

Solventum Q1 FY25 Earnings Call Transcript

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Corporate Speakers:

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Bryan Hanson - *Solventum Corporation; Chief Executive Officer*

Wayde McMillan - *Solventum Corporation; Chief Financial Officer*

Participants:

Steven Valiquette Mizuho - *Managing Director and Senior Equity Research Analyst*

Lei Huang Wells Fargo - *MedTech Equity Associate Research Analyst*

Travis Steed Bank of America; *Analyst*

Rick Wise Stifel - *Managing Director*

Patrick Wood Morgan Stanley - *Research Division, MD of Equity Research*

Jason Bednar Piper Sandler - *Analyst*

David Roman Goldman Sachs – *Managing Director*

Operator

Good afternoon. My name is Amy, and I will be your conference call operator for today. I would like to welcome everyone to the Solventum First Quarter 2025 Earnings Call. As a reminder, this call is being recorded. Thank you. 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 Finance Communications. Please proceed.

Amy Wakeham – *Solventum Corp; Senior Vice President, Investor Relations & External Finance Communications*

Thank you. Good afternoon, and welcome to Solventum's First Quarter Fiscal Year 2025 Earnings Call. Joining me on today's call are Chief Executive Officer, Bryan Hanson and Chief Financial Officer, Wayde McMillan. 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 presentation are both available there now.

During today's call, our discussion and any comments we make will be made on a non-GAAP basis, unless we have specifically called them out as GAAP. The non-GAAP information we discuss 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. And with that, I'd like to now hand the call over to Bryan.

Bryan Hanson - *Solventum Corp; Chief Executive Officer*

All right. Thank you, Amy, and to all of our shareholders and everyone interested in our company story, just thanks for joining us today for our first quarter results. And I'm just going to get straight to the point. We are off to a strong start for 2025. And as a result of this positive momentum, favorable FX and decisive steps we've taken to mitigate the impact of known tariffs, we are raising our organic revenue guidance and confirming EPS for the year.

All right. Before we jump into the strong start for the year, let me just quickly address tariffs specifically, and Wayde will provide more details in a minute. But to be clear, tariffs will be a headwind for us this year. And without them, we would be raising our EPS guidance commensurate with the underlying momentum we're seeing in the business.

Now that said, we've begun executing short-term mitigation measures based on what we know today, and are actively developing, analyzing and, of course, implementing additional strategies. And as a result, and as I just mentioned, we expect to be able to manage the current year headwind within our existing full year EPS guidance. And obviously, given just the fluid nature of the situation, we will continue to closely monitor the evolving policy changes and assess what they mean for our organization.

Relative to our continued momentum, progress here is further evidenced by our first quarter results, marking another positive quarter of volume growth. This makes it now four consecutive quarters of positive growth in sequential improvement as we delivered 4.3% organic sales growth and adjusted earnings per share of \$1.34, again, continuing to perform ahead of expectations.

I think this is particularly impressive, though, given the company's historical performance. As I shared at our recent Investor Day, this business experienced six years of a declining volume trend and seven quarters. That's nearly two years of negative volume growth before our spin.

Now stopping that decline and reversing the trend are direct results of the foundational enhancements we made across three primary areas: the first being our mission and culture. The second, our talent and capabilities; and third, our efforts to stabilize the business across commercial productivity, our innovation process and our strategic focus and alignment. And as I've referenced before, I am very impressed with the team's ability to execute all of these changes as quickly as they have, particularly given the distractions of the separation process. And I want to extend my gratitude to our dedicated team members around the globe, not just for another strong quarter, but really for their hard work overall, which is

advancing our mission and driving us forward. This team continues to impress me, as they make significant progress in executing the separation and advancing across all three phases of our transformation plan and very importantly, delivering results that have already changed the trajectory of this business.

