

Coloplast
Thurs, 19th August 2010
14:00 Hrs UK time
Chaired by Lars Rasmussen

Lars Rasmussen

Good afternoon and welcome to this 9-month 2009/10 conference call. I'm Lars Rasmussen, CEO of Coloplast and I'm joined by Chief Financial Officer, Lene Skole and Director of Investor Relations, Ian Christensen. As usual, we have scheduled about an hour for the call and I'd like you to turn page number 3.

I am very satisfied with the performance for the first 9 months of this year. Our growth is very satisfying and the EBIT margin performance continues to improve, slightly faster than we expected. We realised 7% growth both organically and in Danish Krone driven by the performance, especially within Ostomy Care. Again, this Quarter we can report an EBIT margin of 20% and we are now certain that our current long-term guidance will be met this fiscal year. The free cash flow remains strong from good earnings performance and continued low cash.

We have made the following adjustments to our guidance for 2009/10. Organic growth rate of 6-7% remains unchanged, but with the present currency exchange rates it now corresponds to 7-8% in Danish Krone. We upgrade our EBIT margin expectations slightly from 19-20%, in fixed currencies and in Danish Krone. CAPEX expectations remain around DKK 350 million and, finally, the effective tax rate for 2009/10 is lower from 27-26%.

Please continue to slide number 4. In Danish Krone revenues were up by 7% to DKK 7 billion and the organic growth was 7% in line with guidance. Within Ostomy Care, we saw a very satisfying organic sales growth of 7%. The biggest growth driver in this business segment continues to be the SenSura product line. This Quarter we saw the introduction of Coroplast Care in the US. It is an end-user programme designed to keep a larger part of the hospital new patient discharge in the US market and, over time, this programme will support growth rates in the US.

In urology and constinence care, organic growth was 9%. Growth was driven by intermittent catheters, especially SpeediCath in Europe and SelfCath in the US. In the Quarter we have experienced slower growth in several South European markets, especially Spain. In Spain we have seen distributors lowering stock to put pressure on the ongoing negotiations regarding the split on the 7.5% decrease in reimbursement prices. The US and European urology business saw a good performance this Quarter, especially the men's health and disposable surgical urology had satisfying developments whereas, women's health was impacted by surgeons switching to mini-sling technologies. Therefore, we're also happy that our own mini-sling, Altis, is now ready for commercial launch in Canada.

Within our wound and skincare business, organic growth was flat. I'm satisfied with the progress on our new go-to-market model and we still expect to launch community set-ups

in UK, France and Germany soon. Until then, we continue to expect limited growth in this business area.

If you look at the regions, the European sales ended at 5% organic growth. We were satisfied with the sales in both ostomy and continence care, whereas the Wound Care business was impacted negatively. The growth rate in the Quarter was impacted, especially, by lower growth rates in the Spanish and Greek markets.

Organic revenue in the Americas went up by 13% and we saw satisfactory growth in continence care, whereas the quarterly sales in ostomy and, wound and skincare were lower than expected. For these two areas growth was impacted by shifts in larger distributors for us. Revenue in the rest of the world improved by 10% organically, the trend has increased again especially driven by good growth momentum in China and Japan.

That was it from my part and I will now hand you over to Lene for more details on the financials, please turn to slide number 5.

Lene Skole

Thank you, Lars, and we are now on slide number 5. Gross process amounted to DKK 4.3 billion equal to a gross margin of 61%. This is an improvement of 3 percentage points compared to the same period last year. Improvements in the gross margin results from increased efficiency in the production economy where wage costs are continuously reduced, as a consequence of the ongoing transfer of production to Hungary and China. We expect to finalise the transfer of production from US by the end of October this year and from Denmark by the end of March 2011.

The gross margin in Q3 was negatively impacted by DKK 27 million cost related to the closure of the factory in Vadnais Heights in the US. The costs includes a write-down of machines as the production set-up in China will be based on significantly less automation than is the case in Vadnais Heights. The machines are currently kept as backup should we experience any start-up problems in China. Once we are up and running in China, we will evaluate whether to scrap the machines or whether to transfer them to Hungary as backup. A further write-down could amount to up to DKK 25 million and could come as early as Q4 2009/10.

