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Q3 2018 Smith & Nephew PLC Trading Statement Call

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PRESENTATION

Operator

Good day, and welcome to the Smith & Nephew 2018 Third Quarter Trading Report Conference Call. This call is being recorded.

At this time, I would like to turn the conference over to Namal Nawana, Chief Executive Officer. Please go ahead.

Namal Nawana ***Smith & Nephew plc - CEO & Executive Director***

Thank you. Good morning, and welcome to our third quarter results. With me is Graham Baker, Chief Financial Officer; and Phil Cowdy, Head of Business Development and Corporate Affairs.

Today, I'm going to cover how we've improved our financial performance while at the same time reengineering the business. It's been a busy quarter, and we're making good progress.

Starting with Slide 4, I'm pleased to report that we grew revenue by 3% underlying and 2% reported in the quarter. This organic growth is an acceleration from Q2. We remain on track to meet our full year revenue guidance and are committed to continuously controlling the cost base while delivering on our growth expectations.

The U.S., almost 50% of our revenue, grew an encouraging 4%. Other Established Markets were held back by Europe, which remains weak, particularly in the German and U.K. markets. Germany will remain a drag for multiple quarters still. Emerging Markets continues to perform strongly, up 10%, led by China. At a global level, our 3 core businesses all grew. We'll now go through each of them in turn.

I'll start with Sports Med, Trauma and Other Surgical, where we grew revenue by 4% in the quarter. Performance is led by Sports Medicine Joint Repair, which had another strong quarter at 8% growth. REGENETEN is performing well ahead of our deal model. There's still much more to come from this product as we add manufacturing capacity and roll it out more widely in 2019.

Our enabling technologies declined by 2% in the quarter. We're continuing to expand our WEREWOLF COBLATION system and the launch of the FLOW90 Wand will enable us to bring it into shoulder repair in the first half of 2019.

Trauma & Extremities returned to growth in the quarter, up 3%. This is driven by strong U.S. sales. The U.S. is the only market with access to the new EVOS SMALL plating system, which is being very well received. We expect accelerating growth in international markets as we widen the launch of EVOS SMALL in 2019.

Other Surgical Businesses also accelerated to 12% growth, up 8% in Q2, driven by our NAVIO robotics business. In the last few months, we've added R&D resource to build on the NAVIO platform. I see great potential for us in robotics and are excited by the planned additions to our technology.

Now turning to Reconstruction. Here, our Q3 performance was a real highlight as we took market share. Knees grew at 4% globally, faster than the 3% in Q2. This was despite a drag in the U.S. from ZUK, which is a new unicompartmental knee we acquired from Zimmer in 2015. ZUK was still mainly being used by traditional Zimmer customers, and some of them have moved to a new Zimmer Uni Knee, costing us around 2 points of U.S. Knee growth in the quarter. We'll begin to lap this effect as we enter 2019 and should see growth more driven by the JOURNEY II, LEGION Revision and ANTHEM knee systems, which all grew double digit in Q3.

Moving on to Hips, which grew at 4%, with 6% growth in the U.S. This is a very encouraging trend. Last quarter, I talked about Hips as an example where we have technology that's better than our market share indicates. Throughout our organization, we've now set our focus on our lead hip products, such as POLAR3 and the REDAPT revision system, which are the key drivers of our growth. We anticipate the momentum from these will continue into 2019 and well beyond.

Finally, let me turn to Advanced Wound Management. Overall Advanced Wound Management growth was 1% with a number of factors at work. In Advanced Wound Care, we grew revenue by 1% in the quarter. Our U.S. performance was excellent with double-digit growth, continuing on from strong growth in Q2. However, some of our larger European countries are still challenging. We have been refining our approach to leverage our full portfolio and tenders and have seen some encouraging wins already, but we'll need to build on that in 2019.

Advanced Wound Bioactives declined by 7%. This portfolio continues to see volume challenges in the U.S. The Advanced Wound Bioactive category represent only 7% of group sales but is a 50 basis point drag on the growth of the whole of Smith & Nephew. Our focus is on stabilizing volume.

Advanced Wound Devices grew 11%, accelerating from 9% in Q2, and this was largely driven by PICO. We're continuing to innovate around what is already a truly differentiated technology, achieving 510(k) clearance for PICO 7 in the U.S. and launching PICO 7Y in Europe. PICO 7Y is the first single-use negative-pressure wound therapy system to enable 2 dressings to be used with a single pump, potentially saving costs for customers.

