Chairman’s report 2015/16

Annex 1

Michael Pram Rasmussen:

1. We continue to take market share and increase our EBIT margin

Each year, I look forward to the Annual General Meeting and to presenting the Board's report on Coloplast for the past financial year.

Coloplast is a strong and ambitious company, and we’re continuing our positive development. Your Board and Executive Management intend to ensure that this trend continues going forward so we can continue to grow and make life easier for even more users across the world.

When our company grows and our earnings improve, it provides a number of benefits for Coloplast’s stakeholders: Our customers gain access to new and better products. Our employees get better career opportunities. Society benefits from innovation, growth and tax revenue, and the company's shareholders get a return on their investment.

At Coloplast, our strategy is aimed at achieving profitable growth. In other words, our ambition is to outgrow the market *and* improve our earnings – at the same time.

We achieved that goal in the 2015/16 financial year with Coloplast delivering 7% organic growth in a market growing by 4–5%.

I would like to extend a very warm "Thank you" to all our employees, managers and the executive team for all the hard work they put in to achieve this solid full-year performance.

Turning to our business areas, the Ostomy Care business area excelled this year, delivering the strongest growth performance in a decade. This growth cut across sales regions, and it was driven especially by the new SenSura® Mio product portfolio. Both users and healthcare professionals have given positive feedback on our new products, and especially the latest addition to our product portfolio, the SenSura® Mio Convex, has been exceedingly well received.

Geographically, Europe is the main growth driver overall, and our UK subsidiary performed particularly well. Charter Healthcare, our UK homecare business, produced strong growth in the past financial year after a challenging 2014/15 and is once again taking market share.

In the US, Coloplast faced challenges of consolidation among distributors and changes in their buying patterns. This led to considerable inventory reductions in the market, and we experienced the effects of those changes this past year. However, we note that Coloplast's underlying revenue growth in the US market is above 10%, and we expect the reported figures to reflect the underlying growth in the current financial year.

To support Coloplast's ambition to bring innovative products and services to the US market, the company has entered into a definitive agreement to acquire Comfort Medical for a cash consideration of approx. DKK 1,120m.

Comfort Medical is a privately owned, US direct-to consumer nationwide dealer of catheters and ostomy supplies, and its business model is based on capturing patients through Direct Response Advertisement and physician referrals.

The company is expected to record sales of USD 38m or approx. DKK 270m for the full-year 2016.

In previous years, Coloplast has been able to build a strong consumer channel in the US.
In fact, one third of every newly discharged patient is enrolled in the Coloplast Care prgramme which is remarkable considering Coloplast’s market share of 15 percent.

We see the acquisition of Comfort Medical as part of our overall consumer ambition for Coloplast, securing continued access to innovative technology for end users in the US.

Within Continence Care, many users struggle with old-fashioned products. At the same cost, they would actually be able to upgrade their products substantially - and possibly convert to Coloplast products.

Coloplast continues to be among the world’s most profitable med-tech companies.

Our EBIT margin before special items is 34% at constant exchange rates and 33% in Danish kroner.

As for the special items, since 2011 Coloplast has been named in lawsuits in the United States involving product liability claims resulting from the use of transvaginal surgical mesh products designed to treat pelvic organ prolapse and stress urinary incontinence.

In the full-year financial statements, Coloplast increased the total provision of DKK 750 million in respect of the lawsuits involving the use of transvaginal surgical mesh products. This brought the total provision in the matter to a total of DKK 5.25 billion.

It is estimated that more than 90% of the known cases have now been settled, so we can begin to see a light at the end of the tunnel.

It is a very unfortunate matter, but we believe that this latest provision will cover the costs of closing the remaining cases.

Before I review the financial results for the past year, I would like to present Coloplast's LEAD20 strategy for generating profitable growth and tell you about the progress we're making with our growth initiatives.

Based on LEAD20, we communicated a new long-term financial guidance at our Capital Markets Day held in June of this year in Minneapolis, where Coloplast's US headquarter is based.

