Smith+Nephew
Meet the Management 2021

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Opening Remarks

Andrew Swift

Investor Relations, Smith+Nephew

Welcome

I can see we have a good number of people connected now, so we can make a start. I am Andrew Swift, Smith+Nephew Investor Relations. Before we get into the presentations, I will read out the Safe Harbour statement.

Safe Harbour Statement

Certain statements in this presentation are forward-looking statements. These statements are based on management's current expectations and are subject to uncertainty and changes in circumstances. Actual results may different materially from those included in these statements due to a variety of factors. More information about these factors is contained in the company's filings with the Securities and Exchange Commission.

I am sure you have seen the press release that came out half an hour ago. I would also highlight there are supporting materials for today's event on the platform you are on now. You will find the slide decks for this first session and for the breakouts in the Resources section of the portfolio.

And now to start off the first session of the day, I will hand over to Roland Diggelmann, Chief Executive Officer of Smith+Nephew. Roland?

Introduction

Roland Diggelmann

Chief Executive Officer, Smith+Nephew

Agenda

Thank you very much, Andrew. Good afternoon, good morning to those of you calling in from the US. Welcome to the Smith+Nephew Meet the Management 2021. I am actually really excited for the opportunity to present to you today, even if we have to do this remotely still. But the timing is right and we have some positive news to share with you.

Before we get into the opening session, let us take a quick look at the agenda. In the next hour, Anne-Françoise and I will be talking about the Group strategy for growth. You will have seen in today's press release that we have announced mid-term financial targets, and we will be setting out how we will deliver that performance.

After a short break, we will then move to a series of small group breakout sessions for the pre-registered participants. You will receive connection details for your assigned group shortly.

Over the course of the day, each group will have a Q&A session with me and Anne-Françoise, and meetings with leaders from the three franchises, to get into the details of actually how we will drive each part of the business.

I am sure you will find it an informative day, and come away with a clear picture of how we are moving Smith+Nephew to the next level.

Strategy for Growth

An inflection point – transforming to a structurally higher growth company

Smith+Nephew is at an inflection point. In the last few years:

- We have added new growth drivers;
- We have restructured our commercial model; and
- We have embedded a new culture.

We are now at the point of transforming to a structurally higher growth company. And innovation is truly at the heart of it all. The technology at the company has been strong for a long time, and we are taking it further.

We have built a pipeline of disruptive technology, with established engines to keep adding internal and external growth assets. Delivery will be driven by our work on productivity, and by commercial excellence. Optimised manufacturing and supply chain will provide a solid foundation. And on the commercial side, two of our three franchises providing around 60% of sales, are already performing well.

The aim is to sustain the strong profitable growth in Wound and in Sports Medicine, and top re-establish the momentum that we have actually had for many years in Orthopaedics.

Now we understand that you want to know what this all adds up to. We are committing today to consistent 4-6% organic revenue growth by 2024. We will maintain the higher R&D investment enabling that, while also rebuilding a trading margin to be at or above 21% in 2024, and with continued improvement after that.

- We will maintain discipline in capital allocation.
- We will continue to invest in R&D and tuck-in M&A.
- At the same time, the strong cash flow of the business will also enable us to maintain our progressive dividend policy;
- Will allow us to stay within investment grade credit limits or metrics; and
- Newly announced today, we start the regular buyback with around $250 million $300 million planned in 2022.

Solid long-term demand drivers intact

So before I go into the detail of the strategy, I would take a moment to remind you of where Smith+Nephew is today. We all know the disruptive effects of COVID of course on our industry. But when I look beyond the short-term, the long-term trends underpinning our markets absolutely remain intact.

For instance:

- The prevalence of chronic health conditions;
- We also have the expectation of ever higher levels of activity later in life;
- The demographic shift and the aging populations; and

- Expanding healthcare access in emerging markets.

These trends are all unaffected by the pandemic.

And now we can increasingly add a fifth trend, which is the shift to decentralised care and this has been accelerated by COVID, as both patients and providers look to move care actually away from the mainstream general hospital.

With that comes new opportunities for innovation:

- To meet the needs for simpler procedures;
- For shorter recovery times; and
- For new patterns of patient engagements.

Smith+Nephew: A portfolio of global franchises

Slide six is a reminder of what Smith+Nephew is. We are a major global player in all of the key markets of:

- Sports Medicine,
- Orthopaedics, and
- Advanced Wound Management.

The portfolio is also an attractive mix. Growth at or above the weighted average market growth rate of 4%, can drive leverage for the whole of the P&L in normal conditions. And having the portfolio is actually a well established and proven model in medical devices.

