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PRESENTATION

Operator

Good day, ladies and gentlemen. Welcome to the Smith & Nephew Q3 2008 financial results conference call. For your information, this conference is being recorded.

Before we begin, we would like to read out the Safe Harbor statement. Forward-looking statement. This presentation contains certain forward-looking statements within the meaning of the US Private Securities Litigation Reform Act of 1995. In particular, statements regarding expected revenue growth and trading margins discussed and the outlook are forward-looking statements as are discussions of our product pipeline. These statements, as well as the phrases aim, plan, intend, anticipate, well-placed, believe, estimate, expect, target, consider, and similar expressions are generally intended to identify forward-looking statements.

Such forward-looking statements involve known and unknown risks, uncertainties and other important factors, including but not limited to, the outcome of litigation, claims and regulatory approvals that could cause the actual results, performance, or achievements of Smith & Nephew or industry results to differ materially from any future result, performance, or achievement expressed or implied by such forward-looking statements.

Please refer to the documents that Smith & Nephew has filed with the US Securities and Exchange Commission under the US Securities Exchange Act of 1934, as amended, including Smith & Nephew's most recent annual report on Form 20-F 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 any forward-looking statements contained herein to reflect any change in Smith & Nephew's expectation with regard thereto or any change in events, conditions, or circumstances on which any such statement is based.

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

David Illingworth - Smith & Nephew - Chief Executive

Thank you. Good morning, everyone, and thank you for joining us for our third-quarter results call. I am here with Adrian Hennah, our Chief Financial Officer. I'm going to start with an overview of the business and then hand over to Adrian, who will take us through the numbers.

Q3 has been a solid revenue quarter for us, generating an increase of 10% in reported revenues and 7% on an underlying basis. Our US sales teams have stepped up to the plate and delivered well for us across our businesses, particularly in trauma and endoscopy. In the case of trauma, we have delivered two consecutive quarters of increased revenue growth. Our global knee franchise has also delivered a strong performance. These positive trends were balanced by the continued impact of Plus and some slowing of the market in Europe.

Advanced Wound Management grew above the market at the revenue line again this quarter, and we continued our investment in Negative Pressure Wound Therapy.

Our trading margin at 18.7% reflects the impact we are experiencing from our Negative Pressure Wound Therapy investment, the lost Plus revenues and compliance and legal costs.

Our earnings improvement program is making good progress in this heavy lifting phase of the program. We have some sizable construction projects underway. We're building two new factories in China, one for orthopaedics and one for advancement wound management. Much of the immediate earnings improvement work we're focused on is in systems and processes and in the effective delivery of our plans. We confirm our targeted increase in margin by the end of 2010.

I'll now move on to look at each of our businesses, starting with orthopaedics. In orthopaedics, which now includes reconstructive and trauma, we had global revenue growth of 6%. Excluding the impact of Plus, underlying growth was 9% and this compares to market growth of 8%.

In hips, we built BHR to a substantial market position in the United States, and we have a very good hip range. As we expected, the market is becoming more competitive as other players look for ways to compete against our success with BHR. In particular, we are seeing competition from the use of large metal heads on traditional hip stems. We are continuing our activities in building our resurfacing business, including introducing new sizes of BHR and using BHR's very strong clinical data to drive our sales efforts.

In knees, Legion and JOURNEY continue to perform very well for us, giving us 10% revenue growth this quarter.

In trauma, the US team has delivered two sequential quarters of increasing growth, 8% this quarter. In Europe, we grew revenues by 6% excluding the impact of Plus.

Clinical therapies grew by 10% globally this quarter, benefiting from very good EXOGEN sales.

Our earnings improvement process work is making progress with our longer-term projects, including logistics and manufacturing initiatives. We have a new distribution center in Memphis, and it will be operational early next year.

We have reorganized the biologics element of our research teams in our businesses, and are headquartering them in Raleigh, North Carolina. This regenerated team will have a greater critical mass to use the strong skills we already have in this area. The costs of this work are part of our planned increase in research and development expenditure announced in May, 2007.

Following our settlement with the US Department of Justice last year, we initiated additional compliance work within our reconstructive business. We said in Q2 that we were bearing costs related to the monitor and ongoing compliance. As you know, we are extending this work to all of our businesses globally. We are making good progress and see significant benefits from a level playing field for the industry and standard processes for our business.

The costs of this work include costs to establish the appropriate systems, ongoing costs to maintain the group-wide standards and procedures and we've believed these best serve Smith & Nephew. Adrian will talk a little bit more about the costs.

In endoscopy this quarter, we generated global growth of 8% as the changes made to the US sales force earlier this year delivered a quarter of improved growth. We are encouraged by our progress in the US although revenue growth may be choppy as we revitalize this business. Repair revenues performed strongly and exceeded resection with shoulder and knee products making very strong contributions. Our endoscopic hip business is developing well.

Resection had flat revenues after several quarters of growth and visualization revenues grew by 9%, benefiting from sales of our High Definition camera. Revenues outside the US grew at 9%, slightly less than in recent quarters as parts of the European market were a bit slower.

Let me turn to Advanced Wound Management. Revenues in this business grew by 8% to \$222 million, outperforming the market, as revenues both inside and outside the US grew well. Europe was a little softer due to competitive pressure on pricing and a weaker Southern Europe. Exudate Management revenues in Europe and Australia were offset by weaker US revenues. Recent additions to our infection management range have driven growth to 13% in this segment this quarter.

Our presence in the Negative Pressure Wound Therapy market is becoming more established and we are satisfied with our progress in this very successful first phase. The customer response to date is good. And at the end of the period, we were billing 25% more accounts than at the end of the second quarter. We continue to be confident about our investment, and we are enhancing our product range. As part of our earnings improvement program in this business, we're building a factory in China and expect to start parallel running of this facility in 2009. We are making good progress here, and as you can see from this photo, the brickwork is complete and the roof will be on soon.

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

Adrian Hennah - Smith & Nephew - CFO

Thank you, Dave, and good afternoon, ladies and gentlemen.

Turning firstly to Slide 9 of the presentation on the website, the income statement.

Revenue in the quarter was \$930 million, giving a reported growth rate of 10% on the comparable period last year. Underlying growth after adjusted adjusting for exchange rates was 7%.

