FINAL TRANSCRIPT

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SNN - Q1 2010 Smith & Nephew Earnings Conference Call

Event Date/Time: May. 06. 2010 / 7:30AM GMT

THOMSON REUTERS

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PRESENTATION

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Operator

Good day, ladies and gentlemen and welcome to the first quarter 2010 results conference call. For your information, today's conference is being recorded. At this time I would like to hand the conference over to David Illingworth, CEO. Please go ahead, sir.

David Illingworth - *Smith & Nephew - CEO*

Thank you. Good morning everyone and welcome to our Q1 2010 results presentation. I'm going to kick it off this morning by talking about our performance for the quarter and then I'll hand it over to Adrian who'll take you through the numbers. I'll then come back at the end and take a few minutes to talk about how we're going to deliver on our strategy in 2010 and try to make this come alive for you.

So starting with the highlights for the quarter, in Q1 we saw continued momentum across our businesses, both in revenues and in margins as our actions continue to have a positive impact on our business. We achieved revenues of just under $1b, which is 9% underlying growth. In Orthopedics we grew in all regions, including Europe, where recent actions contributed to a return to growth. Endoscopy had a stronger start to the year than in 2009. And Advanced Wound Management continues to do very well in all geographies.

There were three extra trading days in the quarter which we've commented on which contributed, we believe, about 5% of revenue growth. Our performance is against a backdrop of stabilizing market conditions, although in Orthopedics mix continues to be offset by price.

I would like to be clear about our margin performance. And in round numbers, after adjusting for the BlueSky agreement which Adrian is going to give you a little bit more detail on, and also correcting for the extra trading days, our margin improved by about 100 basis points.

Adjusted earnings per share grew by 43.5% or 30.1% excluding the BlueSky agreement. We had excellent cash flow in the quarter across the business as our focus on cash has paid off and our net debt is now less than $800m.

Moving on to look at our first quarter performance business by business, I'll start with Orthopedics. Orthopedics revenue were $566m in the quarter, with underlying growth of 6%. Market conditions in Orthopedics do seem to be stabilizing. And although pricing pressure continues, we are starting to again see mix benefit as a reward for our innovation. The market grew at around 7% and we had US growth of 7% and European growth of 8%.

Our reconstruction business in the past has focused on high technology, as you know. These high-performance products are for the younger, more active patient. This segment, as we've said before, has been impacted by the economic downturn. We have seen this impact in the last few quarters and expect it will continue for a few more.

In this quarter our traditional products performed very well, particularly in Hips, where R3 and ANTHOLOGY showed strong signs of growth.

BHR, our premium hip resurfacing product, has experienced some weakening in demand. The well documented track record for BHR clearly demonstrates its safety and superior performance. It is the gold standard in resurfacing as the outcome data clearly shows. And we're renewing our efforts to distinguish this product in the marketplace. And we'll be taking a much more aggressive stance to take this positive story to our current and potential customers. And a very detailed and comprehensive marketing campaign is now underway.

In Knees, LEGION and GENESIS continue to support growth, and VISIONAIRE, our customized cutting block, was used in over 2,000 procedures in the quarter.

In Europe we're seeing some early signs that the actions to drive improved performance, which we outlined at the Capital Markets Day meeting last year that some of you attended, are beginning to pay off. Our Trauma business in Europe continues to do well.

Our US Trauma business continues to be an area of focus for us. And although we're satisfied with our progress, it is still too early to see this coming through in the numbers. We are seeing an improvement in the quality of our US Trauma sales force as the selection, training and management of our reps improves.

Many of you will have seen SURESHOT, our new Trauma positioning instrument for femoral nails which won an award at AAOS in March. This product is generating a very good response as it provides clear benefits to both patient and surgeon.

In Clinical Therapies, joint fluid therapy continues to experience tough market conditions, but EXOGEN rebounded nicely, with growth of 14% in the quarter. Our margins in Orthopedics at 25.5% benefited from revenue leverage and inventory management, increasing by 210 basis points in the quarter.

Now turning to Endoscopy. We had excellent revenue performance as revenues were up by 15%, and Sports Medicine, including Resection, performed well. We achieved revenue growth in all geographies, with particularly strong growth in the emerging markets. At the end of last year we initiated a fast-track new development plan to accelerate the introduction of new products and to serve our customers better. As a result we launched several new products at AAOS, all of which were very well received by our customers and which generated a substantial number of new sales leads.

We've completed the building of our Surgical Skills Center in York, England, a substantial investment which provides our customers with a world-class training facility in Europe. And we now have over 30 courses booked with top-class surgeons teaching in this facility. As we've increased the investment in this fast-growing business and the respective sales channels, there's a resulting lower margin in Endoscopy and it was slightly down in the quarter.

