Smith+Nephew Third Quarter 2023 Results

Thursday, 2nd November 2023
Introduction

Deepak Nath  
*CEO, Smith+Nephew*

Good morning and welcome to the Smith+Nephew Third Quarter Trading Report Call. As mentioned, I’m Deepak Nath, Chief Executive Officer, and joining me is Chief Financial Officer, Anne-Françoise Nesmes.

Introduction of John Rogers

So before I begin today’s presentation, I will just draw your attention to our announcement today that John Rogers will succeed Anne-Françoise as Chief Financial Officer in the first quarter of next year, after the publication of our annual report and accounts.

John is an experienced FTSE 100 CFO, having held the post at WPP and Sainsbury’s, and I have no doubt his financial acumen and expertise in leading transformation programmes will be tremendous assets to us. As I have said before, I am very grateful to Anne-Françoise for the time she has given us to ensure an orderly handover and her continued support as we close out 2023 and complete this new transition.

Summary

So now let me turn to our Q3 results. I am pleased to report another good quarter, which maintains our momentum from the first half. Orthopaedics growth has stepped up as expected, with one of the highest growth quarters for many years. And importantly, the strong underlying performance in Sports Medicine and Advanced Wound Management has also continued. There are puts and takes across the portfolio, as you would expect, but the overall picture is of strong innovation-driven growth, backed by improving execution.

We are also advancing the 12-Point Plan with encouraging signs of delivery on outcomes. Our operational improvements under the plan are continuing to drive key metrics toward their targets, particularly around product availability. In Orthopaedics, you can see that translating to better revenue growth, for more lines of the business. Our productivity measures are also progressing. We have made cost savings as planned for 2023, and for the longer term we announced the closure of two of our smaller factories within our network.

With nine months done, we are refining our guidance for the full year. We now expect revenue growth to be towards the higher end of our 6-7% guidance range, reflecting our good momentum and improving execution. And on profitability, we are seeing the expected step-up in the second half, with the seasonal uplift and cost improvements coming through. There is some additional headwind in China as well, and we are reflecting that with trading margin guidance now of around 17.5%. I will come back to our outlook shortly, but first, we will take a look at the details of the quarter.

**Q3 2023 Revenue**

*Broad-based growth across businesses and regions*

Third quarter revenue was $1.4 billion, representing 7.7% underlying growth, with all business units and regions contributing. Anne-Françoise will cover the performance of the business units in more depth in a moment, but you can see that Orthopaedics has continued to accelerate as
the year has progressed, with a slower quarter in Advanced Wound Management. Looking by region, growth was broad-based with 7.2% growth in the US, 7.8% in Other Established Markets, and 9.2% in Emerging Markets.

Within the Emerging Markets, China sales were down 1.4%, with improvements in Knees and Hips performance, but a slowdown in Sports Medicine, where there are some significant moving parts. To cover that, and the rest of the business unit detail, I will now hand over to Anne-Françoise.

**Q3 Financial Results**

Anne-Françoise Nesmes  
*CFO, Smith+Nephew*

**Orthopaedics**

Thank you, Deepak. So I will start with Orthopaedics which grew 8.3% underlying. This follows the 3.9% growth in quarter one and 5.8% growth in quarter two. So even with more difficult comps, we have continued the positive momentum we have seen in the early part of the year. Knees and Hips growth included a better quarter in China, as Deepak just mentioned. The effects of VBP are now fully lapped, and China is back to being accretive to overall recon growth.

When we look our established market recon business, there are green shoots. Some regions are further along than others, but our commercial improvements are taking shape. US product availability is improving, and we are gradually stepping up set deployments across small categories, and I will come back to that in a minute.

Other reconstruction growth of 58.5% was driven by the ongoing adoption of robotics. We exited the quarter with over 25% of our US knee procedures being placed with a robot, and we have contract wins across the sites of care, including large academic medical centres and in ASCs.

We are also seeing good progress with our increased range of indication. Use in revision is already approaching the overall knee utilisation, and we saw the first cases completed with our new Saw Solutions offering in the third quarter. Trauma and Extremities has become an important part of orthopaedics growth story, and it was a bigger sales contributor than Hips in the quarter for the first time, despite us exiting some markets last year, as you may recall.

Underlying growth was 10.4% with the acceleration coming particularly from EVOS and from strong double-digit growth in the US. Trauma is demonstrating what we are aiming for across orthopaedics. We invested over many years to build out our plates and screws platform, starting with the EVOS Mini Plates, then adding Small, and completing our offering with the launch of EVOS Large in 2022.

Our operational improvements on the 12-Point Plan established better supply and replenishment of implants, and in the last two quarters we have also stepped up the deployment of sets. Putting all of that together with better commercial execution is translating into sustainable higher growth.

