Smith+Nephew Q1 2023 Trading Report

Wednesday, 26th April 2023

Introduction

Deepak Nath

CEO, Smith+Nephew

Welcome

Good morning, and welcome to the Smith+Nephew First Quarter Trading Update. I am Deepak Nath, Chief Executive Officer; and joining me is Chief Financial Officer, Anne-Françoise Nesmes.

Summary

I am pleased to report this quarter's numbers. We have maintained the growth momentum from the end of 2022. The 60% of our business in Sports Medicine and Wound Management continues to be consistently strong. In Orthopaedics, we have had another better quarter with improvements in commercial execution and product availability, allowing us to take more advantage of the strong market.

Revenue growth of almost 7% is a good first step towards our full year target. There does look to have been a stronger environment for elective procedures in the first quarter, and Anne-Françoise will take you through the detail of what we have seen shortly.

However, we are not relying on outside conditions for success. Our priority is to deliver on the 12-point plan to transform Smith+Nephew and position us for sustainably higher growth.

In Orthopaedics, we have made further progress this quarter on the fundamental rewiring to improve our competitive position, although we are still less than halfway through the two years of the plan.

On innovation, our growth investments are producing a high cadence of new launches, including in robotics and sports medicine. And we are working hard on productivity, including completing the detailed planning for the cost actions we announced with our full year results.

I will cover our progress in a moment, but for now, I will hand you over to Anne-Françoise to take you through the details of the quarter.

Q1 2023 Revenue

Anne-Françoise Nesmes

CFO, Smith+Nephew

Q1 2023: Strong growth across Established Markets

Thank you, Deepak, and good morning, everyone. Our first quarter revenue was $1.4 billion, with a 6.9% underlying growth. All the franchises contributed to growth and maintained a good momentum from the end of 2022.

When we look at the revenue by region, the performance growth was driven by established markets, with our US business growing at 11.8% underlying and other established markets growing at 7%. Significant factor was that healthcare systems across the Americas, Europe and much of Asia Pacific saw stronger elective procedures volume than anticipated.

With improvements coming through from the 12-point plan, we were better able to take advantage of these conditions, which benefited our surgical businesses, particularly in the early part of the quarter. We were, therefore, able to offset the decline of 7.3% underlying in emerging markets, which reflected the expected slower quarter in China.

VBP remained a headwind with an additional effect from the renewed COVID wave that began late in 2022. This resulted in fewer surgeries and slower shipments into the channel for much of the quarter in China, with a recovery coming only late in March.

Orthopaedics

Looking at the detail by franchises. Orthopaedics grew 3.9% underlying. Knees and hips are the parts of our business where we see the effects of VBP. As we move through the next quarter, we'll begin to lap the implementation, and the headwind should fall away entirely by the second half of the year.

Excluding China, growth was 12% in knees and 10% in hips, reflecting the strong procedure volume recovery that I just mentioned. Other reconstructions growth of 19.7% was driven by accelerating the adoption of robotics. Around 20% of our US knees are now implanted with robotic assistance.

We also reached a development milestone in March with the first surgical procedure using the CORI Digital Tensioner. Deepak will talk more about the new device shortly, which is the first of a series of addition we have planned for CORI in 2023.

The 0.8% decline in Trauma & Extremities reflects our exit from China. We will fully analyse that in the second quarter of 2023 and also lap further exits in Europe during the second half. Growth would have been 1.8% without China and around 4% excluding all market exits and should therefore accelerate as the year progresses.

The US is already showing what our portfolio is capable of with high single-digit growth in the quarter. More broadly, our work to build the portfolio in Orthopaedics around best-in-class and differentiated assets is ongoing, and we believe this will be a significant growth driver for the segment. This is most visible in knees today with cementless and CORI's revision capability and will be more evident in hips and Trauma & Extremities over time.

Sports Medicine & ENT

Moving to our Sports Medicine & ENT franchise, which grew 10% in the quarter, despite some ongoing external supply chain challenges and the impact of the COVID wave in China. Joint repair grew 7.3%, with strong performance across all procedure types. Developing new market segments and the steady stream of innovation have been key components of long-term growth in sports, and that was again the case in Q1.

In biologics, REGENETEN continued to reaccelerate with strong double-digit growth in the quarter, and we added a further growth driver in knee repair, showing our new solutions for ligament reconstruction at AAOS in March.

AET grew 9.1% in the quarter. Core COBLATION and the ongoing ramp of FASTSEAL were the major contributors, along with a soft prior year comparator from supply constraints in 2022. I know there is interest in the recent data collection process in China that includes some sports

medicine products. We are in regular contact with the authorities to discuss future plans, but no decisions have been taken yet on any next steps.

And to give you a sense of what it's being looked at, the data request in China was limited in scope and covered only some joint repair categories in China, representing 1% to 1.5% of Group sales.