I'll now turn to our new commercial model. As I mentioned at the beginning of this update, we've been able to accelerate our growth at a time when we've been making significant changes to our organization structure and how we'll work together going forward. I talked in July about the changes we'd already made to the operating functions, and all our leaders are now fully in place. I've also talked about the need for our commercial model to be more specialized and closer to our customers.

I'm pleased to update you today on what we've done. In essence, we're moving from a regional selling model with traditionally 2 leaders represented on the Executive Committee to a global franchise structure, with dedicated presidents of Orthopaedics, Sports Medicine and ENT and Wound Management, all represented at the Executive Committee. Each president will lead their franchise with global upstream marketing responsibility and full commercial responsibility for their franchise in the U.S. They'll be specialists -- leading specialists. They'll also have responsibility for one more shared global commercial support teams -- sorry for one or more shared global commercial support teams in the critical areas of professional education, sales training and health care economics. We want lift the standard in these functions and be consistent in how we do things.

2 of the 3 franchise presidents are in place already. Brad Cannon is leading the Sports Medicine and ENT franchise. Brad was previously our Chief Marketing Officer and is a proven leader in Smith & Nephew over several years. And additionally, he had strong P&L experience in medical devices prior to joining. We're very happy to have Brad in this role.

Today, I'm also delighted to announce that Skip Kiil has joined Smith & Nephew as our new President of Orthopaedics. Skip joins us from NuVasive, where he was Executive Vice President of Global Commercial. He has a direct experience in the global orthopedics market over an extended period, including P&L experience, and in particular, had a 12-year career with Stryker, where he was leader of its medical surgical group in Europe.

Our existing Presidents of U.S. and international are retiring, but they're still engaged with the business. They'll remain at Smith & Nephew until March of next year, managing the handover to the new structure and ensuring a seamless transition. In summary, these appointments reinforce the changes we're making to our commercial leadership structure designed to give stronger organic growth over time.

Outside of the U.S., we will have 2 regions represented on my executive team: Europe, Middle East and Africa; and Asia Pacific, each under a president. Importantly, we have created country clusters in each region. Country cluster is a group of countries based on geographic proximity, critical mass of revenue and similar go-to-market strategies. They're led by a single Managing Director and have business unit leads for each franchise. This structure reduces complexity and takes out administrative costs and, importantly, brings us closer to our customers. We've eliminated up to 3 levels of generalist management in moving to this new structure, and we're allocating more resources instead to the franchise organizations.

Our cluster managing directors will lead larger organizations and run bigger P&Ls, helping us to attract, develop and retain talent in each of these markets. They run bigger P&Ls than they could have as country general managers. It's a more compelling proposition for the quality of leaders we want at Smith & Nephew. In our initial appointment, I have appointed Max Colella some months ago as the new President of Europe, Middle East and Africa. Max was previously President of the Europe and Canada region under our old structure and reported through our President of International. Now he reports directly to me. As we continue our external search for the new President of Asia Pacific, our existing President of International, Rodrigo Bianchi, will be the interim head of the region. I'm very pleased that almost all of the cluster managing directors are in place already, as are the business unit franchise directors reporting to them throughout the world.

We have made these changes while keeping stability in our selling and customer-facing organizations and accelerating growth sequentially over Q2. Our team has made great progress, and we've achieved a lot in the last few months. I'm personally grateful for the engagement of the whole organization as we make this turn.

I know you're keen to hear more about our long-term strategy. I can report that our analysis is complete, and we're in the advanced stages of defining our strategic imperatives and metrics. We've already given you some high-level elements of our new strategy. Smith & Nephew will remain a portfolio medical device company. We've said we want to be more active in M&A. And to that end, we've been actively working on evaluating numerous bolt-on acquisitions. Majority of the leaders are in place by franchise and regionally. We expect to make appointments shortly for the 2 remaining executive positions, the Presidents of Wound Management and Asia Pacific.

As I just explained, we're moving to a franchise-led approach to run our business. We'll be fully transitioned and tracking results in our new structure from January 1, 2019.

The work on creating a purpose-driven culture is ongoing. We've held workshops across the company, engaging our employees in defining what great looks like for Smith & Nephew. And we're working on articulating the pillars of this culture, and that should be complete by year-end. There's certainly more to come, and you can expect to hear further detail in early 2019.

With that, I'll hand over to Graham to update you on our outlook for the rest of the year.

Graham Timothy Baker ***Smith & Nephew plc - CFO & Executive Director***

Thanks, and good morning, everyone.

As Namal highlighted, we are reiterating our guidance. Within that, we expect underlying revenue growth to be in the lower half of the 2% to 3% range. And as a result of the favorable legal settlement and improved cost control, the trading profit margin will be above that achieved in 2017.

