Solventum Q1 FY26 earnings call transcript

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Corporate speakers:

Bryan Hanson – *Solventum Corporation; Chief Executive Officer*

Wayde McMillan – *Solventum Corporation; Chief Financial Officer*

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

Participants:

Brett Fishbin – *KeyBanc Capital Markets; Equity Research Analyst*

David Roman – *Goldman Sachs; Equity Research Analyst*

Ryan Zimmerman – *BTIG; Equity Research Analyst*

Jason Bednar – *Piper Sandler; Equity Research Analyst*

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

Rick Wise – *Stifel; Equity Research Analyst*

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

Operator

Hello, and welcome to Solventum's First Quarter Fiscal Year 2026 Earnings Call. All lines have been placed on mute to prevent any background noise. [Operator instructions] I would now like to turn the program over to, Amy Wakeham, Senior Vice President of Investor Relations & Finance Communications. You may begin.

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

Thank you. Good afternoon, and welcome to Solventum's First Quarter Fiscal Year 2026 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 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. Please review the supporting schedules in today's earnings press release to reconcile the non-GAAP measures with the GAAP reported numbers. Our discussion on today's call will include forward-looking statements, including, but not limited to, expectations about our future financial and operating performance. These statements are made 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. [Instructions]

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

Bryan Hanson – *Solventum Corporation; Chief Executive Officer*

All right. Great. And thanks, Amy, and to all of our shareholders and everyone else following the Solventum story, I just want to say thanks, and welcome to our first quarter 2026 earnings call. And I'm going to start by addressing our Solvers around the world because I'm pretty sure that a few of them are listening in today. I just want to say thank you. I thank you once again for delivering on your commitments in our fast-paced transformation environment. I know it's not easy. I know it's not easy with the amount of change. But the results that we're sharing today, well, they just don't happen without you and your hard work. And I just want to say I'm extremely proud of not just your dedication, but the results that you continue to deliver. This team's ability to drive outcomes while navigating ongoing separation efforts, ERP implementations and acquisitions and divestitures, well, it's just -- it's a testament to the strong talent that we have in the organization. It's a testament to you. And it's a testament to the culture that we've already built. So again, to our global team members, thank you very much for making it happen.

Okay. Now let's get into it. We delivered first quarter results ahead of our plan and ahead of expectations. Organic sales growth and EPS both exceeded our plan. And it's again reflecting a very strong execution across the organization and the momentum that we've already built. We saw solid performance across all segments, driven by strong commercial execution and new product launches. And thanks to positive volume, mix and continued progress on our savings initiatives, we also achieved better-than-expected performance on margins as well.

This is a clear reflection of the discipline and the rigor we've built into how we manage this business. Q1 is a clear indication that we are well on our way to delivering our 2026 guidance, and importantly, our go-forward LRP objectives. It's clear that our transformation journey is working. It's making progress. We've mentioned before, we've rebuilt our commercial engine with just clearer accountability and needed specialization and stronger leadership. And now innovation is reinforcing the commercial momentum that we've built. And we expect to have close to 20 new products launched over the next 2 years. And as we would expect -- as anyone would expect, a meaningful portion of them will be within our growth driver areas. This will be additional fuel now for that new and enhanced commercial team. And when it comes to operational efficiency and the separation from 3M, we've made meaningful progress on our ERP cutovers as well as the overall separation process. And I can tell you that the team continues to execute against these milestones with purpose.

Now that said, we cannot wait to get to 2027 and put the majority of the separation work behind us. We expect the resources and the bandwidth we free up to create significant value. And that's exactly what our Transform for the Future program is designed to capture.

And as a reminder, our Transform for the Future program is a multiyear $500 million savings program, and it is our way of proactively reshaping our operating structure while freeing up resources to invest for the long term. We are streamlining

systems, increasing automation and optimizing our global footprint while repositioning spend toward the highest return areas of our business. This program is already paying dividends and will deliver more meaningfully in 2027 and beyond.

When looking at our portfolio optimization program, we've moved rapidly here with clear proof points of our ability to execute, ranging from SKU rationalization to the sale of the P&F business to the acquisition of Acera, and we are just getting started. We see portfolio optimization as a perpetual lever for value creation here at Solventum. In other words, as we said in our original Investor Day, we will continually assess our businesses for strategic and financial fit. And when we determine that someone else can offer more value for our business than we derive, or we see another path to increase shareholder value, we will act decisively just like we did with the Purification and Filtration (P&F) business.

Relative to our SKU rationalization, we're more than halfway through this process and expect to finish by the end of this year.

Our separation of P&F is on track and progressing well.

And Acera, although it's early, the performance reinforces our ability to identify, close and effectively integrate attractive assets in our space. In fact, Acera is another great proof point that portfolio optimization isn't just a strategic priority. It's a value creation lever that we absolutely know how to pull. We targeted the right asset, a fast-growth business that is aligned to our existing call points and as a result, immediately beneficial to our combined commercial teams. And importantly, we see Acera as just the beginning.

We have a target-rich environment for additional tuck-in acquisitions and a balance sheet that gives us the flexibility to pursue them while also returning capital to shareholders.

And as you probably remember, we have Board approval for up to $1 billion in share buybacks. And given the substantial value we see in our shares and the quality of our business, one should expect that we will accelerate execution of that approval.

