



## Conference Call Transcript

SNN - Smith & Nephew Acquisition of Plus Orthopedics Conference Call

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Good day Ladies and Gentlemen and welcome to the Smith and Nephew announcement on the purchase of a major European Orthopedic business. [OPERATOR INSTRUCTIONS]. Before we begin we would like to read out the safe harbor statement.

This presentation contains certain forward-looking statements within the meaning of the US Private Securities Litigation Reform Act of 1995. In particular statements regarding plans for us in our business and in our operating margins, discussed under outlook, are forward-looking statements as are discussions of our product pipeline. These statements as well as the phrases aim, plan, intend, anticipate, well placed, believe, estimate, expect, target, consider and similar expressions are generally intended to identify forward-looking statements. Such forward-looking statements involve known and unknown risks, uncertainties and other important factors including, but not limited to the outcome of litigation and regulatory profiles that could cause the actual results, performance or achievements of Smith and Nephew or industry results to differ materially from any future results, performance or achievements expressed or implied by such forward-looking statements.

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Please refer to the documents that Smith and Nephew have filed with the US Securities and Exchange Commission under the U.S. Securities Exchange Act of 1934, as amended, including Smith and Nephew's most recent annual report on Form-20F for a discussion of certain of these factors.

All forward-looking statements in this presentation are based on information available to Smith and Nephew as of the date hereof. All written or oral forward-looking statements attributable to Smith and Nephew, or any person acting on behalf of Smith and Nephew, are expressly qualified in their entirety by the foregoing. Smith and Nephew does not undertake any obligation to update or revise any forward-looking statement contained herein to reflect any change in Smith and 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 Sir Christopher O'Donnell, Chief Executive of Smith and Nephew. Please go ahead.

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**Sir Christopher O'Donnell - Smith & Nephew - CEO, Director**

Good morning. I'm very pleased to be here today with Dave Illingworth our Chief Operating Officer and Adrian Hennah our Chief Financial Officer, to formally announce the acquisition of Plus Orthopedics. We are very excited by the opportunity to buy this business, which we've been following for some time. And it's a very good fit with Smith and Nephew, and it's financially attractive on the basis that we work together.

What I'd like to do is really to just talk off slide four, which relates to our strategy for acquisitions, which we reminded everybody of at our preliminary results presentation. We do look to seek value enhancing acquisitions that relate to unique or additive technologies and products, and that improve our channels to market. And we believe that Plus falls on both of these.

We also have a continuing ongoing focus on the emerging markets for biological repair of cartilage and bone we are looking at prospects in this area. This is not something that Plus specifically adds to, but it does add to our market strengths to enable us to deliver on those. And clearly, we've also said we are going to maintain balance sheet flexibility to deliver on opportunities, like Plus, when they do present themselves.

So what we'd like to do now is I'd like to ask Dave Illingworth to talk to you about Plus. And then ask Adrian Hennah to talk to you about the financial aspects of the transaction. So with that I'm going to hand over to Dave Illingworth, our Chief Operating Officer. Dave.

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**David Illingworth - Smith & Nephew - COO**

Thank you Chris. Let me start with giving a short snapshot introduction to Plus Orthopedics. They were founded in 1991. They are based in Switzerland. The original business really originated in hips, particularly in European designs. They are among the top players in hips in Germany, which is the world's third largest orthopedics market. And they also are a strong player in knees in Germany as well. And their manufacturing is based both in Switzerland and in China.

To give a couple of the acquisition highlights here. It is a purchase price of \$889m including assumed debt. They had revenues in 2006 of \$300m and that represented a growth of 16% over their 2005 revenues, profit before interest and tax \$36m in 2006, which was a growth of 33% over 2005.

Now if I can turn to the benefits. This combination has some clear benefits for us. First it strengthens both our European and our Asian distribution channels. They have an excellent European product portfolio, both in a European designed cementless hip stems, and hinged, fixed, fixed bearing and mobile knees. They have a highly complimentary product range to us, and the business is expected to be highly synergistic. We expect this transaction to be earnings accretive from 2008.

Turning to the opportunities page, this will give us increased leverage in our sales channels both in Europe and Asia. In terms of production we will have increased manufacturing leverage in the combined business, and the ability to plan capacity utilization better. We do expect some marketing and sales infrastructure efficiencies. And we will dedicate focused integration resources to deliver these benefits and opportunities for ourselves.

Turning to the product page, most notable complementary products are a hinged knee, mobile bearing knee, a very nice threaded acetabular cup, some additional shoulder implants that add to our product line and also a line of small joint implants.

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Turning to the next page which shows the global market shares, we move now into the number four position in reconstruction on a global basis. As you can see Zimmer, DePuy, Stryker are one, two and three. And our -- the combined company has 12% market share moving us to the new number four position.

On the last page, as you can see the Plus locations are predominately European based, with a U.S. base in Santiago and Asian operations in China and Japan. So with that as an overview of Plus and the deal, I'd like to turn it over to Adrian Hennah, our Chief Financial Officer.

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**Adrian Hennah - Smith & Nephew - CFO**

Thank you Dave. We've got two slides in this presentation setting out the headline financial numbers for the transaction. We've also got some more detailed financial information on Plus in the Appendix for the presentation. And this will, hopefully, help anyone that need to build a fuller looking model for the combined Group.

Turning then to slide 14, I think it is in the pack, the first of the two financial highlight slides. As you know we're pay CHF1.086m or \$889m, including the assumption of debt, for 100% of the share capital of Plus. We will fund the consideration from cash and from bank borrowings. The consideration paid represents 14 times the 2006 EBITDA, and three times the 2006 revenue.

Plus has achieved revenue growth rates, over the last three years averaging nearly 14% which is, of course, significantly above the European market growth. The profit growth has also been solid, though somewhat less consistent. Operating profits fell in 2005, in large part due to the impact of price reduction, but recovered strongly in 2006. The Plus operating profit margin of 11.6% is well below the Smith and Nephew reconstruction margin of 25%. We see opportunity in the integration of the businesses to improve the Plus margin significantly.

