

# FINAL TRANSCRIPT

**Thomson StreetEvents<sup>SM</sup>**

## **SNUF.PK - Q1 2008 Smith & Nephew Earnings Conference Call**

Event Date/Time: May. 01. 2008 / 7:00AM ET

May. 01. 2008 / 7:00AM, SNUF.PK - Q1 2008 Smith & Nephew Earnings Conference Call

## CORPORATE PARTICIPANTS

**David Illingworth**

*Smith and Nephew - Chief Executive*

**Adrian Hennah**

*Smith and Nephew - CFO*

**Julie Allen**

*Smith & Nephew - Corporate Affairs Officer*

## CONFERENCE CALL PARTICIPANTS

**Michael Matson**

*Wachovia Securities - Analyst*

**Martin Wales**

*UBS - Analyst*

**Yi-Dan Wang**

*Deutsche Bank - Analyst*

**David Adlington**

*Cazenove - Analyst*

**Michael Jungling**

*Merrill Lynch - Analyst*

**Hans Bostrom**

*Goldman Sachs - Analyst*

**Jason Wittes**

*Leerink Swann & Co - Analyst*

## PRESENTATION

### Operator

Good day ladies and gentlemen, and welcome to the Smith & Nephew 2008 Q1 results conference call. For your information, this conference is being recorded. Before we begin, we would like to read out the Safe Harbor statement.

This presentation contains certain forward-looking statements within the meaning of the U.S. Private Securities Litigation Reform Act of 1995. In particular, statements regarding planned growth in our business and in our operating margins discussed under outlook are forward-looking statements, as are discussions of our product pipeline. These statements, as well as the phrases aim, plan, intend, anticipate, well-placed, believe, estimate, expect, target, consider and similar expressions are generally intended to identify forward-looking statements.

Such forward-looking statements involve known and unknown risks, uncertainties and other important factors including, but not limited to, the outcome of litigation and regulatory approval that could cause the actual results, performance or achievements of Smith & Nephew, or industry results, to differ materially from any future results, performance or achievements expressed or implied by such forward-looking statements. Please refer to the documents that Smith & Nephew has filed with the U.S. Securities and Exchange Commission under the U.S. Securities Exchange Act of 1934, as amended, including Smith & Nephew's most recent annual report on Form 20F, for a discussion of certain of these factors.

All forward-looking statements in this presentation are based on information available to Smith & Nephew as of the date hereof. All written or oral forward-looking statements attributable to Smith & Nephew or any person acting on behalf of Smith & Nephew are expressly qualified in their entirety by the foregoing. Smith & Nephew does not undertake any obligation to update or revise

May. 01. 2008 / 7:00AM, SNUF.PK - Q1 2008 Smith & Nephew Earnings Conference Call

any forward-looking statement contained herein to reflect any change in Smith & Nephew's expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

I would now like to hand the call over to your host today, Mr. David Illingworth, Chief Executive of Smith & Nephew. Please go ahead, sir.

---

**David Illingworth** - *Smith and Nephew - Chief Executive*

Thank you very much. Good morning and good afternoon everyone, and thank you for joining us for our first quarter results conference call. With me is Adrian Hennah, our Chief Financial Officer. Today I'll start with the business review and then hand it over to Adrian to take you through the numbers.

So starting with the business highlights for the quarter. This quarter I have some good performance to report, and one negative issue to deal with. I'd like to deal with the negative issue first.

During the integration process for Plus, we found that in parts of the business the sales practices were not as we expect in the Smith & Nephew Group. We're sensitive about discussing these in any detail as we're still investigating some of the issues, and we intend to explore all of our options. The majority of these issues are in Greece, where the bulk of our combined \$60m plus business will be impacted.

We're taking this very seriously. We're conducting a thorough investigation and have taken prompt, decisive action. These practices were against the ethics and policies of Smith & Nephew, and some people were acting in a way entirely unacceptable to us. We will not compromise our standards on this. And we will take the management actions required to prevent any undermining of those standards.

Our actions have had an effect this quarter on our revenues in Europe in Trauma and Reconstruction. Adrian is going to outline the impact we expect for the full year as he takes you through the numbers.

Now I'd like to talk about the businesses. As our competitors have pointed out, this quarter was affected by the Easter effect which reduced sales days by 2% to 3%. Reconstruction had a good quarter, a very good quarter up until the end of February. March was much slower across the business as the AAOs, March, Easter and spring breaks had an unusual impact.

We have good underlying strength in Reconstruction and continue to grow ahead of the market. BHR continued to drive growth in the U.S., and our Knee business grew as we expected.

Trauma, excluding Plus products, in Europe had a very good quarter, but not so good in the U.S. where we have identified some operational issues and have a clear management plan to address them.

Endoscopy growth continued to be strong outside the U.S. and the planned changes in the U.S. which we outlined last year should position us well going forward.

Advanced Wound Management completed a major launch of Negative Pressure Wound Therapy globally. And although our U.S. sales team was clearly focused on this, to the distraction of the broader business, the trade off will be worth it and we continue to be optimistic about the long-term growth prospects this technology will bring to our broader business.

Our earnings improvement program has performed well this quarter, with three out of the four businesses delivering over 200 basis points of margin improvement. We remain confident about the outcome of this program.

May. 01. 2008 / 7:00AM, SNNUF.PK - Q1 2008 Smith & Nephew Earnings Conference Call

Our Reconstruction business had a good first quarter. It outperformed the market growth of 8%, excluding Plus. BHR continues to do very well in the U.S. We're building a great business there and accessing some major accounts. We have an over 50% worldwide market share in resurfacing and remain very positive about BHR in the United States.

Our booth in March at the AAOS was very, very busy as more surgeons than ever came to see our innovative range of products which we believe are second to none in the industry.

Our performance in parts of Europe this quarter was frustrating as the Plus issues impacted and masked an otherwise strong performance. However, we are not going to compromise on our standards, even when it means virtually closing down a business, as we have done in Greece. Our underlying performance in Europe remains healthy.

On the Knee side, excluding Plus, revenues grew by 7%. The innovations that make JOURNEY and DEUCE such great products are gaining acceptance and have helped us regain our positive growth rate in this segment. Given the strength of our product range we would be clearly disappointed if we did not continue to improve our performance in this important market segment.

Our Hip business also performed well, led by BHR in the U.S., where Hips grew by 11% globally, excluding Plus. Excuse me, globally excluding Plus, Hip revenues grew by 9%. Japan had a good quarter as the Plus integration delivered some positive benefits and we are enthusiastic about our prospects there.

The growth in underlying margin in this business was 240 basis points, a good result, and comes from a mix of EIP benefits which account for over half of this improvement and a short-term slowing in research activity as we agreed our research programs with a federally appointed monitor. We now have approval for most of the year's work. It has just taken a while to get there. Our product range is in great shape and will drive growth for the year.

Now, looking forward in Reconstruction, first we have a clear focus on finishing up the integration of Plus and standardizing the sales practices. We expect the impact of this work to be felt for the next two quarters of the year. We know what needs to be done and we are doing it. In the bulk of Plus in Europe we are seeing good performance, with a motivated and energized team joining the Smith & Nephew family.

