Smith+Nephew Q2H1 Results

Thursday, 3rd August 2023

Welcome

Deepak Nath

Chief Executive Officer, Smith+Nephew

Summary

Strong Q2 growth across business units and regions

Welcome to the Smith+Nephew second quarter and first half results call. I am Deepak Nath and joining me is Chief Financial Officer Anne-Françoise Nesmes. I am pleased to report another strong quarter of growth. In Orthopaedics we have improved our underlying dynamics and are set up to accelerate growth in the second half. The momentum in Sports Medicine and Advanced Wound Management has continued. These results have given us the confidence to increase our full year growth guidance. We saw the moderation we expected in the US after a very strong Q1 but that was more than offset by our improving execution globally and the increasing ability of our organisation to take part in stronger markets.

Raising 2023 revenue guidance, margin maintained

Margin development in the first half was in line with our expectations and this should represent the peak of the macro-driven cost pressures. In the second half we expect a clear step-up in both trading margin and cash generation as we drive productivity gains and start to bring down days of inventory.

12-Point Plan delivering sustainable improvement

Importantly, we are continuing to build the foundations for sustainable performance by delivering the 12-Point Plan. Overall I am pleased with the progress of the plan and as with any initiative of this depth and breadth, there are varying degrees of completion. But most elements are either on track or ahead and we are already seeing the benefits coming through. Product availability in Orthopaedics was much better than it was on the back of our own operational improvements, although external supply interruptions and shortages continued to hold back overall Group performance. Later on I will share with you the update KPIs on operations and how we are positioned to convert those into better outcomes in the coming quarters. Our high cadence of innovation has continued right across the portfolio and we have added new growth drivers in Robotics and in Extremities. We are also pleased with our progress on a number of other initiatives including order-to-cash excellence, pricing management and the pursuit of cross-unit business unit deals in ASCs.

For now I will hand over to Anne-Françoise to take you through the detail for the quarter.

Q2 2023 Revenue

Anne-Françoise Nesmes

Chief Financial Officer, Smith+Nephew

Q2 2023

Balanced growth across business units and regions

Thank you, Deepak. Good morning everyone. I will start with the second quarter revenue which was $1.4 billion, representing a 7.8% underlying growth and a 6.6% reported growth. Performance was broad-based with all business units and all regions contributing. I will come

to the detail in a moment but you can see that Orthopaedics accelerated compared to Q1 and Sports Medicine and Advanced Wound Management continued to perform well. Looking by region, established markets growth has remained above historical levels. Our US business grew by 6.3% following a very strong first quarter. Other established markets maintained their performance and grew 8.5% with elective procedure volumes remaining at a high level across Europe and Asia Pacific. Emerging markets grew 11% largely driven by recovery in China where surgical activity returned to more normal levels after Covid outbreaks earlier in the year.

Orthopaedics

I will now go into the detail of each business unit. Orthopaedics grew 5.8% underlying. Growth in Knees and Hips reflected us lapping the impact of VBP. As a reminder, the lower VBP pricing from the tender was gradually implemented during the second quarter of 2022 so while China still reduced growth by around two points in Knees and four points in Hips, that headwind falls away for the rest of 2023. Other reconstruction growth of 21% was driven by the ongoing adoption of robotics and our installed base of capital is increasing nicely across both hospitals and ASCs, passing 650 units in total with a growing funnel. Customers are showing their confidence in the platform by buying second and third CORIs in multi-system deals. The range of surgical applications is being recognised with the majority of deals including our Hip software. Trauma & Extremities grew 2.5% underlying. This was the first quarter after lapping the Trauma exit in China and there should be further growth uplift to come as we lap other market exits in the second half.

Looking beyond those effects we can see our investments are starting to pay off. US Trauma grew 7% in the quarter with EVOS large plates both driving growth and showing the value of a complete solution by pulling through the use of small plates. In Extremities we reached another innovation milestone with the 510(k) clearance and the launch of AETOS, our next generation shoulder.

Improving Orthopaedics performance has been a key priority and we are now seeing multiple trend-breakers lining up in quick succession. Deepak will cover shortly the progress we have made in improving implant availability and we are resolving supply chain challenges that are limiting our instrument deployments in the quarter. We have the highest pace of CORI sales activity we have seen. EVOS growth has accelerated already and the AETOS shoulder makes us competitive for the first time in that large and high-growth category. Putting this all together we are excited at what is to come for Orthopaedics in the coming quarters.

Sports Medicine & ENT

Moving to Sports Medicine & ENT, which grew at 12%, based on our multiyear stream of innovation across both capital and consumables playing an important role. Product availability remains somewhat of a constraint in the quarter with restricted capacity at some component suppliers. However, we were still able to drive an attractive level of growth. Looking by segment Joint Repair grew 12.5% with broad-based strength across procedures and region. REGENETEN, other shoulder repair products and our knee repair portfolio all grew at double-digit growth with Knee growth helped by the new ACL solutions that we launched earlier in the year. AET grew 4.6% in the quarter with WEREWOLF Fastseal and mechanical resection both being major contributors offsetting a slower quarter in video. Of course, I know there is interest from many of you in any developments around the VBP in

China. Our team remains in close contact with the Chinese government and we expect a policy to be finalised later in the year.

ENT growth of 38.9% reflects the continued post-Covid recovery in our core Tonsil & Adenoid business. We expect to return to a more normalised level of growth later in this year as we lap more of the market recovery but ENT continued to be an attractive growth area beyond this for us.

Advanced Wound Management

Now moving to look at Advanced Wound Management which grew 6.2% underlying. Within that Advanced Wound Care grew 2.7% mainly driven by our foam dressings and a strong quarter in Europe. Bioactives grew 3.1% underlying with a slower growth in Q1 mainly reflecting a normalised prior year comparator. Skin Substitutes remained the primary driver of Bioactives. Our portfolio has been growing ahead of the market and we believe the outstanding clinical evidence around GRAFIX in particular positions us for continued strong performance. Finally, Advanced Wound Devices grew 21.4% reflecting double-digit growth on both our traditional and single-use platforms with similar drivers to recent quarters. In the Traditional segment we are driving account conversions to RENASYS with a good pipeline of further opportunities and we are continuing to expand the single-use market with increasing penetration of PICO. Accelerating growth in Negative Pressure is a key component of the 12-Point Plan, as you know.

