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Coloplast A/S (CLPBY.DK)

Q3 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by. Welcome and thank you for joining the Coloplast Nine-Month 2022-2023 Earnings Release Conference Call. Throughout today's presentation, all participants will be in a listen-only mode. The presentation will be followed by a question-and-answer session. [Operator Instructions]

And I would now like to turn the conference over to Kristian Villumsen, President and CEO. Please go ahead.

Kristian Villumsen
President & Chief Executive Officer, Coloplast A/S

Thank you very much, operator; and good morning and welcome to our nine months 2022-2023 conference call. I'm Kristian Villumsen, the CEO of Coloplast, and I'm joined by our 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. Please turn to slide number 3.

We delivered 8% organic growth and a reported EBIT margin before special items of 28% in the third quarter. Return on invested capital after tax and before special items was 19%, reflecting impact from the Atos Medical acquisition. We continue to broadly outgrow the market, and more importantly, we continue help a lot more people who live with intimate healthcare needs. I'm satisfied with the performance of our business in the first nine months of the year, where despite a challenging operating environment, we've accelerated growth and we continue to deliver industry-leading margins.

We're working towards a strong finish in our Q4 and we continue to expect around 8% organic growth and an EBIT margin of 28% to 29% for this financial year.

Now, let me start off with a few highlights. Growth in Q3 was broad-based with strong performance in our Chronic Care businesses. In China, both our Ostomy and Wound Care businesses posted double-digit growth in the quarter as hospital access and procedural volumes fully normalized. Finally, our Voice & Respiratory Care business continued to perform well and we made further progress on the integration of Atos Medical into the Coloplast infrastructure.

We also continue to make good progress on our clinical performance program. In June, we presented the results of the second pivotal study on Luja, our new male intermittent catheter with the unique Micro-hole Zone Technology. The study confirmed the improved performance with Luja found in the first pivotal study, and in addition, it showed improved user perception of the catheterization procedure and outcome. Users simply like Luja.

The product is now launched in five markets with launch in the next wave of markets coming in the autumn as we obtain reimbursement. In our third quarter, we made a final provision of DKK 200 million on the special items related to the Mesh multi-district litigation cases. Anders will provide more details later, but I want to emphasize that this is the final provision. And with this, the MDL cases are now closed.

The Mesh-related provision was fully offset by a reversal of DKK 244 million related to the Atos Medical billing compliance matter in the US. Since the closing of the Atos Medical acquisition, we've had a very strong focus on strengthening billing processes in the US and the provision is now reduced to DKK 90 million from initially DKK 500 million.

Finally, at the beginning of July, we announced the acquisition of Kerecis. Kerecis is an innovative and fast-growing company in the US-centric biologics wound care segment, the fastest-growing segment in the advanced wound care market. Kerecis has developed a unique technology platform based on intact fish skin. The technology is minimally processed, clinically differentiated, scalable, and sustainable, and it's already winning in the biologics segment.

With Kerecis, we believe that we found an asset that will strategically transform our presence in the advanced wound care market, enabled by Coloplast industry-leading infrastructure, we add a high growth and high gross margin business with a strong profitability outlook, well-positioned to lead the category. And therefore, also well-positioned for long-term value creation.

As a result of the acquisition, we raised our long-term growth [ph] outlook to 10%, (04:38) which assumes around 1% organic growth accretion from Kerecis from our financial year 2024-2025. Our long-term EBIT margin expectations of more than 30% are unchanged, now applied to the period beyond the financial year 2024-2025 as we expect short-term margin dilution from the acquisition.

As of today, around 99% of Kerecis' shareholders have agreed to sell their shares to Coloplast. We're on track to both close the transaction and to complete the equity capital raise related to the financing of the acquisition during our fourth quarter. I'm really excited to welcome the Kerecis team to the Coloplast family very soon and to continue their strong growth journey together.

Please turn to slide number 4. Now, let's take a closer look at the details by business area. In Ostomy Care, organic growth was 7% for the first nine months, and growth in Danish kroner was 6%. In Q3, organic growth was 8%, with growth in Danish kroner of 4%. Our SenSura Mio portfolio continues to be the main growth driver, followed by the Provox supporting products and our SenSura and Assura/Alterna portfolios also continue to post solid growth in emerging markets.

From a geographical perspective, growth was broad-based with a strong quarter in emerging markets led by China. Europe, led by the UK as well as the US, also made solid contributions to growth.

In Continence Care, organic growth was 7% for the first nine months with growth in Danish kroner of 6%. In Q3, organic growth was 9% and growth in Danish kroner was 5%. All product categories contributed to growth in Q3, led by continued solid momentum in the SpeediCath ready-to-use intermittent catheters with a good contribution from the SpeediCath Flex portfolio as well as standard and compact catheters.

