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COLO B.CO - Q2 2020 Coloplast A/S Earnings Call

EVENT DATE/TIME: MAY 06, 2020 / 1:00PM GMT

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PRESENTATION

Operator

Thank you, speakers. Your line is now open. Please go ahead.

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

Good afternoon, everybody, and welcome to our second quarter '19/'20 conference call. I am Kristian Villumsen, CEO of Coloplast, and I'm joined by CFO, Anders Lonning-Skovgaard and our Investor Relations team. We'll run the call like we usually do, where we start with a short presentation by Anders and myself and then open up for questions.

We've had significant technical difficulties at our conference center. So at this stage, we believe that not all the people who have wanted to attend the call can attend. So of course, the call will -- is available post the meeting, and we will do our best to make ourselves available for follow-up questions from anyone who wishes to get in contact with the company.

Please turn to Slide #3. Coloplast delivered a strong set of numbers in the second quarter with 9% organic growth, a 15% increase in EBIT and a return on invested capital of 46%. The results reflect strong underlying performance in the company as well as both positive and negative drivers related to the COVID-19 outbreak.

Before we take a closer look at the numbers, I'd like to provide an update on how Coloplast has responded to the outbreak. During the crisis, we've had 3 key priorities: keeping our people safe, continuing to serve our customers and maintaining business operations. We've implemented global guidelines, safety measures and contingency plans to keep our people safe. And the overall result of our efforts is strong, and we will do our utmost to keep it that way.

I'd like to take this opportunity to recognize the efforts of our more than 12,000 people globally in these extraordinary times to support each other, serve customers and ensure business continuity. I also want to express my gratitude to our clinician partners for their dedication to serving patients during this very challenging time.

Our delivery and supply situation continues to look solid after a significant increase in demand in the last weeks of March as distributors and end users build safety stocks. Much praise goes out to our employees in manufacturing and supply chain for helping to get products out the door and into the hands of our customers.

We've kept the lights on. And we continue to serve our consumers with products and services. Our consumers rely on our help and support, so they can continue to manage their condition. Engaging in dialogue with consumers and securing product delivery through our direct businesses has become more important than ever and clearly executing on our digital road map is key.

Today, Coloplast has consumer teams in more than 30 markets who connect with consumers in what we call a high-touch model, via phone, e-mail, web and other media. Practically overnight, following the outbreak, we set up our consumer teams remotely from home, and we have been able to service and talk to our end users exactly like we did before the outbreak.

At Coloplast, we built 1 shared infrastructure. 1 ERP system, 1 CRM system, et cetera. And this has allowed us to act fast and remotely maintaining service level throughout some of the busiest days our company has ever seen. Supporting our health care professionals during the crisis has also been critical. And in the absence of face-to-face meetings, we found new ways to engage with health care professionals through e-mail, webinars, individual outreach and other digital events.

In Ostomy and Continence Care, we've increased our focus on relevant digital tools and services, including lots of education and learning. In Interventional Urology, we've evolved our professional physician education programs, so they can be offered virtually. And we've been offering 2 to 3 live webinars a week since the beginning of April, covering a wide range of topics.

In Wound Care, our focus has been on products, services and education relevant to the current situation. For example, our Comfeel Plus Transparent dressing can be used to protect the skin under the masks and goggles of health care professionals. To use time wisely and help our sales force emerge stronger after the crisis, we've implemented structured training plans across our business -- different business areas to upscale our sales force while not in the field and many other relevant activities.

As a company, we aspire to emerge stronger from this crisis. While focusing on navigating the company through this period of time, we remain focused on our strategic objectives, growth and value creation agenda. A crisis like this demands a prudent approach to cost management, but importantly, we're still moving ahead with the clear majority of our investments in innovation and commercial initiatives. The exception is Interventional Urology, which is also the business hardest hit by COVID-19. We've also approved a few new investment cases. We're maintaining momentum with R&D, unfortunately. We've not seen any significant disruptions to our ongoing clinical trials within the clinical performance program.

Lastly, to ensure that we have enough production capacity for existing and new products, we've decided to increase our CapEx level this year. Last month at Coloplast, we conducted a global people survey that measures our employees' engagement. Given that the survey took place during the COVID-19 outbreak, we're happy with the participation rate. And on a scale of 0 to 10, the average engagement score at Coloplast is 7.9. This is above the health care industry benchmark and on par with our previous surveys. With strong leaders and teams in place who are now working with their specific results to ensure that we act where needed and keep developing our workplace and capabilities. There will also be important learnings from the global working from home experience due to the COVID-19 outbreak, which I think can increase both workplace satisfaction and attract new talent to the company.