Turning then to the second of the highlight slides, slide 15, we expect the impact of the acquisition on 2007 adjusted earnings per share to be broadly neutral, with accretion in 2008 and beyond. We expect the acquisition to earn a return exceeding our cost of capital in the third full year. We are targeting cost synergies from the areas David highlighted. These will come from both companies, and will be equivalent to at least 15% of the acquired cost base, or \$40m per annum by year three.

We clearly have more detailed work to do to define the precise opportunities, but we are focused in particular on administrative marketing and sales infrastructure efficiencies, and on sourcing and production.

We also see significant sales synergies, as David's explained, on putting Plus products through Smith and Nephew channels and vice versa. We expect an increase in revenue from both companies equivalent to about 15% of the acquired sales, or \$45m per annum from year three.

Based on benchmarks of comparable acquisitions, we are expecting cash costs to achieve the synergies of between 1.5 and two times the cost synergies. There will also be, as usual, some non-cash costs, but we are not in a position to estimate these reliably yet.

We have put in the appendices for this presentation a segmental analysis of the Plus sales. We expect to include the vast majority of the Plus activities within our reconstruction business. We have also included in the appendices a summary P&L and balance sheet for Plus for 2006 and 2005.

And with that, I'll hand back to Chris.

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**Sir Christopher O'Donnell - Smith & Nephew - CEO, Director**

Okay, thank you Adrian. Well really just to summarize. Plus is a very exciting addition to our global orthopedic reconstruction business. It takes us as a Company to global number four, which is a significant step forward in our progress. It's a particular step change in Europe, where we doubled our ortho reconstruction business. The product range is very complimentary and it is very compatible with European market needs. And, therefore, it strengthens our channels to market in Europe and Asia particularly, but also some benefits in the U.S. And financially it's earnings accretive from next year.

So we're very pleased to be able to announce this acquisition this morning. And we'll now take questions from any of the people on the call. And with that Operator could you announce the question and answer procedure please.

## QUESTION AND ANSWER

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### **Operator**

Thank you. Ladies and Gentlemen the question and answer session [OPERATOR INSTRUCTIONS]. We will now take the first question. [OPERATOR INSTRUCTIONS].

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### **Sir Christopher O'Donnell - *Smith & Nephew - CEO, Director***

Do we have a first question?

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### **Operator**

We take our first question from Mr. Michael Jungling from Merrill Lynch. Please go ahead.

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

Good morning Gentlemen.

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### **Sir Christopher O'Donnell - *Smith & Nephew - CEO, Director***

Good morning.

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

Good morning. I have three questions if I can please. The first question is, can you comment on the organic growth rate of Plus Orthopedics for 2005 and 2006, and also perhaps comment on the margins? I haven't got access to the packages yet. I've looked on the Internet but I can't find it.

Secondly, are there any material issues with some of the products from Plus Orthopedics? Going through the FDA website we can see that there was an issue in November of 2006 with the Unicodylar new system, and also in 2005 with Modular Plus?

And the third question I have is on the distribution agreement. It appears that Plus has a number of agreements with IsoTis, with [Arthrokinetics], will those distribution agreements and those revenue that you've got. Will they be maintained or will they be seasonal and, therefore, affect the revenues that we should factor into our forecast? Thank you.

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### **Sir Christopher O'Donnell - *Smith & Nephew - CEO, Director***

Okay well let's have a shot of trying to answer those questions Michael, thank you for those. Adrian first of all can you give some flavor to the organic growth -- the historic organic growth of Plus?

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### **Adrian Hennah - *Smith & Nephew - CFO***

Yes sure Michael. I'm sorry you haven't got the presentation, but when you do get in there you'll that there is a little more color to answer your question. But essentially Plus, over the last three years, have averaged a 14% growth rate. It was slightly higher last year at 16% but averaged 14% or thereabouts over the last three years. Its margins in '06 were 11.6%, so well south of the 25% we get in our recon business, and therein lies, of course, a significant element of the opportunity we see.

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

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Adrian just to follow up. Does the 14% include then no acquisitions at all and that is in constant currency?

**Adrian Hennah - Smith & Nephew - CFO**

It's -- pretty much, yes. There are some small acquisitions but in the trend sets you're getting a sense of the underlying growth. There are some small acquisitions in there. I don't -- frankly we haven't got all the things, but there's no major trend change from that.

**Sir Christopher O'Donnell - Smith & Nephew - CEO, Director**

Okay. I'll give you a sort of an overview of the FDA issues, and I'll ask Dave to talk about the -- some of the distributed products. In terms of -- obviously we have had the opportunity of doing pretty systematic due diligence. We've noted the points that you've raised. And the Company has addressed these, and we do not see these as material issues. And obviously any regulatory issues that is a pretty high focus for us. So no we don't see those as particular issues. Distribution Dave?

**David Illingworth - Smith & Nephew - COO**

Yes hi Michael. I think clearly the strategic value of Plus is in the reconstructive area. But there are some other interesting opportunities that present themselves with some of their distributed products. I think where we are on this is that, we're going to work through these over the next several months, and try to understand how these fit in. But I think it would be safe to say that, our going in bias would be towards trying to keep the different pieces of the organization, but we really need to take a close look at it.

**Michael Jungling - Merrill Lynch - Analyst**

Just to follow up Dave. Do you know how much of the total sales of Plus Orthopedics are in relation to products that they distribute, rather than they own themselves? Is it 10%, 5%?

**David Illingworth - Smith & Nephew - COO**

It -- broadly their reconstructive sales are about 90% and they own all of those, the balance being trauma, spine and orthobiologics. And roughly speaking probably half of those are distribution, so it's maybe about 5%.

**Michael Jungling - Merrill Lynch - Analyst**

Lovely thank you.

**Sir Christopher O'Donnell - Smith & Nephew - CEO, Director**

Okay can we take another question?