The SG&A to sales ratio improved by 4 percentage points compared with the first 9 months last year and ended up at 35%. The improved SG&A to sales ratio is a result of our sales force optimisation programmes as well as continued focus on savings and efficiencies. The R&D to sales came in at 4% which is within the range of 4-5% previously estimated. This results in a reported EBIT margin of 20%. Adjusted for special items, the EBIT margin was 21%.

We report special items of DKK 62 million for the first 9 months for 2009/10. These are all severance payments in connection with the transfer of production to Hungary and China. We now expect DKK 18 million for the year as 40 more positions will be closed than previously expected. At the same time, we expect costs to increase slightly as average seniority of the laid-off people is higher than the average assumption used in

previously calculations. We still expect redundancy costs of around DKK 20 million next financial year, but we will contain these in the gross margin.

The operating results, of course, up to the first 9 months of 2009/10 points towards further cost improvements. We have been able to increase our EBIT margin at the same time as we have invested in further transfers of production; I'm referring to the transfer from the US to China as well as in other efficiencies and restructuring. Here I'm referring to the transfer of European bookkeeping functions to Poland and sales force optimisations in many subsidiaries. These are all investments that will improve our future cost base.

Net interest bearing debt to EBITA ended at 0.9 slightly lower than last quarter and we have decided to suspend our net debt to EBITA target range. We have done so, as we wish to reduce our debt in order to be financially well prepared for any acquisition. It is important, however, that I stress that we will be prepared to be increase our net debt to EBITDA substantial for the right acquisition.

CAPEX amounted to DKK 223 million, corresponding to a CAPEX to sales ratio of only 3% and it is expected to end the year around DKK 350 million. Return on investment capital after tax was 22%, which is up from 14% in the same period last year and in line with last quarter. Finally, the free cash flow was DKK 957 million compared with DKK 748 million last year. The improvement comes from stronger earnings and lower CAPEX, whereas changes in net working capital impacted negatively.

As Lars mentioned, we have made minor adjustments to our guidance which I would like to comment on, so please turn to slide 6. For 2009/10 we continue to expect growth of 6-7% organically, but growth in Danish Krone is, now also, expected at 7-8% from previously 6-7%. The change in guidance is solely related to the strengthening of various currencies, especially in the US Dollar and the British Pound which have appreciated during Q3.

The organic growth guidance continues to be based on the current market trend including known healthcare reforms, which will impact in countries such as UK and Spain. For 2009/10 we have made a slight upward adjustment of the EBIT margin from around 20% in fixed currencies as well as in Danish Krone from previously 19% to 20% so two around 20% from 19-20. The EBIT guidance adjustment is based on the assumption that current performance will be kept for the full-year and further efficiency improvements will be able to offset any further write-downs and additional investment in sales force optimisations.

We continue to expect our CAPEX for 2009/10 to be around DKK 350 million. Finally, our effective tax rate is expected to be reduced to 26% from around 27% and this stems from increased earnings tax in Denmark where the corporate tax rate is 25%. Summing up the first three quarters of 2009/10 we see a very satisfying growth rate, gaining market share in most markets; we see positive, continued momentum in our margins and we keep cash generation at a high level. It's all developments that underlines the potential of Coloplast.

This concludes our presentation of the Quarterly Results, so thank you very much for listening and Operator we are now ready to take questions.

Questions and Answers

Vik Chopra – Piper Jeffrey

Hi, thanks for taking my questions this is Vik Chopra from Piper Jeffrey. I have a couple of quick questions for you, so you can you provide us with an update on the Wound Care business please? Which specific regions are you seeing pricing pressure in and when do you expect it to return to growth? Secondly, the 7.5% price cut in Spain in June, how is that impacting you and do you expect other countries to institute similar price cuts. Finally, on the German market can you provide us with an update please; we've seen a couple of quarters of negative trend now? Thanks very much.

Lars Rasmussen

On the Wound Care side we have seen some negative price pressure in the southern part of Europe, it's not something which has been worse or better in the quarter that we have just reported. It is, I guess, what it is and with the build-up that we're doing right now on the covering channel in the market which we've not been covering before, the community channel. We are, right now, training the sales forces in the three big countries in Europe and we expect for them to be on the street within the next couple of months. You need a certain number of faces on until you start to see a sales pick-up, but we expect to see a sales pick-up in the second half of this year or during the next year.