H1 2023 Financials

Anne-Françoise Nesmes

Chief Financial Officer, Smith+Nephew

H1 Revenue by Business Unit

Now I will move to the financials for the first half. Revenue was $2.7 billion in the first half, up 7.3% on an underlying basis compared to H1 2022. Reported revenue was up 5.2% including a foreign exchange headwind of 210 basis points from the strength of the dollar against major currencies. As you can see in this chart, growth was balanced across our businesses with all three units contributing.

H1 Trading Income Statement

Now moving to the summary P&L for the first half, gross profit was $1.9 billion resulting in a gross margin of 69.8% which is a 110-basis point decrease on the prior year. Operating expenses grew faster than sales, driven by increased spending on sales and marketing and this results in a trading profit of $417 million with a margin of 15.3%. I will explain the drivers of the lower margin on the next slide.

H1 2022 to H1 2023 Trading Margin Bridge

Significant headwinds partially offset by 12-Point Plan

Slide 12 shows a more detailed trading margin bridge. There were three major headwinds compared to the first half of 2022, with the first two representing what we expect to be the peak of the macroeconomic pressures. There were around 400 basis points from raw material and staff cost inflation and another 120 basis points from transactional FX. As you know, the transactional FX is the result of a strong dollar on the disproportionately dollar-based

manufacturing cost base, delayed by a year from our hedging programme. The final headwind was around increased selling and marketing spend as part of refreshing our commercial approach for growth in Orthopaedics and Sport and came to 110 basis points. There were also some significant positive offsets in the first half. We saw around 220 basis points of positive leverage from volume and pricing growth, around a third of which was driven by the 12-Point Plan. There were also significant productivity gains with around 150 basis points from operations and procurement savings and 100 basis points from other costs and savings initiatives including restructuring.

I will come to the outlook in a moment but one thing you can see from this bridge is that while the tailwinds are here to stay for some time, the headwinds are either one-off in nature or should significantly ease over the next period. The increase in Orthopaedics and Sports commercial spend is not intended as a repeating exercise. We currently expect transactional FX to be broadly neutral in 2024 and this first half should represent the peak of the pressure from input cost inflation.

H1 Operating Profit and EPSA

Looking further down from the P&L adjusted earnings per share declined by 8% to 34.9 cents. That is slightly more than trading profit, mainly due to higher interest expense, with our average net debt higher than in the first half of 2022. The interim dividend of 14.4 cents per share is unchanged.

FY Cash Flow

Trading cash conversion 26%

Trading cash flow in the period was $110 million with trading cash conversion of 26%. It is lower than in 2022 due to a working capital outlay of $326 million. Whilst we reduced our receivables as a result of the order-to-cash initiative in the 12-Point Plan, the biggest driver of the working capital increase in the first half was inventory.

H1 2023 Inventory Bridge

Let us look at the inventory movement and there are three main drivers to the increase that we expect to reverse. Firstly, we have added some stock to support acceleration in Negative Pressure Wound Therapy. This is a compelling opportunity for the business that carries some upfront inventory requirements which we expect to gradually consume as the segment grows. In addition, we have had some accumulation of both products and instrument sets that are not yet deployed and are currently being held as inventory. This is a result of ongoing supply constraint for a small number of components which hold back assembly, set completion and consequent deployment. Deepak will cover in a moment that we expect to accelerate deployment in the second half which will start bringing down the inventory.

Then within this driver of inventory growth we have also had some excess factory inventory from spot buying of raw materials to protect our manufacturing against external supply disruption. While there are still some areas with tight availability, general improvements in the reliability of global supply chains mean that we are now able to bring in tighter controls on raw materials buying and we can certainly see the level of raw materials inventory coming down in the future.

Finally, as you would expect, there has been inventory growth tracking the overall growth of revenue and that component is neutral to DSI but we should still see improvement in that portion as we execute the 12-Point Plan. Much of our inventory, as you know, sits in Orthopaedics. This is not the driver of the difference in the quarter or in the first half but we are continuing to focus on driving down the Orthopaedics inventory. Overall we are committed to bringing DSI lower and you should expect to see clear progress by the end of the year.

Net Debt Position

Now, to conclude on the financials net debt ended the half year at $2.8 billion. This is an increase of $314 million from the start of the year, including $201 million we paid for the final dividend of 2022. The effect of that is that the leverage finished the half at 2.3x adjusted EBITDA, which remains within our target range of 2.0-2.5x.

Increasing Growth Outlook for 2023

Now I will finish with our updated guidance for the full year. On revenue we are now targeting underlying growth of 6-7% versus our previous expectation of 5-6%. This reflects our strong growth in the first six months, further operational improvements in Orthopaedics as we execute the 12-Point Plan, and continued outperformance in Sports and Advanced Wound Medicine, while also recognising more difficult growth comparators in the second half of the year.

Our guidance for the full year trading margin is maintained for at least 17.5% with headwinds from input cost inflation offset by growth in productivity gains. I would highlight that we expect to deliver this target also after absorbing a 120-basis point headwind from transactional FX. Our outlook therefore represents what would be substantial margin progress on a constant currency basis. I am sure that you have also worked out that our guidance implies a step-up in the second half of the year, in line with our previous commentary that our guidance was H2-weighted margin and cost pressures would peak in H1.

H1 2023 to H2 2023 Trading Margin Bridge

Seasonal margin expansion and productivity gains

To give more perspective on the drivers of the step-up, slide 18 details the components of the margin expansion in the second half. Part of the step-up is a return this year to our historical margin seasonality. This should add around 270-300 basis points over the first half margin and this year we also expect the further effect of productivity improvements accumulating over the course of the year. Our cost reductions including productivity and the 12-Point Plan savings and the unwind of costs should together come to at least a further 250 basis points of second half margin uplift. Incremental cost inflation should be relatively modest with around an 80-basis point headwind from the Merit uplift we made in H1. For what this will look like in your model you should expect gross margin to be higher in H2 and our SG&A spend to be lower in absolute dollar terms than in the first half. Finally, as you think about EPSA we have also updated our technical guidance and expect the full year tax rate on trading results to be around 17%. With that I will hand back to Deepak.