The Collecting Devices business made a solid contribution to growth as the back order situation was resolved in Q3.

From a geographical perspective, all regions contributed to sales growth led by the US and Europe, especially France. Markets where reimbursement has been recently established or improved, such as Poland, Australia, Japan and South Korea continued to perform well and all grew double-digit.

Voice & Respiratory Care posted 9% organic growth for the period since February 1 and 9% in Q3, with solid contribution from both laryngectomy and tracheostomy. Growth in laryngectomy was high-single-digit, driven by an increase in the number of patients served in existing and new markets, as well as an increase in patient value driven by the Provox Life portfolio. All regions contributed to growth led by Europe.

Growth in the tracheostomy and ENT business was double-digit with continued solid demand and positive impact from forward integration in key European markets. In Wound & Skin Care, organic growth was 6% for the first nine months and growth in Danish kroner was also 6%. In Q3, organic growth was 4% and growth in Danish kroner was 1%. The Wound Care business grew 4% organically in the first nine months and 5% in the third quarter. Growth in the quarter was driven by strong double-digit growth in China.

Q3 growth also included around 150 basis points negative impact from back orders, which impacted mostly the performance in our European business. The back orders are now resolved and impact in Q4 is expected to be minimal. The Biatain Silicone portfolio continued to be the main growth contributor in the quarter. In Interventional Urology, organic growth was 11% for the first nine months and growth in Danish kroner was 14%.

In Q3, organic growth was 7% and reported growth in Danish kroner was 6%. Growth in the quarter continued to be broad-based across segments and geographies, up against the high baseline in Q3 last year.

With this, I'll now hand over to Anders, who will take you through the financials and outlook in more detail. Please turn to slide 5.

Anders Lonning-Skovgaard

Chief Financial Officer & Executive Vice President, Coloplast A/S

Thank you, Kristian; and hello, everyone. Reported revenue for the first nine months increased by DKK 1.8 billion, or around 11% compared to last year. Organic growth contributed DKK 1.2 billion, or around 8 percentage points to reported revenue growth. Acquired revenue from the Atos Medical acquisition contributed DKK 633 million to reported revenue for the first nine months, or around 4 percentage points, reflecting four months of impact.

Foreign exchange rates had a negative impact of DKK 127 million, or around minus one percentage point on reported revenue, mainly due to the depreciation of the British pound and the basket of other currencies against Danish kroner.

Please turn to slide 6. Gross profit for the first nine months amounted to DKK 12.2 billion, corresponding to a gross margin of 67% against 69% last year. The gross margin was negatively impacted by increased prices for raw materials, energy and freight, double-digit wage inflation in Hungary, and the ramp-up costs at our sites in Costa Rica. Electricity price hedges at the level of €400 per megawatt hour, a doubling from last year took effect on January 1 and continue to pose significant headwind.

The above-mentioned headwinds were only partly offset by positive impact from the inclusion of Atos Medical, price increases and country and product mix. Leverage on production cost and efficiency savings from the Global Operations Plan 5 also contributed positively to the gross margin. The gross margin includes limited positive impact from currencies of around 10 basis points for the first nine months. Operating expenses for the first nine months amounted to DKK 7.1 billion. The like-for-like increase in operating expenses excluding inorganic impact from Atos Medical was DKK 418 million, or 7% compared to last year.

Atos Medical contributed with DKK 854 million to operating expenses, of which DKK 859 million were related to the PPA amortization included under distribution costs.

The distribution to sales ratio for the first nine months was 31% compared to 30% last year and includes impact from Atos Medical and an increased level of commercial activities. Higher logistics costs and continued commercial investments in Interventional Urology, consumer and digital initiatives as well as Atos Medical all contributed to the increase. The admin-to-sales ratio in the first nine months was 5% compared to 4% last year, primarily impacted by the inclusion of Atos Medical. The R&D-to-sales ratio for the first nine months was 4% of sales on par with last year.

Overall, this resulted in an increase in operating profit before special items of 1% for the first nine months, corresponding to an EBIT margin before special items of 28% compared to 31% last year. The EBIT margin in the first nine months contains around 90 basis points impact from the Atos Medical PPA amortization costs.

Currencies had a limited positive impact of [audio gap] (12:24) special items for the first nine months amounted to DKK 5 million. As Kristian mentioned earlier, we made a final provision of DKK 200 million related to the Mesh MDL cases in Q3, which brings the total provision recognized since our financial year 2013-2014 to DKK 6.35 billion. We now consider the MDL cases to be closed.

