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COLO B.CO - Q4 2017 Coloplast A/S Earnings Call

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PRESENTATION

Lars Rasmussen - *Coloplast A/S - President & CEO*

Good afternoon, and welcome to our full year '16/'17 conference call. I'm Lars Rasmussen, CEO of Coloplast; and I'm joined by CFO, Anders Lonning-Skovgaard, and our investor relations team. We will start with a short presentation by Anders and myself and then open up for questions.

Without further ado, please turn to Slide #3. Today, Coloplast has presented a new long-term guidance for the LEAD20 strategy period. The new guidance is driven by changing market dynamics, which create opportunities to accelerate growth. Furthermore, Coloplast intends to pursue inorganic opportunities to further strengthen our service offering to the consumer. The organic revenue growth guidance is maintained at 7% to 9% per year, where the ambition is to reach the upper end of the interval. Consequently, the EBIT margin guidance is changed from 50 to 100 basis point improvement per annum to a guidance of delivering an EBIT margin of more than 30% in constant currencies.

Please turn to Slide #4. The growth acceleration is to be driven by 2 key pillars: First, we will invest more aggressively to drive top line growth by increasing our organic investments in commercial opportunities. We are committed to investing up to 2% -- 2 percentage points of our revenue on a yearly basis in incremental investments. In addition to the new investment cases presented at our Meet the Management Event, we see further opportunities to drive growth. In the U.S., we will invest more offensively to win across our business areas and to further leverage our investments in Comfort Medical. In emerging markets, the macroeconomic environment is improving, and we see opportunities to capitalize on this and gain market shares. In Europe, we see opportunities across selected markets. The second growth pillar involved pursuing inorganic growth opportunities to further strengthen our service offering towards consumers. We have built an industry-leading consumer machine through Coloplast Care and direct-to-consumer activities. Since acquiring Comfort Medical, our appetite for directly servicing our consumers has increased, and we see opportunities in several markets.

We continue to strive for unparalleled efficiency, and we are committed to maintaining our financial discipline. Today, I am pleased to present further details on our new Global Operations Plan #4, which aims to deliver 150 basis points of margin improvement with full effect from 2021.

Please turn to Slide #5, turning to the results. Coloplast continues to demonstrate industry-leading organic growth and profitability, which I'm very satisfied with. Coloplast delivered a strong fourth quarter of 8% organic growth and a 34% EBIT margin in constant currencies. For the full year, Coloplast delivered a growth of 7% organically and a 33% EBIT margin in constant currencies. Today, the Board of Directors approved an ordinary dividend of DKK 10.5, amounting to a total of DKK 15 per share in dividends this year, an increase of 11% compared to last year, demonstrating the strength of our business and commitment to increasing shareholder value. Our guidance in '17/'18 is an inorganic revenue growth of around 7% in constant currencies and 5% to 6% in Danish krone and an EBIT margin of 31% to 32% in constant currencies and around 31% in Danish krone. Anders will explain the details around how we arrived at this guidance.

Please turn to Slide #6. In Ostomy Care, organic growth was 7%, and growth in Danish krone was 6%. In Q4, organic growth was 7%. Growth continues to be driven by our SenSura and Brava portfolios, especially in the U.K., Germany and China. SenSura Mio Convex was relaunched in April this year and has contributed significantly to the growth in the second half of the year. Our Assura/Alterna portfolio growth was driven by strong performance in China and Argentina.

In Continence Care, organic growth was 7%, and growth in Danish krone was also 7%. In Q4, organic growth came in at 7%. The SpeediCath ready-to-use, intermittent catheters continue to drive growth and especially, the compact category performs well. In the compact segment, we continue to see strong performance in markets like the U.S., France and U.K. SpeediCath Flex has been launched in 14 markets and contributed strongly to growth in Europe and in the U.S. In the U.S., SpeediCath Flex has received very positive feedback due to the product's strong and innovative features. Over the summer, the product was, unfortunately, moved from the coude reimbursement category to the standard reimbursement category. To address this unfortunate issue for consumers, we will launch a new, redesigned SpeediCath Flex coude product in the U.S. next year. We are seeing healthy growth rates in Japan, Australia and South Korea following the introduction of reimbursement in these markets for intermittent catheters last year. Performance in our Conveen collecting device portfolio remains challenged by higher competitive pressure. And finally, we remain satisfied with sales growth of our Peristeen products.

In Urology Care, organic growth was 10%, and growth in Danish krone was also 10%. In Q4, organic growth was 7%. The growth was mainly driven by sales of female pelvic health products, a segment in which we have gained market share after the last competitor left the market in March last year. We also continue to see satisfactory growth in sales of the Titan range of inflatable penile implant devices. Finally, our endourology business saw satisfactory growth in Europe, in particular in France. In Q4, the growth was negatively impacted by Hurricane Harvey that struck Florida, which is an important market for Urology Care.

In Wound & Skin Care, organic growth was -- and growth in Danish krone was 4%. Organic growth for wound care in isolation was also 4%. For Q4, the organic growth for wound care -- for Wound & Skin Care was 16%; and for wound care in isolation, it was 8%. The growth was driven by Biatain sales, in particular Biatain Silicone in Europe -- European markets like the U.K. and Germany. After a challenging start to the year due to price reforms in France and Greece as well as weaker momentum in China, the wound care business posted strong growth in Q4. The growth was driven by double-digit growth in China and strong performances in Germany and Brazil. The skin care business posted a stronger-than-expected Q4 due to new contract wins in the U.S. Finally, contract manufacturing of Compeed impacted growth positively.

