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Coloplast A/S (CLPBY.DK)

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MANAGEMENT DISCUSSION SECTION

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

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, operator. Good morning, and welcome to our full year 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 will start with a short presentation by Anders and myself, and then open up for questions as we usually do.

Could I ask you all to please turn to slide number 3. We delivered 8% organic growth and a reported EBIT margin before special items of 28% for the 2022/2023 financial year. Return on invested capital after tax and before special items was 17%, reflecting impact from the Atos Medical and Kerecis acquisitions. Now, fourth quarter, we delivered organic growth of 8% and a reported EBIT margin before special items of 28%.

I'm satisfied with this year's organic growth results as we continue to take market share across all our business areas. More importantly, we continue to help more than 2 million people with intimate healthcare needs. And we also welcomed more than 260,000 new users into our patient support program, Coloplast Care.

In this challenging macro environment, we maintained an industry-leading profitability level. Still, this year's EBIT margin is below our long-term expectations, with the decline in absolute profits reflecting significant inflationary headwinds across many cost categories.

This was a year of heavy lifting. A lot has happened, both in our external environment and internally. We managed through COVID repercussions in China. We managed through supply disruptions in both Wound Care and Continence Care. We've been integrating Atos. We've acquired Kerecis. And we've had a lot of ongoing work to prepare for a year of launches.

2023/2024 is a comeback year; a year of launches in our core business, a year in which we reaped the rewards of the Atos Medical integration, a year which includes revenue and gross margin benefit from Kerecis. It's also a year of a turning point in our profitability where we expect to return to significant growth in absolute profits.

Now, let me start with some key highlights from our Strive25 strategy. Please turn to slide number 4. Three years into our Strive25 strategy, I'm satisfied with the progress we've made on our priorities focused on four key pillars: growth, innovation, operational efficiency, and sustainability.

We start with growth. Our core Chronic Care businesses, Ostomy and Continence Care, delivered high-single digit growth in the year. Momentum in our core is strong. A key highlight from Chronic Care is our Ostomy Care business in the US, which grew at double-digit rate, continued market share gains and solid progress across all channels.

In the acute channel, our contracts with the two largest group purchasing organizations, Vizient and Premier, were both extended and are now valid into 2026. We also obtained a sole platinum partnership for Ostomy Care with Medline, a leading medical supply company, which represents a significant opportunity to strengthen our position in home health and advance our growth in the community channel.

With Strive25, we set out to build also mid and long-term growth and value-creation options through M&A. We've made three significant investments in the first half of the strategic period, with Kerecis as the latest addition to our portfolio. We expect Kerecis to be growth accretive as of 2024/2025 adding around 1 percentage point to our organic growth and EPS-accretive as of 2026/2027.

Getting closer to the company since we completed the acquisition on August 31 has confirmed our conviction that Kerecis is the emerging category leader in the US-centric biologics wound care segment. Patented and clinically potent fish-skin technology that Kerecis has developed holds immense potential to strategically transform our presence in our largest market, Advanced Wound Care, and it also provides us with a strong commercial footprint in the US. At the same time, our global infrastructure provides Kerecis with a backbone for expansion beyond the US in the medium and long-term.

Now, let's turn to the second pillar of our Strive25 strategy, innovation. Luja, our new intermittent catheter with a Micro-hole Zone Technology, is now launched in six markets with very good feedback from both users and clinicians. We're preparing for launch in more markets in the first half of 2023.2024. We already have positive news from the UK, where we've been awarded reimbursement for Luja at the price level ambition; and from the US, where the product has received a 510(k) approval.

Heylo, our digital leakage platform in Ostomy Care, is now expected to be launched in Germany and the UK in the first half of 2023/2024. Reimbursement discussions are ongoing, and we remain optimistic about Heylo as we believe it has the strong potential to raise the standard of care for Ostomy Care users. We now also have clinical evidence to support this, with the results of the first clinical study showing significant improvement in both quality of life and, not least, a 31% reduction in leakage for users that used Heylo.

Now, let me zoom in on operational efficiency. 2022/2023 was the final year of our Global Operations Plan 5, which had an ambition of keeping blue collar head count neutral through automation, effectively releasing around 1,000 FTEs. Program has been impacted by longer component lead times; and in 2022/2023, we achieved a release of around 800 FTEs, with the remaining FTE release expected in 2023/2024.

Today, we also announced our Global Operations Plan 6, which covers the three-year period until 2025/2026. GOP6 will support Coloplast's long-term financial guidance through key initiatives such as establishing a new manufacturing site in Portugal and a company-wide procurement program aimed at driving cost efficiency.

We've chosen Portugal as the new location for our manufacturing site due to its proximity to key European markets, stable supply of qualified labor, and a very clear sustainability focus. The new site in Portugal is expected to be operational in 2026, and it will also be the largest Coloplast site to-date with around 30,000 square meters, removing the need for additional sites until 2029/2030. The investment level is expected to be around DKK 700 million evenly split over the next three years starting 2023/2024, which also means that our CapEx ratio for the remainder of the Strive25 period is expected to stay around 5% to sales.