Currency movements have been slightly unfavorable since our last update in July, including depreciation of some emerging market currencies. Based on the exchange rates prevailing on the 26th of October this year, foreign exchange, together with the acquisition of Rotation Medical, will now add just under 1 point to growth.

APEX savings are on track, and we're reviewing the overall targets as a result of our commercial restructuring and some other opportunities we've identified in recent months. We'll be able to update you on that in our full year results.

Our tax rate guidance is unchanged to 20% to 21%, barring any one-off items. And finally, I'd note that we've made some minor changes to our technical guidance.

With that, I'll hand back to Namal.

Namal Nawana ***Smith & Nephew plc - CEO & Executive Director***

Thank you, Graham.

To summarize, we're pleased with the progress we've made thus far. Q3 was a solid quarter for Smith & Nephew, with each of our 3 business areas growing and the U.S. achieving growth of 4%.

Our lead products are starting to shine, including in Advanced Wound Devices, Sports Medicine Joint Repair and, encouragingly, our Hip portfolio. And we've delivered these solid results in a period when we redesigned and launched our new organizational structure and appointed the vast majority of our new leaders around the world. There's still more to do, but I'm pleased with the pace of change. Our focus will continue to be on delivering on our plans quarter-by-quarter.

Now we can move to your questions. Thank you, operator.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We will now take our first question from Patrick Wood of Bank of America Merrill Lynch.

Patrick Andrew Robert Wood ***BofA Merrill Lynch, Research Division - Director in Equity Research and Head of the EMEA MedTech & Services Team***

I have 2, please. The first would be on the franchise heads. I'm curious what attributes are you prioritizing and what were you really focused on when selecting candidates for that role. I'm just curious to get some thoughts there. And the second one really on the Knee side. I mean, with the ZUK headwind clearing out a little bit in Q4 and then next year, would you expect momentum to continue at this rate or possibly even improve from here? That'd be helpful.

Namal Nawana ***Smith & Nephew plc - CEO & Executive Director***

Thanks, Patrick. First of all, I'm very excited to move to this new organizational design, where we are franchise focused and also have a regional representation of EMEA and Asia Pacific on my executive team. And I just want to say our previous model having essentially 3 commercial leaders reporting in to me, I've now moved to a model where I have 5 commercial leaders reporting to me. So first and foremost, we're dividing and conquering. And if the priority is commercial acceleration, I believe we're positioning ourselves directly to achieve that in a more enhanced way with this model. Your question related to the attributes of these leaders, we are looking for experienced leaders that have global experience, big P&L experience as well as having a track record of results and also a leader that will help us transform our culture and build the accountability and passion for the businesses they run. Indeed, we've sought individuals that have direct experience in the businesses that they are going to lead and are truly specialists in their domains.

So with Brad Cannon, who obviously -- prior was our Chief Marketing Officer, had also direct experience running our -- some of our international businesses and is familiar with our product range and bringing it through the -- bringing R&D through the pipeline also. So Brad was an easy choice for me. And Brad had very significant multibillion-dollar P&L experience prior to joining Smith & Nephew, so that also was something that made it easy for us to understand he could bring leadership to that sports role.

And our latest appointment, in fact, is Skip Kiil. Skip just joined -- his effective date is today, so I know he's on the call, so welcome, Skip. And what I would say is I'm just so excited to have Skip join our organization. Skip grew up in orthopedics and in MedSurg. He had 12 years at Stryker, starting in sales and moving through sales management, international and global experience, working directly in international markets; and then working for multiple other organizations, including Alcon, a division of Novartis, and running a very large part of their international business and P&Ls; and most recently, leading global commercial for NuVasive, a high-growth business that, again, is very akin to the kinds of businesses we run. So Skip to come back into orthopedics, I know he's excited to be back in orthopedics and leading our franchise. But that kind of experience and that kind of passion for the industry as well as proven track record of growth and delivery is what we've been looking for.

And then we have Max, again, leading our Europe business. He's -- he has real deep domain knowledge of the region. And he had also experienced outside of that region and driven growth in his career in multiple roles and has broad experience across the products that we have. So I'm trying to give you some sense of the kinds of attributes.

And moving to your second question with respect to Knees, I'm really pleased with getting to this double-digit growth for our core and lead assets of JOURNEY II, ANTHEM and, of course, our LEGION Revision. And it's still early days for some of the new components that we have in that LEGION Revision system and particularly with our cone technology and the offset ability in that revision system. But yes, I'm encouraged by that momentum. Obviously, the drag that we've had, actually not just this quarter but in the prior couple of quarters with respect to our Uni Knees, that's something that I've got more into since our last call and learned more about. And so I think that the company did well with an asset for a period of time that came as part of the disposition and the merger to Zimmer Biomet. So I think the company did fine with that asset for a period of time, but now it is in decline, almost expected decline. And then we'll have good plans for that segment in the future. But the core parts of our Knee momentum are solid. So thank you very much for your questions, Patrick.