Okay. So moving to our three operating segments. I'll start with MedSurg, which, of course, is our largest business. We continue to see strong underlying performance in our growth driver areas. Negative pressure wound therapy (NPWT) was led by ongoing demand for traditional and single-use therapy, continued expansion of our V.A.C.® Peel and Place dressing, and of course, our specialized sales force. And now with Acera, it opens the door to the fast-growth acute care synthetic tissue space and really slots perfectly into our advanced wound care infrastructure. We're obviously early in integration, but the thesis is playing out. The team is executing, the product portfolio is resonating with our customers, and we expect Acera to be a meaningful contributor to reported growth as the year progresses. In our infection prevention and surgical solutions (IP&SS) business, Tegaderm™ CHG remains a consistent performer as our team successfully upsells this important clinical solution, and we're encouraged by the adoption of the recent Attest™ sterilization product launches as well. And both of these areas are benefiting from our specialized sales teams.

In Dental Solutions, we are building on the momentum we saw in 2025. Our Clarity™ brand relaunch, the Filtek™ Easy Match and Clinpro™ Clear are resonating with our customers and benefiting, again, from a more specialized sales team. And as we exited 2025, this team made significant strides in improving backorders, and I can tell you that our customers are noticing. I want to thank our supply chain and the Dental teams for making it happen.

Okay. Moving to our Health Information Systems business. We continue to benefit from the strength of our revenue cycle management (RCM) sub-business. And inside RCM, our Autonomous Coding offering continues to gain traction in both outpatient and inpatient settings, and our international expansion is providing a really strong tailwind as well. Relative to AI and autonomous coding, I'm going to reiterate what I said on our last call. We see AI as a helpful tool to deliver better outcomes when it comes to autonomous coding. But what differentiates the outcomes is the data. It's the rules. It's the rigor behind them. And we are differentially able to leverage AI, thanks to our unique ability to efficiently and effectively train it. We built deep rules and algorithms designed to ensure accurate and compliant reimbursement coding. And this, combined with our vast data sets, our proprietary workflows, it allows us to more effectively train and maximize AI and ultimately, as a result of that, deliver autonomous coding that our customers can trust. And I can tell you the economics of autonomous coding, they're compelling. Our customers benefit by improving productivity, eliminating FTE cost infrastructure and improving revenue capture, thanks to increased accuracy. That's a powerful value proposition, reduce cost, improve productivity and capture more revenue. And you can see why our customers are interested in this pathway.

Now shifting gears to everyone's favorite topic, tariffs. We continue to expect the annual headwinds to be in that range of $100 million to $120 million. And I can tell you from the very beginning, our supply chain teams have been actively working on mitigation strategies since we first saw tariff headwinds emerge. And our Transform for the Future program gives us additional firepower to offset these headwinds. And as a result, we've committed to expanding operating margins 50 to 100 basis points in 2026, and we absolutely intend to do so.

But let me just zoom out for a moment because I think it's important to keep the bigger picture in view. Going into Q1, we had people ask whether we could maintain the momentum we saw in 2025. Is it sustainable? And I could see why. We did triple our comparable annual sales growth in 2025, but that was before the full benefits of our recent product launches, our pipeline innovation and the commercial enhancements that we made in 2025. So for our full year 2026 expectations, excluding SKU exits, represent continued progress on that ramp. And as I've said in the past, and I'll say again, it's not a question of whether we get to our LRP (long-range plan) targets of 4% to 5% organic sales growth. It's a question of when.

All right. So let me summarize the key messages that I want you to take away from the call today because we put a lot out there already and Wayde hasn't even gone yet. But number one, our underlying commercial momentum, it's real. It's continuing. And our new product pipeline will be the fuel that, that momentum needs to continue from here. Number two, our operational programs, the Transform for the Future, programmatic supply chain savings and the separation progress that we have made give us additional confidence in the margin expansion story for the full year and of course, well beyond. Number three, we have moved with speed and importantly, impact on portfolio optimization, but we are by no means finished. We will continue to actively shape this portfolio for the long term. And number four, the ramp toward our long-range plan is happening. It is real. And I think it's pretty clear it's happening faster than most people thought possible.

And with that, I'm going to hand things over to Wayde to walk through our financial details. And then, of course, we'll open things up to questions. Okay. Now Wayde, go ahead.

Wayde McMillan – *Solventum Corporation; Chief Financial Officer*

Thanks, Bryan. We're off to a great start in 2026, delivering first quarter results that were ahead of our plan and expectations on both sales and earnings. As usual, I'll begin with an update on separation progress and portfolio actions, then walk through the quarter and conclude with a review of full year outlook.

Our separation from 3M continues to progress well, and we have exited just over 50% of the transition service agreements (TSAs) and are on pace to exit over 90% by the end of 2026. We have also migrated 75% of over 1,200 system applications, which captures the recent and successful ERP cutover in Asia Pacific, including China. We're now looking ahead to our next wave of ERP cutovers, which includes the U.S. and Canada planned for Q3.

There was also meaningful progress across our facilities with the move of our St. Paul, Minnesota facility from the legacy 3M campus to our new stand-alone facility in Eagan, Minnesota, and we achieved a meaningful milestone with the completion of our site migration activities covering several hundred sites around the globe. We also finished a strategic expansion of our manufacturing facility in South Dakota, which enhances our supply chain's flexibility to support existing product growth and new product launches. With further work to streamline our distribution centers, we are now down to 54 worldwide.

Regarding our recent portfolio activities, we continue to make progress on the P&F divestiture with the majority of transition service agreements to be completed in 2027.

And the Acera integration efforts are tracking to plan while maintaining strong momentum of the commercial team.

Now turning to our first quarter results. Starting with top line performance, sales of $2 billion increased 2.1% on an organic basis compared to prior year and decreased 3% on a reported basis. Foreign currency was a 270-basis point benefit to reported growth, while the net impact of acquisitions and divestitures was a 780-basis point headwind on reported growth. Growth in the quarter was driven by stronger than expected performance across all segments, primarily from volume, while pricing remained within the expected range. Our SKU rationalization remains on track with 100 basis points impact in the quarter, tracking in line with our full year expectation. Organic growth on a normalized basis would have been approximately 4% when taking into consideration some separation-related timing benefits that accelerated sales volume of approximately 70 basis points from Q2 into Q1, along with the difficult year-over-year comparison and SKU headwinds, all before the contribution of Acera, which would have added another approximately 40 basis points.

