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Smith & Nephew Q&A

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David Abington: Good morning, everybody. This is the break-out session for Smith & Nephew with Namal and Graham, CEO and CFO. If you don't know me, I'm David Abington with J.P. Morgan.

Namal, you might kick us off here if they have any questions. In terms of, you've been in the role now for six, seven months. Just wondered, in that time period what surprised you both on the upside and the downsides of coming in?

Namal Nawana: Thanks, David. We're going to stay seated here in order to speak into these mics for the people that are joining by webcast. Just get the sound right.

First of all, as I said during the presentation, my outside-in view of Smith & Nephew was that it was an outstanding portfolio. Yet, the growth rates were probably slower than anticipated.

Again, on the upside now, looking at not only our portfolio but what we have in R&D, I feel very optimistic that the portfolio responds to what the customers need.

Equally, on the upside, I would say that the robotic platform in NAVIO, which is a starting platform. It's early days still for NAVIO. I feel it's a very scalable platform and one which we can build off going forward. I see that as a major opportunity for us going forward.

In terms of the things that are a little more work than I anticipated, I would say that we've had to make a big shift in how we're running the company. The portfolio's great. Why aren't we getting the growth that's at least at market growth? That means, to me, that we needed to make a decision around how we go to market.

Becoming more customer-centric for Smith & Nephew is a key. I said our new executive structure, divide and conquer. We've gone from having two commercial presidents to having five. That's about being closer to each of our customers. Whether that's regionally or whether that's by technology area. The amount of change that follows from a move from that regional approach to a franchise-oriented approach.

Then, delayering the company, which I've talked about in our previous update from the third quarter. That's also a lot of work. The good news is that we've done the work. We have our leaders in place now. We're executing against our new strategic imperatives.

We're happy to open up to questions from the room here. Please go ahead. Come up to the mic, if you wouldn't mind, if it's possible. I'll try and repeat the question for those online.

Audience Member: You talked a bit about the marketing presentation and the opportunity to take out additional costs above and beyond the program you laid out. Maybe talk about net savings and how [inaudible] opportunity.

Namal: The first thing I wanted to highlight is that we have a new executive team in place. With our new executive team in place, we got fresh eyes. The established plan I validated actually, in the first update I gave I wanted to make sure that I checked the existing program, Apex.

Once we had done the checks, I was very satisfied that these were all plans that could be executed on. The $160 million by 2022, that's the first thing to understand. The first year of execution has been good. It's been right on the plan, maybe a little ahead of the plan.

[high-pitched hissing]

Namal: I keep checking that sound. It's hissing a little.

Then, going forward we haven't put out any further numbers. We will give our next set of guidance at our February 7th update on the full year. At that point, we can give some longer-term ideas.

[pause]

David: Maybe I can just follow up that [inaudible]. Historically, Smith & Nephew's had a number of cost-saving programs in place. Actually, margins have been fairly flat. Is there something different this time that means we'll be able to see more of that dropping through and what [inaudible]?

Namal: The first part is over half of my leadership team is new-enrolled since I joined the company. We've got a new team. A new team is there to get new results. The first couple of quarters we've seen commercial execution against our sales number. I'm very confident that the leaders that I brought in have done this before.

Particularly, in operations, Mark Gladwell and I worked together for several years. We took out a lot of cost in our last work together. Equally, Graham has got a great plan in place on his side of things. I feel very confident that with this team and this new operating model and running the company as an enterprise, we're going to see those kinds of results over time.

I would always say that, in medical devices, our company is valued principally by its long-term and sustainable growth rate. We are very focused on improving the organic growth of our company. The cost measures that we need to take will not impact our ability to grow faster, which is the priority.

Many people ask me about margins. I'm very confident about improving margins over time. Number one thing is, is this all going to grow?

Audience Member: You have some early wins within the third quarter, particularly in hips. Maybe you could touch on how you were able to turn that franchise around so quickly, so fast.

