

Solventum Corporation

NYSE:SOLV

Earnings Call

Thursday, February 27, 2025 9:30 PM GMT

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Presentation

Operator

Good afternoon. My name is Ellie, and I will be your conference call operator today. I would like to welcome everyone to Solventum's Fourth Quarter 2024 Earnings Call. As a reminder, this conference is being recorded. [Operator Instructions] I would now like to turn the program over to your host for today's conference, Amy Wakeham, Senior Vice President of Investor Relations and External Finance Communications. Please proceed.

Amy Wakeham

Thank you. Good afternoon, and welcome to Solventum's Fourth Quarter Fiscal Year 2024 Earnings Call. Joining me on today's call are Bryan Hanson, our Chief Executive Officer; and Wayde McMillan, our Chief Financial Officer. A replay of today's earnings call will be available later today on the Investor Relations section of our corporate website. The earnings press release, and the presentation are both available there now.

During today's call, our discussion and any comments will be on a non-GAAP basis, unless they are specifically called out as GAAP. The non-GAAP information discussed is not intended to be considered in isolation or as a substitute for the reported GAAP financial information. You are encouraged to review the supporting schedules in today's earnings press release to reconcile the non-GAAP measures with the GAAP reported numbers.

Additionally, our discussion on today's call will include forward-looking statements, including, but not limited to, expectations about our future financial and operating performance. We make these statements based on reasonable assumptions. However, our actual results could differ. Please review our SEC filings for a complete discussion of the risk factors that could cause our actual results to differ materially from any forward-looking statements made today.

Following our prepared remarks, we'll hold a Q&A session. For the Q&A portion of today's call, please limit yourself to 1 question and 1 related follow-up. If you have additional questions, you're welcome to rejoin the queue.

And with that, I'd like to now hand the call over to Bryan.

Bryan C. Hanson

CEO & Director

All right. Great. Thanks, Amy. And to all of our shareholders and everyone interested in our company story, I want to say thanks for joining us today as we review our fourth quarter and full year results for fiscal year 2024. We're also going to talk about our 2025 guidance. And clearly, we'll discuss the announcement we made earlier this week concerning the definitive agreement to divest our Purification & Filtration business to Thermo Fisher.

But first, I just want to take a minute to acknowledge that the team has done a really good job progressing over the past 3 quarters post our separation, and we closed out fiscal year 2024 with solid performance across our businesses, which positions us well for 2025. We've advanced across each of the 3 phases of our transformation that we introduced last year at our first Investor Day. And given how the team is performing and the progress we've made, I got to say that I'm even more excited about the opportunities ahead.

For those of you that are new to our story, let me quickly recap the 2 main pillars of our transformation, again, looking at transformation in 2 ways. The first is that we are focused on establishing our foundation as an independent company. And the second is where we're committed to turning around our business performance particularly as it relates to profitable revenue growth. Both of these pillars should create significant shareholder value as we continue to execute against them. And our fourth quarter results demonstrate that our separation and transformation activities have taken root and point to the improving

results that we expect as we go forward. Our global teams delivered business performance at the high end of our expectations, not just for the quarter, but for the full year. And Q4 marked another positive quarter of volume growth, making it 3 consecutive quarters of improvement.

Now while there's obviously still a lot of work to be done. This is a significant milestone for the company. And looking back before our spin, 3M Healthcare saw 7 quarters of negative volume growth. Now stopping that decline and reversing it especially amid a complex separation, global restructuring, a talent and cultural transformation and a significant divestiture process, any of which pose real risk to business continuity represents a major achievement for this team. And the fact that this team made this progress while managing all these work streams concurrently is a testament to the strength and dedication of our solvers around the world.

I'd actually like to just take a minute to thank all 22,000-plus team members around the world that I'm pretty sure are listening right now to this earnings call. It is your hard work. It is your dedication, and you're the reason why we're ahead of plan. You've been absolutely crucial in maintaining business continuity and most importantly, as we always say, in delivering for our customers and our patients. Your commitment to our mission is clear, and I truly appreciate what you do every single day.

Now moving to our business segments, where we are making progress and beginning to generate positive momentum. I'm going to start first with our largest business segment, MedSurg. We continue to focus on driving the adoption of our recently launched V.A.C. Peel and Place dressing. And as I've shared before, this product gives us really 3 advantages. Number one, it simplifies the procedure; two, it reduces procedure time; and three, it reduces the number of dressing changes per week. All 3 of these are meaningful advances for both patients and providers, and it will give us the platform and the opportunity to expand this market and serve more patients. We remain very focused on increasing capacity to meet the strong demand for this product.

And in our Dental Solutions business, early customer response to the Q4 launch of our first-to-market 3D-printed Clarity Precision Grip attachment has been very positive. This solution focuses on ensuring predictable aligner therapy, and it is designed to simplify the procedure and then ultimately, as a result of that boost practice efficiency. And the products we discussed back in Q3 or the launch in Q3, Clinpro Clear Fluoride Treatment and Filtek Easy Match, are continuing to resonate with our customers as well. And in the case of Clinpro, as I mentioned before, this is another launch where we are rapidly increasing our manufacturing capacity to meet the strong demand.