12-Point Plan Update

Deepak Nath

Chief Executive Officer, Smith+Nephew

Transforming Smith+Nephew

Moving to a consistently higher growth rate

Thank you Anne-Françoise. I will start with a reminder of the transformation that is underway at Smith+Nephew. Firstly, we are becoming a higher growth company with a target of consistent 5%+ growth by 2025. That is more than in the past and we have a clear path to get there. We are fixing the foundations of Orthopaedics, ensuring the continuing strength of Sports Medicine and Advanced Wound Management, which are already outperforming, and converting the increased R&D investment into innovation-driven growth. Each of these elements is a step up from where we were pre-Covid which contributes to building a more attractive growth profile than we have had in the past.

Rebuilding profitability

We are also committed to driving profitability and returning our trading margin to at least 20% by 2025. We are coming through a period of elevated macro pressures and we are rebuilding a margin through manufacturing and COGS optimisation, productivity improvements and growth leverage.

Progress Against Our Two-Year 12-Point Plan

Fixing Orthopaedics

On slide 21 the 12-Point Plan provides the detail of how we do this. We are now approaching the halfway point of the two years and slide 21 is an overview of where we are today based on the milestone completion for each underpinning initiative. Taken as a whole the plan is showing good progress. The varying stages of maturity reflect the breadth of the programme including some initiatives that could move forward immediately and others that by nature would need longer preparation, such as portfolio streamlining or manufacturing optimisation. We are now well advanced with our work to rewire Orthopaedics. We have refocused the commercial organisation, simplified the selling organisation, introduced enhanced commercial processes and rolled out a new growth-oriented incentive structure. Our renewed demand planning process is in place and starting to bear fruit. Our asset utilisation is moving in the right direction with set turns now around 30% higher than at the start of 2022. With better foundations in place and the delivery of key R&D projects in robotics and in extremities, we are now poised to start delivering on that second block of initiatives and win better market share with our technology.

Improving productivity

Our will drill into more detail of our progress in a moment but on improving productivity we are quite advanced in our initiatives on value and cash processes. We have implemented better pricing across our portfolio and, as Anne-Françoise set out earlier, we are driving DSOs down and inventory days are poised to follow in the back half of the year. What will still take time is the work around manufacturing optimisation. We have identified opportunities in our network and there is a process to follow before we can move ahead. The opportunities from

simplification and the cost and asset efficiencies along with it will come later in the plan. These initiatives represent an important part of the midterm margin improvement target.

Accelerating Sports & AWM

We have talked less about the initiatives to accelerate Sports and Advanced Wound Management, however, they are overseen by the same governance structures as the rest of the plan and are being driven with the same urgency by their dedicated teams. With both initiatives being able to move quickly at the start of the plan, we are starting to see progress in competitive conversions in Negative Pressure and the pace in cross-business unit deals into ASCs, which has more than doubled just in 2023.

Ortho Product Availability KPIs Moving Closer to Goals

Orthopaedics is still the single-biggest lever for changing our financial outcomes and it is where we have had the most work to do, particularly around commercial delivery. The good news is that the fix in our Orthopaedics foundations is now well under way. Our KPIs of product availability have continued to improve and the charts update some of the metrics that we showed you with our full year results. Firstly, the value of overdue orders has continued to fall. These have halved since the peak in 2022 and with another 25% reduction since the beginning of the year. We have also showed data on LIFR or line item fill rate. LIFR measures the percentage of customer orders that have been filled so it is an indicator of how well we are meeting demand. Our target is to bring our non-set LIFR to a level that matches industry best practice. As you can see in the chart, our KPI’s continued on its improvement path and has now progressed to about 85% of the way to our goal from the trough level. The gap to that industry standard is now small and LIFR for key priority products is actually moving in the right direction. In particular, EVOS SMALL has reached and maintained the target level and JOURNEY II, our key product in recon, is more than 80% of the way there.

An important part of how we have made this improvement has been the new planning process that we introduced a little over a year ago. Better matching supply to demand at both the volume and mix level has enabled these improvements in order fulfilment as well as in other operational benefits. That has happened alongside other measures like improved logistics with a 60% improvement in customer replenishment speed and significantly improved scores for the health of kits that are already deployed in the field. Putting all of that together we have been able to reduce our total production while continuing to improve product availability and this in turn will ultimately enable reductions in inventory and in manufacturing capacity. To convert implant availability into sales growth we now need to step up the deployment of new instruments to customers.

The sheer number of components and in an instrument set makes this a complex process so we rely significantly on third party providers and just a single missing component could be enough to stop deployment. That has been the case in recent months with supply chain disruptions resulting in incomplete sets. Even so we have already made good progress in resolving these challenges. For example, in Trauma, which was a challenged area in Q1, we had more than a 300%-increase in EVOS sets deployed in Q2. We expect this pattern of greater set deployment to also follow in Hips and Knees in the second half. This is being supplemented by redeployment of around 10% of existing sets across our network. I referred to this last year around this time. Greater pull-through of the more readily available implants should then follow.

Maintaining High Cadence of Innovation in 2023

Trauma & Extremities

Innovation is another key component of our growth plans. You may remember from when I talked about this in February, that we expect more than half of our growth to come from products launched in the last five years. We also said that we expect to launch 25 new products in 2023 which is a clear step-up from our average over the previous three years of around 18. I am pleased to report that we have delivered 13 in the first half of this year, which is a notable inflection from our past and is well on track to deliver our full year expectation. That includes our AETOS Shoulder System which is an important part of our growth plans for Trauma & Extremities. AETOS is designed with both patient and surgeon benefits in mind. The MetaStem aligns with the market trend to minimally invasive, short stem devices. Short stems are easier to implant, have improved bone preservation and are a better fit to anatomy. Also, its compact tray system for procedures allows for shared instruments between the short stem, our existing long stem shoulder and also future options. We are continuing to work on a stem-less variant and also to bring compatibility with CORI. Financially, adding AETOS to our offering enables Smith+Nephew to be competitive in the shoulder market. This is one of the fastest-growing segments in Orthopaedics with a $1.3-billion market growing at around 9%. With this new shoulder opportunity, along with the completed EVOS platform in plates and screws, and the improvements in product and instrument supply, Trauma & Extremities is well positioned to step up to a higher growth rate.