Namal: First of all, I think we've got an unbelievable portfolio on hips. When you actually analyze the technology, these are wonderful technologies. The oxinium bearing construct is the best by survivorship in just about all of the major registries. We should go with confidence.

The POLAR3 construct that I've talked about before, the best survivorship at seven, eight years in the UK national registry. We should have confidence in the quality of our products.

How are we positioning our products? How are we approaching the customers and engaging them so that they understand that value and they can bring that value to their patients?

First thing is focus. I'll be honest. I went around, and I did business reviews in my first month, basically, everywhere in the world. It's an extensive portfolio. Unless people are really passionate about every bit, it's very hard to get the results. That's why I focus, personally, so much on lead products.

Make sure that when people understand the value of a blockbuster product like that, the POLAR3 construct that everybody's behind it. Talking about it and engaging the team, that's big. Then the revision, the REDAPT system is a really complete system. It has some novel features to it.

We're seeing a shift in how revision surgery in hip is being approached. Much simpler constructs are now getting the job done. Some of our modularity allows us to take on really complex hip revision surgery very effectively. Equally, Smith & Nephew has deployed 3D printed technology, allowing bone-in growth as we need with that metaphyseal part of the hip.

All I'd say is that those two things, focus on lead products and revision, has helped us in the short term here getting instrument sets out. That's the mechanics of orthopedics and actually helping our customers do the surgery, they're still in process. We're just at the beginning of our launch plan for revision surgery and REDAPT.

Down the line, we're going to focus much more on approaches to the hip and less invasive approaches, iliotibial-band-sparing approaches, then, equally, robotic surgery. Right now, NAVIO is focused on the knee. As I said during our presentation, we'll see our robotic systems better able to bring value in other forms of surgery including hip surgery.

Audience Member: The timeframes on that one, NAVIO being the [inaudible].

Namal: We're not putting out timeframes at the moment. We'd rather bring that to market and let people try it and use it. You will get an update on NAVIO during the course of the early part of 2019. Some of the things we're doing are certainly expected at the major conferences.

Our customers will get a taste of what else we're building NAVIO to do. I did say, in my last update, that we have increased our resource allocation to NAVIO. We have added programs to enhance the capabilities of our surgical robot.

[pause]

David: In terms of the portfolio, it's a reasonably broad portfolio. You've, historically, talked about expanding it further both through bolt-ons. Then, you've talked about adjacencies. You ought to talk about the particular areas.

Bolt-ons, we don't expect you to answer anything here and inflate the prices. Generally, what sort of assets you're looking for and adjacencies in particular, how should we think about that?

Namal: The first point is to understand what your business model is. To Smith & Nephew, we have a great portfolio. That is a good start. To access growth, our goal is to make sure that we're accessing market segments, any markets that are growing faster than our current aggregate growth rate of four percent. We've got a couple of ways of doing that.

One is through our internal R&D. I mentioned one example, getting into that dual mobility cup with internal R&D. That's a fast-growing segment. Once we have that product launched in the US, we're confident that we can further accelerate our hip portfolio. That being said, we're fighting with one arm behind our backs without deploying our balance sheet.

If we also deploy our balance sheet to bring in new technologies, we have these vast global sales forces. We want them to have the newest technology. Where appropriate. By the way, Ceterix is a great example. We've been looking that asset over a course of several months.

We're the leader in meniscal repair already. We have a product which enables more types of meniscal tears to be repaired rather than resecting the meniscus. Our customers have this little catch code which says, "Save the meniscus." It really is important. That is better for patients.

Now, with this device, we think we can get more of that done. It's a good example of a little adjacency.

To wind back, the process has been to engage our executive team in fully understanding the possibilities, to engage our board in fully understanding the possibilities. Then, we'll make good decisions based on valuations as well as strategic fit as time goes by.

It's not one shot on goal. We're looking a lot of things. Then, we'll selectively pick the things that make most sense to us at that point in time. There's a 400-billion-dollar tech market out there. We're playing in a 400-billion-dollar marketplace. That's why it's important to take a step back first. That's what I want to communicate to all of you is that we've taken that step back.

