due to the market and how much maybe due to competition or pressure from other off label systems? And whether or not that's something that's just a more deferrable procedure in this environment? And then I have a follow up.

David Illingworth - Smith & Nephew - Chief Executive

Okay. Right, let me take a shot at that. I think we may be seeing a little bit coming from the market but I think I should back up a little bit. I think the best way to explain BHR from how I think of it is, if you think about it Matt we've grown BHR to around 3% of the US primary Hip market in just about two years. That's a pretty amazing accomplishment. We've expanded the Hip market in doing so. BHR is clearly the gold standard. We've got over 80,000 implanted now worldwide and over 10,000 in the US.

And sales grew much faster after the launch than we expected and we, without a doubt, we rode that wave up at the beginning and now we are in a little different phase. We're entering a slower growth phase in that part of the Business, where we are going to have to fight harder and we're thrilled with the fact that we now have 3% of the overall market.

I said for several quarters, in fact I've said for several years, that really I don't think the market will be developed fully in the US until we get more competition. Because right now we're fighting the fact that there's a lot of good competitors out there that don't have a Resurfacing product and they don't want us to sell Resurfacing and we, as a Company that might have 10% or 12% of the market in terms of market share in Orthopaedics, we now have 3% of the Hip market with just this one product.

So I think that's a big factor in it. I think we're just entering a new phase with BHR. We don't see a lot of competitive pressure. I think we probably see a little bit. We may see a little bit at the margin in terms of market reaction and we may see a little at the margin in terms of we haven't had the freedom to train the surgeons in the way that we would have liked to. Because we were working our way through the DPA process. I think that's how we look at it.

Matt Miksic - Piper Jaffray - Analyst

Okay, right, that's helpful. A follow up just on your comment on forward-looking view of approaching market growth in Reconstruction. If I heard that correctly.

David Illingworth - Smith & Nephew - Chief Executive

Yes, yes.

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Matt Miksic - Piper Jaffray - Analyst

It seems like you've had, it seems like you've had an opportunity in the past year to do a little bit better than that and, as you pointed out in your final remarks, it seems like that's still the way that you see the long-term model for the Company is growing a bit faster than the market. What kind of period are we in? What's affecting you now that pushes it to give the outlook that you've given for the near-term and maybe what do you see the change is there to help you get back above market growth rates?

David Illingworth - Smith & Nephew - Chief Executive

Yes, that's a great question. I'll tell you. I think part of it is the fact that we don't have a lot of experience at talking about our Orthopaedics business growing under the market, because over the last five or six years or seven years that I've been with the Company, I can only think of one or two quarters where we haven't performed at or above the market in Orthopaedics.

So we -- that may sound strange to you but we just don't have a lot of practice in explaining why we might be a little bit under. But if you look back at all the quarters where we've been above market growth rate, you can't do it every single quarter. There are going to be some variations. There's some ebb and flow of products that come through and clearly I think BHR had a little bit of an impact. We're not very far under the market right now in our Orthopaedics business.

We're not overly alarmed by it. We think that we'll continue to perform very, very well. We have a legacy of doing that, a legacy of being innovative and I am very confident that over the mid to long-term we'll continue to do that.

Matt Miksic - Piper Jaffray - Analyst

Okay. Thanks for taking the questions.

David Illingworth - Smith & Nephew - Chief Executive

You bet Matt. Take care.

Operator

Thank you. The next question comes through from the line of David Adlington from Cazenove. Your question please.

David Adlington - Cazenove - Analyst

Morning. Good morning guys. Thanks for taking the questions. Just two really. Firstly David (inaudible) prepared comments like there was a significant ramp in the intensity towards the end of the DPA process. I wondered if you thought that had an impact on your Orthopaedics business at all?

David Illingworth - Smith & Nephew - Chief Executive

Well, we were sure working hard. I'm sure all the companies were working hard towards that date at the end of the quarter. We were putting a lot of effort into it David. It's hard for me to really understand relatively whether or not we were pedaling harder than -- or not as hard as other companies. So I know we put a tremendous amount of energy into it. We feel very, very good about where we came out.

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We have a better compliance system now as a result of the work that we did. It was tough work. We put a lot of effort into it and we're a better Company for it. And I think that -- I don't know really how to answer your question because I don't know relatively whether or not we worked harder at it or didn't work harder at it.

David Adlington - *Cazenove - Analyst*

Fair enough. But it was definitely an increase in tendency towards the end of the process.

David Illingworth - *Smith & Nephew - Chief Executive*

We were working pretty hard. Yes.

David Adlington - *Cazenove - Analyst*

Yes, yes. And then just a bit of housekeeping. The Swiss Head Office closure, was there any impact on the quarter on margins and will that be meaningful going forward?

Adrian Hennah - *Smith & Nephew - CFO*

No nothing material in the quarter in margins. It's one of many things contributing going forward. We don't want to put too much weight on that particular item David.

David Adlington - *Cazenove - Analyst*

Thanks very much.

