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COLO B.CO - Q3 2018 Coloplast A/S Earnings Call

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AUGUST 08, 2018 / 1:00PM, COLO B.CO - Q3 2018 Coloplast A/S Earnings Call

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## PRESENTATION

### Operator

Good day, and welcome to the interim financial statements of nine months 2017/2018 conference call. Today's conference is being recorded. At this time, I would like to turn the conference over to Mr. Lars Rasmussen, CEO. Please go ahead, sir.

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**Lars Søren Rasmussen** - *Coloplast A/S - CEO and President*

Thank you. Good afternoon, and welcome to our Q3 '17/'18 conference call. My name is Lars Rasmussen. I am CEO of Coloplast, and I'm joined by CFO, Anders Lønning-Skovgaard, and our Investor Relations team. We will start with a short presentation by Anders and myself, and then we will take questions.

Please turn to Slide #3. I'm very pleased with today's results. We have now developed 5 consecutive quarters of 8% growth in a market that is growing 4% to 5%. This speaks to the solid underlying performance across the business and our ability to consistently take market shares. Growth continues to be driven by ability -- by the launch of new innovative products like SenSura Mio Convex and SpeediCath Flex and strong commercial execution. In November last year, we made the decision to increase our investments into sales-enhancing initiatives, and we continue to see an initial return on these investments which I'm very pleased with.

Based on the expectations of a limited impact from the SpeediCath patent expiry, we have upgraded our organic growth guidance for the year from 7% to 8% to around 8%. Our guidance in Danish kroner is unchanged at around 6%. Our EBIT margin guidance is unchanged in fixed currencies at 31% to 32% and in Danish kroner at around 31%.

Our group strategy is centered around delivering profitable growth. We continue to make progress on our unparalleled efficiency agenda. And this quarter, we completed our plan to reduce the number of production employees in Denmark from 700 to 400. We have also accelerated the closure of our factory in Thisted, meaning that the restructuring cost will be higher this financial year than expected. Anders will walk you through this in detail later.



## AUGUST 08, 2018 / 1:00PM, COLO B.CO - Q3 2018 Coloplast A/S Earnings Call

I'm pleased to announce that we have appointed a new leader for our Emerging Markets region. Andrew Robinson joins us on October 1 from Alcon, a Novartis company where he has been leading more than 1,000 cross-functional employees in their Asia-Pacific region.

On September 18, we will host a Capital Markets Day at our headquarters in Humlebæk in Denmark focusing on innovation and commercial initiatives to drive growth. I look forward to welcoming many of you to Humlebæk.

Please turn to Slide #4. Year-to-date, our revenues grew 8% organically and 6% in Danish kroner and amounted to DKK 12 billion. The acquisition of Comfort Medical and Liliat contributed approximately 1 percentage points to reported growth. In Ostomy Care, organic growth was 9% year-to-date and growth in Danish kroner was 5%. For Q3 in isolation, organic growth was 7%. Growth continues to be driven by our SenSura Mio and Brava accessories portfolios in larger markets like the U.K., Germany and the U.S. SenSura Mio Convex continues to contribute strongly to growth.

Our SenSura and Assura/Alterna portfolio growth was driven by satisfactory performance in markets like China, Argentina and Brazil. And growth continues to be negatively impacted by the Greek price reform. Overall, growth in Emerging Markets was weaker in Q3 compared to the first 2 quarters due to timing effects. More specifically, we have won several tenders that we will deliver on in Q4.

We continue to receive positive feedback from health care professionals and users who have trialed our new ostomy appliance SenSura Mio Concave. We have now secured reimbursement and launched the new product portfolio in 9 countries. Clinical studies have demonstrated that SenSura Mio Concave is superior with respect to key clinical parameters, including superior body fit, preference and quality of life. We are proud to be introducing this new product category to end users.

In Continence Care, organic growth was 9% year-to-date and growth in Danish kroner was 7%. For Q3 in isolation, organic growth was 8%. SpeediCath, ready-to-use intermittent catheters, continue to drive growth and especially the compact versions performed well in countries such as the U.K., U.S. and France. So far, we have seen limited impact from the expiry of the SpeediCath ready-to-use patents. On the contrary, we continue to see healthy growth on the standard portfolio in particular in the U.S. and in emerging markets. Growth continues to be negatively impacted by the price reform in Greece. SpeediCath Flex continues to contribute to growth in key markets like the U.K and Germany. And the launch of SpeediCath Flex Coudé Pro in the U.S. has been well received, and this will be a key growth driver going forward. Our Conveen collecting device portfolio posted positive growth due to satisfactory growth in France and Emerging Markets. And finally, sales growth for Peristeen products remained satisfactory.

In Urology Care, organic growth was 10% year-to-date, and growth in Danish kroner was 5%. For Q3 in isolation, organic growth was 11%. The growth was primarily driven by sales of Titan penile implants in the U.S. We see a satisfactory return on the last sales investments we made into the U.S. Urology business last year and continue to invest this year. Our endourology business saw satisfactory growth in especially France and Saudi Arabia.

In Wound & Skin Care, organic growth was 3% year-to-date, and growth in Danish kroner was negative 1%. Organic growth for Wound Care in isolation was 4% year-to-date. For Q3, organic growth for the total business area was 11%, and for Wound Care in isolation, it was 12%. The stronger growth in Q3 in Wound Care was driven by stable growth in China and good growth across our European markets driven by the Biatain Silicone portfolio. The newly launched Biatain Silicone Sizes & Shapes portfolio has begun to meaningfully contribute to growth. Q3 was also positively impacted by an easy comparison in Greece last year, and overall year-to-date, the Greek price reform still has less negative impact.