- It gives the scale to engage with customers and cover back-office costs.
- It also gave us some resilience in the pandemic.
- It creates a range of opportunities for us to allocate capital for growth and returns.
- It also positions us to exploit cross-franchise commercial and technology opportunities, such as ASCs, digital, and biologics. I will talk more about these.

And then by running the portfolio through our franchise-based commercial model, we retain the focus and the accountability to drive each area effectively.

Smith+Nephew today: three global franchises

Slide seven is a bit of a busy slide, but we wanted to be as transparent as possible. It does shows where we are by franchise, and some of the broad-based performance improvements over the last few years.

The areas in green show where our segment has outperformed its market in a particular period. Performance relative to market has improved in more of our segments. And in 2021 actually, two franchises with around 60% of Group sales, that is, Sports Medicine and Advanced Wound Management, are clearly outperforming.

When we look at the reasons for the better performance, it comes from delivery of our strategy. It comes from:

- Innovation;
- Improved commercial execution; and

- Synergistic M&A.

This performance comes from actions that we have taken, rather than from external factors, and that gives us the confidence that we can repeat that success in the rest of the portfolio. Now, as you know, there are still challenges in Orthopaedics, but actually they are quite narrow.

What we need to fix are the short-term supply constraints which have interrupted the progress that we have had in Hips and Trauma; and then the current slow growth in Knees. I think it is important to remember that came after many years of outperformance, and where we are filling the portfolio gap with the rollout of cementless knees, we are going to be very successful.

Strategy for Growth

Three simple strategic imperatives

The next slide shows the background for our Strategy for Growth. By concentrating our innovation and culture on customers, we will consistently deliver 4-6% organic revenue growth, and we will rebuild our profit margin. And to get there, we will compound our outperformance in Advanced Wound Management and Sports Medicine, and regain momentum in Orthopaedics.

The strategy is based on three simple imperatives, which you see in the pyramid on slide number eight.

The first imperative is to strengthen the foundations of Smith+Nephew. A solid base in commercial and manufacturing will enable us to serve customers sustainably and simply, and deliver the best from our core portfolio.

Secondly, we will accelerate our growth profitably, through more robust prioritisation of resources and investment, and with a continued customer focus. And then we will continue to transform ourselves for higher long-term growth, through investment in innovation and acquisitions.

Delivering our strategic imperatives

Key value builders driving the growth strategy

We will deliver these imperatives through four key value builders. These are:

- Productivity;
- Commercial execution;
- Innovation; and
- M&A.

On each of these, we already have a track record of delivery. And in the next section, I will spend some time on each of the four value builders, and what we have planned for each one of them over the next few years.

Delivering our strategic imperatives

Productivity

So I will start with productivity. These measures are mainly aimed at strengthening our base, and laying the ground for acceleration. I will focus now on two areas:

- Optimising manufacturing and supply; and
- Driving ongoing efficiencies for the business through simplification.

Productivity: Resolving the current supply issues

Expecting full resolution of S+N specific issues in H1 2022

The immediate priority on the optimisation side is to resolve the current supply issues. Now I am pleased to report that we have made further progress since the update we gave you together with our Q3 results.

Initial challenge we had was of product supply from our main global orthopaedics facility in Memphis, largely as a result of staffing shortages. That is improving. We successfully stepped up hiring and are moving new staff towards full productivity, towards leading and that will lead to rising output, and falling backorders.

The second challenge has been around logistics, and that is improving further too. There may yet be some bumpiness from external disruptions to freight, but our backlog of finished goods that we need to get to customers is decreasing.

Overall, I am pleased to say we are making good progress on both of these Smith+Nephew specific challenges, and we do expect the full resolution in the first half of next year.

Now it is a little harder to predict are the widely reported global shortages of some raw materials and components, such as electronics, for instance. We are closely managing supply issues, that is, on a case-by-case basis, and we have simplified our processes to be more opportunistic and move quickly when additional supply becomes available.

I am confident in the team's handling of these unusual circumstances, and here too I am encouraged by the progress.

Productivity: Executing transformation plan

Structurally improving supply chain efficiency and resilience

The second aspect of optimisation is our supply and manufacturing, and that is building long-term efficiency. An important part of that will be delivering the transformation plan that we announced back in February.

And on the supply chain side, we have continued the process and we are moving to a specialist third-party logistics partner. The transition in Europe is now complete, and we are preparing for the Memphis transition in 2022. Eventually, our production facilities will ship directly to three global distribution centres, and they will in turn ship directly to the customers wherever possible.

