

Solventum

Q3 FY25 Earnings Call

Transcript

November 6, 2025

4:30 p.m. EST

Corporate Speakers:

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

Bryan Hanson – *Solventum Corporation; Chief Executive Officer*

Wayde McMillan – *Solventum Corporation; Chief Financial Officer*

Participants:

Patrick Wood – *Morgan Stanley; Managing Director and Equity Research Analyst*

Ryan Zimmerman – *BTIG; Equity Research Analyst*

Steven Valiquette – *Mizuho; Managing Director and Senior Equity Research Analyst*

Jason Bednar – *Piper Sandler; Equity Research Analyst*

Travis Steed – *Bank of America; Equity Research Analyst*

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Operator

Good afternoon. My name is Regina, and I will be your conference call operator today. At this time, I would like to welcome everyone to Solventum's Third Quarter 2025 Earnings Call. As a reminder, this conference is being recorded. All lines have been placed on mute to prevent any background noise.

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 Corporation; Senior Vice President, Investor Relations & External Finance Communications

Thank you, and good afternoon. Welcome to Solventum's Third 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 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 they've been 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 one question and one related follow-up. If you have any additional questions, you're more than welcome to rejoin the call queue.

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

Bryan Hanson - Solventum Corporation; Chief Executive Officer

All right. Great. Thank you, Amy. And thanks to everyone for joining us for our third quarter call today. Let's just jump right in. We delivered another strong quarter as we execute out three-phased transformation plan. And the consistent underlying momentum we are seeing reflects not just the effectiveness of the changes we've already made, but also the performance and the dedication of our global teams. This momentum was reflected in our Q3 performance with positive volume growth driving top and bottom line results. And as such, we are again raising our sales growth and EPS guidance for the year.

We are clearly ramping towards our LRP revenue growth targets faster than expected and our momentum is anchored in three primary areas of progress and clear results. The first is the team's ability to manage the separation distractions and importantly execute ERP implementations while also delivering on their commitments. And number two, the commercial restructuring and enhancements we executed last year are rapidly delivering results. We shifted, as you remember, over 1,000 positions to drive specialization. We upgraded commercial leadership, executed an accountability culture with rigorous operating mechanisms, and changed incentives to biased growth, all of which are paying off. And number three, our project to revitalize the innovation process has derived a sharper, more aligned new product pipeline, almost doubling our previously forecasted vitality index and meaningfully increasing the value of our innovation pipeline.

We are also seeing the underlying operating margin improvements we expected as we move through the year and remain focused on driving sustainable efficiencies. Our momentum in programmatic savings and tariff mitigation strategies within our supply chain combined with our Transform for the Future initiative we just announced today, strengthens our ability to deliver our LRP margin targets even in the fact of current tariff headwinds. Our Transform for the Future initiative is a multi-year global initiative designed to further accelerate profitable growth and strengthen our position in a dynamic market. This initiative will reshape our cost structure, improve operational efficiency and fuel innovation as we mix shift resources to our most attractive markets.

As the separation progressed, we are unlocking new efficiencies by gaining full ownership of our IT systems and freeing up resources and bandwidth to more aggressively pursue savings and drive efficiencies for our team members. In other words, given where we are in our journey, this is an excellent time to transform how we operate for a stronger future.

Okay. As we move forward, the third phase of our transformation program, portfolio optimization remains a key priority. This is about making choices to shape our future, focusing on acquiring strategically attractive assets that fit our long-term vision and closely evaluating current assets to ensure go-forward fit. And I'm very proud of the progress we have already made in this phase. And we are more than halfway through our comprehensive SKU rationalization program, which is a solid step in refining our portfolio. And the successful and timely sale of our Purification & Filtration business is another tangible example of this strategy in action, allowing us to quickly and materially reduce our debt, refine our strategic focus, and improve our leverage position, which has resulted in credit upgrades from two of our rating agencies.

We are now positioned to shift our focus toward offensive M&A while expanding our options for capital allocation, including potential capital return initiatives. From an M&A perspective, we are targeting tuck-in opportunities generally valued under \$1 billion in established and attractive markets where we already operate. This approach allows us to build scale in our most promising markets and leverage the capabilities of our enhanced global commercial team.