Operator

(Operator Instructions) We will now take our next question from Kyle Rose of Canaccord.

Kyle William Rose ***Canaccord Genuity Limited, Research Division - Senior Analyst***

So I wanted to ask one big-picture question and then kind of dig into one of the segments. Namal, you've been with the company for -- I guess going on 6 months now. We're clearly starting to see some of the changes you're implementing to the leadership structure and the commercial model. Maybe just kind of help us understand how your view of the opportunity has evolved over the course of the last 6 months, maybe what surprised you, what hasn't surprised you and where you're more or less excited. Then I've got one follow-up.

Namal Nawana ***Smith & Nephew plc - CEO & Executive Director***

Okay. So thank you, Kyle. First of all, it's been a great 6 months. I've enjoyed my time already, and mostly I've enjoyed meeting the team around the world. The last couple of months in particular, my great area of focus has been with our customers and commercial organizations in the different regions of the world, attending many of the conferences, British Orthopaedic Association, at the Australian Orthopaedic Association. And that gives me the joint opportunity of meeting some of our thought leaders as well as our customers in these regions as well as our local staff. And I'm looking forward to also attending the French meeting coming up. And all of this time, I've been really connected with our R&D teams and the technology in the company and actually spent quite a lot of time physically in the labs trying our technology out. And as you know, I was encouraged when I spoke earlier about our portfolio. And if there's something that I continue to be very encouraged about, it's our base technologies. And I think we have a great starting point here, and we have some great things in the pipeline. And I think that we can really build on that to have assets that will help us win share over time, and we're keen to work on those technologies over time. So portfolio, I think, is the big one. It still remains a big plus. On the surprise, I wouldn't call it anything really major surprises, but I would say that the kinds of organizational changes that we have made and have been -- started to make, they're significant. This is a significant shift in how we're going to do business. Moving from a regional selling model to a global franchise model, it doesn't happen overnight. I'm very, very pleased that we've been able to keep the trains running while we're making this turn. And we're most of the way through hiring our leaders, which is great, but that's a lot of organizational change. And yes, I'm very grateful also to our team and to -- and their engagement throughout this process and patience as we've rolled out these new plants and new methods and also their excitement that's growing around how we can together be more relevant and serve our customers in an enhanced manner.

Kyle William Rose ***Canaccord Genuity Limited, Research Division - Senior Analyst***

Great. And then on the Trauma business, I mean, great to see the first positive growth this year. And how much of that is coming against the easy comps from last year? And then just also from a market perspective, I mean, kind of several of your competitors talked about maybe a slowdown in the U.S. trauma market, they see softer procedure volumes for whatever reason. I mean, are you seeing that? Or do you see that more as your success here is indicative of share taking with some of these new products in the U.S.?

Namal Nawana ***Smith & Nephew plc - CEO & Executive Director***

So this is another area -- I love the Trauma business. It's a business I worked in earlier on in my career, and I've got to say, Smith & Nephew's got an outstanding set of intramedullary nails. It always had a little bit of a lag on its plating systems. And with the EVOS system that's been rolling out over the last few years, a couple of years, it's been really that portfolio filling in, having a relevant and powerful product set in those critical segments. The EVOS SMALL is what's helping us to drive growth. And we have now released several hundred sets of EVOS SMALL to our U.S. business, and I think that that's helping us drive some of this growth. So it's really not a market situation for us when we've got shares that are smaller than some of the competitors. For us, it's about the relevance of our portfolio and how we can help people undertake those surgeries in an enhanced way. So we're -- I'm very pleased with the uptake of EVOS SMALL in the U.S. And I think the thing to note is we have not released that in our international markets, so we saw very strong growth in the U.S., which really drove more than its fair share of that 3% overall growth in the quarter. But into 2019, we'll get some more access for our international markets with EVOS SMALL. We've had a fantastic reception to that, and that will drive growth. And then our INTERTAN and our essentially TRIGEN nailing system are fantastic. And the clinical evidence there is outstanding for us to now demonstrate that we have a real reason why people should move from perhaps some of the other market share owners of that space to Smith & Nephew. So a couple of good reasons for us to really feel good about pushing forward in the future.

Operator

We will now take our next question from Julien Dormois of Exane.

