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PRESENTATION

Kristian Villumsen *- Coloplast A/S - President & CEO*

Good afternoon, and welcome to our third quarter '19/'20 conference call. I'm Kristian Villumsen, CEO of Coloplast; and I'm joined by CFO, Anders Lonning-Skovgaard and our Investor Relations team. We'll start with a short presentation by Anders and myself and then open up for questions.

I'd like to start by thanking all of our employees at Coloplast who serve users and our clinician partners every day during these challenging times of a global pandemic. As a company, our priorities during COVID have remained clear, to keep our people safe, continue to serve our customers and maintain business operations. We've done this throughout the COVID-19 pandemic and I'm very pleased with that.

Please turn to Slide #3. Before I dive into today's results, I'd like to zoom out and talk about the next 5 years for a minute. We're currently in the process of finalizing our 2025 strategy, which will be launched at our Capital Markets Day at the end of September. And at the core of the new strategy are two important themes: innovation and growth. To set ourselves up to deliver our 2025 strategy, we are expanding our executive leadership team from 4 to 6 members.

First, we are creating a new Executive Vice President of Innovation position with responsibility for our commercial offering. The new innovation function will combine global marketing, global R&D, Payers & Trade and select other functions related to innovation to secure a singular and end-to-end responsibility for our innovation. Nicolai Buhl Andersen will step into this role as EVP Innovation. Since joining Coloplast in 2005, Nicolai has held various senior management roles in our company, including Head of Ostomy Care and Head of Sales in the Nordic region. And for the last 10 years, Nicolai has been the Senior Vice President of our Global Wound & Skin Care organization. He's a respective people leader with strong followership.

Also, Nicolai is a commercial leader with an ability to focus and simplify, which is crucial in defining, building and delivering our commercial offering. And with this change, I'm elevating a fundamental organizing principle of our company, which is that innovation must be commercially defined, led and delivered. Rasmus Hannemann will take over the role as Senior Vice President of the Wound & Skin Care business and report to Paul Marcun. Rasmus has been with the company for 15 years and is currently SVP, Global Marketing for Chronic Care.

The second change we're making is to create a new Executive Vice President of Growth, which combines the Chronic Care sales organization and the Wound & Skin Care business unit. The growth function will be led by Paul Marcun, who is a recognized sales leader, both energetic and passionate executive who can lead and empower our organization and to take our front-line work to the next level.

The third change we're making is to rename HR to People and Culture and elevate this function to the executive leadership team. Camilla Møhl is appointed Senior Vice President, People and Culture and a member of the executive leadership team. Since joining Coloplast in 2016, Camilla has been Vice President of Global HR for our commercial organization, and in 2019, she was promoted to Vice President of Global HR. Prior to joining Coloplast, Camilla worked more than 15 years within HR at large international companies such as Carlsberg and Mars. Camilla is a recognized HR leader who challenges the status quo, and she's built strong followership and made a significant impact since joining our company 4 years ago.

Finally, a few words on Interventional Urology. As communicated last year, we firmly believe that Interventional Urology belongs with Coloplast. And as part of our 2025 strategy, we will be investing to grow our interventional urology business to help more people in this space. We believe the best organizational setup for Interventional Urology is to maintain the current dedicated structure, led by Steve Blum, who will continue to report to me. I'm excited to launch our 2025 strategy at the end of September with a strong focus on innovation and growth. Our new executive leadership team and organizational set up is the first step. Structure must follow strategy. I'm looking forward to sharing our plan with you on September 29 for you to meet the new executive leadership team either virtually or here in-person at headquarters in Humlebæk.

Now with that, let's take a look at today's results. Please turn to Slide #4. Q3 was a quarter that posed significant challenges due to the COVID-19 outbreak as we had expected. But they were also positives. We delivered negative 2% organic growth in the quarter due to a significant decline in Interventional Urology revenues, the reversal of stock building in Europe, which took place in the second quarter as well as weaker growth in our Wound & Skin Care business due to a decline in overall hospital activity. Starting with Interventional Urology, I'm encouraged by the rate at which elective procedures resumed across the U.S. and most European markets during the third quarter. More specifically, April was down 70%, May was down 45%, and June saw a big improvement and was down only 3%. In July -- and so far in August, trends are stable, and IU for August is going to come back to growth.

Despite the surge in COVID-19 cases in a number of key revenue states, we've seen a faster than expected recovery in our men's and women's health business in the U.S. that now rules out the worst-case scenario that we envisaged when we revised guidance in March. Importantly, with the consistent monthly improvement in sales trends in Interventional Urology, we have reinitiated commercial investments into the business that were temporarily postponed.

Moving to our chronic businesses, both Ostomy and Continence Care delivered 4% organic growth in the quarter. Let me remind you that these businesses delivered abnormally high-growth rates in Q2 due to the stock building by primarily end users in Europe. The magnitude of the stock build in Q2 was around DKK 150 million, and the majority reversed in Q3 and is now expected to be fully reversed in Q4. The underlying growth in the 2 businesses remains resilient, and I'm particularly pleased that the U.S. delivered solid double-digit growth and that the Chinese Ostomy business returned to growth in May, and emerging markets also continue to hold up well.