And finally, ENT growth of 30.8% reflects the post-COVID recovery in tonsil and adenoid procedures. We expect moderation of the growth rate during 2023 as end markets approach more normalised levels. But ENT is an attractive growth area beyond this market recovery.

Advanced Wound Management

Despite facing some ongoing supply challenges here too, Advanced Wound Management grew 7.9% underlying. As in previous quarters, Advanced Wound Care delivered solid performance across most major regions, with underlying growth of 1%, reflecting a strong prior year comparator.

Bioactives grew 15.2% underlying. Shipment timings effect on SANTYL added some growth, but the primary driver here was double-digit growth in skin substitutes. The acquisition of Osiris in 2019 has been a good example of our tuck-in M&A strategy, both adding to the growth of the franchise and delivering attractive financial returns.

A key valuation metric for M&A is ROIC exceeding WACC within a reasonable time scale, and Osiris passed that hurdle in 2022. Advanced Wound Devices growth of 12.9% reflects a similar patterns to the previous quarter, with double-digit growth for single-use product PICO and a significant contribution from traditional platform RENASYS.

2023 outlook unchanged

And finally, I will move to our full year guidance, which is unchanged. We continue to target underlying revenue growth of 5% to 6%. We expect continued above-market growth in Sports Medicine and Advanced Wound Management and improved Orthopaedics performance compared to 2022.

We will deliver that through better commercial execution and growth from new products as we continue to implement the 12-point plan. Our growth in the first quarter is an encouraging start, and the recent growth headwinds in China orthopaedics will ease as the year progresses.

However, as I mentioned before, the first quarter also benefited from higher-than-expected surgery levels in established markets, which are 85% of our business. Our guidance did already assume some market strength in the second half. So while the timing through the year has changed, the overall expectation has not. We do not assume that the end market strength at this level persists for the whole of 2023.

Our guidance for the full year trading margin is also maintained for at least 17.5%. As we have previously mentioned, we expect the trading margin to be H2-weighted, reflecting our historically normal margin seasonality, together with the accumulating benefits of productivity improvements throughout the year.

And now, I will hand you back to Deepak.

Business Review

Deepak Nath

CEO, Smith+Nephew

12-Point Plan initiatives

Thank you, Anne-Françoise. I am sure this slide is familiar to you by now, setting out the 12-point plan. This plan covers the biggest opportunities for the company around:

- Fixing Orthopaedics;
- Improving productivity throughout the value chain; and
- Further accelerating Sports Medicine and Advanced Wound Management.

The plan is central to how we will deliver our midterm targets, and we are continuing to drive these initiatives each quarter.

We updated you in previous quarters on our work to redistribute instrument sets and on our progress on product supply, with LIFR and back orders on a path of recoveries toward our eventual targets.

This is a wide-ranging plan with a lot to do. And today, we can show progress in further areas around logistics, sales force delivery, robotics and productivity.

Continued progress on delivery of plan

Last-mile logistics is another important part of rewiring our commercial delivery for both better growth and greater asset efficiency. Our project team has been working with our local distribution centres to standardise processes around fulfilment, inventory and asset management, and we are seeing some early wins.

One example is Kit Cycle Time, which is the time taken to process a set post surgery and make it available for another procedure. We have reduced that by 40% in just a few months, which means better availability of sets to customers and better asset turns by reducing downtime. We have also made progress in kit health. The team has identified and reconstituted incomplete sets that were previously not turning at all. And the number not ready for surgery is now down by more than 50% from the first quarter of 2022.

In sales force delivery, we are moving our field force to a new digital platform that supports the full range of a rep's activity from training and sales targeting to case scheduling and deal processing. We have some of these digital capabilities already, but with more than 80% of reps already on the new platform, they should be used more consistently in the future.

And importantly, we have also rolled out new sales incentive structures in the first quarter, shifting from a historical emphasis that rewarded retention to growth.

Finally, on Orthopaedics, we have continued to invest in our robotics platform and commercial approach, including the launch of the Digital Tensioner, which I will touch more on in a moment. And as Anne-Françoise mentioned, we are seeing a clear reflection point in utilisation.

Cost actions to deliver mid-term targets

In the category of improving productivity, we finalised the associated cost of our manufacturing network and go-to-market optimisation work stream. As a reminder, we announced a package of productivity measures along with our full year 2022 results. It is broad ranging, with cost levers across manufacturing, sales and marketing and G&A.

The plan is to deliver at least $200 million in annual cost savings by 2025, with the areas for savings shown on the slide. At that point, there were still some detail to be finalised on network optimisation and potential market exits.

The teams have completed this work, and we can now also say that we expect associated non-trading restructuring charges of around $275 million. Around three quarters will be cash costs and around half of the total P&L charges will be taken in 2023.

Maintaining high cadence of launches in 2023

Finally, I will go a little more into our recent innovation. Returns on our R&D investments are one of the building blocks of our growth targets, and we expect a higher cadence of launches than in the past.