Excluding the impact of Plus sales lost directly due to changes to unacceptable sales practices, group sales grew at constant currency by 9%. We estimate that sales of \$13 million were lost in the quarter due to these Plus issues. This is lower than the \$19 million reported in Q2 due only to the fact that in quarter three 2007, the impact of sales was seasonally lower than in quarter two 2007. There was the same number of selling days in quarter three this year as last year.

Trading profit in the quarter was \$174 million, representing an underlying growth of 1%. The decrease in the trading margin was 130 basis points in the quarter. We estimate that trading profit was reduced by about \$7 million as a result of the lost Plus sales and related costs. Absent this Plus effect, Q3 trading margin would have decreased by 80 basis points. Net interest expense in the quarter was \$16 million.

Moving to Slide 10 and moving further down the income statement, the tax charge in quarter three before exceptionals and amortization is 31.4%, our expected rate for the full year. Adjusted attributable profit for quarter three was \$107 million, marginally down on quarter three last year. Adjusted earnings per share grew by 3%, affecting the impact of the share buyback.

Turning to the next slide, Slide 11, and an analysis of revenue by business segment, you will recall that we communicated last quarter that in line with the internal management changes, combining the management of our recon and trauma sales forces and support functions, we will be adjusting our segmental reporting this quarter. We are now accordingly reporting the results of the previous recon and trauma business units in a single ortho business unit. We have, as promised, included sales data for knees, hips, fixation and clinical therapy in the appendices to this presentation.

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.

We have again shown pro forma growth rates excluding the impact of the changes to Plus sales practices at the right-hand side of this table. Pro forma underlying sales growth is 9% for the group as a whole and also 9% forward for ortho.

Turning to the next slide, Slide 12, and an analysis of revenue growth rates by segment and by geography. The underlying growth rate in our orthopaedics business was 6% before adjustment for the sales practice effects. Hips grew at 3%, knees at 10%, trauma fixation at 5%.

In the United States, overall growth was 9%. Growth in the knee business was 13%, benefiting again from good growth in the newer products. Hip growth was 3%. The benefits of the initial high growth phase of BHR in the USA are behind us, as Dave explained earlier.

Trauma fixation growth in the USA improved again to 8% and clinical therapy sales grew by 12%.

In Europe, underlying ortho sales declined by 5%. Adjusting on a pro forma basis for the \$13 million sales practices effect, ortho achieved a sales growth of 3%. Before this adjustment, knee sales increased by 1%, hip sales declined by 2%, trauma fixation sales by 11% and clinical therapy sales by 7%.

Like-for-like pricing in our reconstruction business in the USA and outside the USA was slightly negative. Endoscopy growth rate was 8%. Within this, arthroscopy grew by 8% and visualization related sales grew by 9%. Sales grew in the USA by 7%. Endo sales outside the US grew at 9%, somewhat slower than in recent quarters, especially in Europe. Wound sales grew at 8% in the quarter, including a contribution from NPWT sales of 2%. Total wound sales grew 8% in the USA, 7% in Europe and 11% in the rest of the world.

Turning to the next slide, Slide 13, this shows the usual analysis of revenue and trading profit by business segment. As we have already noted, trading margin for the group overall decreased in the quarter by 130 basis points. As we acquired Plus and BlueSky in quarter two last year, there is no longer a year-on-year margin effect from consolidating them in quarter three. As noted earlier, the decrease in the group trading margin would have been about 80 basis points but for changes to unacceptable Plus sales practices.

Also after strong underlying margin improvement in the first half of the year showed a reduction of 170 basis points, but for the changes to Plus sales practices, the margin would have decreased by 80 basis points.

The quarter saw a significant impact from compliance costs. A number of investors have asked information on the scale of the incremental compliance costs. We expect around \$30 million in the full year. We have incurred about two-thirds of this sum in the year-to-date. A significant proportion of this has been incurred in the USA in connection with our recon business. As mentioned last quarter, and again by Dave this quarter, we have also been investing in further enhancing compliance procedures in the other businesses and in other geographies too.

Endo margin was again impacted by costs associated with defending the Company's intellectual property. As you know, we have had some recent success in a case against Arthrex involving suture anchors and we're also moving to assert our rights in other areas.

Margin in wound was 20 basis points higher. We continue to invest in our NPWT products. NPWT was, as expected, again loss-making in quarter three.

Turning next to Slide 14 and a few words about our share buyback program, the Board has reviewed our current share buyback program in light of the conditions in the financial markets. We established the current program in February 2007 in quite different financial market conditions. Accordingly, the Board has decided to defer the current share buyback program until conditions in the financial markets stabilize. There has been no change in our long-term target balance sheet structure, in our expectations on cash generation or in our acquisition policy.

Turning to Slide 15 and a summary of our debt facilities, understandably, we have been asked by some investors in the last month or so for more detail on our debt facilities. We have therefore included this slide. Note 21 to our 2007 annual report and accounts does set out the position in some detail for anyone that wishes to refer to it.

We have committed facilities of \$2.5 billion in place until May 2012. \$1.5 billion of these facilities is in the form of a committed revolving credit facility. The banking syndicate providing the facility comprises 20 banks. The other \$1 billion of facilities was initially also in the form of a revolving credit facility. During the current year, we exercised an option to convert this \$1 billion facility into a term loan extending to May 2012.

In the light of the developments in the debt market, it is our expectation that we will continue to rely on both of these facilities for the foreseeable future and accordingly, these loans are now classified as long-term borrowings.

Turning lastly for the financial slides, to Slide 16 and the outlook for the rest of 2008. In the orthopaedic implant area, we believe that underlying global market growth remained around 7% through quarter three. We believe that market growth accelerated slightly in the USA and decelerated slightly outside the USA. We expect our growth to be close to market growth in the USA in 2008. We continue to expect that our growth in Europe will be reduced by the impact of the Plus changes.

Within orthopaedic fixation, we have seen global market growth continue at about 11% in quarter three, also with a modest increase from quarter two in the USA. We continue to expect to recover to market growth in trauma fixation in the USA by the year end and that our growth in Europe will be reduced by the impact of the Plus changes.

