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Avanos Medical

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Fawzi Kawash: Hello and welcome. My name is Fawzi Kawash, and I'm an associate with J.P. Morgan. It's my pleasure to introduce Joe Woody, CEO of Avanos.

Joe Woody: Thank you, Fawzi. Thank you, everyone here in the room, and those of you that are listening on the webcast. I'm very excited to update on a three-year transformation that we talked about here in this very room, actually, last year. I want to give an indication of how we did in our first year, give you a report card, and then talk about what's next.

One thing I would say is that the organization really accomplished a lot in year one. We divested a portion of our business. We executed on M&A. We did a lot of restructuring and cost out in the total company. We'll come on to that in a bit and highlight that as we go forward. I would say that for us as a management team, the one thing we have left in the transformation to execute on is consistent and sustainable organic growth.

I'm going to spend just a little bit of time covering our pain management business and talk about how we anticipate that will happen next year. As always, we are talking about forward-looking information. We make comments about our expected performance estimates and so forth. We encourage everyone to review our annual report on Form 10-K and quarterly reports on our Form 10-Q.

In addition, we feel like it's beneficial to look at non-GAAP financial measures, but we do recommend that you reconcile that with GAAP and, again, look at our filings. Of course, this is a highly regulated business. We talk about concepts and technologies that are regulated by the FDA and may or may not come to the market.

The Avanos' investment thesis is something that we introduced last year. We talked about these four pillars in a different way. We said, look, we have solid core categories with consistent organic growth. Clearly, in our digestive health business, we have double-digit growth categories and high single-digit.

Likewise, in the business we had, some of our revenue was negative in growth, and we wanted to eliminate that from our profile. Both of our businesses, the pain business and the digestive health business, have direct adjacencies to add growth. We've done a nice job of adding bolt-on and growth into the business in our M&A efforts, really, at good returns.

I think if you listen to our earnings calls on a regular basis, we really have set out a clearly defined set of transformation priorities. Michael talks about them all the time. I join him on the calls, and we clearly let people know where we are, investors in particular, obviously, in the transformation.

Then we have a very leverageable financial position to generate high material-free cash flow. We've talked about how we want to improve our return on invested capital.

When we came in last year, we were an $800 million global business, but our weighted average market growth rate was only 3.6 percent. That really was not allowing for us to get the leverage and the drop-through that we would like from the benefit of the cost work that we did.

Where we are today is a digestive health and pain management and recovery business, around $675 million, still a global business, but with a weighted average market growth rate of five percent.

We think that we can go from a $1 billion market to move into potential for $6 billion opportunities through M&A as we progress. We still have large addressable markets, and we feel like a right to win. The way to think about this is a more simplified and focused portfolio.

We have two scaled portfolios now. I'll just spend a couple of minutes talking about the two portfolios, digestive health, short-term feeding for the hospitalized patient that has a very serious condition and needs feeding. Then we're also involved in long-term feeding for the patient that has a more chronic disease or may need feeding throughout their life, often served in the home. We utilize DME partnerships for this part of our business.

Anybody that's been following us has clearly seen that digestive health has a number of growth catalysts have been growing above the market in the US, driven by our infant conversions. You've seen a lot of positive growth from, double digit growth from Neomed, and our Cortrak conversions.

We see an opportunity in our international business to duplicate the success that we received in the US. The disease states that we address are prevalent outside of the US, where, for example, nasogastric feeding is still used quite a bit. We've been growing that business at times, double-digit or high single-digit growth.

We're excited about the Tuck-In and Adjacency M&A, and there's some categories that you should think about going forward. One would be pumps and then giving sets. We think that we want to participate, and there's an opportunity for us in certain specialized nutrition, and then intelligent or smart feeding in the hospital setting and really outside of the hospital setting as well.

Pain is refocused into the pain management and recovery business. There's a high focus on orthopedic and sports medicine, because that's the largest bulk of our business.

Think about patients, one in five in the US have OA. We can now treat them in the beginning stages with RF ablation or hyaluronic acid, and then when they move on to maybe a shoulder replacement or a knee replacement, there's an opportunity for us to participate with the epiphycane pumps versus opioids in the surgical process, and then of course, Game Ready for other recovery.