In the U.K. due to the extended lockdown and measures put in place by the NHS to handle the COVID-19 crisis, there's been a significant decline in screening, referrals and operations. We've seen a decline in new patients across all our markets due to COVID-19, but it's been more pronounced than the U.K., both Ostomy and Continence Care. In April and May, new patient discharge was around 60% of pre-COVID levels. June and July improved but were still well below normal levels. This had a negative impact on our growth in the U.K. in Q3 that will also be visible in Q4 and into next year.

The Wound & Skin Care business delivered negative 6% growth. China had another tough quarter as expected due to a significant decline in Wound Care procedures and in hospital sales following the COVID-19 outbreak. We also saw headwinds in our European hospital business, in particular, in France. Our Skin Care business in the U.S. detracted from growth in the quarter due to a decline in demand, which was correlated with the decline in hospital admissions in the U.S. On a positive note, momentum in the European Wound Care business and the U.S. Skin has improved in Q4. We've also moved ahead with the launch of our new Wound Care dressing, Biatain Fiber in 6 markets, and the feedback from health care professionals and users is very positive. As we navigate the crisis, we're adapting our business and commercial activities. In many of our markets, our sales force is still working from home. And as a result, we're accelerating our digital investments. We continue to build stronger capabilities in virtual education, remote support and digital sales.

In our direct businesses, we can see that consumers are shifting to online faster than before, and we are investing to support that. That thing also requires prudent cost management, and today's results reflect strict cost measures that have been put in place. Our aspiration is to emerge stronger from this crisis and continue to focus on our strategic objectives, we're therefore moving ahead with a clear majority of our investments into innovation and commercial activities and initiatives. On March 18, we issued revised financial guidance because of the COVID-19 outbreak. And today, we've narrowed our guidance to the lower end of organic growth and the upper end of margin guidance. Anders will go through the financial outlook and our assumptions in more detail later on.

Now let's have a closer look at the results by business area and geography. Please turn to Slide #5. Ostomy Care organic growth was 8% for the first 9 months and growth in Danish kroner was 7%. In Q3, organic growth was 4% and growth in Danish kroner was 2%. From a product perspective, growth continues to be driven by our SenSura Mio and Brava supporting products in larger markets like the U.K., U.S. and Germany. SenSura Mio Convex continues to be the main contributor to growth driven by Europe and the U.S. Our SenSura and Assura portfolio growth was driven by solid performance in markets like Brazil, in Argentina as well as tender deliveries in Russia. Overall, emerging markets delivered solid growth for the first 9 months. And China contributed to growth despite being adversely impacted by the COVID-19 outbreak in the second quarter.

From a regional perspective, the U.S. had a solid quarter. And even with our sales force all grounded, we're beginning to secure accounts within the Premier GPO. The first conversions are happening, and we built a strong pipeline of opportunities. Revenue growth in China normalized in Q3 as expected, and Q3 saw a large negative impact from destocking, as I explained earlier. Growth in France was negatively impacted by the French price reform introduced in July last year. In Continence Care, organic growth was 7% for the first 9 months and growth in Danish kroner was likewise, 7%. In Q3, organic growth was 4% and growth in Danish kroner was 2%. From a product perspective, the SpeediCath ready-to-use intermittent catheters continue to drive growth. SpeediCath Flex contributed positively to growth, especially in the U.S. and across the European markets. SpeediCath Compact catheters continue to drive growth in countries like the U.K. and France, and sales growth for Peristeen products remains satisfactory, driven by France, the U.S. and the U.K.

From a regional perspective, the U.S. was the main contributor to growth in Q3, tender deliveries in Saudi Arabia also contributed to growth. As mentioned earlier, destocking in Europe had a significant negative impact on growth in the quarter, and France was negatively impacted by the price reform introduced in July last year. We've seen a decline in new patients in Ostomy and Continence Care as a result of the COVID-19 outbreak. Broadly speaking, across markets, surgeries and procedures have picked up again and in our key markets, new patient levels are normalizing. You can also see this in our CARE enrollments. Given that the decline in new patients is expected to be temporary and given that new patients account for around 10% of revenues in Ostomy Care and around 5% in Continence Care, we do not expect this to significantly impact growth rates going forward. In the U.K., however, as explained earlier, the decline in new patients has been more pronounced, leading to a negative impact on growth in Q3, and Q4 will also be impacted. In Interventional Urology, organic growth was negative 10% for the first 9 months and growth in Danish kroner was down 8%. In Q3, organic growth was negative 40% and growth in Danish kroner was down 39%. The negative growth was mainly due to the decline in sales of Titan penile implants and Altis single incision slings due to the cancellation of elective surgeries in the US within men’s and women’s health. Elective procedures in the European business were also negatively impacted, resulting in lower sales of disposable surgical products. As outlined earlier, elective procedures restarted across the quarter at an encouraging pace.

In Wound & Skin Care, organic growth for the first 9 months was 2% and growth in Danish kroner was likewise, 2%. Organic growth for Wound Care in isolation was negative 1%. In Q3, Wound & Skin Care delivered negative 6% organic growth and Wound Care in isolation delivered negative 7% organic growth. The negative growth was driven by a significant decline in Wound Care procedures and hospital sales in China in Q3 -- in Q2 and Q3 due to the COVID-19 outbreak. In Q3, growth was also negatively impacted by a decline in activity in the hospital channel in Europe and in particular, in France. From a country perspective, the U.S. and Germany contributed positively to growth in the first 9 months. China, France and the U.S. skin care business detracted meaningfully from growth in Q3 due to COVID-19 as previously explained. The Compeed Contract Manufacturing business continued to contribute to growth in the first 9 months, but was impacted by lower demand in Q3 due to COVID-19.