Those of you who could make it to AAOS will have seen the CORI Digital Tensioner for soft tissue balancing and knee replacement. It is the only tensioner for robotic-assisted surgery that can take measurements to inform the procedure plan before the surgeon starts cutting bone. The current standard practice uses less reliable methods like manual or mechanical tools, and case series data shows a 64% reduction in variability when using the CORI Tensioner instead. This adds another point of differentiation for robotics platform at a point when all major players are marketing devices.

In Sports Medicine, our focus has been on delivering a steady stream of innovation across procedures. And our new devices for ACL reconstruction are part of that approach. ACL reconstruction is one of the established major categories in knee repair. And a new guide system for graft harvesting, together with the expanded ULTRABUTTON family, supports an increasingly surgical preference for the quadriceps and tendons.

When I step back and look at the whole Sports Medicine portfolio, we now have a recently launched and high-growth products across all of our shoulder repair, meniscus repair, ACL, biologics and the Tower. More broadly, innovation is a central element of our growth model. More than 60% of revenue growth in 2022 came from products launched in the previous five years, and we expect the proportion to remain at least at 50% in 2023.

I am excited about the pipeline still to come and will bring important launches across the franchises throughout 2023.

Summary

So in summary, we are pleased to have started 2023 with a solid first quarter of growth. We were able to take better advantage of higher elective surgery volumes, particularly early in the quarter, but we are also accumulating evidence of more sustainable progress in our 12-point improvement plan.

Sports Medicine and Advanced Wound Management are delivering the consistent performance that we are aiming for. We are continuing to work through the fix of Orthopaedics, and our

growth investments are delivering, whether it is the acquired skin substitutes and bioactives or the high cadence of new launches from our R&D investment right across our portfolio.

We remain focused on driving that transformation through the 12-point plan and look forward to updating you further as the year progresses.

And now we can take your questions.

Q&A

Jack Reynolds-Clark (RBC Capital Markets): So first one is just around guidance for the year. Obviously, you talked about the outlook for the rest of the year implying a deceleration of growth through the remaining quarters. Just wondering if you could provide some more detail around your assumptions here, why you are expecting a slowdown and any visibility you have on revenues through the rest of the year?

The next question is around the cost environment. How are you seeing that unfold so far? And how again are you expecting things to develop through the rest of the year?

And the last question was on kind of pricing. How much of the growth in the quarter so far has been from pricing, both, I guess, in terms of price and easing of deflation and also your own active initiatives to improve pricing?

Anne-Françoise Nesmes: Good morning, Jack. Anne-Françoise here, obviously. I will start with the question on pricing. And if you recall, we saw a changing trend as we exited 2022. We have been very focused on pricing through the 12-point plan, both from a short-term perspective to offset some of the inflationary headwinds, but more longer term as well from a strategic pricing perspective.

We are continuing to see a positive trend in pricing. We have moved away from the deflation we have seen, or the historical price erosion we have seen, in the past. It has continued in Q1. I think it is important to say that this is not what drives our midterm guidance, and that is not a tailwind we will be building on.

You want me to continue to talk on? So I will come back to your first question then around the outlook and the implied deceleration. So it is fair to say that the first quarter has seen improvement in elective procedure. Our assumption is that, overall, the market growth and the market momentum for the full year will not change. So there might be a phasing difference compared to our initial assumptions, but we do not see the overall momentum and market growth to be fundamentally different from our initial assumptions. And that is why we reiterate our guidance of 5% to 6% revenue growth.

I would also say, clearly, that it is one quarter. And you have heard me say it before, one quarter does not make a full year. There will always be variability.

And then the second question around cost. Clearly, there is two elements that will drive the margin. Historically, we always have a margin that is higher in the second half. So that is more weighted to the second half, as you see, the seasonality of the cost and the revenue. There is also this time as well, something to bear in mind, is the productivity improvement flowing through more into the second half.

So that is really the point we made at year-end and the point we are reiterating today around the 17.5% margin guidance, where you should expect to see a better second half. I think I have covered your three questions.

David Adlington (JP Morgan): Firstly, just on the new incentive structures for the sales team. Obviously, that shift towards rewarding growth rather than retention. Just wondered how that had been taken by the sales force and how that is changing behaviours already. And slightly connected to that, given the hotter market environment, I am just wondering how you are seeing the competition for labour and therefore, wage inflation panning out from here.

And the second one, just on the technical guidance. Obviously, your associate numbers changed quite a lot since February. I just wondered what changed so much in the last two months. And is that just Bioventus?

Deepak Nath: Great. So David, the headline answer is the sales force responded very well to the new incentive scheme. We had a chance to roll that out of the national sales meeting back in February, and the response was good. There is increasing confidence. Obviously, the confidence in our portfolio was always there, but product availability and the improvements of the sales force fields has given them confidence to be able to achieve quota. And indeed, in the first quarter, quota attainment was actually quite high, not only in terms of the overall sales force. The distribution of quota attainment was also kind of in the range of what we are targeting.