David Illingworth - *Smith & Nephew - Chief Executive*

Thanks David.

Operator

Thank you. The next question comes through from the line of Hans Bostrom from Goldman Sachs. Hans your question please.

Hans Bostrom - *Goldman Sachs - Analyst*

Good morning. I have two questions please. First of all could you shed some light on the margin improvement you're achieving in Q1, in particular in so far as the gross margin has been the key or sole driver for this, which I would say is a bit counter intuitive, given that your management has been outgrowing the other businesses? Presumably a lower margin business. And also the fact that many of the initiatives you have in manufacturing haven't really come through. Could you give some explanation to that and how we should think about the balance of margin improvement coming from SG&A versus cost of goods sold in the coming quarters for the year?

And my second question relates to your amortization charged at -- was well below our forecast. What should we expect this charge to be for the full year? Thank you very much.

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David Illingworth - *Smith & Nephew - Chief Executive*

Right thanks Hans. Let me take a shot at starting out on the EIP stuff and then Adrian, you could fill in any blanks that I may have left out. And then you can take the amortization piece of it.

Let me -- a couple of headline comments on EIP. We have made a lot of progress. There are some things coming through Hans. We have -- our China Wound factory is now up and running, we're testing new product. Two years ago we hadn't even broken ground on that facility. And even the thought of a facility in a lower cost manufacturing environment, we have a real factory with real people and real machines bolted to the floor and we're producing real product. And we are going to be phasing out the Largo facility through the rest of the year.

The other things that we've -- we've done many other things. It's just off the top of my head in Advanced Wound Management you've mentioned that it is counter intuitive but we had over 100 distributors in the UK distributing Advanced Wound Management product. And we've taken that down to three and that is going to have a major impact on, well -- it's going to have an impact on our profitability in that business.

We've purchased the land for our Orthopaedic facility in China and we'll be starting breaking ground there. We have a new distribution center in North America that's now on line, went live in January of this year. And that's making us more efficient. We've had constant focus on the COG side, as you've recognized. We've got factory floor improvements based on [Kisan] principles. We've rationalized the facilities in Switzerland, closing the former Headquarters site for Plus. The [Rothgroys] facility.

In Endoscopy we've been rationalizing for a while now in manufacturing. We closed our Warsaw, Indiana plant in 2008 and we're getting benefit from that and we're in the process of closing our San Antonio facility. So we have been emphasizing our COGS side of this equation. We -- and I think it's very insightful that you pick out the fact that we're probably shifting our emphasis to the SG&A side now, as we are. And we are going to talk more about that as the year progresses. But clearly we see some real opportunity there for us.

With that Adrian if you want to fill in anything that I may have missed and then hit the amortization piece, that would be nice.

Adrian Hennah - *Smith & Nephew - CFO*

Yes, sorry. Well what you're calling amortization piece, yes the current quarter is a reasonably good guide, give or take the odd million Hans for the full year. If you multiply it by each quarter. Just one word of caution in interpreting the cost of goods versus other headings in terms of movements year on year. Don't forget we have to put the exceptional items into the costs of goods sold and to the selling general on admin. So when you just take the headline number movement it can be a bit distorted. For example quarter one last year we had the inventory value, revaluation on Plus acquisition still going through the numbers. There's a number of factors. You can't just take 2008 costs for sales, 2009 and assume that's all an efficiency movement between the two.

Hans Bostrom - *Goldman Sachs - Analyst*

And a quick follow up on the first question. Is it the case that your China factory has not yet been commissioned and therefore does not incur any expenses?

Adrian Hennah - *Smith & Nephew - CFO*

That is true in terms of -- yes it's true we still have a Largo factory up and running and as at the moment we are not taking product out of the [Sujo] factory into production, but that is going to happen imminently.

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Hans Bostrom - *Goldman Sachs - Analyst*

Okay, thank you.

Adrian Hennah - *Smith & Nephew - CFO*

And indeed Largo will disappear a little bit longer thereafter.

Hans Bostrom - *Goldman Sachs - Analyst*

Thanks very much.

Operator

Thank you. The next question comes from Yi-Dan Wang from Deutsche Bank. Your question please.

Yi-Dan Wang - *Dutsche Bank - Analyst*

Thank you very much. I have two questions. First of all can you comment on the management change in Wound Care and whether -- how smoothly do you expect that changeover to occur? Whether we should factor in any disruptions that may happen there. And then secondly, your Orthopaedic margins seem to be much higher than what I forecast and as you said that you've not seen much benefits from the Swiss Headquarter closure yet. Can you comment on what else happened there in the first quarter that would have helped that margin? Thank you.

David Illingworth - *Smith & Nephew - Chief Executive*

Okay, thanks Yi-Dan. Let me comment on the management change first. First of all we're -- we're sad to see Joe Woody go. He did a great job for us and built a great team and has really begun the process of turning that Business around and leading us to a platform of sustainable growth and profitability in that Business. He is returning to the US and we certainly respect that and he's basically going back to -- back home.