**Operator**

We will now move to Mr. Martin Hall from Eden. Please go ahead.

**Martin Hall - Eden - Analyst**

Good morning. I have two questions. One of which I am sure is in the presentation pack, but I don't have access to it at the moment. What's the level of debt that's being assumed with Pure?

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And my second question, I notice that [after it] you made three quick purchases in your share buy-back program, and that not any more have been made since those early purchases. Is the share buy-back program now on hold for the foreseeable future?

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**Sir Christopher O'Donnell - Smith & Nephew - CEO, Director**

These look like questions for Adrian to me.

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**Adrian Hennah - Smith & Nephew - CFO**

Yes sure, the level of debt is approximately \$190m. The exact number will, of course, be determined on the completion date and so on. But it's around \$190m of debt that we're taking on. That's included in the quoted acquisition price of \$889m.

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**Martin Hall - Eden - Analyst**

Thank you.

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**Adrian Hennah - Smith & Nephew - CFO**

Now the buy-back, no, we absolute -- the buy-back program is not on hold. This acquisition does not directly impact the buy-back program. When we launched the buy-back program with our full year numbers, we said in targeting \$1.5b buy-back over two years that we were assuming \$1b to \$2b of acquisitions over those two years, and that remains the assumption that we are making. Now clearly as time goes on we'll continue to look at that. But as of now, there's no change. We proceed with the buy-back program.

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**Martin Hall - Eden - Analyst**

Okay. Thank you.

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**Sir Christopher O'Donnell - Smith & Nephew - CEO, Director**

Martin, I think I'll just slightly qualify that. Obviously whilst the negotiations were going on at an advanced stage we did actually hold back from buying in the market, and because obviously this is a material development. So, there was a temporary hold whilst we were in the advanced negotiations of a sizeable as an acquisition as this. In principle the program is not on hold.

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**Martin Hall - Eden - Analyst**

Okay. Now I just -- I couldn't understand why you weren't buying back when it dipped off to the 570 level.

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**Sir Christopher O'Donnell - Smith & Nephew - CEO, Director**

Yes, well now you know. Okay.

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**Martin Hall - Eden - Analyst**

Okay thank you.

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**Operator**

Daniel Mahony from Morgan Stanley has our next question. Please go ahead.

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**Daniel Mahony - Morgan Stanley - Analyst**

Hi. Good morning everyone. I've got a couple of questions. When you talk about 2008 accretion, is that pre any estimates on the buy-back Adrian?

And in terms of improving margins, just taking a quick look at the numbers, it looks like gross margins at Plus are in the order of 66% versus I think Smith and Nephew is in the 75% sort of range, which seems to be the difference between, if you like, about 11.6 and -- well the bulk of difference between 11.6 and mid-20's. How easy is it going to be to improve pricing, presumably that's the major component? How easy is it going to be to improve gross margins at Plus?

And could you just give us, Chris, a quick overview of some of the dynamics that are going on in the European market vis a vis pricing, growth etc? Thanks.

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**Sir Christopher O'Donnell - Smith & Nephew - CEO, Director**

Adrian do you want to tackle the accretion in margins, and then Dave and I will reflect on the European market?

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**Adrian Hennah - Smith & Nephew - CFO**

Sure. The -- yes, the accretion we're quoting is independent of the buy-back. So it is an accretion from this acquisition nothing to do with the buy-back. The -- you're quite right when -- I'm glad, Dan, you obviously do have access to the presentation even if some of the other people on the phone don't. Because yes, you're quite right the -- as reported to us in their numbers, the bigger part of the difference between our margins and theirs lies in the gross margin. There is some in operating expense of 2%, 4% or 5% but the bigger part does lie in gross margin. One thing we have learnt over the last months, as we've gone into other program, is different companies treat the different things -- account for things in different places.

So we've got first of all to get a full understanding about gross margin versus other expenses. And obviously we haven't had a chance to do that yet, we've been negotiating to buy them, we've not had full access to the books. But first all we've got to understand exactly what it is. And then -- but we do know -- we do not observe any systematic difference, from the due diligence we've done, price levels systematically different from our own. But frankly we do have some discovery to do there, some learning to do, and therefore we've been focusing exactly on the opportunities.

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**Sir Christopher O'Donnell - Smith & Nephew - CEO, Director**

I've got to say that I don't actually see the issue Daniel, as been principally one of price. If we give you a concrete example of this, Plus are at the point, well because of their growth, their factories, particularly the factories in Switzerland, are pretty full in terms of capacity utilization. And, therefore, they are having to put a substantial amount of work outside.

Now operating at the scale that we are at we probably have some capacity, which we can utilize and actually lower the total cost, which is part of our synergy equation. So actually I think there are quite a few cost based things that you can do. But in general, if you look at orthopedic companies, there is an issue of -- there's a margin relationship of scale, which we've discussed over a long period of time. And bringing Plus and Smith and Nephew together enables us to leverage the scale benefits of Smith and Nephew I think pretty effectively. And so we see leverage as being a much stronger driver than pricing per say in margin improvement.

Dave do you want to reflect on the European markets?

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**David Illingworth - Smith & Nephew - COO**

Yes, I think pricing in Europe, pricing anywhere is a complicated discussion to get into, because you talk about innovation and mix and new products and like for like products. But I think in general, clearly in Germany, there's been a downward pressure on prices the last few years that all the competitors have been dealing with. And I'd have to say that Europe overall has been slightly negative.

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We do have a strong portfolio of new products that we've introduced over the last 12-18 months. And these are products that we fully expect to get some lift in price, due to the fact that they're directed at a different demographic, the younger more active patient for one, with some of the less invasive implants. So I think that would be my comment on Europe in general. And as I said it's a pretty complicated subject to get into.

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**Sir Christopher O'Donnell - Smith & Nephew - CEO, Director**

There's a bit of kind of touch and feel about this Daniel. But very interestingly when we were in the final stages of bidding for Centrepulse three years ago, one of the reasons we didn't raise our bid was it was clear that, the European market was starting to go into a period of reduced growth.