So overall, good reception to the new incentive scheme, increasing confidence from the sales force, particularly on product availability. And one quarter in, the quota attainment is where we expected to net out this point in the year.

And regarding your second question, Anne-Françoise, do you want to take that?

Anne-Françoise Nesmes: So indeed, you are right, David, it is the loss associated to Bioventus. Our technical guidance reflect the loss we took in Q1 on the CartiHeal changes within Bioventus.

David Adlington: I suppose the follow-on question is how do you see that panning out beyond this year?

Anne-Françoise Nesmes: So at this point, the financial exposure is early, please note as well that it is a non-cash cost, but we adjusted the value of Bioventus at the end at December 2022. So the exposure is very limited, and it is non-cash. The biggest adjustment was at the end of 2022.

Kyle Rose (Canaccord): I appreciate the incremental colour on the CORI business. In the US, it sounds like 20% of US knees on CORI. I wondered if you could give us a similar metric on cementless knees in the US and just how that rollout is trending?

Secondarily is plans for the ENGAGE knee. When should we see that in the US market? And then with respect to inventory improvements, glad to see that some of those headwinds are easing. Maybe you could just help us understand where are you still seeing headwinds from an inventory perspective. And when should we expect those headwinds to alleviate as we move through the year?

Deepak Nath: Sure thing. So in terms of CORI, we are pleased with the rollout. As you note, 20% of our procedures in the US now are robotic enabled.

In terms of our porous knee, we continue to see good traction and uptake, of course, in the United States, now a material part of our growth. We do not break out individual product sales. It is part of a broad portfolio of product.

What the porous knee offering has allowed us to do is get into competitive accounts in a way that we could not do prior to us having the offering. We have an initial offering with LEGION CONCELOC. Of course, there is further launches to commence around that portfolio. But we are very pleased with the uptake with LEGION CONCELOC today. We are very pleased with our ability to go into competitive situations in a way that we could not before. And it is one element now of a more comprehensive portfolio in knees and hips. So overall pleased with where we are with that.

ENGAGE is another differentiated element of our portfolio around unicompartmental knees. The early results are good. And we are going through a staged and careful market introduction for ENGAGE, but one element of, again, a broad portfolio of innovations we bring to market. So it is important to underscore that we are not depending on any one factor to drive growth, but it is really about around the portfolio.

The third question was on inventory. As we have acknowledged, we have had high levels of inventory in Orthopaedics, especially, and that really started even before COVID and is persistent right through COVID. And we have talked about steps we are taking to bring that inventory down.

What we are trying to balance is make sure that we have got inventory to fuel growth and new product launches and make sure there is product available to serve our customers.

Equally, in 2022, we called out the fact that there were understandable reasons for inventory increasing last year, particularly around strategic raw material buys in the context of supply chain disruptions, revaluation of inventory. So these were known factors in 2022.

So we are undertaking deliberate steps to bring that inventory down. And truth is, there are more aggressive ways than we are currently undertaking to bring that down. But we believe that would compromise sales growth and our ability to serve our customers. So there is a tension there, but I believe that the targets that we have around day sales of inventory, DSI, takes into account these trade-offs. So I am pleased with the operational progress we are making around that topic.

Sezgi Ozener (HSBC): I have two, please. First of all, the difference in terms of the cost actions, you detailed that you expect $275 million one-off restructuring cost, half of which this year. And this, of course, changes from the guidance earlier in February, in your guidance update, it rises from $70 million to $200 million, the restructuring cost that you advised for 2023. So it will be good to hear the changes that you see. What were the moving parts?

And my second question relates to the expansion of CORI. We have seen a higher other reconstruction growth this quarter. Part of it, I presume is attributable to CORI. What do you see in terms of the expansion plans internationally as well for CORI? I know it is a very nascent subject, but it could be probably meaningful for the midterm. I will stop there.

Deepak Nath: Sezgi, just on your first point around restructuring, the buckets that we see are around our network optimisation, our G&A and sales and marketing levers. Those buckets have not fundamentally changed. We have gone through the work now to crystallise our plans in those areas that gives us a better handle on what is actually going to take to deliver the $200-plus million in annual cost savings.

As I indicated, a big chunk of those costs, in fact, are in network optimisation, as we strive to bring our capacity in line with demand on the back of improving asset efficiency. So more than half the costs are actually related to that.

And then we also broke out what our cash and non-cash costs associated with these. We also want to flag that around half of those costs will be in 2023, with the remaining over 2024 and 2025.

And in terms of benefits, half the benefits will accrue in 2023, 2024, with the remaining half coming in 2025. So we have got a better handle on the phasing of benefits and phasing of costs and also more clarity of what cost are expected to be. So that is your first question.