We're currently seeing a very low inflow of new cases and any future cases will be considered part of the normal course of the Interventional Urology business. The Mesh-related provision was fully offset by an income of DKK 244 million as a result of the reassessment of the Atos Medical billing compliance provision. The special items also included DKK 49 million related to the Atos Medical integration cost as expected.

Financial items in the first nine months were a net expense of DKK 628 million, compared to a net expense of DKK 146 million last year, driven by interest expenses related to the financing of Atos Medical acquisition and losses on balance sheet items denominated in mostly US dollar. The tax expense in the first nine months was DKK 944 million, with a tax rate of 21% compared to a tax rate of 23% last year, positively impacted by the transfer of Atos Medical intellectual property.

As a result of the increase in the net financial expenses, net profit before special items for the first nine months declined 7% compared to last year despite the lower income tax level and the increase in operating profit. Consequently, diluted earnings per share before special items decreased 6% to DKK 16.74.

Please turn to slide 7. Operating cash flow for the first nine months amounted to DKK 2.3 billion, compared to DKK 3 billion last year. The development in cash flows was driven by higher income tax paid, increase in interest payments due to the Atos Medical acquisition and increase in working capital, mostly driven by inventories. Inventories increased due to a higher level of safety stock on raw materials, price increases and an increase in finished goods due to the transfer of production to Costa Rica.

Cash flow from investing activities was an outflow of DKK 655 million, or around 4% of revenue, compared to an outflow of DKK 11.4 billion last year, impacted by the acquisition of Atos Medical. CapEx in the first nine months amounted to DKK 857 million, or 5% of sales, compared to 4% of sales in the same period last year. As a result, the free cash flow for the first nine months was an inflow of DKK 1.7 billion, compared to an outflow of DKK 8.4 billion last year, which was impacted by the Atos Medical acquisition.

The adjusted free cash flow in the first nine months for 2022-2023 was an inflow of DKK 2.2 billion. The trailing 12-month cash conversion was 83% impacted by the development in working capital. Net working capital amounted to around 27% of sales, compared to around 25% at the end of last financial year, impacted mostly by the increase in inventories. We now expect the net working capital for the full year to be around 25% of sales, mostly impacted by the development in inventories.

Now, let's look at the financial guidance for the year. Please turn to slide 8. Our financial guidance for 2022-2023 financial year is unchanged. The organic revenue growth is still expected to be around 8%, and the underlying assumptions on the performance by business area and geography are unchanged. Our reported revenue growth in Danish kroner is still expected at 8% to 9% and continues to assume negative currency impact of around minus 2 percentage points.

Contribution from Atos Medical acquisition to reported growth is around 3 percentage points as expected. The gross margin continues to be expected at 66% to 67%. The assumptions on key cost categories raw materials, energy, freight and wages are largely unchanged. Looking towards Q4, we continue to expect tailwind from freight prices and [ph] increased (17:02) prices in Hungary.

As of July 1, the Hungarian government introduced a price cap on electricity of €200 per megawatt hour, positively impacting around 60% of our consumption, which we have hedged at around €400 per megawatt hour. These positive developments are expected to be offset by continued negative impact from currencies.

The reported EBIT margin before special items is still expected at 28% to 29% and the underlying assumptions are unchanged. Operating costs for the year are still expected to grow below reported revenue in Danish kroner, excluding acquired growth. Impact from currencies is still expected around minus 50 basis points.

We remain committed to delivering industry-leading profitability and returning to an EBIT margin of 30% in the strategic period, excluding impact from the acquisition of Kerecis. For the 2023-2024 financial year, we have now hit around 80% of the electricity consumption in Hungary at a level of €150 per megawatt hour, and I expect around DKK 100 million in tailwind from energy next year. Freight rates also continue to look favorable into next year.

Finally, in our biggest category, raw materials, we now believe that price increases have reached the peak and expect to see a decline in the rate of inflation as we move into the next financial year as well. For 2022-2023, I still expect around DKK 50 million in special items, which in addition to the special items already realized in the first nine months, now include transaction-related expenses from the acquisition of Kerecis.

The CapEx guidance for 2022-2023 is now expected around DKK 1.3 billion from previously around DKK 1.4 billion. The effective tax rate is still expected to be around 21%. The net financial expenses for 2022-2023 are still expected at around minus DKK 700 million. The blended interest rate for Atos Medical financing is now expected around 3.2% from previously 2.9% impacted by the adjustment of the variable interest rate on the two-year bond issue.

Before we open up for questions, I would like to provide a short update on the Italian payback system for medical devices. The Italian government has postponed the deadline for the regional payment requests to the end of October. And as such, we don't expect the resolution in this financial year. However, we continue to provide, as expected, and believe that the amount set aside this financial year is sufficient to cover the impact when it occurs, and it should be treated as a one-off impact.