We have some excellent new products which are key growth drivers. The R3 cup is being very well received and gives surgeons uncompromised flexibility in choice of bearing surfaces. VERILAST, a new articulating surface, significantly reduces wear compared to all load-bearing formulations currently available, and the new LEGION platform continues its quest in establishing itself as the premier revision system.

We also plan to expand our sales force further to cover some territories that are currently underserved and expect to complete this action this year. We've already recruited some very good people.

We acquired a sales force in Japan about two years ago and the team is now performing well. After seven years of regulatory hurdles, we finally have approval for OXINIUM in Japan and we are excited about the prospects.

Looking now at Trauma and Clinical Therapies. Trauma had a strong quarter in Europe, but U.S. performance was not good enough. Overall Fixation growth, excluding Plus, was 6%.

This management team has taken a careful look at the United States and we are clear that we know what the issues are. We are confident that we have as competitive a product range as anyone in the marketplace. We do believe the issues are operational and have an action plan in progress to address them. We will make -- we're going to be making structural changes to separate the trauma and clinical therapy segments, and we're taking actions to leverage both our direct sales force and our full line sales force through structure, people and programs.

May. 01. 2008 / 7:00AM, SNNUF.PK - Q1 2008 Smith & Nephew Earnings Conference Call

Moving on to Clinical Therapies, EXOGEN and DUROLANE in Europe both have performed very well this quarter, using their strong market positions to good advantage. And we have submitted our application for FDA approval for DUROLANE in the United States.

Volume growth across the broad clinical range continues to be good, but our joint fluid therapies business continues to be impacted by price declines and reductions in reimbursement in the marketplace as we expected.

In a quarter of slower revenue growth we achieved good margin growth, up 260 basis points, as our management team continue to be committed to the earnings improvement program and they continue to deliver on their commitments.

For the rest of the year we will make the changes we need to improve this business. We are making some significant structural moves which affect the way of which Reconstruction and Trauma interact and collaborate. These management actions will be coupled with an increased pace of direct sales force recruitment which slowed last year.

We believed, and still believe, that the acquisition of Plus will have a positive effect on our Trauma business in Europe and we remain committed to achieving those synergies, including an expanded sales force and critical mass in key strategic geographies.

In Endoscopy this quarter, performance has been actually very similar to Q4 last year. In the U.S. performance has been in line with our expectations. And outside the U.S. performance again has been very, very good. The actions we outlined last quarter for the U.S. business have been taken. We have a new head of the business and he's changing the internal structure of the business and we've made some key changes in management and sales reps. We've also made good progress this quarter and we expect to continue to do so.

Outside the U.S. growth has continued strongly for us as we benefit from a well developed infrastructure and previous investments. We have focused our visualization business on the more profitable segments, as we've outlined before. And this strategy is now paying off for us. Endoscopy has continued to have good margin growth, an increase of 230 basis points, driven by management actions and from the facility closure last year and the focus on the profitable segments.

Now, for Endoscopy for the rest of the year, we're going to continue our strong focus on arthroscopy, which is a key strength for us. We'll also continue to invest in high-growth segments, such as repair in the shoulder, hip and knee. Geographically we're very strong outside the U.S. and, as we said last quarter, we already have actions in place for the United States which we expect to get us more in line with performance in the market.

We feel good about the new products we have in the pipeline, including the FOOTPRINT Anchor we launched at AANA this week. The team is focused on the continued deliver of our operational excellence.

Now, turning over to Advanced Wound Management this quarter, first and foremost, we had a very successful launch of Negative Pressure Wound Therapy globally. And thankfully now we're able to talk a little bit more about it. We've done a lot of work here. We've launched two new products. We've held multiple training events, attended by over 1,000 potential customers, made up of physicians, surgeons and nurses. We've issued new product literature. We've significantly increased our U.S. sales force to ensure we have the right team for the job. And we've also put new management in place.

We have many customers evaluating our Negative Pressure Wound Therapy products in clinical settings, and we are supporting these in a big way, with help from UHS in the United States.

We're excited about the longer-term prospects for Negative Pressure Wound Therapy. Against the backdrop of this major effort to get Negative Pressure started in the right way, the core U.S. business, which is about 20% of the Advanced Wound Management, was impacted. We believe it is the right tradeoff as we face off with a firmly established competitor. Our confidence continues to build as we remain convinced that we can bring our customers a more flexible and superior solution for their Advanced Wound Care needs.

May. 01. 2008 / 7:00AM, SNNUF.PK - Q1 2008 Smith & Nephew Earnings Conference Call

In Europe, the business performance was line with our expectations, continuing the momentum of Q4 last year. Margins in the quarter were impacted in the short term, predominantly by the cost of the Negative Pressure Wound Therapy launch.

Now the outlook for the rest of the year for Advanced Wound Management. First, we invested in a very big way in the launch of Negative Pressure Wound Therapy. This investment of time, focus and money was absolutely the right move as we begin to engage this \$1b plus market with one dominant well-established player. Now we are moving on to gain the benefits available to us in this fast-growing segment globally. We have the right structure in place to leverage revenue growth on the strength of broader customer penetration in both the Negative Pressure Segment and the core business. As I've said before, we are in this for the long term. And we are laying the foundation to build a substantial business.

Outside of Negative Pressure, we have some significant new products which will drive growth going forward. ALLEVYN Ag is a silver-based dressing, with a lower silver content than Actico and which has more indications for us -- excuse me, more indications for use given its lower price point.

ALLEVYN GENTLE BORDER is a new form of ALLEVYN which reduces the likelihood of tissue damage and which is becoming very popular with the nursing community and patients. We offer the widest range of clinically effective products available on the market, and our plan is to capitalize on this fact as we grow our presence in negative pressure.

Advanced Wound Management has a lot of potential and we're working hard to deliver that potential in the revenue and margin lines.

So, with that, I'm going to turn it over to Adrian to take you through some of the highlights on the numbers.

---

**Adrian Hennah** - *Smith and Nephew - CFO*

Well, thank you Dave. And good morning, ladies and gentlemen. You can turn to slide 14 and the income statement.

Revenue in the quarter was \$911m, giving a headline growth rate of 22% on a comparable period last year. Underlying growth, after adjusting for exchange rate and the acquisition of BlueSky was 2%. We estimate that the overall Group growth number was reduced by about 2% to 3% due to the lower number of selling days in quarter one, 62 as compared to 64 last year.

Our actions to harmonize sales practices in the former Plus organization have had a material impact on growth in the quarter. Excluding Plus products, Group sales grew at constant currency by 5%. Sales of Plus products fell by 17% in quarter one, on pro-forma sales in quarter one 2007 before the acquisition by Smith & Nephew. Most of this reduction was a direct result of our actions to harmonize sales practices. Some was the result of normal post-acquisition dis-synergies as sales forces are combined.

Trading profit in the quarter was \$182m, representing an underlying growth of 6%. The underlying increase in the trading margin was 60 basis points in the quarter. The center spend on R&D was 3.6% in quarter one, down from 4.3% last year, mainly due to the time taken to get monitor approval in the U.S.A. for some research work.