In short, I believe we've adapted well to this new reality. Now on to guidance and results. Please turn to Slide #4. On March 18, we issued revised financial guidance because of the COVID-19 outbreak, which will have a significant negative impact on our Interventional Urology business. We reiterated the guidance today and Anders will go through the financial outlook and our assumptions in more detail later on.

Looking at the quarter's results. The 2 large Chronic Care businesses delivered a strong second quarter with 10% organic growth in Ostomy Care and 12% organic growth in Continence Care. The underlying growth in the 2 business areas was solid in all regions apart from Ostomy Care in China, which was negatively impacted by the COVID-19 outbreak in February and March.

In addition, the quarter saw a large positive impact from stock building in primarily Europe at the end of March by distributors and end users, which clearly outweighed the negative impact in China. Growth in the quarter was inflated by stock building to the tune of around DKK 150 million. As COVID-19 spread to Europe, governments proactively increased prescription rights to allow users to build safety stocks. Distributors that normally carried 2 to 3 weeks of stock in Europe also build safety stocks. The stock levels are expected to normalize over time albeit as long as the uncertainty around COVID-19 remains, we do expect both distributors and end users to maintain some level of safety stock.

In China, a cautious reopening of the economy continues. Our sales reps are in the field visiting hospitals and customers. The number of ostomy surgeries is increasing, and we expect a normalization during Q3. Outpatient clinics are open again. Patient volumes in the clinics have been subdued for some time, but have begun to normalize. And overall, we expect it will take a bit longer for the situation to normalize in China through a gradual normalization during the second half of the financial year in both Ostomy Care and Wound Care.

Interventional Urology business posted 3% organic growth and was already negatively affected by the COVID-19 crisis towards the end of Q2 as elective surgeries were canceled in Europe and the U.S. As I mentioned earlier, we expect the situation to worsen significantly in Q3. The timing and pace of recovery in elected procedures is still very uncertain, but we expect the revenue loss to be recaptured once the situation normalizes.

The Wound and Skin Care business delivered 4%, dented by a weak Chinese market. In Europe and the U.S., the Wound & Skin Care businesses did well in the quarter. But in China where wounds are treated in the hospital, wound procedures were canceled leading to a significant negative impact in the quarter.

Today, the Board of Directors approved a half year interim dividend of DKK 5 per share corresponding to a total interim dividend payout of approximately DKK 1 billion.

Now let's have a closer look at the results by business area and geography. Please turn to Slide 5. In Ostomy Care, organic growth was 9% for the first 6 months and growth in Danish kroner was 10%. In Q2, organic growth was 10% and growth in Danish kroner was likewise, 10%. 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 both Europe and the U.S. Our SenSura and Assura/Alterna portfolio growth was driven by solid performance in markets like Brazil and Argentina as well as tender deliveries in Russia. Overall, emerging markets, excluding China, had a strong first 6 months. From a regional perspective, sales growth was driven by Europe due to the sizable positive impact from stock building in Q2 that I described earlier.

In Europe, the U.K. and Germany were the key contributors to growth. And the U.S. also had a solid quarter. Revenue growth in China in Q2 was negatively affected by the COVID-19 outbreak and the closure of hospitals. China uses predominantly pick up their supplies at the hospital, which led to a decline in sales due to the outbreak. Outside of China, products are delivered to people's homes or picked up at pharmacies. On a positive note, the SenSura Mio portfolio was recently launched in China at a virtual event, which was very well attended.

Also France contributed to growth in the period despite a negative impact from the French price reform introduced in July last year. In Continence Care, organic growth was 9% for the first 6 months and growth in Danish kroner was likewise 9%. In Q2, organic growth was 12% and growth in Danish kroner was likewise 12%.

From a product perspective, 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. Sales growth for Peristeen products remains satisfactory, driven by France, the U.S. and the U.K. From a regional perspective, sales growth was driven by Europe due to the sizable positive impact from stock building in Q2 that I described earlier.

In Europe, the U.K. and Germany were the key contributors to growth. The U.S. also posted a solid quarter. France contributed to growth despite a negative impact from the French price reform introduced in July last year.

On NPDs or new patients in Ostomy and Continence Care, we expect to see a decline as a result of the COVID-19 outbreak. However, most surgeries that lead to ostomies are cancer surgeries, which cannot be postponed for long. In Continence Care, there'll likely be a decline in spinal cord injuries, but this will not be noticeable in a patient population with decade-long survival rates. So overall, we expect to see a temporary decline in new patients, but we do not expect this to significantly impact growth rates moving into next year.