Finally, on our sustainability initiatives, we continue to make good progress on our recycling efforts where we have already reached our 2025 ambition, with 75% of our production waste now recycled. In addition, we reduced our Scope 1 and Scope 2 emissions by 10% from the base year of 2018/2019, including Atos Medical, and positively impacted also by phasing out of natural gas as well as electrification.

Before we take a closer look at today's results, I'd just like to take this opportunity to say thank you to our around 16,000 employees at Coloplast for their continued commitment and hard work in another challenging year. In a dynamic labor market, our voluntary employee turnover rate remains stable, and the employee satisfaction score continues to be well above the healthcare industry benchmark. I'd also like to thank our users, clinician partners and investors for their confidence in our company.

With that, please turn to slide number 5. In Ostomy Care, organic growth was 8% for the full year, and growth in Danish kroner was 5%. In Q4, organic growth was 9%, with growth in Danish kroner of 2%. Our SenSura Mio portfolio continues to be the main growth driver, followed by the Brava-supporting products, and our SenSura and Assura/Alterna portfolios continued to contribute to growth in emerging markets.

From a geographical perspective, growth in Q4 was broad-based with a strong quarter in emerging markets driven by double-digit growth in China; and Europe, driven by UK and the US, also made solid contributions to growth.

In Continence Care, organic growth was 7% for the full year, with growth in Danish kroner of 4%. In Q4, organic growth was 6% and growth in Danish kroner was negative 1%. Growth in Q4 was driven by solid high-single digit growth in intermittent catheters across the SpeediCath portfolio, with a good contribution from compact, standard as well as flexible catheters.

The Bowel Care business had another good quarter, with solid growth contribution, while the Collecting Devices business contracted from growth in the quarter, impacted by order phasing. From a geographical perspective, all regions contributed to sales growth, led by the US, and a good quarter in emerging markets, while growth in Europe was held back by Collecting Devices.

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 10% organic growth for the period since February 1 and 13% in Q4. This also includes some benefit from the lower baseline last year. Growth in laryngectomy was high-single digit, driven by an increase in the number of patients served in both 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 tracheostomy in the ENT business was double-digit, with continued solid demand and positive impact from forward integration in key European markets as well as the US. During the year, we made good progress on the integration of Atos Medical into Coloplast infrastructure, and we are on track to deliver operational synergies of up to DKK 100 million.

Organic growth in Advanced Wound Care for the year was 7% and growth in Danish kroner was 8%, which also includes one month of impact from the Kerecis acquisition. Q4 organic growth was 8% and growth in Danish kroner was 14%. The advanced dressings business grew 6% in the full year and 12% in the fourth quarter. Growth in the quarter was driven by strong performance in Europe, benefiting from the resolution of the backorder situation as well as emerging markets driven by another solid quarter in China.

Biatain Silicone portfolio continued to be the main growth contributor in the quarter. Kerecis delivered pro forma revenues of DKK 772 million for 2022/2023, growing around 50%. Revenue growth was broad-based, led by the hospital channel and surgical wounds. Kerecis' operating profit margin, excluding PPA amortization, was around 6% for the year, as expected.

In Interventional Urology, organic growth was 10% for the full year and growth in Danish kroner was also 10%. In Q4, organic growth was 5% and reported growth in Danish kroner was 0%. Growth in the quarter was both up against the high baseline last year and driven by Men's Health in the US as well as emerging markets detraction to growth that basically was impacted by order phasing.

With this, I'll now hand over to Anders to take you through the financials and outlook in more detail. Please turn to slide 6.

Anders Lonning-Skovgaard

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

Thank you, Kristian, and hello, everyone. Before we look at the numbers, I would also like to thank all our employees for their dedication and contribution in a year challenged by macroeconomic factors, inflation, high interest rates and unfavorable development in currencies have all put pressure on our financial performance in the year, but we remain prudent on cost and focused on helping our users posting a solid growth rate.

Reported revenue for the full year increased by DKK 1.9 billion or around 9% compared to last year. Organic growth contributed DKK 1.7 billion or around 8% to reported revenue. Acquired revenue contributed DKK 708 million to reported revenue for the full year or around 3%, reflecting four months of impact from the Atos Medical acquisition and one month of impact from Kerecis. Foreign exchange rates had a negative impact of DKK 495 million or around minus 2% on reported revenue, mainly due to the depreciation of the British pound and the basket of other currencies against the Danish kroner.

Please turn to slide 7. Gross profit for the full year amounted to DKK 16.3 billion, corresponding to a gross margin of 67% against 69% last year. The gross margin was negatively impacted by increased prices for raw materials and energy, double-digit wage inflation in Hungary and ramp-up costs at our sites in Costa Rica.

The above-mentioned headwinds were only partly offset by positive impact from the inclusion of Atos Medical, price increases, country and product mix, as well as efficiency savings from the Global Operations Plan 5. The gross margin includes negative impact from currencies of around 30 basis points for the full year.

Operating expenses for the full year amounted to DKK 9.4 billion. The like-for-like increase in operating expenses, excluding inorganic impact from Atos Medical and Kerecis, was DKK 409 million or 5% compared to last year. Atos Medical contributed with DKK 1.1 billion to operating expenses, of which DKK 210 million in PPA amortization included on distribution costs. Kerecis contributed with DKK 71 million in operating expenses, reflecting one month of impact.