Turning to our geographical segments. Our -- in our European markets, we saw organic growth of 5% for the full year and 5% in Q4. The growth continues to be satisfactory across the portfolio of countries and, in particular, in U.K., in Germany and also in France.

Organic revenue growth in other developed market was 8% for the full year and 7% in Q4. Growth in the U.S. was negatively impacted by DKK 70 million in Q1 due to inventory reduction. However, the full year Ostomy and Continence Care grew double digits -- however, for the full year, Ostomy and Continence Care grew double digits. Growth rates in Japan, Australia and Canada were all satisfactory.

Revenue in emerging markets grew organically by 13% for the full year and 22% in Q4. The growth was primarily driven by China, Argentina, Russia and the Middle East. We continue to see satisfactory growth rates in China within Ostomy Care, and performance within wound care improved over the course of the year. The strong growth in Q4 was mainly driven by tenders in the Middle East and North Africa, predominantly in Saudi Arabia and Nigeria. In Brazil, the economic environment remains challenging, but we saw an improvement in public sector funding and decent growth in Q4.

With this, I will now hand over to Anders, and please turn to Slide #7.

Anders Lonning-Skovgaard - *Coloplast A/S - Executive VP & CFO*

Thank you, Lars, and good afternoon, everybody. In '16/'17, gross profit was up by 5%, amounting to DKK 10.6 billion. This equals a gross margin of 68% in both constant currencies and Danish krone. We continue to see improvement in production efficiency at our volume sites and, in particular, a positive impact from the relocation of SenSura Mio and Compeed to Hungary, which compensates for the negative gross profit impact from the launch of new products where the production economy is not yet fully optimized. The gross profit was also negatively impacted by rates inflation in Hungary, increasing depreciation levels and costs associated with the relocation of production to Hungary. In addition, the gross profit was negatively impacted by around DKK 20 million in restructuring costs related to the reduction in the number of production employees in Denmark.

The distribution-to-sales ratio came in at 28%, on par with last year. The ratio was impacted by incremental sales investments in wound care, Urology Care in the U.S. and Japan, Australia and South Korea. In Q4, the distribution-to-sales ratio was 28%, compared to 27% last year.

The admin-to-sales ratio came in at 4% of sales and was up DKK 62 million compared to last year. The increase was due to patent litigation cost and transaction cost related to the acquisition of Comfort Medical. In Q4, the ratio was 4% and on par with last year.

The R&D-to-sales ratio came in at 4% of sales and was up DKK 65 million compared to last year. The 13% increase reflects a higher general activity level and our ambition to bring more clinical differentiated products to the market. In Q4, the ratio was 3% and on par with last year.

Overall, this resulted in an increase in operating profit of 4%, which corresponds to an EBIT margin of 32%. In fixed currencies and before the one-off adjustment related to the U.S. Veterans Affairs in Q3, operating profit increased by 9%. This corresponds to an EBIT margin of 33%.

Operating cash flow amounted to DKK 3.3 billion and was approximately DKK 200 million higher than last year. The positive impact came from primarily higher absolute earnings. In '16/'17, missed payments totaled DKK 1.8 billion, and the total missed payments to date now amount to DKK 4.2 billion. Cash flow from investing activities was impacted by the acquisition of Comfort Medical for approximately DKK 1.1 billion, and capacity expansion in machines to reduce existing and new products and the site expense in Tatabanya in Hungary. Investments in intangible assets and property, plant and equipment amounted to DKK 685 million, up 6% compared to last year. Sale of bonds provided DKK 144 million cash contribution.

Adjusted for payments made in connection with the mesh litigation and the acquisition of Comfort Medical, the free cash flow amounted to approximately DKK 4.1 billion compared to DKK 4 billion last year. Hence, underlying free cash flow was in line with last year. Adjusted for the low amount of taxes paid in '15/'16 following a large, voluntary tax payment in '14/'15, the free cash flow in '16/'17 was approximately DKK 500 million, higher than in '15/'16. Cash conversion, defined as free cash flow before interest, tax, M&A relative to EBIT, was 98% for '16/'17.

With respect to the mesh litigations in the U.S., the status is that we have settled more than 95% of the known cases. We still view the provision as sufficient, and we are now in the final phase of the mesh litigation. In '17/'18, we expect to pay out the remaining DKK 1 billion of the DKK 5.25 billion provision.

Please turn to Slide 8. As Lars mentioned at the start of the call, the new Global Operations Plan 4 has been finalized. The plan aims to deliver 150 basis points of EBIT margin improvement with full effect from '20/'21. The savings will be -- will primarily come from an increase in efficiency at our volume sites, procurement savings and the reduction in the number of production employees in Denmark as a result of the planned closure of the Thisted factory. By the end of '19/'20, we intend to reduce the number of production employees in Denmark to 200. Going forward, pilot activities will be consolidated in our innovation factory in [Merto]. The implementation of GOP4 will require us to strengthen our organizations in Hungary and China and to build an organization in Central America. Most of these costs will be incurred in '18/'19 and '19/'20. The closure of the Thisted factory will involve restructuring cost of approximately DKK 50 million in '18/'19 and '19/'20.

In terms of the phasing of the 150 basis point improvement in '19/'20, I expect to begin to realize benefits from the increased efficiency and procurement savings in '20/'21. I expect to realize the full 150 basis point margin improvement as the benefits from the plant closure of the Thisted factory are already realized.

