

Chairman's report 2009/10

1.12.2010

Michael Pram Rasmussen:

I'm delighted to be giving my report on Coloplast for the past financial year.

Our EBIT margin is now over 20%, and Coloplast is outgrowing the market. In other words, our company is delivering on the promises we made to the shareholders back in 2008, and we're even ahead of schedule.

It took hard work and difficult decisions had to be made in order to achieve the results that I will be telling you about today, but the results speak for themselves: The decisions we've made have been the right ones and they were necessary. Today, we have a leaner, healthier and stronger Coloplast.

- That's good for the users, because Coloplast is developing new and improved products that put them back in control of their own lives.
- That's good for our employees, because working at Coloplast has become more meaningful, exciting and challenging.
- That's good for society, because Coloplast pays more taxes and we develop new products that turn passive patients into active citizens.
- And that's good for our shareholders, because Coloplast has gained in value, giving them a good return on their investment.

On the other hand, Coloplast continues to operate in a challenging economic climate. National budget deficits have virtually exploded in many of our core markets due to growing unemployment and a lack of budgetary discipline. As a consequence, spending cuts will be on the political agenda throughout the western world for many years to come.

Today, Coloplast stands much better prepared to tackle this situation than we were two years ago, backed by much more efficient production, a stronger sales organisation and a more focused R&D approach.

All of this makes me confident that Coloplast will continue to produce equally powerful financial results in the future as the ones I'm going to tell you about now.

Coloplast released the full-year financial results for 2009/10 in the morning of 3 November, and shortly thereafter the Annual Report was made available for download on our website along with our updated Corporate Responsibility Report, which I will tell you more about later.

In many ways, the 2009/10 financial year marked a continuation from the previous financial year. A number of the activities launched in 2008/09 are now beginning to show results, and they will continue to do so in the current financial year. At the same time, results will also begin to show from the new activities that were launched in the financial year under review.

These activities create a more efficient Coloplast by, as you can see on the screen,

- reducing production costs
- making the sale force more efficient, and
- optimising our support functions.

As for the first item, most of the planned relocation of production from Denmark and the United States to Hungary and China is now completed. When we're done in March 2011, we'll have 85% of our production located in Hungary and China, 10% in Denmark and the rest in the USA and France. To a great extent, relocation has been a contributing factor to this year's good results, in

combination with a number of other initiatives relating to production: We've consolidated production at fewer factory sites, improved our logistics and distribution, and we've reduced production complexity.

The Coloplast sales force has become more efficient, because our salespeople now call on fewer, but larger clients at the right frequency. Detailed action plans are drawn up for each of these visits. In addition, through new reporting standards, we've created global transparency in our sales activities. As a result, the sales management in one country can find inspiration in the results achieved in other countries. In those countries where these standards have been implemented, our individual salespeople have driven up their sales.

We've changed the thinking behind our support functions, both those at head office and in our subsidiaries. We've been through everything with a fine tooth comb in order to adjust service levels, simplify structures, eliminate unnecessary activities and avoid double efforts. The establishment of a shared finance centre in Poland is a good case in point. The 70 employees working at the centre, which opened on 1 April 2010, handle financial and accounting processes for our nine European subsidiaries. During 2011, the centre will gradually take over these activities for all our European companies.

In order to lift the customer and sales commitment of our subsidiaries even further and to create better opportunities for coordinating activities across national borders, we've revised and standardised our country structures. We call it the "Cronic Care Model". Previously, we often had more general staff than sales and marketing staff referring to each country manager. Today, all general staff report to a single support function manager, and country managers now also have sales and marketing responsibilities. In other words, we have eliminated a management layer, while at the same time making markets a much greater priority for each individual subsidiary.

We had an average of 150 fewer full-time employees in the 2009/10 financial year than we had last year, but nevertheless the revenue they produced was DKK 717 million higher. That reflects a huge efficiency improvement.

In terms of return on the average invested capital (ROIC – Return on Invested Capital), we produced a similar performance: In the previous financial year, Coloplast earned DKK 15 for each DKK 100 invested in the company. In the recent financial year, we earned DKK 23 per DKK 100 invested – and that's after tax! The improvement is very much the result of the much more efficient use of Coloplast's existing investments, primarily at our factories.

Last year, I told you that our Wound & Skin Care business was not as profitable as we would have liked it to be. We've now addressed that problem:

- The business area has been separated from the other business areas, and we've appointed a global manager for the business.
- We've thinned out the product portfolio and reduced the number of markets we serve.
- We've launched a promising new product, Biatain Silicone.

Finally, the management is in the process of appointing and training a sales force that will operate the home care segment of the main markets.

Quite as expected, however, the adjustments made and the rather more introverted focus impacted on our sales growth during the past year. As a result, we failed to generate growth in this business area, but we expect to do so already beginning next year.