The distribution-to-sales ratio for the full year was 31% compared to 30% last year, and includes impact from Atos Medical and Kerecis and an increased level of commercial activities. Distribution costs also include continued commercial investments in Interventional Urology, consumer and digital initiatives, as well as Atos Medical.

The admin-to-sales ratio in the full year was 5% compared to 4% last year, primarily impacted by the inclusion of Atos Medical. The R&D-to-sales ratio for the year was 4% of sales, on par with last year. Overall, this resulted in a decrease in operating profit before special items of 1% for the full year, corresponding to an EBIT margin before special items of 28% compared to 31% last year. The EBIT margin for the full year contains around 90 basis points impact from the PPA amortization cost, majority of which related to the Atos Medical acquisition.

Currency had a negative impact of around 60 basis points to the reported EBIT margin related to unfavorable development across a basket of currencies in the second half of the year. Special items for the full year amounted to DKK 74 million. The special items include the final provision of DKK 200 million related to the mesh multi-district litigation cases in the US Interventional Urology business and an income of DKK 244 million from the reassessment of the Atos Medical billing compliance provision, both booked in Q3. In addition, special items include DKK 65 million related to the Atos Medical integration, and DKK 54 million related to transaction costs from the acquisition of Kerecis.

Financial items for the full year were a net expense of DKK 746 million compared to a net expense of DKK 312 million last year, driven mostly by interest expenses related to the financing of Atos Medical acquisition as well as losses on balance sheet items denominated in mostly US dollar.

The tax expense for the full year was DKK 1.2 billion, 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 to Denmark.

As a result of the increase in net financial expenses, net profit before special items for the full year decreased by 4% compared to last year. Diluted earnings per share before special items decreased 6% to DKK 22.46.

Please turn to slide 8. Operating cash flow for the full year amounted to DKK 4.2 billion, compared to DKK 5 billion last year. The decrease in cash flows was driven by higher income tax paid, increased interest payments due to the Atos Medical acquisition, and an increase in working capital driven by inventories. Inventories increased due to the 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 9 billion impacted by the acquisition of Kerecis, compared to an outflow of DKK 11.8 billion last year impacted by the acquisition of Atos Medical.

CapEx for the full year amounted to DKK 1.2 billion or 5% of sales, on par with last year. As a result, the free cash flow for the full year was an outflow of DKK 4.7 billion compared to an outflow of DKK 6.7 billion last year, both impacted by the acquisitions. The adjusted free cash flow for the year was an inflow of DKK 3.7 billion.

Net working capital amounted to around 26% of sales compared to around 25% at the end of last financial year, mostly impacted by the increase in inventories. We expect the net working capital to be around 25% in 2023/2024 and return to our long-term expectations of around 24% at the end of the strategic period. The trailing 12-month cash conversion was 84%, impacted by the development in working capital.

Now, let's look at the guidance for the 2023/2024 financial year. Please turn to slide 9. For 2023/2024 financial year, we expect organic revenue growth of around 8%, and then reported revenue growth of around 12%. The reported EBIT margin before special items is expected at 27% to 28%. I will go through the detailed assumptions on the next slide. But at the high level, we are looking towards a year with easing pressure from inflation, which will be offset by around 100 basis points dilution from the Kerecis acquisition.

For 2023/2024, I also expect around DKK 50 million in special items related to the ongoing integration of Atos Medical. The net financial expenses for 2023/2024 are expected at around minus DKK 700 million, mostly driven by the Atos Medical financing. The blended interest rate for the debt financing of Atos Medical is expected to be around 3.3%.

CapEx guidance for 2023/2024 is around DKK 1.4 billion and includes investments in existing and our new manufacturing site in Portugal. Our effective tax rate is expected to be around 22%, positively impacted by the transfer of Atos Medical intellectual property. Following the transfer of the intellectual property, there will be an extraordinary tax payment of DKK 2.5 billion in the second quarter of 2023/2024 financial year, which would be offset by reduced tax payments in the following years.

Please turn to slide 10. The organic revenue growth guidance assumes continued good momentum in 2023/2024, with growth across businesses and geographies in line with our Strive25 assumptions with the exception of China. In China, while we are looking into an improvement in growth year-over-year, we do not expect the business to be back to double-digit growth due to continued impact from lower average value per patient on our consumer business.

We have no current knowledge of significant healthcare reforms and expect positive pricing impact in 2023/2024, however, at a lower level compared to 2022/2023. The reported revenue growth guidance assumes around 4 percentage points contribution from the Kerecis acquisition, reflecting 11 months of impact and limited negative impact from currencies.

The gross margin is expected to be around 68%. We expect raw material prices to increase by around mid-single digit compared to around double-digit last year. Blue collar wages in Hungary are expected to increase at a similar level to last year of around double-digit. And on the positive side, we expect tailwind from lower freight rates and energy prices, as well as one-off benefit from the provision of the Italian payback reform of around 40 basis points last year. Finally, Kerecis is expected to contribute to the gross margin with around 1 percentage point.

The EBIT margin guidance before special items assumes prudent cost management of operating cost expected to grow below reported revenue in Danish kroner, excluding acquired growth. The EBIT margin also includes synergies from the integration of Atos Medical. On the other hand, as mentioned, Kerecis is expected to have a negative impact on the EBIT margin of around 100 basis points, which also includes around DKK 100 million in amortization charges. Impact from currencies on the EBIT margin is expected to be negative around 50 basis points with current spot rates.