Please turn to Slide #9. For '17/'18, we expect revenues to grow around 7% organically in constant currencies and 5% to 6% in Danish krone. Our guidance for next year is impacted by 2 larger factors: First, our guidance assumes a negative impact of DKK 100 million from the patent expiry on SpeediCath standard catheters. Second, in '17/'18, we expect a negative pricing pressure of more than 1 percentage point on our top line. This is driven by developments in Greece, where the Ministry of Health is currently working on an extensive reform package, impacting medical device suppliers in 2017 and 2018. Last week, price cuts of around 25% were implemented for Ostomy Care, Continence Care and wound care. The actual reform outcome and impact remain highly uncertain. We have assumed an impact of DKK 100 million in our guidance. Aside from the impact of the patent expiry and health care reforms increase, our guidance assumes stable growth trends across our regions. The guidance in Danish krone is significantly impacted by the depreciation of the US dollar as well as a number of dollar-related currencies against the Danish krone. The currency impact is based on spot rates as of October 31, 2017. Since the start of the calendar year, the dollar has depreciated against the Danish krone by approximately 10%.

For '17/'18, we expect an EBIT margin of 31% to 32% in constant currencies and around 31% in Danish krone. The EBIT margin guidance includes the impact of our assumptions around the SpeediCath patent expiry and health care reforms increase, increase we enjoy above group level margins. On our operating expenses, we expect broadly stable trends into '17/'18. Next year, as part of our up to DKK 2 billion LEAD20 investment commitment, we will invest up to 2% of sales in sales-enhancing initiatives primarily in innovation, wound care, emerging markets and in the U.S. across all our business areas. Higher growth from our new product launches still means pressure on the gross margin. But as previously communicated, we continue to relocate manufacturing out of Denmark to Hungary, and we will reduce the number of production workers in Denmark by additional 100 people in '17/'18. We expect the benefits to be absorbed by the cost of relocation and restructuring cost of approximately DKK 20 million in '17/'18. We expect high single-digit rates inflation in Hungary next year. We also expect depreciations to increase at the same level as last year as a consequence of the last couple of years increase in CapEx. In summary, the EBIT margin guidance is negatively impacted by health care reforms increase as well as patent expiry. Despite the downward pressure on the EBIT margin from these factors, we are in accordance with today's new long-term guidance, accelerating our commercial investments to drive growth.

We currently expect our net financials to end the financial year 2017/'18 at 0 -- DKK 1 million due to hits and gains on the U.S. dollar. CapEx guidance for '17/'18 is expected to be around DKK 700 million and is driven especially by investments in more capacity for new and existing products as well as the factory expansion in Nyírbátor. Finally, our effective tax rate is expected to be around 23%.

This concludes our presentation. Thank you very much. Operator, we are now ready to take questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And now we'll take our first person from the queue, Romain Zana from Exane BNP Paribas.

Romain Zana - *Exane BNP Paribas, Research Division - Research Analyst*

The first one, regarding the 150 bps, you mentioned with full effect as of 2020. Could you please clarify what is the base margin levels for such improvement? Second question, what makes you more confident to better deliver on cost optimization as it has already been a key focus for several years while the margin has been rather flattish? Why it has not worked over recent years? And why it should better work looking forward? And just the last question regarding the wounds in Q4 was strongly up. And I was wondering why we saw such volatility. And what level should we extrapolate looking forward?

Lars Rasmussen - *Coloplast A/S - President & CEO*

All right. Anders, will you take the first question?

Anders Lonning-Skovgaard - *Coloplast A/S - Executive VP & CFO*

Yes. So the basis for our GOP4 plan -- so as I said, we are expecting to have an improvement from the GOP4 plant on the EBIT margin of 150 basis points with full effect from 2021, and the baseline is '16/'17. The question around -- what?

Romain Zana - *Exane BNP Paribas, Research Division - Research Analyst*

It's in DKK or in constant exchange rate?

Anders Lonning-Skovgaard - *Coloplast A/S - Executive VP & CFO*

That's in constant currencies.

Lars Rasmussen - *Coloplast A/S - President & CEO*

Your second question, we -- I didn't get it, if it was about cost optimization or customization?

Romain Zana - *Exane BNP Paribas, Research Division - Research Analyst*

Cost optimization.

Lars Rasmussen - *Coloplast A/S - President & CEO*

Oh, okay. So we'll still leave that with Anders.

Anders Lonning-Skovgaard - *Coloplast A/S - Executive VP & CFO*

Yes. So as I understood your question, it was around why the margin has been more flattish over the last, yes, 3 to 4 years. One reason is -- or the main reason is that the currency has impacted us quite significantly. So the sterling has dropped, and also now the U.S. dollar is also decreasing quite significantly. The other thing is that we, over the years, has also increased our investments into commercial activities in order to drive growth.

Lars Rasmussen - *Coloplast A/S - President & CEO*

And I'm a little bit -- sorry, but your line is really bad. So could you repeat the question about wound care?

Romain Zana - *Exane BNP Paribas, Research Division - Research Analyst*

Yes, sorry, no -- I was just wondering why we saw such volatility through the year with a strong pick-up in Q4. And what level of growth should we extrapolate looking forward for the division?

Lars Rasmussen - *Coloplast A/S - President & CEO*

Ah. That's -- so we don't guide per division going forward. So with that, I cannot help you, but I can put a little bit more light on it anyways. What we see is that China is coming back over the year. So China is doing increasingly better and very, very nice growth. Brazil is also coming back. And Europe is doing really strong, apart from France where we are having a really bad pricing [we've seen]. But apart from that, we are growing above the market in all markets in Europe. And then we have had a skin care which was in the U.S. because basically, one of our competitors have had FDA issues. So that have given some tailwind in that market. So that's -- so all in all, we're actually in a pretty good shape.

