

Smith & Nephew

Turning over that new leaf

We had the opportunity to join Smith & Nephew's (S&N) recent institutional investor roadshow and hear about the introspection that has emerged following the appointment of its new CEO. While endorsing its strategy as a portfolio medical device company, two strategic reviews have identified areas which, when the detail is announced at the Q3 and FY18 results, will enable investors to track S&N's target of returning to market growth rates.

The situation

S&N is Europe's largest medical device company with three divisions that can be further divided into nine franchises and many more product areas. Such a complex organisation operating in c 100 countries has evolved into an unwieldy structure, which had constrained underlying growth to c 2% in Q2 – below the market rate of c 4%. Strategic reviews have benchmarked S&N against its higher-performing peers, which are organised along franchise rather than geographic lines, and examined the organisation from the bottom up. Two areas of focus have been highlighted (in addition to M&A) that should return S&N to higher growth.

It is not the products

In each of its three main business segments and product franchises, S&N has developed products that are best-in-class in terms of their advanced technology and clinical outcomes. Two cases in point are the POLAR3 hip replacement, which has a 99% device survival rate after seven years, and the PICO negative pressure wound therapy product, which NICE has assessed as showing better efficacy than the standard of care. The POLAR3 construct is part of the hip franchise and PICO part of its advanced wound care division, whose segment sales are c 13% and 4% of total sales, respectively.

Targeted corrective action

Two reviews have suggested that S&N's complex, fragmented commercialisation and reporting structures could be the factors that mute its growth to below faster-growing peers. The broad APEX cost-saving programme, and now the streamlining of the commercial organisation, increase the role of the S&N specialist in a more customer-centric approach.

Valuation: Room to improve

S&N trades at 19.5x FY18e earnings, which is between its peers, Stryker (24.1x) and Zimmer (16.9x), although S&N has the highest emerging market exposure.

Consensus estimates

Year end	Revenue (\$m)	PBT (\$m)	EPS (c)	DPS (c)	P/E (x)	Yield (%)
12/16	4,691	959	82.8	30.8	22.3	1.7
12/17	4,765	996	90.8	35.0	20.3	1.9
12/18e	4,962	1,006	94.4	35.1	19.5	1.9
12/19e	5,126	1,082	101.6	38.4	18.2	2.1

Source: Bloomberg

Healthcare equipment & services

28 September 2018

Price 1,402.5p

Market cap £12bn

\$1.315/£

Share price graph



Share details

Code	SN
Listing	LSE
Shares in issue	874.4m

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 emerging markets and in therapeutic segments, such as orthopaedics, endoscopy and wound care with products whose technology and outcomes are at least best-in-class.
- Recent acquisitions have been strategically sensible, alongside divestment of its gynaecology business, from which shareholders benefited 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 a convoluted commercial organisation.
- 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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