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# Smith & Nephew

Healthcare equipment & services

10 November 2017

## No distractions from the search for growth

**Smith & Nephew's Q317 results featured 9% revenue growth in emerging markets that continued the trend of previous quarters. A further efficiency review looks likely to focus on reducing complexity in manufacturing and warehousing, improving the G&A ratio and continued salesforce efficiency. A narrowing of the FY revenue and profit growth expectations towards the lower end of the previously guided range may have disappointed some, but this close to the year-end there should be confidence that the revised FY ranges will remain intact. Management does not comment on M&A speculation, but with the recently announced retirement of its CEO, S&N's continued strength in the attractive emerging markets and rumoured activist interest look likely to stoke further media speculation.**

### Emerging markets remain the Q3 highlight

Reported revenues of $1.15bn were up 3% compared to Q316 and while established market growth was just 1%, the US led with 2% revenue growth. Once again the emerging market business was the star with 9% revenue growth; just below the double-digits of H1. On a franchise basis, there were a number of moving parts with Reconstruction returning to 4% growth led by above-market 6% growth in knee implants. At the more exciting end of the business, Advanced Wound Management revenues grew by 2% and management remains excited about the expanding indications for the NAVIO Robotic Surgical System. Other drivers in the quarter included a $5-6m hit due to hurricane season.

### FY 2017 Guidance ranges narrowed

Any disappointment on the guidance towards the bottom end of the previously announced FY 3-4%, and 20-70bp revenue and profit ranges, respectively was tempered by a press backdrop of S&N as an M&A target. Any company announcing the retirement of its CEO, with rumoured activist interest and with emerging market growth to which competitors would aspire, is likely to be subject to such speculation. In any event, continued growth in emerging markets and further business simplification plans are likely to appeal to both investors and potential acquirers.

### Valuation: Between its bigger US peers

S&N currently trades at c 20x consensus FY17e P/E; between its US peers Stryker (c 24x) and Zimmer (c 13x). Stryker's premium to S&N may be due to its improved portfolio balance and robotics focus. Its US competitors have respective 11% and 15% Asia Pacific sales but neither has S&N's Emerging Market growth prospects.

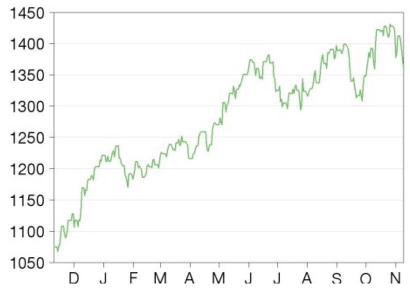
**Consensus estimates**

| Year end | Revenue ($m) | PBT ($m) | EPSA* (c) | DPS (c) | P/E (x) | Yield (%) |
|---|---|---|---|---|---|---|
| 12/15 | 4,634 | 1,040 | 85.1 | 30.8 | 20.6 | 1.8 |
| 12/16 | 4,669 | 965 | 82.6 | 30.8 | 21.2 | 1.8 |
| 12/17e | 4,790 | 939 | 87.6 | 32.3 | 20.0 | 1.8 |
| 12/18e | 5,015 | 1,017 | 94.0 | 35.5 | 18.7 | 2.0 |

Source: Smith & Nephew, Bloomberg. Note: *Before amortisation of intangibles.

| | |
|---|---|
| **Price** | **1,360p** |
| **Market cap** | **£12bn** |
| | $1.29/£ |

**Share price graph**




**Share details**

| | |
|---|---|
| Code | SN |
| Listing | LSE |
| Shares in issue | 875m |

**Business description**

Smith & Nephew is a leading UK-based maker of medical devices. It is the world's number one in arthroscopy products; two in advanced wound management; three in trauma and extremities products; and number four in orthopaedic reconstruction products.

**Bull**

- Strength in attractive market niches, such as arthroscopy, endoscopy and wound care.
- Recent acquisitions have been strategically sensible, alongside divestment of its gynaecology business, from which shareholders are benefiting via a share buyback.
- The biggest European medical device maker, which the specialist and popular press have mentioned as an M&A target.

**Bear**

- Growth continues to be modulated by FX, a larger manufacturing base than competitors and economic conditions in various markets.
- Consolidation of hospital buying patterns plays in favour of even bigger medical device companies.
- Product pricing is likely to stay challenging, as healthcare funding remains under pressure.

**Analysts**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***Smith & Nephew is a client of Edison Investment Research Limited***

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