When it comes to the 7.5% in Spain, it's hard to say much about it because it was introduced by the Spanish Government. It, of course, immediately lend at the table(?) with the distributors which means that they have come to the industry and said, "Look it's not just our problem, we need to find a split of this 7.5%." This is still ongoing and, therefore, I can't be more precise on it at this point in time. When it comes to Germany it's, I think, with what you see in Germany is a sale of the surplus that you have seen for a couple of years in Germany. If you have been following us for quite some time, you know that the most important figure for us is new patient discharge and we have a very strong uptake in new patient discharge also in Germany and maybe even especially in Germany. Therefore, we do expect this to come back to us positively at some point in time. Things have improved tremendously in Germany since over the last 2 years and, I think, we are definitely moving in the right direction.

Great, thank you.

Stephan Gasteyger – Jeffries

Hello, it's Stephan Gasteyger from Jeffries, thank you very much for taking my questions I have two of them please. The first one is really about the countries where you see pricing pressure and I wonder if that is really pure price or if you see also some trading down by some customers and distributors. If there is a negative mix impact, maybe some of the lower end products from you or from competitors? My second question is about the M&A landscape overall, especially in Wound how you see this landscape currently and where you see price expectations, whether they have gone up in the last few quarters or whether they're stable? Thank you very much.

Lars Rasmussen

I think I'll take the first part of the question and Lene will take the second part. When we're looking at the value creation or the value versus the volume in the different markets, we don't see any significant shifts. The only place where we see that we're not really selling any of the products that we used to do is within Wound Care in Greece and part of it is, of course, because there's some lowering of stock, because there have been no changes in pricing in our field in Greece. Then we think that due to the constraints on hospital budgets, the hospitals probably are buying products that are less expensive, but apart from that we don't see that there is a shift in the technologies that are used. I think that we have done whatever we can do to tell you about the different healthcare reforms and the impact of those. In that sense we see quite a safe picture there and that's basically no news. Nothing which have really () since the last time we thought(?) about this.

Lene Skole

If I should comment on the M&A landscape, with the actual M&A landscape we haven't seen any major changes recently. The reason that we talk more about it now is that we as an organisation and, in particular, also financially feel that we are much more prepared now and have a greater desire than we have had over the last year and the year before to actually do something if the right thing comes along on the M&A side. Where we look at things is not as much in Ostomy and Continence care simply because of the size that we have, that it could be or would definitely be very, very difficult to find something there where we would be allowed to do so for competition reasons, whereas Urology and Wound Care are areas where we could actually do something.

Thank you very much.

Martin Parkhoi – Danske Bank

Yes, hello Martin Parkhoi, Danske Bank. Firstly with respect to the growth that you're talking about in Spain where some distributors have taken down their inventory, can you quantify the impact on the growth or maybe even better in absolute numbers how much loss sales you've had in Spain in the Third Quarter. Then, secondly, I can understand that actually the Spanish buyer has picked up again during the Summer as inventories probably have been all the way down. Can you say anything about what kind of growth ratio we then seek(?) to expect(?) and then an abnormal growth rate in the Fourth Quarter. Then with respect to one-offs, can we go a little bit through them. You have 52 million on the production cost included in your guidance now and you have 80 million in special items. Should we expect only these 20 million specialises which will be on the production cost next year, which means that we will get approximately at least one percentage point help from less one-off cost on the margin in 2010/11?

Lars Rasmussen

Let me try to answer the first part of the question, which is really a difficult one Martin because you are absolutely right with what you have picked up. The growth rates are fluctuating a lot and we have, actually, two parts that are moving in the equation. One is that there is this 7.5% reduction of prices which we have not finished negotiating on and therefore we see these very big swings, you see that distributors are not buying anything to make sure that we are sitting at the negotiating table and suddenly they have to fill at least

part of their stock. There is another dynamic and that is that there is a change in the VAT in Spain, it has increased. That also means from 7-8% that also means that at the end of this quarter, our quarter here, that if the balances for example are sitting, the products that they did not sell out and they are marked with a 7% VAT, they are allowed to sell it back to us and then we have to resupply them with new products and the timing of this is we don't exactly know what it is and you will also expect to see that they try to offload some old stuff to us if they can. In that sense it's very hard for me to guide you on it. I think the best guidance I can give you is that we don't see, at least not now, any moves in order to try to put people on cheaper products. They already have quite low prices in Spain. The underlying demand is there, so if you have to use a certain number of bags per week and that part is still running, so therefore you have some short-term (). It's really difficult for me to give you very good guidance on how you should put that into your spreadsheet.

