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Smith & Nephew

Healthcare equipment & services

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Continuing to focus on execution

Smith & Nephew's Q117 demonstrated a return to double-digit growth in emerging markets, with China growing 14% in the quarter. Alongside completion of its restructuring and focus on the execution of improved innovation and efficiency, we believe this improvement in emerging markets will keep S&N on track to meet its current revenue growth (3-4%) and trading profit margin targets for FY17.

Q1 driven by improvement in emerging markets

Reported revenues of $1.1bn were flat compared to 2016. Underlying sales grew 3% in Q1 vs 2% in Q416. Growth in established markets grew just 1% due to ongoing headwinds in parts of Europe, while growth in emerging markets in Q1 returned to double-digits (12% underlying). China, which was particularly weak in 2016, grew 14%. Key revenue drivers included advanced wound devices (+16%), driven by its disposable negative pressure wound therapy device PICO, sports medicine (+7%), trauma & extremities (+5%), other surgical business, which includes ENT and NAVIO (+7%) and knee implants (+5%). Growth in trauma & extremities is significant as it was one of the worst performers in 2016 due to weakness in China, the UK and Germany. Advanced wound care (+1%) continues to be affected by destocking in China and weakness in some European markets and advanced wound bioactives by distributor stocking patterns of SANTYL (-8%). S&N expects a better performance in H217 as new SANTYL effectiveness data in treating pressure ulcers will be available, which should improve uptake.

All parts in place to deliver on 2017 expectations

S&N completed its restructuring in 2016 and we now expect it to be able to deliver its target revenue growth in 2017 (3-4% underlying) and improved trading profit margin (20-70bp) as it focuses on innovation and improved efficiency. Areas we believe will be important to S&N include the uptake of its recent product launches (eg REDAPT and POLARSTEM in hip implants, LENS camera and WEREWOLF COBLATION systems). Of particular interest is the upcoming full market release of the total knee application on its NAVIO robotics-assisted surgery system.

Valuation: Increased premium to peers

S&N currently trades at 20x 2017e P/E, a 15% premium to the average of US peers Stryker (c 21x) and Zimmer (13x). Stryker continues to trade at a slight premium to S&N (+5%), which we believe is due to its improved portfolio balance and leading robotics focus. However, S&N is closing the gap (10% premium earlier in 2017) possibly due to more clarity on its 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	19.7	1.8
12/16	4,669	965	82.6	30.8	20.3	1.8
12/17e	4,769	987	84.4	32.3	19.9	1.9
12/18e	4,966	1,051	92.6	35.5	18.1	2.1

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

Price	**1,301p**
Market cap	**£12bn**
	$1.29/£

Share price graph

Share details

Code	SN
Listing	LSE
Shares in issue	890m

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 positive, alongside divestment of its gynaecology business, from which shareholders are benefitting via a share buyback.
- The biggest European medical device maker, which may be an M&A target.

Bear

- Growth continues to be tempered by FX 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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