We continue to expect the sales practices changes in Plus to reduce revenues in a full 12-month period by about \$100 million, and the impact on 2008 revenues to be somewhat lower than this.

For endo and wound, our view of the market growth and of our sales performance in 2008 remains the same as in February. As far as margins are concerned, we remain confident of achieving our earnings improvement program target for the end of 2010. We also continue to expect a short-term impact on margins from the Plus sales practice changes and the NPWT launch. We expect the loss of profit from the Plus issues to be reduced to 25% of the lost sales during 2009. We do not expect our NPWT sales to earn profit for a few quarters as we invest in the substantial potential of our current and pipeline products. We expect them to be materially profitable thereafter.

We also expect the impact from additional compliance costs throughout the group to be with us for some time. Some of the additional costs, but not all, will cease with the end of the monitored assignment. We're also increasing our investment in compliance procedures somewhat in areas outside our USA recon business and this will continue for some quarters. We do not, however, currently expect the compliance, Plus issue or NPWT launch costs to impact again 2010 margin targets.

Finally, a comment on the tax rate. The tax charge in quarter three, before exceptionals and amortization, is 31.4%, our expected rate for the full year.

When looking at quarter four, please remember that we had a lower rate of 28.2% in quarter four last year due to a tax settlement on better terms than we had expected.

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

David Illingworth - Smith & Nephew - Chief Executive

Thank you very much, Adrian.

In summary, we had a solid quarter. Our revenue performance reflects the hard work that we've put in, particularly in the US this year, where we're seeing positive results in both trauma and endoscopy. Our global knee business and Advanced Wound Management have been strong contributors this quarter as well.

Our earnings improvement work is progressing well. Although our short-term margin is being impacted by the lost Plus revenues, the investments we have decided to make in Negative Pressure Wound Therapy and compliance and legal costs, we are confirming our 2010 margin target as we remain confident with the longer-term improvements, our earnings improvement initiatives will have on our business and our margins.

Economic conditions clearly look like they're going to be tough for a while, but I'm confident we have the right products and the right people operating in high-quality growing segments. Our sales performance in the first three quarters has been good, and we continue to see resilient demand for our products.

Against this background, we continue to be focused on driving efficiencies and tightly managing costs due to the earnings improvement program as well as preserving our flexibility through the prudent management of the balance sheet and our financial structure.

We believe our innovative product lines and the strong healthcare economic benefits they bring position us very well for continued sustainable profitable growth.

Now we're happy to take questions. I think we're going to use the usual system of taking questions. I would ask that each person limit their number of questions to two to allow as many people as possible the opportunity to participate. Can we please have the first questions from the caller?

QUESTION AND ANSWER

Operator

(Operator Instructions). Yi-Dan Wang, Deutsche Bank.

Yi-Dan Wang - Deutsche Bank - Analyst

Thank you very much. First of all, can you provide us with the US and O-US sales growth of hips, knees and trauma and indicate how much of the initiatives that you have implemented in your hip business can help you to obviously counter some of those competitive issues? If you could be specific on when you started and how you -- whether you expect it to more than offset just offset or partially offset the additional pressures you have seen, that would be great. That's my first question.

My second question is on the Department of Justice monitoring process, can you give us a sense of how those costs built up over each other quarters so we can understand what the underlying margins in your orthopaedic business is, and similarly for the Plus-related costs? And then comment on how much of that \$13 million is one-off or temporary versus sustainable costs, and whether we're going to see higher costs in that \$13 million next year. Thank you.

David Illingworth - Smith & Nephew - Chief Executive

Okay. Well Yi-Dan, let me take the second question first. And I will let Adrian continue to rifle through reams of data to try to answer the first question for you.

On the compliance costs, I think it's wrong to try to split it up too much into monitor costs or Department of Justice costs. We believe that our industry and medical devices in general will see a higher hurdle of compliance in the future, not lower hurdle of compliance in the future. And we are taking the opportunity to work with the Department of Justice on our reconstructive business in the US, clearly under a monitor, which has significant costs associated with it; but in parallel develop compliance programs across all of our businesses and our geographies, because we do believe that hurdle will increase in the future. And I think it's good for our industry and good for us at Smith & Nephew to have compliance programs in place that we feel very good about. So that's the work that we are doing.

We have -- if you take all of our compliance and legal costs around that issue, so far year-to-date we have spent about \$20 million. We're projecting that that could be as high as \$30 million by the end of the year. So you can do some of the math on that, but it's hard to split it up into discrete pieces.

I think that's kind of where we are on the compliance costs. We have made a decision to be a little more transparent on that because we have -- for two reasons really. Number one is we've consistently had questions like yours, which has been trying to get at what we are spending on compliance. Clearly, some of those costs will go away over time as we put the systems in place and the monitor activity comes to an end. But they won't substantially go away in 2009. I think it will be somewhat less in 2009, but we will continue to spend money in building our compliance capabilities at least in the near term and probably over the next year or so.

Let me try, I think there was one other -- was there one other part of that question that --? No, I think we've got it, okay. And hips, do you want to comment on the hip side, Adrian?

Adrian Hennah - Smith & Nephew - CFO

Nov. 06. 2008 / 1:30PM UKT, SNUF.PK - Q3 2008 Smith & Nephew Earnings Conference Call

(multiple speakers) I can give Yi-Dan the data she was after, certainly. So if we just run through hips, total as we said is 3%. United States 3%, O-US 4%. Knees, overall 10%, US 13%, O-US 7%. And the trauma fixation business overall 5%, US 8% and O-US 1%. I think that was the data you were after, wasn't it, Yi-Dan?

Yi-Dan Wang - Deutsche Bank - Analyst

Sorry. You started to give -- so trauma, 8% US, 1% outside the US and 5% globally?

Adrian Hennah - Smith & Nephew - CFO

Yes, yes.

Yi-Dan Wang - Deutsche Bank - Analyst

That would be great. Thank you. And my question on the competitive issues in hips.

David Illingworth - Smith & Nephew - Chief Executive

Well, I think there's a couple of things that we are dealing with here. Number one is we're dealing with our own past success. We have had some pretty healthy comparables that we are sort of putting uphill right now on the comparable side of the equation.