In Interventional Urology, organic growth was 6% for the first 6 months and growth in Danish kroner was 8%. In Q2, organic growth was 3% and growth in Danish kroner was 5%. From a product perspective, the growth was driven by sales of Titan Penile implants and Axis Biologics portfolio in the U.S. and sales of disposable surgical products also contributed positively to growth driven by Europe.

As explained earlier, the COVID-19 outbreak had a negative impact on growth in the second quarter. U.S. sales were tracking to expectation until the last few weeks of the quarter when sales declined abruptly. Towards the end of March and during April, revenues in the U.S. have been at or close to 0.

Elective procedures in the European business were also negatively impacted. As the Interventional Urology business navigates this difficult time, cost-saving initiatives have been put in place and commercial investments are currently on hold.

In Wound & Skin Care, organic growth for the first 6 months was 7% and growth in Danish kroner was 8%. Organic growth for Wound care in isolation was 3%. In Q2, Wound & Skin Care delivered 4% and Wound Care in isolation delivered negative 2% growth in the quarter. From a product perspective, the growth in Wound Care was driven by the Biatain Silicone portfolio in Europe, where markets like the U.K. and Germany posted solid growth.

The Biatain Silicone Sizes & Shapes portfolio continues to contribute meaningfully to growth. From a country perspective, the U.S. and Germany were the main contributors to growth. China detracted meaningfully from growth in Q2 due to the COVID-19 outbreak, which had a significant negative impact on wound care procedures. The U.S. Skin Care business had a solid first 6 months, driven by key products like InterDry and EasiCleanse. The performance was lifted by a strong demand as a result of the COVID-19 pandemic. And the Compeed Contract Manufacturing business continued to contribute to growth in the first 6 months.

Turning to geographical segments. We saw organic growth of 7% for the first 6 months in our European markets. The organic growth in Q2 was 9%. The growth was driven by key markets like the U.K. and France. And as described earlier, stock building in Europe had a significant positive impact on growth in Q2. France contributed to growth despite the French price reform, which was introduced in July last year. The Interventional Urology business in Europe was negatively impacted by the COVID-19 outbreak and cancellation of elective procedures.

Organic revenue growth in other developed markets was 10% for the first 6 months. And in Q2, the organic growth was 11%. The growth was driven by the U.S. Chronic Care business as well as a good first quarter for Interventional Urology. Because of COVID-19, the second quarter was tough for Interventional Urology in the U.S., as I described earlier. Skin Care business saw good growth in the period and was supported by increased demand due to COVID-19. Growth rates in Japan and Australia remain satisfactory. Revenue in emerging markets grew organically by 12% for the first 6 months. And in Q2, organic growth came in at 7% due to the large negative impact from COVID-19 in China in Ostomy Care and Wound Care.

Outside of China, emerging markets had a very good start to the year, driven by all regions and in particular, Argentina, Brazil and in Russia with strong tender deliveries.

With this, I'll now hand over to Anders, who will take you through the financial and outlook in more detail. Please 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 6 months increased by 9% compared to the same period last year. Most of the growth was driven by organic growth, which contribute 8% to reported revenue. Overall, the negative impact from the COVID-19 outbreak on our Chinese business and Interventional Urology business was overshadowed by the positive impact from stock building in primarily Europe. Foreign exchange rate had a positive impact of around 1% on reported revenue, primarily due to the appreciation of the U.S. dollar and British pound against Danish kroner.

Please turn to Slide 7. Gross profit was up by 11% to around DKK 6.5 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 and improvements in production efficiency through the GOP4 program, including the closure of the Thisted factory in Denmark in 2019. The gross margin was also positively impacted by restructuring cost of DKK 27 million in the comparison period last year. The gross margin was negatively impacted by increasing cost in Hungary due to salary inflation and labor shortages. In Q2, the gross margin was negatively impacted by product mix due to the decline in U.S. sales in Interventional Urology.

There was a further negative impact on the gross margin from extraordinary costs related to the COVID-19 outbreak, including the implementation of extensive safety measures across the company.