Robotics

We have also added a further feature to CORI with a saw-based solution. This provides an adjustable cutting guide-based solution that fits into the existing CORI total knee workflow. This is without the need for additional incisions that come with traditional pins. This feature adds powerful versatility to CORI, appealing to an even broader range of surgeons with varying preferences by offering both milling and sawing as options. This is another step in our journey to adding features and functionality to CORI. In recent quarters we have highlighted the introduction of revision capability and the unique digital tensioner. The addition of the saw solution highlights our intention to continue to build out CORI at an accelerated pace. The delivery of this project is a testament to the speed of innovation that is being driven by the 12-Point Plan, as well as the agility of our teams in acting quickly to bring these features to market. We just received FDA clearance in June and expect the rollout to begin in the second half of the year.

Improving Organisational Effectiveness

Global business units to drive customer centricity, efficiency, performance

Finally, I want to mention a further development in our plans to strengthen the underlying foundations of the business and how we operate. With the early changes from the 12-Point Plan more settled, it is now an appropriate time for us to move to a more focused way of operating. We recently began the realignment of our commercial model from franchises and regions to global commercial business units, with verticalized commercial teams for Orthopaedics, for Sports Medicine and Wound. ENT is already operating in this structure. In my own experience and when I look across the industry this is a better way of doing business. It drives greater accountability, faster decision making and execution, and increased customer focus in every area of our portfolio. The previous regional marketing organisations

will also roll in to the global business units so we will have a single point of accountability for upstream and downstream marketing, sales and better alignment and resourcing across regions and countries.

The business units are led by dedicated presidents, for each of Orthopaedics, Sports Medicine and Advanced Wound Management, with full global P&L responsibility. In this structure, industry veteran Brad Cannon is solely focused on leading the transformational changes required in Orthopaedics. Scott Schaffner, who was already leading Sports Medicine, joins the Executive Committee as business unit president. We are still committed to cross-business unit opportunities and we are driving them through the governance of the 12-Point Plan structure. Earlier this year Dr Vasant Padmanabhan expanded his role to President of R&D and our ENT business, which is already operating in this verticalized model. Vasant's blend of clinical and technical expertise, business acumen and experience bringing novel therapies to market, will help strengthen our focus on ENT.

Last month Dr Rohit Kashyap joined as President of Advanced Wound Management, following Simon Fraser's decision to retire. Rohit is a seasoned customer and team focused leader with significant global multifunctional experience in wound care and surgical management. Rohit's career includes more than 20 years at Acelity where he was one of the principal architects of the company's strategy and led its execution. Immediately prior to joining Smith+Nephew Rohit was President of Wound and Surgical businesses and Chief Commercial Officer of MIMEDX where for the past three years he has led the business's turnaround in culture and performance to achieve consistent growth. Rohit is an example of the calibre of talent we are seeking and attracting to continue to drive, deliver growth and increase our potential as a company.

Others include a new Head of US Orthopaedic Sales and an operations team of orthopaedic specialists that we brought together in 2022. We will have the opportunity to hear from the presidents in due course, including at our Meet the Management event that is planned for 29th November this year.

Summary

In summary, I am pleased with how the first half of 2023 has developed. We have delivered growth ahead of our plans, driven all three business units and have improved our fundamental positioning through the continued operational fix and turning our innovation investments into a greater intensity of new launches. There is clearly still work to do in some areas. We are at an early stage on our productivity initiatives and are stepping up our profitability and cash generation in the second half. As we deliver that, we will exit this year with momentum that puts us solidly on course to meet our midterm commitments.

Before I finish, I would like to say a few words about Anne-Françoise and her decision to step down as CFO next year. I am saddened to lose her as a colleague. I understand why she feels that as we make our progress with the transformation of Smith+Nephew, now is the right time for her personally to reflect upon what she wants to do in her next career. It is hard to encapsulate the impact that Anne-Françoise has made on Smith+Nephew during her time as CFO. She was instrumental in us navigating the financial challenges in the pandemic and in laying the foundation for the 12-Point Plan. She has also been a champion of our culture and purpose and has been a strong leader. On a personal note, I am grateful for the

support and the counsel that she has provided for me during my time at the company. I am also grateful that she has given us ample time, far, far more than she was required to, for us to identify a successor and ensure a smooth transition. It is good that we will have her for the next few quarters.

Now we will take your questions.

Q&A

Jack Reynolds-Clark (RBC): Hi there, thanks for taking the questions. Starting with the revenue upgrade. Obviously it implies a change in your assumptions around growth through H2. I am wondering, how much of that is coming from your changes in assumptions around market growth versus execution? The second question on pricing, I think you mentioned 2.2 percentage points of leverage coming through on volumes and pricing. I am wondering how much of that is pricing and how much of that is the result of your own pricing initiatives versus generally a more favourable pricing environment? Then on CORI, there was helpful detail in your release around the CORI placement. I was wondering what your utilisation level of CORI is at the moment. I think last time you disclosed it as around 20%.

Deepak Nath: Yes. Let me talk about the revenue picture. Our step-up in the second half reflects seasonality but our confidence comes from the fact that our revenue growth has come across all of our business units. It is Orthopaedics, it is Sports and it is Wound. We expect that to continue. The primary driver for us to increase our guidance is our own commercial execution. There is of course market tailwind and that is primarily an Orthopaedics factor. We expect to be able to better take advantage of that. As you will recall, we have not always been able to take advantage of that market tailwind in years past. We expect to be able to better take advantage of that but it is fundamentally our own commercial execution that underpins that confidence and that step up in growth in the second half of the year.

Pricing is a component of that. It is one of the elements of the 12-Point Plan. Actually Anne-Françoise has been personally leading that particular initiative. There it is about our reaction to inflation and our ability to kind of pass along some of that price onto our customers. However, the more fundamental work we are doing is actually greater price discipline across our portfolio. That work should persist well past the current inflationary period. That is really the more fundamentals of our commercial execution that we plan to improve.

Anne-Françoise Nesmes: Sorry to interrupt, because you referred to the 220 basis points. To what Deepak said when referring to the second half, we have seen positive price momentum in the first half and we are continuing the strong discipline. We are not saying what the split is but you can assume there is product pricing build in that compared to the historic price deflation that we used to see. We are in positive territory for price and very successfully managing that.