This will of course bring a range of benefits. By simplifying the route from factory to customer, we will:

- Bring down lead times;

- Better manage inventory; and
- Reduce the cost and risk from freight.

And then in manufacturing, the new Malaysia orthopaedics facility is on track to supply in 2022. And also, Costa Rica is getting ready to support Wound, as part of the shift to a multi-franchise facilities. Again, cost efficiency is only one part of the rationale. Multi-sourcing in our network will make us more resilient to disruptions at any one site.

These changes will all create a simpler, more efficient, more resilient network for supply to our customers.

Productivity: Ongoing efficiency opportunities

We will make sustained improvements from focus and simplification

And then finally on productivity on the next slide, there are opportunities from increased focus and simplification that can really be an ongoing process rather than to rely on major new restructuring programmes.

We have shown the ability here already to deliver savings from simplification, and our Global Business Services organisation is a great example. GBS was actually initiated in 2017 as a shared services and business process outsourcing organisation, supporting the whole of Smith+Nephew from low-cost locations.

Early savings came in the delivery of the APEX efficiency programme, but the benefit then continued with more savings accruing from other transitions and hosted operations. Two of the opportunities we still have in front of us, are shown on the right of the slide.

Firstly, we can more rationally focus on commercial resources, to better balance growth and also margins. Smith+Nephew actually sells into more than 100 countries, but over 80% of revenue comes from actually from the 10 largest countries. Global launches will focus now more narrowly on the largest markets first. In some cases, there are even lines of business that are unprofitable in smaller countries. Some of these have strategic value to the rest of the portfolio, but we are also reviewing where it makes sense to just exit.

And a second opportunity does comes from simplifying the portfolio. In some categories, we have multiple product lines serving the same clinical need, either as a result of past M&A, or then just as older product generations were never discontinued. This is particularly the case in Orthopaedics.

And one of the example on the slide of UNI knees and clearly this is one where we can consolidate four parallel systems into one and into the modern JOURNEY II UNI platform. We are:

- Reviewing the financial and strategic value of the tail of products;
- Aiming to reduce commercial costs;
- Aiming to simplify distribution; and of course,
- To better control inventory.

Delivering our strategic imperatives

Commercial execution

I will now move on to the second value builder, which is commercial execution. And this is about maximising the value of our really strong core portfolio, and accelerating the business by aligning our commercial approach to evolving customer needs.

Commercial execution: Maximising strong portfolio

AWM shows ability to accelerate existing products

How do we do this? Well, I think it is important to recognise that we already have leading technology across the portfolio. Our JOURNEY II Knee, for instance, and the INTERTAN Nail in Orthopaedics; our WEREWOLF COBLATION System in Sports Medicine; and ALLEVYN LIFE dressings in Wound Care are just a few examples. And these are well established products that are truly differentiated in them marketplace.

The Wound franchise has some very clear examples of what can be done by better driving this core portfolio, even before the benefits of our pipeline.

The left of the slide shows inflections that we have already delivered in established categories. European Wound Care, for instance, is one of our more mature end markets, and with competition from low-cost regional players that is a very particular feature there.

And even so, the team has successfully returned the business to growth through:

- Better execution,
- An enhanced tender approach,
- A renewed focus on key account management, and also
- Improved employee engagement.

All of these factors contributed to sales growth that you see on the left side of the slide.

In Bioactives, Santyl also turned around a multi-year decline. Detailed work on patient engagement, on clinical evidence and reimbursement first has stabilised and then started to grow another mature product line.

And in the franchise sessions later, you will hear more about commercial execution and maximising our already strong portfolio.

I have just talked about Wound and you will hear how selling the procedure rather than individual products has already been a core part of our successful Sports Medicine strategy under Brad Cannon in recent years.

Replicating that success in Orthopaedics is absolutely critical. With our uncemented knee, we now have a strong suite of primary and revision products. They are supported by a range of enabling technologies, so essentially everything necessary to support the surgeon and how they actually wish to approach a particular procedure.

Commercial execution: Aligned with customer needs

Positioned to re-establish Orthopaedics momentum

We have also strengthened the commercial model for Orthopaedics. I did announced that change of the leadership structure in November as part of our Q3 results, and it is about bringing both the Orthopaedics and Sports Medicine business units under Brad Cannon.

This does aligns our commercial structure much better with evolving customer needs and with new high-growth opportunity that we see in the marketplace. While the sales team remain separate, we can go after these targets with a more unified sales approach, and we can leverage our leadership in Sports Medicine and our broad Orthopaedics portfolio. We all know that care is becoming more decentralised with Joint Replacement procedure and the volumes growing rapidly in ASCs.