Moving to the segments. MedSurg delivered $1.2 billion in sales, an increase of 1.2% on an organic basis. Within MedSurg, advanced wound care (AWC) grew 2.1%. Negative pressure wound therapy performance was driven by strong brand, new product launches and commercial enhancements. Acera contributed $28 million to reported sales, which is reflected in the advanced wound care business. Infection prevention and surgical solutions performed well with a tough year-over-year comparison at 0.6% growth, reflecting improved commercial alignment and continued customer demand as well as the previously mentioned separation-related timing benefits. As a reminder, IP&SS growth in the prior year was just over 8% as the primary beneficiary of order timing related to customers buying ahead of ERP and distribution center moves and SKU exits.

Our Dental Solutions segment delivered $354 million in sales, an increase of 3.4% on an organic basis. Growth was driven by innovation as well as separation-related timing benefits. Core restoratives led overall performance, driven by strong underlying demand and commercial execution, leveraging new product launches.

Our Health Information Systems (HIS) had another strong result with $342 million in sales, an increase of 4.7% on an organic basis, driven by strength across revenue cycle management and performance management solutions (PMS), offset by expected double-digit declines in clinician productivity solutions (CPS).

Combined with strong customer retention, the pipeline activity and backlog conversion continue to support confidence in our sales growth. From an operational standpoint, we made further progress in supply chain execution during the quarter. Backorders across the portfolio continued to improve, reflecting improved manufacturing performance and the benefits of ERP and distribution actions.

Looking down the P&L, even in the face of tariffs and inflation, our gross margins of 56.4% improved 80 basis points over prior year, driven by favorable programmatic savings, portfolio moves as well as sales leverage and mix. And we were above our expectations as typical first quarter seasonality was more than offset by benefits from additional sales, favorable mix and higher programmatic savings.

Operating expenses decreased versus prior year, although 100 basis points higher as a percentage of sales. This reflects the impact of portfolio moves, partially offset by the benefit of our savings programs, including Transform for the Future, outpacing investments.

In total, we delivered adjusted operating income of $392 million or an operating margin of 19.5%, similar to last year and consistent with our expectations for a sequential seasonal decrease as operational improvements mostly offset the impact of tariffs and inflation.

Net interest expenses decreased year-over-year, primarily due to a lower average debt balance following the paydown of debt in our third quarter 2025 using proceeds from the P&F divestiture.

Our effective tax rate of 20.4% was within our full year guidance range expectations.

Altogether, we delivered earnings per share of $1.48 or 11% growth, ahead of expectations.

Shifting to our balance sheet. We ended the quarter with $561 million in cash and equivalents and net debt of $4.5 billion.

From a free cash flow perspective, we finished ahead of our expectations, mainly due to timing within the year. We had several expected demands on cash flow in Q1, including higher separation costs and tax payments related to the P&F divestiture, as well as normal seasonality for annual compensation and expense timing. Like last year, we expect Q1 to be the lowest quarter of the year. Looking ahead, free cash flow will improve with Q4 representing the strongest quarter due to step-down of separation-related costs, timing of tax and interest payments and outlook for improved operating results as we exit 2026.

On our fourth quarter earnings call, we indicated the separation costs and P&F divestiture transient headwinds will mostly complete in 2026, and we continue to expect significant improvement in 2027. We also started the first quarter of our share repurchase program and repurchased approximately 923,000 shares for total consideration of $67 million for the 3 months ended March 2026. Our balance sheet strength is well positioned for us to execute our balanced capital plan, inclusive of share repurchases and tuck-in acquisitions.

Regarding our full year 2026 outlook, we delivered a solid first quarter performance, benefiting from commercial execution, increased contributions from innovation and portfolio moves. Our confidence in underlying growth and operating performance continues to increase, and we are off to a great start with important ERP and separation milestones still to go while navigating an elevated macro headwind environment. As a result, we are maintaining our full year organic sales growth and free cash flow guidance as provided on our fourth quarter call, and following the better-than-expected start to the year, we now estimate that our earnings per share will be toward the high end of our initial $6.40 to $6.60 range.

We also want to provide some added insights about sales phasing as it relates to the last large ERP cutover, which is planned for the U.S. in Q3. We estimate over $100 million of sales timing benefit in Q2 that we expect will reverse in 2026, mostly in Q3. The additional sales phasing is an important part of our mitigation strategy, and we will update you on our Q2 and subsequent calls on the eventual impact.

Turning back to the full year. We continue to estimate a foreign exchange benefit of approximately 100 basis points on sales growth and are holding operating margin in the range of 21% to 21.5%, an increase of 50 to 100 basis points over prior year despite significant headwinds from tariffs annualizing and inflationary impacts. No change to our tax rate expectations of 19.5% to 20.5%. In summary, we delivered a strong start to 2026.

Business momentum is improving. The work on the portfolio is having a positive impact, and our execution is creating a clear path to margin expansion and cash conversion.

With that, I'll turn it back to the operator for Q&A.

Operator

[Operator Instructions]. Your first question comes from Brett Fishbin with KeyBanc Capital Markets.

Brett Fishbin – *KeyBanc Capital Markets; Equity Research Analyst*

Just wanted to start off with one on some of the phasing commentary around the ERP event. Just maybe if you could flesh out a little bit where you expect to see the benefit relative to the different segments in 2Q just from a modeling perspective, so we can help understand the transition.