The second one now is around CORI. CORI is really about a global launch. It is global today. So we have gotten traction not only in the United States, but in markets across Europe and Asia. So we have a pretty good view as to where we want to go, where the priority markets are for us. And as important as placements are, Sezgi, what we are actually more interested in is having the appropriate level of utilisation.

And as you called out, other recon showed strong double-digit growth, and that reflects increasing uptake of CORI not only in terms of placements, but also importantly, utilisation of CORI. And we cited the metric of roughly 20% of our knees currently today robotically enabled. So those are the different pieces in terms of how they come together.

Sezgi Ozener: If I may just quickly follow up on the cost actions. Does this network optimisation imply additional exits as compared to what you previously mentioned? And does this have growth implications over the mid and long run?

Anne-Françoise Nesmes: No, really. So here, it is effectively incremental optimisation of the network, particularly looking at the overcapacity that we have in Orthopaedics. As we adjust our processes, clearly, we are becoming more efficient, and that is what we are reflecting. It is difficult to talk a little bit more. We are working through. The details are not finalised. We need to engage with the team, etc., but that is really reflecting the work we are doing around the Orthopaedics.

Deepak Nath: But the short answer to your question around whether it is going to impact growth or not, key consideration in all of this is not to compromise growth in any way. We feel confident in our ability to take out capacity, while certainly release the market and importantly, fuel its growth.

Chris Gretler (Credit Suisse): The first question I have is with respect to your emerging market business. I noticed that there was a substantial step down also in absolute dollar sales. Could you maybe discuss that business briefly? And if you have maybe also a number of that business growing, excluding China, that will be great.

Deepak Nath: Sure, Chris. Good morning. So the overwhelming effect of emerging markets, of course, in terms of the reported numbers is China, and we will get you the ex-China number momentarily.

But in terms of our ability to compete in those markets, we are actually pleased with the progress we are making in important markets, whether in India or other places. The traction we have gotten with CORI and other parts of our portfolio, we are actually pleased with.

So what is also important is to make sure we are able to compete effectively and not just drive growth, but actually profitable growth in these markets. And so there, we are looking at where we are able to effectively compete. So for example, we talked about Trauma and an ability to drive profitable growth. In Trauma, we made the decision strategically to exit.

So that is an important consideration in terms of how we effectively compete in these markets. So we have got a broad portfolio. We are able to tailor our participation in these emerging markets to effectively capitalise on the opportunity there.

And so in terms of the other factor with emerging markets, just to come back to the point that I started with, there is about a 4-point growth headwind just from FX in emerging markets when you take the effect of China out of this, Chris.

Chris Gretler: Okay. And then maybe just the other question was on your comment about the beginning of the year and the elective surgery procedure momentum. Is that solely a US phenomenon on the COVID comp base? Or did you observe this pattern also in other developed countries?

Deepak Nath: It is not just the US. We have seen that recovery actually in other markets as well in developed markets. We have called out the effect in China as well, particularly in the last month of the quarter. Post-COVID, we saw a recovery in procedures as well. There are a couple of different drivers for it, whether it is amelioration of staff shortages or actually pent-up demand. It is hard to tease out the specific factors there. But it is more than just the US market.

And we have been better able to capitalise on that market recovery on the back of operational improvements that we have making as part of the 12-point plan.

Hassan Al-Wakeel (Barclays): I have three, please. So firstly, can you talk about the progress you are making on cementless? Do you think you are closing the gap in terms of share losses versus peers overall here? We have only seen one of your peers report thus far, and the gap is still significant. And I wonder if you see any fundamental reason behind this. Or do you think it is more VBP driven, where you would be overexposed to VBP?

And then secondly, could you talk about the request for information on China VBP for Sports Medicine? How likely a risk do you see this to be? I know it is early stages. And how much of the Sports Medicine business in China do you think potentially could be impacted? And what is your base case in terms of when we will get some clarity?

And then thirdly, I would love to get an update in terms of pipeline of potential higher growth assets for M&A and how you are thinking about capital allocation.

Deepak Nath: So first off, around cementless knee. We do not break that out separately. But as I indicated in response to a previous question, I am pleased with not only the sales of

LEGION CONCELOC, but more importantly, our ability now to go after competitive accounts now that we have a cementless offering. And it is important to note that there is more cementless products to come in the future.

Equally as important is the portfolio that we have. The role of cementless in our portfolio is perhaps different from that of our other competitors. So as I have always said, it is the portfolio, it is the various elements now that have come together for us to have a fuller offering than we have had in our past and closing important gaps that we previously had in our portfolio. So it is about the portfolio that I am looking at. And in fact, the gap in US knees as we see it has actually narrowed.

Hassan, it is also important to note that we are less than halfway through our improvement journey in terms of the 12-point plan, particularly on fixing Orthopaedics. We had not, at this point in our improvement journey, targeted getting to market or above market. We have got some ways to go in terms of rewiring our business, continuing to address the fundamentals in order to be able to better capitalise on the opportunity before us.