OK. Moving to our businesses. Overall, our business mix in the third quarter was largely as expected, but with growth rates of Dental Solutions and HIS better than expected. Our MedSurg business continues to deliver strong growth year-to-date performance in all three of its growth driver areas, leveraging new product innovation, commercial specialization and consistent execution by the team. In Advanced Wound Care specifically, we saw clear acceleration in growth led by our negative pressure wound therapy growth driver. Our newly specialized commercial organization is driving the planned ramp up of Prevena therapy in the V.A.C. Peel and Place Dressing. And with the strong clinical differentiation that we have in the space, a robust --- a very robust DME infrastructure that nobody else has and significant under-penetration of this breakthrough therapy, we see meaningful runway for continued growth acceleration.

In Infection Prevention and Surgical Solutions, aside from the expected impact of the first half order timing, our underlying performance remains strong. Growth was fueled by our two growth drivers in this area, Sterilization Assurance and I.V. Site Management.

Looking at Sterilization Assurance first, our dedicated sales team is capitalizing on the strong brand equity we already have in this space and the momentum from three new sterilization product launches, each designed to simplify and enhance the sterilization process for customers.

In I.V. Site Management, we continue to see robust demand for our Tegaderm Antimicrobial solutions supported by recent launches across Europe, Asia and the U.S. Our specialized teams are driving premium growth by converting customers from standard films to higher value solutions that reduce catheter-related bloodstream infections and ultimately improve patient outcomes. Again, with our strong clinical differentiation, a robust and specialized commercial channel and once again significant under-penetration of this breakthrough technology, we see meaningful runway for continued growth acceleration.

In our Dental Solutions business, we continue to gain momentum in our Core Restoratives growth driver with results driven by a focused portfolio, accelerating new innovation and specialization in our sales channel. This quarter brought two major milestones. First, the launch of our refined and redesigned Clarity brand and the launch of the Solventum Filtek Composite Warmer. This is actually the first fully Solventum branded restorative device. These efforts, alongside continued strong demand for Clinpro Clear and Filtek Easy Match, helped fuel strong sales growth in the quarter. We also saw significant service level improvements driving impressive back order recovery in the quarter. Confidence in our service levels is absolutely critical to driving growth, and I want to congratulate the team for making it happen.

In Health Information Systems, we delivered a solid quarter as we continue to modernize revenue cycle management. We made progress in our autonomous coding offering with high automation and acceptance rates being achieved and our partnership with Ensemble. This demonstrates our operational excellence and service line automation capabilities. These advances continue to position HIS as the largest autonomous coding vendor, underscoring our role as an AI-driven leader, transforming customer operations and setting new standards for efficiency and accuracy. Another important element of our RCM strategy or revenue cycle management strategy is the international expansion of our flagship solution 360 Encompass and autonomous coding options, on track installations in Australia and ongoing expansion in the Middle East demonstrate our commitment to supporting healthcare providers around the world.

In summary, our progress is palpable from our navigation of separation activities, traction from commercial structure and innovation enhancements or portfolio optimization results. We are delivering and delivering with speed here at Solventum and we are just getting started. I am absolutely convinced we have the right strategy, the right global team and the right culture to continue unlocking value for our patients, partners and shareholders. I want to say thank you to the entire Solventum team for your unwavering resolve, your dedication to continuous improvement, and your inspiring progress every single day.

And with that, I'm going to turn it over to Wayde, for a closer look at our financial results and other key updates. Okay. Wayde, I'll pass it to you.

Wayde McMillan - *Solventum Corporation; Chief Financial Officer*

Thanks, Bryan. I'm pleased to report another solid quarter as we navigate the separation from 3M and transform our balance sheet following the sale of the Purification & Filtration business. Consistent with prior quarters, I'll provide you with updates on the separation and P&F divestiture and then transition to our Q3 financial performance and conclude with an update on our 2025 guidance.