Wayde McMillan – *Solventum Corporation; Chief Financial Officer*

Sure. Brett, it's Wayde -- So as we called out in the prepared remarks, as you said, Brett, we are estimating over $100 million additional sales in Q2 as we're working with our customers and distributors to advance orders before we begin our Q3 cutover of ERPs in the U.S. and Canada. This is going to mostly impact IP&SS and Dental, to your question, and this is a key mitigation strategy for us to really ease the number of orders and shipments in Q3 as we ramp up on new ERP functionality. And keep in mind, the U.S. is a very different region and that the majority of our sales go through distribution. And this helps mitigate any challenges with ERP cutovers with advanced orders into the distributors. And then importantly here, when we eventually report Q2, we will provide the amount of orders shipped in advance and then adjust our second half accordingly. So, as we've shared previously, it's difficult to predict advanced orders and volume, and therefore, we're giving you a head up here on magnitude, but not precision, and we'll update you when we report our Q2.

So, the key is we're not adjusting our full year guide. We expect all Q2 advanced orders will be offset in the second half of 2026, mostly in Q3. And the good news here really is that we're nearing the end of our heavy lift on ERPs from 3M. And this will be the last large cutover as we plan to be done with ERPs and 90% of the TSAs by the end of the year.

Bryan Hanson – *Solventum Corporation; Chief Executive Officer*

I might just draft off of that, too. It sounds a little messy in big numbers that we're throwing around, but we feel pretty confident on this one. We got — we're lucky because it's a big region, obviously, the biggest region that we have in the ERP cutover. But we feel like the mitigation efforts that we have here are fantastic. It puts us in a really nice position to have almost all of our business run through distribution in the U.S. And because we can stock up with those distributors, even if we have a challenge, we can cover our customers and continue to recognize revenue, which is great. And then in addition to that, as we said, it's our last one. So, I think the team has gotten pretty good here. So, we've got a tuned-up team that's capable, on top of a really strong contingency program.

Brett Fishbin – *KeyBanc Capital Markets; Equity Research Analyst*

All right. Super clear. And I'll just ask one quick related follow-up. So just thinking about 2Q and that $100 million or so benefit. Just on an underlying basis, is there any major callouts or reason to think that the ex- — call it, -ERP benefit run rate, wouldn't be somewhere within the 2% to 3% current guidance range?

Bryan Hanson – *Solventum Corporation; Chief Executive Officer*

So in other words, if you neutralize the impact of it? I think — is that what you're saying, Brett? I just want to make sure, are you saying that if we neutralize the benefit of that $100 million, what the growth rate would typically be in Q2? Is that what you're saying?

Brett Fishbin – *KeyBanc Capital Markets; Equity Research Analyst*

Yes. Essentially just asking — underlying growth, if you would expect the underlying growth rate to still be somewhere within the guidance range, or if there were any other major callouts that we should be thinking about for 2Q?

Wayde McMillan – *Solventum Corporation; Chief Financial Officer*

No, that's it. And that's the intent of calling out the heads up here on this advanced ordering to just make sure that we've given the heads up because we do think it will be a larger magnitude than we experienced last year. And we're not giving quarterly guidance, but you should assume that given the strong performance in Q2 that we should continue that momentum — or pardon me, in Q1, we should continue that momentum in Q2 and through the rest of the year.

Bryan Hanson – *Solventum Corporation; Chief Executive Officer*

Good way to look at it.

Operator

Your next question comes from David Roman with Goldman Sachs.

David Roman – *Goldman Sachs; Equity Research Analyst*

I know in your prepared remarks, you talked mostly about the contribution to revenue growth coming from volume and mix versus price. Can you maybe give us a little bit more flavor of what the volume versus mix contribution is and what you're seeing from a new product launch perspective year-to-date?

Bryan Hanson – *Solventum Corporation; Chief Executive Officer*

Yes. Maybe I'll start with the new product launches. I'd tell you that, as I referenced even in my prepared remarks, one of the biggest catalysts we have right now, and we've been talking about, is the commercial enhancements. But now we're feeding that commercial machine with some really nice product launches, and I've talked about those in my prepared remarks. They are definitely helping us, and we have more coming, as I talked about, 20 new products that we're going to be launching over the next 2 years. So, it's definitely a combination of the enhanced commercial organization, the focus that we have in growth drivers, and we're peppering in some really nice product launches as well.

But Wayde, maybe you can talk about that.

Wayde McMillan – *Solventum Corporation; Chief Financial Officer*

Yes, sure. On volume mix price, the way to think about it would be our price continues to be in that plus/minus 1%. So that means the majority of our growth is all volume-based and significant contribution from volume.

David Roman – *Goldman Sachs; Equity Research Analyst*

Okay. Very helpful. And maybe just a follow-up. I know that this is the first quarter that you initiated the share repurchase program, another quarter with a lot of macro-related volatility and recognizing that there are different timing elements in a quarter when you can and can't buy back stock. So how did you think about deploying the buyback in the quarter? And was there anything like competing considerations for capital that may have driven the amount to be where it was? Or is this something that we should expect to ramp over the course of the year?

Bryan Hanson – *Solventum Corporation; Chief Executive Officer*

Do you want to take that Wayde, around the offsetting dilution here?