Deepak Nath: I give our teams a lot of credit for the discipline they are driving around that. Coming to your third question around CORI, we are pleased with the utilisation so we are interested not just in placement of CORI. The numbers of CORI are less important to me. What is much more important is the role that CORI plays in driving our Orthopaedics business, driving our full portfolio. That utilisation, I gave you the 20% number, has only improved even further since that. It is a key metric that we track. We do not necessarily

report on that every quarter but, as I have said in previous forums, it is a means to an end. The number of CORI placements is a secondary lever or of secondary importance to me.

Hassan Al-Wakeel (Barclays): Hi, I have three questions please. Firstly, again on the management change, Deepak, we have clearly seen a lot of management change at Smith+Nephew over the years. I wonder if you can elaborate on why this is happening now and particularly early on in your turnaround. Related to this, Deepak, do you remain confident on the medium-term margin that you have highlighted given the significant ramp required beyond this year of in excess of 250 basis points over two years. Secondly, the strength in Knees looks to be driven OUS with US growth of 2.8%, below some of the peers who have already reported. What do you put this down to and how do you consider the cementless knee ramp in the US? Then finally, I would love some commentary around how you see the US environment and backlog. Has the increased utilisation peaked and when do you expect a more normalised level of growth? Thank you.

Deepak Nath: Sure. Hassan, for the first question around management changes, on the one hand I talked about the importance of building a strong foundation for our business and the move from a franchise to a business unit structure is a key part of that. What I'm trying to achieve is greater levels of accountability in the organisation, speed of decision making, remove inefficiencies, delayering the organisation and simplifying how we operate. Those are some of the thinking behind the move from franchises into business units. In my experience they will stand us in good stead over the long term.

In terms of the specific changes, some of those are associated with that move but they have been independent things. In Wound, for example, Simon Fraser deciding to retire was a personal decision for him to retire, nothing to do with the organisational changes. The appointment of Rohit Kashyap is a result of Simon's decision to retire. I had previously talked about Brad Cannon's focus into Orthopaedics. He is a veteran of the industry with a long track record of success. Given the scale of changes that we need to make in Orthopaedics I needed someone of his calibre, of his track record focused solely on Orthopaedics. That has already yielded great benefits in terms of how we operate and the progress we have made on the transformation journey. Each one of these changes has had a particular context around it but taken together I believe that we will be in a much, much better position as a company.

One final point on that which I mentioned in my remarks is in Operations we have assembled a team within Operations that are drawn from the industry. It is the first time we have had such a group that are not only strong operations leaders but actually come from the industry, focused on driving the improvements in the Operations area that are key to us transforming Orthopaedics. Taken together I believe we will be stronger as a company moving forward. So that's the ops or the management changes point.

Second, do I have confidence in the midterm guidance? Absolutely. We have maintained our guidance of at least 17.5% for the year. We have given you what the components of that are from H1 into H2. I am fully confident on our ability to deliver that. You asked about midterm and the ladder up from 2023 onto 2025, we have provided some bridges in the past forum. I think it was the full year results. I am 100% confident on our ability to deliver to that. It is not just words but rather the initiatives that underpin how we are going to get there. That is your second point.

In terms of the comment on Knees, you are right. Compared to our peers who have reported so far, we clearly are ahead outside the United States than we are in the US. In the US we are in the early stages of improving our operations. I talked about the appointment of a new US Sales leader. That occurred in Q2. In addition to that there are several other components of change. First is we have simplified the organisation. We have delayered the US organisation. We have gone from having six regional heads in the US down to three and made further simplifications downstream in that organisation, which is the first component to that. The second component is fundamentally, as I mentioned, our commercial processes. We are not where you would expect us to be and the new processes that was rolled out starting in Q1 right through into Q2 are starting to bear fruit. However, I do believe as the quarters progress they will really start to pay off.

The third piece is a change in incentives where we had been in Orthopaedics primarily focused on retention. We now have incentive programmes that are more growth oriented. That is on the back of improved product availability that you have already seen, I've shown you some of the metrics around that, which is a third component of that. A fourth and final component is refocusing the efforts of our commercial team around our portfolio. That required some fairly intensive training that we invested in the first half of the year that we alluded to. The combination of all of those things will start to yield. Obviously the performance is not quite there in the US yet but I do believe we are well positioned in the back half of the year.

That was I believe your third and final question. I think there was another one that I missed. Cementless knee, yes. We are seeing sequential improvements in terms of growth with our LEGION CONCELOC. We obviously have multiple offerings in cementless. The JOURNEY ROX construct is an important component of that. We are pleased with the progress. We obviously do not break out individual product or family of sales but we are continuing to see good uptake in that area.

I knew there was a fourth one. I lost track of that. Fundamentally, our growth assumptions on the guidance that we provide are based on our improved and improving commercial execution. Our guidance that we provided over the midterm does not assume some exceptional tailwind. It is built on more or less normalised macro factors or procedure environment. Having said that, we do see tailwind. We saw that in Q1, we are seeing that obviously in Q2 at a lower level than in Q1. In terms of how long they persist or where they come from, whether it is backlog or something else, we do not really have the visibility to be able to call that. As a number four player in Orthopaedics, as I have said in the past, where we are going through a performance improvement programme it can be difficult to parse how much of it is you and how much of it is the market.

Sam England (Berenberg): On CORI adoption can you give us a sense of what proportion of those placements are in the ASC channel versus hospitals? More broadly, how did Ortho sales to the ASC channel fair during the first half?

Deepak Nath: Sure. With the 12-Point Plan we are about where I thought we would be at this point of the year. We called out about 45%. It is based on progress in each of the underpinning initiatives and relative to the schedule that we are on. It is built on a combination of those initiatives. 45% is about where we expected to be. As I have said, for the most part we are either on track or ahead in terms of KPIs. That is true right across the board. Having said that, there are some areas that are better than others. In terms of where

I am pleased pricing is clearly an area we called out as one of the elements of the 12-Point Plan. I am very pleased with the progress there. The order-to-cash initiative, very pleased with the progress that we are making there. The cross-business unit deals, which is the 12th element of the 12-Point Plan, both in terms of volume of deals, the number of deals I am pleased with the progress that we are making. We really are taking advantage of the opportunity we have in the ASC. That is the third one.