The other thing is that our competitors, most of them do not have a product for resurfacing and they are beginning to compete with large metalheads and standard stems. And they don't -- I think it's a natural competitive reaction. I think the other thing is that we have had less degrees of freedom on doing anything that we want in terms of training and bringing these new physicians up to speed and we clearly have to continue to work at making sure that we are efficient in our training programs, given the restrictions that we are under with the Department of Justice. So it's a mixture of things. We are pretty happy with our product range.

The other thing to remember is that on BHR, we had one heck of a ramp-up in the early phase of this introduction. I think anybody would be thrilled to have the type of market penetration for a new product that we have had in the US. We think there was somewhere around 3.5% of the market now -- the hip market -- in resurfacing products. And we fully expected the adoption curve to flatten out a little bit as we get a competitive response and we deal with comps and etc.

So I think it's steady as she goes. We are coming out with new sizes. We are working on second and third-generation products where our competitors are still trying to get their first-generation products to the marketplace. We are coming out with more sizes and hopefully we'll have some more degrees of freedom on training as well. So that's really the dynamics as we see them.

Yi-Dan Wang - Deutsche Bank - Analyst

Right, so the competitive issues then, when did you start to see those happening? In terms of the initiatives you're taking, when do you expect that to offset the competitive issues if at all?

David Illingworth - Smith & Nephew - Chief Executive

Well I think the competitive issues started on day one. We have good competitors out on the marketplace. They're always trying to compete with whatever moves we make. We had an exciting new product that was brought to market. It ramped up very quickly. There are competitors -- the competitive response was to bring a product to market, Stryker brought a product to market for instance that they licensed in to bring into the US. And I think the other competitors started figuring out how to put together a strategy to try to combat the success of the BHR with large metalheads and they are clearly working hard to do that. I would be doing the same thing if I was them.

Yi-Dan Wang - Deutsche Bank - Analyst

And in terms of your initiatives, how successful do you think they would be?

David Illingworth - Smith & Nephew - Chief Executive

We're going to keep doing what we're doing. We have over 50% market share worldwide and we are not the least bit embarrassed about where we are. We feel pretty darn good. We have over 3% of the total hip market in the US, which is a phenomenal number at this point in time. Remember we're only a couple years into this. So we feel very, very good about where we are. We're just going to continue steaming ahead with new products, next generation products, new sizes, etc.

Yi-Dan Wang - Deutsche Bank - Analyst

Clearly hips has surprised us quite negatively. I just want to get a sense of what your expectation for that business will be going forward, given all of the issues that you have talked about. Is this quarter going to be the worst we've seen in hips or do you expect further deteriorations from here until some of your initiatives start to take effect?

David Illingworth - Smith & Nephew - Chief Executive

First of all, the initiatives that we are talking about are in place now. We are working on doing an even better job of bringing our clinical data forward. Like I said, we have over 50% market share with this product on a global basis. We have a good hip range. We've got some pretty tough headwinds in terms of comparables that we're dealing with. Obviously at some point in time in the future we won't have that to deal with as much as we do today. But we feel pretty good about where we are on this product range.

We can certainly talk a little bit more about it, Yi-Dan, but we probably should move on and try to get a couple more questions in.

Yi-Dan Wang - Deutsche Bank - Analyst

I appreciate that. Just one last follow-up on the [monet] compliance costs. Just to be clear that your -- so those costs will be less in 2009 than they were in 2008?

David Illingworth - Smith & Nephew - Chief Executive

We believe they will.

Yi-Dan Wang - Deutsche Bank - Analyst

Thank you.

Operator

Matt Miksic, Piper Jaffray.

Matt Miksic - Piper Jaffray - Analyst

Thanks for taking the questions. I wanted to just clarify the FX impact in the quarter. If you could talk about what the impact was versus your expectation heading into the quarter. And then also if you could maybe walk us through how that affects the various lines if at all in the P&L and the bottom line.

Adrian Hennah - Smith & Nephew - CFO

Actually, we don't have expectations that will go into a quarter for what the foreign exchange rates will be. And I think the recent movements have shown the wisdom of not having those particular expectations to be honest, Matt, which is probably not the most helpful of answers. But frankly I know a lot of analysts ask this -- can you give us a rule of thumb for the impact of exchange. Actually we find that quite hard to do.

The translation impacts on our numbers, it's fairly transparent to get them. We publish broadly the currencies in which we have our revenue and it's not -- can put the spread sheet together and put in a particular exchange rate, you can get broadly sort of translation impact.

In terms of the transaction impact, which can be seen as the more profound and important one, we actually have a pretty muted exposure to transaction effect of foreign exchange. And the reason for that is a couple fold.

One is that the bulk of our costs are in SG&A. And there's a fairly good match between the currency of SG&A and the currency of the revenue. It's a little bit dollar heavy, a little bit Sterling heavy because of R&D costs have an orientation there, but by and large, it is a fairly good match.

In terms of cost of sales, which, as you know, is something less than 30% of sales in cost of sales. There, we do have a slight dollar heaviness in orthopaedics and endoscopy. Maybe three quarters of cost of sales is in dollars for orthopaedics and endoscopy as compared to about 50% of revenue. Conversely for the wound business, it's something over half of the cost of sales within Sterling but only about 15% of sales. So in those cases, we have some transaction exposure but if it's muted, it's also delayed because the inventory turn pushes it out and we buy a reasonable amount of for-ex cover against it, which pushes it out. So you will see small transactional exposures depending on the movements principally in Sterling and the dollar, but they're not substantial.

And translation effect, I really -- we struggle to give a rule of thumb. I really think one just has to sort of put a spread sheet together and look at the currencies in which we get our money and put in the different exchange rates.

Matt Miksic - Piper Jaffray - Analyst

So, but just if I'm hearing your answer on the impact, there is an impact. It's just hard to quantify. It sounds like you have a natural hedge in SG&A that for the most part should offset the top-line impact. But in cost of goods maybe less so. And if I'm hearing this right, the rates move pretty quickly in the quarter. So would that suggest that it takes a little longer in that kind of situation for this to effectively -- for your natural hedge to take effect in cost of goods?