We explained at the time of the Plus acquisition that the inventory revaluation item was a non-cash item required under IFRS. The charge in quarter one was \$15m, in line with the guidance we gave at quarter four. There will be no further charges. The amortization charge for acquisition intangibles in the quarter of \$10m includes \$6m for Plus and BlueSky intangibles. Net interest expense in the quarter was \$16m, about a 5% interest rate on average net debt.

Moving then to the next slide, slide 15, and looking further down the income statement, tax charge in quarter one before exceptionals and amortization is 31%, our expected rate for the full year. The adjusted attributable profit for quarter one was \$114m. Adjusted earnings per share grew at 14%, higher than underlying trading profit growth of 6% for three reasons. Exchange movements increased earnings growth by about 3%. Accretion on the share buyback increased it by a further about 1%, and

May. 01. 2008 / 7:00AM, SNNUF.PK - Q1 2008 Smith & Nephew Earnings Conference Call

4% of the growth rate was due to the differing treatment of the acquisitions of Plus and BlueSky under the definition of underlying trading profit and adjusted earnings per share.

Turning to slide 16, 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. You can see in the currency column the impact of the weaker dollar on the translation of our numbers. The average value of the dollar was 14% lower in quarter one 2008 against the euro than quarter one last year, and 1% lower against sterling. We have put the rates and our sales by main geography in the appendix to your pack.

With regard to the adjustment for acquisitions, it might be helpful to remind you that in the year following the year in which an acquisition is made, we calculate the underlying numbers by adding the sales and profit of the acquired entity on a pro-forma basis to the comparative figures.

If we were to exclude the Plus product numbers altogether on the comparative and from the current year numbers, we would, as mentioned a couple of minutes ago, be reporting underlying sales growth from the legacy Smith & Nephew business of 5% for the Group as a whole. We would also be reporting 8% for Recon and 5% for Trauma. We have shown these pro-forma numbers at the right-hand side of this table.

As Dave has said, growth from the Smith & Nephew Recon business in particular was strong. Plus product sales fell 17% on quarter one last year for the Group as a whole, by 13% in Recon and by 51% in Trauma.

Turning to the next slide, slide 17, and an analysis of revenue growth rates by segment and by geography. As we've just seen, the underlying growth rates in our Reconstruction business was 2%, including the legacy Plus products. Hips grew at 4%, Knees at 1%. Excluding Plus products, Recon sales grew 8%.

In the U.S.A. growth in the Knee business was 5%, or a couple of points higher adjusting for the fewer business days. Total Hip growth in quarter one in the U.S.A. was 11%, or again a couple of percentage points higher adjusting for the fewer business days.

Growth in BHR sales in the U.S.A. in quarter one remained strong, but sales were slightly lower than a very strong quarter four, in part due to a small reduction in average selling price.

In Europe, the steps we have taken to improve sales practices in the former Plus organization reduced Recon sales directly by around \$10m in the quarter. Associated disruption has also reduced growth. Like-for-like pricing in our Reconstruction business in the U.S.A. and also outside the U.S.A. on average was slightly negative.

Trauma and Clinical Therapies growth rate was flat, including the legacy Plus products, 5% excluding them. Growth in Fixation in the U.S.A. was weak at around 1%. As you've heard from Dave, we see this as an operational issue and not a product issue.

Clinical Therapies sales growth in the U.S.A. was also 1%. EXOGEN performed well, but SUPARTZ have impacted further by the pricing weakness we experienced through 2007.

Inherent growth in Trauma in Europe was strong. Sales were, however, reduced by about \$6m in quarter one, and growth by almost 20 percentage points, by the steps we have taken to improve Plus sales practices in Europe. Plus had a meaningful Trauma business in Greece which has deteriorated sharply.

Endoscopy growth rate was 4%. Within this the Arthroscopy growth rate was 7%, visualization sales, including DOR, fell by 5%. Endo sales outside the U.S.A. were again strong, with double-digit growth. Sales fell in the U.S.A. by 3% or around flat, adjusting for the fewer sales days.

May. 01. 2008 / 7:00AM, SNUF.PK - Q1 2008 Smith & Nephew Earnings Conference Call

Wound sales grew at 2%. There was solid growth in Europe and Asia. Dave has explained, this was held back by a sales decline in the U.S.A., caused in particular by the focus on preparing for the full launch of our NPWT products.

Turning then to the next slide, which is slide 18, this shows the usual analysis of revenue and trading profit by business segment. As we've already noted, underlying trading margin for the Group overall increased in the quarter by 60 basis points. The reported margin increase of 10 basis points was diluted by 50 basis points by consolidating the lower margin Plus sales which we did not own in quarter one last year.

All three orthopedic businesses showed strong underlying margin improvement in the quarter, Recon up 240 basis points, Trauma up 260 basis points, and Endo up 230 basis points. Trading margin would also have been about 50 basis points higher but for cost arising from the harmonization of Plus sales practices. It has not been immediately possible to reduce overhead cost in line with the lost sales, and we have incurred investigation costs.

Margin in Wound fell substantially on quarter one last year, due principally to costs associated with the launch of the NPWT products. Excluding these costs the margin would have fallen slightly on the comparative quarter which we said at the time reflected some one-off margin benefit.

Turning then to the next slide, slide 19, and the outlook for the rest of 2008. Our view of the Company's overall outlook for the year has been impacted by the changes we are making to the former Plus sales practices. Our investigation into Plus practices in Europe has been very thorough, but it is not yet fully complete. Based on the investigation to date we are currently expecting the harmonization of sales practices to reduce revenues in a full 12-month period by about \$100m.

A large proportion of these customer relationships were lost in quarter one. We currently expect most of the rest to be lost quite quickly. Therefore we estimate the impact on 2008 revenues to be close to the \$100m 12-month impact. Apart from this rebasing of Plus revenues, we do not expect any impact on the robust revenue growth of the Group.

The greatest part of this Plus impact is in Greece. Pro forma sales in 2007 in Greece were over \$60m. We are expecting to have only very modest ongoing sales in Greece in the near term.

We expect the loss of profit on the lost sales, after initial transition, will be the trading profit margin in Recon and Trauma, i.e. around 25% on the lost sales. We will see a somewhat higher impact on profit and margin in the short term. It takes some time to adjust the cost base, and we are bearing some costs associated with the investigation.

In the Recon area, we believe that underlying global market growth, after adjusting for the impact on all competitors of the Easter effects, remained around 8% through quarter one. We continue to expect our growth to exceed market growth in the U.S.A. in 2008. Growth in Europe will be reduced by the impact of the Plus changes, 70% of which we expect to impact Recon.

Within the Trauma and Clinical Therapies business, we continue to see global market growth from Fixation of about 11% through quarter one. In the U.S.A., after a weaker than expected quarter one, we now expect to recover to market growth in Fixation by the year end. Within Europe, we expect about 30% of the reduction in revenues as a result of the changes in Plus sales practices to impact Trauma.

Endo and Wound, our review remains the same as in February.