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

QUESTION AND ANSWER SECTION

Operator: Ladies and gentlemen, at this time, we will begin the question-and-answer session. [Operator Instructions] And we have the first question from Maja Pataki from Kepler Cheuvreux. Your question, please.

Maja Pataki
Analyst, Kepler Cheuvreux SA (Switzerland)

Q

Yeah. Good morning. Thank you very much for taking my question. I have two. Andres, just very quickly coming back to your comments around the reversal in inflation of raw materials, could you give us a bit of an indication where – what the magnitude is? Are we looking from double-digit to high-single-digit? Are we looking from double-digit to mid-single-digit? Just to get a bit of a feeling on that.

And then my second question would be on Heylo. You didn't put anything in the press release, at least I didn't see it. And you haven't really mentioned it on the call. I was under the assumption that come Q3 we should have a better understanding whether the product can be launched. An update on that would be really appreciated. Thank you very much.

Anders Lonning-Skovgaard
Chief Financial Officer & Executive Vice President, Coloplast A/S

A

All right. Thanks for your question. So, Maja, let me start on your question related to raw materials. And so I'm still expecting around the 10% in raw material cost increase for this financial year, but we are starting to see the increase to be reduced. And with the current knowledge, I'm expecting something around mid-single-digit increase on our raw materials in 2023-2024 with the current knowledge.

Maja Pataki
Analyst, Kepler Cheuvreux SA (Switzerland)

Q

Thank you.

Kristian Villumsen
President & Chief Executive Officer, Coloplast A/S

A

Maja, let me comment on Heylo. So we still have a really good dialogue with – I'll say, the product works, the IT setup works. The patients who are on it really, really like it. They don't want to return the products. And the payor discussions right now are really focused on, if you will, the IT infrastructure and the app, the security features around it, exactly what type of service that we provide.

So for me, it's a super constructive dialogue. It's positive. And we'll share more when we get to a conclusion. I am hoping that we'll get to a conclusion this year.

Maja Pataki
Analyst, Kepler Cheuvreux SA (Switzerland)

Q

This year, calendar year, or are you talking...

Kristian Villumsen
President & Chief Executive Officer, Coloplast A/S

A

...calendar.

Maja Pataki
Analyst, Kepler Cheuvreux SA (Switzerland)

Q

...calendar year? Okay. Thank you. Great. Thanks a lot.

Operator: The next question is from the line of Hassan Al-Wakeel with Barclays. Your question, please.

Hassan Al-Wakeel
Analyst, Barclays Capital Securities Ltd.

Q

Hi. Thank you for taking my questions. I have three, please. Firstly, can you talk about the margin guidance? And with nine months under your belt at the low end, is indeed the lower end of the range now more likely? And does the 29.7% currently in consensus for 2024 on an underlying basis ex Kerecis look optimistic and what is the FX impact at current spot for next year?

Secondly, can you talk about the recovery you're seeing in China volumes and whether there is any improvement in average basket sizes in China? And then finally, on Wound Care, you highlight a 150-basis-point headwind from back orders, but adjusting for this growth still seems soft. What do you put this down to and what is the level of market growth that you see? Thank you.

Anders Lonning-Skovgaard
Chief Financial Officer & Executive Vice President, Coloplast A/S

A

All right. Let me start, Hassan, with your first question around our margin guidance for this financial year. So as I said earlier, we are expecting to deliver an EBIT margin in the level of 28% to 29%. We are expecting a strong Q4 in terms of our margin. I am expecting that our gross margin will improve in Q4. We are getting some, you can say, benefits from the cap on energy that the Hungarian government have decided to do. It's a benefit of around the DKK 20 million. And we also see, okay, underlying trends on freight and energy, especially.

So that will benefit us into Q4. And then, we continue to be very prudent on costs. So the capacity costs will also in Q4 grow at a lower level than the top line. So I'm expecting you deliver in line with our external guidance of 28% to 29%. That's the view.

In terms FX, yes, we are having a negative impact from FX this year. I'm expecting something around the 50 basis points. So I will also have a negative impact from FX in Q4 and that will also continue into next year, especially Q1. But then, I'm expecting with the current spot rates, it will start to be a neutral impact.

Kristian Villumsen
President & Chief Executive Officer, Coloplast A/S

A

And Hassan, let me pick up the question on China. We had a good quarter in China as the ostomy business is growing a healthy double-digit, patient inflow is healthy double-digit. Wound Care is strong double-digit. When I look across the performance across the different regions, I'm also encouraged by that. I still see that the average basket size of what people actually purchase compared to where we were pre-COVID is suppressed. And frankly, with what I'm reading about the Chinese economy, I'm not too surprised about that. But, of course, this is something that we continue to monitor.