Looking at Advanced Wound Management, Advanced Wound Management had another great quarter as it grew revenues across the board, with good growth in all geographies. The 11% growth significantly exceeded the market growth of 4%.

We have restructured the US distribution network and have also entered into an agreement with MedPro for the long-term care market. We expect these two initiatives to improve customer service and provide more efficient use of our own resources. In the quarter our US revenues were in line with our expectations, growing at 10%.

Europe performed particularly well, growing by 12%. And our investments in the second half of last year, particularly in Japan, have paid off and the rest of the world grew by 9%.

Negative Pressure Wound Therapy had a good quarter, nearly doubling its revenues. Our US Negative Pressure Wound Therapy business performed to our expectations and we made great strides in Europe. And we're now seeing revenues within customer accounts expand and long-term contracts increasing.

A few comments on the closing-out of the BlueSky purchase agreement. The original agreement included deferred consideration linked to business milestones and a formula for offsetting our legal costs. The vendors of BlueSky were keen to achieve some financial certainty and so we renegotiated and completed the contract this quarter. What we achieved was a good outcome for both parties.

As we move to the next phase in Negative Pressure Therapy, we continue to offer customers the choice of products that they want and to not only make steady progress with existing products but also to invest in real go-forward innovation in this segment.

The excellent 17.8% margin, excluding BlueSky, is a result of sales leverage, strong cost execution and the impact of our facility in China which is starting to make a substantial contribution to cost of goods. I'm very pleased with the sustained performance in this business over the last year.

And with that I'll hand it over to Adrian to take you through the numbers.

Adrian Hennah - *Smith & Nephew - CFO*

Well thank you, Dave. And good morning, ladies and gentlemen. Turning firstly to slide nine, the income statement. Revenue in the quarter was $995m. This represents underlying growth of 9% after adjusting for exchange rates on quarter one last year, with three more sales days in quarter one this year than quarter one last year increasing growth by about 5%. Underlying average daily sales therefore increased by about 4%.

Growth rates referred to in this presentation are before adjusting for the extra sales days unless specifically mentioned.

Trading profit in the quarter was $250m, giving underlying growth of 27%. Profit benefited both from a revision to the acquisition agreement for our NPWT business and from the extra sales days.

We concluded in the quarter an opportunity to negotiate with BlueSky, the vendor of our NPWT business, some changes to the agreement which were favorable to both parties. As a result we were required by accounting rules to credit back to trading profit in quarter one $23m of legal costs that we had previously charged to trading profit. We have set out in the appendix to your pack the accounting logic for this credit.

In essence, however, the original BlueSky agreement provided for deferred consideration to be payable depending on certain sales and other milestones. We also had the right to offset certain legal costs against the deferred consideration. However, because there was uncertainty as to exactly which legal costs could be offset, we have, up to now, prudently charged all legal costs to trading profit.

The revised agreement eliminates all further milestones and clarifies which legal expenses were part of the original consideration. As a consequence, we charged to the acquisition cost and credit back to trading profit $23m in respect of expenses already incurred in all periods up to the end of quarter one. There will be a further $2m credit in quarter two. There is no impact from the changes to the agreement on the carrying value of the assets in the books and this is clearly a one-off non-recurring benefit.

Margin also benefits slightly from the extra trading days as some costs are periodic in nature. Reported trading margin was 390 basis points higher than quarter one last year. Adjusting for the impact of the BlueSky changes and the trading days, trading margin increased by about 100 basis points. Interest costs are down on last year, reflecting lower debt and lower interest costs.

Moving to the next slide and moving further down the income statement. The tax charge for quarter one is 31.6%, our estimate for the full year. Adjusted attributable profit for quarter one was $167m. Adjusted earnings per share were $0.188, which is 44% higher than quarter one last year. Excluding the extra sales days and the BlueSky credit, EPSA grew at 13%.

Turning to the next slide and an analysis of revenue by business segment. You've heard from Dave on the progress of each business. This schedule gives the growth rates in the quarter to which Dave referred. Quarter one the US dollar was weaker than the average of the currencies in which we operate, leading to a reported 6% translation gain on sales.

Turning to slide 12, an analysis of revenue growth rates by business and by geography. As well as the numbers on this slide, we'll also refer to the growth rates of our main product types which are included as usual in the appendix. At constant currency, sales in our Orthopedic business in the quarter grew 6% on quarter one last year. Hips grew at 6%. Knees grew at 9%. Trauma Fixation grew at 3%. And Clinical Therapies grew by 5%. Across Orthopedics we've not yet seen any material increase in price pressure. Like-for-like price reductions were 1% to 2%. Mix continues slightly positive, but materially lower than the trend over the last few years.