In terms of phasing, we are expecting organic growth in the first half of the year to be in the lower end of the guidance, accelerating to the upper end at the guidance in the second half. The contribution from Kerecis to reported growth is expected to have a similar level across the quarters.

I expect significant negative impact from currencies on both the reported growth and the EBIT margin in Q1, mostly impacted by the development in the US dollar. As a result of this, the EBIT margin in the first half of the year is expected to be in the lower end of the guidance, accelerating to the upper end of the guidance in the second half.

With this, I will hand over to Kristian for final remarks. Please turn to slide 11.

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

Thank you, Anders. We now have half the Strive25 strategic period behind us. As we announced the strategy, our financial performance has been challenged by macroeconomic trends and events, including the COVID-19 pandemic and inflation. These challenges have also confirmed the strength of our company and our model. We've been able to maintain growth and industry-leading profitability despite the external pressure. We expect to emerge stronger in the last two years of our strategic period, and we're working on a number of initiatives that position us well for long-term value-creation.

Our strong core Chronic Care businesses will be further strengthened with a significant number of product launches in the second half of our strategic period, combined with solid contribution from our smaller business areas and the strengthening of the portfolio through the acquisitions of Atos Medical and Kerecis, I feel confident that we can accelerate our long-term growth to 8% to 10%.

At the same time, inflation across our key cost categories have started to come down. And combined with initiatives from our GOP6 plan, we are looking towards returning to an EBIT margin of 30% by the end of the strategic period, excluding Kerecis, and an EBIT margin of more than 30% long term, including Kerecis.

Thank you very much. Operator, we're 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] One moment for the first question, please. The first question is from Anchal Verma with JPMorgan. Please go ahead.

Anchal Verma
Analyst, JPMorgan Securities Plc

Q

Hi. Good morning. Thank you for taking my questions. I have three, please. Firstly, can you please give us an update on how the Kerecis' integration is going? And perhaps if you can talk us through the phasing of OpEx costs through next to this year, FY 2024, and going into FY 2025?

And second, could you please provide us an update on the outlook on China? You have mentioned that growth will probably be below the double-digit Strive25 ambitions. So just trying to see how to quantify this and the impact on the Ostomy business going to FY 2024. And in terms of the anti-corruption campaign, is that mainly impacting the Wound Care segment or have you seen a drop down to the other businesses as well?

And just, finally, on your midterm guidance, which you have reiterated, of around 30% excluding Kerecis. Can you provide us a bridge of how you plan to get there from the 27% to 28% margin here, and then going into the midterm of just below 30%, including Kerecis?

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

A

Thank you, Anchal, for three good questions. Let me just start with the question on Kerecis. Kerecis ended the year as planned with DKK 772 million worth of turnover and about 50% growth and EBIT of around 6%, so basically on plan. We're off to a good start.

Just a reminder, when it comes to integration, there's not that much going on this first year, where we're also very much focused on delivering the earn-out. We are focusing the integration activities on four core areas related to quality and regulatory affairs, legal, IT, and things like that. And of course, there will be, over time, a big piece of work on getting Kerecis onto the Coloplast infrastructure. We're also beginning the work on preparing for, if you will, geographical expansion.

There was a question – what was the – there was a question on cost phasing?

Anchal Verma
Analyst, JPMorgan Securities Plc

Q

Yeah. Just phasing of OpEx, how should we think about kind of the dilution at the EBIT level from the additional OpEx spend for Kerecis? And you've given 100 bps rough dilution impact. But is it fair to see that that impact is probably going to be larger in the first year as you start integrating versus going to 2025? Just kind of splitting that between 2024 and 2025.

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

A

So let me take that one. So this financial year, we will include the amortization of around DKK 100 million. And then, the underlying EBIT margin, ex the amortization for Kerecis, we are expecting that to develop linearly from around 6% they delivered last year to the 20% EBIT margin we have communicated in 2025/2026. So you should see that EBIT margin improvement as linear over the period.

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

And then, to your question on China. I just spent a week in China meeting with our team out there. And as we've communicated, we come out of a year now with a low-single digit growth in China, reflecting that we had negative growth in the first half battling COVID incidences and things like that, and then double-digit growth here in the second half.

We have a strong growth in new patient discharge. So the performance in the hospital channel has been good throughout. Really where we've seen a dip has been in the consumer channel where consumers have purchased less. They've tended to trade down. And so, part of my review and visit to China was also going into quite a lot of depth on the dynamics in the consumer channel. We've made a number of changes. And we are a month in and I'm cautiously optimistic that we're going to see a better performance come out of the consumer channel, but I'm not expecting Chinese consumers this year to just come back and start purchasing at similar rates that they were pre-COVID. There's just too much uncertainty in the China economy.

There has been, of course, some rumbling from the anti-corruption campaign that creates a bit of uncertainty. I view that as a thing that's basically passing. We welcome that. But of course, when these things happen, Chinese hospitals tend to not make decisions, and you can't really start new things and activity levels go a bit down. But it's passing.

Anders, you want to talk to the midterm?