Turning to our geographical segments. We saw organic growth of 3% for the first 9 months in our European markets. The organic growth in Q3 was negative 4%. As described earlier, stock building in Europe had a significant positive impact on growth in Q2, but the positive impact was largely reversed in Q3. Interventional Urology business in Europe was negatively impacted by the cancellation of elective procedures, and during the quarter, elective procedure resumed across a number of European markets. The Wound Care business posted negative growth in the quarter due to a decline in hospital procedures, which was most evident in France.

Organic revenue growth in other developed markets was 5% for the first 9 months. In Q3, the organic growth was negative 6%. As outlined earlier, the Interventional Urology business had a very tough quarter, but we're encouraged by the improved momentum across the quarter. The Skin Care business also detracted from growth in the quarter, but momentum is improving in Q4. On a positive note, the Chronic Care business in the U.S. delivered solid double-digit growth in the quarter, and Japan and Australia also contributed to growth. Revenue in emerging markets grew organically by 11% for the first 9 months; and in Q3, organic growth came in at 9%. China posted growth in Ostomy Care again after a tough Q2 due to COVID-19. The Chinese Wound Care business continued to weigh on growth in Q3. Outside of China, merger markets continues to deliver solid growth driven by all regions, and in particular, Latin America. Growth in Q3 was negatively impacted by a tough baseline in Russia due to strong tender activity last year.

With this, I'll now hand over to Anders, who will take you through the financials and outlook in more detail. May I ask you to turn to Slide 6.

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

Thank you, Kristian, and good afternoon, everyone. Reported revenue for the first 9 months increased by 5% compared to the same period last year. Most of the growth was driven by organic growth, which contributed 5% to reported revenue. The net effect from exchange rate developments was neutral. A positive effect from a favorable development in the U.S. dollar and British pound against the Danish kroner was offset by a significant decrease in the value of the Argentinian peso and Brazilian real against the Danish kroner.

Please turn to Slide 7. Gross profit was up by 5% to around DKK 9.5 billion. This equals a gross margin of 68% against 67% last year. The gross margin was positively impacted by operating leverage driven by revenue growth as well as savings from the GOP4 program, including the closure of the Thisted factory in Denmark in 2019. The gross margin was also positively impacted by restructuring costs of DKK 43 million in the comparison period last year. The gross margin was negatively impacted by product mix due to the decline in the U.S. sales in Interventional Urology, increasing costs in Hungary due to salary inflation and labor shortages also weighed on the gross margin. There was a further negative impact on the gross margin from extraordinary costs related to the COVID-19 outbreak. The gross margin includes a positive impact from currencies of around 50 basis points. The distribution-to-sales ratio for the first 9 months came in at 29% on par with last year. The 3% increase reflects increased investments in sales and marketing activities across multiple markets and business areas, for example: in China, the U.S. and the U.K. The impact from these investments was offset by lower travel and sales and marketing expenses due to the COVID-19 situation.

In Q3, distribution costs decreased by 8% compared to last year, reflecting strong cost control as well as sustained investments. The admin-to-sales ratio for the first 9 months came in at 4% of sales on par with last year. In Q3, admin expenses increased by 12% (sic) [DKK 12 million] due to phasing of expenditures. The RD-to-sales ratio came in at 4% of sales, in line with last year. Overall, this resulted in an increase in operating profit of 7% for the first 9 months, corresponding to an EBIT margin of 31% on par with last year. The EBIT margin contains a positive impact from currencies of 40 net basis points. The EBIT margin was positively impacted by cost-saving initiatives and lower spending following the COVID-19 outbreak.

Please turn to Slide 8. Operating cash flow for the first 9 months amounted to around DKK 3.1 billion compared with around DKK 2.6 billion last year, and includes a positive impact of DKK 144 million related to a reclassification of lease payments following the adoption of IFRS 16. The positive development in cash flows was mainly due to an increase in operating profit of DKK 305 million.

Cash flow from investing activities was impacted by investments in automation, IT and the new factory in Costa Rica. CapEx investments amounted to DKK 690 million for the first 9 months, up DKK 276 million compared to last year. As a result, CapEx accounted for 5% of revenues compared to 3% last year. As a result, the free cash flow for the first 9 months was an inflow of DKK 2.4 billion against DKK 2.2 billion last year. Adjusted for the DKK 144 million positive impact from the IFRS 16, the free cash flow was up 3%. Our cash conversion in Q3 calculated as 12-month trading average was 96%. Due to the COVID-19 outbreak, I continue to monitor trade receivables closely. We also continued to pay smaller suppliers earlier. In Q2, a new share buyback program was launched totaling DKK 500 million and is expected to be completed shortly.