There's no denying that these many activities and changes have had human consequences that have not all been of the positive kind. During the year, we had to part with 320 employees in our Danish production and 120 in the USA, while creating new jobs in Hungary and China. The changes made in the subsidiaries and the establishment of the service centre in Szczecin also cost jobs in some countries and created new positions in Poland. Coloplast offered some good terms to the people made redundant, including counselling, continuing education and skills training, so that they can move on in their working lives.

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

We generated organic revenue growth of 7%. Changes in exchange rates improved the revenue growth by 1 percentage point. Revenue measured in Danish kroner was up by 8% to DKK 9.5 billion from DKK 8.8 billion last year.

The gross margin rose from 58% last year to 61% in 2009/10. As I told you earlier, relocation is almost complete and we are very pleased to note that we can now see the effects of our much more efficient production.

EBIT was up by 43% to almost DKK 2 billion from around DKK 1.4 billion in 2008/09. We incurred special items of DKK 83 million this year, almost at the level of last year.

The EBIT margin was 21%, against 16% last year. At constant exchange rates, the EBIT margin was 20%.

The profit for the year grew by 41% to more than DKK 1.2 billion from DKK 883 million last year.

As I mentioned earlier, the return on average invested capital for the year was 23% after tax, up from 15% last year. Our ROIC has improved consistently since the 2006/07 financial year, when it was at 6%, and that is a very satisfactory performance.

We are very pleased to note that Coloplast is again outgrowing the market in our core business areas of Ostomy Care and Urology and Continence Care. As I've already mentioned, our Wound & Skin Care business underperformed the market. Overall, Coloplast is outgrowing the market, which is currently estimated to be expanding at 5%.

Let me delve a little deeper into the numbers.

As I said previously, our overall organic growth rate was 7%.

Coloplast has expanded its market-leading position in the global market for ostomy care products. Organic growth in this area was 7%, 3 percentage points higher than last year, and 2–3% above the market growth rate. Measured in Danish kroner, the growth rate was 9% and revenue amounted to DKK 3.9 billion.

Coloplast now holds more than 35% of the market.

Our Urology & Continence Care revenue rose to DKK 4.1 billion on 9% organic growth. Measured in Danish kroner, growth was 10%.

For continence care products, such as catheters and urine bags, we also expanded our position as a global market leader and we continue to hold about one-third of the global market.

Coloplast holds about a 10% share of the overall global market for urology products for the treatment of disorders such as stress incontinence.

Measured in DKK, sales of Coloplast wound and skin care products rose by 2% to just over DKK 1.5 billion, but measured in local currencies, revenue was unchanged from last year. I've already touched on the reason for this.

The global wound care segment that Coloplast is a part of generated growth rates of 5–7% and our share of this market continues to be in the 5–10% range.

And now for developments in Coloplast's geographical markets.

Europe continues to be our main market. This is where we generate the most of our revenue and it is the base of our largest market shares. This year, our revenue grew by 5% to DKK 7.1 billion. That is one percentage point higher than last year's growth rate, which we would say is satisfactory, considering the difficult economic climate and our already large market share in Europe.

There has been a lot of talk about public spending cuts as well as subsidy and healthcare reform in the European markets. In June 2010, the Spanish authorities announced a 7.5% reduction in reimbursement rates for medical equipment at short notice.

Overall, however, subsidy and healthcare reforms have only had a limited negative impact on Coloplast this past financial year. We are very much aware that conditions may change, considering the very high public sector budget deficits, so we are regularly in touch with the authorities of the relevant European countries in order to draw attention to the consequences of potential changes.

Revenue in the Americas improved by 15% to DKK 1.6 billion. The appreciation of the Canadian dollar and the Brazilian Real against Danish kroner enhanced revenue growth by 3 percentage points, and organic growth was unchanged at 12%.

Overall growth in the region was lifted by market developments in Argentina and Brazil.

The much discussed US healthcare reform was passed in March 2010. The reform is intended to help bring healthcare services to the American people, but it will not be fully implemented until 2019. The reform will be funded through, among other things, a 2.3% tax on medical devices from 2013. We believe that the reform is a matter of swings and roundabouts for Coloplast. We will gain largely as much as we will lose, so that overall the reform will have a neutral effect.

In the Rest of the World, revenue rose by 21% to DKK 842 million on 12% organic growth, a 4 percentage point improvement on last year. Growth was mainly driven by the growing sales in China.

And now for our costs:

We have good control of our costs. Since 2008, we've worked diligently to make our organisation more efficient and to enhance our cost awareness. That is the main reason why our EBIT margin improved again this year.

Distribution costs were at 30% of revenue, unchanged from last year, while administrative expenses continued to fall, this year to 6% of revenue from 7% last year.

I've already mentioned the improved production economy we've achieved from relocating to Hungary and China and from the improved utilisation of our factories. The effects of these activities are now clearly discernible through improvements in our financial statements.