Operator

And now we'll take our next person from the queue, Maja Pataki from Kepler Cheuvreux.

Maja Pataki - *Kepler Cheuvreux, Research Division - Head of Med Tech Devices Sector*

I had a few. First of all, the investment that you're taking into growth, the 2 percentage point of revenue coming up, is that directed to any specific business area? Or is there a focus on one of the divisions? And the second question is, Anders, just to understand. You say that the basis is the 33% EBIT margin that we had in 2016/'17, which gives you quite an attractive margin in '20/'21. What kind of underlying growth assumption is there? Do we need to see an acceleration towards 9% to really get the full 150 basis points coming through and margins above 34%? Or would you actually also be able to deliver this kind of margin with, let's say, 7.5% growth?

Lars Rasmussen - *Coloplast A/S - President & CEO*

So for the last part, I think I can answer that and say that, that's a yes. With the current growth rates, we think that can deliver 150 basis points on the gross margin expansion. When it comes to the growth investments that we're looking at -- but I'd like to maybe talk a little bit more about what it is that we're seeing because we were writing in the release that we came with that we are seeing changing market dynamics. And you can basically view that as either we think that is just harder to grow and we need to invest more. And that was not what we meant with it, but you all know that one of our big competitors came with a profit warning in the quarter that we just went out of, saying that it's harder to grow and it's also harder to deliver on the profitability. We also see a number of the other companies inside of our business areas that are struggling to deliver growth. So seen in that light, we have a different view on our current performance. We think it's better than what we maybe had in mind previously. And we think that -- well, that's the right moment in time to become more bullish, more aggressive. And we think that we have some opportunities to grow that we'd like to pursue. We see that emerging markets is coming back. Emerging markets, there are a number of investment opportunities that we'd like to go for. We have double-digit growth in the U.S., but we have -- we are not satisfied with the growth that we're seeing in the U.S., and we would like to invest further to have a significantly stronger growth in the U.S. And there are a couple of opportunities into Europe that we'd also like to go for. And on top of that, we would like to take the inorganic opportunities to pursue further homecare opportunities to simply come up with a better offering, service offering for our customers. And that's what we go for. And with the guidance that we have today, we give ourselves the opportunity to invest up to 2% instead of 1% as we had before. So that means that we are upping from around DKK 160 million to approximately double up, that we can invest if the right thing comes -- are there. But I'd also like to say that we have an incredibly strong financial discipline in the company. So while we are doing this, we are going through the GOP4 Plan to further enhance our earnings. We are staying very, very committed to run the company, as we're doing today. So we're wasting no money but basically keeping market-leading profitabilities. And of course, we don't invest unless there is a reason for it. So we think it's basically a long-term view on the market. It is the market leader who is stepping up the game, and that's what we go for. That's how we should see what we're doing.

Operator

And now we'll take our next person from the queue, Carsten Madsen from SEB.

Carsten Lønborg Madsen - *SEB, Research Division - Research Analyst*

So 2 questions, I guess. First one is in the period around '21, we now expect this margin lift to occur. And what should we think about top line growth from that period? I know this is extremely long term, but right now, it feels like if you don't invest a lot, then you also don't get a lot of growth. So what are your thoughts about long-term growth and the need to continuously invest a lot of money into sales marketing so that we should not see this as an incremental cost but as a sustainable high cost for you? And then secondly, in other developed markets, you delivered

7% organic growth here in Q4. And that's one of the weaker quarters in the last 3, 4, 5 years. I guess, any chance that you could take a little bit more into that number and explain where you're seeing weakness? Also, maybe highlight a little bit about the U.S. growth.

Lars Rasmussen - *Coloplast A/S - President & CEO*

We -- when it comes to 2021, it's -- you are right. We can guide on that right now, but what we are saying nevertheless is that we're pursuing growth in the upper end of the interval of the 7% to 9%. And of course, there's a very big difference of how much extra firing power you are creating or how much extra bottom line you are creating if you're growing 8% to 9% instead of 7% to 8%. So there is a kind of a knock-on consequence of having higher growth, of course, which is positive. But it is -- the aim of what we are doing here is to get out of the 7% growth momentum and up to something which is at the upper half of the 7% to 9%. And it doesn't sound like much, but it's basically growing double up compared to the markets. So I guess that's as good as I can explain it. And when it comes to the Q4, it's -- the primary way that we look at it is that we have a tough baseline in the U.S. in Q4 last year, where we had around 10% growth in that quarter. So that's, more or less, what it is.

Operator

And now we'll take our next person from the queue, Ian Douglas-Pennant from UBS.

Ian Douglas-Pennant - *UBS Investment Bank, Research Division - Director and Analyst*

It's Ian Douglas-Pennant at UBS. So firstly, on the timing of these investments. Sorry, I'm going to ask in the other [run]. So my understanding of the investments you're announcing today is they are mostly the same initiatives that you have already, just at a different magnitude as they were before. Or am I wrong and this is a completely new strategy like care was when you first announced it? So it's the first question. And then the second question is on the timing of these investments. Given I understand they're mostly sales force investments -- and you may correct me there, are you making them already? And therefore, should we start to see the revenue growth rate start to tick up in fiscal year Q4 this year or might it take a little bit longer than that? And then the final question because I flatter myself that you were referring to our note this morning when you said some people are saying this is more expense to drive the same growth. Why, if this a new growth trajectory, have you not increased your organic revenue growth target going forward?