Our US Sports Medicine franchise already generates 40% of its revenue in the ASCs, and so has existing deep relationships with the centres that are now starting to place hips and knees.

Extremities I think is another real good example, where we see foot and ankle surgeons often specialising in both bone and arthroscopic repair. And then in capital equipment, we can take a more integrated approach to selling our digital surgery portfolio, which includes CORI of course and the updated arthroscopic tower.

So when the two sales forces work together to pursue opportunities, having both franchises under the same leader, will enable greater coordination and also more unified incentives, which I believe is also a key component.

Delivering our strategic imperatives

Innovation

Now on to the third value builder which is innovation, absolutely critical and key for us. We have stepped up our level of investment in R&D, from 4.7% of sales in 2017, to around 6% expected for this year. And I think we are now at the point of starting to realise more of the returns.

From here, we will accelerate our business by launching flawlessly and to scale, and transform our longer-term outlook with investments in truly disruptive platform technologies.

Innovation: Key projects delivered in 2021

New growth drivers added across franchises

Slide 18 shows some of the innovation that we have already delivered in 2021. Now I would not take you through every product in this session, of course, but there are a few points I would like to highlight.

First, there is the breadth. These projects have added new growth drivers across the franchise and across segments, including both consumables and capital equipment.

Second, there is really a healthy mix of lifecycle management, like the new skin substitute versions that are introducing real differentiation, like Fast Fix Flex, which can drive significant expansion of the meniscal repair market, by actually enabling more tears to be repaired. Both types of project are important to having a fresher portfolio and to compete and to drive margins.

And then thirdly, impressive delivery in 2021 reflects only the early stages of the increased R&D investment. The output of most of the investments and the recent step up in projects are still to come.

Innovation: Drives performance across segments

Segment acceleration versus market has followed major new products

Importantly, I think we have demonstrated that when we bring meaningful innovation to the market, it drives visible change in the commercial outcomes that we report to you.

Now I showed this data earlier in the presentation. This is of underlying growth by segment over time, and how it compared to the market. Hips, Trauma, Joint Repair, and Arthroscopic Enabling Technologies have all improved their performance against the market since 2017.

What you see on slide 19, is that in all of these cases, the improvements actually followed major new launches and this just underpins the importance of innovation.

In Hips, the launch of OR3O, the dual-mobility system was followed by above-market growth within a few quarters, and improved performance also followed the launch of EVOS Small and EVOS Wrist in Trauma. Both segments were continuing to outperform before the supply disruptions earlier this year, and I believe we still have important growth drivers early in their lifecycles as that situation then normalises.

In Sports Medicine Joint Repair, the addition of Regeneten in late 2017 and a series of further launches across procedure types moved that line to double-digit and actually to consistent above-market growth.

Then, the multiple launches in the Arthroscopic Tower actually returned AET from multi-year decline, first to growth, and then to consistent market outperformance.

Innovation: Preparing to launch differentiated pipeline

Processes and resourcing to launch at scale

One of the factors of this success, I believe, are the improvements that we have made in launch excellence, particularly the ability to launch rapidly and at scale. OR3O provides an excellent case study for this, as a launch that actually delivered quick returns with just a two year payback on our development costs.

Firstly, we came with effective marketing. We had a very clear message positioning OR3O as the only advanced bearing dual-mobility cup. We also identified the right customers and the right patients, that is high-impact teaching accounts, and those are revision patients at high-risk of the hip dislocating and that is exactly what OR3O is designed to reduce.

We also deployed more capital during the launch, with rapid deployment of instrument sets. And we applied improved end-to-end processes, with consistent coordination of product needs with operations. And importantly, we used evidence and medical education early and effectively leveraging the long clinical history of Oxinium, and running a series of virtual education events.

We will now apply these improvements to the next series of key launches, either underway or expected, and those are the cementless knee, our next generation shoulder, the full launch of Tula, and our next generation negative pressure wound devices.

Our increased investments in innovation should result in a higher cadence of major launches into the future, and consistent launch excellence that can really translate that into profitable growth.

Innovation: Investment in platform technologies

Disruptive platforms with cross-franchise applications

We are also investing now in more transformative projects for the future, and particularly into platform technologies with cross-franchise applications. Robotics of course is one, with the further development of CORI, and you will hear more about CORI later in the breakout session.

The reception in knee surgery have been excellent, we are rolling it out globally. We have recently added regulatory clearance for hip surgery in the US. There is much more in development, of course, and as we add more indications and more devices to the CORI ecosystem. And then I really believe the differentiation of a CT-free, small, modular platform will become even clearer.