Okay, moving to our Health Information Systems business. We continue to focus on our new autonomous coding payment models. And the team now believes that between 50% and 90% of cases have the potential to be automated. And that's thanks to our AI-driven autonomous coding technology, which is really focused on, number one, saving time for our customers, but also money for our customers when they look at revenue cycle management. Medical coding, as I think most of us know, is incredibly complex and our technologies both computer-assisted and the emerging autonomous coding can account for the constant tie to regulatory changes, quality demands and local, state and organizational specific guidance.

And of course, that brings us to our Purification & Filtration business. We saw another quarter of robust demand for our bioprocessing solutions business, giving us confidence in the strength of the end markets and the value of our differentiated technology and recurring revenue model. We'll provide more details obviously shortly, but I want to emphasize, this business is well positioned for growth under its new owner who offers a strong fit strategically.

Okay, shifting to our transformation phases. I want to spend just a few minutes talking about our progress across the 3 phases that we presented back at our initial Investor Day last year. Phase 1 is really all about laying the foundation to set the company up for success. I really do believe you have to have that foundation in place. In this phase, we've been focused on driving and inspiring mission, enhancing talent and building a new culture, one that values decentralized decision-making speed and accountability. And of course, it includes all of our many separation activities.

On the mission front, we've met with teams around the globe and traveled around the globe to directly engage our team members and share our new mission and values. I believe it is critical that everyone

deeply understands our mission and their role in moving it forward. And I can tell you that the reception has been incredibly positive, and it's helping us build a unified one Solventum mindset, which is absolutely instrumental in driving improved performance, particularly when you're looking at sustained improved performance.

In terms of talent, we've moved aggressively to address capability gaps within just a few quarters post-spin, we've built a leadership team where 80%, 8-0 percent, of our leaders are new to the company, bringing deep sector and transformation experience with many of them having specific spin experience as well. We've also made meaningful progress enhancing key positions that are critical to our performance transformation. Of these positions, 60%, again 6-0 percent, were filled by current employees and 40% by external hires, both groups chosen for their relevant experience and capabilities for this transformation. This shift is happening throughout the organization with what I call trickle down talent, raising the bar for excellence at every level of the company. And in terms of culture, we selected leaders who embody our values and culture to help model our new behaviors. And we've implemented a global restructuring through our Solventum Way program to ensure that our structure also supports this culture.

Okay, and finally, on the separation front. Our ability to execute and deliver on our strategic and financial objectives does not make the deep and unique entanglement between 3M and Solventum any less complex. It is a very complex separation. And there clearly remains risk to the separation work ahead with key milestones that will be happening in '25 and '26. Wayne will talk more about those. But we're making steady progress, and I'm proud of the team we have assembled and very importantly proud of their performance to date.

Okay. Moving on to Phase 2. In Phase 2, we've been focusing on establishing a long-term strategic plan to unlock profitable growth and capture the value of the attractive markets where we play. A key part of this phase has been analyzing the markets, the submarkets and the businesses that we have to shape our focused long-term strategy. And as I've mentioned, the speed with which we brought in new talent, has allowed us to accelerate this process. And as a result, we said we'd be ready to share our long-range plan during this call. But after receiving feedback from many of you, we realized it would be better to separate the strategic discussion from this earnings call, particularly in light of the pending sale of our P&F business. And as a result, we'll unveil our long-term strategy at our Investor Day on March 20 in New York City, where we will have more time to not only outline the long-term strategy, but also provide more details about each segment and the progress we've made to date. And we certainly look forward to seeing you there live.

All right. Finally, Phase 3 is all about optimizing our portfolio. In this phase, we have thoroughly assessed the value and strategic alignment of our businesses, and the recently announced divestiture of our Purification & Filtration segment is a direct result of our Phase 3 review. This decision will streamline our focus, reduce our leverage and improve key metrics, and we are confident, confident that P&F with its highly motivated and innovative team will thrive under Thermo Fisher. And I just want to take a minute to personally thank the P&F team for getting us to this point, and I have every confidence you will continue to bring your passion to work and deliver innovative solutions to your customers.

So in closing, we're making steady progress on our transformation. And through in-depth analysis, leveraging both internal talent and external perspectives, we have a very clear understanding of why the 3M Healthcare business has underperformed its markets in the past. And our primary focus at the upcoming Investor Day will be to share our findings, discuss the changes we've made to inflect improvements and very importantly reveal the key elements of our long-term strategy and financial plan. But just as a preview of what's to come because I know that people are excited to hear it, but as a preview of what's to come. I can tell you that we have an incredible value creation story ahead of us. We are confident that the changes we've already made, combined with our forward-looking strategy, will continue to accelerate sustainable volume growth and ultimately deliver significant shareholder value.

Okay, and with that, I'll turn it over to Wayne to walk us through the financial results in more detail and provide our guidance for 2025. He's also going to give additional color on the separation and, of course, the divestiture.

Okay, Wayne?