The next leg of growth is also ready to follow, as we broaden the rollout of our AETOS Shoulder system.
US Ortho: Product availability, set deployments enabling T&E growth; Recon earlier on the same path

And delivery of the 12-Point Plan milestone is continuing to progress, and one area where that is particularly evident is in our product availability across the portfolio. There are still differences between categories, both on the supply KPIs and on the financials, and clearly US Orthopaedics is an area where there is still more to do.

On slide seven you can see some of the detail. Firstly, if you look at the chart to the left, implant availability is moving in the right direction. Overall, orthopaedics non-set LIFR remains on an improving path ahead of our projected plans, and the value of overdue orders has continued to fall. There is some variation within that of course, and that is somewhat a factor in some of the differences you can see across segments. Availability of JOURNEY II with OXINIUM has been lower than the average, and the greater US penetration of this construct makes it particularly relevant to the US Knees growth. The good news is that JOURNEY LIFR was stepping up as we exited the quarter, and should also be on an improving path from here.

A second factor to be aware of, is the importance of set deployments, and again the categories of US Orthopaedics are at different stages of progress towards our goal. Trauma is an early example of what success looks like. EVOS product availability has been at or above target for almost all of 2023, but set deployment only stepped up strongly in Q2, and we have seen a clear inflation in revenue growth in Q3.

Hips and Knees are still following. In US Hips, instrument deployments have started to step up through Q3, and are getting closer to the target fulfilment level. Continuing this and maintaining the implant availability should also be followed by better growth in the coming quarters. Knees are earlier in the process and further from their target, but we have started to see positive momentum later in Q3. Together with improving JOURNEY II and OXINIUM supply, we are on the same path that we have seen playing out in Trauma.

Sports Medicine & ENT

Moving to Sports Medicine and ENT, which grew at 11.1%. A multi-year stream of internal and external innovation was again central to our growth, and that was further helped in the quarter by better product availability. There are still some areas that are constrained, but we are seeing steady improvements in fill rates and overdue order levels that can keep supporting our growth in the coming quarters. Sports Medicine remains a very attractive area of our portfolio, and we are continuing to invest in further opportunities.

Within Sports Medicine, Joint Repair grew 11.3%, with broad-based strength across procedures in established markets. REGENETEN again grew strong double digit, and we are still adding new legs of growth six years after acquiring the product through Rotation Medical. Geographic expansion has continued with launches in Japan and India, and work on further regenerative applications beyond the shoulder is ongoing. AET grew 1.7% in the quarter with WEREWOLF FASTSEAL, LENS 4K, and our DOUBLEFLO management system all contributing.

But as I mentioned, the headwind in the quarter was a slowing market in China, on both consumables and capital. Without China, growth would have been three percentage points higher in Joint Repair and four percentage points higher in AET. There was slower buying in Joint Repair, as wholesalers reduced inventory in anticipation of the VBP process. And there was also
market-wide delays in purchasing around the widely reported ongoing anti-corruption campaign. We expect China to remain a headwind in Q4.

**VBP update**

And of course we know there is interest in VBP, so I wanted to give you an update on the current state of development. The policy is still yet to be fully published, so many of the details are not yet known. For example, we still have to hear the full tender rules or details of the entry prices. Timing has also not been confirmed, but our current assumption is for a process before year end, with the outcomes of the tender to be implemented in the second quarter of 2024. On the scope of the VBP, our understanding is still that the tender will be limited to joint repair only.

However, with more information, the scope looks to be wider than it appeared from the initial data request we talked about before, and we now expect it to cover around 1.5-2.0% of group sales.

Now moving to ENT, ENT growth of 40.2% was driven by our core tonsil and adenoid business. As we expected, demand growth has started to moderate as we lack more of the post-COVID recovery. By improving product availability meant that the quarter also benefited from clearing a significant volume of back-orders. That process is almost complete, so we will expect to return to a more normalised level of growth as we exit 2023.

**Advanced Wound Management**

And finally, Advanced Wound Management grew 3.6% underlying. Within that, Advanced Wound Care and Advanced Wound Devices continued with the trends we have seen in recent quarters. AWC growth of 3.2%, was mainly driven by Europe and came across the categories of dressings.

21.3% growth in Advanced Wound Devices reflected continued double-digit growth on both our traditional negative pressure platform, RENASYS, and our single-use device PICO, and we are continuing to both gain share and expand the market. The slower quarter for the business unit as a whole was driven by Bioactives, which was down 4.8% in the third quarter. The decline reflects a strong comparator from the third quarter of 2022 and also delays to SANTYL shipments in the early part of the quarter, as we fully completed the transition of production to Fort Worth. Our shipments are now back to normal, with Bioactives exiting September strongly, and the segment should return to more typical growth against a more normal comparator in Q4.

And with that, I will hand back to Deepak.