Strategically, I think the positive news is that the surgical activity is back, right. So the patients are coming in – coming through the system and we're winning a very, very strong share of that. To your question on Wound Care, nine months in, we've got a 4% growth. And I would say, nine months in, probably 150 bps to 200 bps worth of headwind. So I'm looking at a business that's growing probably around 6%.

Remember, now our footprint, Hassan, that we have very, very limited exposure to the US Wound Care market, we will be investing there when we've got our pressure injury prevention product ready. So really, this is impact on Europe. In the quarter, China's back very, very strongly, but we're hurt in Europe by these back orders.

We're trading normally here in July. So when I'm looking at the quarter Q4 for Wound Care, I'm definitely also expecting a strong quarter.

Hassan Al-Wakeel
Analyst, Barclays Capital Securities Ltd.

Q

Very helpful. Thank you.

Operator: The next question is from the line of Christian Ryom with Danske Bank. Please go ahead.

Christian Sørup Ryom
Analyst, Danske Bank

Q

Yes, good morning. Thank you for taking my questions. I have a couple on the gross margin and then one on the Voice & Respiratory franchise. So first on the gross margin, can you spell out what was the sequential impact from FX on the gross margin here in Q3 relative to Q2? So how much of the 60 basis points decline in gross margin was explained by FX?

And then, second question relating to the gross margin, what do you expect in terms of the pricing – overall group pricing development for next year? And if I may then also just a quick question on the Voice & Respiratory franchise. So year-to-date, you've had a double-digit growth in tracheostomy. Can you comment a bit of on how sustainable you view that as being? And also, the development in laryngectomy, which on the other end has only in the high-single-digits and whether there is any scope for improving that growth rate. Thank you.

Anders Lonning-Skovgaard
Chief Financial Officer & Executive Vice President, Coloplast A/S

A

So, Christian, let me start on your first questions around the gross margin and the pricing. So your question around the FX impact, so yes, our third quarter had a quite significant FX impact on our gross margin. So just versus last year, the impact was around 7 basis points and versus the second quarter, it was around 100 basis points. So that's also the main explanation why Q3 gross margin was softer than I actually anticipated.

In terms of your pricing question, when we're looking into next year, we're also looking into a year with positive price impact, and we are continuing our work on increasing prices in the markets where we're able to do it and work on the discounts and other things. So I would expect that the impact will be similar to this year also because we are not looking into any healthcare reforms across our main markets. So that would be my expectations for next financial year on pricing. Kristian?

Kristian Villumsen
President & Chief Executive Officer, Coloplast A/S

A

That leaves your question on the Atos Medical franchise, Christian. So on tracheostomy, I'm encouraged by the development. I'll remind you, this is a long journey. So the tracheostomy category, when you look at it from the lens that we have, the reason that's interesting is that there are a lot of patients. But the development of the category really is about building standards of care to serve also the [indiscernible] (30:25) who are discharged with a track to living community.

And that's why, we've been forward-integrating the business, so we can basically take control of how these standards of care are developed. We're investing in that. I'm seeing some good early signs that we're serving more patients directly. And I am expecting that this will continue to help drive growth.

The long-term outlook for me is still positive, but it's going to be a long journey, Christian. But we think with what we've seen so far that there's a lot more work to do. And in some markets, we've come off to a really, really good start on trying to serve patients directly. So your question on lary, remember, this is now a significant and more developed category and the high-single-digit reflects, I think, a really good performance in developing the category, [ph] where with very (31:28) high penetration rates in Northern Europe.

So accelerating from this momentum where we are now is really about continuing strong performance in the Southern Europe and the US, and not least emerging markets. As you know, we've begun the work of also opening up China. Again, it's going to be a long journey. So my view on Atos as a whole is – think of it as a mini-Coloplast that can continue to grow year in, year out, where we have category leadership positions and the growth is going to come from innovation, increasing penetration and an ability to serve patients directly to drive good compliance. I'm pleased with where it is.

Christian Sørup Ryom
Analyst, Danske Bank

Q

Great. Thank you very much.

Operator: The next question is from the line of Veronika Dubajova with Citi. Please go ahead.

Veronika Dubajova
Analyst, Citigroup Global Markets Ltd.

Q

Excellent. Hi, guys. Good morning and thanks for taking my questions. I have two, please. The first one is just on Wound Care, I think you had expressed hope that the segment would perform a lot better this quarter at the end of last quarter. So I'm just kind of wondering what's gone wrong. And I guess, any risks that you're starting to see some permanent damage to your competitive position here, just given how long some of these constraints on the supply side have lasted?

And then, my second question just quickly, any update on where we are with Healthtrust and your expectations there? Thank you.

