

Chairman's report 2008/09

Annex 1

EGE/1.12.09

Michael Pram Rasmussen:

Ladies and Gentlemen,

When I gave my chairman's report to you about a year ago, everybody was talking about the financial crisis. In the meantime, the crisis in the financial sector has evolved into a global economic crisis with serious consequences for many companies and a large number of people both in and outside Denmark.

Coloplast is in good shape in spite of the economic crisis, because, regardless of the rising unemployment, business closures and negative economic growth, users still need catheters, ostomy bags and dressings.

However, although I am here today to tell you about continuing growth and solid financial results, it is also important to say that in most of the world Coloplast products are paid for with public funds. And public deficits have

recently tended to explode all around the globe, and they will continue to do so over the next few years.

This negative economic climate will pose a big challenge for Coloplast in the years ahead.

The public authorities will be under pressure to reduce their spending, and one of the means will be to procure the goods they need at the lowest possible price.

This is a situation where at Coloplast, we must become even more convincing when we explain to the decision-makers why it pays to buy quality products.

We have to explain the *socio-economic* benefits of choosing innovative products that make users better able to help themselves, so they draw less on hospital resources, healthcare professionals as well as on public transfer income, such as public sick benefits.

This is a challenge that we at Coloplast constantly strive to meet.

With these words in mind, I am pleased to present to you Coloplast's solid financial statements for the past financial year.

Coloplast released the full-year financial results for 2008/09 on 6 November, and later that day, the Annual Report was made available on our website. On 17 November, the print version of the Annual Report was sent to those of our registered shareholders who had requested it.

The 2008/09 financial year was truly a year of hard work. Lars Rasmussen was appointed new CEO on the first day of the financial year, that is, on 1 October 2008. During the year that has passed, we have addressed a number of major challenges facing the Group. Let me just mention some of the most important results of these efforts, which will make Coloplast better prepared to take on the future.

First of all, I am pleased to say that it now takes fewer employees to generate higher revenue. At the end of the financial year, we had 437 fewer employees (expressed as full-time equivalents) than we had at the beginning. During the same period, our revenue grew by more than DKK 300 million. This is an indication that our organisation has become leaner and more efficient.

I would also like to emphasise that Coloplast has more than doubled its free cash flows to DKK 1.4 billion from DKK 653

million the previous year. That gives our company a degree of financial latitude that many businesses lack in today's market.

At the start of the year, we expected Coloplast to generate 7–8% organic growth, but unfortunately we didn't quite manage that. The situation in Germany, which I will get back to, turned out to be more serious than we had expected, so we had to lower our growth forecast to around 6%. At the same time, we upgraded our profit guidance, so although we didn't quite make the growth target, we are delivering the profit we had projected.

In June 2009, Coloplast adopted an updated plan for our Global Operations unit. The plan represents the final stage of the relocation process we commenced in 2002 and it will turn our Danish factories into innovation and competency centres while almost all volume production is relocated to Hungary or China.

Previously, Coloplast was able to relocate production to low-wage economies as the employees found themselves a new job or retired. However, we can no longer avoid redundancies, because the natural employee turnover has

dropped dramatically due to the economic crisis. Also, Coloplast has stepped up the relocation pace.

As a result, we announced several so-called collective redundancies during the year, most recently on 20 October when we had to let go 143 employees from our Danish operations. Unfortunately, we expect to have to announce more redundancies in the current financial year if we are to meet our relocation plans. When the plans are fully implemented, we will have about half of the 900 production staff left that were employed in our Danish operations at 1 October 2009.

It is important to Coloplast to help the employees being made redundant. This could involve giving them retraining opportunities and helping them to a career outside Coloplast. Nevertheless, it is sad having to say Goodbye to skilled and loyal employees, but it is a necessary step to take in order to prepare Coloplast in the best possible way for the expected future price pressures that I mentioned earlier.

One of the other important focus areas for Coloplast in the past year was Germany. During the course of the year, we appointed a new management, and one of the effects is that

sales of ostomy products have stabilised over the last two quarters.

Another recurring theme is the Wound & Skin Care business, which unfortunately is not as profitable as we would like it to be. The problem is now being addressed using this approach: We need to get costs under control so the growth we generate in future will produce a satisfactory bottom line. This means that in future Coloplast will be addressing large markets with a smaller, more focused product portfolio.