The gross margin includes a positive impact from currencies of around 30 basis points. The distribution to sales ratio for the first 6 months came in at 29%, on par with the last year. The 9% 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. In Q2, distribution cost increased by 6% compared to last year, reflecting a lower level of spend due to the COVID-19 outbreak. The admin to sales ratio for the first 6 months came in at 4% of sales, on par with last year. The 3% decrease reflects one-off costs incurred last year within IT and legal. The R&D-to-sales ratio came in at 4% of sales, in line with last year. Overall, this resulted in an increase in operating profit of 14% for the first 6 months, corresponding to an EBIT margin of 32% compared to 30% last year. The EBIT margin contains a positive impact from currencies of 30 basis points. The EBIT margin was positively impacted by cost-saving initiatives following the COVID-19 outbreak across all businesses and regions. As Kristian explained earlier, the company continues to invest in commercial activities and innovation apart from Interventional Urology, where the next wave of incremental growth investments is on hold until the situation improves.

Operating cash flow for the first 6 months amounted to around DKK 1.6 billion compared with around DKK 1.2 billion last year and includes a positive impact of DKK 95 million related to a reclassification of lease payments from the -- following the adoption of IFRS 16. The positive development in cash flows was mainly due to an increase in operating profit of DKK 375 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 475 million for the first 6 months, up DKK 202 million compared to last year. As a result, CapEx accounted for 5% of revenues compared to 3% last year. The increase is mainly linked to increased investments in automation, IT and the new factory in Costa Rica.

As a result, the free cash flow for the first 6 months was an inflow of DKK 1.2 billion against DKK 1 billion last year. Adjusted for the DKK 95 million positive impact from IFRS 16, the free cash flow was up 8%. Our cash conversion in Q2 calculated as a 12-month trailing average was 96%. Due to the COVID-19 outbreak, I'm monitoring trade receivables very closely. And we have also decided to pay smaller suppliers earlier.

In Q2, a new share buyback program was launched, totaling DKK 500 million and is expected to be completed by the end of this financial year.

Finally, yesterday, we established a sponsored level-1 ADR program in the U.S. together with Bank of New York Mellon. With the conversion to a sponsor program, we aim to facilitate further access to the Coloplast stock.

Please turn to Slide 8. For '19/'20, we continued to expect revenues to grow 4% to 6% organically and 4% to 6% in Danish kroner. The guidance is based on 4 key assumptions: the first assumption is that the situation in Interventional Urology gradually normalizes during the second half of the financial year. The second assumption is that the situation in China in Ostomy Care and Wound Care gradually normalizes during the second half of the financial year. The third assumption is the positive stock building impact in Q2 in primarily Europe in Ostomy Care and Continence Care businesses, partially reverses in the second half of the financial year. The largest impact from destocking is expected in our fourth quarter. Due to the COVID-19 outbreak, we do, however, expect distributors and end users to carry a higher level of safety stock throughout the year. And the final assumption is a stable global supply and distribution of products.

Aside from these key assumptions, our guidance assumes stable growth trends across our regions as well as continued positive impact from new product launches and commercial investments.

Our guidance also assumes an annual price pressure of up to minus 1 percentage point. We expect price pressure to be closer to the full minus 1% for the '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 is estimated at around DKK 100 million. We are also seeing price pressure from smaller reforms in Switzerland and Holland. With respect to 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 company assumes that the impact of

COVID-19 on sales will be most severe in the third quarter due to Interventional Urology, followed by gradual recovery in the fourth quarter. The guidance in Danish kroner reflects a positive impact from the appreciation of the U.S. dollar and British pound against the Danish kroner, which is partially offset by depreciation of the Argentinian peso and Brazilian real against Danish kroner.

The currency impact is based on spot rates as of May 4. For '19/'20, we continued to expect an EBIT margin of around 30% to 31%. And in constant currencies -- in constant currencies and 30% to 31% in Danish kroner. The EBIT guidance in Danish kroner is partially impacted by the depreciation of the Hungarian forint against the Danish kroner as well as the appreciation of the U.S. dollar and British pound against the Danish kroner. Due to the COVID-19 outbreak, we have seen a natural reduction in cost due to lower travel cost and sales and marketing expenses.

We also initiated cost saving activities in Interventional Urology. We will continue to invest for growth and invest up to 2% of sales, incremental investments, into innovation and sales and marketing activities. The gross margin will be positively impacted by operating leverage and the global operations plan 4, which is on track to deliver 100 basis point 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 in Interventional Urology and cost pressure in Hungary from wage inflation and labor shortages. Additional costs due to the COVID-19 outbreak will also weigh on the 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 positive impact from currency. We now expect our net financials to end the financial year '19/'20 at a minus of around DKK 200 million from previously minus DKK 125 million. This is primarily due to losses on balance sheet items denominated in a number of foreign currencies, including the Brazilian real and the Australian dollar that has depreciated significantly.