We haven't factored any disruption into our projections because we believe that it is going to be a fairly seamless transition. This is a gentleman that is taking over that has been with that business for over 20 years and has a tremendous amount of experience in the Wound Care marketplace. He doesn't have any learning curve at all. He's also been really the chief operating guy in that business over the last couple of years. And in fact when we had the, when we had an opening for the US President's role about a year ago, Joe moved Roger over to the US for a period of time, to get that business sorted and get it up and running. And now I think you're seeing some of the payoff for that with some of our performance.

So we're not expecting any disruption and I don't think you should either. So that's the long and short of it on that. In terms of Orthopaedic margins, I think the general comment on Ortho, it's a lot of little things going on in terms of productivity programs. But there's also a lot of cost control going on in that business, as well as other businesses. And we're being very, very careful about how we spend our expense dollars and because we just don't know how much of a headwind we're going to have with the economic environment.

Adrian, do you want to add anything to that?

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Adrian Hennah - *Smith & Nephew - CFO*

That's right. I think there's nothing specific to call out on margin in the quarter in Ortho at all. Lots of little --.

David Illingworth - *Smith & Nephew - Chief Executive*

Yes, yes. Lots of little --. Okay. Thank you.

Operator

Thank you. The next question comes through from the line of Martin Wales from UBS. Martin your line's open. Thank you.

David Illingworth - *Smith & Nephew - Chief Executive*

Hey Martin.

Martin Wales - *UBS - Analyst*

Thank you. Two questions. Firstly Advanced Wound Management. You talk about contributing 2% to growth in Ortho which implies something in the \$4m range in the quarter, which is pretty similar to what we've seen in previous quarters. It doesn't seem to be a lot of progress in rapid generation there, getting closer to profitability. Well, sorry you said you going to turn profit in a few quarters. Are we getting closer?

David Illingworth - *Smith & Nephew - Chief Executive*

Yes, I'll take that. I think that you're right in your math. You're not right in --. Right the -- I think on negative pressure in the first quarter I think one of the things you need to factor in is that we've brought out a new platform of products and any time you bring out new products you're going to have a lot of people waiting for those new products. Not only on the customer side, but also the sales guys and ladies are hesitant to take old products into account. And I think we saw the effect of that so I wouldn't read too much into exactly where we were with the absolute numbers on negative pressure.

And we continue to move towards profitability in that product line. We can see profitability and that adding real impetus to our profit and our margin over time. And that's -- so we're actually quite pleased.

Martin Wales - *UBS - Analyst*

I guess you have, you seem to have plenty of customers. I guess the big challenge is convert the smaller customers into bigger orders. How close are you to doing that? And have you seen any customers convert from smaller orders to bigger orders yet?

Adrian Hennah - *Smith & Nephew - CFO*

Yes. Well first of all, just on the 2% ratio there's no confusion there. I wasn't quite sure what you said which is why you got a bit of hesitation this end Martin. The Wound or NPWT contributed 2% to the growth in Wound. So therefore, roughly, if you take 2% of the total and add it to last year's number you get to roughly where the current number is. But we're not disclosing that number precisely.

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And that looks very much in line with what we expected in the way of growth for the reasons Dave said. We signaled quite clearly in quarter four that with the new pumps scheduled to come out towards the end of quarter one and they did come out pretty much at the end of quarter one, except for a couple of trial earlier versions. They were going to have a slight chilling effect on customers who were going to wait for these new ones coming out which many of them knew were coming out. So we were actually very pleased with the way sales evolved in quarter one.

And in terms of progression to profitability. We have repeatedly said there's no point in putting us in a box on the exact period this is going to turn to profit. Because there are uncertainties. We are very -- we see and continue to see --.

David Illingworth - *Smith & Nephew - Chief Executive*

We're still in an investing mode as well in the business, so.

Adrian Hennah - *Smith & Nephew - CFO*

Exactly, no question. And it is silly to be forced into a box about when we will make ourselves go profitable in this quarter. In fact it's not the rational thing to do. So we -- we're very happy with where this is headed, Martin.

And sorry and then your question was converting lots of customers into customers with more sales. Yes, I think we've explained in the past that we really have no difficulty getting customers. And, but it's actually not a good idea for profitability to have lots of customers that take a very small amount. Better to have a smaller amount of customers that take a lot.

And that is absolutely the phase we are now into with a better range of pumps that we are introducing, with a broader range of dressings, with a more established and proven service level now that it's been demonstrated to work pretty effectively over time.

So we are now firmly into that phase. It is a new phase in the NPWT battle, if I may use that term that we're entering into now with these new products.

Martin Wales - *UBS - Analyst*

Okay. Could I ask my second question which relates to the dynamic and what's going on in Orthopaedics in Europe? You indicated you've seen some decline in procedures. One tends to think of this as a largely public pay market. Can you give us a little bit more about what's really driving the negative growth we saw in the quarter?