We signaled with our quarter four numbers the two fewer working days in quarter one this year than last year. The rest of the year there is one additional day in quarter two, the same number in quarter three, and two additional days in quarter four.

As far as margins are concerned, we have mentioned that we expect the modest short-term impact on margins from the harmonization between sales practices. We remain, however, firmly on track with our earnings improvement program.

May. 01. 2008 / 7:00AM, SNUF.PK - Q1 2008 Smith & Nephew Earnings Conference Call

And with that update on the outlook, I'll hand back to Dave.

---

**David Illingworth** - *Smith and Nephew - Chief Executive*

Thank you, Adrian. The sales practice issues in parts of the former Plus business are unfortunate, but we've taken decisive and necessary actions in order not to compromise our global standards. We do know that there are significant benefits to come from our acquisition of Plus, and we are committed to working to achieve these.

What I do want to leave you with is our strong belief that the underlying fundamentals of our business are good, and the global market conditions continue to be favorable, driven by underlying demographic trends which are creating strong demand for Smith & Nephew products.

Our Reconstructive business has a track record of consistently outperforming the market and is increasingly becoming known as the provider of real innovation. The focused sales channels that we have across our businesses are firmly established. And now we can focus our attention on achieving better collaboration between those channels.

We have a very strong product portfolio in all of our businesses and are augmenting this with exciting new products, not the least of which is Negative Pressure Wound Therapy.

Our earnings improvement program is, as we expected and as we committed, progressing well to deliver the full benefits of the program as we work toward sustainable, profitable growth.

Now we're happy to take questions. We'll use our usual system of sharing questions from both sides of the Atlantic. And I would ask the operator to try to manage that process equitably for us.

---

## QUESTIONS AND ANSWERS

### Operator

(OPERATOR INSTRUCTIONS). We will now take our first question from Michael Matson from Wachovia Capital Markets. Please go ahead.

---

**Michael Matson** - *Wachovia Securities - Analyst*

Hi. I was wondering, I guess if you could tell us on the Plus issues, how much of that \$100 was in the first quarter. I guess it's a little unclear based on what you're saying. Were these issues discovered late in the quarter, early in the quarter?

---

**David Illingworth** - *Smith and Nephew - Chief Executive*

Well, there's a couple of different questions there. There's the technical question of what is where, and I'll let Adrian handle that. But before I do that, let me just maybe try to answer the second implied question in there and that is a little bit on the timing.

We discovered some issues during the integration of these two companies, some sales practice issues that we were not comfortable with. We embarked on a very thorough investigation to try to understand exactly what was going on. We used internal resources and we also used external resources. We used a major European law firm and we used some expert, accounting experts as well.

May. 01. 2008 / 7:00AM, SNUF.PK - Q1 2008 Smith & Nephew Earnings Conference Call

And we have worked very, very hard to try to get to the point where, today, we can sit here and give you as much transparency as we possibly can. So that's how we got to where we are. We became aware of the issues. We felt compelled to do a thorough and formal investigation. And we are where we are today. We can't give you 100% transparency on this because we have some issues that we still need to deal with. The investigation is not 100% complete, although I don't want to leave you with the impression that we aren't very, very far down the path, because we are. So that's a point to note.

The other point to note is that there are some legal issues, given the fact that we are going to aggressively pursue all of our available options with our vendors. And so we're limited somewhat in what we can and can't say.

So hopefully we've given you enough transparency here to give you a flavor for where we are. And we have tried very, very hard to try to be as accurate as possible, humanly possible, to predict the full impact of this.

With that, I'll turn it over to Adrian. Maybe, Adrian, you can take us through some of the timing.

---

**Adrian Hennah** - *Smith and Nephew - CFO*

Yes, Michael, the narrow answer to your question is we calculate the direct impact of sales lost due to changes in selling practices in quarter one was in the \$16m to \$20m range. \$10m-ish in Recon and \$6m-ish in Trauma. And I think when you see that we are guiding towards around \$100m full-year effect, you can see that the effect has been pretty swift in the first quarter.

---

**Michael Matson** - *Wachovia Securities - Analyst*

Okay. And then with regard to Dave's comment there about the fact that there were some accounting firms involved in this investigation, is there any possibility there could have to be a restatement of financial results?

---

**Adrian Hennah** - *Smith and Nephew - CFO*

No. We're dealing here with sales practices. The reason accounting firms are involved is you want to get into the records to see exactly what's been going on. But we are talking here about sales practice issues.

---

**David Illingworth** - *Smith and Nephew - Chief Executive*

Yes. That's a very good clarification, Adrian. We have used multiple outside experts, agencies, to assist us in the investigation. But clearly these -- what we found and what we always believed and what we found is that this is limited to sales practices.

---

**Michael Matson** - *Wachovia Securities - Analyst*

Okay. And then on the Trauma in the U.S., can you give us some additional details on the problems that you're seeing there? What exactly is going on?

---

**David Illingworth** - *Smith and Nephew - Chief Executive*

Yes, you know what, we have -- I think we've been pretty open and transparent about this in the past. We've talked very openly in our quarterly meetings about the fact that were not -- we were not completely happy with our performance in the U.S.

I think if you go back just a little bit in time here, we divisionalized our business, essentially under some central leadership in Memphis, both the Recon and Trauma businesses. We created divisions. And we had very strong collaboration between those

May. 01. 2008 / 7:00AM, SNNUF.PK - Q1 2008 Smith & Nephew Earnings Conference Call

businesses. And we were actually doing really, really well. We were growing our Trauma business up around 20% and our Recon business up in the high teens, and feeling pretty good about what was going on.

We actually -- we have moved the divisionalization past where I think it is being productive for us. And we need to be able to get the collaboration between the full line sales. What we have today is our full line sales channel reports into our Reconstructive business totally. And our direct Trauma sales channel reports into the Trauma business, obviously. And I think we've lost the collaboration between those two businesses because the Trauma business really is dependent on the full line sales team being effective in delivering sales for the Trauma business. That's why they're called full line sales.

And we've been very, very open with all of you in the past that we thought that this was a major part of the issue. And we're going to make some structural changes. We're not going to give you the exact details today because we haven't announced everything internally. But we're going to make some structural changes, some leadership changes and we're going to get back on track.

We've got a great product line. We deserve to have a much stronger business there. We've always said that. And that's -- and we're moving forward with it.

---

**Michael Matson** - *Wachovia Securities - Analyst*

Okay. And then one final question on the Negative Pressure Wound Therapy. The heavy investment that you're making there and the margin pressure that we're seeing, how long do you expect that phase of the program to continue?

---

**David Illingworth** - *Smith and Nephew - Chief Executive*

Well, we think it's going to pass pretty quickly. That's our prediction. Hopefully that will be true over time. We put a massive effort in place in the first quarter of this year. Think about the fact that we've added a large percentage of new people in the sales force, and getting the right skills. We've got to train all those people. Our management team is focused on training those new folks.

We've brought over 1,000 potential customers in, in multiple locations around the world, to expose them to our products. And that requires all the follow-up that is generated from events like that. We have developed new product material. We've developed new marketing material. We've developed new sales material. We have launched two new rebranded products. And we're out helping UHS get up to speed.