Lars Rasmussen - *Coloplast A/S - President & CEO*

So what is new in the strategy that we come out now is that we are clear about the fact that we would like to do more on the inorganic side. So that also have an impact on the EBIT margin, and that's also contained in the way that we are guiding the EBIT margin. That -- of course, when you are moving forward in the value chain, you move into companies that have a lower EBIT margin than the one that you have in the base business. So that part of it is new that we are so clear about that we want to be further forward integrated. And then we -- what we have -- what we're doing with the other initiatives that we look at, it is also now a bit more consistent that we see that the emerging markets is coming back. So we see more opportunities there than we saw 6 months ago. And those are the basic changes that have been through the strategy. And you are right, we could, of course, go out and guide further than the 9%, but we basically think that in a 3-year horizon, to move from around 7%, as we have performed over the last 3 years to be at the upper half, it's a big move. And to do that with an earning which is over and above 30%, we think that's really interesting if you take a longer-term horizon on this. And that is what we're doing because that's also how we drive the business. So to grow double of the market with our current market crisis, we think that's extremely attractive.

Operator

And now we'll take our next person from the queue, Annette Lykke from Handelsbanken.

Annette Lykke - *Handelsbanken Capital Markets AB, Research Division - Medtech Analyst*

My question is related to the investments you're doing, Lars. And it's -- I know you have tried to answer this in different ways. But my question is that will these investments -- is that necessary to secure your 7% -- or 7% top line growth? Or how much do you think we can -- these investments could sort of result in terms of reaching the 9% growth region? I could also ask differently. Do you see any reasons where market would -- where you -- from negative market conditions are necessary to do these investments? And then I will do my questions.

Lars Rasmussen - *Coloplast A/S - President & CEO*

Okay, all right. We have had 2 quarters with 8% growth. We have had a full year with 7% growth. So in a sense, with what we're investing now, we are between 7% and 8%. That's what we are seeing. And of course, we have all of the things that are moving in positive and negative ways as we are delivering these numbers. We see a number of things that are working for us, and we also see an opportunity to consolidate the way that we go to customers, a way to -- the way that we are servicing our customers, which -- we believe that will give us further growth. And that will give us the opportunity to get to the upper end of the 7% to 9%. So this is not an investment that we need in order to stay at the 7%. We are quite clear about that, that this is what we do to move up and be at the upper end of the interval. And we find that, that is really attractive because it is double up compared to the market growth, and it is the right thing to do in the current environment because we do have the firing power to invest. And that is what we're utilizing.

Annette Lykke - *Handelsbanken Capital Markets AB, Research Division - Medtech Analyst*

And in respect to the Q1 results -- Q4 results here, how much of a -- I would not say donation, but help did you see from ConvaTec having issues to deliver on wound care and Ostomy Care?

Lars Rasmussen - *Coloplast A/S - President & CEO*

Yes. That's a very good question. I think it's a tricky one and it is because we have asked our sales subsidiaries across the globe what they experience. And they report back that they see a normal situation. We have had all the issues, like, for example, in skin care, where we have seen an extraordinary growth because one of our competitors, they're also really hard hit by the fact that the FDA have closed down one of their factories. But on -- we have not heard so that you -- the same issues on any of our other competitors. That's how we see it, but it's not -- of course, it's not the same as -- they're not -- it's just that we have not observed it.

Annette Lykke - *Handelsbanken Capital Markets AB, Research Division - Medtech Analyst*

Okay. And then in respect to the investments in direct marketing, are you -- is it going to be smaller bolt-on acquisitions? Or are there opportunities to see larger acquisitions in this respect?

Lars Rasmussen - *Coloplast A/S - President & CEO*

I can say that it would be smaller deals but it's -- and of course, we don't know if the deals will be done. Then we don't have the dilution of the margin, of course. But we just made sure that there is space for it and we go forward in -- to the extent where it makes sense financially, of course. But it is a change in our guidance because we have learned so much now from Comfort Medical that we can see -- that we see ways to combine care and also the products that we're having to come up with a good outcome. And let me give you -- let me try to give you an example of what kind of outcomes that we're also seeing on other [perms]. We talked to you on the last call about the fact that we have one Encompass, the home health agency unit in the U.S. with more than 200 different locations. And one of the things that made us win there was that we had evidence that if we -- if you combine Coloplast Care with the Coloplast products and the quality of that, then you see a 30% lower readmission rates in ostomy patients. And the readmission for one patient is $9,000. So that fact that we can't do something with Coloplast Care that really makes a difference is now underpinned and publicly available knowledge and peer-reviewed and everything else. And it's those kind of things where we see how we can use that in a fashion where we are forward-integrated that gives us the opportunity that we can basically do other things today that we were able to do before we had this access, before we had this knowledge. And that's why we want to build on it.

Operator

And now we'll take our next person from the queue, Christian Ryom from Nordea.

Christian Sørup Ryom - *Nordea Markets, Research Division - Senior Analyst*

Yes. This is Christian from Nordea Markets. First, a question on the new guidance that you have on the EBIT margin. So guiding now for a constant currency, EBIT margin above 30% for the rest of the strategy period, what should we expect for the margin beyond the next year? This seems to imply that we should expect a continued margin decline also into next year. And then secondly, on the U.S. and your announcement that you intend to relaunch or launch a redesigned version of SpeediCath Flex, will you be removing the existing SpeediCath Flex from the market once the new redesigned version launches?

Lars Rasmussen - *Coloplast A/S - President & CEO*

Yes. Let me start with the last one. So yes, we are going to remove the existing one. We're only going to have one version of SpeediCath Flex in the market.