To be honest it's probably not dramatic, but I think we have a bit of the opposite sense here. We see some more positive vibrations than negative vibrations. Can we absolutely quantify that? No, but typically Germany is now in its third year of DRG's, it usually takes a market about three years to get its mind around what does DRG mean for us. And DRG means you've got to manage the costs of the procedure, not lash around blindly and ask your suppliers to bail you out, which is what's been going on for the last two years.

Because our products are very successful in DRG environments, particularly the U.S. and Australia, and I think we're well positioned to respond to that. I think the additional sales clout in combination that we'll get from Plus can only be helpful to that. And particularly we'll get some access to some of the buying groups in Germany through their German sales force that actually we're not in at the present time. So I think some positives there.

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**Daniel Mahony - Morgan Stanley - Analyst**

Just to follow up on that if I may. So when we think about Plus going forward, should we think that even pre some of the synergies that there's still double digit growth coming from that product portfolio? And also, how does this impact your earnings improvement program? Is that still -- it's not going to be derailed by this presumably?

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**Sir Christopher O'Donnell - Smith & Nephew - CEO, Director**

I think the guidance that we're giving on growth is, we expect the combined business to grow above the orthopedic reconstruction market growth rate, which I think is positive, and as much as we're willing to say at this point in time.

There is no change to our plans related to the earnings improvement program. We do expect to make an announcement at -- with our first quarter results and we are on schedule to do that. And that program will run in parallel with the acquisition and integration program over a three year period of Plus. So I think we are actually -- we will be running those two in -- very much in parallel. And we are taking the opportunity to move ahead with some of the earnings improvement programs, ahead of talking to the market systematically about them at quarter one.

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**Daniel Mahony - Morgan Stanley - Analyst**

Great, thanks very much.

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**Sir Christopher O'Donnell - Smith & Nephew - CEO, Director**

Okay. Next question please.

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**Operator**

We will take our next question from Mr. Martin Wales from UBS. Please go ahead.

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**Martin Wales - UBS - Analyst**

Hello.

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**Sir Christopher O'Donnell - Smith & Nephew - CEO, Director**

Hi Martin.

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**Martin Wales - UBS - Analyst**

Hi. What does this mean in terms of further acquisitions? I think you've highlighted the fact that you would -- had a potential for up to \$1b to \$2b for acquisitions. Should we take it this is a major acquisition, and anything else we do from here is going to be relatively minor?

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**Sir Christopher O'Donnell - Smith & Nephew - CEO, Director**

Adrian, would you like to just go through how our thinking is related to this, from a financial viewpoint? Obviously we want to see the right candidates for acquisitions that's the most important thing. But let's tell you how we're thinking about this from the financial strategy of the Group.

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**Adrian Hennah - Smith & Nephew - CFO**

Yes sure Martin. The \$1b to \$2b we quoted in respect of acquisitions in connection with a buy-back was not a target, it was an assumption. And we were very clear that we were looking at our pipeline, pipelines are uncertain in how they -- acquisition pipelines are uncertain in the rate at which they turn into real things, or indeed whether they're going to turn into real things.

So to the earlier question, does this acquisition impact your buy-back? The answer is no, because we have this target -- we have this assumption of \$1b to \$2b. But we'll keep that under review. If opportunities do come forward, which take us north of \$1b to \$2b then it could have an impact on the buy-backs. And vice versa, if there turn out to be very few, so if we stay south of \$1b, then that would impact the buy-back too. So we don't have a target of \$1b to \$2b we have an assumption. And we have a vigorous pipeline, we are working through opportunities but it is very, very difficult to predict with any certainty timings or magnitude.

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**Martin Wales - UBS - Analyst**

Right we should assume that when you stated the \$1b to \$2b you were aware that this opportunity was possible?

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**Adrian Hennah - Smith & Nephew - CFO**

Well we were clearly aware that this opportunity was possible, but we couldn't tell whether we were going to get it or not.

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**Martin Wales - UBS - Analyst**

Yes.

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**Sir Christopher O'Donnell - Smith & Nephew - CEO, Director**

And the same is true of other items in our pipeline, which may show up this year, they may show up next year, they may never show up. But we continue to work on them, and as Adrian said, we're trying to give you some reasonable overall guidance. But let's be dead clear, we're not stopping our discussions and company follow-ups related to acquisitions. There are a number of opportunities out there, and we'll balance our financial strategy depending on the possible delivery of them.

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**Martin Wales - UBS - Analyst**

Apologies if you mentioned this earlier, but where does this leave you competitively in Europe in terms of market share and market position?

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**Sir Christopher O'Donnell - Smith & Nephew - CEO, Director**

Broadly we think that it probably moves us up a couple of places. But the definition of European market share is a bit more vague than it is at the global level, because virtually everybody reports U.S. and only U.S. But actually the major players don't really focus on giving European numbers. But we think it will probably move us up one or two places from our current number five position in Europe.

**Martin Wales - UBS - Analyst**

Where would you put your European market, as your best estimate?

**Sir Christopher O'Donnell - Smith & Nephew - CEO, Director**

We'd rather not get drawn on that until we actually get through the regulatory processes in Europe. And then we probably would be in a better position to give you an estimate. Okay?

**Martin Wales - UBS - Analyst**

Thank you very much.

**Sir Christopher O'Donnell - Smith & Nephew - CEO, Director**

Thank you. Next question please.

**Operator**

Mr. Yi-Dan Wang from Deutsche Bank has our next question. Please go ahead.

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

Okay. Good morning. I have three questions. The first set of questions are financial. Adrian would you be able to give us the interest rates that will apply to the loan that you will take on to buy this business?

And then secondly, can you comment on how much overlap there is between the customers and products of Plus and Smith and Nephew, in terms of the percentage of revenues of the combined revenues? And how much disruption should we expect to occur to Smith and Nephew's existing businesses during the integration process?