As I have indicated, both at full year 2022 results and also today, I am pleased with the progress we are making. I am pleased with us achieving the interim targets that we have set out against the 12-point plan, but we have some ways to go before we are going to be at or above market in terms of Orthopaedics.

The second question regarding China VBP, we are still early in the engagement. As you know, a request for information covering a range of categories has gone out. We remain in active discussions with the authorities around our business, around the various categories there. Based on the scope of the data request, just to reiterate what Anne-Françoise as mentioned, this covers roughly 1% to 1.5% of our Group sales that it covers.

We break out China in the first half results and full year results in terms of overall sales. So as far as your question around timing, we are not necessarily planning for this to be a 2023 impact and likely into future years, but I do not want to get too far ahead of where the government actually is at the moment.

So what you should know is we have bracketed roughly what the impact is likely to be on our business. It is still early going to say what the level of impact is going to be. There has been no decisions taken by the government. And once we have that, we will obviously come back and characterise that for you.

Anne-Françoise Nesmes: And Hassan, if I may, just to be clear, as we mentioned in the presentation, this is a subset. The data request only concerns a subset of joint repair in China. So it is very narrowed. And as Deepak said, therefore the data covered 1% to 1.5% of Group revenue.

Deepak Nath: Right. And then finally, your third question around M&A. As you can imagine, we have a robust programme looking at the market and looking at opportunities for value creation in that. And obviously, I am not going to get into specific targets here on this call.

Seb Jantet (Liberum): Two, if I may. So first of all, just going back to the strength in Q1 in electives. I know in the comments that you said that it was particularly strong in the quarter. So I guess, what I am wondering is, have you seen the sales growth during the quarter

moderate? And is that what is driving your cautious guidance for the full year? Or are you expecting things to get worse from here?

Second question is around Advanced Wound Care. So just looking at the growth there. I understand there were some tough comps, but can you give any more colour on why the growth was quite so slow in this quarter?

Deepak Nath: So Seb, so as far as our outlook for the year, we had in our guidance assumed that there would be market recovery in 2023. And what we are flagging is although we saw some of that in Q1, perhaps earlier than we had anticipated, we do not expect this kind of high level differences throughout the year. So what we are reflecting is that this market recovery we have assumed already in the guidance and we do not see reason to get much more bullish than we had already incorporated into the guidance. So that is what you are seeing.

And do you want to take the wound point, Anne-Françoise?

Anne-Françoise Nesmes: On the wound point, Seb, on the Advanced Wound Care, the 1% the performance in that segment has been strong across all regions and products. And really, it is a factor of the very strong prior comparator that you see here coming.

Graham Doyle (UBS): Just two for me, please. So it has obviously been pushed a few times around the guidance. Obviously, a strong Q1. I suppose we have seen this with peers as well. Just is there any reason to think that there is a pull forward in demand, and that is why you have this super strong Q1? Or is it just, again, general caution as to why there is no change here?

And then just a follow-up on VBP, just a slightly different one. When does the actual ortho lapping events happen within Q2, just to get a sense of that?

And then would you be able to give us a sense as to how Sports Medicine within China itself has been growing, just to understand that as well?

Anne-Françoise Nesmes: I will take the ortho VBP. We will lap through Q2. And I cannot give a precise but if you recall, provinces implemented at different times. So by the end of Q2, we will have fully lapped it, but it will be throughout the quarter that we will still see the impact depending on the various rollout and the provinces.

In terms of the guidance for sports. On sports, again, I want to reiterate, no decision has been taken, and we are more overweight in sports in China than we were in ortho. But as we said, we have narrowed the range of impact. When you look at the data that has been requested, it represents 1% to 1.5% of Group sales. And of course, what will ever happen, but no decision has been made. We can mitigate some of that.

In terms of the guidance, I reiterate, it has been a strong Q1. We saw elective procedures coming back, particularly in the early part of the year. We saw that particularly in the established markets, but it is too early to tell. The overall market growth in our view for the full year does not change, and that is the basis for our guidance remaining where it is. It is only one quarter. I will remind again people on the phone, we have three quarters to go, and there's no reason to believe the market growth will be higher than what we assumed for the full year.

Graham Doyle: Maybe just a quick follow-up then because obviously, you keep pointing towards obviously three more quarters to go and a little bit of caution. It is early days in April, but is there anything you have seen that has given you a sense of that, that we should be thinking about the Q2 is going to be slightly different? Or is it, again, a little bit too early tell?

Anne-Françoise Nesmes: We are taking a full view on the full year. So I am not going to comment on Q2 today. That is not the purpose of the call. My position is really on the full year view of our market growth.

Jack Reynolds-Clark: Just a follow-up on CORI. I was wondering if you could give an update on your progress on those 300 placement target that you have throughout 2023. And then just bearing in mind what Deepak said about the utilisation being the most important point. Just could you just give some colour around what levers sales teams have to drive that utilisation in placed accounts?