Julien Dormois ***Exane BNP Paribas, Research Division - Research Analyst***

I have 2 questions, please. The first one relates to the weakness that you have been seeing in wound care now for quite a few quarters, mainly coming from Europe. So could you just remind us how much of the wound care business is made in Europe at the moment? And also, you've referred to a new tender approach that you are deploying, so could you just give us a bit more detail and how fast do you think the results should be felt? And the second question is more technical on the guidance. Could you just provide an estimate of the magnitude of the legal settlements that seems to be a reason for the slight upgrade to the margin guidance, please?

Namal Nawana ***Smith & Nephew plc - CEO & Executive Director***

Certainly, Julien. Firstly, when we think about wound management, and for me, coming into the organization, obviously, the scenario I wanted to understand and understand how we are going to get back to good growth. I think you need to really break down the business into its components. And I said last call that I always felt very good about our PICO device and about our ability to grow with devices. And we see a good acceleration quarter -- a sequential acceleration from 9% to 11% growth in the quarter globally. So that's -- so devices is going well, and I foresee that to be a big contributor to growth going forward. On the consumables side, it's certainly a tale of 2 cities or 2 regions, if you like. The United States, we had a fantastic second quarter, and that continued into the third quarter with strong double-digit growth. And that tells me that we have a portfolio that is good and that we can perform with our consumables. Europe has been a challenging region for us with Wound, particularly a couple of our markets. Not all of that is related to the market. I think it's also got -- related to our own performance and our own leadership. We have made some changes in our leadership in those markets in Europe, and I think that that's the first thing, is to have a team that can really represent our products in the way we want them to be represented. And then the portfolio approach, we have an outstanding portfolio and rather than respond to tenders and individual lots of tenders, we are trying to and successfully engaging our customers selectively with our full portfolio. And I think that, that is going to be something that helps us going forward. We don't break out our numbers for individual businesses by region, so I know you requested that, but I will pass on that one for now. And the second part of your question was related to technical guidance. I'm going to hand over to Graham to handle that.

Graham Timothy Baker ***Smith & Nephew plc - CFO & Executive Director***

Thanks, Namal, and thanks, Julien. And we're bound, obviously, by the confidentiality provisions to give too much specific detail on the legal settlement. But in terms of scale, of dimension, it's sort of a handful of basis points of margin. We will disclose that separately at the year-end because, clearly, it's not a recurring item. And we may choose to reinvest a little of that into other opportunities in the business. But just to clarify, whilst that's part of our confidence, it's not the only reason for our confidence and pointing to the top end --

the higher end of our previous guidance on margins, even if you put the legal settlement aside, we are expecting some meaningful progress on margin this year. And if you -- just to give you some sense of that, I think it's not unreasonable to think about the range that we started the year with, which was 30 to 70 basis points of margin progression. And clearly, I'm more confident at the lower end of that range, but I think that's -- something like that is a sensible range of margin progression to be thinking about, even setting aside the legal settlement.

Operator

We will now take our next question from Ian Douglas-Pennant.

Ian Douglas-Pennant ***UBS Investment Bank, Research Division - Director and Analyst***

So first, on the guidance, again, to what extent is the margin strength you've seen this quarter due to mix? It feels like it was also slightly stronger than you're expecting. And when it's slightly weaker, you would expect margins to be upside. And how much is down to the additional cost savings that you've managed? And secondly, could you comment a little bit more. You said you were going to be more active in M&A. Is this just bolt-ons, or are you also considering more transformative type of deals?

Graham Timothy Baker ***Smith & Nephew plc - CFO & Executive Director***

Okay, I'll take the first part of that, Ian, and then Namal can pick up the second one. In terms of the guidance, mix isn't a big part of it. We are seeing progression on margins as well as underlying trading profit position, which is driven by fixed cost control. But there isn't a huge difference between the gross margins of any of our franchises, and there are countervailing parts of that as well as positive parts. So overall, mix is a small part of it. More of it is driven by good cost control and good progress in all parts of our business on cost management.

Namal Nawana ***Smith & Nephew plc - CEO & Executive Director***

And that's a theme that we'll have ongoing. We talked about that actually at the first update that I gave, which is we're very committed to controlling our cost base all along the way as we accelerate growth. And we believe that to be very possible and I think shown you that, that can be done. With respect to your second question on M&A, we're a portfolio medical device company. And portfolio medical device companies to succeed do great R&D internally, which I think we've been doing because we have a good portfolio. But secondly, they do look outside to get in new technologies as appropriate to enhance the portfolio. And in these early days of the new leadership, and as I start to bring the full team together and move to this new organizational model, necessarily what we've been doing is we've been focused on delivering results with our core businesses. And then complementarily, the current M&A focus has been on bolt-ons and that all we're really reporting at the moment is our current activity is really on bolt-ons to our core. And that certainly doesn't mean that's all we'll do. That just means that in these early days, the kind of work we're taking on is really improving our business, changing our organizational net design and our work methods and looking at enhancing our portfolio sensibly with some near-term technologies. So thank you.