Anders Lonning-Skovgaard - *Coloplast A/S - Executive VP & CFO*

Yes. And in relation to the 30%, so what I said earlier is that for '17/'18, we expect an EBIT margin in constant currencies of 31% to 32%, but we are not giving any, you can say, specific guidance of what we expect our EBIT margin to be in the following years because that depends on the top line but also depends on how much we are going to invest into our business. The reason of the 30% is for us to have some maneuver room in order to invest into the business and to be in the upper end of our growth ambition.

Operator

And now we take our next person from the queue, Scott Bardo from Berenberg.

Jakob Adam Berry - *Berenberg, Research Division - Analyst*

It's Jakob Berry on behalf of Scott. Just a few questions left. Firstly, you mentioned there are plenty of inorganic opportunities in the retail distribution channel. I'm just wondering why you haven't been more active on the M&A front if this is the case given the flexibility of your balance sheet and how much competition there is for these assets given that some of your competitors don't have the same flexibility you do. Second question, given the heightened investments you're making, I'm just wondering how you think about your dividend policy going forward and the prospect for any further buyback programs. And then lastly, you seem to baking in a reasonable amount of caution for SpeediCath next year. Are you aware of any concrete time lines for new competition coming on? Can you provide an update on that?

Lars Rasmussen - *Coloplast A/S - President & CEO*

Yes. So why not more active on the forward integration side, there is no doubt that, that when you do forward-integrate, you forward-integrate into companies that are much less profitable than our current business. So there's no reason to do that unless you have a model by which you will grow your business over and above what you could do in other ways or protect your business in other -- in ways that you could do -- or protect your business better than you could do in other ways. And in a sense, you could consider what we did in the U.S. as kind of an incubator thinking.

So we have bought something which we have had [as a lab] to figure out how can we connect the quality and performance of our products with the quality and service of Coloplast Care and make that together with a forward-integrated organization, a stronger offering to the customers than if you were just bolting on something that you didn't do anything with. And it's actually tricky to do that because, first of all, you are very -- you're tied on both hands and feet when it comes to the legal consequences of owning both sides of the value chain. So the moment you are a manufacturer, you -- and you are running a patient support program, you have to be very, very careful how you connect that to a direct business, which is in direct contact with patients. So all of that, we needed to understand better and we understand it to a much larger degree today. And that's also why we are being more -- having more appetite on these type of investments because we know now how -- what we can do and what we cannot do and how to pursue growth in a profitable way in this setup. And so it's not difficult to buy something. But it's very difficult to make it a good business, and that's what we have been concerned with. When it comes to dividends and share buyback, there's no changes. It's -- we pay back excess cash, and we will continue the share buyback program to the tune of DKK 500 million per year in order to have a backing for our shareholder programs. So that's basically also what you see today in the payout that we're having. What was the last question?

Jakob Adam Berry - *Berenberg, Research Division - Analyst*

Just on the SpeediCath, yes.

Lars Rasmussen - *Coloplast A/S - President & CEO*

Oh, on the SpeediCath, yes. And we have had -- we have not seen any news on that front at this point in time.

Operator

And we'll take our next person from the queue, Inês Silva from BoA.

Inês Duarte da Silva - *BofA Merrill Lynch, Research Division - Associate*

So firstly -- my first question is, what -- could you be more specific in what exactly changed in your view in the markets where you operate, where -- that made you realize that the current cost structure that you have would not enable you to grow ahead of 7%? And then my second question is in regards to a potential M&A strategy that you have alluded to, would you be willing to sacrifice margins even if it was temporarily in order to pursue a vertical integration opportunity?

Lars Rasmussen - *Coloplast A/S - President & CEO*

So what changed is that we see that, that's -- our competition is growing less than what we anticipated that they would do. And that sort of puts our growth rate into perspective. And we think that, that is an opportunity. It's our clear impression from working in the market and what we see in the market on a daily basis. Of course, we are much closer to that than you are -- that there is an opportunity to grow faster than what we are doing. We think that with the profitability that we are showing here of plus 30% and in that environment to be able to really gain market share to the tune of twice the market growth, we think that's extremely important and extremely interesting to us to go for that now that we see the opportunity. But it is -- basically, it's based on what we are picking up in the market of our current strength vis-à-vis our competitors. And when it comes to M&A, we gave a guidance of the plus 30%. Now that includes the M&A activities that we are thinking about.

Inês Duarte da Silva - *BofA Merrill Lynch, Research Division - Associate*

But even so, I understand it includes it. But if you in a certainty -- you have a certain margin and then -- would you be willing to sacrifice some of that margin in order to pursue an M&A opportunity even if, in the end of the day, the margin would still be up -- above 30%?

Lars Rasmussen - *Coloplast A/S - President & CEO*

We expect that we can keep our margin above the 30% with all the plans that we can think about. We are not -- we don't anticipate that we, in this plan period, will come back and say, "By the way, the 30% was not what we could -- level that we need to go, deeper than that." We think that we can stay above the 30%.

Inês Duarte da Silva - *BofA Merrill Lynch, Research Division - Associate*

I'm sorry. Maybe I'm not being clear. Let me try to ask the question in another way. Do you anticipate any M&A opportunities where the opportunity would be dilutive to the margins at least in a short-term perspective?

Lars Rasmussen - *Coloplast A/S - President & CEO*

What -- I think that what you -- what -- the way that I think about this is that we want to -- if at all possible, we would do more homecare acquisitions. And homecare companies, they have a lower margin than (inaudible) current market -- margin is. And when we take some of those and bolt them on to the company, that will have a dilutive margin effect on the whole thing. And that is what -- that is why we are explaining that as we have plans to take some homecare companies and add to the base, it will also mean that we will see margins above the 30% but maybe not in the level of 34% and 33%. So that's how you should think about it. It's smaller things that we are bolting on. And it has an effect, but we do not go below the 30%. Does that clarify?