Now more broadly speaking, from a macroeconomic perspective, this quarter, well, it has certainly been one of the more eventful starts to a new year. And as such, we are actively navigating a shifting geopolitical landscape and rapidly evolving trade policies. Now while we are managing this turbulent environment aggressively, we are also ensuring that our primary focus remains very clear. Number 1, and obviously, delivering for our customers worldwide so patients continue to receive the care they need and number 2, and very importantly, staying committed to investing in the key areas that will support continued and sustainable improvement in our growth.

And as a result, just as I outlined at our Investor Day, we are fully committed to our growth and margin drivers to reposition this company for profitable growth and drive meaningful value for shareholders.

Okay. Now moving to our business segments, where progress and positive momentum continue. The MedSurg business had a very strong quarter, benefiting from positive underlying business performance and favorable order timing. Now regarding our underlying business performance, we continue to focus on driving the adoption of our recently launched V.A.C Peel and Place dressing. As many of you may remember, this is a product within our negative pressure wound therapy business, which is one of our key growth drivers.

As I've mentioned previously, this product provides value in three areas. It simplifies the procedure, it reduces procedure time and importantly reduces the number of dressing changes per week, all of which are meaningful advances for both patients and providers, and the team has done a really good job of ramping capacity to meet the very strong demand and our newly dedicated commercial team continues to drive momentum in this space.

And also in MedSurg, in the growth driver area of IV side management, we are very pleased with the traction that we're seeing in this space. And our newly dedicated commercial team has successfully converted key accounts during the quarter. Given our momentum here and to further support the needs of this business, we have invested hundreds of millions of dollars for capacity expansion in the U.S., specifically in South Dakota with strong support of the then Governor Kristi Noem. And moving to our Dental Solutions business, we saw benefits in three areas: first, in our core restored as growth driver as well as our strategic bed area of aesthetics and across other recent product launches. In core Restoratives, our differentiated and strong brand recognition continues to resonate with our customers, and it provides a solid foundation for growth and our recent product launch of Filtek Easy-Match and our refocused dedicated sales team continued to support solid growth in this area.

Anaesthetics customer response to the Q4 launch of our first-to-market and 3D printed Clarity Precision Grip Attachments remains very positive. And this product enhances our ability to offer a unique combination of dental and ortho solutions really enabling the team to expand their conversations with both dentists and orthodontists.

And then finally, our Clinpro Clear Fluoride Treatment launch continues to gain traction with customers and had strong demand in the quarter. It's the combination of these areas has helped to drive offsets for decelerating areas like impressioning materials to help stabilize the segment even as overall market volumes remain challenged.

Okay. In our HIS business, we are focused on our growth driver of revenue cycle management. And as you remember, a key component of this is autonomous coding. And as we've mentioned, our AI-driven autonomous coding technology really focuses on streamlining the coding process to help save our customers time and money. And medical coding is incredibly complex, and our computer-assisted and emerging autonomous technology can account for the constant tide of regulatory changes, quality demands and local, state and organization specific guidance. And this HIS team is highly focused on leading the way in autonomous coding. And doing so, of course, with leading AI-driven solutions, that's for sure, but importantly and probably most important, leveraging our decades of trusted high-quality and compliant coding.

And last but not least, turning to our Purification and Filtration business. We saw another quarter of robust demand for our bioprocessing solutions which gives us confidence in the strength of the end markets and the value of the segment's differentiated technology and reoccurring revenue model. And our investment in additional capacity in our industrial business, supported accelerated growth in the quarter as well. And as we shared in our last quarter, the P&F business is very well positioned for growth under its new owner, where it has a really strong strategic fit. We expect, as we mentioned before, to complete the transaction by the end of 2025, and our team is working very diligently for a smooth close and ultimately, a smooth transition. At our recent Investor Day, I spoke extensively about our progress across the three phases

of our transformation plan. And if you didn't see it, I would encourage you to watch the replay or read the transcript for more details. Both of those are available on our Investor Relations website. But just as a quick summary regarding Phase I, our mission and values have been deployed globally and through our communications and transformation efforts, we are seeing deep understanding and most importantly, connection from our team members to both.