Adrian Hennah - Smith & Nephew - CFO

No, let's focus on the movement in the quarter. Clearly, when the dollars got very strong in the quarter, what we will see us in our orthopaedic and endoscopy businesses, there will be a small, and I emphasize small, because again, it's only on the cost of sales, and it's only the mismatch between three-quarters in dollars of the cost of sales and a half in dollars of the revenue. So we're talking only about 25% of the revenue and we're only talking about 25% of the total cost -- sales are only going to be 25% of sales. So it's a muted impact and it will be delayed because as you probably know, there's quite a chunky inventory cycle, particularly in the orthopaedic businesses because of our business model. So until that goes through, it doesn't hit the P&L.

And we also buy For-Ex cover out for several months. So you won't be seeing the impact if current exchange rates stay as they are until well into 2009. So we're not -- and in wound, you will be seeing a different impact because of the Sterling orientation. So again I repeat transaction, muted impact and delayed impact.

Translation, well clearly it's bigger. We report in dollars, so clearly the dollar is strong against the euro. You're going to see an impact. But you've just go to put that into a spreadsheet to figure out exactly what it is, I'm afraid.

Matt Miksic - Piper Jaffray - Analyst

Okay. Second question on just the US revenues. You talked about an acceleration in the US in the quarter, which is a little -- it's unusual to hear about for a summer quarter. If you could talk about maybe what's driving that and what the implications are for Q4.

And also, just, Dave, maybe if you could talk a little -- you talked about competitive effect on hips of metal -- large diameter metal on metal in traditional stems. Also would appreciate your thoughts on how much off-label competition you're seeing on BHR.

David Illingworth - Smith & Nephew - Chief Executive

Let me take your question about the US revenues. Yes, you're right, the summer traditionally is a little bit slow, but we took some very deliberate actions a couple of quarters ago to do some things to generate a little more robust performance in the US in a few of our businesses. In trauma, for instance, we aligned our trauma sales teams in the field under common management so that we could get the leverage that we felt like we were losing in that business. And it's worked out very well for us. And what we've said is that by the end of the year, we would be back up to market growth rates and we still believe that we are going to be right around there. So I think it's going as we had planned it to be. So that's trauma.

On the endoscopy side, we've made some structural changes in the way that we deploy our sales resources as well. We haven't been -- we haven't talked a lot about it, but we have talked about what we were -- the specifics of what we're doing, but we talked about the fact that we were making some changes structurally in our sales force. And that has been paying off for us with now two quarters of sequential growth in the US endoscopy business.

And then in wound, I've been saying for a couple years now that we don't punch our weight in the US in our wound care business. We treat -- we are the number one company in the world in treating hard to heal wounds, and yet we just don't get our fair share of the business in the US. And we've been making investments in that business over the last couple of years to make sure that we change that dynamic.

We have a new management team in place. We have invested in Negative Pressure Wound Therapy, which is a big growth area for us. And as you know, we have invested heavily in that area as you can see from some of the margin impact this year, that we have made conscious decisions to go after a very, very attractive segment and feeling like we had a product that was really getting traction and we didn't want to lose that momentum.

So I think that's the reason for the revenue impact, is essentially the actions that we have taken over the last six to 12 months in positioning those businesses. And they are paying off and we are glad that they are. I really can't comment on any off-label issues with large metalheads because I'm just not aware of it certainly at my level. I just don't really know.

Matt Miksic - Piper Jaffray - Analyst

Okay. And then the last part of the trends in the US, implications for Q4, should we look for these kinds of sort of investments in management and operational changes that you've made to carry through to Q4? Or was this against an easier comp last year? How should we think about those businesses going forward?

David Illingworth - Smith & Nephew - Chief Executive

Well, I will give you a steer on a couple maybe. I've already told you one, which was the trauma piece. We originally said that our expectations were we would get the market growth rates by the end of the year. We are going to be hovering somewhere in that area by the end of the year, so we still have a little ways to go there, so we are expecting to continue to see some progress.

Endoscopy is a little harder to call, just because there's a lot of lumpiness and choppiness with capital equipment and larger pieces of equipment and it's just a little bit harder to call, but we're certainly happy with where we're headed in that business.

And I think wound, we will continue to see progress there. We have seen growth just about every quarter. And so our expectations are that we are going to continue to get traction and negative pressure. Our growth rate and negative pressure continues to grow. As I said, we have 25% more billable accounts right now today than we had at the end of the second quarter. And that's a big deal for us. So we expect it to continue.

Matt Miksic - Piper Jaffray - Analyst

Okay. Thanks for taking the question.

Operator

Charles Weston, Nomura.

Charles Weston - Nomura Securities International - Analyst

Good afternoon. I have a few questions. First of all, on the outlook for the US orthopaedics reconstructive business, you now say that you are expecting to get close to market growth rates for the rest of the year. Before you were guiding towards in excess of market growth rates. And I just wanted to check whether this was down to -- certainly down to the additional BHR competition that you were talking about or whether there's anything else going on there that we ought to know about?

In wound management, you appear to be disclosing slightly differently the subsectors now, Exudate Management and infection management. I haven't heard those terms being used in your disclosures before, and I was wondering whether you could help us by giving us some kind of indication of what proportion of your wound management sales Exudate Management is and infection management is.

And lastly in endoscopy, it appears that you spent significantly more than we were expecting on the litigation costs and I understand that some of those are already going on in the second quarter. There was another big step-up. And I was just wondering if all of that could have been spent on litigation and defense of your IP, or whether there was anything else going on there that might be incremental costs.

David Illingworth - Smith & Nephew - Chief Executive

Okay. Well let me try to hit those three questions, Charles. First of all, I wouldn't read too much into the words around what we're saying on recon. It is slightly nuanced. We chose those words carefully. I think we're going to be closer to market growth rates than we are to above market growth rates. I wouldn't -- there's nothing specific in there that you -- that we should be steering you towards that we are concerned about. Clearly, we have the same challenges in front of us that all the other companies have in terms of making sure that we do things within the -- under the restrictions of the compliance issues we're dealing with and the federal monitors, etc., etc. So it's an additional challenge for us, but there's nothing that I would point out that led us to that nuance. We just wanted to be as accurate as we possibly could.