Kristian Villumsen
President & Chief Executive Officer, Coloplast A/S

A

The thank you, Veronika. Yeah. When you've got back orders, it's poison. But the good news is that they're now resolved. We're shipping normally here in July. I'm expecting a significantly stronger quarter here in Q4 and also then have a better momentum coming into next year. So the momentum is coming back. I am expecting that with what we've got in the pipeline also that we've got a good commercial agenda to continue to drive growth above market.

On Healthtrust, I think I would say, low likelihood with the current information that I have now. There's really no tender process that's been announced. And for me, that basically means that there will be no imminent decisions to carry out a switch. So that's my info on Healthtrust at the moment.

Veronika Dubajova
Analyst, Citigroup Global Markets Ltd.

Q

That's helpful. Thanks, Kristian. And on Wound Care, I mean, what do you – I understand you've had some headwinds here, but are you still confident that once you are fully supplied, you can go back to winning market share following some of the product launches and just remind us if there is anything else in the pipeline that's coming there.

Kristian Villumsen
President & Chief Executive Officer, Coloplast A/S

A

Yes. So, remember, Veronika, the ambition for us is that we want to grow more than market here. We've exposed ourselves in the dressings category towards silicone. And we're awaiting a launch of the dressings portfolio in the US until we can deliver the pressure injury prevention product. We've also said that we will launch that in the latter half of this strategic period. So that's definitely in the pipeline.

China is doing well. It's growing very strong, double-digit, good footprint. And then, we've had this headwind in Europe. So I feel confident that we can continue to grow the business at above market. And of course, we are expanding our presence in Wound Care now also with the with the Kerecis acquisition. But I feel confident that the dressing business standalone can continue to grow clearly above market.

Operator: The next question is from the line of Shubhangi Gupta with HSBC. Please go ahead.

Shubhangi Gupta
Analyst, HSBC Securities & Capital Markets (India) Pvt Ltd.

Q

Hi. Thanks for taking my question. So my first question is regarding your long-term margin guidance. So can you please simplify how do we get from 28%, 29% in FY 2023 to over 30%? And second is on the CapEx guidance for this year. So what can the DKK 100 million cut be attributed to? And third, can you please shed some light regarding where you at Kerecis acquisition? Thank you.

Anders Lonning-Skovgaard
Chief Financial Officer & Executive Vice President, Coloplast A/S

A

Yeah. So thanks a lot for your questions. Let me start. So we are still committed to deliver the 30% long-term EBIT margin guidance. As we have mentioned several times, we are expecting that our gross margin will improve and contribute. I have mentioned electricity that will already next year contribute. We are also expecting freight and some of the other cost categories to contribute to the improvement in our underlying gross margin. And then, we will continue to be very prudent on our cost and make sure that we are delivering on the long-term EBIT margin of 30% as earlier communicated.

In terms of our CapEx guidance for this year, so we have reduced it with DKK 100 million to DKK 1.3 billion. It's just a matter of timing of some projects. So there's nothing really underlying. So this is just my view currently.

Kristian Villumsen
President & Chief Executive Officer, Coloplast A/S

A

Sorry, could you repeat the question that you had around the Kerecis acquisition?

Shubhangi Gupta
Analyst, HSBC Securities & Capital Markets (India) Pvt Ltd.

Q

Yes. So can you just shed some light on where you are with that Kerecis acquisition? So in your press release, you have mentioned that 99% of the shareholders of Kerecis have agreed to sell their shares to Coloplast. So, yeah, if you could also give some light on the discount – price discounting?

Kristian Villumsen
President & Chief Executive Officer, Coloplast A/S

A

Yes. So far, so good. Process is going according to plan. We still expect the transaction to close in in Q4 on the back of the necessary approvals. We can't imagine that there'll be any hiccup with that. We also expect to do the equity raise in this quarter. Our anchor shareholder and his family are very supportive and we've received a lot of interest related to this. So you should expect that all of this will transpire in our Q4.

Shubhangi Gupta
Analyst, HSBC Securities & Capital Markets (India) Pvt Ltd.

Q

Thank you.

Operator: The next question is from the line of Robert Davies with Morgan Stanley. Please go ahead.

Robert J. Davies
Analyst, Morgan Stanley & Co. International Plc

Q

Thank you. Most of my questions have been covered. I just had a couple I wanted to touch on. Just one with the current reimbursement trends you're seeing within the Wound Care segment, just across the different pockets, would be kind of interested to hear if there's any update there. And the other one was just on the interest cost, which came in a little bit higher than expected. What are you expecting for interest costs into 2024? Is there any further step-up into next year, we should expect? Thank you.