We've hired great talent across a significant number of critical to transformation roles, and our separation efforts continue to be on track. As a matter of fact, we have a very large team mobilized right now across the globe and have just started this week with our largest ERP cutover to date. And I know that team is working around the clock to execute this very important phase of our separation, and I want to thank each and every one of them for burning the midnight oil and moving us forward.

And moving to Phase II as a global team, I can tell you that we are very aligned and executing a long-range plan we just unveiled at our Investor Day, and we are hyper-focused on driving our five growth driver areas, which will help expand our scale within our most attractive markets and ultimately, as a result of that, increase the weighted average market growth of our business.

And finally, on Phase III, once we closed the divestiture of the P&F business, we anticipate being able to execute tuck-in M&A, which as we said before, will focus on enhancing our recently presented organic long-range plan.

So in summary, it's pretty clear that we are making steady progress on our transformation, and we're extremely confident that the changes we've already made, combined with our newly defined strategic plan will accelerate sustainable and profitable volume growth and ultimately, ultimately deliver significant shareholder value.

And with that, I'll turn it over to Wayde to walk us through more detail on our first quarter results and 2025 guidance as well as provide additional color on the separation and on everybody's favorite topic tariffs. Okay, Wayde, we'll pass it over to you.

Wayde McMillan - *Solventum Corporation; Chief Financial Officer*

Thanks, and thank you to everyone at Solventum for the continued progress and for delivering a strong start to fiscal year 2025. As you heard from Bryan, we're making meaningful progress on the three-phase transformation plan as we complete our first full year as a public company. I'll focus my comments initially on a quick separation update before moving into our Q1 financial performance. Then we'll wrap up with our 2025 guidance update, which includes the impact of tariffs.

Overall, the separation remains on track and we are executing against key milestones while delivering on our financial goals. To date, we have exited just over 30% of the more than 200 transition service agreements and we plan to exit all transition agreements over the next two years.

In operations and supply chain, we continue to make progress consolidating across manufacturing and distribution centers. We expect to significantly advance progress on our ERP milestones with four deployments planned this year, including our first major deployment in Q2. We want to thank our global team of dedicated people around the world for their efforts in this large-scale separation.

Now turning to our Q1 results. Starting with sales, first quarter 2025 sales of \$2.1 billion increased 4.3% on an organic basis compared to prior year and increased 2.6% on a reported basis. During the quarter, foreign exchange was a 160 basis point headwind. Overall, we had a stronger-than-expected volume performance driven by improved commercial execution as we drive focus and alignment across the organization on our growth drivers to accelerate sustainable sales growth.

We also benefited from order timing related to customers buying ahead of upcoming ERP and distribution center moves and SKU exits. We expect this favorable timing benefit will be offset by year-end mostly in Q2 and Q3. The impact of SKU exits in the quarter was 30 basis points.

All in, we estimate our normalized Q1 organic sales growth is closer to 2.5%. Pricing remains consistent within our expected range and we are encouraged by the continued shift to delivering positive volume growth across the businesses.

Moving to the segments. Our largest segment, MedSurg delivered \$1.2 billion of sales, an increase of 6% on an organic basis. Growth was broad-based and led by the infection prevention and surgical solutions business which grew 8.2% and was the primary beneficiary of the previously mentioned timing benefits, which drove the significantly higher-than-expected performance.

Advanced Wound Care growth of 2.8% was driven by negative pressure wound therapy consumables and continued market adoption of single-use negative pressure wound therapy. Our Dental Solutions segment delivered \$328 million of revenue, an increase of 40 basis points on an organic basis. And as you heard from Brian earlier, we are seeing the positive benefit of new product launches even as the end market continues to be challenged, and we remain encouraged by the overall resilience of our dental portfolio.

Our Health Information Systems segment contributed \$329 million of revenue, an increase of 3.9% on an organic basis which benefited from strong customer retention of our revenue cycle management software solutions. The competitive environment has resulted in continued declines in clinician productivity solutions. However, this product category grew in the current quarter primarily due to an easy prior year comparison.