**Closing Remarks**

Deepak Nath

*CEO, Smith+Nephew*

Thank you Anne-Françoise. On revenue, 7.5% underlying growth in the first nine months positions us well to meet our full year target. There are a few moving parts to keep in mind for the remainder of the year. On the positive side, we should see higher growth again in Advanced Wound Management, mainly due to improvement in Bioactives, and we should continue our positive momentum in Orthopaedics. As headwinds, we expect a slower Q4 in Sports Medicine,
with low to mid single-digit growth. This is due to the combination of the pre-VBP effects and a broader market slowdown in China, as well as a strong comp from Q4 2022 in the rest of the world. Also, as an Anne-Françoise just mentioned, ENT growth should normalise after Q3. Putting all of that together, the portfolio as a whole is well positioned, and we expect full year growth to be towards the higher end of our 6-7% guidance range.

On profitability, the dynamics so far in the second half have been as we described with our H1 results, which is encouraging. The drivers, expected H2 margin step-up, are all coming through; those being the usual seasonal uplift, the unwind of one-time commercial costs from H1, and our planned cost reductions. There is still more to do, but as you may be aware, the fourth quarter is typically our highest sales quarter and, therefore, highest margin quarter of the year. The progress we have made already in Q3 means that the remaining uplift to hit our full-year targets is well within the historical range.

The change is the headwind from China that we have highlighted. As you know, our guidance included some pre-VBP impact. There are now other moving parts in China as well, and while we are working to offset these, there is only so much that can be done in the remaining quarter of the year. Reflecting that, our expectation for trading margin is now around 17.5%.

Overall, I am pleased with another strong quarter, progressing the fix to Orthopaedics and continuing to invest in and drive Sports Medicine and Wound. The portfolio is moving in the right direction, our 2023 financials are trending as expected, and the 12-Point Plan is advancing. It is a wide-ranging programme where we are on track, or ahead in most areas, and with green shoots in the areas where there is still more to do.

We have talked a lot so far about fixing our operations, but there is much more to Smith+Nephew than that. The returns from our multi-year innovation investments are an important growth driver too. We'll talk more about that aspect at our ‘Meet the Management’ event on November 29th, and I would encourage you all to join us in London.

With that, we can move to your questions.

**Q&A**

**Robert Davies (Morgan Stanley):** Yes. Thank you for taking my questions. My first one was just on the progress you are making from a growth perspective on the Orthopaedic side. Obviously a large part of that was driven by the other recon segment, but just maybe walk us through the underlying trends you are seeing in both Hip and Knee, and any significance of the regional variations you have got there?

And then my second one, your commentary around the margin outlook for the full year, is around 17.5%. I guess there is some debate of whether that is doable with the investor community, but looking forward through 2024 and beyond, are you still comfortable with the 20% margin target and even with the new moving parts that you have highlighted today? Thank you.

**Deepak Nath:** Thank you Robert. So first off, in Orthopaedics, we are pleased with the overall growth, as I mentioned. Other recon, which reflects the uptick of CORI, not only in terms of placements but actually also utilization, where we are now up to 25% of our US business, flowing through robotics, is encouraging. But in addition, as Anne-Françoise mentioned, it is
not just CORI, but it is actually Trauma as well, that is contributing to growth. And on top of that, you have got Hips stabilising and Knees continuing to grow where the soft spot remains the US.

So in terms of regional variations, the market continue to be strong in Q3 – not as robust as Q1 or Q2, but continues to be strong. And the fact is, on the back of the operational improvements we are making, we were able to participate in the market upside, which was not always the case, as you will recall, Robert.

And if I look at outside the United States, our commercial execution on top of product availability, which is coming from operational improvements, has enabled us to really participate in that growth. In the US, we are continuing to do that, Hips is better than in Knees, and the reason Knees are behind primarily has to do with continuing supply challenges, particularly on OXINIUM. So when you look at the product mix in the US, the particular constructs and particular SKUs in the US were impacted, and that also had an impact both in replenishment and set delivery.

The good news is, as we exited September, we saw significant improvement in OXINIUM supply that contributed to sets starting to flow again in the US. So I expect the momentum built up in September to continue into Q4. So hopefully that gives you a bit of colour on the drivers of growth, the regional variation.

So in terms of margin around 17.5%, obviously we have indicated that we expect a step-up in 2024 and in 2025. We expect more of it in 2025 than we do in 2024. But it is not going to be a hockey stick. It will not be linear, we do not expect a hockey stick from between 2024 and 2025. So I continue to feel good about where we are positioned relative to our midterm guidance. As you mentioned, there are more moving pieces, there are more headwinds than at the time that we issued the guidance, the primary headwind being China, particularly around the Sports VBP. But on top of that, there’s been, of course, some effects from the anti-corruption campaign that has rolled out in China, and we saw the impact of that in Q2. So that remains an uncertainty, but even with that factored in, I feel, at least at this point, good about our ability to hit our midterm guidance.

Robert Davies: Thank you. Maybe just one follow-up around the Advanced Wound Bioactives. Could you just give us a little bit more colour on where the softness in that particular business came from, in the quarter?