I'm pleased to tell you that the results are beginning to materialise. In 2008/09, the Wound & Skin Care business contributed a substantially higher profit margin than it did in 2007/08. Over the next year, management will be focused on generating more growth in the business and to continue to enhance earnings.

With these words, I will now present our consolidated financial highlights.

We generated organic revenue growth of 6%. Changes in exchange rates reduced revenue growth by 2 percentage

points. Revenue measured in Danish kroner was up by 4% to DKK 8.8bn from almost DKK 8.5bn last year.

EBIT was up by 40% to almost DKK 1.4bn from DKK 1bn in 2007/08. Although this year we incurred special restructuring costs of DKK 80m, our non-recurring items were lower than last year's amount of DKK 160m.

The EBIT margin was 16%, against 12% last year. At constant exchange rates, the EBIT margin was 17%.

The profit for the year was DKK 883m against DKK 715m in 2007/08.

The return on invested capital for the year was 15% after tax, a powerful improvement on last year's 10% and 6% the year before.

All of our three business areas, Ostomy Care, Urology & Continence Care and Wound & Skin Care, continued to report growth. Our Urology & Continence Care business is outperforming the market, the Ostomy Care business is growing in line with the market and the Wound & Skin Care business is underperforming the market. Overall, Coloplast is growing in line with the market.

Let me delve a little deeper into the numbers.

As I said previously, our overall organic growth rate was 6%.

Once again, Coloplast was the largest player in the global market for ostomy care products. Organic growth in this area was 4%, 2 percentage points less than last year; the reason being the still challenging conditions in the German market. The growth rate was in line with the market rate, and Coloplast's market share is 35–40%.

Due to exchange rate developments, especially the weaker pound sterling, sales of ostomy care products in Danish kroner-terms rose by 1% to DKK 3.6bn.

Our Urology & Continence Care revenue increased to DKK 3.6bn. Organic growth was 9%. Measured in Danish kroner, growth was 7%.

For continence care products, we retained our position as a global market leader in the field and we hold about one-third of the global market.

Coloplast holds a 5–10% share of the combined global urology product market.

Sales of wound and skin care products rose by 3% to DKK 1.5bn. The moderate growth rate was due to the earnings-enhancing initiatives I mentioned before and which will initially have a negative impact on our revenue.

Organic growth for the period was also 3%, whereas the market growth was about twice as high. Coloplast holds a 5–10% share of the global wound and skin care market.

I will now touch briefly on developments in our geographic markets.

Europe is still our primary source of revenue and the base of our largest market shares. This year, our revenue expressed in Danish kroner grew by 1% to DKK 6.7bn. This unimpressive performance was due especially to the challenges in Germany and the weak pound sterling. The organic growth rate was 4%. Organic growth in Europe excluding Germany was a powerful 7%. In other words, growth outside Germany was satisfactory.

At last year's general meeting, I told you about a health care reform in the UK that had been underway since 2005 and

that it will cover, among other things, the terms for providing stoma and incontinence appliances and related services.

The final reform was announced on 1 April of this year, and it turned out to be better than expected, due not least to a diligent effort by our UK subsidiary. They have consistently made the British decision-makers aware of the negative consequences for users of the more extensive plans originally being considered.

Revenue in the Americas rose by 19% to 1.4bn. The US dollar appreciation relative to Danish kroner enhanced the growth rate by 7 percentage points, and organic growth was unchanged at 12%.

US users now receive subsidies for a lot more intermittent catheters than they did before, and that had a positive effect on our overall growth in the region.

Coloplast's new US head office opened in June 2009. Within a few years, the US subsidiary will be the largest in the Coloplast Group, and the new head office will provide a strong base for sustaining growth in this important market.

In the Rest of the World, revenue rose by 15% to DKK 694m on 8% organic growth. Japan and Australia represent our two largest markets in this region.

And now for our costs:

As I mentioned previously, we have made a diligent effort to reduce our costs due to the very competitive market situation as well as the price pressure, but also in order to enhance our EBIT margin.

I am very pleased to report that we have come quite a long way in only a year. Our distribution costs make up 30% of our revenue, compared with 31% last year, and we have reduced our administrative costs from 10% of revenue last year to only 7% this year.