Finally, the Purification and Filtration segment delivered \$242 million of sales an increase of 2.2% on an organic basis, led by our bioprocessing filtration and industrial filtration categories. Similar to the prior quarter, performance in these areas was partially offset by declines in membranes.

As a reminder, ordering timing benefits in Q1 last year resulted in a tough comparison. Looking down the P&L, gross margins were 55.6% of sales in the quarter, slightly ahead of our expectations and down 260 basis points compared to the prior year. Our current quarter results include approximately 100 basis points of increased cost paid to 3M as part of the supply agreement when comparing year-over-year.

Gross margins also decreased sequentially as expected based on normal manufacturing seasonality. Operating expenses increased versus the prior year and were roughly flat on a sequential basis as planned. The increased year-over-year spend reflects public company stand-up costs and growth investments to support our business transformation.

Savings from the recent restructuring are on track and will continue to ramp through the year. Altogether, operating expenses were in line with our expectations.

In total, we delivered adjusted operating income of \$407 million, which translates to an operating margin of 19.7% ahead of expectations. Moving down the P&L to nonoperating items. Our net interest expense remained consistent with Q4. Lastly, our effective tax rate of 19.9% is just below the low end of our full year outlook and reflects a slightly favorable jurisdictional mix.

Overall, we delivered earnings per share of \$1.34, ahead of our expectations, driven by sales outperformance and favorable margins. We also ended the quarter with \$534 million in cash and equivalents with no outstanding borrowings on our revolving credit facility.

To date, we have made cumulative repayments of \$400 million on our \$1.5 billion prepayable term loans, which includes another \$100 million paid off in March. For Q1, our free cash flow declined \$80 million, which was consistent with our expectations and reflects both Q1 planned payments and onetime separation costs, as well as the timing of interest payments and shift into the execution phase across several separation projects.

Now turning to our 2025 guidance update which reflects our strong Q1 performance and momentum to start the year. As a reminder, our guidance is for the whole company, including the purification and filtration business, which is held for sale until the transaction closes, which is expected before the end of the year.

Starting with full year organic sales growth, we are increasing our outlook to a range of 1.5% to 2.5%, an increase of 50 basis points above our prior guidance. We continue to estimate a 50 basis point impact of SKU exits, which we anticipate will ramp throughout the year. Excluding this planned impact, our annual growth outlook is 2% to 3%, reflecting the momentum we are seeing in volume-driven performance across our business segments as we execute against the phased approach to reposition for growth.

Regarding foreign exchange: given the recent weakening of the U.S. dollar, we now estimate currency will have a neutral impact on sales growth for the year. This compares to our prior outlook of a roughly 150 basis point headwind and will have a positive benefit on our reported sales and earnings per share.

For earnings per share, we are maintaining our initial \$5.45 to \$5.65 earnings per share guidance, including estimated tariff headwinds that will impact us during the second half of 2025. The current trade policy environment and tariffs are an evolving dynamic and challenging to quantify.

We currently estimate tariff headwinds of approximately \$80 million to \$100 million in 2025 and which translates to an earnings per share impact of \$0.35 to \$0.45. This will pressure our gross margin and operating margin in the second half of the year.

And we now anticipate operating margins for the year will be at the low end of our planned range of 20% to 21%. We expect our strong Q1 performance and business momentum favorable foreign exchange and mitigation actions to offset the impact of tariffs within our earnings per share guidance range.

Our tariff estimate includes all known tariffs at this time with the following assumptions: U.S. exports to China at 125% and represents about half of the total impact with expected exemptions. U.S. to and from the EU remains at 10% and which represents about 1/3 of the total impact. The remaining balance of tariff impacts reflects smaller amounts for Mexico and Canada, given the USMCA exemptions and minimal imports from China to the U.S., consistent with our prior view. It's important to highlight that due to the short duration of our inventory turns approximately one quarter.