We expect to be the first to actually add Knee and Hip revisions to our platforms. We are working on a novel soft-tissue balancing device for knee replacement, and we are working towards shoulder replacement with CORI following our Extremities acquisition earlier this year.

And then the unique ability to integrate our robotics platform with our Arthroscopic Tower will support the expansion in Sports Medicine.

Another platform is Biologics, which is a capability we have built up through acquisitions in Wound and Sports Medicine. It is early to be talking about specific projects at this stage, but we are looking at applications across all three franchises in Biologics.

And then finally, there is digital as a true capability. We already have marketed products in all three franchises, such as data analytics in Orthopaedics, then of course the connected tower in Sports Medicine, and also wearables in wound with the LEAF patient monitoring system. We will continue to work on digital applications covering the whole cycle of care, both internally and with partners, and then potential applications for visualization and also artificial intelligence.

Delivering our strategic imperatives

Key value builders driving the growth strategy

The final of our value builders is M&A. We have added assets over recent years that move a number of our segments to structurally higher growth potential, such as:

- Adding the Osiris skin substitutes to Bioactives;
- Tula to our ENT business; and then
- Adding Extremities to Trauma.

We will continue to use bolt-on acquisitions to enhance our portfolio and pipeline.

M&A: Enhancing our portfolio and pipeline

Continue with small and mid-sized bolt-ons

Our criteria for acquisitions are unchanged. We are looking for technology that can change the standard of care, like Tula, like Regeneten. And we are looking for assets in high growth categories that improve the mix of our portfolio.

Assets will also be synergistic with our current portfolio, usually where our existing sales teams are already visiting the right clinical call points for the new asset.

And we will stick with valuations that make sense. We are looking at range of metrics, but in particular, we look for the ROIC to exceed our WACC within a reasonable timescale, typically it is three to five years depending on the asset.

So that is our strategy in summary, the four value drivers that will:

- Strengthen our foundations;
- Accelerate profitable growth; and
- Transform the long-term profile of the company.

Now to take you through what that means in numbers, I will pass you over to our Chief Financial Officer, Anne-Françoise Nesmes.

Financial Framework and Capital Allocation

Anne-Françoise Nesmes

Chief Financial Officer, Smith & Newphew

Welcome

Thank you, Roland. Good morning, good afternoon, everyone. In the next few slides:

- I will cover our financial framework, trying to bring together all of value builders that Roland has spoken about;
- I will talk about the levers that underpin and drive our mid-term commitments; and
- I will also cover our updated capital allocation policy.

Near-term external influences

But first, le me cover the short-term, where there is a number of external factors and influences that we have got to work through.

On the positive side, there is more recovery to come from COVID. We know surgery volumes in Joint Replacement and ENT have not yet returned to pre-pandemic levels. For Joint Replacement, we are still expecting to see a benefit at some point of the pent-up demand when healthcare systems catch up, although, unfortunately, we all know that new variants of COVID are a reminder of how difficult it is to predict the timing of the recovery.

Our assumption is that waiting lists will be addressed over time, but the speed will vary by market and will be generally very gradual. One of the headwinds for 2022 is from the volume-based procurement tender in China for Hip and Knee, which we expect will be implemented in the Spring 2022.

We have been in discussions with our distribution partners around the future go-to model market, and our future terms of business. This process, the negotiations are well advanced but not quite finalised yet, and we expect to be able share detailed financial impact with our full year results.

And then finally, a factor that is well-publicised, widely reported as it effects many industries is the inflation in raw materials and logistics as a headwind. Clearly, there is lots of variation between categories for us, but it is quite clear that our overall materials inflation in 2022 will be higher than we have normally experienced. And as Roland mentioned earlier, we are on the front food with that and negotiating with our partners.

Commitment to consistent 4-6% organic growth

But if I then move to what does it mean for the mid-term and how we will achieve our growth. Slide 22 shows you the levers of revenue growth that we expect from now till 2024, and sustainably thereafter.

Now I can imagine, I can picture you, I can see you. I can imagine that you are already trying to measure the bar. So let me emphasise very quickly that these are directional and they are not to scale. They are here illustratively to represent where we are heading.

And let me put very quickly to the side, the fact that there will be a rebasing of our China business as a result of VBP in 2022. But then let us look forward and let us look at how we are building our business. One of the major positive contributors will be from our improved commercial execution, and we have also including here taking part in market recovery.

We have got great product, unique products that the franchise will cover with you later on, and that will drive growth. We would also see contribution from our innovation, particularly for the near-term projects such as porous knee, the next generation shoulder, Tula or the next generation of negative pressure wound therapy products.