Wound, we are on track, I would say, against a fairly aspirational plan that we had around Negative Pressure. Product availability, there are two components to it. It is improving LIFR which is really tied to replenishment of sets in Orthopaedics. How well are we replenishing those sets that are already out there? You see the progress that we have charted that is good. The part that is not good with that is driving down the sales DSIs related to it. That has been slower but we understand why it is slower. Fundamentally, it is because we have had supply interruptions of individual components. In Q1 it was cross-linked polymer, that is a key part of certain constructs, that we were challenged in terms of supply. That inhibited our ability to complete sets or replenish certain portions of our sets so there are things that, as Anne-Françoise said, that are stuck in inventory rather than being deployed in the field. There are good reasons for why it is where it is but the underlying improvements in process around our commercial operations and really our manufacturing operations and ability to connect commercial and sales, that we have made tremendous progress in. There it is moving from high level volume-based forecast to forecasts that are tied to mix, actual SKU level. That is the real improvement that we need to make in order to better match supply to demand. There I feel good about the progress but the KPI of inventory clearly we have got work to do there, to give you an example where we are not where we need to be.

In terms of have we needed to make adjustments to our plan, what I would say is not major ones. Having said that, there is a very tight level of governance around this. It is every two weeks that we meet. I chair the meeting together with Anne-Françoise and the reason we do that is to make decisions at the pace that we need to make to be able to run a programme given the imperatives that we have around improvement. Within the range of those we have had to make adjustments and refinements but not major ones. That is not because we are loath to make them. It is because we have generally called it okay. If we need to make it, we will do so. We have got a mechanism to do it but we have not needed to do it.

Your question around ASCs, about a third of our CORIs are in the ASC channel. We are seeing good growth. I think 20% growth in ASCs in our recon business. We are out participating in the shift of procedures in the US that are going from hospitals into the ASCs.

Graham Doyle (UBS): Can I ask some questions on the margin? The H1 margin was historically weak and I know we had the message at the start of the year that it would be H2 weighted but it is also a historic step-up in H2. Was this genuinely what you were expecting or is it the bottom of the range of what you were expecting for the first half? When I look at slide 18 you have got the building blocks up and even if I add those building blocks I am not getting to much more than 17.5%. Are we just less optimistic maybe than at the start of the year in terms of margin?

Deepak Nath: Do you want to take that? Go ahead.

Anne-Françoise Nesmes: Yes, I was going to take this one. Clearly our margins, as we said in the statement, are in line with our expectations and as anticipated. We said at the beginning of the year that the margins and the profitability will be H2 weighted. What we are expecting to see is the operating leverage, as you are pointing out on slide 18, coming through and importantly returning to historical seasonality. Yes, the H1 margin is lower but that was implied in our initial guidance given that we are returning to historical seasonality. The productivity improvements, we have always signposted were in the second half. We have already made progress in terms of cost savings and restructuring. On top of that we are unwinding the cost spend, the pre-selling and marketing that we have seen in the first half. We are in line and tracking to what we said we would.

Deepak Nath: Just to accentuate the point, when we say our expectations, this is what our budget was built to. We truly are on budget to H1 of the year. I think the point is some of the favourability in revenue that we had that are ahead of our expectations did not necessarily translate into favourability in margin. We have given you the bridge around that. However, truly our budget was as we came in.

Graham Doyle: Maybe if we think about next year, it is just a broader question. There is obviously a big step-up, as Hassan pointed out, in terms of margin to get towards that target. What happens if the order of the market does not grow? We have got a big backlog. You have got a tough comp. I know there is obviously the absolute amount of revenue will still be quite high but you have got to go from taking very little share in the US, losing share, to taking a lot of share. Is that in the plan?

Deepak Nath: Yes. It reflects back to how our plan is constructed and what is the anchor to our guidance? Our guidance was built and our assumption was built on more or less normal Orthopaedic volumes. Any tailwind we have is a big upside. Implied in that is share recovery and here I want to parse what that means. Over the last couple of years we have lost share not because we have necessarily been displaced from accounts but because we have given up procedures largely on the back of our failure to supply reliably. Recovering that share, though not easy, is easier than if you had to go back into accounts that you are completely displaced from. To put it simply, there are surgeons that are already trained in our systems who have had to resort to other companies' products because we have not been able to supply as well or as regularly as we should have been able to. It is that recovery that underpins the next couple of years.

The second more structural component to that is our innovations. We have invested in R&D in particular in Orthopaedics. Robotics is a big component of that but it is not just Robotics. It is cementless, it is in Trauma & Extremities and in other parts of our portfolio. However, let us just take Robotics, CORI we have a high level of conviction around. What we are doing in the 12-Point Plan is accelerating certain features and functionality that was previously contemplated in the pipeline but not at the pace that we are bringing this out. There you see this. Every quarter I talk about something related to CORI and it did not just happen. It represents an acceleration of the plans that we had. When you take a step back and look at what we have brought onto CORI, we have got not only a milling-based approach. Now we have accelerated our programmes to bring a cutting-based approach onto CORI. It is a platform that now has cutting and milling and the intention is that it appeals to a broader range of surgeons. That represents an acceleration. The digital tensioner is another thing. It

is another capability where surgeons are able to plan their procedures before ever making a cut. That is a unique selling feature of the digital tensioner. We brought that out last quarter. Again, not to go down the rabbit hole on any one feature but in totality a significant investment. We believe in CORI. I believe that will be a driver of growth, not just in terms of Robotics. You see our other Recon line, which is where we park our Robotics numbers, there is a reasonable amount of growth. However, it is really how we use CORI to drive the rest of our portfolio. That is the refocus of our commercial organisation that I am talking about. There I do feel good about how we are positioned for the midterm. Hopefully that gives you a bit of colour around how our guidance is built up.

Graham Doyle: Thank you.

Veronika Dubajova (Citi): Good morning and thank you guys for first squeezing me in. I have two please. The first one is, Deepak, maybe to follow on a little bit on the competitive environment and how you are feeling about your performance in Orthopaedics. Maybe you can tie this also to the changes that you have made to the sales organisation in the US year-to-date. Obviously when we look at the growth rates clearly the gap between you and peers has narrowed this quarter. I appreciate there is a lot of comp effects in there and noise but do you feel you are starting to make progress versus where you were 12 months ago? Maybe just talk to how the commercial organisation changes, including the training programme and the restructuring you have done year-to-date, fits into that and really what your ambition is as you move into the back half of the year and into 2024. Then I will have a follow-up after that but maybe we start there.