Wayde D. McMillan
Chief Financial Officer

Thanks, and thank you to everyone at Solventum for delivering on a successful first year. As you heard from Bryan, we've made significant progress in a relatively short time since our spin last March. I'll focus my comments first on a separation update and then move into our Q4 financial performance before wrapping up with our 2025 guidance.

Overall, the separation is on track, and we're executing against separation milestones while delivering on our financial goals. To date, we have exited roughly 1/4 of over 200 transition service agreements, and we are planning to exit all transition service agreements over the next 2 years. We have successfully implemented new ERP systems in 6 countries to date, including recent deployments in Europe and South America. In operations and supply chain, we contracted to build a new plant in Brazil, where we recently began construction and have entered into a contract with a new European distribution center partner as part of a planned cutover later this year. While we've made significant progress separating, some of the hardest work is ahead with our largest ERP implementations and shift to distribution centers in large regions, along with manufacturing transfers upcoming in 2025 and in 2026. Our progress to date is encouraging, and I want to thank our global team of dedicated people around the world for their efforts in this large-scale separation.

Now turning to our Q4 results. Starting with sales. Fourth quarter 2024 sales of \$2.1 billion increased 2.3% compared to prior year on an organic basis and increased 1.9% on a reported basis, which reflects positive momentum and an easier year-over-year comparison. During the quarter, foreign exchange was a 60 basis point headwind as the U.S. dollar strengthened considerably against most major currencies. Sales performance benefited from favorable volumes, with pricing back to a normalized range, consistent with our expectations. While there remains significant work to sustainably elevate our growth, we are encouraged by the initial volume improvements post spin.

Moving to the segments. Our largest segment, MedSurg, delivered \$1.2 billion of sales, an increase of 1.8% on an organic basis. Growth was led by higher OEM and advanced wound care. Within advanced wound care, growth was driven by negative pressure wound therapy consumables and continued market adoption of single-use negative pressure wound therapy. Our Dental segment delivered \$315 million of revenue, an increase of 4.2% on an organic basis. And while dental was one of the primary beneficiaries of an easier year-over-year comparison, the segment also benefited from recent product launches, as mentioned earlier. Our Health Information Systems segment contributed \$336 million of revenue, an increase of 1.1% on an organic basis which benefited from adoption of our revenue cycle management platform solution. Strength in revenue cycle management was partially offset by a decline in clinician productivity solutions.

Finally, the Purification & Filtration segment delivered \$235 million of sales, an increase of 3.5% on an organic basis fueled by continued strength in our bioprocessing filtration and industrial filtration. Performance in these areas was partially offset by declines in membranes.

Looking down the P&L. Gross margin was 56.2% in the quarter, slightly ahead of our expectations and down 100 basis points versus prior year. Results include approximately 100 basis points of increased cost paid to 3M as part of the supply agreement. Gross margins decreased sequentially as expected. However, they were partially mitigated by favorable product mix benefits.

Operating expenses increased versus the prior year and sequentially from Q3. As we've shared before, the added spend reflects public company stand-up costs and growth investments to support our business transformation. Q4 spend also included Purification & Filtration divestiture costs. Altogether, our operating expenses were in line with our expectations, excluding divestiture-related spend. Note, we will start to benefit from savings of our recently announced restructuring in Q1. We'll touch more on future spending levels as part of 2025 guidance. In total, we delivered adjusted operating income of \$422 million, which translates to operating margin of 20.4%, slightly ahead of our expectations.

Moving down the P&L to nonoperating items. Our net interest expense remained consistent. We also absorbed some onetime expenses associated with the write-down of legacy 3M investments. Lastly,

our effective tax rate of 17.4% puts our full year tax rate of 18.1% toward the low end of our full year guidance range of 18% to 19%. All in, we delivered earnings per share of \$1.41 ahead of our expectations.

Before providing our 2025 guidance, let's recap our first fiscal year as a public company. We delivered 1.2% organic sales growth as we navigated business continuity challenges associated with the separation, eliminated 3,500 SKUs without material revenue impact and began to drive volume back in a positive direction. As a result, we generated organic sales growth ahead of our initial expectations. On the bottom line, we generated non-GAAP earnings per share of \$6.70, also ahead of our initial earnings per share guidance, driven by the better sales performance.

Turning to the balance sheet. We ended the year with \$762 million in cash and equivalents with no outstanding borrowings on our credit facility, and we made cumulative repayments of \$300 million on our \$1.5 billion prepayable term loans. This includes an additional \$100 million debt pay down during Q4. We also generated \$92 million of free cash flow in Q4, bringing our year-to-date total free cash flow to \$805 million, just above the initial guide range for the year.

Regarding the Purification & Filtration divestiture, it is a major milestone for our portfolio transformation strategy. When the transaction closes, we expect margins will improve, and it enables us to accelerate our time line to deleverage the balance sheet and positions us to begin executing our strategy to augment sales growth with tuck-in acquisitions. We anticipate net proceeds will be used primarily to pay down debt and are committed to achieving solid investment-grade ratings with an expected close by the end of 2025. We anticipate the impact to earnings per share to be neutral in 2025.