The impact of tariffs implemented in Q2 will be fully realized in our financial results starting in Q3 and continuing through Q4. Our team has moved quickly to adapt to the changing situation, while this will be an ongoing process of assessment and mitigation, we've already taken steps and are executing several action plans to mitigate the headwinds. We have filed for and received nearly all outstanding USMCA certifications and working across regions to secure additional exemptions. We're continuing to optimize our inventory leveraging sourcing options across our supply chain and thoughtfully evaluating selective pricing strategies. We are also maintaining our free cash flow guidance of \$450 million to \$550 million.

Before closing out, I also want to reiterate our commitment to continued investment focused on the long-term value creation opportunity ahead while also looking for opportunities to expand margins and generate strong cash flows.

In conclusion, we're building momentum, having delivered a strong financial performance in Q1 and as we execute on our separation plans. With that, we'll now hand it back to the operator for the Q&A portion of the call.

Operator

Your first question comes from the line of Patrick wood with Morgan Stanley.

Patrick Wood - Morgan Stanley - Research Division, MD of Equity Research

Beautiful. I'll leave the tariffs to everybody else because I can't survive talking about that topic anymore. So I'm going to go on the top line actually. How confident are you around that kind of 2.5% underlying? And I say this because obviously, the remaining core growth like -- is like 4.6%, obviously, we'll combine 4.3%, like really, really strong quarter. Is this like a SKU level analysis or something like that? Because how confident are you that, that's actually stocking from the customers and not just some of the commercial plans that you guys have been putting through and therefore, is a little bit more durable than maybe you're suggesting?

Wayde McMillan - Solventum Corporation; Chief Financial Officer

Patrick, it's Wayde. We're confident. It's a number that's tough to predict beforehand because it's difficult to know how much customers are going to be buying in and the timing of it and to the extent of it. But after the fact, we've got good analytics. We work with our distributor partners as well as our end customers and understand their order patterns and it's something that we're confident in. It is still an estimate. We specifically called it out closer to 2.5% because there is some variability to it. But the 2.5% is a good number for us, and that's what we think is the number that we grew in the quarter,

exclusive of those customer order buying ahead, and what that means for us is a really strong quarter. It's more than double the growth rate that we had in 2024. So very happy to see the continued acceleration of the business, and it's really across all four of our segments. So, we had a really strong quarter here to start the year.

Patrick Wood - *Morgan Stanley - Research Division, MD of Equity Research*

Yes. It's definitely faster than we thought. And then just as a quick follow-up, is it a fair assumption on our end to assume that the the general price mix trends that you've seen in the previous quarter was consistent here. You hinted that in the opening remarks, but is it fair to assume that the entire delta basically is all volume?

Wayde McMillan - *Solventum Corporation; Chief Financial Officer*

Yes. So we've been anticipating this for some time as we've got the business focused on volume growth, which we think is the sustainable strategy. And so for pricing, again this quarter, we saw it in that normalized range for us, which is between plus or minus 1%, and it's not really the driver that we're focused on, it's all about volume growth for us from here.

Operator

Your next question comes from the line of Rick Wise with Stifel.

Rick Wise - *Stifel - Managing Director*

Maybe just to start with thinking about the year ahead, I mean, to say a simplest, tariffs are a bigger headwind, you were very clear. But offsetting that is the business momentum is the lower -- is the lower FX. Can you help us at all think through the quarterly cadence as we adjust our models? I mean just starting with the second quarter, last year, it was sort of flat sequentially, but you have new products, you've got commercial momentum, et cetera. Help us a little bit directionally if you could.

Bryan Hanson - *Solventum Corp; Chief Executive Officer*

I just want to make sure that we clarify, Rick, are you talking about growth by quarter -- what are you talking about?

Rick Wise - *Stifel - Managing Director*

Growth or dollars in -- can you report higher numbers in the second quarter given all the positives and relative to the negative impact of tariffs. Top line -- top line Bryan. I'm not -- sorry if I'm not being clear.