Lene Skole

Martin, if I could comment on the (). The special items restructuring costs, you are right; we have so far this year had 62 and that we guide up to 84 this year. That's the special items. Then we have in the gross margin within the gross margin we have also taken 27 million, which was a write-down of machines in Vadnais Heights. With regard to next year, these costs won't come again next year, but as I mentioned then next year we will still have restructuring costs of DKK20 million, but we will not report them as special items. We will contain them within the gross margin. Then finally, there is, as I mentioned, the risk that we may want to take an additional write-down of machines of up to 25 million, which could come as early as Q4, but which is as yet undecided.

But let me be absolutely sure; this 25 million you have included in your guidance?

Yes, we have included that in the guidance, so that's included that we can contain that in the guidance.

Klaus Madsen – Handelsbanken

My first question is a fundamental question on growth and growth perspectives. You've now initiated a number of programmes like targeting and segmentation retention programme in the US, () sales force rollout and also a number of new product launches, which I guess are all part of your preparations for growth. Are there any other major initiatives being initiated by you to stimulate growth and more importantly, when should we see some of the concerted efforts of those programmes start to accelerate growth for you?

I think the last part of what we have been entertaining you with over the last couple of years works (?). If you look at the way that we are growing in Ostomy and I will make no secret out of that being our first priority for the revamp that we have made at Coloplast. I am really pleased to see how things are working. We have around 7% growth now in Ostomy and we came from a very different level last year. We are growing almost twice as fast as the market is growing in Ostomy, despite the fact we're market leaders, I think that just goes to prove that the programmes that we have put in place, they work, but it takes some time for them to work.

I can also say that you know that we are measuring very much on new patient discounts and we do see that things are going in the right direction for us. Our segmentation targeting, our efforts to get a better foothold in the largest accounts is working well for us, so for Ostomy I am quite pleased with what we see there. We have seen a more, I would say, volatile picture in () business, but still we are definitely way above the market growth in this market. I think it's a very different story when we talk about (), because that is an area where we have been so harsh in our approach and really done, I would say, the right things in order to improve on the profitability, but you're definitely right, the jury is out when it comes to can we also get growth out of that? In a sense I feel that we are quite open with it because ()() happen next year and of course in the second half of next year (), but I'm confident, as I always send in the conference call presentation I'm pleased with the efforts that we're doing. I think it is the right things that we're doing and I like what I see when it comes to the things that we're doing to improve on the business front, but I do know as well as you that the only thing that really counts is results, so they should come and that's also what we're looking for. To top that off, we've just introduced a Coloplast care in the US, because the US is one of the areas where we really like to see a bit of growth momentum in all of our business areas of course and especially in the Ostomy care and it's off to a good start, but you also know like the other things that we have been working on it's not results tomorrow, but you have to put money in the bank in order to get an interest rate on.

I guess you're pointing towards a growth phase for Coloplast from next fiscal year onwards and will we see the main contribution to the growth acceleration from Wound Care or should we also assume that you can accelerate growth in the two bigger businesses?

I would really love to guide when we are guiding for next year also on the growth numbers, but I guess that you have...with what I'm saying you of course understand that we are not satisfied with the flat growth in Wound Care, so we'd like to see that going up and of course we do our very best to see if we can up the growth also in the other businesses, but how much we are willing to promise, we'll have to wait until we're guiding for the next year.

An add-on on the acquisition side, would you in any way consider now with new people on certain key functions, would you consider a broader scope of your business at all? It could be buying adjacent areas with neurology or maybe a completely new or somewhat related business area?

In a sense you can say we are in five business areas, because we are in Ostomy, () and Wound Care, then we have skin care, which is a newish business and we also have urology care. We are not thinking of adding a sixth business area, but with the business areas we have, we consider them as being ()().

David Adlington- JP Morgan

Firstly, on the tax rates, I wondered if that's going to be sustainable beyond this year. Secondly, the 450 positions; are those people already gone or are there still some cost savings to come through on that?

With regards to the tax rates, the reduction in tax rates simply comes from the fact that we need a mark-up in the countries and that mark-up is unchanged and then when our profitability goes up, then we have more tax, more of the profitability that's in being taxed in Denmark where the tax rate is 25, so that's actually what brings it down. With the current profit levels, then yes, I believe that that reduction is sustainable.

Regarding the number of people that we are laying off, we have laid off at this point in time 272, so that means that we still have a little further to go and we expect that to be finished by April of 2011.