Now turning to our initial 2025 guidance and outlook. Similar to our approach to guidance for 2024, we'll continue to provide our organic sales growth, earnings per share and free cash flow metrics. Given we're still a new company, we are also providing some additional considerations at the outset of the year. Keep in mind, this guidance is for the total company, including the Purification & Filtration business. We will provide updated guidance when the transaction closes.

Reported sales growth will be impacted by recent strengthening of the U.S. dollar, which we estimate will create an expected 150 basis point headwind with the biggest impact on Q1. We expect organic sales growth of 1% to 2%, which is net of an estimated 50 basis point impact related to SKU exits. Excluding the 50 basis point impact, our normalized annual growth outlook is 1.5% to 2.5%. This reflects the expected underlying improvement for volume across our business segments as we execute against the phased approach to reposition for growth. Regarding our SKU rationalization program, we are exiting an additional 2,000 SKUs in a wave 2, bringing our total exits to over 5,000 or 8% and completes the program. This will have a 50 basis point impact on 2025 and a 100 basis point impact on 2026. Executing this initiative simplifies our supply chain, saves rebranding dollars and also improves our operating metrics over time.

Looking down the P&L. We expect operating margin between 20% and 21%. This outlook includes annualizing the roughly 100 basis point headwind associated with the higher cost of sales from the 3M supply agreement in the first half. Additionally, we expect savings from our Solventum Way restructuring program will more than offset the annualization of stand-up costs and growth investments in 2025. We expect the net savings of the restructuring will increase through the year, resulting in an expected ramp for operating margins from Q1 into the second half of the year.

Moving now to earnings per share. We are guiding to a range of \$5.45 to \$5.65. This includes an additional quarter of interest expense in Q1 2025 and as mentioned earlier, we expect the divestiture of our Purification & Filtration business to be neutral to earnings per share when closed later this year.

Before we move on, regarding tariffs. Our guidance does not assume any tariff impact at this time, given the current dynamic environment and an inability to predict potential financial impact. We are also providing free cash flow guidance in the range of \$450 million to \$550 million, which contemplates capital expenditures between \$350 million and \$450 million as well as annualizing higher interest expense and onetime separation expense.

Before closing out, I also want to remind you that we anticipate Q1 results will be the quarter most impacted by both foreign exchange headwinds and timing of spend. When coupled with the expected pace of increased restructuring savings through 2025, Q1 is the expected low point for both operating margins and earnings per share with improvement through the balance of the year.

In conclusion, we wrapped up an incredibly busy and eventful inaugural year following the completion of the spin and are progressing on our journey as a new public company, delivering 3 consecutive quarters of better-than-expected performance, which is particularly encouraging given the complex and highly entangled separation. We've consistently delivered on our near-term financial objectives, while executing on our separation activities and focusing on turning around the business.

Looking ahead, we'll continue to execute on our 3-phased approach to transform our business, and we use our collective expertise in health, material and data science to deliver on our mission. While we know this turnaround will take time and focused investment, we are encouraged by the early meaningful progress and remain well positioned to execute our value creation plan.

We look forward to our upcoming Investor Day when we plan to share more about the path ahead, including our long-range financial guidance.

With that, I'll now hand it back to the operator for the Q&A portion of the call.

Question and Answer

Operator

[Operator Instructions] Your first question comes from Jason Bednar from Piper Sandler.

Jason M. Bednar

Piper Sandler & Co., Research Division

I don't think I heard, Bryan or Wayde, a buildup or a construction of the organic growth by segment. So just as we're thinking about modeling out the business, not just on a sequential basis, but also across the various segments. Is there any other color you can give like MedSurg kind of at or above the range, Dental below the range? Anything like that would be very helpful.

Wayde D. McMillan

Chief Financial Officer

Jason, it's Wayde. As you mentioned, we're providing guidance at the segment level. But what we would say is the initiatives that we have underway cuts across all 4 segments. So you know we've made structural changes in the business. We've been investing in talent and all that is designed to improve the commercial efforts within our business, and those are going to be more short-term improvements in nature. And then, of course, looking at new products and our innovation pipeline and looking to accelerate that as well. And so those are -- both of those are taking root in all 4 of our segments. And so we would expect all of our businesses to continue to improve. We're just not giving specific guidance on the segment level.

Bryan C. Hanson

CEO & Director

One other thing I'll just add, too, is in the coming Investor Day on March 20, we'll have an opportunity for the president of each of the businesses to get up, talk about their business. And that will give you some more color on what they would expect. Again, we're not even at that meeting going to give guidance by business, but you'll get a better feel of what they're thinking.

Jason M. Bednar

Piper Sandler & Co., Research Division

All right, looking forward to that. And then just the free cash flow guidance was a little bit lighter than we were thinking. I think you mentioned some things in there, not just around CapEx, but interest payments. Is that a free cash flow after interest payments -- or sorry, or I guess, is there anything else of onetime in there? Maybe I ask that in a wrong way, but just what's explaining that lighter guide at least relative to what we're modeling, and how others are probably modeling it as well?