In addition, we expect hedging losses on the U.S. dollar and British pound against the Danish kroner as a result of the appreciation of both currencies against Danish kroner. CapEx guidance for '19/'20 is now expected to be around DKK 950 million from previously DKK 850 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. We have raised the CapEx guidance by DKK 100 million to ensure sufficient production capacity for new and existing products.

Finally, our effective tax rate is expected to be around 23%.

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

Thank you, Anders. Before we move to the Q&A, I'd like to mention that our Capital Markets Day event has been postponed due to the COVID-19 outbreak. The company is focused on navigating the COVID-19 situation, but the strategy work continues. And once we have more clarity around the outbreak, we will announce a new date for our Capital Markets Day. Because of the technical difficulties that we know that some people have had of getting access to the call, the way that we're going to handle the Q&A now is that we'll take questions from the people who got in on the call. And then I know a number of people who wanted to be in the call have sent questions along to our Investor Relations team, and we will read those out loud and answer them to the best of our ability. Again, I want to reiterate, if anyone who listens to this afterwards, who needs to get access to us and have any questions and answers, please reach out to Investor Relations, and we will do our best to accommodate your need.

Thank you, operator. We're now ready to take questions from the people on the call.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of Alex Gibson from Morgan Stanley.

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

I have 3 questions I wanted to ask, hopefully quick. The first one on the stocking impact. Do you anticipate that, that will continue into the next quarter and then revert? And if so, where are you seeing that? My second question would also be about the stocking levels. Based on your discussions with customers and purchasing managers, how long do you expect them to keep an elevated stock? Would this be until lockdowns have ended? Or would it potentially be until things are back to normal with everyone back in offices, et cetera? And then lastly, on the cost side of the business. Based on your experience over the last couple of quarters, do you see that there's any costs that are more structural in nature, either up or down that will develop over the next few years, whether this is safety measures in manufacturing facilities, more people working from home, any idea on midterm cost savings or higher costs ideas would be great.

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

Thanks a lot, Alex. I'll start with the stocking impact, and then Anders will comment on costs. So the stock building that we saw in the Q2 was mainly Europe, not exclusively Europe, but mainly Europe. And we're really not seeing additional stock building right now. But of course, since this is human beings buying these products and human beings have psychology, then this is not entirely predictable, but we're not seeing that much now. Your question about how long people will hold on to this stock, I think, is -- that's a great question. I'd say we expect that people will hang on to some of that stock, exactly how much, the honest answer is we don't know. But we believe that this COVID-19 event has basically spooked everybody enough that they want to make sure that they have access to product and hold on to a bit more product than they normally will. But as people see things start to normalize, lockdowns being lifted, [kids] coming back to work, businesses starting to reopen, some of that will come off, but some of that will also move into next year. Anders, do you want to comment on the question on cost?

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

Yes. So in terms of cost, so this year, we are going to see a significant reduction in terms of our capital pattern. So we will see reduced travel spend. And we have also now seen that a lot of our white collar people across the group, they are working from home. And so they're working with all our, you can say, IT infrastructure from home. And it's actually working pretty okay. I think we have done really well over this challenging period to serve our customers also from working from home. So I think over time, that we don't need to travel as much as we did in the past, but maybe some of those savings, we will invest further into the digitalization of the way we're operating and the way we are working. So I think that could be a dynamic into the post corona. I think we will also maybe work a bit more with virtual meeting as a consequence of this. We are having a lot of virtual meetings today as a consequence of the working from home, and it's actually working out pretty well. Also our Board meeting earlier today was a virtual meeting, and it is working out pretty well. So I think digitalization of our working behavior, reduction in our travel spend are some of the examples of things that will impact us positively on the other side of the corona situation.

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

One of the impact that I saw, adding to that, is we are, of course, spending more money on PPE to protect our employees and things like that. That we will continue to do for as long as that is the stated guidelines from local health authorities. We also expect that this will be a requirement for sales force for the foreseeable future. And so we worked hard to make sure that we have access to this type of equipment and steady supply. So you're going to see, I think, things impacting in both directions, but most certainly, it will impact the way that we will work also going forward.

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

Okay. And maybe just one quick follow-up. On your guidance of 4% to 6%, does that assume that the DKK 140 million (sic) [DKK 150 million] of stocking will reverse completely in the second half? How much is remaining? Is it DKK 50 million or just to get an expectation?

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

So in terms of the around DKK 150 million stocking impact we had in the second quarter, our assumption is that, that will partly be reversed and most of it in our fourth quarter.

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

So the majority or minority of the DKK 150 million, just to get sense?