In the United States, Orthopedic growth was 7%. US reconstructive sales grew at 10%. Adjusting for the extra sales days, this was slightly below market growth. Growth in our US Knee business was 11%. US Hip growth was 8%. Growth in our traditional products was strong. We continue to be impacted by our focus on higher specification products. Trauma Fixation sales in the United States were flat. Clinical Therapies sales in the USA grew 6%. EXOGEN returned a strong growth, SUPARTZ continued to be under pressure.

In Europe, Ortho sales grew by 8%. Adjusting for the extra sales days, this was in line with our estimate of market growth. The European market remains weak. Good work being done by our European orthopedic management team has restored our performance to market growth and we expect further improvement in the results over coming quarters.

In the rest of the world, Orthopedic sales grew by 1%. Positive underlying trends in the emerging markets continued, though a strong comparative helped by some large tender business reduced the growth in the quarter. We continue to see impact from the macroeconomic challenges in the more mature of our rest of the world markets, especially in Japan and Australia.

Endoscopy sales grew by 15%. Sports Medicine sales, which include both repair and resection, grew strongly again at 17%. Visualization and related sales were flat year on year. This is a significant improvement on the declines experienced through 2009. Visualization sales accounted last year for about 15% of global Endo sales. Endo sales in the United States grew by 9%, in Europe at 16% and in the rest of the world at 23%.

Wound sales grew by 11% in the quarter. This included a contribution from NPWT sales of 3%. Total Wound sales grew by 10% in the United States, by 12% in Europe and 9% in the rest of the world. Wound sales were slightly boosted in quarter one by the timing of price increases in Germany. There will be an equal and opposite effect in quarter two. We continue to see clear signs of good progress with NPWT. We expected some reduction in wholesale inventory in Wound in the United States in quarter one as we consolidated a number of our distributors. In fact this did not happen in quarter one and we now expect a modest reduction in quarter two.

Turning to the next slide, slide 13, this shows the usual analysis of trading profit by business segment. As we have already noted, the reported trading margin for the Group was up 390 basis points in the quarter from quarter one last year and the core increase was about 100 basis points.

In Ortho we again saw a good margin improvement in the quarter. We continue to see significant further opportunities to improve the efficiency of our processes. This will put us in a good position to reinvest in the many opportunities we see for growth in this business and to deal with the price pressures as Western governments deal with their substantial deficits.

The ongoing Endo margin decreased slightly in the quarter. [A signal] with our full year numbers, we see particularly substantial opportunities to invest in our Endo business and expect some modest ongoing reduction in margin.

In Wound we again saw a significant underlying increase in the margin after adjusting for the BlueSky change and the extra sales days. We are seeing a substantial benefit from the China factory in these numbers for the first time. Investment in NPWT including in legal costs will continue to impact the Wound margin for some time.

Turning to slide 14 and the cash flow statement. We had another good quarter of cash generation, with $131m of free cash flow in the quarter. We continued to invest strongly in [instruments] which accounted for the largest part of the $74m of capital expenditure. We are making progress in improving the efficiency with which we use our inventory and we see significant further opportunity here over time.

Restructuring spends continued in line with guidance. We include, as usual, an analysis of the total spend on the restructuring programs in an appendix. Net debt decreased to below $800m in the quarter, principally as a result of the free cash flow generation.

Turning lastly in this financial part of the presentation to slide 15 and the outlook. There's been no change in our view of the outlook for 2010 for the Group as a whole. In the Orthopedic Reconstructive area, we believe that underlying global market growth increased slightly quarter on quarter, to around 7% in quarter one. We expect our recon growth to return to the market growth rate during 2010.

In Orthopedic Trauma we expect to return to the market growth rate over time. In Orthopedic Clinical Therapies we expect competitive pressures to continue. The planned sale of our outpatient pain management business was completed in April. Together with the termination of a small spine distributorship we held in Germany, this will reduce Clinical Therapies sales by about $20m this year. There will not be a material impact on profit.

With Endoscopy we expect to grow ahead of the market in Sports Medicine. Within Wound we expect good progress with NPWT sales to push growth ahead of the market. We have, as usual, included in the appendices a table setting out the number of business days in each quarter. There is one more day in quarter two and there will be four less days in quarter four.

With regard to margin, we continue to see significant opportunities to improve the efficiency of our business. We also continue to see significant opportunities for new investment.

And with that brief update on the outlook on 2010, I'll hand back to Dave.

David Illingworth - *Smith & Nephew - CEO*

Thank you, Adrian. I appreciate that. I have talked a lot about strategy in recent quarters and I just want to emphasize for a minute that our strategy really does determine our activities and drives our priorities every day. And this year all of our management team have objectives that are designed to deliver on this strategy.