Deepak Nath: So, first off there was a comp topic Q3 2022 versus this. Secondly, we made the decision several years ago to transfer production in-house. We had previously been manufacturing in Curacao, and in Q3 we completed the transfer into our Fort Worth facility. That was done for resilience reasons, it was done as part of our cost reduction or productivity programme. And as we transferred that production, we hit a couple of bumps within the quarter, that we were able to resolve and get back on track actually as we hit September.

So we are in a good place as we exited Q3, and we expect that to continue into Q4. So we get into more normalised combs in Q4, and with our factory now humming in Fort Worth we expect that to normalise.

Robert Davies: Understood. That is great. Thank you very much.

Deepak Nath: Sure thing.
**Veronika Dubajova (Citi):** Hi guys, good morning and thank you for taking my questions. I will keep it to two as well. The first one, Deepak, I know you are not going to give us 2024 guidance, but just curious on some of the moving parts that you see, as you move into next year. Maybe if you could comment, one, on how you feel about the market, and obviously I think J&J made some pretty strong comments recently, about how they expect elevated utilisation and volume growth to continue. And also do you think 2024 is the year when we start to see some improved momentum in Knees and Hips, on a full-year basis?

And maybe for Anne-Françoise on that as well. Just in terms of the P&L moving parts, I am thinking FX and inflation, if you have any high-level thoughts at this point in time, to help us as we think about 2024, that would be super helpful.

And then my second question is just maybe a follow-up to comments that Deepak, you have already made, but just for avoidance of doubt, obviously now that you have more clarity on VBP, do you still feel confident in your ability to achieve the 20% midterm target? And what are some of the offsets that you see against that increased scope of the VBP process in Sports Med? Thank you.

**Deepak Nath:** Thanks for the questions, Veronica. So just on the guidance of some of the moving pieces, we do expect positive impacts as we go into 2024 from revenue leverage. We start to see that come through in Q3, and we are going to build on that in Q4, and we expect that to continue in 2024. Pricing, there is of course the inflation offset, but some of the more strategic work we are doing on pricing we will expect to continue to pay dividends as we go into 2024. Also, ongoing productivity gains under the 12-Point Plan will be a factor as we head into 2024.

Then I mentioned of course the VBP in Sports Medicine that will act as a headwind. Anne-Françoise talked about, previously we have guided to around 1-1.5% of group sales being impacted by VBP. Based on the expanded scope that we see, we think it will be more like 1.5-2%. So that will have an impact that offsets some of the factors that I mentioned.

In terms of transactional FX, it had been a headwind in 2023, but we do not expect that in 2024. And also we do not expect the same scale of headwind in terms of input cost inflation in 2024. So the bridge that we provided at H1 gives some good indication as to the major factors that we see influencing a margin step-up as we go into next year and beyond, including materials and staff cost, inflation, offset or unwind rather, our COGS and manufacturing optimisation, and the cost reduction programmes having a full-year effect in 2024, in terms of what we started in 2023. And of course, as I said, the growth leverage.

So as I indicated, I feel good about leaving our guidance for 2025 unchanged. And in terms of the shape of the trajectory from 2023 levels, as I said, we do not expect it to be linear, and more of it will come in 2025 than 2024, but we also do not expect it to be hockey stick. So hopefully that gives you a bit of colour. I think I made the comment around FX already, so hopefully that addresses your first question.

Your second question around VBP, I think I incorporated that into my response. So in terms of the factors that we believe will offset the more expanded scope, it really comes down to the factors I enumerated earlier. It is growth leverage from other parts of the portfolio, it is the cost reductions having the full-year effect. Our productivity initiatives, the unwind in terms of input cost, inflation. So those are some of the factors, and also to keep in mind that in China, not all
aspects of Sports Medicine are covered. REGENETEN we expect to launch in China, we expect to be a growth driver. Of course the AET part is not included in the VBP guidance, so we expect that to be a growth driver as well.

So hopefully those pieces all make sense, Veronika.

**Veronika Dubajova:** No, that is very clear, Deepak. And maybe just quickly if I can squeeze a quick follow-up, I think you have alluded to this in the press release. Obviously you are starting to make progress on some of the manufacturing footprint optimisation. When can we expect to hear more from you on how this is underpinning the 2025 margin target? And anything you can share high-level about how that is going at this stage?

**Deepak Nath:** Sure, you should expect more at our full-year results, Veronika, but as I shared our network optimisation efforts continue. So we have announced that we are going to be closing two of our smaller factories within our network – that represents about 20% reduction in footprint, in manufacturing. We have also reduced headcount as part of this process as well. And so we will give you an update specifically on the numbers in full year. So combination of those factors we expect will contribute towards our gross margin improvement efforts.