Deepak Nath: Yes, sure, Veronika, thanks. First off, the headline answer is I feel good about where we are. As you correctly note, the gap relative to competitors, we are ahead of one of them and we have narrowed the gap relative to the other competitors that have reported so far. I am pleased with where we are but this is very much in the early stages of the improvement journey on commercial. You rightly note the changes in organisation, the changes in commercial process. In the US, where our biggest challenge lie in terms of commercial performance in the US, we brought a lot of these together in Q2. It started in Q1. Actually, some of that the seeds were sown back in 2022. They have come together in Q2. They have had impact very clearly but the bigger impact is to come in the back half of the year and in time beyond. As you know, in commercial it is not a switch that you turn on. You have got to make sure you lay the foundations. You make sure you are thoughtful about the changes you are making. Then of course let the organisation do its job. I do believe that we are well positioned now, having brought together the major elements but the proof will be in the pudding and that will be best judged in terms of our performance here on out. However, just to give you a sense of timing to accentuate it, a lot of these elements came together really in Q2. I do feel good about it but obviously the big part of the improvements will come in the quarters that follow.

Veronika Dubajova: That is very clear. I apologise if this comes across as aggressive. It is not intended as that but it is definitely one that has come up a lot in my conversations this morning, which is 1.1 percentage points of spend that you have called out in selling and marketing, was this always in the plan from the outset of the year? The nature of it, the spend of it and I guess maybe give us the background for why we had not heard about it until now. It is clearly a surprise of a profitability in the first half of the year for all of us.

Deepak Nath: Yes, sure. Some of it was planned. For example, we had always planned to bring together our commercial organisation for a longer period of time than we historically do with much more intensive training than we do and that is all about the refocus and so forth. That was planned. The part that was not is around commissions. A couple of factors there that were to a higher level than we had originally planned for. For example, I called out supply chain interruptions. That is a very, very real factor for folks in the field. Whether in the Orthopaedics side where they are counting on sets to be delivered to drive growth and when those sets are not complete that really impacts their ability to go out and get new business. It is a very real impact in the field. On the Sports side we have had quite a few challenges in being able to deliver products needed to drive growth. The teams have done a remarkable job selling through that but there has been tremendous component shortages in Sports and we have had to make sure that we buffer to some extent the organisation from those challenges. That part of the selling spend related to commissions was to a higher level than we expected. In the back half of the year a lot of these things are coming together because we have got line of sight to what we are able to produce. We will not need those types of investment. To your point, some of it expected, some of it not so.

Veronika Dubajova: That is very clear, thank you guys. I will jump back into the queue.

David Adlington (JP Morgan): Hi, three please. Firstly on the supply constraints, I just wondered if you were able to give some more colour in terms of what they actually are. How much of a headwind were they overall and when do you expect them to resolve? Second one on free cash flow, I just wondered if you had any guidance for the full year whether you expect to be in positive territory for the full year or not. Then finally just in terms of Chinese VBP for Sports medicine, are you expecting any destocking ahead of that and if so, is that factored into the guidance?

Deepak Nath: Sure. Do you want to take the free cash flow one?

Anne-Françoise Nesmes: Yes, in terms of free cash flow and cash conversion, as we guided with the full year results, the movements will depend on the inventory and quite clearly, as we said today here, the drag on the cash flow has been the increasing inventory. We are looking to address that and bring it back to a more reasonable level. We will not be quite a historical level of free cash flow or trading cash conversion but we are getting back. We will be getting back to nearer or approaching those historical levels as we return inventory to a more normal position, until we start decreasing particularly the DSIs.

Deepak Nath: Supply constraints, to give you a little bit of colour, on Sports we rely on basically third parties to provide different components that go into the products that we make. We have had challenges with one or the other component for quite some time. Historically it has been semiconductors that have really impacted our AET business in Sports. That has improved from last year to this year and resins was another area that I called out in times past. That has largely improved. Not to pre-pandemic levels but improved relative to where we were last year. What has not improved is one or other component where it is not some big category. It is just an individual component related to a challenge that a particular supplier is having either around labour or their own input raw materials. There are about six or seven of those today. There was a much longer list. We have whittled it down to six or seven today, that are really impacting the pace at which we produce. It is reflected in raw material inventory because we have got the 100 other things that we need to complete it but

for the six or seven things that we are waiting on the stuff sits in inventory as work-in-progress and our field does not get it in the way they are expecting to see it. It is those call it six or seven things, individual components in Sports against a backdrop of improving overall situation in semiconductors and resins which was a topic last year for that business.

In Orthopaedics I want to draw a distinction between supply versus product availability. The reason we call it product availability in Orthopaedics, by far the biggest challenge for Orthopaedics was us. Our ability to connect operations and commercial that led to us not being able to bring the products where they are needed at the time that they are needed. There the large part of the fix was things that we needed to do inhouse. All of the things that I have talked about today and at previous forums. There I feel good about the progress that we are making but that does not mean there are no supply challenges in Orthopaedics and there were some. The one I believe I called attention to in Q1 was cross-linked polymer which goes into some of the inserts that we make. It is a key part of certain knee constructs. When you do not have it, you do not have a construct that is complete and you are in a painful situation in the field in terms of your ability to supply customers. That was a very significant impact for us in Q1 and impacted our ability to complete implant sets.

There are other components that go into instrument sets and there we are more reliant on third party versus our own manufacturing. Those have been, I would say, irregular supply where we do not get what we need in the quantities that we need it when we need it. It is not a large number of components so it is really a small handful. However, those handful can keep you from being able to complete those instrument sets and therefore all of that stock sits in your inventory versus being deployed and being able to help you turn sets. It is a different type of problem manifested in similar ways. However, like I said, when I look out into the back half of the year I do see some improvement in terms of what we are expecting to get. Hopefully that gives you the colour around supply, to answer your first question.

Your third question around China VBP and then around destocking, in terms of timing of when that will occur we are obviously in close touch with the government in China around the authorities that are tasked with bringing this to life. It is hard to tell exactly when that will occur but suffice it to say we have got a range of plans to deal with destocking and other behaviours that you might see when something like this goes into effect. We obviously have some experience dealing with this with the Orthopaedics VBP. We have applied the lessons that we have learnt in that process to manage this as best we can.