Although cutting costs is no shortcut to greatness, there is no doubt that increasing the cost awareness at Coloplast has been a healthy exercise.

I am also very pleased to see that the relocations to Hungary and China have given us an improved production economy. Unfortunately, the production apparatus was not fully utilised

during the past financial year due to lower-than-expected sales. That is the reason why the improvements have not yet fed through to our financial statements.

Finally, I would like to emphasise that Coloplast developed and brought to market a larger number of new and improved products on time than ever before, while also keeping a tight rein on costs. That's a job well done.

Our total assets were largely unchanged from last year at DKK 8bn. The reason we've been able to keep total assets unchanged is not least that we have reduced our inventories by almost 20%.

We invested a gross amount of DKK 487m in property, plant and equipment in 2008/09. That was almost one-third less than last year and was due to lower-than-expected sales as well as to the more critical approach we have been taking to each individual capital expenditure decision. The investments made were mainly for production equipment for the factories in Hungary and China and for the new US headquarters.

Equity increased by DKK 559m to DKK 2.9bn. The positive effect from the profit for the year was partly offset by

dividends paid of DKK 257m and a foreign exchange loss of DKK 54m taken directly to equity. The equity ratio rose to 36% from 29% at 30 September 2008.

Net interest-bearing debt fell by about 33% to DKK 2.3bn, mainly due to the very positive change in the free cash flow that I mentioned earlier.

The Board of Directors recommends that the ordinary dividend per share be increased to DKK 7, which would represent an increase of DKK 1, or 17%, over last year. A dividend of DKK 7 per share equals a pay-out ratio of 34% which means that 34% of the profit of the year is paid to the shareholders.

On the first business day of the financial year, Coloplast shares were quoted on Nasdaq OMX Copenhagen at a price of DKK 387.5 per share. This morning, Coloplast shares were trading at DKK 462, equal to an increase of 19%. Coloplast shares outperformed the C20 index during the year.

On pages 19-57 of the Annual Report, you will find our consolidated income statement, balance sheet, statement of

changes in equity and cash flow statement. The parent company financial statements are set out on pages 61-69. The Management statement and the Independent auditors' report are on pages 16–17, the latter being what in auditors' terms is an unqualified report.

Next in my report, I will touch on our capital structure and share buy-backs.

Coloplast pursues the objective of ensuring stability and maintaining substantial financial latitude in order to support its future strategic progress, including growth through acquisitions.

An assessment of our corporate financial strength builds especially on the ratio of net debt to EBITDA, that is earnings before interest, tax, depreciation and amortisation. The ratio of our net debt to EBITDA is 1.2, or considerably lower than last year's figure of 2.2. It is also below our target band of net debt relative to EBITDA of 1.5–2.5.

Considering the continuing stable developments in the financial markets and our improved and enhanced cash generation, the Board of Directors has resolved to launch a

share buy-back plan of up to a total of DKK 1bn for the next two financial years. We do not expect this will bring the company's net debt to EBITDA ratio back to within the above-mentioned range and it should therefore be seen as a cautious return to regular share buy-backs.

For us to go ahead with the buy-back programme, it will require that you, the shareholders, authorise to the Board of Directors to cause the company to buy back shares for up to 10% of the share capital. Should other opportunities arise during the period, such as acquisitions or the like, which the Board of Directors considers to be more attractive to the shareholders, the authorisation may not be utilised.

Coloplast aims to manufacture and sell safe products in a sustainable manner that both caters to our customers' needs and considers environmental concerns. In that spirit, Coloplast assumes a responsibility that goes substantially beyond regulatory requirements, including through our membership of the UN Global Compact.

Since 2002, we have worked to phase out the so-called phthalates, which are used as plastic softeners, from Coloplast production. We've done that because phthalates

are suspected to have a hormone disrupting effect and perhaps even to cause cancer. Although there is no ban on using phthalates in medical equipment, Coloplast has developed safer, phthalate-free products for 60% of our product portfolio. By the end of the next calendar year, we will have phthalate-free alternatives for virtually all of our products.

And now for our corporate governance.