Adrian Hennah - *Smith & Nephew - CFO*

Well I think two things to call out. One, we do feel that across the board there were a little bit of softness. It's at the level where it's actually quite hard to pull out softness from other factors. But that is our general feeling and also across the board.

A couple of specifics, the biggest by far is that in the UK, coincidentally actually, for slightly different but connected reasons in all three of our orthopedic related businesses, there was a very strong comparative.

I think in quarter one last year the NHS moved somewhat from -- somewhat from paying for implants when they are implanted to taking them into inventory. So there was quite a stocking up in the US -- in the UK in quarter one last year, which had a year on year effect, similar, similar thing in Trauma but more hospital specific.

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And then in the case of Endo there was quite -- there has been quite a campaign for some time in the NHS to increase the amount of capital equipment associated with Endosurgery, so they can essentially clean it more vigorously before it's re-used. And that program has run its course.

Now they may well be connected with economic pressures, in a broader sense that might be connected. But those were the two main drivers.

We've also seen some pockets. Eastern Europe has been a bit tough from an economic point of view, we've seen that in the numbers, but that's a fairly small beer] if that answers your question Martin.

Martin Wales - UBS - Analyst

That's great, thanks a lot.

David Illingworth - Smith & Nephew - Chief Executive

Thank you.

Operator

Thank you. The next question comes through from the line of Michael Junging from Merrill Lynch, Michael your question please.

Michael Junging - Merrill Lynch - Analyst

Great. Thank you very much. Two questions, firstly on the earnings improvement program. You've mentioned in the past that you would achieve these EIP targets even if there was very, very tough macroeconomic conditions.

I would just like to know whether you still stand by these comments, because from my perspective I can't imagine that you would have expected zero percent growth, Endoscopy as an example, particularly when the incremental growth margin that you've now lost on those sales is going to be a bit of a pain in the next 12 months or so.

And then secondly on the pricing policy for all three divisions, in tough economic times are you being forced or pushed with hospitals to be a little bit more flexible on price to share the economic burden? Thank you.

David Illingworth - Smith & Nephew - Chief Executive

Thanks Michael. Let me take the first one since I'm the one that is historically been misquoted on this. What I did say is that I did not foresee a scenario where we didn't have an opportunity to continue to make our targets at the time. And clearly the economic situation for us is more difficult, so I think it's a very fair question.

We have opportunity, rich opportunity in our business to enhance our margins and to improve the efficiency and the profitability of our business. We've tackled it through some formal programs. We knew that if we got hit with some really tough economic headwinds that we might have to go back to the drawing board and really roll up our sleeves and decide if we had to take some further action in our business, which we believe is available to us.

And I think we just have to assess that, and that's what we are doing. So I think your question is a good one. We haven't come off our targets in the sense that we believe that we have the opportunity to make them.

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Has the environment got tougher for us? Absolutely, there is -- it's gotten tougher for everybody. Did we foresee that we would have some of the growth -- some of the factors that you laid out like the capital markets and endoscopy and --.

I think that -- the second part of your question is probably even more critical for us in understanding how hard it's going to be for us to get to those margins targets, which is the pricing. Because pricing has a pretty dramatic effect on our business, and it has a pretty immediate effect as you know.

So we are keeping very close tabs on it. We still believe that we have the opportunity by doing the right things to not only meet the margins targets that we've set, but also do it in a way that doesn't compromise the long term health of this business.

Because what we don't want to do is take action that is going to be short term in nature just to make a target. It's very, very important for us to build a great business and have good long term health in this business.

So, we are keeping our eye on it. What I did say was I didn't foresee a scenario that -- where we couldn't make it. It's -- you're right it's gotten harder, and -- but we are rolling up our sleeves and going after it.

And I think we are going to continue to be transparent on new ideas throughout the year, because I think there are some other things that we have the opportunity to go after and we just need to figure out how to get after them.

Adrian, do you want to add?

Adrian Hennah - *Smith & Nephew - CFO*

That's fine Dave, thank you.

Michael Junging - *Merrill Lynch - Analyst*

Dave just a final question on the EIP, if the sales momentum in Q1 continues at the same rate for the next three quarters is the EIP program still achievable?

David Illingworth - *Smith & Nephew - Chief Executive*

Well you're asking a hypothetical question. I mean I don't -- we don't know exactly what's going to happen over the next three quarters. Clearly it would put more risk in the numbers.

I think -- that's kind of how we look at it, is when we started this program we had a very clear line of sight as to what programs would deliver what value. And as the economic environment has changed on us that line of sight has got a little bit more cloudy.

But it doesn't mean that we feel like we can't make those numbers. We do believe that we can still make those numbers, and the line of sight has got a little bit more difficult for us, because of the economic environment.

Michael Junging - *Merrill Lynch - Analyst*

Thank you.

David Illingworth - *Smith & Nephew - Chief Executive*

You bet Michael.