**Anne-Françoise Nesmes:** And then just to add to this, Veronika. I think two elements. One is the efforts of the network optimisation will be more visible in Orthopaedics. There are actions across the whole network in terms of the lean and continuous improvement, but clearly Orthopaedics will benefit the most. So as you look at the segmental analysis, you will see the margin improve. And one, the driver will of course be revenue leverage, but the other is also the action around the network and the manufacturing costs. I think the second as well, it is important to understand, it does not flow immediately through the P&L. As you know, there is a phasing impact of cost of goods, inflation, etc. And Deepak talked about the shape of the guidance. Part of that is because the savings from manufacturing take longer to flow through as you build into your inventory. And the savings only flow through as you release the inventory that will be produced at a lower cost. So that will take some time.

**Veronika Dubajova:** Great. Well, I look forward to hearing more about that. Thanks guys.

**Deepak Nath:** Sure thing.

**Lisa Bedell Clive (Bernstein):** Hi, there. First question on CORI, can you just comment on what the current commercial strategy is for CORI? I am aware some of your bigger competitors are placing robots for free. So what proportion of your CORI instalments are sold, leased, placed, etc.? And how should we think about that evolution going forward? And then second, just on utilisation of CORI increasing, can you just comment on why the total US Knee business was down this quarter, and how we should think about the timeline for that recovering? That would be helpful to hear a little bit more on that.

**Deepak Nath:** Sure thing. So with CORI, our interest is not just placements, but it is placements plus utilisation. So that is what we are looking for, which is why I reported on the utilisation number. The mix of business models in terms of cash sales, and rentals, and lease models, and so forth, they do vary across geographies and actually within geographies as well. And that does vary from quarter to quarter. I would say we are competitive and we do our best to address the needs of customers. And some customers prefer cash sales, others prefer lease models, and we are responsive to the needs of our customers.
But in the end, the strategy we are running though is not to place robots willy-nilly, but rather to place them where we expect to see utilisation, so that combination is important for us. And we are also looking at where we place them, and we are encouraged by the uptake we have gotten, not only in academic medical centres, where historically we have had a weaker presence, and we are starting to see and gain traction in that; but also in the ASCs, which as you know is a growing segment. And CORI is very well positioned within that segment as well, and we are pleased with the uptake we are seeing there.

In terms of the US Knee business, the primary factor in Q3 really was around some product supply challenges. Although LIFR overall has improved in Orthopaedics – that is product availability overall has improved in orthopaedics – our US business tends to be heavy on JOURNEY OXINIUM. Some of those SKUs continue to experience particular challenges in Q3 that impacted not only replenishment of implants, but also our ability to place complete sets that can be utilised in procedures.

As I mentioned, when we look within the quarter, September was where we saw significant recovery of that, and we continued that improvement, actually, into the first month of this quarter as well. So we are pleased with the improvement there, and we expect now in Q4 to recover in US Knees. So hopefully that addresses both of your questions.

**Lisa Bedell Clive:** Great. And just one last follow-up, just on Cementless Knees, what proportion of that 25% are done with CORI, or done with Cementless? I am just trying to understand whether there is a mixed improvement opportunity if Cementless is still not used very widely. Thanks.

**Deepak Nath:** We do not break out Cementless versus other. What we are really looking at is constructs, and in particular Cementless is not what is driving CORI. So for us it is about selling the portfolio we’ve got. We are very pleased with our portfolio's position relative to our competitors, so we are actually really looking at whole constructs, not any one particular product line.

**Lisa Bedell Clive:** Thanks.

**Jack Reynolds-Clark (RBC):** Hi, there. Thank you for taking the questions. Two for me please. The first was on pricing. You touched on it earlier, but I was wondering if you could give a bit of colour around the contribution of pricing to your growth in the quarter. That has two parts to it: first is the development of price erosion, or lack thereof, through the quarter, but then also the initiatives that you are implementing as part of the 12-Point Plan.

And then the second question was on CORI placements. Obviously, appreciating that your focus is on penetration and utilisation, which obviously seems to be trending quite nicely, but I was wondering if you could give some colour on where you are on that 300 placement target for the year. And then also how that is split between ASCs and hospitals.

**Anne-Françoise Nesmes:** I will take the pricing. Hi, Jack. In terms of the pricing, it is an important element of the 12-Point Plan, it is part of one of the initiatives as you mentioned yourself. It is also important to try to offset some of the inflationary pressure we are all seeing. And we have continued to make good progress in updating and standardising our pricing controls across the portfolio. So we have continued to see positive pricing, like we did at the end of last year. That has continued into a low single-digit positive through the third quarter. So we
are pretty pleased on the progress we are making here, and it is really great collaboration between all the teams here from commercial, the selling organisation, to finance and others.

Now, looking further out, there is more strategic works to do on pricing – as we have discussed before, when we launch new products, how we are pricing ladder, etc. – but we do not depend on pricing as a tailwind to reach our midterm guidance.

Deepak Nath: On CORI, we will update you in terms of numbers of placements at full year. We are making progress towards the goal that you mentioned, Jack, and in terms of ASC, a bit better than our overall share in ASCs. In other words, we are pleased with the kind of traction we are getting at the ASC, which is a big growth driver. So we will come back to you in terms of specific numbers of placements. We just do not want to get into every quarter updates and numbers of CORIs.