Wayde D. McMillan

Chief Financial Officer

Yes. We are just a little bit below consensus there, and we were keeping an eye on that one because one of the things that we've been building up over time here is total cost of separation. So, I think that's probably what you're getting at, Jason. So, we've given the CapEx piece, and of course, we've got our earnings per share guidance out there. And so, the piece really, I think, is separation that I would point people to. And the best way to really forecast that or model that would be to look at our Q4 exit rate of just over \$130 million of non-GAAP separation-related costs. And you can run rate that into 2025. Just a little step up would be a good place to have it for 2025 because that's where our biggest spend is going to be. And then the good news from there is that we'll be stepping it down in 2026 and then another step down in 2027 when we complete most of the separation-related work. So '25 is the year that we've got a lot of separation costs to transition out of our TSAs. And then as I mentioned, good-sized step down '26 and then again in '27.

Operator

Your next question comes from the line of Patrick Wood from Morgan Stanley.

Patrick Andrew Robert Wood

Morgan Stanley, Research Division

I had one kind of financial question and then a quick follow-up. The 2026 SKU rationalization, I'm sure on the 20th you guys will get into this a little bit more, but just conceptually, is it fair to assume that while you're going to have 100 points of organic growth headwind on that side, that we should see something on the operating margin as those efficiencies from running that through the year are there. Is that just said that there will be some kind of an offset from the efficiencies below in the P&L?

Wayde D. McMillan

Chief Financial Officer

Yes, I'm glad you brought that one up, Patrick. As we mentioned in our prepared remarks, we will see some revenue as well as margin improvement, but it's really small. I think 10, 20 basis point type of improvements. So, it's really about simplification of the business. That's really why we run the process and be able to get 8% of our SKUs out of the supply chain is big. And we also wanted to get in front of all the rebranding efforts that we have to do across all of our products. But at the same time, we do get a small benefit in sales growth and a small benefit in gross and operating margins, and that will be included in our long-range guide that we provided at the Investor Day coming up, but it's not the main reason for doing it.

Patrick Andrew Robert Wood

Morgan Stanley, Research Division

That's really helpful. And then just as a quick follow-up. I appreciate the comments on M&A. If I dial my mind back to about a year ago or so when we were originally chatting, you guys were running way ahead in terms of restructuring the group with the P&F sale on that side. You're talking about M&A. I mean, I guess it's one thing financially to be in a place where you can execute. But how ready is the organization because there's a lot of work to do internally to bolt in new business without it being too disruptive. I'm just trying to understand how much that timeline on adding new assets has been pulled forward or not?

Bryan C. Hanson

CEO & Director

Yes, it's a great question. I would say one of the nicest things about the P&F transaction is it does pull in the time frame where we would be able to transact from an M&A perspective. It doesn't really change the strategy, but it definitely moves up our time line. And we've been building capacity for that. We've been adding people that are capable in the area from a scouting perspective, from a deal negotiation standpoint, integration, you name it. And we really want to make sure that capacity wouldn't be a reason why we couldn't move forward with tuck-in M&A.

The nice thing about this is that we're talking about smaller transactions here. We're in great markets. We don't have to do anything large. We don't have to do anything risky. We can just look at picking up innovation, driving into the commercial channel that we have and then getting more out of markets that we're in. So it does move our time frame up. I believe we have the capacity to do it. I'd be thinking about early 2026 as the time frame because there's -- we want to make sure that we pay down debt, and we're on top of that for a period of time with a really nice leverage ratio, and then we'll start moving in that direction.

Operator

Your next question comes from the line of David Roman from Goldman Sachs.

David Harrison Roman

Goldman Sachs Group, Inc., Research Division

I wanted to maybe just to start with the top line performance that has improved as we've gone through the course of 2024. And I think you're right, it's pretty clear on the volume side that, that's driving the

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turnaround here and the pricing is unfolding as you have communicated. But maybe you could just sort of unpack for us what are the factors influencing the top line performance as you exit 2024? And how you kind of thought about those key underlying drivers as you put together the 2025 outlook.

Bryan C. Hanson
CEO & Director

Maybe I'll start with that one, David, and then Wayde, if you want to add any color. I've been talking about the improvement that we need in what I just defined as 3 vectors. It's really not rocket science. There's only 3 ways that you start to collect growth in the businesses. That's either, one, commercial excellence. I want to call then organic or R&D innovation and then M&A, right? Those are the 3 vectors. I would just say on a commercial excellence, that's the fastest. It can almost be immediate, and I'll talk a little bit more about that in a second. The second is R&D, and that takes a little bit longer, usually 18 months to 3 years in the space that we're in from ideation to launch. And of course, M&A depends on your balance sheet, your readiness from a capacity standpoint and then very obviously, attractive assets that would need to be available.

I'd just say that out of the gate here, we're very much focused on leveraging commercial excellence. That's the primary vector of improvement. And then, of course, some of the existing R&D pipeline that I talked about in my prepared remarks. But a lot of what we're focusing on now is commercial excellence. We've made significant changes in talent. We shifted the compensation towards growth. We've upscaled in our accountability culture. You've got to be urgent and accountable to deliver results in this organization now, not delivering results is not acceptable. We've increased the sophistication of our commercial operations. That's really important to be able to point the team in the right direction and give them the tools needed to be successful, and then we started the specialization of our teams as well. So that's the big push so far.