Please turn to Slide #9. On March 18, Coloplast issued revised guidance for the financial year '19/'20 due to the COVID-19 situation. With one quarter left of the financial year, Coloplast's guidance is now narrowed. For '19/'20, we expect organic growth of around 4% from previously 4% to 6%, due to a weaker outlook for the Wound & Skin Care business and the U.K. Chronic Care business. Due to the depreciation of the U.S. dollar, Brazilian real and the Argentinian peso against Danish kroner, reported growth in Danish kroner is expected to be 3% to 4% from previously 4% to 6%. The currency impact is based on spot rates as of August 14.

The organic growth guidance is based on 4 key assumptions: The first assumption is that after a significant negative impact in Q3, the situation in Interventional Urology is expected to gradually normalize in Q4. The situation improved throughout Q3 at a pace that implies that our worst-case scenario is now out of scope. The second assumption is that Q4 will see lower growth in the U.K. Chronic Care business, driven by a decline in new patients due to COVID-19. Due to the COVID-19 and the extended lockdown in the U.K., there has been a significant decline in screening, referrals and operations. This has resulted in a decline in NPDs in both Ostomy and Continence Care. The third assumption is that our Wound & Skin Care business, including our Contract Manufacturing business in Europe and the U.S., will post a weaker growth in the second half of the year than previously anticipated due to a decline in hospital procedures. The situation in China in Wound Care is still expected to normalize by the end of Q4.

The final assumption is a stable supply and distribution of our products across the company. Our guidance also assumes an annual price pressure of up to minus 1 percentage point. Price pressure will be closer to the full 1 percentage point for '19/'20, due to the French price reform within Ostomy Care and Continence Care, which was implemented in July 2019. The full year impact of the French price reform was around DKK 100 million. We're also seeing price pressure from smaller reforms in Switzerland and Holland.

With respect to the phasing of tenders in emerging markets, the first 6 months saw a good contribution to growth from tender deliveries in Russia. Last year, the Russian tenders fell in the second half of the year, which means that we will have a tougher comparison period in the second half of this year due to Russia. Overall, in terms of phasing of growth in Q3 and Q4, the impact of COVID-19 on sales was the most severe in the third quarter due to the Interventional Urology, and we expect improving momentum into the fourth quarter. For '19/'20, we expect an EBIT margin of around 31% in constant currencies from previously 30% to 31%. More specifically, we expect to be in the upper end of around 31%. The reported margin in Danish kroner is expected to be around 31% from previously 30% to 31%. The reported margin in Danish kroner is positively impacted by the Hungarian forint. But this is offset by the depreciation of the U.S. dollar, Brazilian real and the Argentinian peso against the Danish kroner.

As a result of the COVID-19 outbreak, we have exercised strong cost control, and we have also seen a natural reduction in costs due to lower travel costs and sales and marketing spend. To ensure that we emerge strongly from the crisis, we continue to invest for growth, and invest up to 2% of sales in incremental investments into innovation and sales and marketing initiatives. Overall, for the year, I still expect SG&A cost and R&D expenditures to increase by low single-digit percentages. Year-to-date, the increase was 3%. The gross margin will be positively impacted by operating leverage and the Global Operations Plan 4, which is on track to deliver 100 basis points EBIT margin improvement in '19/'20. The positive impact is expected to be partly offset by product mix due to the decline in U.S. sales Interventional Urology and cost pressure in Hungary from wage inflation and labor shortages.

Additional cost due to the COVID-19 outbreak will also weigh on this margin. We will not incur any restructuring costs in '19/'20 compared to DKK 43 million in '18/'19. Overall, the expectation is still that the gross margin for '19/'20 will be in line with '18/'19 factoring in a positive impact from currency. We now expect our net financials to end the financial year '19/'20 at minus DKK 350 million from previously minus DKK 200 million. This is primarily due to further losses on balance sheet items denominated in a number of foreign currencies, including the Brazilian real and the Argentinian peso that have depreciated significantly. In addition, we expect hedging losses on the U.S. dollar and British pound against Danish kroner as a result of the appreciation of both currencies against the Danish kroner.

CapEx guidance for '19/'20 is still expected to be around DKK 950 million and is driven by investments in more capacity for new and existing products as well as the factory expansion in Costa Rica, automation initiatives and IT investments into digitalization. Finally, our effective tax rate is expected to be around 23%.

Thank you very much. Operator, we are now ready to take questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question comes from the line of Martin Parkhøi of Danske Bank.

Martin Parkhøi - *Danske Bank A/S, Research Division - Senior Equity Analyst*

And as said, it's Martin from Danske Bank. A couple of questions. Firstly, on the U.K. Chronic business, where you see this negative impact in the fourth quarter. How do you think that the waiting list for -- will cope in U.K.? And when can we see a normalization? Do you expect this to have a similar impact on growth in your Chronic Care based in the U.K. in the -- going into the first and second quarter of next financial year? And then just on the distribution cost in the third quarter, which was somewhat lower than last year. How much is driven by natural cost savings from COVID-19 like less traveling and less promotion? And how much is actually from prudent cost measures, which also could have an impact going into next year? And then finally, just on Argentina, where there was, again, a significant impact in the third quarter. And just for once, could you let me know how much has emerging markets growth of 9% in the third quarter been boosted by this hyperinflation's impact on organic growth in Argentina?