Operator

We will now take our next question from Lisa Clive.

Elisabeth Decou Bedell Clive ***Sanford C. Bernstein & Co., LLC., Research Division - Senior Analyst***

A few questions, just thank you very much on the detailed explanation on the organizational change underway. Just given the realignment, how do you make these changes without creating instability across the organization? Your predecessor certainly did quite a lot of work really to break down the historic silo structure of Smith & Nephew, and there was a lot of reorganization on his watch. In hindsight, that created a lot of headwinds to performance. How do you really rebuild an organization like this without causing too much trauma in the process? Second question, just on bioactives, if we could just drill into the short -- the disappointing numbers in a bit more detail. Why are the volumes going down so much, especially when I think you've had some pretty recent good data on the efficacy of SANTYL? So is this all OASIS? And also, could you remind us of how the sales of the division are split today? I think when you originally purchased Healthpoint, SANTYL was like 75% of the business, so just putting SANTYL and OASIS and REGRANEX in perspective. And then the third question, if you could just give some comments on how NAVIO is progressing versus your expectations and if we may see a sort of uptick from already a pretty good Knee growth number on the back of that.

Namal Nawana ***Smith & Nephew plc - CEO & Executive Director***

Thank you, Lisa. First of all, deciding what method to run an organization is I think a key part of our shift in strategy. And we've really benchmarked how best-performing companies that run medical device portfolios operate. And we weren't going to wait to orient our sales in a way that allows us to succeed. I'm very clear about running organizations. And in terms of the numbers of layers that we had in some of our international markets, with having -- bringing closeness to our customer and having our orientation to the -- and deep specialist knowledge of our businesses, I think, are all enhancements. As we've made these organizational changes, the customer-facing parts of Smith & Nephew, we're pretty well oriented to those franchises already. So the go-to-market at the customer itself is already in that franchise orientation. And so really, the work that we've been doing is to take out generalist decision-makers on those roles between myself, as the Chief Executive, and our team that serve our customer every day. And so I think that our approach to provide stability to the customer while changing how decisions get made at Smith & Nephew is not one that requires a lot of instability. Equally, we have had a wonderful time with respect to engaging our organization in dialogue and asking each other what do we want of our culture going forward and what do we expect of each other and how do we want to win together. And I got to tell you I'm very encouraged with the engagement of our team throughout that process. So far from thinking that changes are bad, I think changes are essential because we want a different result. And that's what we're going to get with having specialists leading our businesses and having structures that bring us closer to our end markets.

Let me address the NAVIO piece before maybe asking Graham to chip in on -- a little bit on the bioactives. But -- so NAVIO, first of all, the underlying technology of NAVIO is outstanding, CT-free navigation and robotics. The -- it's early days still, and that's why we've said a number of times that we'll -- we want to continue to introduce this important technology. We're making very good progress. We're seeing good responses from our customers. But what I communicated just at the high level now is that we're going to add to our technology. And so this technology will develop over the coming years. It's going to be important in how we perform with Knees and our broader portfolio. And at the right times, we'll continue to communicate on what the technology actually is and does. And with that, I'll hand over to Graham for the bioactives piece.

Graham Timothy Baker ***Smith & Nephew plc - CFO & Executive Director***

So thanks, Namal. Thanks for the question, Lisa. A couple of things on bioactives. We don't give a detailed split-outs of the products within that, but you are right in assuming that SANTYL is the overwhelmingly largest part of the franchise. I think you're right to recognize that there's some good data around SANTYL, and that has been improved in the last 18 months, and so we do believe it's a good product. Having said that, there are probably 2 things behind the volumes: one is I think all health care systems are more cautious around cost, and it is a -- it's a product that we priced per value and that there are low-cost alternatives, particularly if there are less severe injuries needing debridement, that typically attracts recommendations from -- going to pharmacy if people are looking for low-cost alternatives. The second is that there was actually some volatility in that. And in the third quarter last year, we did have a couple of very severely injured patients in the United States who were driving some peaky volume there in the third quarter. So there is a bit of noise quarter-to-quarter in there as well. Obviously, we're disappointed to see continued decline. As Namal highlighted, our focus is on stabilizing the volumes there. And as we look forwards, we think we are still in line with the guidance we gave earlier, which for this year is a mid-single-digit decline.