And the third question is, Adrian would you be able to tell us what Smith and Nephew's cost of capital is? And whether your comment about exceeding cost of capital, I've assumed that's after tax?

**Sir Christopher O'Donnell - Smith & Nephew - CEO, Director**

Right, so why don't we deal with the interest and the cost of capital questions first, and then we'll talk about the business sales combination.

**Adrian Hennah - Smith & Nephew - CFO**

Yes, I'm not going to give you an exact interest rate. For the simple reason that we have a facility in place to guarantee that we can do this, should the walls fall to bits tomorrow. So we have surety of something in place. But there is a competitive process to be done to actually put a slight more permanence to be in place between now and completion, and that's the competitive process with banks. So we're not going to talk

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about specific interest rates. But there's nothing surprising in it, we're moving from 200m net cash to 600m or 700m borrowing before the buy-back or future acquisition, so there's no dramatic change here. You can get pretty close in interest rates just by looking at the market out there.

The cost of capital we've used for this acquisition and what's behind that prediction is down to 9% and it is obviously after tax. The -- as some very smart person who reads our accounts very precisely may notice that, where we do our test of the goodwill impairment, the great things you've got to do in accounting, we use 10% there, but 9% is the number we've used for this acquisition.

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

And that's presuming -- that that's also including the costs and the revenue synergies, the impact of those I mean?

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**Adrian Hennah - Smith & Nephew - CFO**

Yes, what we're saying is in the first full year, taking into account the cost synergies and the revenue synergies, we will -- we expect to be exceeding our cost of capital of 9%.

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

Okay great.

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**Sir Christopher O'Donnell - Smith & Nephew - CEO, Director**

Okay and in terms of your question about customers and sales force and product overlap, Dave do you want to have a shot at that?

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**David Illingworth - Smith & Nephew - COO**

Sure, sure. I think at the end point we can only make some broad assumptions about the integration of these two businesses. But I think there is a couple of things that we can tell you. Number one is we do believe that we can effectively integrate these businesses as a starting point. We did a lot of due diligence, as much as we possibly could. And we've had a little bit of practice lately in modeling this out. And we do believe that we're going to be able to effectively integrate these businesses. So that's the starting point.

Secondly is we do want to keep our sales channels. So we have a strong desire to keep these highly motivated sales channels engaged, and we're going to address the integration with that as a bias.

And then thirdly is we want to make sure that this combination is as seamless as possible to the customers on both sides. And those are the going in principles to the integration. We think it's very doable, and we're looking forward to getting started.

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**Sir Christopher O'Donnell - Smith & Nephew - CEO, Director**

I think Yi-Dan one comment I would add is that, actually we see more opportunities than issues here. We've been able to identify a number of potential opportunities in different countries. And actually they do look very encouraging. But as Dave says, we've got to really get into this and work our way through it, with the management of Plus in more detail, to generate a seamless integration plan particularly for customers, but also for the business.

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

Okay, that's very helpful. You haven't said much about sales [v] synergies. Does that mean you don't expect there to be any? Or is that part of the -- is the sales synergies number a net figure?

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**Sir Christopher O'Donnell - Smith & Nephew - CEO, Director**

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We've essentially given a net number here, which really means we don't expect significant sales dissynergies per say, over a three-year period.

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**Adrian Hennah - Smith & Nephew - CFO**

There'll be [inaudible] some modest ones.

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**David Illingworth - Smith & Nephew - COO**

Yes there is some [detail] it's not going to hold, but they're -- it's all net.

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

Okay. I've got one last question. For the Plus business, that growth rate is pretty impressive, given that they operate in Europe. Can you talk about what is behind that?

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**Sir Christopher O'Donnell - Smith & Nephew - CEO, Director**

I think they've got some very good products in particular, and they work very consistently to build the business, a good management team. We've been very impressed with what they've done. They think things through and they get things done. And they've been very consistent in targeting the European markets and also Asian markets, particularly China and more latterly in Japan. They've had some growth out of the U.S. too. So it's been a consistent performance over the last several years, and really products and very, very intense customer support.

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

Thank you.

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**Sir Christopher O'Donnell - Smith & Nephew - CEO, Director**

Okay, we take another question.

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**Operator**

From Redburn Partners, we will take the next question from Ilan Chaitowitz. Please go ahead.

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**Ilan Chaitowitz - Redburn Partners - Analyst**

Hi. This is Ilan Chaitowitz here.

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**Sir Christopher O'Donnell - Smith & Nephew - CEO, Director**

Hi.

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**Ilan Chaitowitz - Redburn Partners - Analyst**

Just a few questions that haven't been asked already. Could you give a bit more clarification on the sales account overlap? Are you -- is there much overlap, particularly in Germany, between with your -- the accounts that you're currently servicing, is there any scope there to cut costs?

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Second question is you pointed out they've got manufacturing in China. Have you got -- is there any scope to move more of your own production to low labor cost countries, in particular, on the recon side?

And finally, are there any tax implications for this deal going forward?

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**Sir Christopher O'Donnell - Smith & Nephew - CEO, Director**

Okay, Dave do you want to tackle the first two?

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**David Illingworth - Smith & Nephew - COO**

Well I think the first one is the same answer I gave Yi-Dan. We are only one hour into the planning of the integration process, and we haven't started the integration yet, so I think it's too soon to tell. But I think it's important to go back to the principles that we're setting for ourselves.

Number one is that we do believe that we can effectively integrate this business and a large piece of it is in Germany. We do want to keep both sales channels, and we want to make sure that this combination is as seamless as possible for our customers. And really that's about as far as we can go at this point, until we get some more planning done.

In terms of China, I think that China gives us a very nice base of operations in Asia. And we have been looking at Asian operations for a while now actually within Smith and Nephew. And I think what this does for us is, more than anything, it gives us a little bit of a head start on the plans that we had, already put in place, for moving some of our production to these lower cost manufacturing sites.