Kristian Villumsen - *Coloplast A/S - President & CEO*

Thank you, Martin. This is Kristian. Good questions. I'll start with U.K., and then Anders will talk to distribution costs and exotic currencies. So at the high level, like we said, the -- if we look at the new patient momentum in Europe, we're seeing normalization outside of U.K. U.K., we have seen a pronounced effect. It's -- the lockdown has been both severe and prolonged. We are noting with some optimism, the communication that's come out of the NHS leadership over the last few weeks with very strong communication that's followed up with significant investments to all of NHS to basically get rid of the waiting lists. We are also noting that they're allocating, at least the way we read the communication, billions of pounds, and they include private sector capacity to get rid of this and to see improvement that should start to get real effect by end of October and a return to pre-corona levels until at least March. But of course, that will depend on how effective they are, Martin. And we'll have to see that we, of course, follow that development very closely. Patient recruitment and initiation in U.K. has been improving, but we are following the government's action on a daily basis here. Anders, you want to talk to distribution costs and currency?

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

Yes. So thanks, Martin, for the questions. So first of all, in terms of the distribution costs, yes, we saw a significant reduction in our third quarter. It's a combination of the initiatives we basically started back in January, February, where we have been quite prudent on hiring of new employees. We have also been seeing a significant cost saving from global travel ban, and we are not doing the same number of congresses, sales meetings as we used to. So that is all in all, contributing quite significantly to our distribution cost development. When that is said, we have continued a number of commercial initiatives that we actually started the year with, so we initiated a number of things in China, in EM and also in the U.S., and we continued with that also in our third quarter. In relation to your question around Argentina, yes, Argentina, we have a quite significant impact on the organic growth from higher prices and inflation, but we're also seeing a positive impact on our volumes. For the group, it's around 30 basis points impact from Argentina.

Operator

Our next question comes from the line of Annette Lykke of Handelsbanken.

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

Just to follow-up on Martin's question, but looking at the inflow of patients within spinal surgery. This must be relating to fewer traffic accidents or can you postpone these and how do you see the trend? And then finally, on Interventional Urology, in Q4, do you see any pent-up demand? Or should we see a risk of more postponements of these elective surgery as well? And then finally, could you say a little bit about China? You mentioned some investments you're doing here. What kind of reasoning should we see if any in China and the Wound & Skin Care market there or the Wound Care market, sorry.

Kristian Villumsen - *Coloplast A/S - President & CEO*

Thanks, Annette. I'll see if I took some notes there, see if I remember everything. Look, we stopped the spinal. And so you're right to remark that if you look at spinal cord injuries, people stay at home and don't drive the car, traffic accidents come down, you'll have fewer people who break their back. I will remind you that people also break their back when they climb a ladder in the garden doing gardening work and things like that, so it's not just in cars. But we have seen a reduction. We have seen a reduction there, but we also see an inflow of patients from a number of different procedures. So people who go through surgery for enlarged prostate, urethral strictures and other things, bladder cancers, things like that. So there are other procedures that basically lead to a prescription of intermittent catheters and we've also seen a decline on that side. So it's not just on the spinal cord side.

On the Interventional Urology business, we've seen -- since the low point, we've seen improvements month-over-month. We expect to get back to growth this month. I was with the team on video last night. That's is a good pipeline. It's probably too early to say whether we're seeing a lot of pent-up demand, but we are seeing broad-based pickup in North America, particularly in men's health. We're also seeing Southern Europe come back pretty strong. And select emerging markets. So we follow that development closely. I think as long as the COVID situation in North America remains, if you will, local outbreaks and no national lockdowns, we're going to see continued execution of surgeries. And then just to be -- just to clarify, your question on China, was that on Wound Care? Or...

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

Exactly. Yes, please. On the Wound Care where you have the, I mean -- yes?

Kristian Villumsen - *Coloplast A/S - President & CEO*

So China Wound Care has been soft since the COVID outbreak. And we are expecting that to persist through this quarter and then gradually pick up as we move into next year. But this is basically from a decline in relative hospital procedures, and it's also been some reluctance for patients to return to the hospital. We have continued to invest in China. We have also invested this year on the digital and consumer side. And I think that answers your question.

Operator

Our next question comes from the line of Niels Leth from Carnegie.

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

So my first question would be about the change in your management structure. So will this change contain a change in growth priorities between your 4 business areas? And to what extent will this management change also come with an increased need for staff functions in your head office? My second question would be on the corona crisis and how this crisis has -- if this crisis has changed the need for your physical sales representation in various markets? And to what extent that you will be able to grow your business with fewer feet on the street?

Kristian Villumsen - *Coloplast A/S - President & CEO*

Thank you, Niels, 2 great questions. When it comes to structure, this is definitely not something that means that we're going to staff up and spend more money in HQ. If anything, this is the simplification of responsibility and I'm really trying to solve for 2 things, 3 to be more exact: The first one is to get a singular responsibility for innovation and you've heard us talk a lot about the clinical performance program, which requires us to not only build a products with technology that's able to do more clinically. We need to tie that together with a strong clinical package and we need to convince payers that this is also worth a premium. So you basically need to tie together a number of elements and ensure that these are integrated together with the commercial package. We're simply setting ourselves up that there is one commercial leader at the end of the table to ensure that this integration happens, and we deliver a super strong package to the market. I also have a conviction that this is the type of work that's going to be required for the future.