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

Yeah. So let me speak to the midterm moving parts. We are still committed to deliver a 30% EBIT margin ex Kerecis in 2024/2025. The main drivers, first of all, that's growth. We are expecting to continue to grow the business in the level of 8% to 10% as we have communicated after the Kerecis acquisition.

Secondly, we are expecting that the gross margin will improve as inflation, input costs are starting to ease. We have also initiated a pretty large procurement program that is addressing all our external spend across the company. And we also expect that will contribute to the margin improvement.

And then, finally, we are continuing with a very tight cost control, and I will also expect the scalability across the whole business will impact the margin outlook. So we are still comfortable that we will get back to the 30% level, ex Kerecis, in 2024/2025. And in terms of our longer-term guidance of 30% including Kerecis, that will be in some years after.

Anchal Verma
Analyst, JPMorgan Securities Plc
Q

Perfect. That's clear. Thank you.

Operator: The next question is from Hassan Al-Wakeel with Barclays. Please go ahead.

Hassan Al-Wakeel
Analyst, Barclays Capital Securities Ltd.

Q

Hi. Thank you for taking my questions. I also have three, please. If I could start with guidance, could you help with the margin bridge to 2024, given the 27.9% you reported in 2023 and some of the key cost buckets here? What are the key drivers for the top and bottom end of the guidance? I guess I'm trying to understand the degree of buffer you have, given you're now talking about the lower end now for the first half.

Secondly, following up on Kerecis. Could you talk about the driver for the weaker pro forma margin of 6% versus your initial expectation at the time of acquisition of 10%? Has anything changed since you gave the guidance and how should we be thinking about 2024 margins?

And then, finally, could you provide an update on the Italian payback reform. You mentioned a baseline benefit next year, given the 40 basis points of headwind to gross margin you booked in the last year. How has this resolved versus your expectation and what has been accrued historically? And was this impact higher or lower in the fourth quarter? Thank you.

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

A

Yes. Hassan, let me start with the guidance for this financial year and the moving parts. So I already talked to most of the, you can say, moving parts in my initial review. But as I communicated, before Kerecis, we are guiding an EBIT margin in the level of 28% to 29%. There are a number of moving parts on the cost of goods sold. We, as I said earlier, are seeing the raw materials prices increasing by something around mid-single digit. Energy, we have hedged, as we have talked about a lot. So we will see a quite significant improvement versus last year on that one, and the same thing goes for freight. And then, on the wages in Hungary, that will be around double-digit, as I mentioned earlier.

And on the gross margin – and now, I'll take your Italian provision question. So as we talked about last year quite a bit, we are part of this Italian clawback. And throughout the year, we have made an accrual of around 40 basis points. So it has been equal across all the quarters. We actually anticipated that it would be settled during autumn, but it continues to be delayed. And now, we expect some kind of a conclusion around Christmas. But that's, of course, uncertain, but I am confident that we have accrued for the historic, you can say, challenges related to the clawback. But that is giving us some tailwind this year of around 40 basis points.

So on the gross margin, the real, you can say, moving parts, that is the raw material development, how is that going to develop? My best view right now is mid-single digit. So that's definitely something we are focusing a lot on also through the procurement activities that we are currently doing.

And then, for the remaining part of the margin, so we are, you can say, very prudent on our cost. So I'm expecting that the remaining part of our costs will grow at a lower level than the growth. And we will also see some benefits from synergies and the uncertainty around the full-year EBIT outlook, that's on the currency side. With the spot rates, we are looking at currently, we will have some headwind of around 50 basis points. So those are some of the main moving parts towards the guidance for this year before Kerecis.

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

A

And then, Hassan, to your question on Kerecis, it's quite simple. We're ramping up, and the ramp-up has begun. We have a team that's very eager to try and deliver the earn-out. So it's basically – it's ramp-up costs. We're adding quite a few people this year. And you will see like we've said before, the margin will gradually expand as we move toward the end of the period 2025/2026, and we'll get to a margin of 20%. So nothing really changed, but we are ramping up.

Hassan Al-Wakeel
Analyst, Barclays Capital Securities Ltd.
Q

Very helpful. And if I can just follow up on the margin point. I think you've talked about the phasing of margins, clearly. How should we be thinking about phasing of growth given easier comps in the first quarter?

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

So the growth – as I also mentioned earlier, we will have a little bit lower – in the lower end of the guidance in the first half from organic growth point of view, and then higher in the second half, and it's mainly due to our urology business. And then, also, the reported growth before Kerecis will, in the first quarter, be quite significantly impacted by currency due to the US dollar.

Hassan Al-Wakeel
Analyst, Barclays Capital Securities Ltd.
Q

Perfect. Thank you.

Operator: Your next question comes from Maja Stephanie Pataki with Kepler Cheuvreux. Please go ahead.

Maja Pataki
Analyst, Kepler Cheuvreux SA (Switzerland)
Q

Yes. Good morning. Thanks for taking my questions. I have a few. Let me start on China. Kristian, China and lower spending due to consumer sentiment has been a topic now for several quarters. How convinced are you that this is not a structural trend that we're looking at and the China is just going to be impacted by that headwind for more than just a year? That would be my first question.