In the wound care segments, again, I wouldn't read too much into that either. Maybe -- you know, you are right. As you asked the question, you're probably right. We did talk about some of those segments that we normally talk about the major segments with our wound care team when we talk about how they run the business, the antimicrobials and the Exudate Management and the Negative Pressure Wound Therapy, etc. We could certainly get with you one-on-one and bring you up to speed. Do you have it? (multiple speakers)

Adrian Hennah - Smith & Nephew - CFO

Yes, Charles, if you look at the appendix, it's Page 22 in the presentation, where we give the breakdown. We've given the total of Exudate Management in the quarter at \$67 million and infection management, \$29 million -- so it's sort of roughly 30% and 15% of the total.

Charles Weston - Nomura Securities International - Analyst

Oh, great. Thanks.

David Illingworth - Smith & Nephew - Chief Executive

And the last question you had was about endoscopy and the legal costs?

Charles Weston - Nomura Securities International - Analyst

That's right.

David Illingworth - Smith & Nephew - Chief Executive

Yes.

Adrian Hennah - Smith & Nephew - CFO

Yes, and Charles, you're right. You noted absolutely right here. In the sense that the whole of the margin reduction endoscopy is not down to additional costs in respect of intellectual property protection. The explanation -- the main explanation is [Wolf and West]. We always consistently say you can't trap margins quarter by quarter, segment by segment and expect a complete explanation because stuff happens quarter by quarter. And if I was ranking it, that's explanation number one.

There is movement in the IPR costs. It's not cheap pursuing these cases. And there is a mismatch between when expenditure gets occurred around court hearings and where it gets concentrated and the benefit, which, as you know, we haven't booked because it's still subject to appeal in this Arthrex case. And then there was also a little bit of additional cost around some of the evolution of the sales force in the area, but that comes into the category of Wolf and West, you do it all the time.

So the bottom line to answer your question is, Charles, yes, the whole margin movement is not attributable to IP costs, but that is one of the more unusual ones which we chose to call out, frankly.

Charles Weston - Nomura Securities International - Analyst

And in terms of how that might progress forward, obviously, you won the Arthrex case. Congratulations on that. What kind of cost reduction will you therefore be able to get on the assumption that there isn't an appeal?

Adrian Hennah - Smith & Nephew - CFO

Well, John, we haven't won the Arthrex case. We won the hearing. We also got an injunction, but both the hearing and the injunction are subject to an appeal, so, which is why we haven't booked any benefit. So we haven't won the thing yet. We hope we will win it, but the due process needs to go to do that.

We are signaling that there are some other areas of intellectual property that we are going to seek to serve our rights in and it's an important area. We are a leader in terms of innovation in particular repair segments and endoscopy, and it's important to our economic well-being that we defend our intellectual property rights in the area.

So there is in there a signal of on an ongoing basis, a little bit more, nothing like the total of what we're talking about in either quarter two or quarter three. There was a lumpiness about it and really it's not -- I can't give you a specific number, Charles. That's not helpful if you know what I mean. It's definitely not helpful to you.

Charles Weston - Nomura Securities International - Analyst

Okay, thank you.

Operator

David Adlington, Cazenove.

David Adlington - Cazenove - Analyst

A couple of quick questions. Firstly, as we look at 2009, I think there's quite a few moving parts, particularly in ortho. I just wondered if you could give us some sort of top-level help in terms of how you see both the growth rates and the margins developing in ortho as we look into next year?

David Illingworth - Smith & Nephew - Chief Executive

Nov. 06. 2008 / 1:30PM UKT, SNUF.PK - Q3 2008 Smith & Nephew Earnings Conference Call

Well, we haven't given any guidance for 2009 yet, David, as you know. I think if you look at where we historically have been, we have been either at or slightly above market growth rates. And we certainly don't see anything dramatic that is going to impact that.

In terms of margins, as far as giving margins for individual businesses in advance, we certainly don't want to do that. But I can tell you that we are 18 months into a four-year program for Earnings Improvement Programme. We have already delivered 130 basis points of improvement to date and we have a very clear view to our projection of 400 basis points over the four years through 2010.

We have real programs and we've always said that this middle phase is kind of a heavy-lifting phase where you make early investments, and it doesn't pay off till the later stages. But those investments have occurred. We continue to have significant cost savings programs across our business.

And what we desperately tried to do by being very upfront and honest with all the folks that we talk to on these calls is we want to be able to retain the flexibility within our business to invest and make the short-term decisions that are in the best interests of this Company without regard to being held to some quarterly number for margins. And I think that we've done a pretty good job of that and we are on track.

We do have some headwinds that were slightly larger and stronger headwinds than we had originally projected when we did our flight plan. But we feel after looking at where we are, that we're going to be able to handle those in the timeframe that we said we were going to be able to handle them and we will still deliver the 400 basis points of margin expansion.

So I think the overarching answer is you should continue to see progress. We will continue to give you as much visibility as the programs come to fruition, and give you real hard numbers and we're feeling pretty good about it.

David Adlington - Cazenove - Analyst

Okay, great. And then again a follow-up. Just really in response to the last paragraph in your outlook statement, where you mentioned your sensitivity impact of the current economic turmoil. I just wonder if you've actually seen any impact to date.

David Illingworth - Smith & Nephew - Chief Executive

Well, first of all, I think the word sensitive -- it can easily be put in the wrong context. What we mean by that is look, we have a global economic crisis that's going on. We don't want to presume or assume that we won't be impacted in some way, although we're not seeing anything right now in our business.

I think the point that is important to make from our point of view that accurately describes where we are is we have to make sure that we prepare for whatever potential impacts may come down the road. I think we're actually in a pretty good position because we don't have to immediately stop what we're doing and start efficiency programs and productivity programs in our business and earnings improvement programs in our business. We actually have those ongoing, so we have a bias towards making sure that we are thoughtful about any potential impacts in our environment. And that's what I mean by sensitive to it, is that we want to make sure that we're prepared. We would like to be able to stay as much ahead of the curve as we can. And that's where we are.

David Adlington - Cazenove - Analyst

So you haven't (multiple speakers)

David Illingworth - Smith & Nephew - Chief Executive

Adrian do you have any --?

David Adlington - Cazenove - Analyst

So you haven't seen any impact to date?