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Operator

Thank you. The next question comes through from the line of Tom Jones from JP Morgan. Tom your question please.

Tom Jones - *JP Morgan - Analyst*

Good morning gentlemen. Thanks for taking my two questions. The first question I have is just on your guidance really for the -- for your performance of your Trauma business. You are sticking to your guidance and you expect and hope to get that up to kind of a market level growth rate.

But have your expectations for growth in the Trauma market shifted materially given the slowdown that the Trauma market's largest player is steering investors towards?

And the second question really relates to your capital structure. Cash flow seems to be improving, you've got a nice little cash boost from Plus. And if you start to get near your margin targets I assume you can hold working capital in check. Then your debt balance is going to start to drop off quite sharply over the next two years.

So I just wondered how you felt you see your capital structure developing, and what your preference is for use of excess capital would be, be that acquisitions, returning it to shareholders, just carry on paying down debt or perhaps even think about doing the buyback again.

You were quite happy to use expensive debt to buy expensive shares a year and half ago, and your shares are half the price they were and debts a quarter to a half the price it was. So just to share some thoughts there would be helpful, thanks.

David Illingworth - *Smith & Nephew - Chief Executive*

Okay, all right. Well I'll tell you what we'll divide up the labor on this I'll take a shot at the first one and then turn it over to Adrian for some comments on capital structure.

Trauma, first of all the guidance that we've always given on Trauma has been relative to the market growth rate. And we have to -- we have to understand that. Clearly with the results that have come out recently indicate to us that the market in Trauma is growing slower than everybody was originally projecting.

We are -- I guess the way I would describe where I am on Trauma is I am pleased with the progress we are making in Trauma, but not completely satisfied. We have a pretty fresh range of products. We do compete against a very large competitor with a commanding part of the market in terms of share. And that's always a challenge for us. But I think we are doing a pretty good job.

But all of the guidance we've given has been relative to the market growth rates. So if those market growth rates come down I think we should -- we are going to have to assume that we are going to have to move our numbers around as well.

Adrian do you want to --?

Adrian Hennah - *Smith & Nephew - CFO*

Yes, good question Tom on some of the borrowing. Yes, there is no question we have a strong balance sheet position with a frankly, pretty attractive borrowing facility of the price and the maturity not maturing until May 2012, and looking ample for our requirements. There is no question that's very favorable.

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Equally we stopped the buyback a little while ago as you know, because as was leadingly obvious the debt markets were rather different from when we started the buyback program, and we felt we just ought to pause to let things clarify themselves. And that we go back and revisit that question in time.

Frankly, it's not top of our agenda to revisit it at the moment. We are focused on let's generate some more cash. It's a good thing in this time, in this environment clearly to be cash strong. So our focus at the moment is very much on generating cash, paying down the borrowing.

At some point we'll cause just to have to make some decisions, because as you know, if you've read the small print within that \$2.5b that \$1b is a [temoin]. So if we get materially beneath \$1b we are going to have to start thinking about canceling an offer. But that's frankly a problem we'll cross when we get there Tom. We haven't any definitive plans at the moment.

Tom Jones - *JP Morgan - Analyst*

Okay. And then going back to acquisitions for a moment you've been quite quiet on the M&A front since you've got your fingers a little bit burnt with Plus. Has Smith & Nephew's appetite for -- or historically quite voracious appetite for M&A diminished a little bit by that? Or are you just more focused internally rather than externally at the moment?

David Illingworth - *Smith & Nephew - Chief Executive*

Well there's a lot of questions there. I don't -- this is probably the first time we've ever been described as having a voracious appetite for M&A.

But we -- I think we are a little bit more cautious as a result of -- not only the issues that we faced with Plus, but also the compliance issues that we face around the world. I think our hurdle the hurdle rate has gone up for us. The level of due diligence that we do is especially rigorous.

We continue to look at things. They have to support our strategy, and they have to be compelling for us. Because I think your last point was, well it was a question really, you know I think we are - we do have a stronger focus internally.

We think there is a lot of value we can bring back to our shareholders in terms of running this business more effectively. And that's something that is completely in our control. And that's what we are really focused on.

So if I was going to give a priority I would say our priority one would be our productivity in our business and increasing the -- our profit and our margins. And if something comes along that makes compelling sense for us on the M&A side we take a look at it.

Tom Jones - *JP Morgan - Analyst*

Good that's good to hear. Thanks.

Operator

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

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Julien Dormois - *Exane BNP Paribas - Analyst*

Hi, good morning gentlemen. Basically one housekeeping question which would be on the growth rates you experienced in the hip and knee business in the US please.

And the second question would more relate to any, I would say, trend in the rate of procedures you may have noticed in orthopedics and endoscopy as well. Would you said that, for example, the start of the year was pretty good and then declining, or has it been pretty stable across the board in Q1, and how we should see it evolving for the rest of the year please.