Conversely, on the other hand, we're solving for a singular responsibility for sales growth and building up and strengthening our capability on that side, ensuring discipline on the quarter and the year. And the news structure basically reflects that you're going to see these themes elaborated upon extensively in our CMD, particularly on the innovation side, where we also aim to show you some of the technology and things that we are bringing to bear to drive growth. The third thing that we're solving for is more work on leadership and culture in the company. And so we are promoting Camilla Møhl to SVP for people and culture as part of the ELT, and she'll join Nicolai Buhl Andersen as new members. Paul Marcun will run the growth function and the rest of the lineup, you know very well.

To your second question, Niels, on corona, what impact it has on our -- if I may call it this, our commercial model and our ability to drive demand with frontline? I think that question is very pertinent. The challenge is this differs quite significantly by market. So if I look at China right now, the team is back. We're meeting customers. Productivity levels are getting close to what we saw before COVID-19. We're seeing that also broadly happening in Asia. If I look to Europe, it's a bit of a mixed bag. Our teams are back in Germany, for example. And in a couple of other European markets, whereas in the U.K., we're grounded. And if I look to the U.S., Chronic Care business, our teams are still at home. So if anything, for now, we are investing to enable our people who are at home to engage with customers with digital tools. And of course, we're also thinking about what mix that we are going to have in terms of resources, whether if you look into the future, whether we drive demand with the -- with salespeople all on the outside, if you will, and maybe some of them will work more from the inside. But a firm conclusion of that is I think it's still too early to form. But we are working on enabling them to be effective right now.

Operator

And our next question comes from the line of Alex Gibson at Morgan Stanley.

Alexander Matthew Gibson - *Morgan Stanley, Research Division - Equity Analyst*

I have two. The first one is just regarding the U.K. Chronic Care weakness you're seeing. And given that we're now in mid August, could you give us a bit of an impact on the organic growth development in Q4 and into 2021? Specifically, can the weakness in the U.K. alone result in the lower growth for Ostomy and Continence in Q4 versus Q3? And could it also result in 2021 organic growth being below your long-term run rate of 7% to 9% in those 2 divisions because of the lag effect on new patient starts, just some helpful guidance in the impact of the U.K. business there? And then my second question is on any cost savings you're making today due to changes in business practices? Can you quantify the amount of any cost savings, which you believe could be sustained into the long term? And with these cost savings, do you envisage that you would reinvest them? Or do you believe that you could run with structurally higher margins? The cost savings, I'm thinking of like whether it's travel, office space, sales force, you partly alluded to it, but I was hoping you could provide some more detail on the quantity of those potential cost savings.

Kristian Villumsen - *Coloplast A/S - President & CEO*

Thank you. Good question. So the dynamics are a bit tricky. So you have to remember that the Chronic Care business structurally is made up mostly of demand that's already in community, right? So around 10% of the patient base is renewed every year. On the Ostomy side, and it's around 5%

on the Continence side. The rest is basically demand that is in community, so there it's a robustness to the demand that we don't expect will change as a result of COVID. If I look to U.K. specifically, we are looking into Q4 where we expect Chronic Care to be flattish and the return to growth, and this is -- my comment there is for U.K., the return to growth really will be dependent on, I think, the NHS' ability to basically get rid of the backlog. Now the way we assess the situation is that the effort is serious, that real capital is being allocated to get rid of the backlog, and the NHS has also set targets for when they want to get back to something that's close to normal, but that is going to extend into next year. And whether that's going to affect Chronic Care long-term growth rates, well, there are a number of moving parts for the Chronic Care business going into next year that it's not just U.K. and Europe, I think -- remember, we also have headwind this year in France from the French Healthcare Reform. And we also have a China that for the -- since COVID or, particularly in Q2, was subdued. So we are seeing effects back and forth, but we'll be talking more about that as we issue guidance for next year later. I hope that's enough. Anders, you want to talk to what we're doing on cost savings?

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

Yes. So thanks for the question. In terms of our cost development, as I said earlier, we have been quite prudent on costs since the corona outbreak that started back in January, February. We are focusing a lot on hiring and replacing open positions. We are focusing a lot on the sales and marketing costs, in general. And then we have a global travel ban. So in terms of whether some of these will also continue, there's no doubt, I think that we are not going to have the same level of traveling as we had before corona. We are going to see quite a significant cost reduction from that area alone and that will continue into next year. We are not going to have the same number of sales and marketing events as we used to have, that will also be done digitally. We have seen, it's actually working pretty okay. So I think there are some opportunities here that we can reduce our spending on. And then, of course, we are looking into where do we have growth opportunities? Where do we have opportunities to grow? So that -- as you know, we are trying to invest into activities that will grow the business and we are seeing those as well, including innovation. But from a cost saving point of view, I'm pretty sure that we are not going back to the levels we have seen before, especially on travel, and to a large extent, also on sales and marketing events.

Alexander Matthew Gibson - *Morgan Stanley, Research Division - Equity Analyst*

Okay. That's very helpful. And on that last point, in terms of thinking about the drop through, would you reinvest any of those savings that you're making on the less sales and marketing events, travel costs? Or do you think that they would go straight back into doubling up efforts on clinical trials and growth opportunities? Just to understand if there's actually a margin upside here or not?

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

So now we have a new strategy that will come up. So we will present the new strategy end of September. And here, we will also talk to, as Kristian mentioned earlier, growth and innovation, but also how we see opportunities to grow into the next 2025 strategic period. And how we are going to allocate our funds, that's something we will be talking further to when we have the strategy update end of September.