Bryan Hanson - *Solventum Corp; Chief Executive Officer*

Probably for clarification, tariffs really don't have a significant impact for us on the top line. It's definitely more of a bottom line challenge for us. The ordering ahead of the timing that we saw in the quarter was more associated with our ERP cutovers and plant distribution changes and some buy ahead on the SKU rationalization. That will come back in Q2, Q3, maybe even Q4, most of the impact will be in Q3. That's the way we're looking at it today because by the time we get to Q3, we'll be past the distribution center changes, and we should be free and clear see those changes.

Operator

The next question comes from the line of Jason Bednar with Piper Sandler.

Jason Bednar - Piper Sandler - Analyst

Nice start to the year here guys. I want to come back a little bit on Patrick's question and talking about that 2.5% underlying. I guess my question is more around how does that compare to what you were internally expecting. It sounds like it's nicely above -- nicely above most of our models. But I guess kind of where are you at? Where are you executing, and then we're five weeks removed here from quarter end. I guess, on that order timing that you referenced for 1Q, did you have any additional buy ahead in April? Or did some of that -- you already start seeing some of that draw down in April and early May?

Bryan Hanson - Solventum Corp; Chief Executive Officer

Why don't I start maybe with how we're looking at the 2.5% and how it compared to our performance or assumption of performance? And then Wayde, you could talk more about the drawdown it was above our expectations, too. We're very happy with the 2.5%. As a matter of fact, if you think about it on an annual basis, I'm not saying we're going to do 2.5% but the last time in this company did 2.5% was I think, 2018. So, it was a long time ago. So, we were very happy with the performance in the quarter.

It was definitely ahead of our expectation even on an underlying basis. And really, the key driver for it is the thing that we talked about at our investor meeting, which is we are seeing the benefits of our enhancements to the commercial organization and the focus that we now have. Because remember, we've enhanced the commercial organization by dedicating the sales organizations to those growth driver areas and we're just seeing traction as a result of it. Now we have to keep that going. And quite frankly, we shouldn't be happy with 2.5% because we're still not at market but it's a really nice improvement off of last year.

Wayde McMillan - Solventum Corporation; Chief Financial Officer

Yes. And then just picking up on what we're seeing so far in Q2. The -- just before I get into Q2 specifically, as Bryan mentioned just a minute ago, -- the expectation is because of our ERP cutover and distribution center moves in Q2 that we'll see the majority of that order timing come back in Q3. It is tough to predict. We could see more of it in Q2 or a little bit more in Q4, but our expectation is most of it comes on the back of our ERP and distribution center moves which the big moves are coming here in Q2.

As far as quarter-to-date for us, it's in line with those expectations but we've got a ways to go yet. And we are actually just as Bryan said in his prepared remarks, the team is hunkered down right now as we go through the ERP implementation this week, and we're right in the throes of it.

So from that standpoint, the expectation would be -- we could see some of the headwind come back here in Q2, but we think the majority will be coming in Q3.

Operator

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

David Roman - Goldman Sachs – Managing Director

I wanted to go into a little bit more detail here on the top line drivers, especially in MedSurg and certainly appreciate the order timing dynamic. But as you look at on an underlying basis, it sounds like both infection prevention and Advanced Wound Care are tracking ahead of where your original expectations are. So, could you maybe just unpack for us in a little bit more specific, some of the drivers there? How much of that is new product launches or some of the commercial changes that you've made in the downstream organization? And I have a follow-up on the P&L.

Bryan Hanson - *Solventum Corp; Chief Executive Officer*

Yes. Yes. They're kind of connected, but you hit both of them. The way we look at it is there were three vectors of advancing the growth of our business. The first one and the one that is really benefiting us today is the commercial execution improvements. But as you have those improvements, you can also benefit from existing brands that we have in the marketplace and then new product launches as well, the ones that we just recently launched. And so it's a combination of the team is just focused, its delivering, the urgency around and the focus on delivering what you commit to is there, which makes a big difference.