And therefore, by 2024, we expect to be delivering sustainable 4-6% organic growth as a result. And I would like to make it clear that this does not depend on the contribution from pent-up demand.

And then commercial execution will continue to be a benefit in the long-term; and of course, our sustained investments in R&D should mean that the innovation contribution continues, as we have our next generation of pipeline based on our platform technologies.

Franchise level prioritisation & execution

Investing to drive sustainable revenue growth

Now what does it look by franchise? You can see on slide 27 that the starting point for each franchise is a little different. In the near-term, strengthening the foundations of supply and execution is key for Orthopaedics. In Sports, we will continue to drive the flow of new products. And in Wound, the continued improvements in commercial execution will create momentum.

What is clear though is that over time, innovation will become a more important driver for all three franchises.

Now I would not go into the fine details here. We have got great talented team who are ready to speak with you in the breakout sessions. They will talk you through their winning strategy. They are prepared to your questions. I do not want to steal their thunder here and you have. There is more to come.

Smith+Nephew today – trading profit margin

Margin recovering, increased investment for growth

Now if I turn my attention to trading margin. Clearly, our trading margin has recovered from the trough in 2020, but we recognise that it is not yet back to the pre-COVID level.

Slide 28 shows the trading margin development up to 2021 with our guidance, which is at the low end of our previously stated 18-19% range. But importantly, you can also see here on this slide, the R&D step up that we have talked about.

We have made a choice, a conscious decision to invest behind innovation, maintain our investment through COVID and you see that as a result, R&D is around now 60% of revenue and it has impacted margin by about 100 basis points compared to 2019.

As we have also spoken as well before, there is a further 150% basis point headwinds from the initial M&A dilution.

But now clearly, those investments are laying the foundation for our improved growth trajectory. They will both drive revenue and margin in the mid-term.

And then just to wrap up quickly on the margin, there are elements in terms of the 2021 performance like inflation and FX which we have spoken about and some of that was offset by a combination of structural and discretionary cost savings.

Growth translating to sustainable earnings growth

But again, if we turn our attention to the future and if we look at 2024, we expect trading margin to be at or above 21%. And slide 29 shows you the levers that will take us there, including our continued and maintaining our investment in R&D. Again, there is still some initial headwinds to absorb, VBP and input cost inflation, which I have talked about.

But these will be more than offset by the tailwinds we see. Productivity improvements will provide efficiency gains, and the higher revenue growth from commercial execution and innovation will also enhance positive operating leverage.

There will also be a benefit from our recent M&A acquisitions, such as Tusker and Integra, as their profitability rise, as we drive the sales growth, we will see that flow through the bottom line. And clearly, that is the ambition of our M&A activity.

But importantly, 2024 is not the limit of our ambition. We do expect further trading margin improvement beyond that, which will then give us choices of how much we invest in further growth, or how much we allow to flow through to the bottom line.

Revised capital allocation policy

And to finish off, let me come to the capital allocation, where we are announcing today a revised framework for our use of cash. This new policy is aimed at supporting our strategy, while also maintaining greater balance sheet efficiency with shareholder returns.

Our first priority is to continue to invest in innovation and our sustainability agenda, and the second priority is acquisition. As you can see, these are in line with the strategic priority of revenue growth, but they are also essential for the sustainable growth of earnings and free cash flow.

And we will do that while maintaining our current commitment to our equity and bondholder with investment grade credit metrics, and also continuing our progressive dividend policy.

But we are confident in our growth outlook. We are confident in our strong cash generation. And it means that even after these investments and commitments, we expect to have surplus cash available.

And we are therefore making a new commitment today to return the surplus cash to shareholders in the form of a regular annual buyback. We will start in 2022, when we expect around $250 million to $300 million to be returned to the shareholders.

And amongst all of this, in this capital allocation process, we are also committed to regular review the opportunity to optimise our balance sheet and maintain efficiency, whilst meeting our commitments and investment needs.

So with that, I will pass you back to Roland to sum up.

Conclusion

Roland Diggelmann

Chief Executive Officer, Smith+Nephew

Underpinned by Culture and Sustainability

Thank you, Anne-Françoise. You have heard our strategy, how we will go about it, and the financial outcomes we are committed to delivering.

I also want to mention the real deep commitment to our culture that underpins all of our work. The pillars of care, collaboration and courage, and our life unlimited purpose. They unite the team in what we do and how we do it.

I firmly believe that we all engage more when we are working for a purpose that we truly believe in. And that purpose is, of course, not just limited to doing business. Taking the limits off living also applies to the wider health of society, and we also keep challenging ourselves to continuously do more here.