Operator

We will now take our next question from Veronika Dubajova of Goldman Sachs.

Veronika Dubajova ***Goldman Sachs Group Inc., Research Division - Equity Analyst***

I have 2, please. First of all, this new commercial structure that you are implementing, I'd like to understand what, if anything, it means for the cost base of the business. And I think, Graham, you made an allusion to you reviewing APEX in light of this. And so if you can comment on sort of any preliminary thoughts you have, that would be helpful. And then my second question is, I appreciate that at this stage, that focus currently for M&A is really on small bolt-ons. But Namal, I'd love to understand sort of in the medium to long term how are you thinking about adding another leg to the Smith & Nephew stool. And has your -- have your thoughts about that changed at all in the last 6 months?

Namal Nawana ***Smith & Nephew plc - CEO & Executive Director***

Thanks, Veronika. First of all, the new structure, by eliminating some of the layers and I -- particularly in our international markets, I mean, there is initial positive from that cost base change. But as I also said, we're orienting to a franchise and making sure that we fuel that franchise growth. So net-net, we won't report on the individual components that drive the cost base. For now what we will say is that we are very satisfied that we can control our cost base whilst we accelerate the business over time. In terms of the APEX effects, yes, I mean, there -- first of all, APEX is on track, and we're delivering on the expected benefits of APEX, and certainly, the program is progressing. I can say that our new Head of Operations, Mark Gladwell, has now had time to evaluate what was in place and is making progress on scoping the total work that he wants to do. So that's something again that we will report on heading into next year. But APEX is on track. And this commercial part, and I don't think that there's a big shift in what we're planning around APEX. And finally, with respect to your question on M&A, I have said and strongly believe that as a portfolio medical device company, we should choose the businesses we want to be in. There are very attractive spaces in Med device, and as time passes, we'll certainly pressure test which areas we want to be in, with a strong balance sheet and the strong support form all in Smith & Nephew to be the owner of good businesses in the med device space.

Veronika Dubajova ***Goldman Sachs Group Inc., Research Division - Equity Analyst***

That's great. Can I just follow up for the quick technical question? I saw, Graham, that you increased the guidance for the restructuring cost for the year. Anything in particular driving that?

Graham Timothy Baker ***Smith & Nephew plc - CFO & Executive Director***

Just progress continuing slightly quicker than we'd originally planned, nothing beyond that. You'll see we also pulled down the MDR cost guidance as well. And again, it's the same thing, just a little bit of a phasing difference.

Operator

We will now take our next question from Michael Jungling of Morgan Stanley.

Michael Klaus Jungling ***Morgan Stanley, Research Division - MD, Head of MedTech & Services and Analyst***

I have 2 questions. Firstly, on the management changes, can you give us some more details of how many senior management changes have been made, how many of those are internal from Smith & Nephew and how many are external? I can't calculate that from what you've given us. And then secondly, on the margin expansion, I'm trying to understand what has changed. Since we've had a margin outlook earlier this year downgraded, very quickly afterwards, we have an upgrade. And it's unclear to me how this could happen so quickly within a year. Was there kitchen sinking of the margins earlier this year to make it easier in a transition? Have the cost savings been brought forward, or have indeed the total magnitude of the cost savings increased? And as part of margin expansion, Namal, are you still happy that 2019 is going to be a margin expansion year?

Namal Nawana ***Smith & Nephew plc - CEO & Executive Director***

Thanks, Michael. With respect to the management changes, I haven't counted people in terms of internal, external. I think what I can tell you is that by the end of the year, more than half -- well more than half of the Executive Committee will be new in role. And that I think is purposeful and significant, and I think this renewed leadership will bring energy to our organization as well as what I'm looking for, which is specialist understanding of the businesses that we have. In terms of the commercial roles, the President of Orthopaedics, as I've announced, is an external hire. The President of Wound Management is an external higher and the President of Asia Pacific will be an external hire. So in the commercial roles, again, 3 out of 5 will be external hires and the other 2 coming from within our organization, So I think a good balance there and, again, good energy that will be brought to the team. Obviously, I am new as well, and I'd already reported on our Head of Operations being new and creating the QA/RA role in my executive, also a new hire external. So quite a lot of people have been brought in and, I would say, in a relatively short period of time at this very executive level. And beneath that, there are some also external hires as we've made some changes to management below these ranks and levels and what I would say is more predominantly internal as we go down the organization and for good reason. As we've taken out management layers, the talent pool that we've been able to draw upon has been larger. And so being able to deploy people in what they're best at is easier in that circumstance. So that's kind of the organizational question. And then your other questions?