Anders Lonning-Skovgaard
Chief Financial Officer & Executive Vice President, Coloplast A/S

A

So, Robert, on your second question around interest rates, so what I said earlier is that we are currently looking into a blended interest rate of 3.2%. So you should use that when you estimate the interest expenses also into 2023-2024.

Kristian Villumsen
President & Chief Executive Officer, Coloplast A/S

A

And to your question on reimbursement trends in Wound Care, I'll say that for the dressings category, historically, this has been a category that's probably been more reform exposed than if you look at the rest of the company. We sell – the pricing situation in China is stable, and I'll remind you that we do not have much of a dressings presence in the US at the moment. We are waiting to launch the portfolio until we've got the final products ready.

On the Kerecis side, what we're moving into, there is a – the vast majority of the business is hospital-focused. The majority of the growth is hospital-focused with very stable and favorable pricing. And then, there's a lot of stuff happening in the, if you will, in the outpatient setting or in the community setting. That's probably with – it's a longer conversation than we have here. But I'll say, we still have and expect strong growth in that setting. With Kerecis, there's some really nice work done from the Kerecis team that allows the portfolio to play with different brands at different reimbursement levels and we have good access.

So that's probably my answer to the question at this stage. And then, of course, more once the transaction is closed and we're up and running.

Robert J. Davies
Analyst, Morgan Stanley & Co. International Plc

Q

Okay. Thank you.

Operator: The next question is from the line of Christoph Gretler with CS. Please go ahead.

Christoph Gretler
Analyst, Credit Suisse Securities Europe Ltd (Switzerland)

Q

Thank you, operator, and good morning, Kristian and Anders. See, I have got two questions, and on the first is with respect to China. Do you think there's actually already time to start investing again in that country? I mean, from your press release, sounds like you're optimistic about the long-term growth prospects. But I just wondering whether there is any change in attitude on that.

And the second question, with respect to your US Ostomy Care business, could you maybe discuss the new patient discharge trends? It looks like some of your competitors became a bit more optimistic. Let's put it that way. And I was wondering whether your business is still growing in the double-digits there. Thank you.

Kristian Villumsen
President & Chief Executive Officer, Coloplast A/S

A

So thank you. Thank you, Christoph. So I'm probably reading some of the same newspapers that you are. So if you read many of those newspapers, there are good reasons to be a little worried about where China is these days. But if you allow myself to disregard all the geopolitics and news on the economy at the moment, the fundamental activity level, surgical activity level in China, we view as back. All right. And if I look across the entire world – this is the largest population. This is going to be the largest demographic shift in human history.

And therefore, also one of the most significant opportunities from a patient volume perspective when it comes to the ostomy business. And so you should definitely expect that we're totally committed to that and that we – when we think of the types of investments that are going in there, I don't think it's going to be sales force footprint. We have a very, very large sales force presence. But I am envisioning that we will be investing in the activities that are going directly to consumer and to services, some of the things that we're doing to develop our other categories in China, and we'll probably be able to talk more about that next year. Some of that will be quite tactical. Some of that is more long term in nature.

But we are seeing a trend, Christoph, where China, if you will, as a country, are making decisions where we increasingly have to treat them as a, if you will, a segment of one. So if you think of how they're regulating the treatment of patient data, healthcare professional data, the kinds of regulations that they have around introducing new products, things like that, they're a segment on their own. But given the mission of the company, the size of China, we're committed and we will also be allocating resources and capital going forward.

To your question on US, a double-digit growth. So we've got really good momentum in the US and we have for quite some time now the long long-term strategy that we had about winning positions on the GPOs, building dedicated sales force, dedicated consumer programs, expanding the full portfolio. It's worked and it's paying off. And so we're clearly taking share in the US on Ostomy Care. And in the hospital channel, the way that we look at the data, we're also a clear number two.

Christoph Gretler
Analyst, Credit Suisse Securities Europe Ltd (Switzerland)

Q

Okay. Thank you. I appreciate your comment, Kristian.

Operator: The next question is from the line of Sam England with Berenberg. Please go ahead.

Sam England
Analyst, Joh. Berenberg, Gossler & Co. KG (United Kingdom)

Q

Hi, guys. Thanks for taking the questions. So the first one around Voice & Respiratory, you highlighted that growth in Q3 was being driven by markets outside of the US in what was historically a US-centric business when you bought it. Can you talk a bit about how we do grow in the business in international markets. And then, particularly, how much of the growth is being driven by the integration of the two businesses and access to Coloplast for the broader platform?