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**Ilan Chaitowitz - Redburn Partners - Analyst**

Thanks, and just the tax -- any tax issues?

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**Adrian Hennah - Smith & Nephew - CFO**

Yes, if you're one of the lucky ones that have got access to the presentation, you'll see it in the appendices we've put an abbreviated P&L. And you'll see from that that Plus in '06 had a tax rate of about 32%. And, as you know, we are guiding to a very roughly 31% for our own tax rate for the coming year. So frankly, we wouldn't suggest anybody changes their models for the total tax rate of Smith and Nephew.

Looking forward yes, I mean Switzerland may well offer some opportunities, and we will certainly look for that, and look for upside in that as we get more into the business.

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**Ilan Chaitowitz - Redburn Partners - Analyst**

Okay, thank you very much.

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**Sir Christopher O'Donnell - Smith & Nephew - CEO, Director**

Okay, next question please.

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**Operator**

We now move to Ed Ridley from Lehman Brothers. Please go ahead.

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**Ed Ridley-Day - Lehman Brothers - Analyst**

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Hi there, thanks. Firstly, on -- following on in terms of manufacturing, you have fairly interesting possibilities. Could you just tell us what percentage of Plus's current manufacturing capacity is in China, and how much spare capacity there is there?

And also in terms of their R&D, do they have any external R&D relationships, as we have seen with other Swiss MedTech companies? And if -- are any other relationships like that, and indeed do they own all their IP?

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**Sir Christopher O'Donnell - Smith & Nephew - CEO, Director**

Well let's deal with the R&D one first. Yes, they do own all their IP. And broadly they do the majority of their R&D in-house. So if you're thinking about the book model, then no they're not involved in a model like that. So it's very different from say [Synthase].

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**Ed Ridley-Day - Lehman Brothers - Analyst**

Sure.

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**Sir Christopher O'Donnell - Smith & Nephew - CEO, Director**

With regard to manufacturing capacity I'm not sure we can give you a precise answer.

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**David Illingworth - Smith & Nephew - COO**

Well I think we can give you an imprecise answer, as hottest in China right now. There is a lot of the production in China, most of the production in China, goes to manufacture a price point product for the Chinese market. And in terms of capacity, I think, really the easiest [inaudible] is that we believe that, it gives us a head start in terms of quality, if we want to move to greater capacity in the future.

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**Ed Ridley-Day - Lehman Brothers - Analyst**

Okay. That's very helpful, thanks. It's -- and just to follow up also, I know you don't want to label this market share issue, but just in Germany, what is the top market share in Germany?

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**Sir Christopher O'Donnell - Smith & Nephew - CEO, Director**

What is the what, sorry?

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**David Illingworth - Smith & Nephew - COO**

I don't have those numbers actually in front of me.

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**Sir Christopher O'Donnell - Smith & Nephew - CEO, Director**

Who has got the leadership? Well Zimmer has the -- Zimmer center [inaudible].

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**David Illingworth - Smith & Nephew - COO**

But I don't know what the leadership is.

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**Sir Christopher O'Donnell - Smith & Nephew - CEO, Director**

But I couldn't tell you what the number is specifically in Germany.

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**Ed Ridley-Day - Lehman Brothers - Analyst**

Okay, thanks.

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**Sir Christopher O'Donnell - Smith & Nephew - CEO, Director**

Thank you. Right next question please?

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**Operator**

Mr. Charles Weston from Nomura Code has our next question. Please go ahead.

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**Charles Weston - Nomura Code Securities - Analyst**

Hello and good morning. I have --

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**Sir Christopher O'Donnell - Smith & Nephew - CEO, Director**

Morning.

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**Charles Weston - Nomura Code Securities - Analyst**

Three questions. First of all, you mentioned the opportunity for synergies and improved market presence in Asia. But looking at the Plus accounts, it looks like there is only \$22m of revenue in rest of world. I guess some of that is coming from South Africa and Australia. So, is -- they don't have that much sales in Asia. So, I was wondering if you could talk about what kind of plans you have, using Plus's position there, to improve your growth rates in Asia?

And secondly, I can't find any split in sales of hips and knees, just as a -- an approximate proportion of Plus's sales. So, I'd be very grateful if you could give me that?

And lastly, I may have missed this as well. When do you expect the deal to close, ultimately?

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**Sir Christopher O'Donnell - Smith & Nephew - CEO, Director**

Okay.

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**David Illingworth - Smith & Nephew - COO**

Okay. Do you want me to take the Asia piece?

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**Sir Christopher O'Donnell - Smith & Nephew - CEO, Director**

Yes.

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**David Illingworth - Smith & Nephew - COO**

Well first of all, the majority of rest of world is Asia. So, the -- that assumption you made is actually incorrect. And I think the best way to think of this is that it's not just the Plus business in Asia, but it's the combination of our businesses that we think that's going give us the synergy.

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We invested in a sales channel about, well I guess about a year and a half ago, the acquisition of an additional sales channel. So, we have a nice team of people on the ground. But we've been having difficulty getting some of our products approved through the regulatory agencies in Japan. And actually, Plus has the exact opposite situation. They have fewer sales people than we have, but they actually have a nice array of products that are already approved. So, we think that the combination of those two is actually going to help us quite a bit. And the majority of that business is in Japan and China.

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**Adrian Hennah** - *Smith & Nephew - CFO*

Okay. And with regards the hips and knees, around half of the business -- around half of the total revenue is in hips. Something over a third is in knees and then the rest is the shoulders, toes and the other stuff that Chris and Dave have referred to.

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**Sir Christopher O'Donnell** - *Smith & Nephew - CEO, Director*

Okay. And closure, and actually it's a good point, because I'm not sure we did actually cover this, which is roughly speaking we have some individual country anti-trust clearances to obtain. And we -- our estimate is somewhere between two and three months to close.

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**Charles Weston** - *Nomura Code Securities - Analyst*

Great thank you very much.