Deepak Nath: Yeah. So Jack, so have not committed to providing you quarterly placement numbers. So we will come back later in the year, update you on our progress towards the 300 number. Yes, I am pleased with the uptake that we are seeing in the market, the reception in the market, the funnel that we have, building the quality of the funnel, not only the United States, but also around the world, I am very pleased with.

So overall, good progress at this point in the year. It is a back after the year weighted thing, as many of our improvement programmes are. So we expect that a lot of the placements are going to come in the Q3, Q4 time frame. But the funnel is developing very nicely on that point.

Regarding utilisation, just wanted to cover that it is important. The strategy we are following with CORI is not to place CORI everywhere, but rather to be strategic about where we take it and to place it where we have fully trained surgeons or this high embrace for the product and where we expect to see high utilisation. So that is what I wanted to cover, which is it is not just placements for the sake of placements, but really placements where there is a high level of interest and a high level of adoption is what we are targeting with CORI. And the numbers, around 20% of utilisation, reflects that strategy.

So we are pleased with where we have placed CORI so far and the kind of use that it is getting where we have placed it. So that is good.

What we are also pleased with is the kind of enthusiasm we see from customers for those who have had exposure to CORI, the kind of differentiation in functionality that we offer. We talked about the digital tensioner. We have done the first cases with this. Already, the reception has been very good around that.

Prior to that, I have also indicated that the only robotic platform to have a revision indication, that has been really well received by the market.

And when I look at the pipeline that is coming with the planned fruition in 2023 and in the early part of 2024, a very, very robust programme there. So very exciting things already that have come on to CORI, high level differentiation and actually even more exciting things to come as I look at the rest of the year and 2024.

Veronika Dubajova (Citi): Two questions for me, please. The first one is just, Deepak and Anne-Françoise, would love to get your thoughts on why you think the market has started off

so well. And I guess, do you think this is pent-up demand? Do you think this is staffing? And maybe just remind us, as you look at the 2022 baseline, in particular in the US I am thinking, which, in your mind, last year were the worst quarters, just so we can kind of think about some of the strength that you are seeing and what is driving it and how it might translate into the remainder of the year.

And then my second question, to kind of push you a little bit, Anne-Françoise, a little bit on the margin commentary. I mean, if indeed your assumption here is correct, which this is a pull forward of strength that you had expected in the second half of the year, should we be starting to have a different view on that margin phasing H1 to H2? Just trying to reconcile those two comments given where the Q1 organic came out. So if you can comment to that, that would be great.

Deepak Nath: Sure. Hi Veronika. In terms of the factors driving the market recovery, I think it is pull forward relative to the assumptions that we had made. And from what we can tell, there is some level of pent-up demand. Although from the visibility that we have, it is hard to tell whether the procedure is really a reason for due to pent-up demand or just normal course. That is kind of hard to parse that. But there is absolutely a factor in that.

The second piece of this is staff shortages. I think you have seen some of the commentary from our customers around improvement in staff shortages, reliant on contract labour versus salaried employees and other things that are causing an improvement in surgical capacity that is translating into perhaps a more seamless way to do elective procedures, such as knee and hip replacement. So I think what we are seeing is perhaps earlier improvement on that front than we had anticipated.

And in terms of impact to margins, there is historical seasonality in our business based on when procedures get done and also spending patterns in accounts. And what we are seeing is kind of things going back to normal levels in terms of promotional activities occur and the pace of sales activity. So in that sense, we are looking for 2023 to have that normal seasonality.

In terms of the drop-through of this growth into margins, fundamentally, we expect the same pattern of a stronger second half than the first half. But also, I want to bring back a point that Anne-Françoise has mentioned in terms of the accumulating benefits of productivity as part of the 12-point plan.

As I mentioned, we are less than halfway through our two-year plan around operational improvements around 12-point plan. And those benefits will accrue in the second half of the year. So I want to caution us in saying that we are likely to see that ahead of where we have targeted. We have a pretty good view as to what we targeted in terms of the operational improvements. We are right on track to achieving those interim targets and we expect, that in the second half, a lot of those improvements will come to fruition that will enable us to drop the growth and impact the growth to the bottom line.

So I would not want to get too far ahead of where we actually are in terms of the operational improvements, Veronika.

Veronika Dubajova: Okay. Understood. And I think David had asked this question, and apologies if I missed the answer. But just the cost development year-to-date. I am asking in

particular about some of the inflationary impacts, both on raw materials, freight and wages. How do those track against the expectations you had at the outset when you gave guidance?

Deepak Nath: Yes. Sorry, Jack, apologies, I did not get to that question, but thank you, Veronika, for reminding us. So relative to our expectations, we are right on target relative to both the assumption of inflation, the level of inflation and how we thought that was going to play out. So three months into the year, I would say we are right on track relative to our assumptions.