Wayde McMillan – *Solventum Corporation; Chief Financial Officer*

Yes. Yes. So I can start us off there. So as you mentioned, David, we're very happy to have our share repurchase program kicked off. We started it here in Q1. And we have multiple layers to it. The first layer is to repurchase shares to offset dilution of stock-based comp and to hold our share count flat. And then we also have an opportunity to buy given if we see value in the shares. And so we'll be certainly looking at that where the stock has been more recently here in Q2. We're not commenting on Q2 yet, we'll do that when we report Q2. But you can imagine, we see a lot of value in the stock where it's trading today. And then we're going to balance that with our M&A plan and our acquisitions, and as you know, it's a balanced plan for us. We're going to be — just like when we launched the authorization program, we also launched the first acquisition of Acera. And so we're going to have a balanced plan, we're going to be looking at tuck-in acquisitions and where we can drive value there, we'll also be looking at our share repurchase program with a minimum of anti-dilution and then being opportunistic where we see value in the stock.

Operator

Your next question comes from Ryan Zimmerman with BTIG.

Ryan Zimmerman – *BTIG; Equity Research Analyst*

I just want to follow up on some of the ERP cutover dynamics here. I think you called out, Wayde, about a 70-basis point impact from some order pull-forward. And so as you think about what occurred in Asia with the ERP cutover, what did you see in terms of impact when you did that cutover that informs kind of — and again, appreciating the logic behind the dynamics of 2Q versus 3Q within the U.S., but what have you seen thus far with that cutover? And how much of that 70 basis points was reflective of preparation for the Asia ERP cutover?

Wayde McMillan – *Solventum Corporation; Chief Financial Officer*

Yes, sure. And so obviously, a lot of questions around ERP, and it makes sense because we've got a lot of people around the company working on delivering these. And our primary objective is always to ensure we get product available for our customers. We want to make sure, number one, we're servicing our customers. And we certainly want to keep ourselves on track from a financial standpoint as well.

So, you brought up Asia Pac. So, the good news there is we have had a very successful ERP cutover in Asia Pacific, and that included multiple countries, plus China for us. And so that one is actually in the rearview mirror now, Ryan. And that is -- the team did a really nice job. We started with Europe, many countries in Europe, moved to Asia Pacific, and now we're moving to the U.S.

So, the 70 basis points that you referenced, that we called out in the prepared remarks, was related to volume that's been purchased ahead of mostly SKU exits and some of the separation work that we're doing, not necessarily for ERP. There's a little bit of ERP in there, but given that the ERP cutovers aren't until Q3, the majority of that is other separation activity. Think about countries where we're going to have a couple of months where we don't have registrations. We're cutting our registrations over from 3M to Solventum, so, we had to ship some advanced orders to keep customers stocked as we transition and have a blackout on registrations.

So, lots of complexity. We don't always share a lot of the details about what the teams are working through to deliver the separation and cutover from 3M. But the 70 basis points in the quarter, just to clarify, was volume that we would have normally seen in Q2, and so we've essentially got 70 basis points of extra volume here in Q1 from Q2.

Ryan Zimmerman – *BTIG; Equity Research Analyst*

Understood. Appreciate that, Wayde.

And looking at margins, gross margins really came in well ahead of consensus is nice to see. I don't believe there's any refund activity in there, but you didn't call out — I think your comments suggested that you're still holding the line on tariff assumptions for the year, but where is your head at on tariff refund or what we could see potentially through the year with some of those changes on the tariff rate?

Wayde McMillan – *Solventum Corporation; Chief Financial Officer*

Sure. Yes, I think two questions there, really. One, gross margin was strong in the quarter. As we mentioned on the call, we had a benefit of sales and mix as well as some of the higher programmatic savings. And we normally expect some seasonality headwinds in Q1. We saw those, but they were more than offset by those things that came in better than expected. So really pleased that the team was able to deliver the programmatic savings and the margin expansion, especially in the face of tariffs, as you mentioned. So, getting 80 basis points of margin expansion here. And we certainly benefited from the portfolio moves we've made as well, both the P&F divestiture and Acera acquisition are accretive to our gross margins.

And so, then as you move to tariffs, the big headwind inside of that is certainly a fluid situation, as we all know. We're monitoring it, managing it very closely, but without clarity at this point, we're just holding our estimate in that same $100 million to $120 million for the year. Our Q1 came in right at the high end of that range from a quarterly basis, so we're still within our range, and it certainly does not include any booking of any potential refunds or anything there. We are not doing that at this point. We are in process of working on refunds like most companies are, but we have not booked anything in our results yet, and that will be something that we look at down the road.

Bryan Hanson – *Solventum Corporation; Chief Executive Officer*

Wayde, on the gross margin side, that came up, maybe you could talk about anything you want to provide for the rest of the year. I don't know if you want to here — or you want to do it...

Wayde McMillan – *Solventum Corporation; Chief Financial Officer*

Yes, it's probably perfect timing, Bryan, actually. Thanks for bringing that up.

So, we do want to make sure everyone understands this was a strong quarter for us, and so we do expect the rest of the year to be slightly below Q1. Our estimate, we think, is closer to 56%, and is probably a good estimate for the coming quarters for the rest of the year here. So strong Q1, a little above 56%. We think the rest of the year is going to come in closer to just under 56% would be a good estimate.

Operator

Your next question comes from Jason Bednar with Piper Sandler.

Jason Bednar – *Piper Sandler; Equity Research Analyst*

I'm going to layer on to the whole ERP cutover topic, but from a different angle. So, you sound super confident around the planning. Maybe talk about what this big U.S. ERP change means for your OpEx savings plans? When do you begin realizing cost savings from this switch, see those benefits later this year, early next year? And is that wrapped into your restructuring cost savings program? Or is that — are these two distinct items?

Bryan Hanson – *Solventum Corporation; Chief Executive Officer*

Yes. And maybe I'll just quickly say on the mitigation plan. I just want to call out the team right now because everyone is working really hard on the ERP cutovers. And as you can imagine, it's a very large group of cross-functional people that are just flat out right now. I just want to give them kudos because the mitigation process that we've gone through is probably the best I've ever seen. So, I feel very confident coming into Q3. But really coming into your question, on does this open up margin opportunity, Wayde, maybe I'll flip that over to you.