But then again, we're taking advantage of some of those R&D gems that we found in a bit of an anemic pipeline, and we're going to be leveraging those in the short term. But here's the thing, make no mistake, we are going to be building a stronger innovation pipeline. It is going to be driven off of the focused strategy that we're going to talk about coming in March 20, and we will use the P&F sale proceeds after we digest it for a period to move quicker into that M&A as well. But right now, just out of the gate, what you're seeing mainly is just traction on the commercial side of things.

Wayde D. McMillan
Chief Financial Officer

So I think Bryan covered that, obviously, really well. We've got a lot of good work going on there. David, I'll just affirm your comment around what we saw throughout 2024, and how that leads into 2025 outlook. So you're right, volume has continued to improve. So in the first half of the year, our growth was more than all price, meaning volume was declining. In the second half of the year, we saw that reverse, and we saw our price come into more of a normalized range, and we see volume now more than all the growth. And so we're seeing a nice momentum and build of volume improvement across our businesses. And as that momentum through Q4, that gives us the confidence to guide up like we are for 2025.

And so just to highlight that in this vein of thinking, in 2025, we've got a 1% to 2% guide, but that now includes the 50 basis point of SKU headwind. So you normalize that's 1.5% to 2.5%, that's coming off of a year of 1.2%, where price was a good size in the first half of the year. And we're not assuming that for 2025, we think price will continue in this normalized range. And so we really are counting on the things that Bryan just mentioned, those improvements across the business. And that's what gives us confidence to guide in that 1.5% to 2.5% on a normalized basis for 2025.

David Harrison Roman
Goldman Sachs Group, Inc., Research Division

That's helpful. And I feel here to tell me that you're going to cover this next topic at the analyst meeting, but I'm hoping to get a little bit of color here, which is just on what's happening in your end markets? Because as I look at your performance and then the peers that we're able to track both on the public and private side, I'm having trouble finding what peers are growing at a rate that averages your growth back

to 4% to 6%. So as you've gone through the separation here, is -- maybe you could just sort of update us on your thoughts on what's happening in these end markets and where is the competition doing better than you? And maybe help us provide a little bit more color on the confidence you have in that market outlook?

Bryan C. Hanson

CEO & Director

Maybe -- so yes, I hate to punt to the Investor Day, but we'll talk more about at the Investor Day for sure. But I will talk about Dental because it's kind of a standout growth rate in the fourth quarter. And it's just incongruent with what I think everybody sees happening in the dental market. So if I just talk about that one. It's important to look at the fourth quarter as a good quarter, no question for the team, but it was an easy comment. And so the best way to think about our Dental performance is to blend it with Q3 because that's why the easy comp occurred. And if you do that, you're going to see it's kind of flattish, which is probably more indicative of what's happening in the market right now. As said, we are seeing some good performance in the new products that they're launching. And Karim, who is leader of that business, will talk more about it on March 20. But that one is the one that probably stands out as most incongruent in the quarter with the market and the other performance of other players in dental, but it's mainly because of a comp difference.

Operator

Your next question comes from the line of Travis Steed from Bank of America.

Travis Lee Steed

BofA Securities, Research Division

Wayde, I wanted to touch on the operating margin guide, the 20% to 21% in 2025. It looks like you're already kind of at 21.3% since you've been post spin. I know there's a lot of moving parts between that and in '25. So just trying to -- if there's a way to think about kind of the puts and takes on that '25 op margin guidance, if there's a way to kind of evaluate the underlying performance of your margin expansion and progression over the course of the year, and how to think about kind of the puts and takes there?

Wayde D. McMillan

Chief Financial Officer

Sure. Yes. And it certainly has been a journey. Our first quarter when we went to look in Q2, which is really before any changes were made to the business, we had 20.7% operating margins. And then as you've seen from there, we've continued to make investments in our critical functions to stand up our public company as well as growth investments throughout the year. As you mentioned, Travis, many puts and takes across the separation and spin. But the way that I would have people look at it and it's the way we're looking at it is after 3 quarters, we've really settled into our business model. We've made those critical investments we needed to make in functions. And when we talk about that, we mean areas like cybersecurity, our controllership accounting teams, our legal compliance teams, so we made the investments that we felt necessary to stand up this public company.

We've also layered in growth investments. And so as we exit the year, Q4 at 20.4%. We think that is the run rate that will now carry into 2025, and then we'll start to build upon it. And so we've got a guidance range of 20% to 21%, but I would remind people that we also have the additional 50 basis point headwind in 2025 as we annualize the costs from the 3M separation-related agreement where they can step up costs. And so we had 50 basis points this year. We'll have an additional 50 basis points next year as we annualize it. So we're starting with that 20% to 21% operating margin. And that's -- as you all know, 2025 will be the first year of 4 quarters for the business, and then we'll go to work on improving operating margins from there.