David Illingworth - Smith & Nephew - Chief Executive

No, not yet. Not yet. But that's what I mean. We don't want to say because we haven't seen any impact to date there won't be any because I don't want to make that call. I just want to make sure that we're prepared to deal with whatever comes our way.

David Adlington - Cazenove - Analyst

Great, thank you.

Operator

Michael Jungling, Merrill Lynch.

Michael Jungling - Merrill Lynch - Analyst

Thank you and good afternoon and good morning. I have a couple of questions. Firstly on the Earnings Improvement Programme, and this is a question for Adrian. Many investors have bought your stock on the basis that you will see a nice improvement in margins over time, maybe 400 basis points. But it's getting more and more difficult to track that. And I was hoping you could perhaps provide today the underlying EBITDA margin improvement at the beginning of 2007 when you first made the announcement, what it was at the end of 2007 and where we stand in the first nine months of 2008.

And then the second question I have is in relation to your compliance program, what impact do you think this will have on your top line now that you're rolling it out into the other areas of endoscopy and wound care, and perhaps also the non-DoJ settled areas of orthopaedics, do you expect perhaps that sales growth could slow similar to what we've seen with one of your competitors who has been quite aggressive in doing this as well? Thank you.

David Illingworth - Smith & Nephew - Chief Executive

Thank you, Michael.

Adrian Hennah - Smith & Nephew - CFO

Yes, Michael, you and I have talked on several occasions about this concept of underlying and I must confess I find it quite a difficult one to be - to understand how we can give you quite the transparency you aspire to. What we've tried to do is to highlight those things which are clearly of a very short-term nature and others as they come on without getting to the point where you say all debits are temporary and we're going to exclude them because that's just not credible.

So starting at the top of the list, we clearly -- we do adjust in the numbers we give you for the consolidation of Plus and BlueSky, because that's simply a consolidation issue when you are consolidating at lower margins and higher margins. You have that data.

We give you the data for the impact of the Plus unacceptable sales practices effect because that is an extremely unusual set of circumstances. That will play through.

We reflected, as Dave mentioned a few minutes ago, about do we mention the compliance costs number or not and you and a number of your peers in other organizations, a number of investors have also asked us for that number with a view to having a sense of well how much of that is temporary, how much of that is "underlying" or not. And we've come to the conclusion we should on balance give that number, the estimate of \$30-million-ish this year with it being somewhat smaller, but not hugely smaller next year.

But after that, you begin to say, well what is it that we should be giving exact numbers of and how temporary are they? Excuse me, NPWT will also be in that category where we're giving an indication, although not a precise quantification of the magnitude of the investments in that area.

But beyond that, you begin to say well what is exactly that we should be showing is underlying. And we believe that what we're trying to do is to give the appropriate level of transparency without giving you so much that you get into the nitty-gritty of the way we run the business at an excessive level. So that's what we try to do, Michael. Maybe we don't wholly succeed, but it's certainly what we're trying to do.

David Illingworth - Smith & Nephew - Chief Executive

Yes, and just --

Michael Jungling - Merrill Lynch - Analyst

Adrian, just a question. So when you say to us in the press release that your margin targets from the EIP program is on track, what does it actually mean then?

Adrian Hennah - Smith & Nephew - CFO

Well what it means is, Michael, as you know in the year before we started this, we were at 20.5% margin. And we therefore basically said by the end of 2010, you would be at 24.5% margin. It got confused when we bought Plus in the sense that you are buying a lower margin business, but as it happened and I know we've explained this to investors including yourself or tried to anyway, Michael, that by coincidence, the cost synergies we expected from Plus pretty much exactly offset the consolidation of its lower margin over the same timeframe. So actually over the four years, to the end of 2010, that washed out. So as it stands, we are still looking for 24.5% as the margin target at the end of 2010 to meet the initial EIP goal.

David Illingworth - Smith & Nephew - Chief Executive

Yes, and the only caveats we have put on that, Michael, is that obviously if we make some major acquisition, then we have to deal with that. And secondly is if there is any major unexpected pricing movements in the marketplace that we just haven't either expected or projected. But those are the only two caveats we put on it so we expect to be at 24.5% at the end of 2010 as Adrian says, and deal with the other headwinds that we have along the way. So that's where we are.

You did ask a part of your question that dealt with our competitiveness by having enhanced compliance programs. Look, we decided to take advantage of the momentum of the work of the monitor and the work that we're doing in the US to enhance the processes across the group. We do not believe that being a best-in-class, ethical, compliant company will make us less competitive, period. That is our going in assumption; we don't believe it will happen. We believe that customers fundamentally want to deal with ethical players in the marketplace and that is our goal. And we just wanted to take advantage of the momentum of the work that is being currently done. I can't speak to what the competition is doing, but we've been doing this for some time. And you could see where we are on revenue. For the most part we're doing well relative to the market. And we would hope to continue to be able to make those trade-offs along the way and get these programs put in place without having any significant dislocating effects with our customers or our competitiveness.

Michael Jungling - Merrill Lynch - Analyst

Just a follow-up question for Adrian. So if I look at 2010, is it fair to assume that maybe a 24.5% margin is still achievable because eventually the monitoring costs will wash out over time. We will see the Plus orthopaedics issues evaporate over time. So is a 24.5% margin still, even with all things being in there, a reasonable target to aim for?

Adrian Hennah - Smith & Nephew - CFO

It's an end 2010 target, Michael. We've always said that. It isn't the margin we expect in 2010, but by the end of 2010, you heard Dave reaffirm that for the goal and absolutely we reaffirm that as a goal. That is our -- and clearly as we do that, among the considerations we take into account is the duration of some of these impacts that you're highlighting.

David Illingworth - Smith & Nephew - Chief Executive

Nov. 06. 2008 / 1:30PM UKT, SNUF.PK - Q3 2008 Smith & Nephew Earnings Conference Call

And Michael, just one addition, editorial comment here. We don't make these projections and commitments lightly. We have a view towards the programs that are currently in place. We know what's going on in our organization and the bias that we have towards operational efficiency and delivering these commitments and we -- and clearly we believe we have the ability to meet those commitments by the end of 2010.