Operator

And now we'll take our next person from the queue, Niels Leth from Carnegie.

Niels Granholm-Leth - *Carnegie Investment Bank AB, Research Division - Co-head of Research of Denmark & Financial Analyst*

Yes. Just a quick question on the progression of earnings over the next couple of years until we reach '20/'21. Is it fair to assume that we should expect a couple of years with more earnings volatility between quarters that we have seen historically from Coloplast?

Anders Lonning-Skovgaard - *Coloplast A/S - Executive VP & CFO*

That depends on the growth, Niels. So it depends on how the growth will develop, and it also depends on how aggressive we will be in our investment plan. But -- so no, I don't see a big change in the volatility quarter-over-quarter in the planning period.

Operator

And now we'll take our next person, Yi-Dan Wang from Deutsche Bank.

Lars Rasmussen - *Coloplast A/S - President & CEO*

Hello?

Yi-Dan Wang - *Deutsche Bank AG, Research Division - Research Analyst*

Hello, can you hear me?

Lars Rasmussen - *Coloplast A/S - President & CEO*

Yes, now we can.

Yi-Dan Wang - *Deutsche Bank AG, Research Division - Research Analyst*

Oh, great, great, great. I had it on mute, yes. So I think 3 questions. The first question is on the return on investments that's being -- improving very nicely in your business while you've developed organically and not being in the distribution -- not increasing your presence in distribution. But with all the benefit that you can see that you can get from distribution, how should we think about the returns? In the short term, I fully understand that it will be lower, but once you do all the work you need to do, what would returns be? That's question number one. And then the second question is regarding the organic growth guidance that you've given, the 7% to 9%. If I look at the business historically over the last 2, 3 years anyway, you've had to deal with a number of issues in those businesses. And if we adjust for those issues, the underlying momentum of the business was growing at least 9% on that level of investment. But if you -- I mean, to keep or to have the growth at the higher end of that but with additional investments, you're effectively baking in significant issues that you need to overcome to the same sort of degree as you've seen over the last 2 years going forward. I'm just wondering what sort of issues that we should be thinking about that's moving you in that direction. Maybe I will stop with those.

Lars Rasmussen - *Coloplast A/S - President & CEO*

Yes, okay. Let me start with the organic question. You are right, Yi-Dan, that if you clean up for all of the unforeseen things that came in -- or said in another way, if you have a perfect year, you're growing around 9%. And you don't have a perfect year. You'll have a lot of smaller things that hit you. And when you have that, you arrive at the 7%. And so it is -- well, yes, where we have these normal things coming in that we say that we want to be at the upper end of the guidance. But you are right. If we, at that point in time, then hit a perfect year where nothing really is out of the ordinary, then you will have more, of course. But that's how we have thought about it. And then...

Yi-Dan Wang - *Deutsche Bank AG, Research Division - Research Analyst*

Yes. So just to follow up from that. I suppose if I look at the business over the last 3, 4 years, the business in terms of the new products that have come out, in terms of the investments you've played, which has delivered some but probably not fully delivering what you have invested for. So the underlying momentum of the business was going to accelerate anyway, which should be enough to absorb the unforeseen issues, if you like, and then you put the additional investments on top. So can we take it that your opportunity is very, very (inaudible)?

Lars Rasmussen - *Coloplast A/S - President & CEO*

Yes, yes. It's -- if what you say is if I would like to up the guidance right now on this call, it's not in my plan. But what -- I think the basic of this is that we have -- we are seeing opportunities to pursue more growth, and we think we can do it at a reasonable price. And we think it's a very good point in time to increase the investment capacity so that we can really go forward. And that is what we're doing. We have this upswing beginning in emerging markets. We see some opportunities in the U.S., and that's why we are not satisfied with around 10% growth in the U.S. So that's what we go for, and I think that can bring us to the upper end of the interval, yes. But it's -- I understand...

Yi-Dan Wang - *Deutsche Bank AG, Research Division - Research Analyst*

Well -- so there may be 2, 3 major issues.

Lars Rasmussen - *Coloplast A/S - President & CEO*

I see where you're coming from, Yi-Dan, but the reality really also is that, that you are hit from things that you don't expect in most years. And with that, we have been able to grow around the 7%. So should be able to grow at the upper end of the interval is -- that's a big difference to us.

Yi-Dan Wang - *Deutsche Bank AG, Research Division - Research Analyst*

Okay. And then returns?

Anders Lonning-Skovgaard - *Coloplast A/S - Executive VP & CFO*

Yes. In relation to the return of investments -- so after we have acquired Comfort Medical, we have delivered a return on investment, the last financial year, of 47%. And it, of course, depends on how big the acquisitions you're going to make, how big they are, but I would still believe that we are in the mid-40s moving forward.

Yi-Dan Wang - *Deutsche Bank AG, Research Division - Research Analyst*

First, the question is really on the return of the assets you're going to buy. So maybe the easiest thing to do is just to look at Comfort Medical, where you've had some experience already and you know how much dilution that you've had from it. So once you're done all the stuff you need to do with it, that you could possibly do with it, will the return of that acquisition be similar to what Coloplast was on before it acquired it? Or would the return of acquiring distributors generally be lower? So if we were to model going further, obviously depends on the mix, how much of these acquisitions that you do. But just academically, how should we think about -- should we just -- as you increase amount of acquisition in your revenue, should we just sort of taper down the returns accordingly? Am I making sense?