We restructured our commercial organization here, and we do feel like we're seeing growth catalysts in the business. We're seeing the surgical pain business come back to the level. Game Ready did produce growth in Q4.

We feel like the HA market will stabilize by the end of 2024, and then double-digit opportunities for Trident and Ambit in the ambulatory surgical centers. The thing to understand about this year for the pain business is that we did experience a $13 million backlog.

We moved that down to 1.5 million in Q4, and we really completed our commercial reset in Q4 of 2023. A bit later in the presentation, I'm going to talk a little bit more about the green shoots that we see or the reasons to believe in this business and why we feel like it's headed into growth.

We also showed this slide last year. We use it quite a bit internally in our business, and we talk about it oftentimes in our earnings call. Strategic and commercial optimization. We really did a lot of optimization work, frankly, in the pain business, but also in our digestive health business and international.

Transformation of the product portfolio, certainly the divestiture of RH, and the Diros acquisition was evident of that. We've done a nice job removing costs in the business. I'll come on to that in a bit. Of course, we're always focused on the efficient capital allocation strategies to increase our returns on invested capital. The intent is to deliver stakeholders value.

Year one, I think most of our report card would be an A with the exception of pain management and recovery turnaround that affects our organic growth. I'm going to come back to that.

In digestive health, we continue to grow above market. Nice job really in the US and outside of the US. We exited low margin, low growth product categories about 15 million in SKUs and products that we discontinued. Of course, we were divested of our respiratory health business.

There was a lot of work done in the cost section on supply chain through product focus and improving our plant execution. We executed on $20 million in cost savings. Then we also talked to the street about the fact that we've identified 50 million and we feel very confident about that.

Continued the M&A. We did say also when there isn't M&A available that we would repurchase shares. We executed in 2023 on 40 million in share repurchases.

I'll spend just a moment on pain management and recovery because look, this is key to Avanos organic growth. Really, we can do all the things associated with our transformation. If we don't do this, it'd be all for naught. There's three ways to think about this. Commercial reset, we restructured new management, new sales force, about 30 percent, new channels.

We directed it to orthopedic and sports medicine in recovery and pain management. We also refined our brand strategies and we started to invest differently in this business. We had curbed our investment as the business was turning negative. Now we're reinvesting in the business.

We did experience the supply chain shortages, but we moved down from 13 million to one and a half million in back orders. What we did realize is that as we lost those customers, there was a longer customer reacquisition cycle. We did see in the fourth quarter that surgical pain stabilized and we feel like it's going to be set for growth.

That'll be the first time in a number of years that investors have been able to see that. Game Ready actually grew greater than mid single digit in the fourth quarter. We feel very strongly about that growth and the interventional pain. The business is now stabilizing obviously with the new channel approach, but also because we have supply available. We did receive some favorable international reimbursement in Japan and the UK.

We have said that the HA market is not expected to stabilize until the end of 2024. What we do expect is six percent year on year pain growth excluding HA and currency. I'm sure in the Q&A session we can clarify some of that and why we believe that. A lot of what we see in terms of the account conversions, the momentum in the business is putting in a direction where we can be confident about mid single digit growth next year.

Here's what you can expect for year two. We continue to invest and grow the digestive health business. You're likely to see some M&A in the digestive health segment. You can never predict obviously M&A, but you're likely to see that inside of the next year. We do think we're going to be in the year where we can realize mid single digit growth and profitability, and pain management.

We have plenty of M&A opportunities and a strong pipeline. I think a good track record there on valuation as well. We'll continue to outsource and work on our business process efficiencies. On the cost side. We're doing some work as well on labor efficiency and indirect spend.

Lastly, we are opportunistic about share repurchases and have been doing that in the past couple of years. We would pay down debt if there were no M&A opportunities that arise as you can't really judge these, but we have plenty of opportunities in a very full pipeline.

Delivering on the transformation priorities does support the value creation metrics that we laid out in our New York investor meeting in the summer of last year.