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

So as Kristian also mentioned, the situation is uncertain. So what we are expecting, it will partly be reversed and the majority would be in our fourth quarter. So that also means that there will be something that will be carried over into next financial year.

Operator

Your 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*

A question on your operating expenses. So can you talk about how much expenses such as travel, promotion and marketing those cost items, which have come to a halt during this crisis. How much does these costs represent of your OpEx?

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

All right. Thanks for that question. So if I should give a little bit further color to our costs, so our distribution costs, R&D and admin, so year-to-date, our cost base, it grew around 8%. We have, over the course of the Q2, and that will continue into Q3 and Q4, we are very prudent on cost and we are also naturally going to see a reduction in our travel spend, sales and marketing, in general. We're not going to have congresses, the sales meetings, national sales meetings like that. And we have also initiated a number of cost saving activities across our IU business. I'm not going to give you specific numbers on how much we are spending on travel as such. But it is quite a significant amount. And it also means that we will see for the year that our costs will only grow at low single digit. So we are going to see that our costs in the second half of the year will come down as a consequence of the initiatives that I talked to earlier. It's also important to mention that we will keep our investments into commercial activities. We will also continue to invest into innovation. So that is going to run as normal. So it is the cost related to travel, as I said, and other sales and marketing activities that we are addressing.

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

Okay. And could you then talk about your gross margin and the effect from the lower revenue in your Urology division in the next 1 or 2 quarters? To what extent will that be recognizable on your gross margin?

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

Yes. So the drivers in terms of our gross margin is the following. So year-to-date, we are having a gross margin in the level of 68%. So that is higher compared to last year. I am expecting for the full year that we will continue to see impact from the global operations plan 4 and especially the closure of the Thisted factory. We're also not expecting any restructuring costs this year. Last year, we had an impact of DKK 43 million. On the negative side, we will have a negative impact from IU because our IU gross margin, especially on the penile implant is higher than the group average. We're also facing higher salary increases in Hungary, it's about 10%. And as I have been talking to quite a number of times, we have also

-- it has also been necessary to hire quite a lot of blue collars from Ukraine, and that is also more costly. And then also, as Kristian talked to earlier, we're also having extra costs related to safety measures, masks, et cetera. But at the end of the day, including an estimated (inaudible) impact, I expect that the gross margin for the year is going to be around last year's level.

Operator

No further questions. Please continue.

Ellen Bjurgert - *Coloplast A/S - VP of IR*

Okay. Hello, everyone. This is Ellen Bjurgert from Investor Relations. I'm really sorry for the technical difficulties today. I will now read out the questions that have been sent to us by our analysts. So first, we have Maja Pataki from Kepler Cheuvreux. Her question is, as you mentioned, you are keeping the pace on your R&D projects in Ostomy and Continence. Has there been any change to launch timing?

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

So let me take a stab at that. The largest R&D projects that we run now are within the clinical performance programs -- clinical performance program and the most progressed projects that we run are within Ostomy. All of the clinical trials that we're running there have been fully staffed and are ongoing, and the recruitment in these trials are from everything that we know now, not affected by the COVID-19 situation. And therefore, at this stage, we don't see any effect on launch timing on ongoing clinical trials in these Ostomy projects. On the Continence side, we are a little further out with the work and some of the clinical work has not been initiated. And as you can imagine, starting to recruit for clinical trials at this stage is difficult. The clinical trials are, as of now, not on critical path to launch time, but of course, if the situation persists, they may actually affect the launch time. Other than that, the effect on the remaining part of the portfolio, we don't see any impact on timing.

Ellen Bjurgert - *Coloplast A/S - VP of IR*

Okay. Maja's second question is, when you refer to normalization, are you talking about meeting last year's levels in revenues or in growth?

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

We are talking about getting back to growth. And so -- but underneath that growth, of course, there are leading indicators. So the things that we look for when we start talking about getting back to growth is are we seeing a resumption of surgery? Are we seeing access, again, being possible? And of course, the biggest factor for the impact, both for Q3 is Interventional Urology. So we are looking for resumption of surgeries, but we refer to growth.

Ellen Bjurgert - *Coloplast A/S - VP of IR*

Okay. The next question comes from Julien Dormois from Exane BNP Paribas. One question. There has been a pretty wide discrepancy in terms of performance across Wound Care players in Q1. Could you help us understand why your business has been more impacted than some of your peers i.e., is it geographical mix, product portfolio orientated towards elective surgeries, lack of distributor stocking or something else?