We've done the groundwork. That piece is established. Now we're operating, checking against that as we go. With franchise presidents in place, they're really focused about accelerating their areas of business, then, at the executive level, with Phil Cowdy, our head of business development, Graham, myself. We're also looking at adjacent areas to operate as well.

Audience Member: Historically, in M&A you put towards the value, you haven't done as much as maybe the company could have done. You also, separately, mentioned a lack of professional courage amongst the employees. Going forward, should we expect you to be more willing to pay up for assets? On the outside, it's all seemed that you've not been willing to pay the price that some of the competitors have.

Namal: There's lots of good assets and good valuations. Then, there's a lot that are not at good valuations. Where the valuations aren't right, we'll be patient. There are so many different circumstances right now. There's lots of opportunity for us in the near term.

Over time, valuations come in and out. That's why I go back to you have to know the overall plan. Then, be able to choose when you execute on one or other element of it.

In terms of history, it's about business model. We want to accelerate our growth with our current portfolio. That's our goal. That's why we have 16 and a half thousand employees. That's why we have franchise presidents now, five commercial leaders instead of two.

Divide and conquer, make sure that we get that commercial excellence and execution, but then keep enhancing the portfolio, internal R&D as well as M&A. It's about business model. Med-tech's different to pharma. You've got much shorter cycle times of innovation. You've got a hundred products getting through the 510(k) process.

We've got a government shut-down right now. [laughs] Ordinarily, you've got a lot of things coming through every year. If it's not your own, you should be thinking of de-risked innovation like that and bringing it into your portfolio when it makes sense.

I think that we're in a great place. The team's engaged around looking for the right things. By the way, our R&D folks are fired up too. We've got a lot of good things that we've refocused and want to accelerate certain other things that will make a big difference to us.

Audience Member: I just want to [inaudible] mention [inaudible]. Do you see there are opportunities for bioactive [inaudible]?

Namal: The question was, how does advanced wound care fit into the M&A strategy and do you see opportunities in fields like bioactives? The first part is, we're the second largest wound management company by revenue. We're the most complete wound management company in our portfolio and types of assets. The company made a strategic decision several years ago to get into bioactives.

It got into bioactives with the idea that it would have a portfolio of bioactive products. We're reasonably, pretty much a one-hit wonder at the moment in bioactives. We've been fairly exposed to the procedural volumes that we're seeing, and customers want here in the US. Just like any other part of our portfolio, we are looking at the right M&A for our advanced wound management business.

There are some really fast-growing segments in wound management. We should be, like anything else, looking at that. We are. First of all is, again, in the wound area, Smith & Nephew, our Q3 result was one percent growth in wound.

Our Q3 result for sports and ortho was four percent growth. If we look at what's holding us back from getting to our aggregate market growth rate, really it's a couple of things. One is the wound bioactives and two is maybe Europe. We're really focused on fixing those things. There's a couple of ways of doing it.

Audience Member: One more question.

Namal: Please.

Audience Member: Focusing on bioactive, it's close quarter between med-tech and pharmaceutical. Is that a challenge for the organization to be closer to pharmaceutical regulatories?

Namal: First of all, it's been in the portfolio for a while. The company now understands it. We're in the therapy world. That's what it is from a regulation standpoint. Once you have regulatory specialists, most of our regulatory leaders, including Melissa Guerdan, our head of QA/RA, have experience in both pharma and med-tech. That's not really a concern for us.

In terms of the channel, this is the key thing is that this is a different kind of channel. How do you get your products to the customers? It's very sophisticated. There's a lot of different people involved. How do you leverage that? What's the best way of winning in that field?

My new president for the franchise starts pretty much today. [laughs] I'm going to go and introduce him to the team in Fort Worth middle of the week. I'm sure that's something that Simon will get his teeth into over the course of the next little while.