So, you know what, we knew that we were going to be making a trade off of sorts. But the stakes for us are big, and we think that this is a big lever for us. And we tried to do it the right way.

And, you know, our U.S. business is only 20% of our total Wound Care revenues. So kind of have to put it a little bit in perspective. And the reason why they are only 20% of our global revenues is because we haven't had a product like Negative Pressure and others to really give us the real leverage in this marketplace, so we are investing in it right now.

So I think it will pass pretty quickly, we are expecting it to pass pretty quickly. We might see a little bit in the second quarter, but it's going to pass pretty quickly, and we are going to reap the rewards down the road for this.

---

**Michael Matson** - *Wachovia Securities - Analyst*

Alright that's all I've got, thanks.

May. 01. 2008 / 7:00AM, SNNUF.PK - Q1 2008 Smith & Nephew Earnings Conference Call

**Operator**

The next question will come from Martin Wales from UBS. Please go ahead.

**Martin Wales - UBS - Analyst**

Good morning, good afternoon. Just following on from the previous question slightly, in the past you've talked more generally about the issue of how you keep your sales force discipline, yet get some -- encourage cross-selling. To what extent any change you're making in Trauma or elsewhere, taking that into account. And do you have anything else you can add in terms of what progress you've made in pursuing that argument about getting some element cross-selling across there in Trauma and Recon?

**David Illingworth - Smith and Nephew - Chief Executive**

Well I think this is a move towards that Martin. We've always talked about the leverage we could have. The first thing we needed to do was establish these unique selling channels. And sometimes you have to make a statement about these unique selling channels, and we've done that.

I think what we did individualizing these businesses -- you know, we have a division for Sports Medicine, we have a division for Trauma, and we have a division for Recon. And to establish those unique sales channels is critical so that they can all stand on their own.

I think now we are in phase where we are going to start moving towards getting some collaboration between those sales channels. You are not seeing it today. But I think you are going to see it in the very near future. And the first step is going to be getting back the momentum that we had in this Trauma business when our full line sales team was working closer with the Trauma sales team.

**Martin Wales - UBS - Analyst**

How, thanks David, how happy are you with the momentum you are seeing in the U.S. knee business? Obviously it's been quite a mixed bag in recent quarters with a weak Q3 a strong Q4, reasonably strong underlying Q1, but not quite as strong as Q4. Are we right to read the trend line as being upwards? Is there more to be done there?

**David Illingworth - Smith and Nephew - Chief Executive**

Well you were breaking up a little bit, so I am not sure I got the exact question.

**Martin Wales - UBS - Analyst**

About U.S. Knees. Are you happy with the momentum?

**David Illingworth - Smith and Nephew - Chief Executive**

U.S. Knees, well, yes, I am pretty happy with it. I mean, would I like it to be higher? Sure, I'd like it to be a lot higher. I think we've got a very, very strong Knee platform. I've been saying this for three or four quarters now. And we knew that we had to rebalance the focus of our full line sales team. And they were putting a lot of effort into the BHR launch, which by the way is paying huge dividends for us now. So its -- it was a great thing to do.

May. 01. 2008 / 7:00AM, SNNUF.PK - Q1 2008 Smith & Nephew Earnings Conference Call

I think we probably saw a little bit higher up-tick in fourth quarter than we were expecting. And we tried to sort of get everybody's expectations down a little bit after we got out of the fourth quarter of last year. So its pretty much were we expected it. I think if you draw a trend line we are pretty happy.

We are still a little bit behind market growth rates, maybe a 1%, 1.5%. And we'd like to be up at market growth rates or a little bit higher. But we'll just keep marching in that direction. So, yes, I -- that's a very long answer to a question I could have said, yes, I am happy.

---

**Martin Wales** - UBS - Analyst

Okay, thank you.

---

**Operator**

Yi-Dan Wang from Deutsche Bank will have our next question.

---

**Yi-Dan Wang** - Deutsche Bank - Analyst

Thank you very much. First of all regarding to the Wound Management division, can you give us an indication of the investments you expect to go into the Negative Pressure Wound Therapy part of the business in the rest of the year? I suppose specifically whether the investments we saw in Q1 was a bolus investment, or is that amount going to be maintained through -- well for the rest of '08, and then margins will improve as sales come in. So if you could give us some indications there that would be great? And then I have a couple of more questions.

---

**David Illingworth** - Smith and Nephew - Chief Executive

Okay.

---

**Adrian Hennah** - Smith and Nephew - CFO

Yi-Dan, its Adrian here. It won't surprise you to know that we are not going to give you completely as much quantification as you'd like on this. But the answer is partly yes it was a bolus, and Dave gave you a sense of some of the activities that were going on the quarter. The level of number of potential customers we've had in, the amount of training we've had to do. And clearly that's not a level that's going to be sustained through the whole of the year. So the expenditure will wane somewhat.

But equally some of the expenditure we've incurred, for example, the expansion of the sales force is there on an ongoing basis. And we expect that to be recovered from the expanding sales. So it's a bit of both, which is probably not a surprising answer to you Yi-Dan.

---

**Yi-Dan Wang** - Deutsche Bank - Analyst

Okay. So regarding -- just a follow up from that, regarding the sales force expansion, can you give us a sense of how much your U.S. sales force base has increased by? And whether the increase we saw in Q1 would sustain you for the next, I suppose, two or three years as you leverage on this product line? Because I was under the impression that the sales force that you -- that the size of your sales force was adequate already.

May. 01. 2008 / 7:00AM, SNNUF.PK - Q1 2008 Smith & Nephew Earnings Conference Call

If you could clarify whether the sales force addition is Smith & Nephew own employees? Or does that also include the people that you had to train up at UHS? Thanks.

---

**Adrian Hennah** - *Smith and Nephew - CFO*

Well Yi-Dan there's been about a 30% increase in the size of our U.S. sales force in the first quarter.

---

**David Illingworth** - *Smith and Nephew - Chief Executive*

That's a rough number.

---

**Adrian Hennah** - *Smith and Nephew - CFO*

Yes, very roughly. The -- as for is it going to be that level for the next three years? We don't know. This is clearly an iterative process we are going to have to see what happens as we go forward.

---

**David Illingworth** - *Smith and Nephew - Chief Executive*

And it does not include the UHS resource though Yi-Dan.

---

**Adrian Hennah** - *Smith and Nephew - CFO*

That's absolutely correct.

---

**Yi-Dan Wang** - *Deutsche Bank - Analyst*

Okay. And then when do you expect the Wound margins to get back to where it was?

---

**Adrian Hennah** - *Smith and Nephew - CFO*

Relatively swiftly, Yi-Dan. The -- obviously a little bit depends on the exactly rate of growth of the NPWT sales. And that's clearly a little hard to forecast for us. Not only are we not giving guidance for it but there is a significant delta behind that, as you can imagine, the rate of which it -- so it's relatively swiftly but we can't be precise about it.

---

**Yi-Dan Wang** - *Deutsche Bank - Analyst*

Swiftly meaning in the next quarter or two, or is it more of a -- towards the end of '08?