My second question is for Anders on the gross margin. I mean you've been talking to the cost of goods sold with Hassan and during the call. You sound hopeful that there would be a positive impact brought from the development on that side, yet I'm surprised to see your gross margin guidance really just embedding the Italian payback system. Is that just a cautionary approach to the gross margin from your side, or is there anything else in there?

And then, Kristian, the last question, again back to you. On Medline, you mentioned that you haven't added partnership there and offered significant opportunity. Could you maybe talk to how big or how we should think about the opportunity going forward? Thank you.

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

Yeah. Let start with the two questions for me, Maja. Thank you. Good questions. So yes, it's true. This dynamic has persisted in China, and really I am not too optimistic that the average spend is going to change much this year. I don't have visibility to say that. But what I can see is that the company is very competitive in the hospital channel. So we win probably two out of three patients that leave a hospital in China. We've got good growth in new patients. We've had some hiccups in the consumer channel, where we, over the last year, donated a few share points to some local competitors. We've made some changes to how we work in the consumer channel, and I just spent a week there with the team. I feel confident, based on about six weeks' worth of data, that we are rectifying this and can maintain a strong share position also in the online channel and get some growth.

So we are guiding for a higher growth this year, mid-single digit in China, maybe mid-single digit plus, depending on how successful we are over the coming quarters. But I don't really have visibility to be much more optimistic about the Chinese economy. I don't think it's going to persist forever. I don't think it's going to persist forever. And if you look at the raw data on China and the demographic explosion that will happen there, this will continue to be a significant growth driver for the company over the medium and long-term.

Medline is a really good opportunity. Medline, very strong distributor, lots of salespeople, a very, very strong presence in home health. So I view this as part of the equation to the plan where we need to continue to grow Ostomy Care double-digit in North America that we've done over the last 24 months. So that's how I see it.

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

Yeah. And let me take your question on the gross margin. So I am saying we have an expectation of around 67%. So I am, you can say, optimistic that we will see an improvement in our gross margin versus 2022/2023. But I'm not going to guide specifically on the decimals. And the same thing goes for when I include the Kerecis, I'm optimistic that we will sit with a group gross margin of around 68%.

Maja Pataki
Analyst, Kepler Cheuvreux SA (Switzerland)
Q

Got it. Anders, and just very quickly on the one-time tax payment that you're taking in Q2 next year, and then you say that this is going to enable you to have lower tax payments going forward. Could you give us an indication of what kind of impact that should be?

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

So we will have this negative cash flow impact in our second quarter of around DKK 2.5 billion. And then, you can say, the reduced tax will then be spread out over a four to five-year period.

Maja Pataki
Analyst, Kepler Cheuvreux SA (Switzerland)
Q

Thank you.

Operator: The next question comes from Christian Ryom with Danske Bank. Please go ahead.

Christian Sørup Ryom
Analyst, Danske Bank
Q

Yes. Good morning and thank you for taking my questions. I have three as well. First one is on your pricing expectations for 2023/2024 and why you don't spell out any impact of pricing in the gross margin bridge that you show on page 10?

And then, second question is to the outlook for your working capital ratio to sales. You end the year about 26%. How do you expect that to develop in 2024?

And then, final question is to Atos. As I understand that you now believe that you realized the full synergies that you spelled out when announcing the acquisition, do you see scope for more potential synergies here as we look ahead? Thank you.

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

A

All right. Christian, let me take those questions. Thanks. In terms of pricing, so as we have also talked about quite a bit, we saw a positive price impact last year. And I'm also expecting positive price impact in 2023/2024, driven by basically all businesses and most regions. The impact I'm seeing in 2023/2024 is, however, a bit lower than last year, but it's not that significant that I am calling it out in the gross margin bridge year-over-year.

The second question around working capital. Yes, we ended the year with a working capital ratio of around 26%. We are working on getting that reduced again. And my expectation for the coming year, 2023/2024, is around 25%. And I'm still having the ambition to deliver around 24% at the end of the strategic period. And the improvement – it's a mix of improvement in our, you can say, accounts receivable, but also on our inventory.

Then, in terms of your Atos integration question, so that's something we have been working a lot on over the last year – one-and-a-half years. And the work will also continue in the next couple of years. We have gotten around half of the synergies so far, and we are expecting that will continue into the next year. So the synergy will continue to contribute to our EBIT margin development in the coming years.

Christian Sørup Ryom
Analyst, Danske Bank

Q

Okay. Thank you. Maybe just a quick follow-up. So the Atos synergies that you're including for 2024, is that the DKK 100 million run rate that you were, I think, spelling out when you did the acquisition?

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

A

No, we are not at that level yet. So it's not at the DKK 100 million yet. That will be a little bit later. And I also said up to DKK 100 million.

Christian Sørup Ryom
Analyst, Danske Bank

Q

Okay, great. Thank you.

Operator: The next question comes from Veronika Dubajova with Citi. Please go ahead.

Veronika Dubajova
Analyst, Citigroup Global Markets Ltd.

Q

Hi, guys. Good morning, and hope you can hear me okay. I had three questions, please. The first one, just want to understand the inflation assumption that you have in the gross margin guidance. Your degree of confidence at the mid-single digit raw material inflation number is the right number. And I'm asking this not [indiscernible] (00:48:37) to the downside, but also risk to the upside. Obviously, we have seen some deflationary pressure. So I'd love to get a little bit more insight into what you're seeing there?