[pause]

David: Maybe just as a follow-up, there've been a couple of markets, particularly in the UK which have been a lot softer. You've taken a slightly different response this time around to the previous markets [inaudible] see. Maybe you could talk to what's driving that softness and your reaction to it and how it might play out from here.

Namal: Fair to say that when you look at analyzer performance in wound management our performance in the UK and Europe have been poor. Some of that's, frankly, self-inflicted. We have changed our leadership. We have changed our approach. Certainly, for the markets that are tender-driven markets in Europe, we're going to really lean on our portfolio more.

We've seen some early signs that when we lean on our portfolio and some of our lead assets, engage our customers with those lead assets during the tendering process, we're going to do better. So much of this gets down to leadership and human beings that are specialists in the area that are accountable to getting the results that we believe we should have.

The dynamics in Europe are slightly different to the dynamics in America. We do see some low-cost players in the UK and in Europe. They're pretty focused in small segments of the market. Previously, we haven't addressed that.

Our team is ready to address, how do we compete in segments where we have massive volume, we have great factories? Volume helps us absorb our fixed costs. Selectively, there is opportunity where we have margin for some of those segments.

[pause]

Audience Member: One of the great opportunities in wound is with PICO, a new product there also launched. Maybe talk to the opportunities there and how sustainable that growth is. It's been one of the big upsides of [inaudible].

Namal: When I was looking from the outside into the company, most people know that I had a long history in surgery, basically, most forms of surgery, wound management a little less. One of the products I got most excited about, before joining the company, was PICO.

The reason is that very seldomly do you have both the technology, which is a leading technology, but also the evidence to show that that technology concomitantly improves the clinical outcomes as well as reduces the overall cost to healthcare systems. That is what PICO can do.

We feel that the nice med-tech innovation piece is very, very helpful to us. It's an endorsement that shows that for all types of surgical site infections, PICO should be used. You have less infection and you lower the overall cost to the payers. This is something that's good for every stakeholder.

What are the necessary elements that need to be in place for PICO to have a broader impact? If we were to go to every single doctor in a hospital and ask them to use PICO, it's going to take a while. We're seeing multiple ways that we need to engage our customers at the provider level, at the system level, in order to get a bigger impact with PICO.

The other thing is that, very candidly, Smith & Nephew a couple of years ago, had a real issue with our negative pressure overall hospital-based systems. Here in the US, we don't have the amount of presence that we need to have that halo and to have customers that we engage with that already are using our hospital-based products to pull through our PICO.

We want to also change that. In part, PICO's success also meant that we have to get back on market with our hospital-based negative pressure, which we've just started to do now.

[pause]

David: One other franchise we really haven't covered is the trauma franchise, which is, historically, a fairly volatile one. Any thoughts in terms of if that volatility is beginning to ebb away? Should we continue to expect that franchise to be volatile?

Namal: First of all, in my opinion, there's absolutely no reason for volatility in a trauma franchise, particularly at our levels of share. I've known Smith & Nephew's trauma portfolio, pretty much, all my working life, having started life in a hospital. The intermodality nailing portfolio at Smith & Nephew is still the best. We just need to be accountable to delivering the results of that.

What hasn't been as good for Smith & Nephew has been its plating system. The introduction of our EVOS platform, we really have some really great plating systems. We haven't really launched that globally yet. We've launched that in the US partially. We saw growth of about three percent in the third quarter of last year.

There's some growth back into our trauma business. I will say that I see a major opportunity for us in trauma. In titanium products, we're the best [inaudible] now, by far. We've got to deal with our spatial frame, being the leading product for a long time but now a little exposed. We've got to launch products better.

EVOS is a big opportunity for us. [inaudible] but I really like the trauma space. I worked in it myself 20 years ago. [laughs] It's like going back in time. I say it's a great portfolio, once again, in consistent way of engaging customers and model for winning.

David: We'll wrap it up there. Thanks very much, Namal.

Namal: Thanks for your interest, everyone. Take care.