Michael Jungling - Merrill Lynch - Analyst

Great. And one final question. You mentioned in your press release that in Europe you are seeing weakness in southern Europe in wound care. I suspect that's got to do with the economic issues in Spain and Portugal. Is that correct? And if it is, why could that not impact, for instance, endoscopy or orthopaedics?

Adrian Hennah - Smith & Nephew - CFO

I think we probably shouldn't make too much of this. We have seen, in those countries that you describe, we have seen a bit of weakness in the quarter in wound, but I wouldn't want to overstate too much of this. I don't think it's a major signal that should be extrapolated too far out.

Michael Jungling - Merrill Lynch - Analyst

Okay, thank you.

Operator

Ilan Chaitowitz, Redburn Partners.

Ilan Chaitowitz - Redburn Partners - Analyst

I've got three questions. Firstly, just a follow-on from the last question, which I thought was very pertinent. If we are looking for quite a strong margin uptick over the course, into the end of 2010, would it be fair to say that this quarter is really the trough margin that we should be seeing in your business over the next two to three years? That's the first question.

The second thing is, could you go into a bit more detail into the pricing dynamics, maybe quantifying what the price cuts were in the US versus Europe?

And the final question relates to the gross margin. Now that came off in Q3. Can you give a bit more clarity on what's going on there? Is that a volume? Is that the pricing hitting or is there any sort of compliance, IP issues in there? Can you just explain what's going on with the gross margin?

Adrian Hennah - Smith & Nephew - CFO

Yes. Well I'll take the last one first and then work up. The gross margin -- the exceptionals was the answer with the gross margin. Exceptionals aren't huge this quarter, but there are some, and they disproportionately end up in cost of sales as opposed to other items. So we just happen to have a disproportionate number of the exceptionals in cost of sales this quarter. It doesn't mean anything, is the bottom line.

Where were the price cuts, we clearly aren't going to go into where price cuts are on a product-by-product basis. That would not be helpful at all. Perhaps one thing to highlight is -- not to highlight but to mention is that in the context of BHR, we have, as you know, been seeing price reductions in line with our expectation on that product, which is clearly a US issue.

David Illingworth - Smith & Nephew - Chief Executive

And in line with plan.

Adrian Hennah - Smith & Nephew - CFO

Exactly. Exactly. But beyond that, it would not be appropriate. And again, let's emphasize, we're talking about slight like-for-like price in both the US and Europe. Again, this is not a heavy signal that you should be over-extrapolating from.

In terms of your question about if the end of 2010 is on track, is this a trough margin, we absolutely are not going to get in the game of giving you margin-by-margin forecasts. It's just a completely stupid place to get. We were very, very clear about that in the February '07 when we set off on this thing, and we are not going to move from that position. It leaves management in a silly position if you get into it. It leaves you with a process of making silly decisions if you're not careful, and we're not going to put ourselves in that position.

Ilan Chaitowitz - Redburn Partners - Analyst

Thanks. Just on a pricing issue, it was more a geographic understanding of what's going on with maybe versus the US and Europe or the rest of the world. If you could just quantify that a bit more clearly if possible; and describe -- in the US it sounds like it's competitive. In Europe are you seeing harder pushback from hospital purchasing groups or health services?

David Illingworth - Smith & Nephew - Chief Executive

Well, I don't think it's -- nothing has changed. I think for this past several years, we have seen a slightly, slightly more pressure on prices in Europe than we've seen in the US, but that's probably about as far as it's helpful to go. And it really hasn't changed. We are just reiterating what we have said probably if I go back and look at it, we probably said it every quarter for the last couple of years, that there is slightly more pressure on price in Europe than there has been in the US.

Adrian Hennah - Smith & Nephew - CFO

Yes, just getting back to David Adlington's question earlier, we do not sense that what we are experiencing yet anyway is the early sign of the macroeconomic issues. We're not seeing anything out of line that would lead us to suspect that is the case.

Ilan Chaitowitz - Redburn Partners - Analyst

Thank you very much.

David Illingworth - Smith & Nephew - Chief Executive

Thank you. I think we have time for one more question if we can.

Operator

Joanne Wuensch, BMO Capital.

Joanne Wuensch - BMO Capital Markets - Analyst

Thank you very much for squeezing me in. I appreciate it. It seems like in this quarter you had three different expenses which were a little bit higher than at least we were expecting and that will trail off over the next let's call it six quarters. And I know you don't want to get specific on it, but if you could just give us an idea of how those will pattern. And specifically I'm looking for your compliance expenses, your BlueSky investments and your litigation costs. Thank you.

David Illingworth - Smith & Nephew - Chief Executive

Okay. Well I think actually Adrian has hit those today, but maybe it wasn't quite as clear as it needs to be, so let's maybe go over that again. On the compliance costs, you should expect slightly less in compliance costs in 2009. We will continue to spend dollars on compliance in this Company in order to get the systems and the structure and the procedures in place and the systems in order to support it. But it will be less in 2009 than you saw in 2008. In terms of the litigation costs and the IP costs, that's really an unknown. We have to obviously defend our territory when it's threatened. And --

Adrian Hennah - *Smith & Nephew - CFO*

But it's not big enough to move the group dial. It might move the endo dial a bit, but those numbers are not big enough to move the group dial.

David Illingworth - *Smith & Nephew - Chief Executive*

Right. And as far as Negative Pressure Wound Therapy, we've talked a lot over the last couple of quarters about the fact that we have seized an opportunity. And our belief is that we have a product that is pretty exciting. We are combining it with a sales force and a company that delivers a very broad range of wound care solutions to our patients, and we think we have a real right to win in this marketplace, to go out and be a significant player. We were very pleased with the early reaction to the product in the marketplace. We decided to invest at a higher level than we had originally planned, and those investments are paying off for us. We do believe that it will continue to have a dilutive effect on our business for a few more quarters, but we will probably get towards the end of '09, and see that business start to become materially profitable for us. So that's kind of the general steer on those buckets that you laid out.

Joanne Wuensch - *BMO Capital Markets - Analyst*

Okay, thank you very much.

David Illingworth - *Smith & Nephew - Chief Executive*

Thank you. And I just want to thank everyone for attending and look forward to talking with you over the next couple of weeks. Thank you very much.

Operator

Thank you for attending today's conference. You may now replace your handsets.

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