Operator

Our next question comes from the line of Kit Lee at Jefferies.

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

Two, please. The first question is just on your new products and clinical trials as part of the new strategy. I appreciate that you'll be giving the update later on. But just do you expect the launch to be more back-end loaded because of COVID? Or is that not the case? And then my second question is on the Wound Care performance in 3Q. Just wondering what was the trend in the more chronic segment, i.e., in the Wound Care clinics? Was those pretty negative as well? Or was that better than the hospital sales?

Kristian Villumsen - *Coloplast A/S - President & CEO*

Thank you for those questions. Let me start with the question on new products and clinical trials. So the reality is that COVID has materially impacted our ability to recruit and conduct a trial on the Continence side. So we have -- we've seen some delay on that front. It's probably too early to say whether this is going to be -- it's something that will materially also delay the project. This is right now not on critical path for launch. But if the situation persists, then we have that risk on the Continence side. On the Ostomy side, we have things running now under, if you will, a COVID-19 virtual protocol. And we'll see whether we're able to fully conclude that and whether that works effectively, but COVID has definitely increased that uncertainty, unfortunately. On Wound Care, was the question for Europe only, that's how I heard it. We've definitely seen that the...

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

Yes, exactly.

Kristian Villumsen - *Coloplast A/S - President & CEO*

Yes, we've definitely seen demand to be more resilient in community than it is in acute. As you heard from the commentary, we have more on acute business in France, so therefore, we've also seen more of a slowdown in France than elsewhere in Europe. But we have seen a level of slowdown also in community; but between the 2, clearly, acute has been the hardest hit.

Operator

Our next question comes from the line of Veronika Dubajova of Goldman Sachs.

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

I have three, please. One, I just want to kind of follow-up a little bit on the previous question that Kit had asked around the Wound Care. And trying to understand what it is that has changed versus where we were a quarter ago? I appreciate China has been slow to recover, but I think you've talked about that pretty extensively. Is it that the magnitude of the headwind in the acute setting is greater? Or is it that you think the recovery will take longer? Exactly what is it that's kind of driving you to the lower end of the guidance? I'd just be helpful to get a little bit more precision. And I guess related to that, how do you think about that lasting beyond the end of the fiscal year as far as Wound Care is concerned? And then I had a quick follow-up on the U.K. and just your degree of confidence that the softness you're seeing is broader market-driven as opposed to anything that would be Coloplast specific? And if you have an update on the competitive environment here, given some of the historical issues in this business, that would be helpful.

Kristian Villumsen - *Coloplast A/S - President & CEO*

I counted that as 2 questions, Veronika. I thought you said you had 3. So that's one on Wound Care and one on U.K.?

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

The Wound really had 2 parts, right? What's changed and how do you think about it?

Kristian Villumsen - *Coloplast A/S - President & CEO*

Let me just see if I cover all the bases, and then you ask a follow-up if I don't. So on Wound Care, I think, we can say the headwind on acute was maybe a bit stronger than we had anticipated. We definitely also had headwind on Skin in the U.S., we're seeing that come back. And then the consumer business, which is the Contract Manufacturing business has, of course, also been affected. That these 3 in combination is basically what leads us to where we are. On the positive side, we got our new fiber product launched and it's been very positively received, and our teams are upping their forecast based on customer feedback, so we'll see how this plays into next year.

On U.K., this is overwhelmingly environment, so this has been a super tricky operating environment. It is, of course, also a very competitive market. We've had over the past 12 months product launches also from some of the local players. So it's definitely also a competitive environment, but the slowdown is overwhelmingly the environment.

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

And Kristian, your thoughts on Wound for 2021? I guess -- the reason I'm asking is your competitors in the space, I think, have been somewhat more cautious on the pace of recovery here. I'm kind of curious how you're thinking about it? When does the Wound Care business normalize, not just in China, but on a global basis?

Kristian Villumsen - *Coloplast A/S - President & CEO*

Right. So if I look at where -- the way we're looking at things for U.S. now, things are improving. We're expecting that improving trend to continue in the next year. I will see there's also going to be a positive effect from Biatain Fiber, particularly in Europe. We are seeing the Wound Care trend in Europe looking significantly better and we're expecting to come back to growth here in Q4. And then to me, the question mark is, how pronounced things are going to be on China? And we've guided all along that Q4, we would see, if you will, the end of the trough, and we're still expecting that. But China being China, I also want to see how Q1 picks up. So with us, it is a bit of a geographically mixed bag. But what I'm saying to the team, Veronika, is they have a great baseline to work with.

Operator

Our next question comes from the line of Kate Kalashnikova from Citi.

Kateryna Kalashnikova - *Citigroup Inc., Research Division - Director & European Medical Technology Analyst*

Kristian, it's Kate Kalashnikova from Citigroup. I've got three questions, please. First, on Interventional Urology, could you give us a bit more color on year-on-year procedural trends in July and August so far? I think you earlier said that you aim to get back to growth this month. Could you also comment on your expectations for next year? Now secondly, on Chronic Care, could you quantify how much of that DKK 150 million for this impact -- the benefit of Q2 has already reversed in Q3? Is it reasonable to assume roughly equal for Ostomy and Continence?