---

**Adrian Hennah** - *Smith and Nephew - CFO*

Relatively swiftly, Yi-Dan.

May. 01. 2008 / 7:00AM, SNUF.PK - Q1 2008 Smith & Nephew Earnings Conference Call

**Yi-Dan Wang** - Deutsche Bank - Analyst

Fine, okay. My other questions then, if you look at Recon and the -- Recon margins specifically and then similarly for Trauma. What would it be if you exclude the DOJ cost and the negative impact from the Plus business that we saw this quarter?

**Adrian Hennah** - Smith and Nephew - CFO

The -- yes, I can't quantify it exactly for you. Not least because we are not giving you the exact monitor costs. But what I can tell you is the substantial increase that you saw in the recon margin was certainly boosted by the reduction in R&D spend, because of the delays in R&D spend in quarter one. But conversely it did have to absorb monitor costs, which are still [trotting] along and the associated costs.

And the -- for the Group as a whole, not specifically Recon but a large part was in Recon and the rest in Trauma. But for the Group as a whole we reckon there was a 50 basis points hit in the quarter as a result of the cost arising from our -- the actions around the Plus sales practices.

**Yi-Dan Wang** - Deutsche Bank - Analyst

Right, okay and then that 50%, presumably, will be the amount we expect for the rest of the year? Or it will probably bit a bit more than that actually.

**Adrian Hennah** - Smith and Nephew - CFO

No it won't Yi-Dan. The -- what -- this is quite an important bit of the guidance. What we're saying in terms of the profit impact from the reduction in sales, we are saying we expect in a full 12 month period, we said \$100m, roughly \$100m of sales reduction.

We are expecting that once we got through the transition that the drop through on profit on that will be the, essentially the orthopedic margin, around 25%. But that in the intervening period we will see an impact on profit that is somewhat higher, somewhat higher than 25 basis points. We do not expect it to be higher than 50 basis points. In fact definitely not, definitely less than that for the full year, because we would have born the bulk of the investigation costs up front, and we will be working, as you can imagine, to sort out the overheads quickly. So we would expect that percent to fall quite rapidly.

**Yi-Dan Wang** - Deutsche Bank - Analyst

Okay, great. Thank you. And regarding the Plus issues, when did you become aware of the unusual sales practices?

**David Illingworth** - Smith and Nephew - Chief Executive

Well, we became aware of them during the course of the integration Yi-Dan. And these practices came to light, came to our attention, suspicions however you want to call it. And as soon as we became aware of them we began a thorough investigation. It made substantial progress. It continues to make substantial progress. It's not fully complete.

And quite frankly we have -- you have to be very thorough on this. And it's not easy to find out exactly what's going on all the time. So what we have done is we have worked very, very hard to get to the point where we are today to try to give as much transparency as we can possibly give at this point in time. And I think we are actually able to give quite a bit in terms of our projections and the quantum's and where we think we are. But as far as any other details, exact details we are going to have to pass on those, just because we have some issues to deal with going forward with making any types of claims and legal issues we have to deal with.

May. 01. 2008 / 7:00AM, SNNUF.PK - Q1 2008 Smith & Nephew Earnings Conference Call

**Yi-Dan Wang** - Deutsche Bank - Analyst

Right. Are you able to indicate when you commenced your investigation, and why we were not made aware of these issues earlier? Presumably I believe this sort of thing would have been looked at during the due diligence process, before you bought the business.

**David Illingworth** - Smith and Nephew - Chief Executive

Absolutely. We did a thorough job of due diligence. And we did a very thorough job of due diligence. It was a competitive process. We had access to as much information as they would give us. We had the reps and warranties in the -- from the vendor. And we were -- we couldn't predict that we would find something in the integration that had not been disclosed to us.

So as soon as we became suspicious we started an investigation. It would not have been proper to alert anyone at any point in time until we understood what was going on. And now we understand and we are making a disclosure on it.

**Yi-Dan Wang** - Deutsche Bank - Analyst

Okay. Thank you.

**Operator**

(OPERATOR INSTRUCTIONS). Our next question will be from David Adlington from Cazenove. Please go ahead.

**David Adlington** - Cazenove - Analyst

Hi guys, thanks for taking the questions. Firstly I am just wondering, just on the Plus issue, I am just wondering why those sales have been completely lost. If you are just changing the sales practice I am just trying to get a feel for why they are completely lost, and you can't actually keep on selling to those surgeons.

**David Illingworth** - Smith and Nephew - Chief Executive

Because they are not buying from us.

**David Adlington** - Cazenove - Analyst

Are they buying from your competitors now or --

**David Illingworth** - Smith and Nephew - Chief Executive

Look David, I don't know where you are heading on this, but you'll have to appreciate that we are very, very unhappy with the sales practices that we found. There may be, as a consequence, potentially a number of legal issues arising, and there are clearly limits on how much detail we are able to share at the present. So I think there will be a time and a place for some additional transparency. And no one would like to have that more than us.

May. 01. 2008 / 7:00AM, SNUF.PK - Q1 2008 Smith & Nephew Earnings Conference Call

**David Adlington** - *Cazenove - Analyst*

Alright. Moving on to the Negative Pressure, you said that you had still 1,000 customers come in to look at the product so far. I was just wondering what sort of conversion you had from -- to people actually buying or at least trialing the product.

**David Illingworth** - *Smith and Nephew - Chief Executive*

The feedback has been great. We -- the customers that I've talked to and I've talked to a few, actually more than a few, have said that the product works very well, and they are excited about it. And they are glad that there is an alternative in the marketplace. We have a very entrenched singularly focused competitor. And we are just kind of duking it out in the marketplace right now. And -- but the feedback has been very good, very good.

**David Adlington** - *Cazenove - Analyst*

Give the lack of some clinical data in this area, are you finding that the fact that actual practitioners like to try out products themselves, do you find that they were at least trying out your product before taking a decision?

**David Illingworth** - *Smith and Nephew - Chief Executive*

Yes I think they are trying it out. The lack of clinical data generally from all competitors pretty much dictates that the customers are going to want to do an evaluation, and we encourage it. That's sort of our silver bullet here, is that our feeling is once we get into the account and they understand the flexibility and some of the technology advantages of our product, and the fact that it works is going to give us an advantage. And especially when you couple it with a broader range of potential offerings for these customers to solve in a cost effective way these chronic wounds.

So we are actually -- we are very bullish about it, but we are also, I've been saying this over and over again. And nobody is going to trip me up into saying something different today, in that I know is going to be a tough go in the early time, because the competitors -- it's a strong competitor. They've got a good product. They've done a good job developing the marketplace. They've got good strong key opinion leaders out there. And we can't just expect to walk in and start taking a large percentage of this market. We are going to have to earn it.

**David Adlington** - *Cazenove - Analyst*

Just one final follow up, you probably won't answer it anyway, but I thought I'd try. Any indications of what sort of discounts you are getting in against KCI?

**David Illingworth** - *Smith and Nephew - Chief Executive*

No, no we are hopefully not going in and selling this on -- based on price. We are going in with a broad product basket and a relationship on how we can help these hospitals be more efficient in solving these hard to heal wounds and that's how we are approaching it so no, no comment there.