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**Sir Christopher O'Donnell** - *Smith & Nephew - CEO, Director*

Okay. Next question please?

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**Operator**

Ingeborg Oie from Goldman Sachs is our next question.

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**Ingeborg Oie** - *Goldman Sachs - Analyst*

Good morning gentlemen.

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**Sir Christopher O'Donnell** - *Smith & Nephew - CEO, Director*

Good morning.

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**Ingeborg Oie** - *Goldman Sachs - Analyst*

I've got a few questions here. Firstly in your strategy of acquiring unique and additive technologies, could you comment on what are the particularly unique aspects of Plus's -- well the unique products that you're acquiring there?

Then secondly, could you comment on what's the -- how you split the confederate consideration you're paying between fixed and intangible assets, and how much will be allocated to goodwill, if you have a sense of that?

Then yes. That's it actually.

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**Sir Christopher O'Donnell** - *Smith & Nephew - CEO, Director*

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Okay. Fine, well, let's have a shot at this product one. Do you want to have a go that Dave?

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**David Illingworth - Smith & Nephew - COO**

Sure, I think there is actually a couple of things that are unique about Plus in terms of Europe. First is they are the only European-based orthopedic company competing in Europe. And we feel very strongly about the fact that, the reason they're growth rate has been superior is because that they have an inherent better understanding of the European customers. And they're closer to the European customers, both in the support and the design of products. And we would like to be able to preserve that as we combine these companies.

In terms of unique products, I think they would be unique to us, would be the better way to -- or kind of the way to think about it. They do have a mobile bearing knee and a hinged knee, which will be 100% complementary to our product line. They also have a very strong history in, what I would call, a European quote unquote European hip, which is the cementless rectangular dual taper hip design, straight stem hip design. And they have really built their company on the success of this hip stem in the European market.

The -- there's a couple of other smaller pieces, which we don't have, that are very complementary with the small joint implants. And they also have a very interesting threaded acetabular cup, which will be 100% complementary to our product line as well.

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**Sir Christopher O'Donnell - Smith & Nephew - CEO, Director**

I think the way of thinking about this Ingeborg is realistically two things here. We see Plus very much as a very important channel acquisition, with a very good and complementary product range. And they do have some interesting technologies in development, but in common with our own really interesting technologies in development. And we don't particularly want to talk about them until we're ready to do so. And we're not really ready to do so at this point in time. So, that's the sort of -- the technology thing.

But I think the importance of Plus to Smith & Nephew is channels to market, very, very complementary product range to our own and complementary -- complementarity in the positioning of the channels on a global basis. And we'll work to bring out some of the more unique attributes as Dave referenced. So, that's how we see it. Adrian, financial positioning?

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**Adrian Hennah - Smith & Nephew - CFO**

Yes. On the allocations of consideration, we're -- if you look at the last appendix in the presentation we gave you, you'll see a Swiss franc balance sheet for Plus. And that will show you that at December 31, '06 they had net assets of CHF262m. Now clearly, we need to see the value of that [in the business], and hopefully there won't be huge changes in [the CHF262m], but that's an exercise we've still got to go through.

And then, of course, we've got the interesting exercise of determining how much of the rest is acquisition intangibles and how much is goodwill. And I have learnt never to predict that particular exercise. So, I'm afraid we'll have to just be a bit patient to find that one out.

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**Ingeborg Oie - Goldman Sachs - Analyst**

Okay, thank you very much. Just one final question, could you comment on which countries there are substantial antitrust problems?

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**Sir Christopher O'Donnell - Smith & Nephew - CEO, Director**

It's not really an issue of problems we are required to get clearance in certain countries. Germany will probably be the most substantive of those. And that's -- but we see that as a case of putting the filings in. And it -- and we are required to get clearance ahead of closing the deal.

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**Ingeborg Oie - Goldman Sachs - Analyst**

Okay. Thank you very much.

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**Sir Christopher O'Donnell - Smith & Nephew - CEO, Director**

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Okay. Another question?

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**Operator**

We will now move to Mr. Max Herrmann from ING. Please go ahead.

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**Max Herrmann - ING Barings - Analyst**

Morning.

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**Sir Christopher O'Donnell - Smith & Nephew - CEO, Director**

Morning.

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**Max Herrmann - ING Barings - Analyst**

Just a quick clarification just in terms of, people were asking a lot about the overlaps. Can you tell us exactly how much, in sales, Smith & Nephew's business was in Germany? And how much of Plus net's was this is on the recon side? It's obviously interesting to see that they're recon business in Europe is actually bigger than yours.

And then secondly just with regards to the comments on R&D, can you elaborate a little bit about whether there's anything new -- expected launches from the Plus business that you could take more globally, anything that you've particularly highlighted in their development pipeline? Thank you.

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**Sir Christopher O'Donnell - Smith & Nephew - CEO, Director**

Well, probably this won't be as helpful as you would like Max. But we've said we're going to stay at the European level in terms of the information flow on this. And certainly at this time, which is usually the level which we give information. And so, broadly we're going to stick to that level.

And in terms of forward pipeline, yes, they have some interesting things in their research pipeline. And we want to sit down and go through those with them in more detail. Clearly, what we want to do is manage the totality of the sales channels, because there are a lot of cross-selling opportunities. And, therefore, we've got to prioritize what gets done when. So, I think we'd be in a better position to talk about that at a later date, rather than today.

What we certainly don't do is flag up something that's unique, and then find that we've actually got some bigger opportunities to deliver in the short term. And then work our way through the -- we've told the opposite -- the competition as to what's going on.

So, I think we're going to sit on that one. But we are encouraged by the work they've done on the business to bring out new products consistently over a period of years.

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**Max Herrmann - ING Barings - Analyst**

Maybe you can answer the German question in a slightly different way. Just to give us a feel for how much more significant their business is in Germany and Continental Europe, compared with Smith & Nephew, which I believe was always more -- based in different European markets than the Continental?