Anders Lonning-Skovgaard - *Coloplast A/S - Executive VP & CFO*

So overall, as Lars also mentioned earlier, the profitability levels we look at in the dealer space is significantly lower than our group margin. So initially, they are diluting our group margin, but we believe that we can accelerate growth from acquiring dealers across some of our markets.

Yi-Dan Wang - *Deutsche Bank AG, Research Division - Research Analyst*

Right. So -- but my point is, yes, you can accelerate growth, but the incremental growth you get relative to the capital you've committed to get that growth, is that similar to the incremental growth you would have gotten on your existing business for the capital that you would commit on the existing business?

Anders Lonning-Skovgaard - *Coloplast A/S - Executive VP & CFO*

No. It will not be at the level of our existing business.

Yi-Dan Wang - *Deutsche Bank AG, Research Division - Research Analyst*

Eventually, eventually, the return would be lower?

Anders Lonning-Skovgaard - *Coloplast A/S - Executive VP & CFO*

Yes. Eventually, also, the return on potential acquisition will not be at the level of our existing business.

Yi-Dan Wang - *Deutsche Bank AG, Research Division - Research Analyst*

Okay. And then how much lower do you expect it to be?

Anders Lonning-Skovgaard - *Coloplast A/S - Executive VP & CFO*

That, of course, depends on the acquisitions that we are planning to do, the size, the growth, the profitability level. So that depends -- yes.

Yi-Dan Wang - *Deutsche Bank AG, Research Division - Research Analyst*

Right, no -- I can understand that. I'm just saying take Comfort Medical as an example. You've bought it already, owned it for almost a year. And you obviously see opportunities where you can make it more value-accretive, I suppose is the word for it. So at the end of -- and I'd expect your acquisition to be similar.

Lars Rasmussen - *Coloplast A/S - President & CEO*

It's -- I think that your question -- even though I appreciate your question, I think that it's maybe a little bit too precise because we are also seeking these investments to get a place at the table with the payers because that's where we are -- that's where you're negotiating for the future. That's where you are part of the negotiation when you set prices. That's also part where you are -- part of deciding whether -- and on what terms that the new products offered to the market, whether you arrive at lump sum, so not lump sums and so on. So you have more into it than is this investment in line with what you're doing in the business because if you take an investment in a new product and if you take an investment in a new sales force, we come up with something which is almost 50% return on invested capital. It's really, really strong. But what we're looking at here is it's expanding the business out of where we are today and also to have -- what do you call that? You call it more, how do you secure more loyalty and how do you make sure that you are part of the negotiations of what the market is going to look like going forward. So in that sense, we have a bit more into it than just return on invested capital. But of course, it needs to be significantly positive. But it will be never be as positive as the new investment in a salesperson or a new investment in a new product.

Yi-Dan Wang - *Deutsche Bank AG, Research Division - Research Analyst*

Okay. That's very clear. So we'll watch and wait and see and watch how it goes. And then the last question on the direct-to-consumer platform. Now that, I suppose, Convex Mio is the first time that you're using that platform to sell the -- sort of the bigger part of your ostomy revenue or products that could count for a bigger part of your ostomy revenue. When can we start to see some benefits from that? And actually, before we even get there, how significant do you think this channel is to the industry as a whole, not just for the coming year but over the next 3 to 5 years?

Lars Rasmussen - *Coloplast A/S - President & CEO*

The wholesale confidence or...

Yi-Dan Wang - *Deutsche Bank AG, Research Division - Research Analyst*

No, the direct-to-consumer platform that you've been building, the DtC.

Lars Rasmussen - *Coloplast A/S - President & CEO*

Oh, yes. So it's...

Yi-Dan Wang - *Deutsche Bank AG, Research Division - Research Analyst*

The one that says 1 million patients in the database, that one.

Lars Rasmussen - *Coloplast A/S - President & CEO*

Yes, yes, exactly. So the DtC platform is -- you could say that it's a way to get data on what is going on in the different markets, but it's also a feeding channel, if you will, for Coloplast Care where we have much closer contact with the end users. And as I just explained, there's one example before that when you have Coloplast Care and the -- and our products combined, we start to be able to make offerings that we could not do before because we have more data. So the investment in DtC is giving us growth. And we have said historically that we think that a couple of percentage points of what we see of growth in the company comes out of the direct-to-consumer activities. I think that's more or less the same today. It's -- that's what we are seeing. So that, in and of itself, is actually extremely value-creating.

Yi-Dan Wang - *Deutsche Bank AG, Research Division - Research Analyst*

Right. But do you think that [comfort set] would increase? I suppose historically, you've only really used it for your [Accentury] products. So -- and those that (inaudible) products.

Lars Rasmussen - *Coloplast A/S - President & CEO*

Yes. Well, that's, of course, what we are investing for, no doubt about that.

Yi-Dan Wang - *Deutsche Bank AG, Research Division - Research Analyst*

Right. But the question is, do you expect the benefit from DtC to be increasing from the 2% at the current rate?

Lars Rasmussen - *Coloplast A/S - President & CEO*

Yes. So with -- what we're implying today is that we're investing to increase the impact of the DtC channel. That's our aim with this. It is to be able to grow faster, and this is one of the ways. So if that's the question, yes.

Actually, we are out of time. So thank you for all of your questions, and we know that we're going to meet a lot of you in the coming days. So, well, thank you very much. We're looking forward to meeting you.