This year, we are proud to have committed to achieve net zero emissions across our global operations by 2045. This adds to challenging long-term sustainability targets around:

- Impact on our communities;
- Other environmental goals; and also
- On sustainable product development.

In this area, we look forward to updating you early next year on our progress, and that will be through our 2021 Sustainability Report.

Transforming to a structurally higher growth company

So I would like to leave you with some of the reasons to be confident that we will deliver on our commitments.

Firstly, as mentioned, our market fundamentals are truly strong, and we are among the leading global players in all of our franchises. What gives me most confidence is our strong and innovative portfolio and the enhanced pipeline from our investments in R&D and also in M&A.

We have a proven track record in driving improved performance from our existing portfolio, and two of the three franchises, representing around 60% of sales, are delivering profitable growth already through execution of our strategy.

In Orthopaedics, we are filling the portfolio gap that has held us back, and we have clear plans to drive growth with improved operations, and an enhanced commercial structure to also pursue high-growth cross franchise opportunities.

And the growth in margins will also be further enhanced through financial discipline and capital returns as you have just heard from Anne-Françoise.

So with that, we will take a few questions before then moving to the breakout sessions. Thank you very much.

Q&A

Andrew Swift: Thank you, Roland. So for this session, you can enter questions through the messaging function on the right-hand side of your screens. We will have time for a few now, and then when we get to the actual breakout sessions, pre-registered investors and analysts will have plenty of time to ask questions in person then. We have received some questions as the presentation has been going on.

A few, Roland, around mid-term growth and it being above the levels that the company has been able to sustain in the past, and why that is and what is different now?

Roland Diggelmann: Well, I think it is a new team here at work. I think it is a very clear simplified strategy, but I also believe that through the course even of the pandemic we have made investments for future growth. We have ring-fenced some of the R&D. We have made investments in M&A. And I think some of these are coming through.

Some of the evidence is coming through now. We see strong execution in 60% of our business in Sports Medicine and in Wound. We also see the examples that when we bring true innovation to the market, such as OR3O in Hips, we see fast induction, we see growth coming through.

So why now? I think we have a line of sight of the pandemic. It is not over yet, but we feel this is the right time. I believe we are at an inflection point, and we will bring the innovation to fruition and to market growth.

Andrew Swift: We have quite a few questions about the trajectory of the margin in different forms between here and 2024, if it is a steady progression of the 21% or more backend loaded?

Anne-Françoise Nesmes: I am happy to take that if you want, Roland.

Roland Diggelmann: Yeah, sure. Please go ahead.

Anne-Françoise Nesmes: Clearly, we are committed to sustain margin improvement and a steady margin improvement, which you may see between now and 2024. And we have talked about the levers in the presentation, some of them we have given example for including commercial execution. The Wound performance to me is incredible and we see that flowing through the Wound franchise.

So productivity, we have done it with shared services. So we know the levers we have got to pull. We know it is around revenue growth and it is around productivity and that will flow through the bottom line. So we are committed to a steady margin improvement and there will be more to come in terms of specific 2022 margin guidance during our full year results in February.

Andrew Swift: And also connected to that and some other questions, when we think we will get back to pre-COVID levels?

Anne-Françoise Nesmes: Yes. So clearly, and here maybe happy Roland and I, we can share the question. Clearly, as I said in the presentation, we are not back to that level and we are signposting by 2024 to be at or above 21% and continue to improve. So we are committed to driving margin improvements.

For those of you who followed us for a little bit of time, you know that we need to improve our top line growth and that is our top priority. Driving revenue growth through innovation, through commercial execution is what we need to do and that is where we invest in. And then once we have that revenue growth, then we have choices to look at where do we reinvest or does some of it flow through to the bottom line.

But if I may as well, I would quite like to make a point that margin is important, that is our focus. I know that is what you shareholders measure us on. But I guess, as a new CFO, I would like to take the opportunity to expand a little bit and think about earnings growth and total return to shareholders and cash conversion. Those are also measures of financial success, which I want the team to be focused on as well.

Andrew Swift: Then a few people asking views on 2021 guidance if we still stand by that?

Anne-Françoise Nesmes: Well, we have not mentioned it today because we stand. We remain on track and there is no change to our guidance.

Andrew Swift: And also questions on opportunities in the different franchises and how we see those.

Roland Diggelmann: Yeah. Maybe I can take this one. Obviously, Anne-Françoise has also showed on the slide how we view the different franchises relative to their strategic remit, how they are positioned. I think in, Orthopaedics, clearly, we have a gap that we have filled. It was the porous knee, which is really exciting now that we are going to a full launch. We have some homework to do around the commercial excellence and around operations and supply. And this should allow us then to get the Orthopaedics franchise to the next level.