**David Adlington** - *Cazenove - Analyst*

Alright, thanks.

May. 01. 2008 / 7:00AM, SNNUF.PK - Q1 2008 Smith & Nephew Earnings Conference Call

**Operator**

Michael Jungling from Merrill Lynch will be our next questioner.

**Michael Jungling - Merrill Lynch - Analyst**

Great. Thank you. I've got three questions; firstly if I look at Plus the sales will be reduced, I think, it's about \$100m. So are you suggesting that about a third of the Plus orthopedic revenues have just gone up in smoke? Is that pretty much what you were telling us?

Number two, when it comes to the Plus acquisition due diligence did you do this yourself, or did you use external auditors?

And then thirdly, are the selling practices that you described illegal or unethical? Thank you

**David Illingworth - Smith and Nephew - Chief Executive**

Yes, let me -- I'll try to split these up a little bit. First of all as far as your first question is it a third of the business? Yes, roughly a third. We think its \$100m and that's about a third so it's kind of hard to not say anything but yes on that.

In terms of due diligence we had, we did have some outside experts help us on due diligence, we always do. We certainly thought we did a strong job on the due diligence side of it. With hindsight it is clear that due diligence did not uncover the sales practices, which were unacceptable to us. It was, however, a very, very thorough due diligence process involving the outside legal and financial support. So we were quite happy with it at the time.

I think the other thing to note is that Plus was sold in a competitive process. Where a competitor was for sale, and where we were bidding against other competitors. And in such a situation like that you may not see everything. And you rely on representations and warranties from the vendor, which we did. So we are certainly going to look at any lessons learned. But we are also going to aggressively pursue whatever options we have going forward legally.

As far as your last question, were they legal issues or business ethics issues, I think it really doesn't matter. They didn't meet our standards, our business practice standards. We are not going to comment any further on that at this point in time, because we are just not in a position to do that, although I certainly do appreciate your question Michael.

**Michael Jungling - Merrill Lynch - Analyst**

Dave, just a follow up on that. You are saying it doesn't matter, but if it's unethical you do have time to convert people to an ethical selling practice? If it's illegal I guess you've got to stop them immediately. And it seems to me that you had to stop these things immediately. So does the -- is the Government involved in this investigation? Or is it an investigation purely between Smith & Nephew and the vendor?

**David Illingworth - Smith and Nephew - Chief Executive**

Well Michael we've pretty much said all we can say on this. And clearly when we get in a position to be more transparent on some of your questions, we'll be more than happy to engage. But at this point in time we -- this is really all we have to say. And we've given quite a bit of transparency on the numbers.

May. 01. 2008 / 7:00AM, SNUF.PK - Q1 2008 Smith & Nephew Earnings Conference Call

**Michael Jungling** - *Merrill Lynch - Analyst*

Is it -- Dave, just one last thing, is -- can you comment on whether the Government is involved in this investigation?

**David Illingworth** - *Smith and Nephew - Chief Executive*

No I can't comment.

**Michael Jungling** - *Merrill Lynch - Analyst*

Okay, thank you.

**Adrian Hennah** - *Smith and Nephew - CFO*

Well we can say one thing, which may be on your mind Michael, is clearly these things came to light to us in the course of the integration of Plus at the same time as this informal SEC enquiry going on in respect of a number of countries, relating to the whole industry. What we can say is that, A, that investigation continues to go on and we continue to cooperate with it. But, B, that in the course of that we have informed the SEC of these things, as you would have expected us to.

**Michael Jungling** - *Merrill Lynch - Analyst*

Thank you.

**Operator**

We will now move to Hans Bostrom from Goldman Sachs. Please go ahead.

**Hans Bostrom** - *Goldman Sachs - Analyst*

Good afternoon gentlemen. I have three questions as well. Could you let us understand at what point you think you might have to incur impairment charges for the acquisition you made last year? And in terms of timing and whether this is relating to the legal recourse you are seeking as well?

Secondly, I'd like you to elaborate a bit about the pricing comment you made in Reconstructive. What has been the driver for the change to negative pricing? And the degree to which this is negative in terms of percentage points would be helpful as well.

And thirdly, if you could give some more color on your comment about this Trauma sales force situation? Should we understand this that you are actually looking to amalgamate the Trauma and the Recon sales force yet again? Or is there some other configuration that you had in mind?

**David Illingworth** - *Smith and Nephew - Chief Executive*

Okay. Let me take the last one first and then I'll -- since Adrian made the comment on pricing, I'll make him clarify that one and also he can handle the impairment question.

May. 01. 2008 / 7:00AM, SNUF.PK - Q1 2008 Smith & Nephew Earnings Conference Call

No we are not planning on going back to a combined sales force in Trauma and in Recon. We feel very strongly that it's important to have the separate sales channels. And in fact when we developed this separate sales channel, this direct sales in Trauma, we performed extremely well. It was when we did a hard divisionalization and actually put those sales channels under separate leaders that we started seeing a drop off in the productivity amongst those two sales forces.

So we are going to try to change that dynamic a little bit, Hans. We are going to try to find the right place in the organization where these unique channels can come together. So that not only do we get the uniqueness of the channels but we get the collaboration. And that's the -- that's what we are trying to do, and that's the best picture that I can draw for you. But we are certainly not going back to a combined sales force.

---

**Adrian Hennah** - *Smith and Nephew - CFO*

Hans, on your question on the price environment, we absolutely were not meaning to indicate that we expect any change in the price environment inside the U.S. or outside the U.S. We have experienced a small decrease in average pricing in the U.S. simply because there has been a small decrease in pricing on the BHR, which is in line with the trend that we've talked about for some time. So we certainly were not meaning to indicate a softening in the pricing.

---

**David Illingworth** - *Smith and Nephew - Chief Executive*

Yes I think it would be wrong to indicate anything else, Hans. We actually are still ahead of our original modeling of where we thought pricing would be on BHR. And so it's not anything unexpected for us. And maybe the comment was a little misleading.

---

**Hans Bostrom** - *Goldman Sachs - Analyst*

Yes, thank you for that.

---

**Adrian Hennah** - *Smith and Nephew - CFO*

In respect of the impairment charges Hans, the -- as you probably know under the relevant accounting rules you have one year from making an acquisition to finalize the valuations of your acquisition intangibles and so on, which means that we have until the end of the next quarter to do this. So it would be premature for us to finalize in respect of impairment charges just at the moment.

---

**Hans Bostrom** - *Goldman Sachs - Analyst*

And could I ask about BHR pricing? Could you give us an indication on what the average selling price decrease has been on a year over year basis?

---

**David Illingworth** - *Smith and Nephew - Chief Executive*

No we can't, Hans sorry.

---

**Adrian Hennah** - *Smith and Nephew - CFO*

Not huge Hans, and it's actually less than we expected at the outset. But we can't quantify for it for you it wouldn't be sensible.