Kristian Villumsen - *Coloplast A/S - President & CEO*

Kate, I'm not hearing your second question. What's your second? Could you repeat your second question, please?

Kateryna Kalashnikova - *Citigroup Inc., Research Division - Director & European Medical Technology Analyst*

Sure. The second one is on Chronic Care. Could you quantify how much of the DKK 150 million from Q2 has already reversed in Q3? And is it roughly equal spread between Ostomy and Continence? And then my second one is for Anders on margin. Full year margin guidance of 31% feels quite conservative, given 31.4% margin year-to-date, even with lower top line outlook. Could you just clarify, if 31% is a margin floor given the guidance upgrade for margin. And perhaps the guidance of around 31% could technically mean flat margin to 50 basis points margin expansion for the year. Or if I should read it as 31% flat?

Kristian Villumsen - *Coloplast A/S - President & CEO*

Thank you very much, Kate. On IU, so I'm reluctant to start forecasting the business into next year. We are, I think, through the worst on that, knock on wood, with what we've seen this year. You saw the month-on-month numbers in print on the interim financial report. And like I said, we expect August to come back to growth. And of course, this year too -- the last 2 months to be growth months and as a trend moving into next year. We are going to be talking a lot about baseline next year, given just the composition of sales this year. But there's a good pipeline of procedures lined up in -- particularly in North America. We're also seeing a strong pickup in demand, particularly in Southern Europe, and in select places in emerging markets.

On Chronic Care, on the stocking effect of the DKK 150 million, the vast majority was reversed here in Q3, is our assessment. So if I were to give -- put a number to that, I'd say, around DKK 130 million here in Q3 and the rest in Q4 with the uncertainties that, that have just as illustration that the vast majority has already been reversed. And to your question of whether -- how this is split, this is roughly 50-50 Ostomy in the Continence. Anders, margin?

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

Yes, so in terms of your margin question, Kate, so as I mentioned earlier, I'm expecting that the margin guidance for the year will be in the upper end of the 31%. And that's due to the fact that the gross margin -- I still expect that the gross margin will be for the year, flattish compared to last year. In terms of our cost development into our fourth quarter, we are going to increase our cost run rate from Q3 into Q4 because we have initiated a number of investments. We have started to close open positions, especially in Urology. But net-net, we are expecting for the year, the EBIT margin to be in the upper end of the around 31% EBIT margin guidance I gave earlier.

Kateryna Kalashnikova - *Citigroup Inc., Research Division - Director & European Medical Technology Analyst*

Okay. So 31% is the floor.

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

As I said earlier, we are guiding around 31% EBIT margin guidance, and I expect it to be in the upper end of that. So above the 31.0%.

Operator

Our next question comes from the line of [Hendrick Ingmann] of ABG.

Unidentified Analyst

Just a quick one. Can you say a little more about the feedback you have had from the premier? To be over the accounts, You're saying you've started to convert some wind despite not being able to see people physically. And then secondly, have you seen any relief of pressure on the wage inflation and then general on, you can say, the externally for workforce down in Hungary now as the COVID situation is (inaudible)?

Kristian Villumsen - *Coloplast A/S - President & CEO*

Thank you. The first question on Premier, we have started working with accounts that we already had lined up before the final contract, and I'm very happy to say that we've also seen the first conversions. The way we work with the frontline is basically as a pipeline of commercial opportunities. And the discussion that we have with the U.S. team is watch the shape of the pipeline from initial discovery all the way through contract finalization to pull-through, and the pipeline looks healthy. And we've managed to find a good way to do virtual in servicing and have gotten started. But I don't want to provide an impression that this is as good as having people back in the field full time. It's not. But things are happening, which is encouraging. When it comes to Hungary, wage and inflation, we are moderately optimistic that with the current environment the wage inflation numbers will come down, but we'll see -- we'll see how things pan out over the coming quarters, but we're moderately optimistic that the pressure is going -- the top of the pressure is going to be taken off.

Unidentified Analyst

And you still have the same amount of Ukrainians working for you down there right now?

Kristian Villumsen - *Coloplast A/S - President & CEO*

Yes, more or less.

Operator

Our next question comes from -- sorry...

Kristian Villumsen - *Coloplast A/S - President & CEO*

So I want to say we are -- we're -- we have time for one more question, and then we'll have to terminate the call. We're moving on to our next meeting.

Operator

Okay. Then our final question comes from the line of David Adlington at JPMorgan.

David James Adlington - *JPMorgan Chase & Co, Research Division - Head of Medical Technology and Services Equity Research*

Most of them have been answered, but just maybe one final one on pricing. We've seen some companies start to talk about potential increased pricing pressure as we come to the other side of COVID, just wondered if you're seeing any early indications of that, either by geography or by business line?

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

So thanks for that question, David. As you know, this year, we have been quite significantly impacted by the health care reform in France and also a little bit in some other European markets. With the knowledge we have today, we don't see any big reforms coming up into next financial year. So at least that is going to have a a positive impact compared to '19/'20 with the knowledge we have today.

Kristian Villumsen - *Coloplast A/S - President & CEO*

With that, ladies and gentlemen, we're concluding today's call. Thank you for participating. We look forward to seeing many of you either live or on video calls over the coming weeks. Take care.