Due to the new rules applying to listed companies, your Board of Directors has resolved to set up an audit committee whose members will be appointed following this general meeting. Assuming that they are reelected, the committee will consist of three board members: Niels Peter Louis-Hansen, Jørgen Tang-Jensen and myself as chairman of the committee.

All audit committee members will receive remuneration corresponding to half of the ordinary board remuneration, that is DKK 162,500.

Now, let me turn to the management's incentive programme.

Pursuant to section 69b of the Danish Public Companies Act, the shareholders in general meeting are required to adopt general guidelines for incentive pay to members of a company's board of directors and its executive management before a specific agreement to this effect is made.

The new Danish tax reform taking effect in 2010 will change the rules of deductibility available to Coloplast in respect of the Executive Board's share option programme as well as how the executive members are taxed on their options. Accordingly, the Board proposes to revise the overall guidelines, so as to eliminate the effects of the tax reform for all parties as much as possible. We propose to do that by awarding the members of the Executive Board a number of additional options corresponding to an extra month's pay.

The reason is that going forward the executive board members will have any capital gains taxed as personal income instead of as previously as the lower rate share income. Previously, the company did not have the right to deduct the expense, but it can from now on deduct the full amount of any capital gain the executive board members may get. As a result, the changes that we propose are aimed to have a neutral cost impact for Coloplast.

Your Board of Directors also proposes to amend the guidelines to the effect that members of the Executive Board will be able to exchange part of their bonus corresponding to one month's pay for an additional number of options for the upcoming year, also corresponding to one month's pay. This option is open to members of the Executive Board in connection with the annual review of the Executive Board's remuneration in December of each year.

Accordingly, the executive board members will be given an opportunity to make a more long-term investment in Coloplast.

You received the amended guidelines as an appendix to the notice convening this general meeting and they are also available on the Coloplast website.

You will find a full report on corporate governance at Coloplast on our website. The website also contains a more detailed review of our corporate social responsibility efforts. Finally, the Management's Report also includes a summary review on pages 9–10 of the Annual Report.

Let me now turn to our financial forecasts.

The Board of Directors has decided to retain the company's long-term financial goals. These are:

- to generate annual organic revenue growth above the general market growth; and
- to have an EBIT margin of at least 20%.

Since the beginning of 2009, Coloplast has pursued a strategy with a “profitable growth” theme. This means that, at Coloplast, we see earnings as a prerequisite for growth.

Specifically, this means for the Ostomy and Continence Care businesses that Coloplast will be focused on the core European markets while making selective investments in countries outside of Europe.

When it comes to Urology and Wound & Skin Care, the strategy is to strongly enhance earnings through efficiency improvements and cost savings in order to invest in growth.

The Group plans to continue to reduce costs, among other things by continuing to relocate production to low-wage

economies and by being strongly focused on maintaining cost-conscious behaviour.

And now for our financial forecasts for the 2009/10 financial year.

For the 2009/10 financial year, Coloplast expects organic revenue growth of 6–7%. At the exchange rates prevailing at the end of October, this corresponds to 4–5% growth when measured in Danish kroner. The growth rate reflects the expected price pressure that I spoke of earlier, including the fact that prices, as you know, have fallen in the UK and that prices of wound care products are expected to fall in France.

We expect an EBIT margin of 17-18% at constant exchange rates, corresponding to 16-17% when measured in Danish kroner. The improvement is driven by the initiatives we took in 2008/09 and the additional relocation of production. The price reductions I just mentioned will have the opposite effect.

Gross investments in property, plant and equipment are expected to amount to DKK 500–600m.

The effective tax rate is expected to be about 27%.

As you can see from my report, we've had a very busy year at Coloplast. The many important initiatives taken have already yielded good results. Our company now stands leaner, healthier and more efficient than it did last year, and we are also reporting an improved profit of DKK 883m.

I am very pleased with the course we have charted for Coloplast. I am confident that it will serve the best interests of our shareholders, our customer and our employees.

In a recent employee satisfaction survey, Coloplast was given an improved rating despite the many changes and unpleasant redundancies. This is very positive and it shows that Coloplast is on the right track.

I would like to thank all of our executives, managers and employees for their contributions during this past year. And let me also thank my colleagues on the Board of Directors for their good and constructive collaboration.

Thank you.