Kristian Villumsen
President & Chief Executive Officer, Coloplast A/S

A

So, yes, thank you for that question, Sam. So it's really not US – and hasn't historically been a US-centric business. It's quite Europe-heavy. In fact, it's historically been even more Europe-heavy than Coloplast is. And so the way to think of it is if you look at Northern Europe and you think of the patient populations, treatment penetration or about, let's call that, index 100, pretty much everybody gets on product. There's still work to do on how much volume people use, but standards of care are high.

If you go to Southern Europe, you can divide that number roughly by two. And then, from Southern Europe to the US, you can divide that number again roughly by two. And then, of course, when you look into emerging markets, there are very, very low standards of care. So you look to US – of course, it needs to be a significant growth driver. Southern Europe needs to be a significant growth driver. And EM too and the way that we're thinking about that is that we run pretty much like we've done with Coloplast Global, a portfolio of commercial investments across those geographies.

And for EM, it is a select group of markets where we are investing. The most clear benefit – two, three very clear benefits from joining the Coloplast family, one is that we basically put Atos Medical on the Coloplast infrastructure, including our shared services center out of Poland. So you get a higher degree of scalability in the growth.

In almost all emerging markets, we've been present for a very, very long time, which basically means that once you start investing in those markets to drive the Voice & Respiratory Care portfolio, we have a backbone in place. We've got companies there, we've got IT infrastructure, HR teams, regulatory teams, et cetera, which means that you can also drive your expansion and you're building up healthcare standards faster because really the most important thing that you're doing is that you're hiring a commercial team and people to drive medical affairs.

So I am expecting that the growth in the franchise will be driven for the foreseeable future by Southern Europe, US and EM, and a little less by Northern Europe. But you need to think of it as something that is basically because Atos has such a high category market share position, the growth is going to come mostly from building standards of care, driving treatment penetration and treatment standards and compliance. And the final thing I'll say is, remember also in this business, 55% to 60% of the turnover is served directly. We serve the patients directly, long-term growth.

Sam England
Analyst, Joh. Berenberg, Gossler & Co. KG (United Kingdom)
Q

Okay, great. Thanks.

Operator: The next question is from the line of Martin Parkhøi with SEB. Please go ahead.

Kristian Villumsen
President & Chief Executive Officer, Coloplast A/S
A

Can't hear you, Martin.

Operator: Okay. It seems like Martin just disconnected. So in the meantime, we can maybe continue with Graham Doyle with UBS. Please go ahead.

Graham Doyle
Analyst, UBS AG (London Branch)
Q

Morning, guys. Thanks for taking my questions. Just two from me. On Atos, when you look at the growth in this quarter – but maybe if you give us a bit of shape of the last year or so as well, how does that split in terms of actual and HMEs versus accessories? So just to get a sense of where that growth is coming from. Maybe if you could comment on is there any sort of cyclicality to the accessories? Are you seeing anything in that market, which maybe gives you concern from a macro backdrop or not?

And then, on Kerecis, it's a question I didn't get to ask last time which just – there's obviously a comment around the transaction being increasingly accretive to EPS for full year 2026-2027. Just to be clear, does that mean that you think it's actually accretive rather than it gets less dilutive, for example. Just to better understand it because when we put work through the assumptions that go into it, it's kind of – it's pretty close one way or the other. So it'd just be good to get a sense of that. Thank you.

Kristian Villumsen
President & Chief Executive Officer, Coloplast A/S

A

So thank you, Graham. On Atos, so when we run this business and we talk about performance, we talk about how many puncture sets have we sold, how many HMEs have we sold in a market? How many – the different accessories that we've sold. We talk about the mix of products. So our success on basically migrating people to new technology – the Provox Life portfolio and it varies a little bit across the quarters. And it's not something I would put too much emphasis on on a call like this. We manage it at a very high level of granularity. The growth is going to come from working on that month in, month out in the markets where we're already present, opening up new markets and building standards of care.

Over the last 12 months, there's not a lot of shift in the actual composition of the growth within the laryngectomy category. But the contribution from the tracheostomy category has increased, which is in my mind just the very, very positive, not least because we're also seeing traction in some of the markets where we've gone direct in serving tracheostomy users directly. And on Kerecis, you should think of that as actually accretive.

Graham Doyle
Analyst, UBS AG (London Branch)

Q

Perfect. That's very clear. Thank you very much.

Operator: [Operator Instructions] So far, there are no further questions and I hand back to Kristian Villumsen for closing comments.

Kristian Villumsen
President & Chief Executive Officer, Coloplast A/S

Well, thank you to everybody who dialed in and for the questions. And as usual, if there's anything that we can do, please reach out to our Investor Relations team and we look forward to meeting many of you in the market tomorrow and in the coming weeks. Thank you.

Operator: Ladies and gentlemen, the conference is now concluded and you may disconnect. Thank you very much for joining and have a pleasant day. Goodbye.