We think in 2024 we're set for mid single digit organic growth, margin expansion at plus 400 to 500 basis points would put us in a 20 percent or north EBITDA margin, free cash flow generation greater than 100 million, 60 percent free cash flow conversion and a real opportunity to increase our ROIC from 5.8 percent to greater than 8 percent.

I'm going to ask Michael Greiner, our CFO, to join me for a Q&A session and we're happy to clarify anything about our recent filings or something that you see in the presentation that you'd like more clarification on. Thank you.

Fawzi: Well, thanks, Joe. I'll start with a few questions and I'll turn over to the audience to ask questions if anyone has any. To begin with, how does the pre-announcement from last week impact the transformation?

Joe: I'll say a couple of things and I think Michael will want to pick up on it, but I don't think it changes the 2025 metrics that we have in place. We certainly have said that we start from a lower base and we have some changes in 2024, but we're going to start to see that growth out of the pain business.

We feel strong about the momentum that's building. We've been happy about the digestive health business and the above market growth that we have there. Likewise, even though it doesn't pertain specifically to the three-year transformation plan, the M&A pipeline is full to enhance what we think we can do with the business. We're confident there.

Michael may want to say a few things about margin or anything you'd really like to add.

Michael Greiner: Yeah, I think the communication we had last week indicated we were sticking with our 2025 guidance levels that we provided at our investor day with 20 million of high margin revenue being called down for '24 and obviously creating a new baseline specific to our HA platform.

One would have to assume we have to make up that margin elsewhere. We were tracking ahead on both gross margin as well as our OPEX goals as Joe points out with our year one transformation checklist report card. We're now no longer tracking ahead based on this 20 million and we're back in the ranges of what we laid out on '25.

Really, the way to think about it is we gave back a little bit of what we had booked for ourselves and income statement through our first year of the transformation but that still keeps us on track for the '25 targets.

Fawzi: Great. Secondly, can you elaborate on the status of the transformation plan and some of your key accomplishments?

Joe: I outlined them in the presentation but it's worth saying again, I really give the organization an A with the exception of organic growth. That is the last component that allows for us to have the realization of all the value metrics into 2025.

You think about divesting a division, the respiratory division, acquiring Diros and putting ourselves with the Trident technology and the ambulatory surgical center. Michael did a nice job as the chief transformation officer identifying 50 million in total cost, 20 million came out in the year.

Then we actually did a nice job, I think, of structuring the pain organization and setting it so that it can grow and be more profitable. A lot of accomplishment in a short period of time and generally met our internal metrics on the pain business outside of the Medicare changes and reimbursement in the HA market.

Would you like to add?

Michael: Yeah, the only thing to add to that is if you look at the investing of the RH portfolio with a great partner there, to Joe's point, the cost take out, getting out of revenue that was either low margin or just not positioned to win longer term. We've simplified our ability to execute.

Now, granted Q4 and the pre-announcement, you would argue against that, but we have over the long run here simplified our ability to execute. And so the confidence level and what we're going to be able to do in year two of the transformation, getting to our targets in '25 is high in the organization because we are much more focused than we have historically been.

Fawzi: My final question before I turn it over. You mentioned 2024 pain management and recovery growth of mid single digits. What gives you confidence in your ability to execute upon that in 2024?

Joe: Watching it progress, despite the fact that there was a big supply chain number is one thing. Seeing acute pain, or now we call it surgical pain, so those of you that have been following us, move into growth and be set to move into growth in 2024, albeit low single digit growth, gives me great confidence.

I can see the excitement level in the Trident technology, in the Ambulatory Surgical Center. We know the Cool Leaf customers want to come back now that they feel they can trust the supply chain and the availability of products. We've seen Game Ready move.

Kurt Holbrook, who's our chief commercial officer, really completed the reset in Q4. He's brought new talent into the business, a different approach from a marketing perspective. We're putting dollars in his hands as well so that he can move the needle on the business. A lot of confidence. It didn't happen as fast as we would have liked.

Part of that might have been the supply chain aspect of it, but we like the metrics that we're seeing as we move into the year.

Fawzi: Please raise your hand if you have any questions in the audience. If no further questions, we can conclude the presentation. Thank you very much.

Joe: Very much. Thank you. Yep.

Fawzi: Thanks, everyone.