Our updated long-term target is for annual organic growth in the 7–9% range and an annual improvement of our EBIT margin by 0.5–1.0 percentage point. (Not many other companies are able to grow as much or have an ambition to reach such a high EBIT margin.)

We aim to achieve the strong growth and improved earnings performance by executing on our new strategy over a three-to-five-year period. Allow me to present the four themes of our strategy:

1. Coloplast aims to deliver ***superior products and innovation***.

Innovation is the cornerstone of all our business areas. Within ostomy care, superior products and innovation means that future generations of ostomy bags will deliver a clinically-proven reduction of leakage.

Our ambition in the Continence Care business is to reduce the burden of bladder management.

In our Wound Care business, we will deliver fewer days with wounds for the users, and in our Urology Care business we will strengthen our product portfolio.

Coloplast launched three new products in the past year: all fine examples of how our company's growth ambition can be achieved through superior products and innovation.

In Ostomy Care, we launched the SenSura® Mio Convex. The remarkable thing about the SenSura® Mio Convex is that this is the first product where clinical studies have shown that a stoma bag like this reduces leakage. This is a breakthrough, because leakage is a paramount concern for users of stoma bags. The SenSura® Mio Convex also features a significantly improved filter and a neutral colour, for a more discreet user experience. Sales have surpassed expectations, and Coloplast is unable to keep up with demand. We expect to have access to new capacity from the end of March 2017, and we look forward to accommodating the current huge demand for our product.

In the Continence Care business, we launched the Speedicath® Flex, a catheter for men that is easier and less complicated to use than other catheters.

Lastly, in Wound Care, we launched the Biatain® Silicone Sizes & Shapes portfolio, a series of dressings in various shapes and sizes that conform to the contours of the body, for example the hollow of the knee or the elbow.

We aim for our new products to drive growth in their respective business areas.

2. The second theme of LEAD20 is about having a ***unique user-focused market approach***.

In our Ostomy Care and Continence Care businesses, we are continuing efforts to build a consumer-oriented healthcare company. Our approach is to have a direct interaction with our users, such as through the Coloplast Care programme. Today, Coloplast Care reaches out to more than 400,000 users worldwide.

3. The third theme is about leadership. ***Strong leadership development*** is key to supporting growth at Coloplast.

Coloplast is a growing company, and we have a constant need for new leaders. Our ambition is to fill two of every three vacant leadership positions with in-house candidates. This will test our ability to recruit and develop the next generation of leaders across geographies and functions. We expect to establish at least 250 new leadership positions by 2020.

4. ***Unparalleled efficiency*** is already a part of Coloplast's DNA.

Our ambition is to enhance efficiency, in the way we manufacture our products or in the way we fulfil our aim of bringing new products to market faster, as in our current Innovation Excellence project.

These are initiatives that will consistently increase our company's competitive ability.

In addition, we will ensure that Coloplast always has effective and scalable administrative functions.

Achieving our long-term goals of high organic growth rates and improved earnings requires investment, so Coloplast will be investing as much as DKK 2 billion over the next five years. Our investment focus will target strategic initiatives in innovation, expansion of the Wound Care business and professionalisation of our user-focused market approach across selected markets.

Our ambition is to double Coloplast's wound care business by 2020/21. To do that, we will invest in innovation aimed at expanding our product portfolio. Other investments include setting up a dedicated Wound & Skin Care organisation in the US, where today we only have a small market share.

From a geographical perspective, our investment focus will be on the US, the UK, Japan, Australia and selected emerging markets.

In order to deliver on our ambition for future growth, we expanded the Coloplast factory at Tatabánya in Hungary by a further 20,000 square metres in the last financial year, and we are currently planning to build a new factory in Hungary in 2017/18.

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I will now review the three geographical markets we operate in.

Europe is a core market for Coloplast. We generate 63% of our revenue in Europe, where Coloplast is clearly the market leader in ostomy care and continence care. We aim to retain and expand this position by launching strong new products and by engaging even more with our users – through the Coloplast Care programme, for example.