My second question is just on the Heylo progress, and thank you for sharing some of the clinical data this morning. Where are you with the discussions with the German payer? And what has been the holdup that's leading to that process taking longer? And then, I have a third follow-up after that, but maybe I'll let you answer these two.

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

A

Yeah. Thanks a lot, Veronika, for your questions. Let me start with the raw materials. So what I said earlier, right now, I'm expecting mid-single digit price increases on our raw material cost base. When we double-click on the total cost category, we are seeing some, you can say, categories that are increasing more. And then we're also seeing quite a bit of categories where we have a decline in the price increases. So it is really a mix of a number of different categories, so injection molding, packaging, et cetera. I must say I am becoming more optimistic also because the general inflation level is starting to come down. But for now, my assumption is mid-single digit.

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

A

And then, to your question on Heylo, Veronika. Yes, we had some really promising results here now with a more than 30% reduction in leakage, super positive responses from the people participating in the study. And the holdup with the payor is really – it's a dialogue that we've had around what, if you will, the app support to the user should actually entail. And the German payor basically insists that we complete the app development before formalizing a decision, and there's a bit of time in actually making that happen. So I'm, therefore, saying that we'll launch in the first half. I am still optimistic that this thing is going to make it to market. And definitely, with the data that we now have on the clinical side, we have a strong case to make.

Veronika Dubajova
Analyst, Citigroup Global Markets Ltd.

Q

That's very helpful. Thanks, Kristian. And maybe my final question really ties into Heylo and slightly more in the bigger picture on the clinical innovation program. It's been a number of years that we've talked about it and waited for some impact here. I'm just curious how you're feeling just more broadly about this initiative and its ability to drive accelerated growth rate? And is fiscal 2024 when we start to see this or are we still a number of years away from that? If you can sort of do a little bit of self-assessment to grading of the program, that would be helpful. Thank you, guys.

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

A

Well, as the CEO of the company, I always want more and I want it faster. And Luja is coming; and the second half of the strategic period, it will make an impact. This is an absolutely incredible platform. We're live in six markets. We'll launch in most of the major markets now. We are ahead of plan in the first markets, and the conversion of our offering to be spearheaded by Luja is well underway. I am very optimistic about what we can do with that product, Veronika. It will set a new standard for the category. And I can see the way that our competitors is reacting. They can see it.

So I am definitely expecting that this is going to accelerate the Continence Care growth in the last half of the strategic period. Remember, this also needs to be rolled out to the full platform. We're starting with male, which is two-thirds of the market. It will come for females. We'll do a set version. And so, definitely optimistic.

We've always been more hesitant about, if you will, the path to market for the digital ostomy appliance. We've got a great product. We now know that it also works clinically. But the dialogues with payors to, basically, get it into market are – they're more technically complex and they're also just – they're not as linear. But once we get it into market, I also feel confident that this will be a great addition to the Ostomy portfolio and also upgrade the value of Ostomy users and, therefore, also upgrade the value of the market.

And then, finally, I'd just remind you, Veronika, there's a lot of other launches coming. So we are looking into two years now where we will be launching a number of things on ostomy, bowel management and wound care. So we are really moving into a more – if you will, from a launch point of view, a significantly more active period from the company. We're basically rolling out the largest innovation road map in my 15 years with the company.

Veronika Dubajova
Analyst, Citigroup Global Markets Ltd.

Q

That's helpful. Thanks, guys.

Operator: The next question comes from Oliver Metzger with ODDO BHF. Please go ahead.

Oliver Metzger
Analyst, ODDO BHF AG

Q

Good morning. Thanks a lot for taking my questions. The first two are on GOP6. So you focus on a company-wide procurement. Can you remind us how procurement is organized currently? So as we visited your facility some years ago, I had the impression that procurement is already well organized. And in this context, can you give us an indication where do you see procurement costs to decline relatively?

And the third question is a more general question on wound care market. So apart from Kerecis, I think you're doing a good job. However, the overall market dynamics remain unchanged to quite mature market. So given the changes we have observed over last one-and-a-half years in the economic environment, high interest rates, also more pressure from the healthcare systems, so do you see any changes that some consultation might start or a shift in the landscape that, for example, some manufacturers become more aggressive in price and market share? So that would be quite interesting to know. Thank you.

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

A

Thank you for those two good questions. So just as a reminder, procurement is organized under operations. We've not changed the way we organize. But of course, what's happened to the company over the last 24, 30 months, the environment has changed significantly. So this has become a key focus area. We are throwing resources after it; a lot of renewed attention. We're anchoring it in the executive team. And we're not really giving you specific guidance on the impact of that program. We view it as part of a portfolio of initiatives for us to get back to the 30% margin.

To your question, Oliver, on the wound care market, yeah, I'm probably – I've been in the game too long to come with any definite answers on what will happen to that market. I think there's been talks about consolidation for as long as I can remember. I'm not necessarily seeing that change now. We would need to see somebody fundamentally change their strategic stance, as you can see from the way that we are moving on the chessboard.

We are, of course, bullish about taking a real position in biologics with the acquisition of Kerecis. And I can talk at length about why we think that there's a really interesting play there with that particular technology, and there will also be opportunity for combination products with our existing business and synergies to the existing wound care business. So we definitely think that there's a good play where we can drive growth and value-creation over the medium and long-term.