Jack Reynolds-Clark: No, understood completely. And then if I could just squeeze in another one around AETOS, I am wondering what your thoughts were, if you had any further developments around introducing that onto CORI, obviously following the launch?

Deepak Nath: So as you know, Shoulders is a growth market within Orthopaedics. Our entry into that important segment with AETOS, we are pleased with the initial results primarily – so far the activity has been around design surgeons, but we have also taken it beyond that initial group. So overall, good traction that we have gotten. As I indicated, I think on the H1 call, maybe it was a Q1 call, I forget now, but we see the potential of CORI in Shoulder. The form factor of CORI is very well suited for the shoulder application, so it is in our pipeline, and we look forward to updating you on that, at the right time. But where I will leave it is, very excited about the potential for CORI in Shoulder.

Jack Reynolds-Clark: Great, thanks a lot.

David Adlington (JP Morgan): Hey guys, thanks for the questions. Firstly, again back onto CORI. I just wondered if you could give us some colour in terms of what you are doing differently to drive that big step-up in growth, and how sustainable you thought that was.

And then secondly, just on the GLP-1 impact, I’m afraid we are going to touch on it, so maybe not so much on Ortho, but just want to get your thoughts in terms of wound care, given the importance of diabetic and venous leg ulcers for you in that business. Thank you.

Deepak Nath: Sure, David. In terms of CORI, CORI is not something we are driving in isolation. At the end of the day, what matters to us is selling the portfolio that we have. We are very excited about the differentiation that we have across Orthopaedics, but certainly within Knee. So the focus is on selling the portfolio, CORI together with JOURNEY and LEGION, so it is that combination. So, we are executing six plays that take into account our differentiation and where we think we can win. So our CORI results are to be viewed in the context of the broader commercial execution improvements that we are making on the back of the investments in innovation.

So in terms of constructs, JOURNEY II obviously is exciting. In terms of true next-gen knee construct that we have, we have some great differentiators of our own. CORI is the only robotics platform to have a revision indication. Also the knee tensioner that we released recently onto CORI will enable surgeons to do soft tissue balancing before making cuts. CORI is the only platform that does not require imaging. And now with added functionality onto CORI, the ability
to do cutting, Saw-based solutions on top of milling, all of these things come together for us to put together an attractive value proposition for our customers, is selling the whole portfolio. So that is really the differentiator for us.

In terms of GLP-1s and wound, just narrowing in on, say, diabetic foot ulcers, they are about, I think, 20% of the wound market. And people who have diabetes with diabetic foot ulcers take 10 to 15 years for these ulcers to manifest. And for this group, GLP-1s have been available for some good length of time already. And so these issues occur as a result of issues with glycaemic control, not obesity per se. So some of the data that you are seeing on GLP-1 and obesity is not directly applicable to DFUs. So putting those things together, we do not expect a significant impact to our wound business as a result of GLP-1s, on some of the new data that is coming out on GLP-1s.

David Adlington: That is great, thank you.

Deepak Nath: Good, David.

Graham Doyle (UBS): Morning guys, thank you for taking the questions. Just firstly, one on the short-term margin, then maybe I will ask a follow-up on 2025. So just from what you are saying, and obviously to change the guidance from at least 17.5% to around 17.5%, it implies something like a 20-30 basis points lowering in that target, seemingly driven by China and some issues over a short period of months. So could you contextualise that? Because annualising that would be worrying when we think about next year, so maybe just contextualise what has actually happened there, and then how much is attributable to it? And then I will just follow up with the 2025 question after, if that is okay?

Anne-Françoise Nesmes: So I will take the question on the margin, and as we have mentioned there is many moving parts. And the dynamics we have seen so far in the second half have been as we described with our H1 results, driving productivity, driving the operating leverage. And what we are seeing now is the additional headwind from China to consider. When we gave the guidance, we did include some pre-VBP impact, but there are more moving parts at this point in time. And to your question, whilst we are working to offset the impacts of China, there is only so much that can be done within one quarter of the year remaining. And that is why we adjusted to around 17.5%. But clearly, we are still seeing the seasonality and the seasonally higher margin, the unwind of one-time commercial costs, and the cost reductions coming through. And we should not forget that our Q4 is always the highest sales quarter, as Deepak mentioned before. So clearly, we are working through, and it is just one quarter that we can offset.

Deepak Nath: And in particular, we did not signal 20 or 30 basis points, we just said around 17.5%, just to be clear, Graham. And as I mentioned, the VBP is something that we had anticipated, we called out the 1.5-2% group sales. The added impact of the anti-corruption campaign, we do not necessarily think that that is going to persist for an indefinite timeframe, it is hard to tell how long that will last. So VBP, of course, is more permanent, but this impact of the anti-corruption category we do not believe will be the case. But in particular, we did not signal 20-30 basis points, just to be clear.