The U.S. Skin Care business detracted from growth in the quarter due to the intensifying competition in the U.S. Contract manufacturing of Compeed contributed negatively to growth year-to-date, due to inventory reductions in connection with the sales of the Compeed brand from Johnson & Johnson's to HRA Pharma. As expected, part of the DKK 30 million negative impact in the first half was regained in Q3.

And turning to our geographical segments. We saw organic growth of 5% year-to-date and 6% in Q3 in our European markets. The growth continues to be satisfactory across the portfolio of countries and, in particular, in key markets like the U.K. and France.



## AUGUST 08, 2018 / 1:00PM, COLO B.CO - Q3 2018 Coloplast A/S Earnings Call

Organic revenue growth in other developed markets was 12% year-to-date and 10% in Q3. The U.S. Chronic Care business continues to post double digit growth. In Ostomy Care, we continue to secure new hospital wins. Growth rate in Japan and Australia remained satisfactory. Growth in the U.S. year-to-date was positively impacted by inventory reductions of DKK 70 million in Q1 last year.

Revenue in Emerging Markets grew organically by 14% year-to-date and 11% in Q3. And markets like China, Argentina, Brazil continue to deliver very satisfactory performance. A number of smaller markets that we have recently invested in, for example Turkey and India, also delivered strong performance. And growth year-to-date was negatively impacted by the Greek price reform. As mentioned earlier, we won a number of tenders in Q3 that we will deliver on in Q4.

With this, I will now give the word to Anders. Please turn to Slide #5.

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

Thank you, Lars, and good afternoon, everyone. Reported revenue year-to-date increased by DKK 667 million or 6% compared to the same period last year. Most of the growth was driven by organic growth, which contributed DKK 920 million or 8% to reported revenue. Acquisitions contributed DKK 135 million or 1 percentage point to reported revenue. Foreign exchange rate had a significant negative impact of DKK 478 million or 4 percentage points on reported revenue, primarily due to the depreciation of the U.S. dollar and dollar-related currencies against the Danish kroner. Reported revenue growth was impacted by the DKK 90 million one-off revenue adjustment to the U.S. Department of Veterans Affairs in our third quarter last year. The matter has not affected organic growth for the reporting period.

Please turn to Slide 6. Gross profit was up by 4% year-to-date to around DKK 8.2 billion. This equals a gross margin of 67%, compared to 68% last year. FX had a significant negative impact of 60 basis points on the gross margin. Year-to-date, in constant currencies and adjusted for the DKK 90 million Veterans Affairs payment in Q3 last year, the gross margin was 67% compared to 68% last year. The gross margin was positively impacted by improvements in production efficiency at our volume sites and the relocation of SenSura Mio to Hungary. The gross margin was negatively impacted by product mix due to the launch of new products where the production economy is not yet fully optimized.

Increasing depreciation levels also had negative impact on the gross margin. In Q3, we had DKK 21 million in restructuring costs related to the reduction of production employees in Denmark. In the first nine months, total restructuring costs were DKK 29 million. As Lars mentioned earlier, we have now completed the reduction of production employees in Denmark from 700 to 400. We have also accelerated the closure of the Thisted factory in Denmark, which means that the restructuring costs will be higher this year than we had originally anticipated. In total, we now expect to have DKK 45 million in restructuring cost this year, which is DKK 25 million more than we have previously communicated.

The Global Operations Plan IV is still expected to deliver an EBIT margin improvement of 100 basis points in '19/'20 and 150 basis points in '20/'21. In total, we still expect approximately DKK 50 million in restructuring cost, but they will now be split between '17/'18 and '18/'19 versus previously '18/'19 and '19/'20.

The distribution to sales ratio came in at 29% compared to 28% last year. The 9% increase is in line with our long-term guidance of increased investments to drive further growth over the next couple of years. The clear majority of the new incremental investment cases for this financial year were approved in Q1 across our business areas and regions. Overall, new investments remain on track, and we have seen a return on some of these investments already. The admin to sales ratio came in at 4% of sales, on par with the recent trend.

The R&D to sales ratio came in at 4% of sales, in line with last year. The 10% increase in R&D costs reflects a higher general activity level. Other operating income and expenses amounted to DKK 35 million compared to DKK 15 million last year. The increase was mainly due to a nonrecurring income from a patent settlement in Urology Care in Q1.

Overall, year-to-date, this resulted in an increase in operating profit in fixed currencies and adjusted for the DKK 90 million Veterans Affairs payment in Q3 last year of 3%, corresponding to an EBIT margin of 31% in fixed currencies. In actual currencies and adjusted for the DKK 90 million Veterans Affairs payment, operating profit declined by 1%, corresponding to an EBIT margin of 30%.



## AUGUST 08, 2018 / 1:00PM, COLO B.CO - Q3 2018 Coloplast A/S Earnings Call

Operating cash flow amounted to DKK 2.8 billion compared with DKK 1.7 billion last year. The increase is primarily explained by higher mesh payments last year compared to this year. Total mesh payments year-to-date amount to DKK 0.4 billion. Total mesh payments to date amounted to DKK 4.6 billion.

Cash flow from investing activities was impacted by the site expansion in Nyírbátor in Hungary and the acquisition of a plot of land in Costa Rica as well as capacity expansion in machines to produce new and existing products. Investments in intangible assets and property, plant and equipment amounted to DKK 521 million year-to-date, up DKK 98 million compared to last year.