Robert Davis (Morgan Stanley): Thank you for taking my question. My first one was just around your EBIT bridge into the second half year. I also had a couple of follow-ups on that. The first one was just around the second half weighting of that EBIT bridge is obviously higher even than the pre-Covid levels. I know you have cited this historic seasonality but I just wondered if you could touch on the second half weighting of the EBIT as a percentage of the overall Group seems to be 300-400 basis points above what the previous highs have been in terms of EBIT contribution as a proportion of the full year. Then just a couple. We had FX guidance I think of 120 basis points transactional. Where does that fit into your guidance in your 1H/2H margin bridge? Is that included in the underlying numbers as part of that seasonal pickup? Then two follow-ups. One was just on the profitability of first half margins compared to a couple of years ago. You are 240-250 basis points below where you were. I would just be curious in terms of a divisional standpoint, where are you seeing higher or

lower margins versus 24 months ago by a divisional basis? Then a final one, if I can squeeze it in, just on your innovation pipeline. Is any of that extra innovation spend and R&D push costing you on the margin side? Thank you.

Deepak Nath: Do you want to unpack that first one?

Anne-Françoise Nesmes: Yes, good morning Robert. There was quite a few here. In terms of the weighting of EBIT in the second half, you are right, historically it has been 45%, 47% to 53%, 55% in the second half. Here, given the pattern, it is fair to say there is a higher percentage of EBIT in the second half. A lot of that is driven by returning to the seasonal uplift we have seen but also a flow-through of the productivity improvement and the cost savings. That is really what is driving that proportion.

The FX impact is throughout the various proportion. It shows through mostly in cost of goods because that is a proportion where we have our US cost base. I would say we should recognise 120 basis points of margin erosion from FX. We are absorbing so when we talk about at least 17.5% it is after quite a headwind in FX and we should recognise that therefore the efforts to improve margin are coming through.

From the divisional or the segmental reporting, clearly there is a range and you can find the information. Of course from an accounting perspective it is after allocating all costs and the facilities and actually allocating exchange rate. We are seeing good improvement in Orthopaedics and to the earlier question, the improvement in the midterm margin is mostly driven by the Orthopaedics segment returning to nearer to the historical profitability level we had, which is what we discussed in the full year results earlier this year. Orthopaedics is on track. We see good improvement. Sports is improving. When you look at Wound there is a slight dilution because of the investment we are making behind Negative Pressure. All divisions are tracking very well and being where we want them to be.

The final question on R&D margin, there is no further dilution of R&D. We have made the step up in the R&D investment in 2018 and 2019. We have kept it through the Covid period. We are now in the right position and that is not dilutive to margin. I think I have covered all your four questions but I cheated. I took notes whilst Deepak is trying to memorise it.

Robert Davis: Thank you very much, that was very helpful.

Chris Gretler (Credit Suisse): Hey, good morning Deepak and Anne-Françoise. Thanks. Actually I still have three questions left and the first is just on the Dressings business in Wound Care. Could you discuss that? It looks like, at least from our perspective, that you are losing share there. Could you maybe discuss how happy you are with the performance there? The second question would be on AETOS on CORI. I think you mentioned that in your prepared remarks. Could you maybe specify the timing of when you expect that to become available? A third question is just on cost inflation, given where we stand right now. How should we expect that going into 2024? It is obviously easing substantially now in the second half, that headwind. Maybe if you could give us an indication there at the current levels how that would impact your business. Thank you.

Deepak Nath: Sure. Maybe I will take the first two and you can take the third one. Let me start with the second question which is CORI on Shoulder. When would I want it? I would want it tomorrow if I had my druthers but we have to sequence that in with the other CORI

programmes. We have made really good progress on Knee. There are a couple more elements that are still coming on Knee. There is a fairly robust pipeline of projects in Hips that we need to prioritise. However, I am quite excited about the applicability of CORI for Shoulder. The anatomy in the shoulder is such that CORI is very well positioned to play an important role in Shoulder. We recognise that opportunity. We recognise that the form factor for a CORI is well suited for the shoulder. It is in place in terms of a pipeline. We just need to factor it in with other CORI programmes we have in place. We will give you some visibility, a peak behind the curtain, when we have the Meet the Management session in November. Stay tuned for that.

The first question now, Chris, just remind me. I just drew a blank there. AWC. Sorry, thank you.

Chris Gretler: Sorry, it is actually the Dressings.

Deepak Nath: Maybe I too should take notes. Fundamentally about Wound it is about our portfolio. You are right, with Foams & Dressings you can parse this all different ways but fundamentally what I am actually pleased with is how our portfolio in Wound is performing. We have got the broadest portfolio in the industry. Not only is it broad, it is actually quite rich in terms of what we have in each of our categories. Our Biologics portfolio is performing very, very well. Our Skin Substitutes business continues to be above market. There is great clinical data that we have built up over a long period of time that is fuelling this growth. I feel very, very good about where we are positioned there. Negative Pressure is called out as the 12-Point Plan, a tremendous opportunity in the back of RENASYS, a refreshed portfolio there to drive really growth in that category. When I see those growth drivers line up I do feel good. There is also quite a robust pipeline in Wound, particularly around Foams & Dressings. I am very excited about what the future holds there. However, when you add all of these things up the story is one of each element of the portfolio plays its role but it is the totality. It is the breadth and the richness that I am most excited about. It is the source of our competitive advantage within that.

Anne-Françoise Nesmes: In terms of cost, to finish off, as we have said here today, we expect the cost pressures or the inflation to have peaked and our midterm guidance always assumes that moderate inflation in 2024 and 2025. What I would add though is of course, as you know, cost inflation will unwind through the cost of goods line as we sell the inventory that we have built at a higher cost. There will be a phasing of that effect as inflation comes down.

Chris Gretler: Thank you.

Deepak Nath: Okay, I am getting a note that we need to finish here because our first meeting is in a few minutes. I want to take this opportunity to thank everyone for coming. Thank you for your questions and your engagement. I am looking forward to coming back in the next quarter and continuing to show you the story of progress. Thank you very much.

[END OF TRANSCRIPT]