Travis Lee Steed

BofA Securities, Research Division

Okay. And then congrats on the P&F divestiture. But I did want to ask, first of all, is that when you think about the kind of the divestiture of the business and the potential to simplify the portfolio, is the P&F divestiture kind of the one big one? Or is this going to be other things coming potentially over the course of the next few years? And then on the P&F divestitures, a little hard for us to get the models to EPS neutral. So curious how you're thinking about the conservatism built into the EPS impact of that divestiture.

Bryan C. Hanson

CEO & Director

Wayde, why don't you start with the neutral view on 2025, specifically? Maybe talk about the annualized version the first. And then I'll talk about other part of the question?

Wayde D. McMillan

Chief Financial Officer

Sure. Yes, I'm glad you brought that one up, Travis, because I see a lot of people looking at this on an annualized basis, and that's not obviously how it's going to play out this year. So on an annualized basis, I would agree it's accretive. However, we're planning to close this divestiture sometime in the second half as we progress to the end of the year. And so keep in mind, the EPS impact is dependent upon the timing of the close, the timing and the cost of the tender of the debt and then obviously, timing of stranded cost reductions.

So we don't know what month specifically the deal will close. It will be in the second half. But how fast we can tender the debt post close and at what cost has to be factored in as well. So, there'll be a shorter period of time of interest savings than EBITDA savings. So, it's not just a simple 12-month math as some people may be thinking. So altogether, we're planning for the deal to be neutral here in 2025.

Bryan C. Hanson

CEO & Director

Hopefully, that helps. I think some people are looking at it on an annualized basis, and that math obviously make sense that you see it as creative. But just given the timing of '25, it's going to be neutral.

Just on the other part of your question, Travis, I guess the way I would answer it is that not answer that you're going to get these situations, I suppose, but maybe I'll give you some color. I think it's pretty obvious that portfolio optimization is a -- it's an ongoing process. I think the best leadership teams look at this in a perpetual way and are always looking at the value of their portfolio. And we're going to continue to do that. We're going to assess the value of our businesses, and we're going to make thoughtful decisions on where we're going to invest and where we're not just like we've said from the beginning. And I probably want to make sure that I underline if we determined at some point in the future that a business is more highly valued elsewhere, then we'll consider all the appropriate variables to determine whether we should do a transaction.

And we're going to do the normal stuff that everybody does, which is, does it make sense for shareholders? Is it strategic and financial benefit to the company? Do we have the organizational capacity? But very importantly for us, we need to make sure that we're always considering tax consideration, tax implications. Do we do anything that could disrupt the tax-free nature of the spin? And then obviously, if we're still connected with 3M, when we do a transaction, that TSA bridging is another variable that we have to consider. But I guess the short story is it's a never-ending process when you look at portfolio optimization.

Operator

[Operator Instructions] Your next question comes from the line of Vik Chopra from Wells Fargo.

Vikramjeet Singh Chopra

Wells Fargo Securities, LLC, Research Division

Two for me. I appreciate the situation where tariffs is dynamic. But can you help us understand how much of your manufacturing is coming from Mexico? How much flexibility you have to move production elsewhere and to take price to offset any tariff impact? And then I had a follow-up, please.

Wayde D. McMillan
Chief Financial Officer

Sure. I could take that one. And it is certainly the topic of the day, Vik. And so like others, we're obviously concerned and we're monitoring this very closely. All we know at this point really is that China has had the 10% tariff put on it from the U.S. And given that that's implemented, we are including that small piece in our guide, but it's very small relatively, given our limited imports from China. But it's really too early to speculate, and that's why we're not including any large tariff impact or potential speculative impact in our guide because we really don't know where this is going to land, and there's certainly timing dynamics where it seems to be very fluid and changing a lot.

Having said that, we do believe our global footprint likely has less exposure than the other countries. And we have less manufacturing in China. We have 1 plant there, 2 in Mexico and 1 in Canada. And so relative to others, we do think we probably have less exposure. But having said that, we do have plants and businesses in these regions. And depending on where this lands, there may be an impact from tariffs. But at this point, we're not going to speculate on what it is.

Maybe the last thing I would just add is one of our segments, HIS, does not have manufacturing production. So it does not have any exposure. So in addition to a lot of our manufacturing being within the U.S. One of our segments doesn't have any exposure at all. So relative to others, we're probably going to have less exposure. And then to your specific question on Mexico, I mentioned we have 2 plants there. A small percentage of our sales is in those 3 countries, China, Mexico, Canada, and pretty relatively small percentage of our production as well.

Vikramjeet Singh Chopra
Wells Fargo Securities, LLC, Research Division

Great. Helpful color. And my follow-up question is you've sold the Purification & Filtration business. The majority of the proceeds will be used to repay debt. But are there any plans to initiate a dividend or buy back any stock?

Bryan C. Hanson
CEO & Director

You probably don't want me answering that.