Wayde McMillan – *Solventum Corporation; Chief Financial Officer*

Yes. So not the primary objective. Primary objective here is separation from 3M. And because we were in a separation situation, there wasn't a lot of preplanning going around with the ERP cutovers, and so OpEx does not benefit significantly from the ERP cutovers at this time. However, Transform for the Future is designed to then pick up on the systems that we have and start to work on what we can see from savings going into the future. And so first, we've got to separate from 3M. We get the systems stood up. Then we'll be looking at through our Transform for the Future program for additional system benefits, automation, system efficiencies, but that really is hand in glove with the rest of the Transform for the Future work we're doing, which thinks about structural areas as well. And it's not just efficiencies but certainly looking for effectiveness there.

What I would say on operational — our operating expenses, though, just to make sure we cover this, is we had $740 million of OpEx in Q1, which is lower in dollars, but higher in as a percentage of OpEx, and that — some of that was due to seasonality, which we always see higher seasonal expenses in Q1. But we do expect our operating expenses to step down from Q1 into Q2, Q3 and Q4. And I just want to make sure everybody understands that as well, that there are seasonal pressures on Q1 OpEx that we have every year around compensation related and other timing of expenses that happen in the first quarter. That's one of the reasons our operating margins are always a seasonally low quarter for us. And then we look for a step down in OpEx expenses as we go through the rest of the year, which helps us increase our operating margins as we move through the year as well.

Jason Bednar – *Piper Sandler; Equity Research Analyst*

All right. Very clear.

I want to — so just as a follow-up, Bryan, I think you mentioned 20 new products that are to come on over the next couple of years. Sorry if I have any of the details wrong, going through the airport. But any breakouts you're able to give around the segmenting of those new products? What does the cadence look like of the launch activity? And just how are you thinking about the contribution to growth from these new products?

And sorry, I'm going to layer on one more. Just can you clarify, are these brand-new products? Or are these relaunches of existing products? I know you've talked about that latter item before, so just trying to figure out if these are, again, distinct or kind of captured within each other.

Bryan Hanson – *Solventum Corporation; Chief Executive Officer*

Yes. Thanks for the question. You remembered exactly. I said almost 20 and you nailed it. So, I appreciate that.

I would say that it's mainly — your last question there, it's mainly new products. There are some relaunches in certain areas where we're going to do capacity expansion because we have great demand, we just don't have the capacity. And once we get that demand, then we're going to relaunch the product on a global basis. But most of these, the largest majority would be new products in each of our businesses.

From a cadence perspective, you're asking about that, it's a pretty steady cadence. I'd say it's going to accelerate through the 2 years, but I don't want to give the impression it's back-end loaded. That's not the case. It's going to be a nice cadence this year, the same thing next year.

And it's really dedicated to our growth driver areas. There are some outside of that, but mainly growth driver areas and then across each of our businesses. What I would tell you, when we think about the portfolio, we're really thinking kind of singles, doubles, triples, right? We're not looking at one item as the game changer, as the home run we need. So, it really reduces the risk of the portfolio launches that we have. It's a combined portfolio that we'll launch on a cadence that we think is acceptable and digestible to the organization, and it will give that new commercial team the fuel they need to be able to hit our LRP targets and hopefully at some point beyond.

Operator

Your next question comes from Travis Steed with Bank of America.

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

Congrats on the good quarter. I guess I'll follow up on some of the portfolio comments that you made in the prepared remarks. Just curious if there's anything else you could say on that. Do you have any signs that someone else maybe might be willing to pay a higher value than the public investors are valuing parts of the business at? And kind of timing, is there anything that might slow that down? It seems like something that could happen fairly quick. Just anything else you could say on the portfolio side.

Bryan Hanson – *Solventum Corporation; Chief Executive Officer*

Yes. We obviously had a feeling people might ask about that because we're leaning in on this being a vector of value creation. I would say that the good news is where we are from a spin perspective. In a spin environment, I think most people know that there are considerations outside of the typical things you look at on whether you do or don't transact. And the further the spin gets in the rearview mirror, the more flexibility we have. So, I think that by itself kind of indicates where we are.

And then it's just a simple formula that you said. I don't want to lean in one direction or the other because I don't want to give anything away, but my sense is that as we see others that view our businesses either strategically more relevant to them or financially, we're going to pay attention to it, right? We're going to unlock shareholder value, whether that be a transaction or other methods of being able to drive shareholder value, that would be our intent.

I don't want to speak to timeline because I don't want to set any expectations, I just know that we're constantly looking at this as anybody would — should. And that means both ways. We're looking at things that could exit, and we're looking at things that should come in. And Acera is a great example on the other side of that equation of exactly the type of deal we're looking for when it comes to portfolio optimization. It's a perfect asset, right? It's got great growth. It fits very squarely into the business that we have today. As a result, it's lower risk because we know the space, right? And so, you're going to expect us to do more of that.

As I said, I think we've got a pretty target-rich environment, and we can do those as well as give cash back to our shareholders. So, we feel like we're in a good position here.

Operator

Your next question comes from Rick Wise with Stifel.

Rick Wise – *Stifel; Equity Research Analyst*

Nice to see another excellent quarter here. It's hard to resist coming back to the second quarter, Wayde, only because I just always think it's important to get the numbers right so that you all can do your thing, and as you say, a lot of moving pieces here. I'm just coming at it another way, I mean, consensus is a shade over $2 billion for the second quarter coming into the call. I mean, do you feel like that adequately reflects or is a reasonable midpoint way to think about the second quarter? And again, just reflecting all the puts and takes.