Overall, our work to complete the separation from 3M is going very well. The dedicated separation management teams at 3M and at Solventum are working well together on multiple fronts, our separation from 3M and the divestiture of P&F. We continue to execute against milestones while making foundational changes to deliver on our long-range plan. In Q3, after a successful European ERP conversion, we are winding down interim mitigation efforts and are fulfilling orders from our dedicated European distribution centers. We also continue to simplify our supply chain network. Now, with 21 global Solventum-owned manufacturing locations down from the 29 we had at the March 2025 Investor Day. Seven of the eight facilities were conveyed as part of the sale of the Purification & Filtration segment, while the eighth facility was an exit from one of our three remaining Dental plants. We've also completed about half of the manufacturing line transitions, all while improving product availability as part of our commitment to deliver for customers and patients. Regarding the P&F divestiture, the teams are finalizing plans and positioned for success. At the close, 1,700 employees transitioned as part of the successful handover, along with the initiation of nearly 200 transition agreements.

Now, turning to our Q3 results, starting with sales. Third quarter 2025 sales of \$2.1 billion increased 2.7% on an organic basis compared to prior year and increased 0.7% on a reported basis. During the quarter, foreign exchange was a 110-basis-point benefit to reported growth, while the intra-quarter sale of the P&F business represented a 310-basis-point impact on our reported growth. Overall, we had stronger than expected sales growth driven by higher performance in Dental and HIS. Importantly, volume continues to be the main driver of growth, as we align our organization to deliver sustainable sales growth and new product innovation. Pricing remains within the expected range of plus or minus 1%. Our SKU rationalization program also remains on track with 60-basis-point impact in the quarter.

Moving to the segments, our largest segment, MedSurg delivered \$1.2 billion in sales, an increase of 1.1% on an organic basis. Within MedSurg, the Advanced Wound Care business grew 2.7%, an expected improvement over the first half of the year, which was driven by negative pressure wound therapy. Notably, growth was led by single-use Prevena, which exited the quarter at double-digit growth. As expected, Advanced Wound Care performance was partially offset by infection prevention and surgical solutions, which was flat in the quarter. As a reminder, infection prevention and surgical solutions was the primary beneficiary of order timing in the first half of the year. We have communicated the first half benefit would reverse mostly in Q3 and we anticipate absorbing the balance of the timing headwind in Q4.

Our Dental Solutions segment delivered higher than expected \$340 million in sales, an increase of 6.5% on an organic basis. On a normalized basis, we grew in the 2% to 3% range. The additional growth came from back-order improvements along with an easier comparable. Our focus on innovation across our restorative and prevention products as well as our Clarity Aligners is translating to improved performance.

Our HIS segment also contributed higher than expected \$345 million in sales, an increase of 5.6% on an organic basis driven by strong performance management solutions due to favorable consulting fees and service milestones in the quarter, as well as strong revenue cycle management software solutions. Together, these more than offset expected declines in clinician productivity solutions. We remain focused on system implementations to support our hospital customers as they navigate a dynamic environment.

Looking down the P&L, gross margins were 55.8% of sales in the quarter, a 20-basis-point sequential reduction, which largely reflects the 130-basis-point impact of tariff headwinds, including mitigation and offset by strong manufacturing performance. And to a lesser extent, the expected partial quarter 20-basis-point benefit of the Purification & Filtration sale. Our manufacturing and supply chain organization remains focused on delivering programmatic savings and margin expansion. Sequentially, operating expenses increased by \$3 million to \$739 million, driven mainly by an increase in equity compensation and other benefits, which were partially offset by the P&F sale and further savings from our Solventum Way restructuring program. In total, we delivered adjusted operating income of \$431 million, which translates to an operating margin of 20.6% in line with our expectations.

Moving down the P&L to non-operating items. Our net interest expense and other non-operating spend improved modestly versus Q2 driven by \$10 million reduction in interest expense following the partial quarter benefit of the \$2.7 billion debt payoff following the P&F sale.

Lastly, our effective tax rate of 21.8% was higher than the first half due to a tax rate increase in a foreign jurisdiction during the quarter and a change in our geographic mix due to the significant paydown of US-based debt. Overall, we delivered earnings per share of \$1.50, ahead of our expectations driven by sales outperformance, stronger gross margins and lower net interest expense.