We've had a lot of changes in leadership, as we've talked about. So we've got a lot of different folks in place that are driving this harder than before. And you look at some of the names that we're talking about that create an opportunity now for that new engine to drive it, which should be things like Tegaderm CHG - that is a product that's been out for a while but it's a brand that is highly recognized is differentiated and is significantly underpenetrated, as you probably remember from our presentation during the Investor Day. V.A.C Peel and Place is another one. It's a great product. And it doesn't sound that great when you hear it, but it's a game changer when it comes to negative pressure wound therapy, and the team is highly focused on it. eBowie-Dick is in our sterilization assurance business. This is basically taking an 80-year old process that was antiquated and is digitizing it. It's changing the game. So it's a really cool technology as well.

And then you've got Clinpro Clear, Clarity Precision Grip Attachments that you would have in the dental business. That's different from insure. But again, this whole theme of the engine now being able to leverage new products is there. And it's the same thing in HIS. It's another motivator for the new team that's focused on this to drive autonomous coding which is part of the revenue cycle management growth driver.

So across the board, whether it's in MedSurg, whether it's in dental, whether it's in HIS, it's the commercial focus that we have. It's the desire now to achieve the goals that are set and it's the focus on these new product launches that are really driving.

Operator

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

Travis Steed - *Bank of America; Analyst*

Congrats on a good quarter. I wanted to ask a little more on the tariffs in a way that you could help us kind of think about the mitigation efforts, how you're offsetting \$0.40 of earnings here. How much of that is FX? How much it's operational and all that?

Wayde McMillan - *Solventum Corporation; Chief Financial Officer*

Yes. Those are the key areas for us. So just to maybe reiterate what we've got out there. And keep in mind, the inventory turns fast for us. So, we just want to make sure we emphasize that because we have to be one of the fastest inventory turn companies out there. I think under 3M inventory was managed very tightly, and we continue to have a 90-day

inventory turn here on a three-month turn. So as a result of that, we see the impact immediately start in Q3, and we'll have it in Q4. So in other words, we have two quarters of impact here.

And so that \$80 million to \$100 million that we're estimating will be spread across Q3 and Q4 for us this year. We provided the major components as well. U.S. to China is half of it. And so we're closely monitoring those.

So I think even before we get into the mitigations, exemptions play an important role here. And obviously, we're working closely with our teams and working with their regional partners and exemptions in China are important to us, and that's where we've landed at this estimate. So as far as the mitigation goes, you've called it out strong business performance in Q1, and we're expecting that through the remainder of the year. Favorable foreign exchange. As you mentioned, we're not putting specific dollar amounts on any of these, but they are all major drivers in the offset.

And then within those additional mitigating strategies, we're continuing to optimize our inventory the sourcing teams are busy. It is incredible. How much time and effort actually has been put into these initiatives that weren't expected. And so the teams are heavily focused on sourcing options all across our supply chain. And then obviously, we're looking at thoughtful pricing strategies where we think that makes sense for the long-term business, where they makes sense for our customers as well as those in our value chain.

So overall, we're very happy to be holding our key metrics here despite the tariff headwinds.

Operator

The next question comes from the line of Vik Chopra with Wells Fargo.

Lei Huang - *Wells Fargo; Associate Research Analyst*

It's Lei, calling in for Vik. Just two related to tariffs, please. First, clarification, the 10% you're assuming for Europe. So it sounds like you're not assuming that rate goes up after the 90-day pause. I just want to confirm that. And two, can you just give some color around how we think about annualized tariff impact if we should start by just annualizing what you've given for this year? Or, could it be higher or lower given mitigation, et cetera?

Bryan Hanson - *Solventum Corp; Chief Executive Officer*

Sure, Lei. I can take that one. So that -- you heard the prepared remarks correctly, we're assuming that the 10% to and from the EU stays in place. And so we're not assuming those exemptions go away and there's any change to that. So, our assumption is just it's 10% for the rest of the year, and that's what we're including in our guidance.

On the annualized, it's really difficult to annualize right now. And so the short answer is no, I would not annualize our \$80 million to \$100 million that we're expecting here in Q3 and Q4. And it's too early to try to annualize the number or think about what the impact to 2026 might be. It's just too early to call.