Adrian Hennah - *Smith & Nephew - CFO*

Yes, sure Julien. The -- you wanted the hip and knee growth in the US. This is our hip and knee growth in the US. In the -- let me give you the full just to be clear. So Smith & Nephew hips grew 2% worldwide, 1% in the US 2% outside the US.

Smith & Nephew -- so that was hip growth that was hip growth. Smith & Nephew knee growth 5% worldwide, 4% in the US 5% outside the US for a total recon of 3% as you can see in the numbers worldwide, 3% United States and 4% OUS.

In terms of trends within the quarter I don't think we've pulled out anything it's too -- this is too refined for us to be saying week three was a bit stronger four. We don't see anything systematic through the quarter.

Taking our data together with that we've seen from our competitors it's clear the market in aggregate is a bit softer. But to identify a trend within that I think is asking for us to over-interpret data.

Julien Dormois - *Exane BNP Paribas - Analyst*

Okay, thank you.

Operator

Thank you. The next question comes through from the line of Karl Bradshaw from Morgan Stanley, Karl your question please.

Karl Bradshaw - *Morgan Stanley - Analyst*

Morning gentlemen. Thanks for taking my questions. I have two questions the first is a follow up on Tom's question actually just related to the Trauma market.

Just looking at your US Trauma growth of 7% that seems to be higher than what one of your major competitors reported in the last -- a couple of days ago. I was just wondering if you had a view on what the market was growing at in the first quarter, and whether you think you are taking share in Trauma in the US that's my first question.

Adrian Hennah - *Smith & Nephew - CFO*

Well Karl, the Trauma market, just staring at the numbers here, we see -- and I guess it's a little hard to interpret sometimes the big giant numbers because they are not great at breaking it out between Spine and Trauma and so on.

But we think the market is probably growing at around 8% overall globally around 6% in the US and around 10% outside the US compared to our 6% overall round market growth in the US and the 5% outside the US.

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The - so yes I guess the -- it was interesting to hear from the Synthes reports that they appear to be seeing a softening in the US. Not inconsistent with us, although as you can see from our numbers not really very apparent there.

I would say that our focus in Trauma at the moment is still on operational issues. We know we made some changes to the way we manage the sales force in the course of last year. And we still have more work to do there. So frankly that is our focus probably more than the market just at the moment just in Trauma.

Karl Bradshaw - *Morgan Stanley - Analyst*

Okay, great. And my second question just relates to some of the Acute Care Episode demonstrations that are going on in the US where CMS is running a number of studies in certain hospitals in the US where they are talking about bundling physician payments for hip and knee implants into the total reimbursement that Medicare would give.

I was just wondering what your views were if that became rolled out across the whole of the US, and how you might think that that might impact implant pricing in the longer term for hips and knees, thanks.

Adrian Hennah - *Smith & Nephew - CFO*

Well it's hard to comment on that one specifically Karl, but clearly there is a lot of experimentation happening in the US now about comparative effectiveness and different ways to get value out of the system. And we certainly are of the view that there is going to be more of this.

And the politically -- the goals of the Obama administration coinciding with the inherent pressures on government funding, and indeed private funding on healthcare in the US coupled with the extenuated government borrowing as a result of the credit and associated crisis.

All of these are going to put more pressure in the systems for finding ways to source -- for healthcare providers to source more effectively. So we expect to see many, many more things like this, and certainly we are very focused on getting our business into shape to deal with these things effectively.

Karl Bradshaw - *Morgan Stanley - Analyst*

Okay, great. Thanks very much gentlemen.

David Illingworth - *Smith & Nephew - Chief Executive*

Thank you.

Operator

Thank you. The next question comes through from the line of Scott Bardo from Credit Suisse. Scott your question please.

Scott Bardo - *Credit Suisse - Analyst*

Thanks for taking my question. Firstly, it seems that it's the first time that you've not given the underlying Ortho growth excluding Plus. I just wondered if you could break this out for us please?

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And the second question is just following on from the previous question walking through the quarter, we noticed obviously for Endoscopy that December was a much weaker month than Q4. Has that trend continued in Q1, and have you noticed any weakness for the last month in Ortho?

Adrian Hennah - *Smith & Nephew - CFO*

Yes. So question one why have we stopped talking about growth excluding Plus. It's with a great merciful relief we've stopped talking about Ortho growth excluding Plus to be honest.

We gave guidance at the end of last year that, I think we said we lost about \$63m from sales in the course of last year, and we thought that it might peak at about \$80m of sales. That's still our forecast, and you can take from that that we did lose a little bit more in quarter one.

It may have cost us a percent or something in terms of the overall growth in Ortho, but frankly it's not something we want to repeatedly focus on at that level externally. So it's something -- I know it's not the answer to your question, but we regard this as a historic issue now essentially, and we want to move on from it which is why we didn't (inaudible).

Scott Bardo - *Credit Suisse - Analyst*

Sorry, just following on Adrian, so correct me if I am wrong but in Q4 the Plus effect was about a 300 basis point impact on growth rate. So by your comments there are we to assume that including Plus your growth rates also were boosted by around 2%?