Shifting to our balance sheet. The higher estimated \$3.6 billion net proceeds from the Purification & Filtration sale resulted in an improved \$1.6 billion of cash and equivalents with no outstanding borrowings on our revolving credit facility. Additionally, we paid down \$2.7 billion of debt in the quarter. This represents a transformation of our balance sheet just six quarters following our separation from 3M. Looking ahead, we are well-positioned to execute on our Phase 3 portfolio optimization with added flexibility across a range of capital allocation options to unlock shareholder value. For Q3, free cash flow decreased by \$22 million, excluding P&F divestiture impact of \$189 million, free cash flow increased \$167 million. On a year-to-date basis, free cash flow excluding separation costs and divestiture costs is \$735 million, with a conversion rate of 93%. As a reminder, we expect to see a step down in separation costs in 2026 and again in 2027, as we complete the separation from 3M.

Now, turning to our 2025 guidance update, which reflects our Q3 performance and sustain momentum. Starting with our top line, we are increasing our guidance to the high end of our full year organic sales growth range of 2% to 3%. By segment, we expect MedSurg will improve sequentially again in Q4, giving continued strength in Advanced Wound Care and improving infection prevention and surgical solution volumes as we expect to digest the remaining first half volume benefit in Q4. We anticipate Dental to again be stronger than the first half given strong new product momentum. Finally, HIS is expected to grow in line with the first half of the year and continue to benefit from strength in revenue cycle management. We continue to estimate a 50-basis-point impact of SKU exits for this year and 100-basis-point impact in 2026. Excluding this planned impact, our annual growth outlook for 2025 is now at the high end of 2.5% to 3.5%, reflecting the continued volume-driven performance across our business segments as we execute against the phased approach to reposition for growth.

We are progressing towards our 2028 long-range plan goal of 4% to 5% faster than expected, with continued sales and margin improvement planned in 2026. We are revising our full year net interest expense assumption to approximate \$360 million and our total non-operating expense assumption to approximately \$400 million for the year. And we continue to estimate the full year effective tax rate will be at the low end of our 20% to 21% range.

Before commenting on earnings per share, our 2025 tariff headwind estimate remains unchanged at \$60 million to \$80 million, with a greater headwind expected in Q4 than the impact in Q3. Altogether, for earnings per share, we have increased our guidance to a range of \$5.98 to \$6.08. This represents an increase following the \$5.88 to \$6.03 update we issued on September 1 after completing the EPS accretive Purification & Filtration sale. This further increase reflects our strong performance in the quarter, combined with expectations for continued execution as we complete our first full fiscal year as a standalone organization.

For free cash flow, we have updated the guidance range to \$150 million to \$250 million due to the P&F divestiture, including classification of certain impacts to free cash flow. Excluding the impact of the P&F divestiture, free cash flows are still expected to be in the range of \$450 million to \$550 million. As Bryan mentioned at the outset of the call, we have announced our Transform for the Future restructuring program. This program is designed to offset the impact of tariff pressures, divestiture stranded costs and separation impacts as we exit TSAs. The program also fuels investment to drive sales growth all while we deliver on our margin expansion plans consistent with our long-range plan. Once fully implemented, the four-year program is projected to deliver annual savings of approximately \$500 million and is expected to cost \$500 million in total. We will provide more detail on our 2026 guidance on our Q4 earnings call.

Before wrapping up, I want to extend my gratitude to also Solventum team members for their outstanding work and collaboration in successfully completing the sale of the Purification & Filtration business. Closing this transaction only six quarters after separation is a major achievement that strengthens our balance sheet and accelerates transformation. At the same time, we're staying disciplined, balancing strategic investment with cost transformation to deliver expanding margins, robust cash flow and lasting shareholder value.

Concluding the financial section, we delivered another strong quarter and are making great progress towards achieving our long-range plan goals of accelerating sales growth to 4% to 5% and growing EPS at a 10% CAGR.

With that, I'll now hand it back to Bryan for a quick summary.