We have everything it takes. We have the products. We have the reach. We have the innovation capabilities. Sports Medicine is clearly more advanced. It is already been growing and outgrowing the markets on the basis of a very complete portfolio, both Joint Repair and also the Arthroscopic Enabling Technologies. So we expect Sports Medicine to outperform the market going forward.

And in Wound, as mentioned, a lot of the focus has been on execution. This is showing. But it is also combined with a very strong and growing portfolio. So here too, I think we have come back and we are in a very strong position to be able to outgrow the market going forward.

Andrew Swift: And a couple of questions we have about R&D priorities and strategy and the right level of spend going forward.

Roland Diggelmann: Well, you have seen that we have deliberately increased R&D. This was a choice that we made very deliberately. I am absolutely convinced that this industry is driven by innovation and this innovation comes internally and externally. We have increased our R&D spend from about 4.7% in 2017 to now about 6%. And I believe it is at the right level.

So we are not thinking of a further step up in R&D, but what you will start to see is the R&D investments that we have made are coming into products that are coming to the market that will drive the sales line. And that is what we have mentioned and what Anne-Françoise has also just mentioned.

What is so important for us is that we get to a structurally higher sales level. And with the innovation, with the deliberate choices that we have made, I believe we will get there.

Andrew Swift: And questions on revenue growth from 2022 to 2024. Why we have not guided to that? And if you are saying that it will be below the mid-single-digit growth that we guided for 2024?

Anne-Françoise Nesmes: Yeah. Happy. That is the problem of not being in the same room, is not it? So clearly, when we look at revenue growth, again, it will be steady and it is quite interesting to think about at the earlier stage, there will be a recovery from COVID and then clearly the momentums come more from the innovation. So whilst it is again a steady revenue growth, do not expect to be big bounce back. And therefore, everything will be within that guidance of 4% to 6%. There is very much almost two phases in the earlier year. It is COVID recovery and then you see the innovation accelerating and coming through. But again, it will be like margin, steady expansion of revenue.

Andrew Swift: I know the question we have on capital allocation. Does the commitment to a buyback indicate that investment opportunities are becoming thinner or simply that the company thinks that the shares offer better return potential on the next three to five years?

Anne-Françoise Nesmes: So I think our capital allocation really reflect our strategy. First is innovation. Second is acquisition. And Roland has outlined the criteria for that. And then it is return to shareholder via dividends or through the share buyback. Well, I think the share buyback reflects is our confidence in the business while also the ability of the business to generate cash. And it is something we do not often talk about unfortunately but we generate cash. We have excess cash. We need to optimise the balance sheet and return funds to shareholders.

So I think it is very much aligned with the strategy and it is almost a natural logical consequence of the strategy we have outlined today.

Andrew Swift: So there is probably time for one final question. Could you discuss the interaction of the growth and margin ambition by 2024? What the effect of trading margin would be at the different parts of the revenue range and how that relates to the 21% target?

Anne-Françoise Nesmes: So, as I said, the margin will be driven by the revenue growth. So first, looking for that operating leverage from getting momentum in that top line growth and then secondly driving the productivity. And we have outlined in the presentation some of the levers we will have. An example was the prioritisation of the most profitable markets being super disciplined on where we launch, which also simplifies your business.

The second, although it takes a little bit more time to achieve, but it is the portfolio rationalisation. We have done some work already around EU MDR, but there is more to go after. And the example we know is in Orthopaedic franchise, 25% of SKUs generate less than 2% of revenue.

Now clearly, some of those SKUs will be needed because you need your bag as the team tells me, we need the complete tool to be able to perform a surgery or for the surgeons to perform a surgery. But there is more we can do in terms of simplification and that will all flow to the bottom line. And as our margin recovered, then it gives us the choices, do we want to reinvest further or do we let it flow to the bottom line? And that is the position we need to be in.

Andrew Swift: I think given time, there are more questions that people have but there will be time to cover that in the breakout sessions as well. So we will close this session. There is now a short break before we move to the breakout sessions, which will start at 13.45 UK Time. So if you are registered you will have received the personal link to connect to the breakouts in the last hour.

When you do connect through that, you will be moved to the right room by a moderator. So to make sure that to run smoothly, we would ask that you log in ten minutes before the session begins and you can stay muted until the start time. And as a reminder, the materials for this session and to support the breakout sessions are in the Resources section of the portal and available to you. So thank you all for joining, and we will speak again in a moment.

Anne-Françoise Nesmes: Thank you.

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