Graham Doyle: No, I appreciate that. Above 17.5% and then around 17.5%, they are different. So I am picking that point. So 2025, I am just thinking of the things that have changed from when you set that guidance at the start of the year, is obviously ~ VBP itself is new, and
then it sounds to me, based on the original guidance, the margin base for the end of this year is going to be lower versus where you were originally. It sounded like, when we talked – I think it was the Q1 call – that the 20% target in 2025 had fat or had excess in it. It is going to be difficult, but would you be able to share with us the degree of space you have in that number? Because obviously you are taking account of newer headwinds, but you still seem very confident on it, and it was something you said at Q1 as well, we talked about VBP.

**Deepak Nath:** Right.

**Graham Doyle:** So would you be able to – just to give us real confidence in how we think about modelling that so we know that you have got numerous levers that could have theoretically gotten you to 21% or 22%. And then we can work back that way, rather than starting at 20% as the optimum and taking the headwinds off that?

**Deepak Nath:** I believe contingency is the word you are looking for, Graham, rather than fat. All kidding aside, when you put guidance out, you try to have some amount of contingencies built in to account for things, for moving pieces. And so as I indicated in Q1, but really at H1 when the question came up, based on what we knew at that point in time around VBP – which is really the only real big factor that is changed, since we set out guidance. We believe that based on that, we could buffer through that and offset the expected headwinds from VBP. Even with the expanded scope that we see now, we expect to be able to offset that in the guidance and still achieve what we set out in the midterm. So that is the fundamental assertion that we are making.

There are other positive factors as well. So, as I mentioned, the 12-Point Plan, we continue to make progress on it, some areas we are ahead, and other areas we are just according to plan, and where we are not according to plan, but there are actually green shoots there as well. So we are actually pleased with the traction that we are getting with the 12-Point Plan. You have seen that translate into revenue growth; Q3 is further evidence for that. I do believe we will continue to drive growth, and that should translate into operating leverage.

In terms of inflation, it is anybody’s guess as to how persistent that is going to be. Anne-Françoise mentioned the fact that there is latency, so there is about a year gap between when you see inflation start to recede, from a macroeconomic perspective, and how that enters into our P&L. So that is another delta, right? We have assumed a certain level of inflation, persistent inflation, actually into 2024 in terms of how our guidance is built. And I would say so far in 2023, you can probably surmise from our comments that inflation is not worse than we have modelled, in terms of how it is impacting P&L.

So those are some of the moving pieces that hopefully gives you a bit of colour.

**Graham Doyle:** No, that is really helpful. Probably fat is not the word to use right now with GLP-1s, but thank you very much.

**Deepak Nath:** I was not thinking that but yeah, fair enough.

**Hassan Al-Wakeel (Barclays):** Hi, good morning. Thank you for taking my questions. I have a couple please. Firstly, on VBP, you mentioned the scope is wider, now impacting 1.5-2% of sales versus 1-1.5% previously. Can you explain what is incremental here? And can you also talk about the extent to which you are seeing destocking in the channel? Maybe help us by telling us what China joint repair was down by in the quarter?
And then secondly, on growth. How do you think about the current procedural landscape in the US and when this pent-up demand in the market may recede? Do you think that current market expectations for 5% organic growth and a 120 basis points of margin expansion next year are achievable? And particularly on margin, given the extra headwinds that you are talking about incrementally, today. Thank you.

**Deepak Nath:** So, in terms of VBP, just to ground us and to reiterate what Anne-Françoise said, China cost us about three points of growth in joint repair in Sports in this quarter. Then we talked about the impact on AET – that is not related to VBP, but that is related to the overall slowdown in the healthcare market, in part because of the anti-corruption campaign.

So, in terms of the expanded scope, it is still very much an ongoing thing, Hassan. We expect another communication here, I think in mid-November that will spell out the categories. So still within joint repair, but it is just particular product categories within joint repair. So it is not that AET is now in the mix where it was previously not. So it is really more product categories within joint repair that accounts for why it is bigger than we originally thought. But to ground us, it cost us about three points in Q3.

So in terms of your question around how much destocking that we see in the channel, there is a couple of facts. So, first of all, as we indicated, we do see that we have some experience with how Ortho went, to calibrate how to manage this with our distributors this time around. So what I can say is, similar type of activities as we saw when Orthopaedics went at this point in the development of VBP. And it is hard to actually unpick that from what is going on in the market. There is some indications as it pertains to Sports in particular, patients are waiting to have their procedures done post VBP, because they are out of pocket, pay would be lower.

So there is some effect around that, and of course I mentioned the overall healthcare market slowdown that impacted not just us or Orthopaedics or Sports, but just generally in healthcare. So it can be difficult to unpick how much of this is VBP, how much of it is Sports-related procedure slowdown in anticipation of VBP among patients, and of course the overall healthcare market. So those are the different pieces to that.