Oliver Metzger
Analyst, ODDO BHF AG
Q

Yeah. Okay. Thank you. But do you see any more intense price competition in this very traditional wound care?

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

You fell out at of my end. Can you repeat the question, please?

Oliver Metzger
Analyst, ODDO BHF AG
Q

Sorry. But do you see any form of stronger price erosion in the traditional wound care segment?

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

So there's definitely hard competition, also price competition. And of course, in this type of environment, this may go up. There's definitely a risk that this may go up, Oliver.

Oliver Metzger
Analyst, ODDO BHF AG
Q

Okay, great. Thank you very much.

Operator: The next question comes from Graham Doyle with UBS. Please go ahead.

Graham Doyle
Analyst, UBS AG (London Branch)
Q

Morning, guys. And thanks for taking my question. Just one from me. It's really on the cost side. We obviously focus a lot on the COGS line and the gross margin specifically, but there's more costs below that in sales and marketing and R&D and G&A. And I suppose one of the things that's been kind of interesting over the last four or five years is clearly you've been investing heavily on the sales and marketing line and part for the US opportunity around GPOs, but growth hasn't really accelerated on the back of that.

And it kind of begs the question, is it getting harder to generate that growth in the core business, ex Kerecis? Or is the investment just not paying off in this particular instance? Because presumably, you could have the margin being materially higher at the EBIT level, if you were to maybe just rein in some of that spend. I think most of us would have expected that spend to ease off at this stage, given we're well advanced into the GPO opportunity. So it'd be good to get a sense as to how you think about that. And maybe just, like, what's the line or the bar that has to be met before you either increase or decrease that spend? Thank you.

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

Okay. So a couple of reflections to it. That's a really good question. So look at the growth of the Ostomy business, right? This is an 8% growth business. So depending on where you look, 3, 4 points above market, Continence

Care and here I'll look at the catheter business is high-single digit, multiple points above market. Of course, what's happened now to the business is that we've been impacted by China.

So if you look at the way that we've talked about growth acceleration in that mix, we had US at double-digit, we had China, we had innovation and, of course, Atos. When we talked about it the last time, we had investors assembled here in HQ, Atos is delivering. US, I would say, on Ostomy really delivering. We're just a tad below on Continence Care, but still doing well. But China is, of course, not.

And now, like I said to Veronika's question earlier, the latter half of the strategic period is when we need to reap the benefits of the investments that we've made into innovation. So I am definitely expecting that the Luja platform will accelerate the Continence Care franchise.

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

And Graham, maybe we can also just add that in the first part of this strategic period, we invested quite significantly across the business. So we invested in the US, selected European and emerging markets. We also increased our investments in innovation. And we are not expecting to continue investments at that level in the remaining part of the strategic program or a strategic period. So that is because we have done a lot of investments that we now expect will pay off.

Graham Doyle Q
Analyst, UBS AG (London Branch)

Okay, great. That's actually really helpful. I appreciate the clarity there. Thank you, guys. Bye-bye.

Operator: In the interest of time, the last question come from Martin Parkhøi with SEB. Please go ahead.

Martin Parkhøi Q
Analyst, Skandinaviska Enskilda Banken AB

Yes. Thank you very much. And then, I will just keep them to two. Just back to the margin, sorry for that. Of course, with the guidance this year of 28% to 29%, adjusted for Kerecis, you still expect to deliver 30% by the end of the Strive25 period. So I appreciate you cannot give as detailed a bridge as you have done for this year, but still at the midpoint of 28.5%, how will we reach the 1.5% by the end of the Strive25?

And then, secondly, just on Portugal. And I know there was a question earlier and – sorry for repeating that. But can you maybe talk a little bit how much volume at the end, in five-year time, you expect to get out of Portugal? You talk about an attractive salary level in Portugal. Maybe you can elaborate a little bit on that compared to the other manufacturing sites there?

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

So thanks a lot, Martin. To your first question around the moving parts towards the 30%. I think I already spoke to some of the key moving parts early on in the call. But firstly, it's growth needed to be in the level of 8% to 10%. We are expecting gross margin will continue to improve, also, through the procurement program that we have initiated. And then, we will continue to be prudent across the rest of the cost base, including having impact from scalability. So those are some of the main moving parts towards the 30%.

In relation to your second question around Portugal. So as you know, we are also currently ramping up in Costa Rica. And in Costa Rica, we are expecting around 20% to 25% of the production volume will be produced by 2025. Portugal, now we announced it today, we are expecting it will be up and running in 2026. So it will take some time until we will see a significant, you can say, volume coming out of Portugal with the forecast we are currently doing.

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

A

So Martin, to your question on salary levels in Portugal. Right now, they're on par with what we have in Hungary, but of course much, much lower salary inflation. It will be a Continence Care factory. So this is where we will base our Luja expansion to begin with. And I guess, Martin, when we get further down, we can give you a bit of pointers on how much of the volume it will be, but that would be at a later stage.

Martin Parkhøi
Analyst, Skandinaviska Enskilda Banken AB

Q

Thank you.

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

All right, ladies and gentlemen, thank you for your questions today. We hope to see you on the road over the coming days and weeks.