Adjusted for payments made in connection with the mesh investigation and acquisitions including Comfort Medical and Livial, the free cash flow amounted to approximately DKK 2.6 billion compared to DKK 2.5 billion last year. The increase is mainly due to improved working capital management. Our cash conversion rate in Q3 calculated as a 12-month trading average was 103%.

With respect to the mesh litigation, in the U.S., we have settled more than 95% of the known cases. We still view the provision as sufficient, and we are in the final phase of the mesh litigation. In '17/'18, we now expect to pay out DKK 500 million of the remaining DKK 1 billion of the -- in total DKK 5.25 billion provision. Finally the first half of the approved share buyback program of in total DKK 1 billion was completed in May.

Please turn to Slide 7. Our organic revenue guidance for '17/'18 is now an organic growth of around 8%. Our reported growth in Danish kroner is unchanged at around 6%. Acquisitions are expected to contribute 1.3 percentage points to reported growth. As Lars mentioned earlier, we have upgraded our full year guidance for organic growth from 7% to 8% to around 8% due to the limited impact from the SpeediCath patent expiry since we have reduced the impact for the year from DKK 50 million to DKK 0 million. We still expect to see an impact from the health care reforms in Greece in Ostomy Care, Continence Care and Wound Care of up to DKK 100 million.

In Q3, we adjusted our pricing towards our distributor to affect a 25% price cut. We've also made some adjustments to the product portfolio that we will sell in Greece. On a group level, we now expect negative pricing pressure of up to 1 percentage point on our top line due to health care reforms in Greece from previously more than 1 percentage point.

We expect Wound & Skin Care to deliver a full year growth of 2% to 4% due to improved performance in Wound Care offset by weaker momentum in Skin Care. The guidance in Danish kroner is significantly impacted by the depreciation of the U.S. dollar as well as the dollar-related currencies against the Danish kroner.

The currency impact is based on spot rates as of August 2. For '17/'18, we continue to expect an EBIT margin of 31% to 32% in constant currencies and around 31% in Danish kroner. The EBIT margin guidance includes the impact of the health care reforms in Greece as well as acquisitions.

Our guidance continues to assume a proportionally higher absolute EBIT in the second half of the year compared to the first half. Historically, Q4 has always been our strongest quarter in nominal sales translating into a higher EBIT margin, driven primarily by leverage on our fixed costs. We expect to see the same pattern this year. We also continue to expect broadly stable trends on our operating expenses. Overall, our expectation for the full year is that the EBIT margin in fixed currencies will be around middle of the 31 to 32 percentage point range.

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. We expect the benefit to be absorbed by the cost of relocation and restructuring cost of approximately DKK 45 million in '17/'18. We also expect high single-digit wage inflation in Hungary in '17/'18. Overall, our expectation is still that the gross margin in fixed currency will be in the line with last year at around 68%.

We now expect our net financials to end the financial year '17/'18 at around minus DKK 50 million from previously DKK 0 million, primarily due to currency translation losses on balance sheet items denominated in Argentinian pesos and Brazilian real, only partly offset by hedging gains on the U.S. dollar against Danish kroner.



## AUGUST 08, 2018 / 1:00PM, COLO B.CO - Q3 2018 Coloplast A/S Earnings Call

CapEx guidance for '17/'18 is unchanged at around DKK 700 million and is driven by investments in more capacity for new and existing products, the Nyírbátor factory expansion which became operational during Q3 and the acquisition of a plot of land in Costa Rica where we intend to build our future volume factories. 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) We will take our first question from Veronika Dubajova from Goldman Sachs.

#### Veronika Dubajova - Goldman Sachs Group Inc., Research Division - Equity Analyst

I will keep it to 2. The first one is, I'd love to get a little bit more color, Lars, from you about the momentum in Ostomy. It's quite hard for us to know what impact the tenders might have had. And it would be good to understand maybe excluding those tenders, how the business grew and what your degree of confidence is in returning back to that very high single-digit growth rate that you were delivering in the first half of the year? And then my second question is for Anders. It's a bit financial. If I look at the divisional profitability that you are disclosing, both Urology and Wound & Skin Care have seen some margin compression on a 9-month basis. Is this really where most of your investments are going into and that's why we're seeing margins compressed? Or is there something else going on in the businesses that would explain that?

#### Lars Søren Rasmussen - Coloplast A/S - CEO and President

All right. Veronika, on the Ostomy Care, you see the impact from the orders that we talked about for emerging markets that we have not delivered, so -- and actually, it's a bit more than DKK 40 million that we have produced, manufactured that will be ready to ship but where we are missing some of the shipping documents and bank guarantees to ship them. So that will impact the growth for the quarter for Ostomy Care with approximately a couple of percentage points, a little bit more. And it will also mean that the growth in the quarter for Emerging Markets would grow to around 15% because it's all Emerging Markets related, of course. So in that sense, it's all there. We are quite confident that we will then deliver this in this current quarter. And that means that we had a little bit lower growth in the quarter we just reported, and we'll have a little bit higher compared to what we believed that we needed in order to deliver a year to the tune of 8% growth. So it's actually the same -- very, very nice momentum that we continue to have like what we have had for the first half year also. I guess that, that was what you're asking, right?

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

And Veronika, in terms of your question related to our segment operating profit for Urology Care and Wound & Skin Care, so please be aware that the numbers we're reporting here is in reported currency. So if we take Urology Care first, we look at the underlying profitability development. We are seeing growth, high organic growth in the level of 10% for the year, but we're also seeing an underlying in fixed currencies improved profitability levels. But due to the fact that a lot of the Urology Care growth is in the U.S., in reported currencies, the currency effect is quite significant. For the Wound & Skin Care part, we are also investing into this area. So the investments into wound and skin is also in the U.S., and that is also having an effect on the reported profitability levels.