**Anne-Françoise Nesmes:** The other question was around margin, Hassan, was it not, the second question?

**Hassan Al-Wakeel:** It was around the current procedural landscape in the US, and then also expectations for 2024.

**Deepak Nath:** Yes, yes, sorry Hassan. So procedure wise, I think Q3 was another robust quarter, but not nearly to the same level that we could see as Q1 and Q2. So in terms of pent-up demand, for us, our growth is going to come primarily from improved commercial execution. A tailwind in the market will help, but in the end, given where we are, given what our performance in the recent past in Orthopaedics has been, what we are counting on, and what our guidance is built on, is our ability to execute better commercially within an existing market. So by far, that will be the bigger driver for us.

And in terms of the margin number you indicated, obviously we are not going to be talking about 2024 guidance yet. We will do that in February.

**Hassan Al-Wakeel:** Okay. If I can just follow up again on margins, maybe to ask in a different way. What is your current base-case on when China anti-corruption impact abates? What is the
current margin effect, if at all? And to what extent could it impact your ability to hit 2025? I ask because you are talking about further headwinds today, and at H1 results your confidence around midterm margins was abundantly clear.

**Deepak Nath:** So just to be clear, VBP as we envisioned it, even with the broader scope that we are getting indications of, would still have us leaving our midterm guidance where it is. The impact of the anti-corruption campaign, it is a bit hard to tell, Hassan. We are not counting on that being a persistent effect. In other words, VBP price reductions happen, and you are not expecting that to reset. The additional headwind for the year is the impact around capital sales and, to some extent procedures, based on the anti-corruption campaign.

So I was in China just about a week ago. The indications are that there is some improvement in procedures in September, and the expectation is that it would get better in Q4, but it is hard to tell. It really is hard to tell how that is going to play out. But for what it is worth, we do not expect that to be a persistent factor going into 2024 and beyond, and therefore the impact on midterm margins to be negligible.

**Hassan Al-Wakeel:** Perfect. Thank you.

**Sezgi Oezner (HSBC):** Hello, thanks for taking my questions, I will have two please. First of all, in terms of the CORI expansion that we are seeing, which one do you see as the bigger of a driver? The wider indication of CORI or the lower pricing associated with CORI? And how do you see the client base responding to that? Whether the peer is a free offering of CORI, is a decision maker, or whether the volume growth is more impactful at that?

And second of all, if we circle back to the potential costs associated with the programme, how confident are you that they will remain within the realm that you had announced so far, and that we will not see any one-off costs coming from the programme within the remainder of the year 2024 and 2025? Thank you.

**Deepak Nath:** Sezgi, so in terms of CORI, as I mentioned, CORI is not in isolation, it is the package. It is CORI plus best-in-class implants, with JOURNEY II, best-in-class revision, capabilities, and so on and so forth. It is not just CORI. But as it pertains to CORI itself, it is the form factor that gives it a broad appeal, not only in larger centres, academic medical centres, but also importantly in ASCs, where its form factor and its price, I think, is very attractive for that segment. As you mentioned, CORI has some great features and benefits, there are indications that are only available on CORI at this point. So, for example, the revision indication, it is the only robotic platform to offer that. We have a great package combination of CORI plus revision implants that I think is very distinctive for us. In addition, the fact that it is a milling-based solution, but now recently we have offered a cutting approach, a Saw-based solution gives great flexibility to our surgeons.

Currently CORI does not require imaging. Our pipeline includes the ability to offer image-based solutions as well, so we will talk more about that, at ‘Meet the Management’ session. And then I talked about the knee tensioner. CORI is the only platform to offer the ability to do soft tissue balancing before doing cuts, and we believe that is a great addition. So you put these pieces together, you can talk about any one thing, but really the power is in the combination and the power is in the combination of CORI plus best-in-class implant portfolio. And that is really what I think will be the winner for us.
And once we are through the 12-Point Plan, we fix those fundamental wiring of Orthopaedics, which we are well on track to doing. So the operational improvements, combined with the improvements we are making in commercial execution, together with a best-in-class portfolio, that is what I think will set us apart in terms of driving growth.

In terms of restructuring costs, Sezgi, we feel good about the number we put out, and we are tracking well to that. We, of course, are keeping a close eye to that, and we report that out every quarter to our Board, and obviously we are monitoring that very carefully. We feel good about where we are positioned relative to the envelope that we indicated.

Sezgi Oezner: Thanks very much.

Deepak Nath: Absolutely.

Great, thank you very much. As I said, I am pleased with what was another strong quarter for us. We are making great progress in our 12-Point Plan, we are starting to see the results of that come through in the financials. We have a lot to be excited about, and as I said, in addition to fixing our operations, we are very excited about what the investments and innovations that we have made are starting to deliver. And I am very excited to be able to talk about that at our ‘Meet the Management’ session on 29th November, which I hope you will all attend. So thank you very much for your questions.

[END OF TRANSCRIPT]