Graham Timothy Baker ***Smith & Nephew plc - CFO & Executive Director***

So maybe I'll take the...

Namal Nawana ***Smith & Nephew plc - CEO & Executive Director***

In terms of the margin question, first of all, Mike, I don't think there's any intent other than clarity and prudence to -- by the team in providing guidance with respect to margin. And Graham can add to that if he wishes. I think I was clear on the last call, which is to say that we're going to control our costs as we accelerate our business, and that's already helping. And the team has understood the message. The team has -- we've examined our opportunities in this case, and we're executing against them. So I'm pleased to say that, that direction and that execution is paying off and that we can report on that contributing to our performance.

Graham Timothy Baker ***Smith & Nephew plc - CFO & Executive Director***

So I'll just pick up on a couple of specifics, Michael. Obviously, since we've put out the amended guidance at the end of Q1, we've seen 2 good quarters of revenue growth, with momentum picking up, and clearly, that gives us confidence. We've seen continued on progress -- on-track progress of the APEX program. And since Namal joined, we have and continued to exercise tight cost control, and many of the things that he said about how we intend to run the business have had an impact. So moving from at or above to now above, I think that's the right guidance to give, and I don't think it should be too big a surprise. We're not really talking about huge changes there.

Michael Klaus Jungling ***Morgan Stanley, Research Division - MD, Head of MedTech & Services and Analyst***

Okay. And can I just ask about 2019, and are we still confident that 2019 will be a margin expansion year? If APEX is doing well and so forth, it seems to me it's reasonable to assume that '19 is a margin expansion year.

Namal Nawana ***Smith & Nephew plc - CEO & Executive Director***

So Michael, Namal here. Yes, so I think that at a high level, we think that's right. We're going to obviously print our guidance for next year, shortly in the new year. So we'll do that in full, but look, we're on a good trend here, so...

Graham Timothy Baker ***Smith & Nephew plc - CFO & Executive Director***

And I think the only qualifier to that, clearly, Michael, the legal gain, that's a nonrecurring item; but on a -- and now putting that one aside, yes, we absolutely will see -- expect to see margin progression in 2019.

Operator

So we'll go to our next question from Tom Jones of Berenberg.

Thomas M. Jones ***Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst of Healthcare***

I'm going to try 2, but you only want 1, just pick whichever you like. On the kind of improved margin outlook for this year, just a quick clarification. Is this primarily an operating leverage thing, which you sort of alluded to in your answer -- last answer, Graham? Is it kind of quicker realization of planned cost savings? Or have you actually found some extra cost savings that you weren't expecting? Because, obviously, those 3 different things have very different implications for the long-term margin outlook. Just some clarification there will be very helpful. And then the quick final one for Namal. A lot of people ask you about M&A, but now you've had been in post 6 months and had a good chance to look across the portfolio. I'm not expecting you to be drawing out some specific answer, but are there any assets or business lines within Smith & Nephew now that you think perhaps deserve to be -- or less deserving to be in the portfolio than when you first arrived?

Namal Nawana ***Smith & Nephew plc - CEO & Executive Director***

So Graham, on the [first one].

Graham Timothy Baker ***Smith & Nephew plc - CFO & Executive Director***

Yes, sure. So Tom, some contribution at the gross margin line, but the larger part is coming at the -- out of operating leverage and the fixed cost base. And by and large, APEX is on track, not ahead, not behind, it's roughly where we expected it to be. And so there have been some other restraints and other measures that we've taken outside the APEX program to manage our costs effectively. We'll come back to you with guidance about exactly what that means for the future when we get to the year-end.

Namal Nawana ***Smith & Nephew plc - CEO & Executive Director***

And going to your second -- and Tom, your second question, yes, obviously, as a portfolio company, we will examine our portfolios and certainly going to a new franchise structure. That's why we have presidents is to evaluate what portfolio they want to have. And over time, I'm sure there'll be adds as well as, yes, potentially some subtractions. So that's one of the reasons why we want to be a franchise organization is to give the presidents that accountability to really enhance their portfolio in both directions. So thanks very much for your question.

Let me maybe close the call by saying thank you to you all for your interest. We think Q3 was a solid quarter that's taking us in the direction that we want to go. We are able to sequentially accelerate our growth whilst concomitantly reengineering our organization and really indicating to our organization how we want to move going forward. I'm very encouraged with the external hires joining our company as well as our new leaders joining my Executive Committee and look forward to reporting on our continued progress in the coming months and quarters. So thanks very much for joining. Take care.

Operator

This concludes today's call. Thank you for your participation. You may now disconnect.