#### Veronika Dubajova - Goldman Sachs Group Inc., Research Division - Equity Analyst

Okay, that's very helpful. And can I just ask a quick follow up? For the concave SenSura Mio, do you have an update on when you're planning to launch that in the U.S.?



## AUGUST 08, 2018 / 1:00PM, COLO B.CO - Q3 2018 Coloplast A/S Earnings Call

**Lars Søren Rasmussen** - Coloplast A/S - CEO and President

No, we don't have a date for that yet.

**Operator**

And your next question is from Patrick Wood from Bank of America Merrill Lynch.

**Patrick Andrew Robert Wood** - BofA Merrill Lynch, Research Division - Director in Equity Research and Head of the EMEA MedTech & Services Team

Perfect. I'll keep it to 2, if I can. The first would be on the ostomy side in the U.S. I know you saw good growth on the accessories side, but I'm curious if you saw good growth outside of accessories, i.e., in the core bags business. And on the back of that, how are you guys feeling about the GPO contract renewals that are coming up next year? That will be the first one. And then on the second one, just a little bit of help, if you can, on the margin. I know at the group level, obviously, you've done quarters in the past where you've had the kind of margin that you need to hit the 31% reported group EBIT margin...

**Lars Søren Rasmussen** - Coloplast A/S - CEO and President

Patrick, after the GPO contract, the question that you started on there, could you start from there again? Because (inaudible). Yes.

**Patrick Andrew Robert Wood** - BofA Merrill Lynch, Research Division - Director in Equity Research and Head of the EMEA MedTech & Services Team

Yes, of course, of course. On the margin side basically, for the group EBIT margin, the Q4 required is obviously fairly large. I know you talked about getting leverage on the OpEx base and, obviously, that benefiting. But if you look at the year-on-year trend in the margin from Q1 to 3, you need a big Q4 to make that work. Is that really all just operating leverage on the products? Or is there something else going on that, that we can't see? That'd be really helpful.

**Lars Søren Rasmussen** - Coloplast A/S - CEO and President

Okay. Maybe Anders will start with the margin question, and then I come back to the ostomy growth on bags and plates and the GPO.

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

Yes. So in terms of the margin, so for the year, as I said earlier, we are expecting that the full year EBIT margin in fixed currencies will be in the middle of our range of 31% to 32%. And that requires a strong Q4. And my assumptions are, as we've also seen in the past, that we will have a strong nominal quarter, both in terms of sales, and that will have a leverage effect across the business both on the production side but also across the fixed cost in the remaining part of the P&L. So my expectation is that the EBIT margin will improve in our fourth quarter. In terms of the cost levels, I'm expecting it will be, yes, stable versus the remaining -- versus the year-to-date numbers.

**Lars Søren Rasmussen** - Coloplast A/S - CEO and President

All right. And then on the ostomy growth, I can confirm that on top of the accessories growth, we are winning shares on bags and plates the U.S. And when it comes to the GPO, I mean, it's -- and by the way, we're also winning acute contracts and so on. But on the GPO side, it's -- yes, of course, very, very aware that the bidding process will be in 2019 for Vizient and for Premier. I think that we have a stronger position than last time, but

## AUGUST 08, 2018 / 1:00PM, COLO B.CO - Q3 2018 Coloplast A/S Earnings Call

that's not a guarantee, of course. We have a very, very strong convex offering. We have had a quite successful IDN strategy, which also meant that we became preferred supplier to Cleveland Clinic and so on. So I think that we have -- we are in a very different position than last time, but you only know the day that is revealed who is on the GPO whether you are or not. But it's a continuous effort for us to be on the GPO; as far as we think, it's very important.

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**Operator**

(Operator Instructions) Our next question is from Chris Gretler from Crédit Suisse.

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**Christoph Gretler - Crédit Suisse AG, Research Division - MD in Equity Research**

On the -- first is on Wound Care, I'm obviously, very impressed with the growth momentum there. Maybe could you speak about the success you have so far on the U.S. market? That would be my first question. I'll take it one after the other.

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**Lars Søren Rasmussen - Coloplast A/S - CEO and President**

So on Wound Care, the main driver of the growth that we are seeing is China and Europe. So if you look at the U.S., then we have launched this -- you could say a key milestone for us is April this year where we launched the Biatain Silicone prevention -- for prevention of -- for prevention and treatment, but it takes time to get started there. And quite frankly, you know that our base is very small in the U.S., so we can easily make a nice growth percentage. But if you take the total impact on the group level for Wound Care, it's very limited, what comes out of U.S. at this point in time. It is China, and it is Europe that have very strong performance.

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**Christoph Gretler - Crédit Suisse AG, Research Division - MD in Equity Research**

Okay, good. Yes, let's see. And then the second question is on the price reforms. It looks fairly quiet at the moment. Maybe could you update us on what you see right now and what we should be aware of?

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**Lars Søren Rasmussen - Coloplast A/S - CEO and President**

Yes, we don't think that price reforms are quiet, at least not if you look at Greece where we're actually taking a hit of up to DKK 100 million this year. But apart from that, it's quiet you could say. There will be a price review on ostomy and Continence Care in France last year. But as -- that's the big thing that we are looking into for next year.

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**Christoph Gretler - Crédit Suisse AG, Research Division - MD in Equity Research**

Okay. And then maybe just on the SpeediCath. It looks like the patent expiry has been substantially less severe, impacts have been substantially less severe than feared. I mean, there has to be certain gains in terms of profitability as a result of that. Could you remind us what happened to those, when those 2 investments or to kind of back up your guidance?