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

Okay. That's a great question. To understand these numbers, you need a bit of nuance on geography and how the business is composed when it comes to both geography and channel. So our business -- our Wound Care business, one of our -- the largest Wound Care business that we have is in China. China is a hospital market, overwhelmingly a hospital market, and therefore, with COVID-19 shutting down, all activity for a while here in Q2, we've been quite heavily affected in China. In Europe, we are -- we mostly have a community business. Demand in community is, as you can imagine, more stable. In some markets in Europe, we do have a significant presence in hospitals. One example of that would be France. And then for the U.S., really, our Wound Care business is quite small. It's mostly a Skin Care business. So the answer to this, I believe, is mostly driven by the geographical composition of our Wound Care business compared to the companies that we compete with.

Ellen Bjurgert - *Coloplast A/S - VP of IR*

Okay. Next questions come from Veronika Dubajova at Goldman Sachs. Veronika has 3 questions. We'll take the first question first. How do you think about the duration of the stocking impact that you saw in the second quarter? Do you anticipate more stock building in the third quarter? When do you expect the customers to destock back to normalized levels? And was this degree of stock building contemplated in your guidance?

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

That's actually 4 questions in 1. If I read them in a sentence, they get going, Veronika. So we already talked a bit about this stocking situation. And we are really debating human psychology. So for our business has overwhelmingly been -- well, it's been mostly European phenomenon, not exclusively, but mostly. And our access to human psychology is probably not better than yours. But we believe that many people are going to find themselves wanting to have a bit more product than they usually do. And that, that effect is going to persist from some time. The question about whether we anticipate more stock building in Q3, we don't at this stage. We don't at this stage, but of course, if things worsen, this might affect how people behave. So in -- we expect some of this destocking to -- or some of the stocking to reverse throughout the next 6 months, what level that will be, I think it will be significant, but exactly at what level, we don't put a number to that. Was this degree of stock building contemplated in your guidance? Not on March 18 when we issued the guidance of 46%. So you have to remember the moving parts in the guidance here for the full year and that things become a little more dynamic on the quarters because of the situation than normally. The big swing factor for our guidance for the year is, of course, the effect on Interventional Urology. We are seeing a very significant impact on surgeries -- elective surgeries here in April. But we also expect that this is going to gradually get back to normal over the coming months or at least it's going to gradually pick up. The stocking here in Europe, we already commented on coming at least partly back. And then the final effect that I think we should bring forward is we expect the normalization in China to take a bit longer than when we talked earlier in the year, but still normalizing through the second half of the year.

Ellen Bjurgert - *Coloplast A/S - VP of IR*

The second question is, is the Q2 OpEx run rate a good proxy for the remainder of the year?

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

Yes. So thanks for that question. I think I earlier talked a bit to the underlying drivers of our cost [actually] in the first half and also how I see it in the second half. So as I mentioned, year-to-date, so within the first half, our cost increased by around (technical difficulty) percent and for the full year, I'm expecting that our costs, so our distribution cost, our R&D and our admin cost will increase low single digit.

Ellen Bjurgert - *Coloplast A/S - VP of IR*

And the final question, can you provide color on what drove the sequential decline in gross margin in Q2? And whether this is a good proxy for the second half of '19/'20?

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

Yes. So in terms of our drivers on the gross margin in Q2, so I also talked to the overall drivers early on. But specifically in Q2, we had a lower sales of urology in U.S. And as I said earlier, our gross margin on penile implants in the U.S. is above-average or above the group average. And so for the full year, also, as I mentioned earlier, I expect that our gross margin will be at the level of the guidance.

Ellen Bjurgert - *Coloplast A/S - VP of IR*

The next question comes from Søren Hansen at Sydbank. How do you see the pent-up demand for the Urology business on the back of the COVID-19 outbreak. Do you expect the volumes in the Urology business in '20/'21 to exceed the volumes in '18/'19?

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

Good question, Søren. The honest answer is, this is probably a bit too early to talk about that. Remember that the key exposure in our IU business is U.S., which is 50% of men's health and women's health and the elective procedures. So this is where we're going to see most of the impact. We have also seen in Europe and emerging markets that hospitals have delayed Endo procedures, things like kidney stone removals and things like that. So for now, we're still working with the assumptions that we talked about earlier that we're seeing for every month we are postponing normalization, it's about DKK 100 million in impact. And we earlier talked about a normalization period of 2 to 5 months, and we are still working with that. And probably the truth is going to be somewhere in that range.