Bryan Hanson - *Solventum Corporation; Chief Executive Officer*

Okay. Thanks, Wayde. And so, we had a lot of information in our prepared remarks, and I just want to make sure we summarize the most relevant points. So, let me just do that now. First, our commercial and new innovation enhancements are delivering faster and more materially than we expected. And this has resulted in faster ramp towards our LRP revenue growth target and sets us up well for improvements in 2026.

Number two, our supply chain and tariff mitigation and savings initiatives, together with our new Transform for the Future program, drive tangible confidence in our ability to improve margins in 2026 and deliver our LRP margin target even with significant tariff impacts that were not contemplated in those targets.

Number three, with SKU rationalization and the P&F sale, we are seeing meaningful results in our portfolio optimization strategy, and portfolio optimization will continue to be a lever for value creation here at Solventum. And then, finally, our significant debt reduction has strengthened our position to pursue tuck-in M&A. And it expands our options for capital allocation, including potential capital return initiatives.

Okay. And with that, I'm just going to reiterate once more. We have a bright future. We have the right strategy. We have the right team, and we are well on our way.

Okay. Let's go to Q&A.

Operator

Thank you. I'd like to remind everyone to please limit yourself to one question and one related follow-up, if applicable. We'll pause for just a moment to compile the Q&A roster. Our first question will come from the line of Patrick Wood with Morgan Stanley. Please go ahead.

Patrick Wood – *Morgan Stanley; Analyst*

Beautiful. Thanks so much. I'll keep it to one. But the Transform for the Future program was this one that was kind of kicking around that you guys had initiated pretty early on? Or was this a function of tariffs, if you see what I mean? And then, when you're thinking about the savings and the reinvestment from that, what I'd like – if you had to pick a couple of buckets, the main areas you're most interested in internally reinvesting in, where is that, is that the sales force, is that marketing like how should we think about that? Thanks.

Bryan Hanson - *Solventum Corporation; Chief Executive Officer*

Yeah. No. Good to hear from you and thanks for the question. I just say maybe to start it was something that we were always contemplating. If you just think about it, Transform for the Future is part of the transformation phase. We enter the three phases that we've talked about. And so, it's always been there, but we really had to wait until we were ready. But we had to get through our Solventum Way restructuring changes. Obviously, there was a lot that was happening there. We wanted to make progress on the separation from 3M and also the sale of P&F. And now, we have, I'm just going to call the systems and the bandwidth to do Transform for the Future. So, something we had always contemplated and certainly, you can imagine the focus on it because of tariffs is pretty high. So, with that, maybe, I'll transfer to Wayde on a couple of the areas that we're going to focus on savings and then we can talk about the reinvestment.

Wayde McMillan - *Solventum Corporation; Chief Financial Officer*

Sounds good, Bryan. Happy to. And as Bryan said, it's a broad program. And so, we are looking across all areas of the organization. Actually, it's very comprehensive looking at our operating structure, looking at procurement, cost management, supply chain team, manufacturing, looking at our global footprint as well, and then, looking at streamlining our systems, as Bryan said in his prepared remarks. And we'll be working through final ERP implementations here in 2026, taking over ownership of those systems and then certainly looking at increasing automation as well. So, we're very focused on separation today, but looking forward to freeing up resources and working on this program over the next several years. I think, Bryan, you want to touch on the reinvestment.

Bryan Hanson - Solventum Corporation; Chief Executive Officer

Yeah. And ultimately when you think about the reinvestment, it just really accelerates our opportunity to mix shift our spend to those areas with the highest returns. You've hit some of them. Obviously, research and development is going to be an area of concentration. The commercial infrastructure, we need to drive it, so on and so forth. Those are the areas of the shift. Not saying that we don't spend a lot in those areas today. What I'm saying is we're going to shift the focus of that spend to the highest return areas.

Patrick Wood – Morgan Stanley; Analyst

Love it. Thanks for the question, guys.

Wayde McMillan - Solventum Corporation; Chief Financial Officer

Thanks.

Bryan Hanson - Solventum Corporation; Chief Executive Officer

Thanks, Patrick.

Operator

Our next question will come from the line of Ryan Zimmerman with BTIG. Please go ahead.