We generate 22% of our revenue in developed markets outside Europe: i.e. the US, Canada, Japan and Australia. We intend to accelerate growth in these markets and take additional market share.

The US continues to represent one of the most important investment opportunities for Coloplast, and our ambition is to exceed 10% in organic growth per year. Coloplast is launching new products in the US market, while also investing in the sales organisation and in user-directed initiatives intended to drive market demand.

Japan’s healthcare authorities have increased subsidies for disposable catheters, giving the country’s some 100,000 catheter users access to better products. This marks a breakthrough for Coloplast, because it allows us to serve the market with much better products than before.

Australia has also raised the subsidy provided to citizens with a permanent disability. As in Japan, the change will give users better access to modern catheter products.

The new subsidy rules are expected to contribute to long-term growth.

We generate the last 15% of our revenue from our Emerging markets. In the past financial year, Coloplast lost growth momentum in these markets, mainly due to slowing growth in the Wound Care business in China, Brazil and Saudi Arabia.

Coloplast will continue to invest in selected emerging markets, aiming to work together with the health authorities and healthcare professionals in each of these countries to make assistive products more accessible.

In South Korea, subsidies to the country’s catheter users were increased this past year, making life easier for South Koreans with spinal cord injury, for example, by giving them access to better catheters.

3. Consolidated financial highlights for the 2015/2016 financial year

I will now review our financial highlights for the past year.

Coloplast released its full-year financial results for the 2015/16 financial year on 2 November, and the Annual Report and updated Corporate Responsibility Report were also released later that same day.

Backed by a positive growth performance in all business areas and in all regions, Coloplast expanded its position as a global market leader in the past financial year.

Organic revenue growth was 7%. In Danish kroner, revenue was up by 6% to DKK 14,681 million from DKK 13,909 million last year. Measured in Danish kroner, revenue growth was adversely affected by developments in the British pound, Argentine pesos and Brazilian real.

The gross margin was 69% at constant exchange rates and 68% in Danish kroner.

EBIT before special items increased by 7% to reach DKK 4,846 million. EBIT before special items was 34% at constant exchange rates, up from 33% last year. Measured in Danish kroner, the EBIT margin was 33%.

EBIT was affected by an increase in provisions of DKK 750 million to cover potential settlements and costs in connection with the lawsuits in the United Stated alleging injury resulting from the use of transvaginal surgical mesh products.

Net profit for the year was DKK 3,728 million before special items and DKK 3,143 million after special items against DKK 899 million last year.

ROIC for the year before special items and after tax was 49%, against 48% last year.

At 30 September 2016, Coloplast had 10,275 employees, of whom 8,875 worked in international locations. During the financial year, the number of employees increased by 6%. Our headcount is growing, especially in sales and production, reflecting the fact that our business is growing and that we are investing in growth.

Our Ostomy Care business grew by 9% – its best performance in ten years – driven mainly by the SenSura® Mio portfolio, which includes the SenSura® Mio Convex, which is now available in 16 countries.

Revenue was DKK 5,935 million, equalling 40.4% of our consolidated revenue.

Coloplast has retained its position as the global market leader in ostomy care products, holding 35–40% of the market. Market growth is estimated to have been 4–5%.

The Continence Care business generated 5% organic growth. Growth was mainly driven by sales of SpeediCath® intermittent catheters, especially the compact catheters, and Peristeen. Continence Care revenue was DKK 5,182 million, equalling 35.3% of our consolidated revenue.

Coloplast remains the global market leader in this field, with a market share of about 40%. Market growth is estimated to have been 5–6%.

The Urology Care business grew by 9%. Growth was mainly driven by sales of penile implants and implants for women suffering stress urinary incontinence and pelvic organ prolapse. Revenue was DKK 1,497 million, equalling 10.2% of our consolidated revenue.

Coloplast currently holds a 10–15% share of the overall global market for urology products, which will grow an estimated 3–5%.

Wound and skin care product sales grew by 6%, driven mainly by sales of the Biatain® Silicone portfolio in the European market. Revenue was DKK 2,067 million, equalling 14.1% of our consolidated revenue.