Our strategy has four pillars. Being customer-led, being efficient, investing in the business and all of us being aligned to deliver on the strategy. Now to demonstrate this, the next few slides outline some of the activities we have planned for the rest of the year and I will give you a bit more detail about just a few of these. Starting with customer-led on slide 18.

Customer-led for us means anticipating and meeting customer needs. And this year we have multiple programs in place across all of our businesses. We are using the KLEOS name to brand our global training. This year KLEOS centers will open in Chengdu, China, and Lucerne, Switzerland. The first Fellows program, the 'Wider Scope of Arthroscopy', run by Endoscopy last year, was very successful. And we'll run a further two programs this year. And in fact one is running this week and has 70 surgeons attending, and a quarter of them from outside the US.

We started our Company-wide major accounts program. In short this means we have a specific person, Jerry Goodman, who is leading an initiative across all of Smith & Nephew to give our customers one access point.

Efficiency. Efficiency has been very important to us over the last few years and continues to be. And this year we have a lot going on and it's coming through in the numbers. The way we run our facilities is a big part of our drive to be more efficient.

In Advanced Wound Management we expect to see continued margin contribution from the China factory, and we saw the start of this in the first quarter of 2010. The Beijing factory for Orthopedics will officially open this quarter and I will personally be there soon for that event. Our global procurement function is developing centers of excellence to leverage our scale and reduce costs by managing our suppliers more effectively. And really there are two key reasons for being more efficient. One obviously is to increase our margins, but the second is just as important, which is to allow us to reinvest in our business.

This year our investment plans include the move of our Orthopedics business in Memphis. We will have all of our Memphis-based team in one building by the end of the year which we expect will increase the effectiveness of the team. And we're building a world-class training facility on the site as well.

Endoscopy is expanding its investment in emerging markets through the provision of local training which will now be in local languages. This investment is designed to build a stronger business for us in these markets, as we've done in other places outside the US. And Advanced Wound Management is continuing its investment in Negative Pressure Wound Therapy and new products.

We're also sponsoring the World Union of Wound Health Society meeting in Japan this year, a very significant event in the global wound care market. We're very excited about our plans for this year. We have a lot going on and expect to make substantial progress.

So, in conclusion, let me just review the quarter. The first quarter saw us maintain our momentum from 2009 in both revenues and margin improvement. Clearly healthcare systems worldwide continue to face challenges, although we are seeing increasing signs of stabilization in our markets.

Our Orthopedics revenues have strengthened and the improvement in Europe is great to see this quarter. Endoscopy had a good quarter globally, with excellent growth in repair and resection. And Advanced Wound Management is performing very well across the board. In summary, we are pleased with the first quarter in the business and we're on track to improve the efficiency of our business and to invest for the long term.

So with that, that completes our presentation. We will use our usual system of taking questions. And I would ask everyone's indulgence to please limit your questions to two to allow as many people as possible the opportunity to participate in the Q&A today. Can we please have the first questions from the callers?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Our first question today comes from Karl Bradshaw of Morgan Stanley. Your line is now open.

Karl Bradshaw - *Morgan Stanley - Analyst*

Hi there. Thanks for taking my questions. The first one relates to your margin progression through 2010 and 2011. Could you talk about where -- which of the divisions you see the greatest margin upside?

And also could you talk a little bit more about any negative impact from metal on metal that came out of AAOS? Thanks very much.

David Illingworth - *Smith & Nephew - CEO*

Okay, all right. Let me try to take a shot at the first. Adrian, please jump in any time you feel like you would like to.

The -- when we started the earnings improvement program, when we announced the earnings improvement program, which was really an internal rallying cry for our businesses to start putting more focus on efficiency, we signaled that we probably saw about half of the margin expansion coming from our Wound business, and the other half of the margin expansion coming from a combination of the other businesses over time.

And we've done a very nice job of increasing the efficiency of the Wound Care business. We saw less scope for margin improvement in Endoscopy, just because we felt like we were running a much leaner business there and there were some opportunities for us to actually invest more in getting some new products out to the market in a quicker way.

I think I would have to say that right now we look to the Orthopedics business as being probably the most fertile ground for us to be digging in, in terms of improving the efficiency of the business. But I think there is a balance there with how much do we actually reinvest back in the business going forward.

We still see substantial scope for improvements across the Group. And -- but we are starting to get into a phase where we are saying to ourselves how much do we contribute to the bottom line and how much do we reinvest back in the business as some of the markets recover?

So that's -- those would be my comments on margin. Do you have anything to add on that, Adrian?

Adrian Hennah - *Smith & Nephew - CFO*

I think it's an important distinction, there are some businesses where we see significant scope for efficiency improvement. That does not translate necessarily into significantly scope for improvement on the bottom line. So particularly in our Orthopedics business we see substantial scope for efficiency improvement but also substantial scope for reinvestment. So as you look beyond 2010, it is a balance of those two things.