Wayde D. McMillan
Chief Financial Officer

I could certainly take this one. As you mentioned, Vik, and we've had in our prepared remarks there, primarily all the proceeds are going to go down to paying debt. Regarding a share repurchase and dividend, we are not planning those. One of the reasons is related to our 3M agreements. So in our tax matters agreement with 3M, there are certain restrictions with respect to asset sales. And so based on those restrictions, we can't use proceeds for things like share repurchase. So I'll just back up and remind everybody about our capital plan priorities that we've been communicating since our first Investor Day and the spin, where first priority is funding the operations of the business and paying down debt. And that's exactly what we're doing here. And then it also positions us for tuck-in acquisitions, as we've mentioned a couple of times here, and that hasn't changed. So the good news is we're now in a position with the delevered and stronger balance sheet to go on offense with M&A.

Operator

Your last question comes from the line of Rick Wise from Stifel.

Frederick Allen Wise
Stifel, Nicolaus & Company, Incorporated, Research Division

Maybe I'll ask another guidance question. I would expect nothing less than from Wayde, I would expect more from you, Bryan. I'm sure this is thoughtfully and balanced guidance when we look at the top line growth and the EPS outlook. Maybe you could help us better understand, we've heard a lot of the headwinds in the incremental, the SKU exit impacts, but help us understand that upper end of the guidance range and the things that you're counting on to go right, what gets you to that top end? What could do even -- help you do even better? And maybe there's color around commercial execution or some of the new products in MedSurg. Just help us better understand the upper end of things.

Bryan C. Hanson
CEO & Director

Yes. That's a great question. It's -- the way that I look at it is one, and probably one of the most important ones is not necessarily commercially based, at least not from a performance standpoint, it is the ERP cutovers. If we can get through the ERP cutovers, we've got 2 pretty material ones coming up this year in '25. We've got serious mitigation plans in place to make sure that we don't have any disruption. But those things can be -- they can be fickle. And so that's one of the things we're looking at that would -- if it goes really well, it helps us get to the top end of that range. If it doesn't go well, then that could push us down to the bottom part of the range. That's probably the biggest variable that's to some extent in under our control, but even the best laid plans don't typically survive first contact with the enemy, right. So that's one.

The second one is that this commercial piece that I talked about. We have hired some really, really good talent. We have a completely new disciplined model in the way that we're going to market. We're specializing the sales organization. We've picked our growth drivers, and we're going to be doubling down in those areas. So if we pick the right growth drivers and we deliver with that execution model, that helps us get to the top end of the range. No question about it.

There's not much we can do to add incremental R&D at this point. That ideation process takes a while, like I mentioned. But we are going to try to find the gems in the portfolio. We're going to get more aggressive on the prediction of growth in those areas, and we're going to build the capacity around them. And right now, a perfect example, Peel and Place and Clinpro, two great products, we way underclubbed because of conservatism, what we felt those products could do, we don't have the capacity to sell them. So we've got to do a better job of that in '25 because those products are already in the queue. But those are the 2 biggest things -- the 3 biggest things actually that I believe can help us get to the top end of the range. The one that just going to keep you up at night is that ERP cutover. We got to do our job to mitigate that.

Frederick Allen Wise
Stifel, Nicolaus & Company, Incorporated, Research Division

Got you. That's great, Bryan. And maybe just last for me, just a more focused one. We haven't talked much about HIS. And I just wanted to -- not knowing much about this space really. I just wanted to better understand when you talk about 50% to 90% of cases can be automated in the autonomous coding. Just where are we, and where are you in realizing this opportunity? What are you expecting? What are you assuming for this year? It's now going to be post this sale, a bigger piece and a more important piece of the business. So just help update us. I know we'll talk more about it at the Analyst Day, too.

Bryan C. Hanson
CEO & Director

Yes, absolutely, Rick. So I will never do the same justice that Garri will do when she gets up on stage and she presents her business, but I'll give you the importance of autonomous coding from a layman's perspective. And here's what you've got to know about revenue cycle management. It is a very labor-intensive process with a lot of things that change. And what you typically find, it's hard to find the people that know how to do the coding. So you're always pressed on being able to get people to do this well, and they make mistakes. It's just humanity. It's going to make mistakes. And so what we're trying to do is to take the pressure on the FTE side of the equation out of the equation by doing autonomous coding. I would say we're early in the phases of this. We've got to prove it out. But we do believe that the technology could apply to 50% to 90% of cases. That's significant. That's important.

Now we've got to prove that it works, and we've got to be able to validate that our autonomous coding could do it as well as people can, if not better. But the idea would be you take that labor challenge out of the picture, you also reduce mistakes because you've got an AI system that's going to be able to do it likely better without the mistakes than a human would do, and you bring down the cost and the efficiency as a result of it. It's pretty exciting for us because we're so highly penetrated with Encompass 360, which is our software package for RCM. This is the next potential area of growth, that and data integrity, which is another interesting area that you'll hear more about on March 20. But I like what I'm hearing. We just got to prove it out.

Operator

I will now turn the call back over to Amy for closing remarks.

Amy Wakeham

Thank you, Ellie, and thank you to everyone who joined us. Thank you for listening and for your questions. We appreciate your interest in Solventum. If you have follow-up questions or need anything else, please don't hesitate to reach out directly. This concludes our fourth quarter 2024 earnings call, Ellie, you can now close us out.

Operator

This concludes today's conference call. You may now disconnect.

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