Ryan Zimmerman - BTIG; Analyst

Thanks for taking the question. Just to dovetail on Patrick's just real quick and then I have a more high-level question. The program, the \$500 million in cost, Wayde, is that equal over the next four years? Is that upfront? I might have missed that.

Wayde McMillan - Solventum Corporation; Chief Financial Officer

Yeah. Ryan, we haven't given details on the cadence of the spend yet. Just that that \$500 million cost we're planning over the next four years. And so, it'll be dictated by the different projects. There's many multiple projects that we're planning to execute over the next few years.

Ryan Zimmerman - BTIG; Analyst

Okay. All right. And then, if I think about kind of your guidance for the remainder of the year, getting to that kind of 3% or so. Clearly, you guys outperformed in the back, in this quarter. But it does imply a little bit of a lower growth profile in the back in the fourth quarter – excuse me. And so, is there anything in there, maybe from the Dental back order dynamic that you're contemplating or that we should contemplate when we think about kind of your fourth quarter implied guidance?

Wayde McMillan - Solventum Corporation; Chief Financial Officer

Yeah. I'm glad you asked that one, Ryan, because as you know and others know, we've had some lumpiness to the first half of the year around volume as our customers prepared for our ERP systems and DC cutovers. And so, just to reiterate there, what we've guided to now is the high end of our 2% to 3% annual guide. And what you're talking about is that Q4 essentially puts us at the midpoint of that, around 2.5% for the quarter. But you have to remember that that also includes absorbing the remaining first half volume give back in IPSS. So, we'll still have some pressure in Q4 in IPSS. If you normalize for that, it's going to be in line with the growth rate in the previous two quarters.

Operator

Our next question will come from the line of Steven Valiquette with Mizuho Securities. Please go ahead.

Steven Valiquette – Mizuho; Analyst

Hi, thanks. Good afternoon. Thanks for taking the question. Congrats on these results, especially on the Dental sector. So, I guess my question in relation to Dental, there was – yeah, somewhat of a common geographic theme across most of the other publicly traded dental companies that Europe had a pretty strong recovery in 3Q. But the US market was still fairly choppy. Just curious, within your Dental portfolio, are you seeing similar trends geographically or perhaps it looks different dynamics for you guys? Thanks.

Bryan Hanson - Solventum Corporation; Chief Executive Officer

Yeah. Thanks for the question. I would say we didn't see anything that was dramatically different by region. The real momentum for us comes around new products. So, we've launched those on a global basis and they're getting traction not just in the US, but outside the US as well. So, I just kind of give a shout out to that Dental team. They're really doing a nice job from an innovation perspective and a specialized sales organization they've put into place is receiving those new products quite well and delivering results. Thanks for the question though.

Steven Valiquette – Mizuho; Analyst

All right. Thanks.

Operator

Our next question comes from the line of Jason Bednar with Piper Sandler. Please go ahead.

Jason Bednar – Piper Sandler; Analyst

Hey, good afternoon. Thanks for taking the questions and congrats on the results here. I've got two, I'll just ask the first one, first here to start picking up on the Dental theme. Wayde, I heard you about pricing contributions for the company, but was there any benefit in your results there for Dental from tariff-related price uplift? We've seen that from some other players. And just maybe what kind of visibility you have to sustaining that underlying 2% to 3% growth you saw during the quarter, maybe not just in 4Q like you guided but even in the quarters that follow?

Bryan Hanson - Solventum Corporation; Chief Executive Officer

Yeah. I'm going to put the Dental team on the spot because I absolutely believe it's sustainable. It's not something that we can improve. So, I'm feeling good about the momentum in that business. Again, really focusing on the commercial infrastructure they put into place, a change in new product cadence, which looks really good and healthy, not just now, but in the future. And so, I'm feeling pretty good about the momentum that we have there.

And relative to pricing, we didn't see any extraordinary pricing in the quarter. It's in line with what we typically see.

Jason Bednar – Piper Sandler; Analyst

All right. Understood. And then, as a follow-up, Bryan or Wayde, why is the tariff impact range still as wide as it is? I mean, isn't all of that effectively capitalized in the balance sheet at this point? Should we be able to dial that into a tighter range than what we probably had three months ago?