May. 01. 2008 / 7:00AM, SNUF.PK - Q1 2008 Smith & Nephew Earnings Conference Call

**Hans Bostrom** - *Goldman Sachs - Analyst*

And where do you see that going? Is this an ongoing trend, because you have been giving fairly mixed signals say over the last couple of quarters? In Q3 I seem to remember you said it was coming down and then in Q4 it was stabilizing. And now it seems to be coming down again. So it would be interesting to actually get a sense of how this could evolve in your opinion.

**Adrian Hennah** - *Smith and Nephew - CFO*

You're quite right Hans, that's exactly what we said in quarter three and quarter four. But we also were talking each time about the experience in the quarter rather than our expectations and trends. I think from the outset here we've -- without giving specific prices, because that wouldn't be helpful. We've talked that -- we launched at a particularly high price and we did not expect that price to be sustained indefinitely.

And we also talked last quarter, and it remains our observation this quarter, that the reason the price is falling is absolutely not to do with price competition with Stryker and Cormet. But it's to do with the fact that as BHR gets bigger it gets on to more radar screens in more hospitals. And within the discretion we give to the reps anyway, you see a slight erosion of the price.

It's -- it was absolutely what we expected. We do expect it to have a bit further to go. And which is no change in the position we've held since the launch Hans.

**Hans Bostrom** - *Goldman Sachs - Analyst*

And a very quick follow up questions, sorry new question, on R&D expenses. Where should we see this going for the year given the delay in the first quarter as a percentage of revenue?

**Adrian Hennah** - *Smith and Nephew - CFO*

What we see happening is the reduction has principally been due to delays in getting monitor approval in the U.S. And I think other companies have experienced similar phenomenon. We are now pretty much there. We haven't really had issues with the monitor on what we are going to do, just time of getting the process to get it all agreed.

So I think our basic expectation is you've got to shift this thing by a quarter. Not that the ongoing level is change but that there is going to be some -- will have been some reduction we don't catch up in the year in the first quarter.

It also doesn't change our expectation that over the slightly longer term that we will see a modest increase in R&D spend to about 5%, which is guidance we've given before.

**Hans Bostrom** - *Goldman Sachs - Analyst*

Thanks very much.

**David Illingworth** - *Smith and Nephew - Chief Executive*

Thank you Hans.

**Operator**

The next question is from Rafael Tejada from Leerink Swann. Please go ahead. Mr. Tejada your line is open.

May. 01. 2008 / 7:00AM, SNNUF.PK - Q1 2008 Smith & Nephew Earnings Conference Call

**Jason Wittes** - *Leerink Swann & Co - Analyst*

Hi, yes, hi, it's Jason Wittes, thank you. First question, I am sorry to belabor the point here but it does seem as if there may be more issues to drop in the investigation. The \$100m that you pointed out to this year is falling out. Can we assume that that's pretty close to the number its going to be or is there still more to be done?

**David Illingworth** - *Smith and Nephew - Chief Executive*

We -- well we've tried to make it as close to the number that its going to be that we believe as humanly possible at this point in time.

**Adrian Hennah** - *Smith and Nephew - CFO*

Yes we -- there are no guarantees in life. But we have done a very thorough investigation. It isn't 100% complete.

**David Illingworth** - *Smith and Nephew - Chief Executive*

But it's complete enough that we think we know what the impact could be, and we are taking -- I hate to throw the word out, conservative. But we are trying to put a believable number out there. We don't want to go through this multiple times. This is not -- we are not happy with this, as you can imagine.

And we'd like to -- nobody wants to get this behind us any faster than us, so that we can focus on some fundamentals in our business that we are excited about. And that's where we are. So I think we've put a number out there that is, we think, is a pretty good number. And we'd be disappointed if it got bigger.

**Jason Wittes** - *Leerink Swann & Co - Analyst*

Just one clarification I think would make people feel better. I understand the investigation is still ongoing, but can we assume that in most -- in all of the regions now you've at least you've very far along in terms of investigating? Or are there areas that you haven't checked as thoroughly as you have, say, Greece, at this point?

**Adrian Hennah** - *Smith and Nephew - CFO*

We've checked all areas -- we are -- we've substantially advanced in all areas, and we believe we've got a clear line of sight on the main issues.

**David Illingworth** - *Smith and Nephew - Chief Executive*

Yes. I think we are very far along. Everywhere we have -- we are a matter of weeks from, we think, from getting to the end of this.

**Jason Wittes** - *Leerink Swann & Co - Analyst*

Okay, just switching gears. There was a competitive bidding process for Negative Wound Pressure Management here in the U.S. Have you guys been -- were you guys involved with that? And is there anything you can tell us about what contracts you may be involved with at this point?

May. 01. 2008 / 7:00AM, SNNUF.PK - Q1 2008 Smith & Nephew Earnings Conference Call

**Adrian Hennah** - *Smith and Nephew - CFO*

We lost that question slightly, Jason, could you say it again it was a poor reception?

**Jason Wittes** - *Leerink Swann & Co - Analyst*

I am sorry. I was asking about the competitive bidding process here in the U.S. for CMS. And I wanted to know if you guys participated? And, B, if you had been able to win some of the contracts that were up for grabs at this point?

**David Illingworth** - *Smith and Nephew - Chief Executive*

No, no we didn't participate. No we don't believe it is going to have an impact on our wound care core business. And yes we think we -- we would hope that we could fill some of the void where some of those practices -- some of that competitive bidding process may have been impacting other competitors.

**Jason Wittes** - *Leerink Swann & Co - Analyst*

Was it -- was the decision not to compete just because you had just bought the BlueSky business, and just weren't in a position to do that? Or was there another reason for it?

**David Illingworth** - *Smith and Nephew - Chief Executive*

I think we are still confused with --.

**Adrian Hennah** - *Smith and Nephew - CFO*

Are you talking about these 10 cities where there was a --

**Jason Wittes** - *Leerink Swann & Co - Analyst*

Yes I am.

**Adrian Hennah** - *Smith and Nephew - CFO*

We did compete.

**David Illingworth** - *Smith and Nephew - Chief Executive*

We did compete.

**Adrian Hennah** - *Smith and Nephew - CFO*

I am sorry we were on cross purposes with you (multiple speakers). Yes we did compete. And while we've heard from other people on their telephone calls saying that they may not be going forward in that. We would be happy to serve any customer at a sensible price in the United States.

May. 01. 2008 / 7:00AM, SNUF.PK - Q1 2008 Smith & Nephew Earnings Conference Call

**Jason Wittes** - *Leerink Swann & Co - Analyst*

Okay, thank you.

**Adrian Hennah** - *Smith and Nephew - CFO*

Including in those 10 cities. Sorry, Jason, we were slightly at cross-purposes in your question initially.

**David Illingworth** - *Smith and Nephew - Chief Executive*

Okay. Alright, well thank you very much. And appreciate all the thoughtful questions. And we are going to run off to our Annual General Meeting. Thank you very much.

**Operator**

That will conclude today's conference call. Thank you for your participation ladies and gentlemen. You may now disconnect.

#### DISCLAIMER

Thomson Financial reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON FINANCIAL OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2008, Thomson Financial. All Rights Reserved.