Adrian Hennah - *Smith & Nephew - CFO*

No the -- we've got -- it was an annualizing thing here. Don't forget this thing started to impact most profoundly in quarter one last year. And so the annual effect, which is what we are talking about in growth, is dropping out.

So in terms of incremental loss, above the annual rate of quarter one last year, it's pretty small. It may be a percent in terms of the overall Ortho growth. It will be more if you delve down into Ortho Europe. So there is an effect there, no question. It's just that it's in the category of stuff we expect to deal with now.

But let me repeat, I think in terms of understanding us, and if you want to get into that level of understanding of underlying this, we still think moving from \$63m or whatever it was last year to \$80m as a peak loss, so another \$15m, \$16m, \$17m or sales loss incrementally spread through the year is roughly where we think we'll end up. And we got a quarter of the way there in quarter one as it happens if that answers your question.

Scott Bardo - *Credit Suisse - Analyst*

Thank you.

Adrian Hennah - *Smith & Nephew - CFO*

In terms of your question, which I think I -- the second one was you said that within quarter four we did indeed call out that Endo was quite strong in period 12. And really did that as a signal with our full year numbers to say don't -- we felt that the Endo capital performance in quarter four slightly understated the weakness of the market, because we had a lumpily strong period 12.

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And I think that was the case. There is no question we then saw a weaker quarter one a fall of 12% in Visualisation. And indeed we had a small amount of capital in the Arthroscopy business, so Arthroscopy grew at 3% overall. Embedded in that are things like pumps, hand held instruments, which are sort of in the capital category.

But even if you take all capital as opposed to just Visualisation capital we saw a fall in sales of about the same 12%, 13% in the quarter.

Break that down by period it's a lumpy business, capital, so it does bounce around. And I am not sure it's helpful -- it doesn't give us any great insight to look at the --

David Illingworth - *Smith & Nephew - Chief Executive*

Well there may very well have been an end of the year effect with budgets and so forth. We don't really know. It's hard to really tell. But clearly if we struggled to try to explain the 12, period 12, then we could probably come up with some theories. But we've moved on and we just wanted to call it out as a fact.

Adrian Hennah - *Smith & Nephew - CFO*

Yes.

Scott Bardo - *Credit Suisse - Analyst*

Yes, but sorry just to run on your Visualisation business within Endoscopy was particularly weak in December is my understanding. I just wondered whether that trend for continued weakness has continued through Q1.

Adrian Hennah - *Smith & Nephew - CFO*

No. Sorry Scott. It was the other way round, maybe we weren't quite clear. It was --

David Illingworth - *Smith & Nephew - Chief Executive*

Particularly strong.

Adrian Hennah - *Smith & Nephew - CFO*

Particularly strong in period 12.

Scott Bardo - *Credit Suisse - Analyst*

Okay, thanks.

Adrian Hennah - *Smith & Nephew - CFO*

Which meant that we felt that the average for quarter four slightly over-stated the -- where the market was going.

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Scott Bardo - *Credit Suisse - Analyst*

Okay. Thanks Adrian.

David Illingworth - *Smith & Nephew - Chief Executive*

Yes, you bet.

Operator

Thank you. The next question comes through from the line of Ilan Chaitowitz from Redburn Partners, Ilan your question please.

Ilan Chaitowitz - *Redburn Partners - Analyst*

Almost, it's Ilan Chaitowitz from Redburn. Morning. Thanks for taking the question. Just a couple of questions. Firstly on your margin guidance which you are sticking to, just wondering if you are forecasting a steady state environment from Q1 to get to your margin guidance, or if you are forecasting an improvement in Recon and market growth to get to it.

And the second question is there wasn't really any star product launches, I think, with any of the big players, but you as well at Las Vegas. And I am just wondering if, given the trend in Q1, we should expect to see lower than market growth for the remainder of this year within Recon in particular.

David Illingworth - *Smith & Nephew - Chief Executive*

Okay. Well I think -- look, I think, in terms of what we expect from the environment and the headwind is that we don't expect it to get any easier any time soon. And it could potentially soften a little bit more, make it a little bit more difficult for us. And I don't really know how to give you a lot more information other than that.

I don't think we are assuming any kind of steady state from any period. I think what we are doing is being thoughtful about the fact that we have a bigger challenge in front of us, and we have a little bit less line of sight on exactly what we need to do.

But we are committed to doing everything that we can, and we do believe that there is substantial opportunity in this business for us to improve the margins. So that would be my comment on the guidance there for margin, unless you want to add anything?

Adrian Hennah - *Smith & Nephew - CFO*

No. Just to emphasize that it's because of the uncertainty, and we certainly don't think we've got a better crystal ball than you guys on the phones. Because of the uncertainty that we are calling out the risk and that the uncertainty is bigger and the risk therefore is bigger that's really the logic of it.