Wayde McMillan - Solventum Corporation; Chief Financial Officer

Yeah. Jason, we talked about that a lot heading into the quarter and we decided just to hold it because it is such a dynamic environment. And so, we'll wait to see here. That's the best estimate that we can have at this point in time. The range we felt is appropriate given the high and low ends for what we think could happen. Of course, very dynamic out there. And we'll see how this progresses through the end of the year.

Operator

Our next question will come...

Bryan Hanson - Solventum Corporation; Chief Executive Officer

To your point just – yeah, I was going to say, just to your point in the way that we capitalize things, it would be even if things change, it would be very little impact to this year. Go ahead. I'm sorry.

Operator

Our next question will come from the line of Travis Steed with Bank of America. Please go ahead.

Travis Steed – BofA Securities; Analyst

Hey. Thanks for the question. I wanted to ask about your comment on kind of progressing towards the 2028 longrange plan of 4% to 5% faster than expected. It looks like already excluding SKUs, you're only 100 basis points away from market growth this year. How should we think about kind of that going forward? Can you close that gap next year? And Wayde, anything else to kind of think about on the kind of puts and takes to consider as we dial in models for next year?

Bryan Hanson - Solventum Corporation; Chief Executive Officer

Yeah. Maybe I'll start with that Wayde, and if you want to provide any additional color. I'd just say that, we are giving a lot of color right now, so, we're not going to give any more than that relative to guidance for 2026. I think, the takeaway is the ramp that we're seeing, the LRP just stated, it is happening faster than expected. I remember that when we presented the LRP back in March, I had people come up to me afterwards saying, I don't know that you can get there. You're reaching too far. I think, anyone who doubted us now knows that we're already ramping pretty rapidly to it. And it's not a question of when. It's not a question of if. It's a question of when. And remember, once we get there, the bus doesn't stop, right? That's not the final stop. We're going to revise once we get there and shoot for a higher target. We're not going to make that change now and we're not going to try to change the timeline. We're going to keep the LRP as it is. But it's pretty clear we're progressing faster than people thought.

Wayde McMillan - Solventum Corporation; Chief Financial Officer

Yeah. And just picking up on 2026 guidance. Travis, I'd be disappointed if you didn't ask for 2026 on a Q3 call, knowing that we don't guide until Q4. But we do have some color that I think could help everybody, as you think about our 2026 numbers. And one of them is the good news is that, we don't see any full year significant, tougher, easy comps next year. And that's important because we've had some intra-quarter ups and downs during the year. And so, we've provided color throughout the year so that it can support the modeling on a quarterly basis, but it all nets out for the year. Our expectation is that this final volume headwind for IPSS in Q4 will net us out for the year. And then, on a full year basis, we won't see any tougher, easy comps. But of course, we have to take a look at the inter-quarter timing as we get into 2026. But other than that, we're not guiding to 2026 just at this time, but hopefully that's helpful on the sales line.

Travis Steed – BofA Securities; Analyst

Yeah. It's helpful and glad, I'm predictable, Wayde. I've – Kind of my second question in on, the comment you guys made on the balance sheet has been transformed in the six quarters and you're ready to execute on portfolio optimization, just

wanting to kind dial into that a little bit and kind of what that means and how quickly that could happen and the ability to kind of improve the free cash flow from where it is today to help fund those acquisitions?

Bryan Hanson - *Solventum Corporation; Chief Executive Officer*

Yeah. Yeah, absolutely. I think, the reason why we're kind of doubling down on that capital allocation question is because we are feeling very confident about the operating cash that we're generating and we feel like it's extremely durable. And of course, combine that with where we are from a balance sheet perspective and it allows us to do multiple things now, right? We can do the M&A that we've been talking about, and it certainly opens the door to giving cash back as well. So, those are the things that we're contemplating having conversations with our board, as you can imagine. And at the appropriate time, we'll update. Wayde, anything?