Ed Ridley-Day – Bank of America Merrill Lynch

Just one area that we haven't discussed today is the rest of the world and Asia and it's not something we often discuss on your calls, but you clearly had a very good performance there in the recent period. I wonder if you could talk a little bit about the strong organic growth there in more detail. Clearly you're getting good orders in China, if you could talk a little bit about what's driving that, I think that would be helpful?

When we talked about this last time we also said that we now are in a period where we have quite easy figures to compare ourselves up against last year in Japan, so Japan is part of why we're seeing a nice growth rate in that region and that is to do with the fact that we had a very high sales in the first half of last year and weak sales in the second half of last year. When we are looking in China, we still see China growing fast and we are still investing and keep investing heavily in China. It's Ostomy and Wound Care those are the business areas that are driving the growth for us in China and that's more or less the same picture that we see in India, but from a lower base. You can take all of these countries also () Brazil for example, we still see in those markets that we have nice growth. We are market leaders, but the markets are expanding fast and therefore we need to do the same.

That's very interesting. Also in China, we've seen in other areas that actually pricing is quite strong in China relative to particularly some European countries. Could you give us an idea about how pricing is relative to your average European country and China?

I think it's very difficult, because there is no re-investment in China; therefore the pricing is what the customers are willing to pay. We have a very different assortment that we're offering in China than we have in the rest of the world. We have most of () products and we sell them at the same prices as we sell them on an average European market, but we also have products that we more or less sell at the same price as the cost price for () product, therefore it's a more consumer type of market still than a real reinvest market and people find the product that they feel that they can afford and where they find the value for money that they consider and that's what they pay, so I can't really give you an average selling price like many of the other markets.

Still, that's very helpful. Thanks.

Yi-Dan Wang – Deutsche Bank

I have a few questions. The first one is on Colotech(?) We've seen that business being owned by a different group of people for quite some time now; have you seen any changes in the way they're approaching the Ostomy market that you could provide a bit more

colour on and how that would impact you? Secondly, on gross margin, I was wondering if Lene could give us some sense of how much FX impacted gross margins and what your expectation is for the rest of the year from an FX side. Finally, on gross margin, relocations aside, what other initiatives are you implementing to improve gross margin there and what sort of benefits should we expect there?

Colotech is an important competitor for Coloplast and unfortunately it's also a closed book in many ways, because it's owned by private equity, so in that sense the only thing we know about Colotech is what we see in the market and what we hear in the market. The latest example of what is going on there would have to be the WOCN Conference, which was taking place in the US recently, and there we saw Colotech investing more than they used to do in order to show presence, but we did not see anything on, for example, the product side, we did not see anything on the marketing initiative side, which is different than what it has been for the past 20 years. We are investing to follow the new patient discharge curves and upticks. We don't see any change from what has been the trend for many years, so in that sense we don't see much in that part of the business. That's probably the most transparent part of the business. Then they of course also have medical () and they are playing in different fields of the () than what we are. They are very much hospital-driven, which is a market where we are not really competing, so we don't have much transparency there either. Finally, they have a Wound Care business where we can buy different () but I'm not really having the same insight as I have in Ostomy on that side, because the markets are more diverse and we are concentrating our efforts in a few big countries for the time being. In that sense, you asked the question before, and we haven't seen any major changes, I would say. It might be that maybe you should move on with the gross margin.

Yes, I can do that with regards to currencies. Year-to-date there is only a minor effect, hardly anything. In Q3 there was an improvement coming from currencies of close to but less than 0.5%, so currencies haven't really impacted significantly on gross margin. You also talked about initiatives that we're taken and I can't comment specifically on what we might be able to see on the gross margin going forward. I can only assure you that we keep trying to optimise our stocks and () as we possibly can.

I think we could maybe add to give it a little bit more colour that the other side of the equation we can talk about gross margin is the pricing and the rebate structures that we are having. I guess as any other company we of course are very aware to make sure that we are aligned and that we have the right structure ().

The impact of FX on gross margins in the rest of the year, do you expect much more benefit than what you're seeing in the third quarter?

It depends on the currencies, how they move, so I don't know.

If you are seeing currencies stay where they are now?

If they stay where they are, then we don't really expect any major impact.

Additional benefit. Thank you.

Closing Comments

Thank you very much for participating and thank you for your questions. We are looking forward to meeting you over the next few days, thanks.