Robert Davies (Morgan Stanley): I had a few. One was on just your comments around if potential VBP impacts came through in the Sports Med division. You highlighted, I think, some options to have some additional cost takeout or some offsets against that. I was just wondering if you could flesh out a few more details of what you were thinking along those lines.

The second one was just around the balancing the supply chain against product availability, against last-mile logistics. Can you just give us a bit more colour in terms of where you are in that journey and, I guess, the kind of data points that we can get along the way? Because that is a pretty common question we get from investors is just how do we sort of see progress as you go along on that journey and just how you are balancing the sort of last mile logistics against product availability.

And then the last one was just really on market share positions. This is another one that has come up every now and again. Just how do you see your market share developing across your key franchises? And are there areas you are willing to give up or step away if they are not high enough growth areas? I would just be curious to hear your thoughts on that.

Anne-Françoise Nesmes: Hi Robert, I will take the sports VBP. And I reiterate, discussions have started with the government. It is simply a data request at this point. So we try to frame to give you a feel for what the data request represent. And as we said, it is about 1% to 1.5% of our revenue. And therefore, it is too early to talk about impact.

You can refer back to the Orthopaedic VBP, where we were able to take action. But again, we do not know if it will be similar to the Orthopaedic VBP. It could take a different shape. So it is far too early to jump the bridge and draw conclusion in terms of what needs to be done. And as of today, we framed for you the revenue that is under consideration.

Deepak Nath: Just to build on that point, even if the levels get to orthopaedics levels of VBP, we do not see this as a reason to change our midterm guidance. The range of impact that we see are within the range of risks and opportunities that we consider in building our guidance. So we do not see a reason to change our guidance as a result of the VBP impact. It is important to underscore on this call, even if the Sports VBP price levels get to Orthopaedics levels of price reductions.

Second, on your point around product availability, so let me parse this with Orthopaedics versus the rest of it. In Orthopaedics, our product availability challenges have only partially to do with broader supply chain challenges. So as you have suggested and implied in your questions, there is a lot around last-mile logistics that we have not gotten right that has resulted in low product availability, even as we are having high levels of inventory.

And on that, we carved out improvements in LIFR at the full year 2022 call. One quarter in, we have only improved upon that position in LIFR. We did not necessarily cite the number for you. But in fact, at the end of Q1, we are in even better position around LIFR than we were at the end of Q4.

So continued improvements in our processes that is leading to better availability for sets.We have got a better cadence around replenishment. So we have called out some highlights for you in our commentary around that. So we have got more work to do there yet to get to where the industry is around LIFR. It will take another three quarters or so to get to, I would say, industry levels of product availability in Orthopaedics.

But I am actually very pleased with the improvements we are making operationally to get there. Now ultimately, what we are looking to get to is really better asset efficiency, right? So bring inventory levels down at the same time that we are improving LIFR or product availability. And so we are well along that journey there.

The backdrop, though, is around broader supply chain interruptions. That is really impacted our Sports business and Wound. We are able to power through that and post impressive growth numbers in Sports and Wound, despite those supply chain challenges. But those continue to be day-to-day. There is some improvements in some areas and not enough in others. So it is very much a hand-to-mouth kind of thing.

The categories have not changed, the semiconductors, it is resins, it is polymers, various mechanical components. The specifics vary month to month, but we are very much not out of the woods there in terms of getting into a steady state. We had a little bit of that impact also in Orthopaedics, particularly related to polymer in the first couple of months of the quarter, but we were able to work through that. So just wanted to call that out as a point that is distinct from product availability.

So in terms of market share position, as I mentioned, in Orthopaedics, on the back of the rewiring, the improvements in operations, improvements in commercial, kind of operations improvements, or the new incentive scheme we have rolled out, we do expect that to translate into at or above market growth over time. We are just not at that point in time yet. We laid the groundwork. We have made some important steps. The building blocks are in place, and we have got to let that kind of play through before it translates into market share gains in CORI category.

But in Sports and Wound, we continue to set the pace. We are pleased with the level of progress there even relative to market. We have been in a good place, and we have consistently delivered over the course of time. And we expect to do that into the future.

In terms of looking at are we willing to step away from places? I think the most salient example has come up a couple of times on this call today is Trauma in China. It is an area where we could have gone for growth at the expense of margin, and we decided that we would be cautious there and go for a more disciplined profitable growth. There are other markets. We have called out China, but there are also smaller markets where, in particular product lines, particular businesses we have chosen to step away rather than just go for [inaudible 1:03:22], right?

So we are prepared to do that. We have done that. Trauma is one of those places, but we are looking to do that in other places as well. So at the end of the day, we are focused on growth, but actually more important than just growth alone is profitable growth.

Great. Thank you for all of your interest and the questions. We look forward to coming back to you with our half year results in three months' time.

[END OF TRANSCRIPT]