Obviously, the tariffs are subject to change on an annual basis or over a longer span and our mitigation strategies are underway. And some of those are shorter term, but some are longer term as well. I mentioned the manufacturing supply chain team have been working on mitigations. Some of those have time sensitivity with them. And we've been to date, and we'll continue to strengthen our regional supply chain strategy.

So these are strategies that were before tariffs. Certainly, we've given them a higher sense of urgency, but they'll be ongoing over time. We're also continuing to work with our industry trade associations to secure more exemptions in the various regions.

And then I mentioned the selective pricing strategy. So, it's really not something that I would recommend trying to annualize at this point, just given the difference between the impacts we're expecting here in 2025 and mitigations related to those and what the impacts might be over the longer term as well as what our mitigation strategies might be over the longer term.

Our goal, obviously, is to manage the business and in our metrics. And, so we're very happy to be holding our key metrics here.

Operator

The next question comes from the line of Steven Valiquette with Mizuho.

Steven Valiquette - *Mizuho - Managing Director and Senior Equity Research Analyst*

Maybe just a question on dental for a moment here. Last quarter, when you guys had 4% organic growth you talked about, you were taking share relative to the market growth. This quarter, a little bit slower at the 0.4%. But a lot of surveys suggest that the market also kind of slowed down a lot in the quarter as well. So, I guess I'm curious how you think you performed just relative to the market in dental in the first quarter.

Bryan Hanson - *Solventum Corp; Chief Executive Officer*

Yes. I think pretty well. I mean, generally speaking, if you think about that business, we are in categories that even in challenging times for the dental market are pretty resilient, if you chip a tooth, you get a cavity, you're usually going to take care of it because there's pain involved, certainly an aesthetic issue with it as well. So we're in, I would say, generally speaking, more resilient areas. So, that's a benefit to us.

And we have launched new innovation. Dental, the dental group is probably at ahead of the reboot of innovation, and they're launching products now that are absolutely giving them tailwind for the year, and we fully expect that to continue throughout the year.

Operator

The last question comes from the line of Travis Steed with a follow-up question from Bank of America.

Travis Steed - *Bank of America; Analyst*

Hey, I had a follow-up, thanks for putting me back on. I was curious Wayde, if you can help us characterize how much of the tariff impact is tied up with the P&F business versus kind of what we'll call RemainCo.

Wayde McMillan - *Solventum Corporation; Chief Financial Officer*

Yes. So, we're not breaking that out, Travis, and that's really because we're guiding for the whole company at this point. And the timing related to P&F is somewhat variable as we look to plan to close before the end of the year. But, I think just maybe part of your question maybe as you're modeling this, I think it's important to think about operating margins as well.

As I said in our prepared remarks, we're now planning for operating margins to be at the low end of 20% to 21%. But there's a key dynamic in here in timing throughout the quarters of the year. We're expecting Q2 to be another strong quarter like we saw in Q1. In fact, we're planning for it to be above that full year number above 20%.

And then with the pressure that we're seeing from the tariffs, we're expecting that pressure to be in the second half. And if you're just doing it mathematically for us to end up at the lower end of our guidance range, that would mean the second half of the year would have to be below 20%. So, I just want to make sure everybody has that as you're thinking about the phasing. But we'll bring P&F into it when we close, and we'll provide a pro forma financial information so that it's easy to see the business without P&F. But at this point, we're guiding with P&F still in the business as a holdco

Operator

At this time, there are no further questions. I would like to turn it back over to Amy for closing remarks.

Amy Wakeham – *Solventum Corporation; Senior Vice President, Investor Relations & External Finance Communications*

Great. Thank you, Amy, and thank you, everyone, for listening and for your questions. We appreciate your interest in Solventum. If you do have any follow-up or need anything else, please don't hesitate to reach out to us directly. This concludes our first quarter fiscal year 2025 conference call. Operator, Amy, you can now close the call.

Operator

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