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**Lars Søren Rasmussen - Coloplast A/S - CEO and President**

So what we have done is that we have -- you see this reflected in the sales numbers. So we'll start out with the guidance of around 7%, and then we increase it to between 7% and 8% because of no impact from the patent expiry, and now we are upping it to around 8% because we don't expect any impact this year from it. And by the way, we don't expect to have any kind of reservation or anything else for this. In the coming years, it's sort of behind us. So that's how you see that. Maybe I'm not fully aware what is this that you're referring to.



## AUGUST 08, 2018 / 1:00PM, COLO B.CO - Q3 2018 Coloplast A/S Earnings Call

**Christoph Gretler** - *Crédit Suisse AG, Research Division - MD in Equity Research*

Just so that there is DKK 100 million less lost sales relative to your original expectation. So it had no, pretty good to no incremental contribution margin, so I was just wondering...

**Lars Søren Rasmussen** - *Coloplast A/S - CEO and President*

Yes, yes, that's right. But please remember that this is an investment year. So whatever we can get our hands on, we are investing in future growth. And then we try to basically bottle it so that we are delivering on the 31% to 32%. And as Anders alluded to in the presentation, we'll get into the middle of the rings with that. And that's everything else we are investing because that's what we have said. Also, we want to grow at the upper end of the 8% to 9% interval, and that takes investment.

**Christoph Gretler** - *Crédit Suisse AG, Research Division - MD in Equity Research*

Yes, fully understood. The last question is on Costa Rica. Could you actually speak about that location relative to your other manufacturing sites in terms of cost and preferential tax treatment maybe?

**Lars Søren Rasmussen** - *Coloplast A/S - CEO and President*

Yes. So it's a mature area, in a sense because there are quite a number of medical device companies in Costa Rica already. It is not like when we started out our strategy 20 years ago in Hungary, where we had a lot of aides from the government and so on in order to establish factories. That's not what we're seeing. But -- so there's no sort of benefits, and there's no tax impact either. We are going to invest to the same tune as when we're opening a factory in Hungary over the last years. It [caught] in the DKK 700 million this year that we are giving the DKK 700 million and in that we are investing approximately DKK 100 million in a piece of land. And if you look at the report on the 100,000 square meters, where we can build approximately 60,000 square meters of factories. And if you're looking at the cost of labor in Costa Rica, it's approximately 15% to 20% lower price than what we see in Hungary for the blue collar workers and if you're looking at the white collar workers, it's like there is almost a fixed price for white collar workers across the globe. So it's more or less the same that you're also seeing -- as we see in Hungary. So skilled people are, of course, more costly. But access to very well-educated people on the blue collar side and also on the white collar side. And as we speak, we actually have people from Costa Rica and Hungary to be trained on new machines that will be transferred together with them back to Costa Rica. So we are pushing ahead.

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

If I may add, in terms of the building of the factory, that is included in our long-term CapEx guidance of the 4% to 5%. And that will start to impact next year.

**Operator**

And your next question comes from Michael Jungling from Morgan Stanley.

**Michael Klaus Jungling** - *Morgan Stanley, Research Division - MD, Head of MedTech & Services and Analyst*

I have 3 questions. Firstly, on SpeediCath, the patent expiry, can you comment on whether you've seen new competition entering the market. I'm talking about smaller players, such as the smaller one that we've seen in the U.K. And you also mentioned I think the risk is over for SpeediCath patent expiry. Does that mean that the ConvaTec launch expected later on this year is irrelevant? Question #2 is on Emerging Markets...



## AUGUST 08, 2018 / 1:00PM, COLO B.CO - Q3 2018 Coloplast A/S Earnings Call

**Lars Søren Rasmussen** - Coloplast A/S - CEO and President

Can we pause it there? Let's take one at a time. So I would -- you never heard me say that, that we don't see any risks on any of our product areas. We expect -- and we actually expected that there'll be launches as a consequence of the patent expiry, and we have not seen anyone -- any launches yet that we have noticed, at least. Of course, we expect to see launches going forward. What I said was that we are not going to put any specific guidance on any competitive launches into our forward-looking guidance as a consequence of the patent expiry. There will be, of course, competitive products. We also have, as you know, the BBT that we are ready to launch. But now our volume is actually much higher than what we had expected at this point in time, and therefore, we are postponing the BBT launch until we have more capacity, machine capacity onboard, because we're using the same machines to produce the new BBT product as for the standard SpeediCath products. And that's why we don't think that we should take the risk of putting in extra new product into machines that are already pretty utilized, and we had expected that the volume would go down due to the fact that we would have less sales of SpeediCath as a consequence of the patent runout. That has not been in the case and therefore we have this postponement. So the only thing that you should take away is that we had a provision this year for the patent runout. We're not going to have a provision going forward. That's the only thing I'm saying. Of course, I would expect that we will have competitive pressure as we always have.

**Michael Klaus Jungling** - Morgan Stanley, Research Division - MD, Head of MedTech & Services and Analyst

Great, that's very clear. Second question is on Emerging Markets. Can you comment why you have leadership change for the Emerging Markets?

**Lars Søren Rasmussen** - Coloplast A/S - CEO and President

Yes. Because Paul Marcun, who was running it for -- quite successfully for some years, he has gotten a job where he got into the executive management of Getinge, and where he could get an area where he could get end-to-end responsibility and profit and loss responsibility, and that was for him the right point in time in his career to have that, and that was what he was wishing for. So we couldn't offer something similar to him. He was sitting on a regional Turkey, and therefore, he did the change.