Growth in the wound care market alone is estimated at 3–5%. Coloplast has an estimated market share of 7–9%.

And now for the trends in Coloplast's geographical markets.

In Europe, organic growth was 6%. Revenue was DKK 9,213 million, equalling 63% of our consolidated revenue.

In other developed markets, organic growth was 6%. Revenue was DKK 3,177 million, which amounted to 22% of our consolidated revenue.

In Emerging markets, organic growth was 14%. Revenue was DKK 2,291 million, which amounted to 15% of our consolidated revenue.

And now for our costs, which our company has well under control.

Distribution costs, which include our sales and marketing costs, amounted to DKK 4,131 million, or 28% of revenue, which was consistent with last year.

Administrative expenses amounted to DKK 561 million, a DKK 39 million reduction from DKK 600 million last year. Last year's administrative expenses included non-recurring costs of DKK 75 million relating to the industry-wide investigation of sales and marketing practices in the US by the US Department of Justice and an increase in losses on trade receivables in southern Europe. This year's administrative expenses accounted for 4% of revenue, which was in line with last year both before and after non-recurring costs.

R&D costs were DKK 509 million, a 15% increase over last year resulting from a general increase in business activity, in part due to new product launches, such as SpeediCath® Flex and Biatain® Silicone Sizes & Shapes. R&D costs amounted to 3% of revenue, which was consistent with last year's percentage.

At DKK 11,007 million, total assets increased by DKK 190 million relative to last year.

Equity increased by DKK 362 million to DKK 5,068 million.

The free cash flow for the year amounted to DKK 2,425 million against DKK 2,869 million last year. Cash flows for the year included approximately DKK 1,600 million paid in respect of lawsuits involving product liability claims resulting from the use of transvaginal surgical mesh products designed to treat pelvic organ prolapse and stress urinary incontinence.

We returned a part of the free cash flow to our shareholders by way of share buy-backs and dividends.

For example, in the second quarter of 2015/16, Coloplast launched a DKK 1 billion share buy-back programme running until the end of the 2016/17 financial year. The first part of the share buy-back programme of DKK 500 million was completed in August 2016.

The Board of Directors recommends that the shareholders approve a year-end dividend of DKK 9 per share at today's general meeting. This brings the dividend paid for the year to DKK 13.5 per share, as compared with DKK 12.5 per share last year. The total dividend payout for 2015/16 amounts to DKK 2,859 million and the pay-out ratio is 91%.

On the final business day of the 2014/15 financial year, Coloplast was quoted on NASDAQ Copenhagen at a price of DKK 472.7 per share. On the final day of the financial year under review, our shares closed 9% higher for the year at DKK 514 per share.

Including the dividends Coloplast paid out in December 2015 and after the release of the H1 Interim report, Coloplast shares have produced a return on investment of 11%. By comparison, an investment in the C20 index during the same period yielded a return of 0%.

Since the release of our full-year results on 2 November, the Coloplast share has fallen by 3.7 percent. At lunchtime today, the share price was DKK 450.

And now for our financial forecasts.

Coloplast maintains its long-term financial guidance of 7–9% sales growth per year and an EBIT margin improvement of 0.5–1.0 percentage point per year.

For 2016/17, we expect organic revenue growth of 7–8% at constant exchange rates and of 5–6% in Danish kroner. The revenue growth in DKK is expected to be 1-2%-points higher due to the Comfort Medical acquisition.

The EBIT margin is expected to be 33–34% at constant exchange rates and about 33% in Danish kroner.

Capital expenditure is expected to be in the neighbourhood of DKK 700 million.

The effective tax rate is expected to be about 23%.

This marks the end of my report today.

Let me conclude by once again extending a “Thank you” to our employees, managers and our executive team for a job well done and to my colleagues on the Board of Directors for their constructive collaboration.

We’ve now talked a lot about the value created for Coloplast and our shareholders over the years, so let me end by showing you our new corporate video to give you an idea of the value Coloplast creates for its users.

(Corp. Video)