Endoscopy we're quite clear that we're not signaling improvements in margin in Endoscopy. In fact just the opposite.

David Illingworth - *Smith & Nephew - CEO*

Yes. On the metal on metal, our metal on metal product is our BHR. It's our hip resurfacing product, and has been a little bit of a nuisance for us because we really need to get the story about BHR back out into the marketplace. We're taking a much more aggressive stance in terms of getting that messaging back out because really there is a differentiation between the BHR resurfacing product and some of the other metal on metal designs in the marketplace. And I believe the clinical data supports that differentiation.

So you're going to see us take a much more proactive and a much more aggressive stance to make sure that the right message gets to the marketplace about the effectiveness of our BHR product going forward.

Karl Bradshaw - *Morgan Stanley - Analyst*

That's great. Thank you very much.

David Illingworth - *Smith & Nephew - CEO*

You're welcome.

Operator

Our next question today will come from Joanne Wuensch of BMO Capital Markets. Your line is open. Please go ahead.

Joanne Wuensch - *BMO Capital Markets - Analyst*

Hi this is Joanne. Can you hear me?

David Illingworth - *Smith & Nephew - CEO*

Yes. Hi.

Joanne Wuensch - *BMO Capital Markets - Analyst*

Hi. The question I have is two-fold. One, can you comment on the foreign exchange outlook and how it may impact your business?

And the second one is I was very impressed by the number of procedures that have been performed in VISIONAIRE just in the quarter alone, and if you could just give some qualitative information on the uptake of that product that would be great. Thank you.

David Illingworth - *Smith & Nephew - CEO*

Want to take a shot at the exchange?

Adrian Hennah - *Smith & Nephew - CFO*

Yes. If today's exchange rates continue, well first of all you saw in the quarter a 6% gain from the year-on-year movement in exchange rate. If today's were to continue, we're looking at something like a 2% gain in quarter two and then a decline in the second half of around 3% for about a 1% gain over the full year, roughly, roughly in revenue.

Dave are you going to --?

David Illingworth - *Smith & Nephew - CEO*

Well we're pleased with the uptake of VISIONAIRE, just as you're surprised, we're pleased. And I think that it -- I think it's a proof statement, Joanne, that essentially if you bring a product to the marketplace that has real clinical value, makes the procedure more effective and more accurate, and secondarily really does take cost out of the total procedure price and is giving the patient a better outcome, there's real need in the marketplace for that. And I think that that's the -- those are the factors we are going to be focused on as we innovate going forward with our new product introduction. So we're very, very pleased with VISIONAIRE.

Operator

Our next question today comes from Matt Miksic of Piper Jaffray. Your line is open. Please go ahead.

Matt Miksic - *Piper Jaffray - Analyst*

Hi, can you hear me okay?

David Illingworth - *Smith & Nephew - CEO*

Yes. How are you doing, Matt?

Matt Miksic - *Piper Jaffray - Analyst*

Fine. Thanks for taking our questions. One follow-up on the -- on VISIONAIRE in particular as it pertains to the US Knee business. Given that you've been ramping on this, I guess, over the last year, and some other folks have been in this market for a while, there's other folks entering this custom jig market and understanding what's good and different about yours. But what is this doing to your mix in Knees given that there is an up-charge to this up-front? And how should we think about that as you get into the comps later in the year in this business? Any comments you could have either on what it's doing to your mix, what you think it's doing to industry mix.

And then I have one follow-up.

David Illingworth - *Smith & Nephew - CEO*

Well I'm not sure I'm going to be able to give you a lot of -- a very crisp answer, because we haven't talked about the pull-through effects of this product yet. And it's really just a little bit too early to be talking about that. We're still trying to understand exactly what it's doing to our business, because remember, this is not a product. This is an instrument of sorts. It's a cutting block. And we -- there is an up-charge to use this product.

I think the thing that we've got going for us, Matt, that is going to work in our favor in the long-term is that we own this technology. We're doing it ourselves. We don't contract this in. It's not a sourced product. We don't have a partnership with anybody. We have actual engineers sitting at CAD/CAM devices and they're hooked up to our machines that are cutting these cutting blocks and making these products for these procedures, so we can make them very, very customized and make them apply to our products more specifically than we might with an outside vendor.

And I think longer term, it's not going just be about this cutting block. It's going to be about more customized-type solutions that can help make the procedures more efficient, take the cost out of the procedure longer term. And that's why we are excited about it. It's not VISIONAIRE per se. And I think that we will, in the future, we'll talk more about what are the pull-through effects on different type, different classes of products as we get a little bit better information.