**Michael Klaus Jungling** - Morgan Stanley, Research Division - MD, Head of MedTech & Services and Analyst

Okay, great. And the last question is on Wound & Skin Care. Can you talk a little bit about how you see the future? I'm talking about the consistency of organic growth. The volatility between quarters is extraordinarily high. How do you feel about more consistent organic growth between quarters for Wound & Skin Care?

**Lars Søren Rasmussen** - Coloplast A/S - CEO and President

I don't feel very well about saying that we will have consistent growth going forward in the Wound & Skin Care. We have a 12% growth for the quarter. We have 3%, approximately 3% growth for the year-to-date. So that's a very big discrepancy between the quarters. And it is harder for us to predict. What I can say is that we are investing more and more into more innovation. We have had some years when we did turnaround on the business to make it more profitable. A couple of years back, we started to invest. We are launching, as we speak, new products. We're also launching ourselves into the U.S. where we have basically not touched the Wound & Skin Care business very much and definitely not invested in it, since I became CEO of the company. So in that sense, we are in a situation where we're investing more in Wound & Skin Care, and therefore, I also expect on average to see a higher growth rate in the Wound & Skin Care area going forward because that's what we're investing for. But from quarter-to-quarter, it's very, very hard to predict what is going on.



## AUGUST 08, 2018 / 1:00PM, COLO B.CO - Q3 2018 Coloplast A/S Earnings Call

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

But this year we are -- Michael, this year we are also impacted by the Compeed business as we talked about in the first half that there was destocking on our Compeed business in the first half, and part of this destocking effect is back in our third quarter. So that is also a reason why we see these fluctuations quarter-over-quarter.

**Operator**

And our next question comes from Ian Douglas-Pennant from UBS .

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

And the first question is on the Wound Care market. I'm very surprised to see such good growth coming out of that this quarter. Could you talk about, firstly, the pricing pressure that you're seeing globally, but also the U.K. in particular, in your exposure to that market? And the second question is on the growth investments that you're making. Are you still seeing lots of opportunity for investments? Or do you think the kind of weight of OpEx growth should slow next year and then we'd see margin expansion?

**Lars Søren Rasmussen** - Coloplast A/S - CEO and President

Yes, so on the Wound Care market, yes, we see pricing pressure. And we have been more optimistic on the market growth than most of our peers for the last couple of years, and we are adjusting into their levels. Because we have also -- we have actually expected that the market will grow something like 3% to 5%, and we are maybe more seeing something between 2% and 4%, maybe more 2% than 4% for the time being. And that is a consequence of price pressure. And that is a consequence of some of the leading companies in the market offering very, very big discounts to stay on the contracts that they're already having and also to a level where we have been very surprised to see what is going on. So you know there's a very big difference if you have rebate strategies carried out by smaller players in the market or if you see rebate strategies carried out by the big ones in the market. And we see the big ones, and that is -- then you basically have to follow suit as a smaller player. So that is really taking value out of the market, and I guess that, that is what we are seeing. So in a sense, it's quite negative. Having said that, we have very strong growth in Europe. We also have very, very good growth in China, as I mentioned a couple of times. And since we have such a big footprint in Europe, it means a lot to us that we see this growth. And I can only confirm that the U.K. market is a market where there is a lot of rebates given. It's a very, very competitive market for the time being. But we are keeping up quite well, not least because we have good innovation in the market.

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

Sorry, can I just confirm that the pricing pressure you're talking about, that is not -- that's a global thing. It's not any one market more than others, U.K. as well?

**Lars Søren Rasmussen** - Coloplast A/S - CEO and President

It's very much Europe. It's very, very much Europe and then U.S. and then it sort of lessens when you get into Emerging Markets compared to what it has been in the past. All right. If you look at the growth initiatives now, as you know, we try to grow 7% to 9%. And as we also specified, we'd like to get to the upper end of the interval and now we're at 8%. So not too bad. But we see a lot of opportunities to invest. It is, however -- having said that, it is an investment year we have this year. But we see -- but we are also investing quite a bit, and we also see opportunities going forward to both grow at a high pace and also to expand markets. And I hope that you'll come to our Capital Markets Day because we will spend quite a bit of resources explaining how we see the market and the opportunities to grow as a company but also the opportunities to grow the markets because we think that there are many opportunities that we can still go for. So we are quite optimistic about growth, and it's not just about covering more geographical space. It is very, very much about the innovation and innovation-driven. And as you know we are spending the last couple of years



## AUGUST 08, 2018 / 1:00PM, COLO B.CO - Q3 2018 Coloplast A/S Earnings Call

sort of creating a parallel product portfolio that we're going to launch from 2020 and onwards. And we are going for the first time to really talk about that at the Capital Markets Day. We think that, that has the potential to expand the market.

**Operator**

And our next question is from Yi-Dan Wang from Deutsche Bank.

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

I have several questions. Starting with a quick follow-up, if I could. When would you be launching the BBT product into the market? And then secondly, a question to Anders. Why will the margin in urology and Wound & Skin Care be affected much by the FX when the products are largely made in the U.S.? I mean, some are made in Europe, but the amount of products that are made outside of the U.S. that are sold into U.S. is relatively limited. So if I'm wrong in thinking about that, please correct me. I'll start with those, and then a few questions to Lars.