Wayde McMillan - *Solventum Corporation; Chief Financial Officer*

Yeah. And just pick up on the last part of your question around the free cash flows. And again, I'm glad you asked. This one gives us an opportunity to talk a little bit more about it. As we called out in prepared remarks, we have some accounting for the P&F divestiture that impacts the free cash flow line, but that's offset in the investing cash flows. And so, that caused us to revise our guidance for free cash flows for the year. But if you net out the impact of the P&F divestiture, we're still right in line with our beginning of the year, \$450 million to \$550 million of free cash flows. And so, what I shared last call on the Q2 call is that we do have some timing throughout the year that we're dealing with. But our expectation would be similar cash flows to Q3 net of the divestiture, which I shared in my prepared remarks around \$170 million to \$200 million. And so, if we assume the same type of free cash flow benefit ex-divestiture in Q4, we'll be right into our guidance range for the year.

And we intentionally added some additional color around free cash flows, excluding the separation costs, which will step down somewhat in 2026, but most of it and be almost all done in 2027. And then, these divestiture impacts that are classified to free cash flow, because we want to make sure that we're highlighting the very strong free cash flow conversion for the business. And on a year-to-date basis, what we look like over 90% free cash flow conversion, excluding those two major initiatives. And so, we can't wait to get to the other side of the separation as well as get through the divestiture here and really show the cash generation power of this business on the free cash flow line.

Operator

Our next question will come from the line of Vik Chopra with Wells Fargo. Please go ahead.

Lei Huang – *Wells Fargo; Associate Analyst*

Hi. Thank you. It's Lei calling in for Vik. You gave some helpful color on 2026 in terms of I think about the top line growth. Can you share any color as far as how to think about margin expansion? And I like that is also ahead of plan as you look at the LRP target? And I have a follow-up.

Wayde McMillan - *Solventum Corporation; Chief Financial Officer*

Sure. So, for 2026, what we shared on our prepared remarks is that we would expect to see continued improvement on both the top line and the bottom line. What we do have to highlight is that obviously tariffs are going to be more – assuming the assumptions that are in place today, there will be more of a headwind next year and that'll pressure operating margin expansion. But that's one of the reasons we've got our programmatic savings as well as our new transformation – Transform for the Future program here to offset that. So, we might see a little bit more pressure on the bottom line in 2026. But just pulling back up to the long-range plan commentary we gave on the bottom line for earnings per share growth, we're planning a 10% CAGR for earnings per share over the three-year long-range plan period. And it's our goal. We're looking to expand earnings per share 10% each year, might not happen every single year, but that's our goal.

Bryan Hanson - *Solventum Corporation; Chief Executive Officer*

Yeah. Maybe just to draft off that as well. One of the reasons we're talking about the programmatic savings, the tariff mitigation that we're doing in supply chain and also the Transform for the Future is we wanted to take that concern off the table that tariffs might actually drive margins down in 2026. We just take that off the table. We're seeing that we're going to improve margins. We're not going to say how much, but we just wanted to be very clear that that's the expectation.

Lei Huang – *Wells Fargo, Associate Analyst*

That's super helpful. Thank you. And just my quick follow-up is you mentioned a few times about the firepower to do deals and such going forward. Can you just remind us what you've said about potential areas of interest and any comment on how soon we might expect to see something? Thank you.

Bryan Hanson - *Solventum Corporation; Chief Executive Officer*

Yeah. We're actually actively looking for opportunities to move forward. And these would be tuck-in type acquisitions. We just referenced in the prepared something below \$1 billion in value, obviously not sales, but \$1 billion in value. And it would be close to the best; it would be in areas that we already play. We have commercial infrastructure that we can leverage. It would just fit to reduce the risk, reduce the complexity and ensure that we get a good outcome. So, that's where we're going to concentrate. You can imagine, just given the scale of MedSurg, that's an area of concentration, but we're looking for these in all of our businesses right now.

Operator

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

Amy Wakeham - *Solventum Corporation; Senior Vice President of Investor Relations & External Finance Communications*

Great. Thanks, Regina. And thanks, everyone, for listening and to our analysts for your questions. If you have follow-up questions or need anything else, please don't hesitate to contact the Investor Relations team. This concludes our third quarter of fiscal year 2025 conference call. Regina, you may now close things out

Operator

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