Matt Miksic - *Piper Jaffray - Analyst*

Sure. So just so I understand your comment, it sounds like because you're doing it yourself, as you grow this business you might -- we might expect you to get maybe more leverage out of this business than folks who have partnered with other third parties. But the charge does come through -- the up-charge does flow through your Knee business, correct?

David Illingworth - *Smith & Nephew - CEO*

That's correct.

Matt Miksic - *Piper Jaffray - Analyst*

So -- and then the other -- that's helpful. And then the other follow-up I had just was strategically. I know you don't like to tip your hand too much. But curious about your interest in spine as a strategic area for investment given you shed some assets there recently. Is that a signal that you're moving away or is that still an interest area for you going forward?

David Illingworth - *Smith & Nephew - CEO*

It's still an interest area for us. We think that spine is an exciting segment to be in. It's growing quickly. It's profitable. It's adjacent in terms of technology and customers. So we're as excited as we ever have been. And I would not take a -- the disposition of a small distribution relationship in one country as any kind of signal to where we're headed with that.

Matt Miksic - *Piper Jaffray - Analyst*

Sure. Okay. Thanks Dave.

David Illingworth - *Smith & Nephew - CEO*

All right. Thanks Matt. Take care.

Operator

Our next question today comes from Julien Dormois of Exane. Your line is open. Please go ahead.

Julien Dormois - *Exane BNP Paribas - Analyst*

Hi. Good morning, gentlemen. Thanks for taking my question. Basically I have two questions. The first one will be on a quick update on the legal status of negative pressure in the US. From my understanding there was about two months for the Judge to potentially overturn the Jury decision. So I was wondering if anything had happened on that front and if -- what are the next steps in this procedure?

And the second thing is about the extra selling days, which contributed nicely in Q1. I was just wondering whether there was a different impact depending on the region. For example, has it brought more growth to the US or to Europe? So a quick help here would be appreciated.

David Illingworth - *Smith & Nephew - CEO*

All right. Well let me take the first one, Adrian. I'll let you think about the second one, if you want to tackle that, try to segment out the selling days there.

On the US trial with KCI, I think the general question was where do we go from here? What's going to happen? First of all we're disappointed with the Jury decision. But this is really just a -- just one battle in a long war. We've been talking about that for a long time. We haven't trumpeted our victories very loudly over the last year where we won nine decisions in a row in Europe. And in the same way we are not trumpeting this all that loudly either. There's going to be some good news and bad news along the way. But we're confident that our position will prevail in the end, allowing us to give our customers what they want, which is a choice.

Specifically, the US trial process has not concluded yet, Julien. The Judge still has to determine validity. And a hearing date is set for 17 May. And it could take weeks for the Judge to deliberate after that date. Depending on the outcome, KCI could apply for an injunction. After that it's likely that one or both sides will appeal, and this process is going to take another year to 18 months. So we're far from over. And it's just -- it's an ongoing battle and it's part of the process.

What we can say is that we've won similar trials in Europe during 2009, as you're well aware. If we didn't win them initially, we won them on appeal. So we still are hopeful that we'll get our points across here.

And also that it really doesn't change the status quo. We're still committed to selling all the products in all the markets that we've entered. So our commitment is to give our clinicians the widest range of choice for negative pressure. That's what they're telling us that they want. And we have some very interesting ideas coming down the road in this segment. So we remain very, very optimistic and very bullish on Negative Pressure Wound Therapy.

Adrian do you want to tackle the selling days?

Adrian Hennah - *Smith & Nephew - CFO*

Yes, sure. The nuances of extra days. Julien, there are some small differences. The -- for example, Good Friday. People work on Good Friday a little more in the United States than they do in Europe, so that impacts things. But frankly it's between those two, its pretty nuanced and we don't really call that out.

Perhaps what is worth noting, however, is that in the rest of the world in our numbers there is less impact because, particularly in our emerging markets, we sell quite a lot to distributors and that is less impacted by sales days. So in the rest of the world we adjust less in getting a feeling for what's going on in the underlying business. And also in Wound we adjust a little less because much of their business is sold to wholesalers so it isn't quite so much day-driven. But as -- within the Orthopedic business and between the US and Europe, it frankly is only shades.

Julien Dormois - *Exane BNP Paribas - Analyst*

Okay. That's very helpful. Thank you.

David Illingworth - *Smith & Nephew - CEO*

You're welcome.

Operator

Our next question today comes from David Adlington of JP Morgan. Your line is open. Please go ahead.

David Adlington - *JP Morgan - Analyst*

Morning, chaps. Thanks for taking the question. When I strip out the 5 percentage points sales day impact in your Recon growth, I think that has come in [slightly below] our expectation, I think that is reflected in your guidance. I think you've touched it down a bit. I'm just wondering why you continue to lose share in Hips and Knees, and just wondering what you could do to turn that around going forward.