Wayde McMillan – *Solventum Corporation; Chief Financial Officer*

Yes. Rick, so it's probably worth coming back to this one because it is certainly a dynamic that we want to make sure people understand in the quarter.

So, what we're not commenting on is guidance for the quarters here as we go, but what I would say is, I wouldn't change the total year for the quarterly phasing here. So, number one thing, our guidance stays the same for the year. I would like people to think about; nothing changes for the total year. In fact, you might not even look at your models for Q2, just keep them the way they are. When we get to Q2, we're going to over-achieve because of a certain amount of advanced ordering. It's going to be higher or lower than 100. 100 is a very round large number. We have a lot of active work going on across multiple distributor channels now. When that number lands in Q2, we'll let everybody know, we can call it out, and then we'll get a clear read-through of our numbers without that advanced ordering. And then we're just going to take that advanced order number, and we're going to take it out of the second half, mostly in Q3.

So, we don't want to get too precise around that number and what we're thinking about for Q2 at this point, just giving a heads up that we are using this mitigation strategy. It's great that we have a higher amount of products through distribution in the U.S., so it gives us a real nice mitigation strategy for the ERPs here.

Bryan Hanson – *Solventum Corporation; Chief Executive Officer*

I think it's a — if you think about it, it's — I think in the other question that we had, you can kind of expect Q2, again, not guiding to it, but in the normalized range in the guidance that we've given, and this is going to be substantially higher, Q2 is going to come in substantially higher. We just don't want you to try to model it because it will be wrong. So, when we get to Q2, we have the actuals, as Wayde said, we'll give you the information, and then we'll help you with your models in Q3 and Q4.

Rick Wise – *Stifel; Equity Research Analyst*

Okay. And I guess I can't think of anything much more related and making Amy happy than talking about 2Q EPS. I mean you nudged us — that you nudged your range more towards the upper end. And again, if consensus is $1.65, I think, for the second quarter. Again, Wayde — leave it alone, even with the — I mean, Acera, there's going to be more Acera. Acera is accelerating more new products, more cost reduction. You have an extra $100 million in revenue, presumably some leverage there. I mean, again, just conceptually, what do we do with that? Where do we stick it, so to speak?

Wayde McMillan – *Solventum Corporation; Chief Financial Officer*

Yes. I definitely see the challenge, Rick. Yes.

So, if we just set aside the phasing for a second, and we look at the business, you're right. We should see improvement in EPS in Q2 because Q1 is our lowest operating margin quarter and we had a very tough comp in sales in the first quarter, and so that puts some pressure on our operating growth. But from a dollar standpoint, we're going to see Q2, from a dollar standpoint, have a good sales growth quarter. We're going to see higher operating margins, and that should help drive improvement in earnings per share.

But if you bring that phasing back into it, so we get an extra $100 million. If you just do the math on that, and we're not going to be increasing our investments or anything like that. So, you're going to see a pretty clear drop-through in gross margins.

Now we're going to wait to see what the mix looks like on that and how the — what's the $100 million going to look like? Is it going to be higher or lower? What's the gross margin on it? We're not going to change investments. So, if you just do a natural look at it, it's about 5% extra sales, it's about a 30 cent drop-through on EPS. And so again, I wouldn't recommend taking that from any angle of precision, just given that we haven't finalized what that phasing is going to look like other than it's going to be a large magnitude. And so, with that in mind, I think Q2 looks like another strong quarter for us. We should see improved earnings per share. And then certainly, this phasing is going to drop through an additional amount. We just don't know exactly what it will be at this point.

Operator

Your next question comes from Steven Valiquette with Mizuho Securities.

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

So, I guess for us, just within the HIS segment, you mentioned that the Autonomous Coding offering is still gaining pretty good traction here in both the outpatient and inpatient settings. Our understanding is that some customers will embrace this — the fully autonomous coding, maybe for some portion of their coding needs for medical billing, but not quite 100% yet. Others may still be in pilot phase, but some might still be using primarily your more traditional computer-assisted coding or CAC solutions. So I guess what I'm really trying to get to is if you're able to kind of answer this, would be just what's the rough approximation for just your current mix of full AI autonomous coding versus CAC revenue within the franchise, if you think about it that way or maybe from a customer standpoint, but not a revenue standpoint?

Bryan Hanson – *Solventum Corporation; Chief Executive Officer*

It's a great question, actually. I'd say the good news, I'll just take a step back is that our team is really increasing in their level of confidence on how much of the coding can eventually be done fully autonomous. So, we're talking now 80%, 90% of all coding, whether that be inpatient or outpatient. We're talking about a high level of coding that should be able to migrate in that direction. Now to be honest, when you look at it and implement it, it takes longer than just saying it. So, you're in a definitely mixed situation where some are using it in certain aspects and others are not using it in those same aspects. And we're going to continue to proliferate it. I'll give you probably a good view, and I think it's safe for us to say, just during the strat plan period, our assumption is, given the progress that we're making, and really the trust that our customers have in our capability to do this in a safe way because the risk associated with doing it wrong is pretty significant from a revenue capture standpoint and also compliance. But even with those as a backdrop, the progress that we're making, we think we can get close to 50%, 5-0 percent of our customers during the strat plan period moving over to autonomous coding. And then in those hospitals, in those systems, we'll continue to move up the ladder on the percentage of autonomous coding that they use. So, you're going to start with a particular swim lane and then you're going to expand from there. But you're right on. It's happening. Our confidence is growing. The confidence from our customers is growing. And as I said before, the benefit for our customers is pretty significant. When you bring this in, you see FTE infrastructure reductions, you see productivity because you're getting much faster speed in getting that reimbursement. And then you're getting reimbursement and revenue capture that's higher because you don't have as many mistakes. So, it's a really nice package for our customers, and we're moving extremely rapidly, but we're doing it safely. We want to make sure that we don't cause problems for our customers.