**Lars Søren Rasmussen** - *Coloplast A/S - CEO and President*

But you know we're only allowing 2 questions per person to answer. You're already out of questions. So when we talk about BBT, I would rather not give an answer to when exactly we are launching it. As I said, it's -- BBT is going to be produced on the same machines as the current products are produced on. And since we are sitting on much more than what we thought, we have a higher volume on those machines. And therefore, we have ordered new machines. So one, when the new machines are here, then we can launch. So we ordered the new machines some time back. And it takes approximately a year for a machine to be ready. But it's not for sure the day that the capacity is available. We're also pushing on the button and launching that. It depends on several factors. So you could say that within the coming year, we'll have the capacity ready. But when we're launching that, that's -- that will be -- I can't say that at this point. But it is the capacity part which is basically what we're waiting for.

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

But you seemed to have a lot more capacity issues these days than you had previously. I mean, you're launching a lot of very innovative products, and all of them seem, well, more than not are seeming to do better than you expect. So why are you guys not planning a bit more into the capacity part and...

**Lars Søren Rasmussen** - *Coloplast A/S - CEO and President*

Yes, that's a good question. It's -- we just need to...

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

It shouldn't cost that much more money to bring in a few more machines.

**Lars Søren Rasmussen** - *Coloplast A/S - CEO and President*

We just need to adjust to -- yes, you're right. We need to adjust for more positive outlook, and that's the only thing. So it's not -- it's a really good question, Yi-Dan. Of course, we should have done that because it's crazy not to sell if we can. And then the second part of the question, Anders?



## AUGUST 08, 2018 / 1:00PM, COLO B.CO - Q3 2018 Coloplast A/S Earnings Call

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

So in relation to the urology profitability, yes, so you are right that the majority of our sales in the U.S. of our implants business is also produced in the U.S. But it has -- the dollar is impacting the top line, but you also need to take into account that we are investing quite significantly into Urology Care. We have expanded our sales force quite significantly both last year but also this year, and that is also included in our profit and loss for Urology Care.

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

Okay. All right, that's clear. And then my questions to Lars. So when we look at the ostomy market in the U.S., I mean, clearly, you made some very good progress with the Cleveland Clinic. Are you able to say what kind of readmission rates at the Cleveland Clinic achieved with your product versus Hollister's products? And how much of that was achieved due to product versus services? And how has the amount of work Coloplast need to do and the amount of time required to win new contracts changed since the Cleveland Clinic?

**Lars Søren Rasmussen** - Coloplast A/S - CEO and President

I can't give you the specifics that you are asking for in the first part of your question. But there's no doubt that with the success that we are seeing, we are also in a position where we can be significantly more targeted in the way that we go about other targets that we have in our list. But also it means that we can be much more precise in the way that we are preparing ourselves to be competitive when it comes to the bidding process for the next round of GPO. It's that, that comes out in 2019. But as I said before, there's no guarantee of course, but we are significantly more competitive now than we have ever been before in the market, both when it comes to the kind of programs that we have behind us and also the product portfolio. We didn't have convex the last time we went about this. We didn't have concave. We -- there's a number of accessories that we did not have. We have -- we basically have the full portfolio. We even have a new hospital assortment in the market, and that means that we have a completely different standing.

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

Okay. Last one. So we saw very -- well, actually pretty good Continence Care growth, the growth rate being maintained versus previous quarter despite a much tougher comparison. How much of that is coming from the Flex Pro benefit in the U.S., if any yet?

**Lars Søren Rasmussen** - Coloplast A/S - CEO and President

We do have the progress on Flex Pro as we anticipated, but it was launched last quarter. It's still a small product in this environment because it is actually a pretty large environment that it's coming into. So I think that the way you should think about Flex Pro is that it is a key driver for growth in the U.S. Continence Care side for the next years.

**Operator**

We will then take our next question from Christian Ryom from Nordea.

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

This is Christian. I have only one question regarding the gross margin dynamics going forward. You commented on the gross margin here in the third quarter that, that was negatively impacted from your product mix specifically, lower production efficiency on the new products. How should we think about when we look, both to Q4 but also into next year in terms of your launch pipeline of new products? Will this be a sort of persistent negative impact we will have? And what are the time lines for, say, start delivering production efficiencies from your move of newer products to Hungary?



## AUGUST 08, 2018 / 1:00PM, COLO B.CO - Q3 2018 Coloplast A/S Earnings Call

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

Yes, so in terms of our gross margin, so as I talked to earlier, the gross margin is negatively impacted in Q3 but also year-to-date from the mix as we are selling more of the new launches we have been doing over the last couple of years. We have addressed this by firstly reducing the number of production employees in Denmark from 700 to 400, the production employees. And that program, we have just finalized, and the next phase of our production optimization program, the GOP IV, we have also initiated, and that program is going to bring EBIT margin improvements of 100 basis points in '19/'20 and 150 basis points in '20/'21. What we're working on in this program that is consolidation of the 2 sites that we have in Denmark, and we are expecting that we will close Thisted by the end of next financial year. We are also working on optimization of procurement as raw materials is around 50% of our cost of goods sold, and I also expect that we will continue to see more scalable effects on our volume side. So we are working on a number of activities in order to improve our gross margin going forward. But as I said earlier, this year, also due to the restructuring cost in fixed currencies, it is in the level of last year, and that's also how I see it for next year.

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

Maybe one follow up. I think you've earlier commented that you've now completed your move of the convex portfolio to Hungary. How far along are you there in terms of gaining the scale benefits from production? Is that a matter of months or a matter of years in terms of sort of gaining the full gross margin effect from that product or that production move?

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

Yes, so as we have mentioned earlier, we have moved our convex machines from Denmark to Hungary, and we're actually being producing in Hungary for quite some time. And we are starting to see an improved production economy on our convex production quarter-over-quarter. So the more volumes we are getting through, yes, the more efficient and the lower unit costs that we're going to see. So it is something we are seeing improvements on quarter-over-quarter.