David Illingworth - *Smith & Nephew - CEO*

Well that's a good question David. The -- it's really, and it's kind of the same answer we've been giving in the past. We have focused our business on the younger, more active patient which is a -- basically a higher tech segment of the knee and hip market. And that segment has been under some considerable pressure over the last few quarters. And we don't expect that to change over the next couple of quarters. So I think we're going to continue to deal with this.

But I think you have to look at what's going on across the business if you look at it as a whole. First of all the -- our core products are doing extremely well. If you take a look at our core Hips and Knees, we're growing above the market growth rate. So we are -- the simple fact of the matter is that with our performance in the first quarter, which was at the lower end of the range in terms of relative to market growth, we felt it was prudent to say that it's probably going to take a few more quarters as we continue to claw our way back to market growth rates.

I can say that Europe is performing very well. And we're happy with the rebound in Europe. We are expecting to get a rebound in the BHR business and that remains to be seen. What kind of impact we can get based on a bit more aggressive stance on our marketing campaigns, because we clearly want to get that message out to our customer base that all metal on metal bearing surfaces are not created equal. And we have -- we're the only game in town that has the clinical data to make that claim and to prove it.

And the fact of the matter is the definition of 'it's as good as' is 'it isn't'. And we feel very proud of where we are with the BHR and the track record that it has. So we're going to get a bit more aggressive on that and we'll see what kind of results we get.

David Adlington - *JP Morgan - Analyst*

Great. Thanks. Maybe just a follow-up. It looks from your -- you've subtly changed I think the guidance on your expectation on Recon growth. I wonder what had changed since your Q4 results that led you to downgrade that a little bit.

David Illingworth - *Smith & Nephew - CEO*

Well I think subtle is the operative word. It's so subtle it's hard to detect almost, David. It's not a lot different. What we're saying is that -- and I'll restate what I already said. We have a couple more quarters that we don't see a strong rebound in the younger more active patient segment. So we're just being cautious in trying to predict when that segment of the market will recover. And when it does, I think we're going to be the strong beneficiary of that.

David Adlington - *JP Morgan - Analyst*

Okay. Understood. Thanks very much.

David Illingworth - *Smith & Nephew - CEO*

You're welcome.

Operator

Our next question today will come from Lisa Clive of Sanford Bernstein. Your line is open. Please go ahead.

Lisa Clive - *Sanford Bernstein - Analyst*

Good morning. First question on BHR and the US. I know you don't like to break it out separately from your US Hip sales, but given all of the controversy around metal on metal, it would just be helpful if you could give us an indication of exactly what that growth rate was.

And second question, within Europe, could you give us a rough breakdown of which countries you're seeing the most pressure and which are a bit easier? This will just help thinking of at what point different health systems are going to be putting pressure on budgets.

Adrian Hennah - *Smith & Nephew - CFO*

Yes. As regards the growth rate, it was BHR of course, that was the question, growth of the BHR in the USA. Yes, we don't give a specific number. But we can say it is declining still. There is still a bracket around the year-on-year movement in BHR in the USA. Not a huge number in the brackets, but there is a number in the brackets and there are brackets.

As regards Europe, are you going to do it?

David Illingworth - *Smith & Nephew - CEO*

Well I don't -- we don't sit around the table and talk about any of the markets being easy. Each year I think we battle it out in just about every marketplace, but there are markets that are showing some strength. We're seeing some good growth in Germany. The Italian market has been a challenge for us, I think for us and everyone else. Some of the Southern European markets have been a challenge. The UK has been somewhat buoyant for us over the mid term.

Adrian Hennah - *Smith & Nephew - CFO*

Yes, it does still clearly vary by business unit. You've seen at the level of our [GVUs], Endo is doing extremely good throughout Europe. And that's because of the product offering and the position we've got.

With the other two businesses it's a little patchy. But if you were looking for themes, it's weaker in Southern Europe than it is in Northern Europe, and Eastern Europe is a bit weak.

David Illingworth - *Smith & Nephew - CEO*

Yes. It's kind of hard for us to talk about it in that context because we're really happy with what's going on in Europe right now in terms of it helping our overall global numbers. We're seeing a little bit of a strengthening in Europe so it's -- we're taking a little bit of a positive bias to it. But I would agree with Adrian. I think the Southern European countries are the ones that are providing the challenge for us.

Lisa Clive - *Sanford Bernstein - Analyst*

And just one follow-up question, specifically looking at patient volumes in Europe. In the US it does seem like we're seeing a rebound as the economic sensitivity has annualized. Are you seeing the same thing in Europe or is that still under pressure? It did seem like Europe may have slowed down volume-wise a little bit later than the US. So should we expect that to recover a little bit later too?