Ilan Chaitowitz - *Redburn Partners - Analyst*

Okay.

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David Illingworth - *Smith & Nephew - Chief Executive*

What was the other question about product launches? (Inaudible). We -- your probably right we didn't focus as much as the AAOS on new products. I think a lot of companies didn't focus as much on new products.

But we've had a -- we've had a recent series of pretty successful new product launches. They are nowhere near their full potential, but there is a long way for them to go.

We feel very good about our pipeline across the business. We certainly don't have a new BHR or an OXINIUM in the near term, but we are comfortable with the number and quality of the more incremental improvements that we are bringing out.

In Recon for instance, we brought out the R3 Acetabular Cup in a formal launch, and it's fully approved in the US. We have a new system called VISIONAIRE that we are launching, which is a custom cutting block. Which not only has benefits for the patient in terms of more accurate implants hopefully, but also more -- it has benefits for the payers as well and the providers in terms of their efficiency and how long it takes them to actually do a procedure.

And for us, it has benefits in the term -- the value proposition for us is that we can do it with fewer instruments, and we get much more effective and it fits right in with what we are trying to do in terms of designing new products.

We also have a mid-head resection BHR that is outside the US. In Trauma we've had recently extensions of the leading Perilock system, and we've had a couple of range extensions on the INERTAN Nail that's going to be coming up in the next couple of quarters.

And in Endoscopy we brought out a new product called BONECUTTER ELECTROBLADE which we are pretty excited about. We just introduced OSTEORAPTOR Anchor, which extends our repair range into small joints. And in Wound Management we brought out a whole new platform of pumps.

So, there has been a lot going on. We probably didn't trumpet it as much as we normally would at the AAOS, because we were focused on some other things. But we feel pretty good about where we are.

Ilan Chaitowitz - *Redburn Partners - Analyst*

Thank you. It was just -- it was more a question of the -- of your current portfolio and growing below market. And I guess how long do you think that could persist for?

David Illingworth - *Smith & Nephew - Chief Executive*

I don't think I would trade my portfolio with anybody. Off the top of my head I can't think of anybody out there that I'd want to trade with.

So I think -- look I think I said it earlier, or I'd repeat what I said earlier in the sense of if you go back six or seven years, if you take the last 25 or 30 quarters, there is probably only -- you can probably count the number of quarters on one hand where we didn't meet or exceed the market growth rates in Orthopedics.

So the vast majority of those quarters we've outperformed. And you are going to have this ebb and flow and warp and weft in your quarterly results. And it doesn't alarm us. We've got a really good portfolio and we are very excited about our future.

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Ilan Chaitowitz - Redburn Partners - Analyst

Thank you.

Julie Allen - Smith & Nephew - Corporate Affairs

I think we've got time to take about one more question.

Operator

Okay, thank you. The next question comes through from the of Justin Smith from MF Global. Justin your question please.

Justin Smith - MF Global - Analyst

Thanks very much for taking my question its actually two, the first one just going back to the EIP and just in response to Michael's question earlier with regards to rolling up your sleeves.

I am just kind of wondering if isn't that process of trying to find new savings or new efficiencies we should be thinking about extra incremental benefits in -- beyond your target of fourth quarter '10. If there is any extra benefits that might come through there.

And the second question is just going back to Tom's question and talking about the dividend. Is it very much a case that we shouldn't be thinking about doing any increases beyond earnings growth because there is this priority on deleveraging? Or is there a lot more to it in terms of dividend policy than that? Many thanks.

David Illingworth - Smith & Nephew - Chief Executive

Okay. Well I think if I started talking about any incremental benefits over our current targets, Adrian would jump across the table and tackle me and put a muzzle on me. We certainly have our hands full. He is shaking his head, by the way, in the vertical direction.

We've got our hands full. We've got a lot of great programs going on. I really believe that if you take a look at what we've done that we've demonstrated that there is real programs going on. They take a lot of work. There is a lot of people involved. It's heavy lifting many times.

You don't pick up and move from Florida to China with your manufacturing without a lot of effort by a lot of people, and so we are just focused on the things that we have available to us.

We clearly have more risk in the system because we've got the greatest global economic meltdown over the last 80 years that we are faced with. And so, no, I wouldn't say that we are -- we would be anywhere -- we would be bullish at all about expanding our commitment on that. But we do believe that those targets are still available to us.

As far as the dividend do you want to take that?

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Adrian Hennah - *Smith & Nephew - CFO*

Yes. Justin our policy on the dividend for, I think, since 2005 has been one of 10% increase in dollar terms unless there is a good reason why not. And we are -- we haven't discussed changing that. And if we do -- if there is a reason we will change it obviously, but at the moment that's our policy.

Justin Smith - *MF Global - Analyst*

Okay. Many thanks. Thank you.

David Illingworth - *Smith & Nephew - Chief Executive*

Okay, well thank you. Thank you all very, very much. We appreciate the attendance and the participation and the great questions, appreciate it.

Operator

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

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