**Operator**

And our next question comes from Oliver Metzger from Commerzbank.

**Oliver Metzger** - Commerzbank AG, Research Division - Analyst

Not so many left. The first one is just a comment on the pricing of SpeediCath Flex in the markets outside the U.S. Yes, we have a quite good visibility but outside of U.S., could you give us the feeling of which of the price premium has similar extent in the U.S. or imagine it could be? And my second question is a comment on your Emerging Markets' performance. So it was heavily impacted by Greece. Greece is an important market for you. It would be quite interesting to know how the underlying Emerging Markets excluding Greece would develop -- would have been developed? And, yes, basically these are my 2 questions.

**Lars Søren Rasmussen** - Coloplast A/S - CEO and President

Okay. So I take the last one first. I think maybe you came a little bit late into the call. The thing is that, we had 11% growth in Emerging Markets in the third quarter. But because of these orders that we actually did receive and manufacture but that we could not ship because we were sort of missing bank guarantees and other documents. If you take that, that's approximately a little bit more than DKK 40 million, and that means that the growth would've been around 15% if you take that back. And that would also impact primarily Ostomy Care. So that also mean that the growth in Ostomy Care would have been 9% instead of 7%. And I mention those numbers because we're quite confident that we are -- we're going to ship them this quarter, so they come on top in that sense in this quarter that we're in now. Pricing on Flex outside of the U.S. is more or less in line with



## AUGUST 08, 2018 / 1:00PM, COLO B.CO - Q3 2018 Coloplast A/S Earnings Call

what you call SpeediCath Compact pricing. So that's not the same kind of premium as a Coudé type of product or this type of product because it's not really the Coudé category in Europe; it's more a standard product. So in that sense it's priced in a different way in Europe than it is in the U.S.

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**Oliver Metzger** - Commerzbank AG, Research Division - Analyst

To my first question, I think there was a misunderstanding. So what would have been the performance of Emerging Markets excluding Greece?

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**Lars Søren Rasmussen** - Coloplast A/S - CEO and President

But then you have to -- then you have to take approximately DKK 100 million for the full year, so then DKK 75 million for year-to-date because of the impact from Greece.

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**Operator**

And we will then take our next question from Kit Lee from Jefferies.

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**Nyeok Lee** - Jefferies LLC, Research Division - Equity Associate

I only have one last -- just a question on the SenSura Mio Concave launch. Have you seen any competitive win since you've launched the product? Or have most of the sales mainly come from, I guess, your own patient switching from one of your products to the concave version?

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**Lars Søren Rasmussen** - Coloplast A/S - CEO and President

Yes. Please be aware that this is a completely new category. So for us it's a matter of introducing a new category to both professionals and to patients. So therefore, it's -- we are having real sales but we are building a market, and therefore, it's not something that is growing very, very fast, and if we can point to specific wins that we had to concave but, of course, we have a more complete range than anybody else in the market has at the time being. All right. I think that we are ready for the last question.

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**Operator**

And your last question comes Annette Lykke from Handelsbanken.

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

My question was in respect to China. If or when you would launch SenSura Mio program and are also launching the convex products range in China. And then just a question on U.K. We have seen a couple of companies suffering a bit from NHS. So far it doesn't look like you are suffering but are there any risks that, that the financial crisis there would hit the use of ostomy or any of your other products?

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**Lars Søren Rasmussen** - Coloplast A/S - CEO and President

So we launched the SenSura product range a few years ago in China; that's our focus for that time being. But of course, it's a market that is developing quite rapidly, it's a market where we have very high market shares. And we do whatever it takes for us to grow in a profitable way. In China, we have significantly more than 50% market share and are quite committed to drive the market there and it's also the one place where we have the highest share of customers that are served on an online basis. So it's a very, very interesting market for us. I'm sorry, I missed out the same part of your question.



AUGUST 08, 2018 / 1:00PM, COLO B.CO - Q3 2018 Coloplast A/S Earnings Call

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

But in respect to SenSura Mio, have you also launched the convex spec [back] assortment -- in China?

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**Lars Søren Rasmussen** - *Coloplast A/S - CEO and President*

No, no, no we have not. Not yet.

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

Is that a plan, and do you expect -- I guess [abilities] is also an issue in these markets.

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**Lars Søren Rasmussen** - *Coloplast A/S - CEO and President*

It's an opportunity at some point in time, but we have not launched it as we speak.

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

The other question was on NHS in U.K. Do you see any potential negative impact looking forward as we see some healthcare companies suffering in this market?

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**Lars Søren Rasmussen** - *Coloplast A/S - CEO and President*

No, it's developing quite nicely for us, when you're looking at the share gain that we're having and also total business that we're looking at in the U.K. Of course, the big towns in the U.K. have been the currency part, where we've had a significant impact from the currency, but if you're looking in isolation at the way that the market is going, we have a very strong organization and very good gains. Some years back that the CCTs were implemented in the society but so far, they have shown quite good understanding towards the quality of products that people need to have and also the accessibility that people need to have for these kind of products in order to be able to take care of themselves for as long a time as possible. Because that's really what this is about. It is about taking about care of herself and not being -- not needing any professional aid in connection to changes and so on.

All right. Thank you very much. Looking forward to seeing all of you over the next weeks. Have a nice day.

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**Operator**

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

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## AUGUST 08, 2018 / 1:00PM, COLO B.CO - Q3 2018 Coloplast A/S Earnings Call

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