Operator

And your last question is a follow-up from David Roman with Goldman Sachs.

David Roman – *Goldman Sachs; Equity Research Analyst*

I really appreciate your taking the additional follow-up. And I hate to come back to the Q2 dynamic, just getting so many questions on this that I thought it would be helpful for us if you just to clarify here on just the broad call, which is, is the message leave Q2 the same? We're going to beat Q2 and then lower the back half to right-size that? Or is the message on an underlying basis, Q2 would improve and there will be some unknown upside that may or may not come out of the back half of the year? I think there's just some confusion from investors about what exactly the message is here, about how to think about Q2 and then the implications for the back half.

Wayde McMillan – *Solventum Corporation; Chief Financial Officer*

Yes. Sure, David. And Bryan, I can start this one.

We certainly talked a lot about this before the call, whether we thought it would be helpful to give a heads up for over $100 million phasing or if we just wait for Q2 to come in. And we said we think it would be more helpful even though it may be challenging for people.

So to restate it, we would recommend, of course, you all can do whatever you'd like to do, but our recommendation would be to not change your models for Q2 because just like you said, whatever the advanced orders are in Q2, we're just going to take the mirror image of that and take it out of the second half, mostly in Q3. So, if you want to just take a simple approach, don't change anything. And when Q2 happens, we'll take the mirror image, reduce the second half or whatever the advanced orders were. They'll end up being either above or below that $100 million, but we think it's going to be at that kind of a magnitude.

To clarify, and this was to Rick's question, I did just want to share with people that we do see momentum in the business. We do see our growth rate strengthening. Q1 was a very tough comp. So, we would expect our growth rate to improve. And we'd also expect our earnings per share to improve because our operating margin is also improving. And we expect operating margin improvement off that Q1 seasonally low operating margin. So really, two separate things there. But hopefully, that clarifies it, David, and thanks for bringing that back up.

David Roman – *Goldman Sachs; Equity Research Analyst*

Yes. No, that's very helpful. And then maybe just lastly, as you exit the year then, when all is said and done, you would expect 2026 growth to improve versus 2025 and continue to put you on a trajectory toward the LRP targets that you issued?

Wayde McMillan – *Solventum Corporation; Chief Financial Officer*

Absolutely. Yes, that's the whole goal. We've said before we expect all of our segments to improve on an underlying basis. They all have growth drivers. They've all got commercial improvements, innovation improvements. We've got a lot of momentum in all three businesses, and that's on an underlying basis. As we know, Dental had a significant improvement in second half last year in backorders, and so you have to look at Dental on an underlying basis without that tough comp, but other than that, yes, we would expect the improvement across all of 2026 across all three businesses.

Bryan Hanson – *Solventum Corporation; Chief Executive Officer*

You want me -- I think it was the last question, right? Okay. Maybe what I'll do, if we can, Operator, before I pass it to Amy to close this out. I just wanted to say a couple of words directly to our team members. A lot of them, I think, are listening in right now. What I know for a fact at Solventum is we focus on the thing we need to do next. We don't spend a lot of time talking about the things we've already done. And I want to just take a minute publicly and compliment our team and really give them credit for a very fast-paced transformation and the results that they're delivering. And I'm just going to give you a quick summary of things that they've accomplished here just since then. I'm not going to complete laundry list, but it's some of the key things that have occurred, and I want to make sure they're getting credit for it.

I'll just start with almost 100% of the LT and 60% of our XLT are new to the organization and we've made those changes with a very little impact to the movement of the organization.

We completed our first global restructuring, I think everybody remembers Solventum Way with over $100 million in savings, and that put us in place to have a structure that will drive our new culture. We created a new mission. We created a new value system, our cultures. And all of that has been digested by our team with 90% of the team members understanding it and getting behind it and it's giving them energy.

We scored above benchmark on our first global employee survey. That's a little surprising when you think about it because we have a lot of challenging situations, changing environment, turbulent environment. It gives you a sense of the type of people we have in this organization. They can go through that kind of fire and still feel good. Which is amazing.

We completely revamped our R&D team, R&D process. We increased our vitality index because of that from 2% — from 2% to the mid-teens, significantly increasing the pipeline value that we have. We identified our primary markets and our growth drivers. But importantly, inside of that, people might have missed this, we specialized over 1,000 reps around the globe to be able to drive those growth drivers. That is a significant commercial change that we put into place.

We completed more than half of our complex separation from 3M, and that includes multiple and concurrent ERP cutovers, some of those we just talked about and also concurrent manufacturing and distribution center changes, closures and also openings.

We implemented a multiyear SKU rationalization program.

We sold and began separating our P&F business for $4 billion, which, by the way, is the best — is one of the best, if not the best, multiples in the sector.

We paid down half the original $8 billion debt that we had when we got on spin, acquired and began integrating Acera, announced and started implementing a $1 billion share repurchase program and kicked off a multiyear global cost savings program aimed at $0.5 billion of savings. And all of that, all of that while this team has tripled the comparable sales growth from our starting point. And I'd say this team has been a little bit busy. And I just want to take a second to say that that is not possible if we don't have a deeply connected team and an experienced team.

So, I just want to say thank you to our global team members and to everyone else, I just want to say thanks for listening. Thanks for being a part of it today.

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

Great. Thank you, Bryan. Thank you, everyone, for listening and to our analysts for your questions. As a reminder, if you have any follow-ups or need anything else, please don't hesitate to contact the Investor Relations team directly. This concludes our first quarter fiscal year 2026 conference call. Sarah, you can go ahead and close things out.

Operator

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

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