Ellen Bjurgert - *Coloplast A/S - VP of IR*

Next question comes from Scott Bardo at Berenberg. Three questions. The first question is outside of the stocking benefit that you quantified, it seems that Europe grew approximately 3% organically in Q2 on an underlying basis. This would be below historic trend. What are the main reasons for this? Any red flags?

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

So let me take that one. So in terms of our European growth, as we have been talking to the DKK 150 million stocking effect is largely in Europe. So we have also seen some stocking effect outside of Europe. Then please also remember that we are having a price reform running in France. And over the course of the year, we are seeing a negative impact from around DKK 100 million.

And then we have the IU business in Europe that is also impacting us negatively. If we look at the underlying trends of our Chronic business in Europe, they are developing as we had expected. We continue to see good growth within Ostomy with our SenSura Mio platform and especially Convex. We also continue to see good growth within our supporting products. And within continents, our Flex category and our Compact products also continue to grow as expected. So that's some of the main dynamics for our European growth.

Ellen Bjurgert - *Coloplast A/S - VP of IR*

Question 2. When considering currencies, the gross margins didn't progress meaningfully in Q2. Plus 30 basis points ex currency. This seems surprising given a bumper performance in more profitable regions, including Europe and product categories, Ostomy and Continence Care. Does this signal gross margin contraction in the upcoming Q3 quarter when COVID impacts are more pronounced?

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

Yes. So for the Q2, I think I have been talking to the drivers. So compared to Q1, we have this negative mix impact from IU and then we have also included extra cost in terms of the safety measures that we have been talking to earlier. We are expecting, as I mentioned earlier as well that, especially in Q3, we are going to have a negative impact from our IU business in the U.S., but overall, for the year, including the positive impact from the (technical difficulty) that our gross margin will be in line with last year.

Ellen Bjurgert - *Coloplast A/S - VP of IR*

Question 3. Can you estimate the declines in Ostomy and intermittent catheter procedures for the month of April. When would lower surgical procedures impact grow?

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

So thank you for that question, Scott. That's -- I think that's a good question. We don't yet have full visibility on where surgical procedures are. Like I said earlier in the call, most of the surgical procedures that lead to an ostomy are cancer. So there is definitely a limit to how long you can postpone that. We know that there has been some level of surgical procedures in many other markets also in April. That's a reverse effect actually that -- for some of the procedures that have relate -- that have been related to reversals of ostomy. These are -- they are not being carried out, and therefore, people continue on the product. So there's a bit of put and take, I think, on that.

On the catheter side, the core patient segment is spinal cord injuries. And new spinal cord injuries, these -- there's a relatively low number of these patients, many of them come from traffic accidents. So you -- I don't have traffic accident numbers, but I am quite certain that they will have been lower in the month of April because people have been grounded. But since these are patient segments that are very, very long, we don't expect that to have an immaterial impact. So for how long could this situation persist and before it has an impact on growth, I'd say, I am looking with moderate optimism on where Europe is at this moment, that we're gradually starting to open up. The number of markets are -- have either begun elective procedures or signaling that they're going to do elective procedures, and that definitely also suggests that they will be doing something as important as cancer surgeries. I hope that answers your question.

Ellen Bjurgert - *Coloplast A/S - VP of IR*

The next question comes from Christoph Gretler at Crédit Suisse. Christoph would like to ask about the path of recovery in China, in Wound Care and Ostomy Care. And what is the current run rate of the original plan in March, April?

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

Thank you, Christoph. A nice pointed question. So China, of course, was first hit, and so in the month of February, particularly in the month of March, we saw a significant impact. We are close to normal levels of surgeries now on ostomy. We're expecting these surgeries to normalize through the month of -- probably through the month of May, maybe end of June. We're also seeing outpatient activity picking up, good activity in the direct channel. So we're confident that we're going to get back to good growth on the Ostomy side. It will normalize through the second half of the year. The pickup is taking a bit longer on the Wound Care side and which probably has something to do with the fact that people -- people have to return to hospital to pick up the product and are maybe less willing to do so then if they have to go and pick up Ostomy products. But we are still seeing and expecting that there'll be normalization through the second half of the year. I hope that answers your question.

Ellen Bjurgert - *Coloplast A/S - VP of IR*

Okay. That was all the questions that we have time for today.

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

So I want to thank all of you who made it through to the call. And I apologize on behalf of the company that we had technical difficulties. I want to reiterate that should you have any more questions, please reach out to our Investor Relations teams and -- team, and we'll do our best to answer your question, and I hope all of you are safe out there. Have a good day.

Operator

That does conclude our call for today. Thank you for participating. You may all disconnect.