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**Sir Christopher O'Donnell - Smith & Nephew - CEO, Director**

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Well, if you take the U.K. out of the equation, where we're stronger than they are, then the doubling of Continental Europe shifts up a bit more. So, they are stronger in -- particularly in the German-speaking areas and in some other countries. However, we are stronger in others. So actually, the whole thing is very complementary.

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**Max Herrmann - ING Barings - Analyst**

Thank you.

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**Sir Christopher O'Donnell - Smith & Nephew - CEO, Director**

That's as far as we're going to go. Sorry about that. Okay. Next one please?

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**Operator**

Jack Scannell from Sanford Bernstein has the next question. Please go ahead.

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**Jack Scannell - Sanford Bernstein - Analyst**

Hi. I've got two questions. The first regards the difference in margins between the Plus Orthopedic business and yours. Now, you say that you contrasted 11% for Plus versus around 25% for our Reconstruction business. The question is how much of that is geographic and how much is scale based?

And then the second question relates, if I may, to the FDA Panel on the Corin hip-resurfacing product. And really the question is there, do you think there's some qualified enthusiasm on the FDA Panel for the Corin resurfacing product? How do you think that bears on U.S. resurfacing in general and VHR in particular?

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**Sir Christopher O'Donnell - Smith & Nephew - CEO, Director**

Well, I'll try and deal with these two questions. First one is, is it scale or geography. Adrian?

Oh okay, my answer is its scale. We can't really -- the geographical impact of this isn't that significant. It really is that things get better as you -- in terms of margin wise, if you're a bigger orthopedic business, because you get so much more leverage out of your R&D and your upfront investment in product launch. If you sell twice as much then you -- whatever that cost is, you're halving it. So, I think it's a straightforward scale issue, much more than a margin -- than a geographical issue. I guess the other one?

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**David Illingworth - Smith & Nephew - COO**

Yes. I don't know what Corin in the U.S. has to do with Plus. But I think -- I think overall, we're glad to have another strong player in the U.S. helping to develop that market. It's an early market, its' a large potential market. And clearly everybody was -- had us clearly -- had us very squarely in the center of their target. And it's nice to have another credible player helping to develop that very large marketplace. I think it's not going to do much. We don't think it's going to have a lot of impact on our projections on how we were planning on growing that business in the U.S.

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**Jack Scannell - Sanford Bernstein - Analyst**

Okay. Thanks very much.

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**Sir Christopher O'Donnell - Smith & Nephew - CEO, Director**

Okay. And we will take one final question please?

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**Operator**

We have a follow-up question from Michael Jungling from Merrill Lynch. Please go ahead.

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**Michael Jungling - Merrill Lynch - Analyst**

Thank you. The -- I have three -- really three quick questions. The first one is can you give us indication of how certain this deal is? Could another large orthopedics medical device company come in and offer you or also offer Plus more money?

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**Sir Christopher O'Donnell - Smith & Nephew - CEO, Director**

That's a quick one. It's contingent only on antitrust clearance.

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**Michael Jungling - Merrill Lynch - Analyst**

So, there's no possibility for someone else buying it?

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**Sir Christopher O'Donnell - Smith & Nephew - CEO, Director**

No, we've signed an agreement.

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**Michael Jungling - Merrill Lynch - Analyst**

Secondly, on the guidance for accretion in 2008, does this include both the cost synergies of the 40m, and also the revenue synergies of 45m or only the cost synergies?

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**Sir Christopher O'Donnell - Smith & Nephew - CEO, Director**

The cost synergies are really over a three-year period. And the revenue synergies we see as being also part of the totality of the accretion program. But we think we can hit the targets based on the costs only.

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**Michael Jungling - Merrill Lynch - Analyst**

Okay. And the final question I have is if I look at the accounts of Plus Orthopedics, can I get indication of what the true EBIT margin is if I take out the amortization of intangibles?

And related to that is if in 2006, sales growth was not impacted by acquisitions, why is it that, intangibles has gone from 20 -- sorry, yes intangibles have gone from 20 to 34m?

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**Adrian Hennah - Smith & Nephew - CFO**

There were some acquisitions, just some small things. You're quite right Michael that is why I caveated the earlier answer to say there were some things. But materially, you are -- this company has [act] -- it will organically out-perform European markets substantially. You're quite right. You obviously have now the whole of the presentation on that [business]?

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**Michael Jungling - Merrill Lynch - Analyst**

I have. I've now got it. And the EBITA margin?

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**Adrian Hennah** - *Smith & Nephew - CFO*

What was the question on EBITA margin?

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

Well, we've got EBIT margin but obviously you -- in the accounts you're also amortizing, I imagine, some intangibles, is it material? For instance, could the EBIT margin actually -- or EBITA margin be one percentage point higher than reported?

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**Adrian Hennah** - *Smith & Nephew - CFO*

I can't remember the exact number, but you're not being materially -- your materially in the right ballpark if you just take that, given the uncertainties that there inevitably are around the future progresses, [declining] of synergies and that sort of thing.

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

Okay. And the last one is, on the spine product, I can see they've got a fusion as well as non-fusion products. Spine is not a core business for you, what do you intend to do with the spine franchise?

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**David Illingworth** - *Smith & Nephew - COO*

Well, I think the answer that we gave earlier to the distributed products is the answer about spine. We do believe, Michael, that the strategic value of Plus is in recon clearly. But we think there are some other interesting opportunities and we're going to take a look at these. We're going to work through these areas over the next several months. But I think it would be safe to assume that our going in bias, would be to try to figure out how to keep all the moving parts of this business.

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

Okay. Thank you.

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**Sir Christopher O'Donnell** - *Smith & Nephew - CEO, Director*

Right then. Okay, thank you Michael. Thank you everybody else on the call. And we hope that roughly around the time of our follow-on results, in addition to the [EIT] program, we ought to be able to give you an update at least on progress of the acquisition program here. And then to, eventually telling you about the fact we've closed on it. So, thank you all very much for your time and attention.

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