Adrian Hennah - *Smith & Nephew - CFO*

Well I would say we're not seeing the -- certainly if you look over the last couple of quarters, two or three quarters rather than just this quarter we -- the European market, from our perception, has -- we're talking Ortho here principally rather than Wound actually because we see more, but in Orthopedic we haven't seen the return to the volume growth we've seen in the US. We are -- in fact, on the contrary, we see probably more pressures rather than less.

Lisa Clive - *Sanford Bernstein - Analyst*

Thanks very much.

Operator

Our next question today comes from Martin Wales of UBS. Your line is open. Please go ahead.

Martin Wales - *UBS - Analyst*

Hello. Just a couple of questions on the Healthcare Reform. What impact, if any, are you expecting as the previously uninsured as people start to come on stream in the US? I appreciate most of the people will be covered -- won't come on immediately and probably won't be suitable for orthopedic operations, but presumably some of the iller patients may qualify and may come on early.

Secondly, do you have any idea what sort of impact that's going to have on pricing for you and for your customers, the hospitals?

David Illingworth - *Smith & Nephew - CEO*

Well I think pricing generally is going to have pressure, Martin, going forward. I think that's the environment that we're in. These healthcare systems around the world are finding it a challenge to fund themselves. And we're either going to be part of the problem or part of the solution. And that's one of the reasons why we've really changed the focus in our business to one where, when we innovate, we were concerned with better clinical outcomes at lower cost.

And we're going to continue to provide that focus on -- with our internal folks to make sure that they get the message, and that products that go into the pipeline really can be part of the solution, because I think pricing pressure is here to stay. It's always been here. I've been in medical devices for over 30 years, and pricing pressure has always been here. I think it's a little more acute at the moment because of what's going on. So that's how we're addressing that. We don't see a lot of positive uplift as part of what's going on in healthcare reform in the US.

Martin Wales - *UBS - Analyst*

No, I'm more concerned that you're going have patients where the reimbursement for operations is going to be only marginally profitable for hospitals, so it's going to cause them -- and that's going to happen this year, as I understand it, in some cases, and that's with harsher pressure, well more pressure to your pricing than you are seeing thus far. I guess that's where I'm coming from. I'm just wondering if you have --?

David Illingworth - *Smith & Nephew - CEO*

Yes, as I said I think we're going to see continued pricing. We haven't seen pricing -- pricing pressure. And we haven't seen it come through as of yet, other than the 1% to 2% pricing pressure that we've seen across our business for the last really 18 months. But it would not surprise us to see some increased pricing pressure in the future.

I don't think we are going to get a lot of uplift in procedure volume per se, because I think a lot of the -- most of the folks who are getting hip and knee replacements are of Medicare age already so they have some built-in coverage. But I think it remains to be seen.

But we're working aggressively to be part of the solution, Martin. And I think that is the answer for companies and it would be a way for us to differentiate ourselves going forward.

Okay. I think we have time for one more question, so choose carefully please, operator.

Operator

Our next question today comes from Veronika Dubajova of Goldman Sachs. Your line is now open. Thank you.

Veronika Dubajova - *Goldman Sachs - Analyst*

Thank you. Veronika Dubajova here from Goldman Sachs. David, two quick questions, if I can. One, I know you've discussed pricing pressure to some extent, but we're hearing these anecdotal stories of the hospitals getting 70% pricing discounts through purchasing organizations. Is this really what you're seeing on the ground and we just haven't seen it in your numbers? Can you give us some qualitative guidance on that?

And second, really quickly, I'm going to push my luck here, could you give us any sense for how much the BHR decline has impacted your US Recon growth? Thank you.

David Illingworth - *Smith & Nephew - CEO*

Well no, we're -- I can't say that we're seeing 70% price reductions. I think there are situations where accounts are coming to us and trying to get a leverage with a broader range of products, consolidation of vendors, suppliers, etc., I think normal business practices that you would expect. And we're reacting to those where it's appropriate, and not reacting when it's not appropriate for us. And right now it's in the normal course of business, I would say.

The BHR, do you want to take another shot at it?

Adrian Hennah - *Smith & Nephew - CFO*

Well I've already said I'm not going to say any more around the number in the brackets, but maybe a supplementary bit of data that might help is that BHR accounts for 20% to 25% of our Hip sales in the United States.

Veronika Dubajova - *Goldman Sachs - Analyst*

That's terrific. Thank you very much.

David Illingworth - *Smith & Nephew - CEO*

Thanks Veronika. All right. Well, thank you. Thank you very much everyone. I appreciate your attendance and look forward to talking to you over the next few months.

Operator

Ladies and gentlemen, that would conclude today's conference call. You may now disconnect. Thank you.