Our R&D costs are at the same level as last year, that is, at 4% of revenue. We have several exciting new products in the pipeline, but let me just mention one, the Speedicath Compact Male. This is a discreet catheter for men and something our users have been demanding for quite some time. We expect a lot from this product.

Despite the higher GBP/DKK and USD/DKK exchange rates, our total assets declined slightly relative to last year to stand at DKK 7.8 billion. The lower amount was amongst other things due to the depreciation charges being higher than new capital expenditure.

We invested a gross amount of DKK 260 million in property, plant and equipment in 2009/10. That's DKK 227 million less than in the previous financial year, when we built our new US head office. The investments made were mainly for production equipment for the factories in Hungary and China.

Equity increased by DKK 602 million to DKK 3.5 billion. In addition to the profit for the year of DKK 1.2 billion, we recorded DKK 159 million from the sale of shares to employees, their exercise of share options as well as currency-related income. This was partly offset by dividend payments of DKK 300 million and by share buy-backs of DKK 500 million.

The equity ratio increased to 44% from 36% at 30 September 2009.

We repaid about DKK 800 million in debt and our net interest-bearing debt fell by about one-third to DKK 1.6 billion. The main explanation for this is that our earnings are improving and that has a positive effect on our cash flows.

Your Board recommends that the company pays an ordinary dividend of DKK 10 per share. That's DKK 3 per share, or just over 40%, more than last year, and like last year, it equals a pay-out ratio of 34%. In other words, we're distributing 34% of the year's profit 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 425.5 per share. The shares ended the financial year at DKK 653.5 per share, equal to an increase of 54%. And at lunchtime today the price per share was 768. In other words, the Coloplast share outperformed the 24% improvement of the C20 index.

On 1 July 2010, Coloplast regained its place in the OMX C20 index of the most traded shares. Being a C20 share means a lot more media coverage for our company and more attention from international investors. During the past financial year, foreign investor ownership in Coloplast rose from 12% to 20%.

On pages 19-56 of the Annual Report, you will find our statement of comprehensive income, balance sheet, statement of changes in equity, cash flow statement and the notes to the financial statements. The parent company financial statements are set out on pages 60-67. The Management statement and the Independent auditors' report are on pages 17-18, 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 goal of ensuring stability and maintaining substantial financial latitude in order to support its future strategic progress, including growth through acquisitions.

The ratio of net debt to EBITDA is an important factor in gauging our company's financial strength. We have a target band of net debt relative to EBITDA of 1.5–2.5, but the Board has suspended that target. We intend to reduce our debt financing in order to strengthen our capital resources, but we're willing to accept a higher debt ratio in order to capitalise on potential acquisition opportunities. The ratio of our net debt to EBITDA is 0.6, or slightly higher than last year's figure of 1.2.

During the past financial year, the Board completed half of the DKK 1 billion share buy-back programme approved by the shareholders at last year's AGM. The second half of the programme will be implemented from the beginning of 2011 until the end of the 2010/11 financial year. The necessary authorisations to the Board will be presented for approval at today's general meeting.

Coloplast aims to manufacture and sell products in a sustainable manner. In that spirit, Coloplast assumes a responsibility that goes substantially beyond regulatory requirements, including through our membership of the UN Global Compact.

This year, we have published a Corporate Responsibility Report. We intend this to be an annual publication that will feature the main results and challenges for Coloplast from a corporate responsibility perspective. Those interested can get a print version of the report here today, and it is also available from our website.

In October 2010, Coloplast opened a whistleblower hotline, which our employees and business partners can use as a last resort to report serious offences and allegations involving Coloplast either by telephone or on our website. This means that Coloplast has joined the ever growing circle of global businesses that have a similar hotline service. This is something people may not feel comfortable with, but other companies have reported positive experiences. There can be no assurance that all of our employees in our more than 50 countries of operation are comfortable with discussing potential wrongdoings openly with their managers and leaders.

Last year, Coloplast established an audit committee, and it has now been in operation for a full year. As the name indicates, the committee monitors the statutory audit and our financial reporting process. Going forward, another of the audit committee's duties will be to follow up on the nature and the number of reports made to the whistleblower hotline.

As you can see from the documents distributed ahead of this general meeting, the Board proposes a number of amendments to our articles of association that are required under the new Danish Companies Act as well as various wording changes which the chairman of the meeting will go through.

In addition, the Board proposes an amendment to management's incentive programme. According to s.69b of the Companies Act, these amended principles and guidelines must be adopted by the shareholders in general meeting before they can be used as a basis for specific agreements with members of the executive management or of the board of directors.

Let me make a few comments about the proposal to revise the remuneration of the executive management. Very briefly, the proposal is based on the Board's wishes to award more share options to the members of the executive management. The Board prefers to keep the executive remuneration and salaries at a reasonable level, while also giving the executive members an opportunity to earn more if the shareholders do the same. It is also important to us on the Board

that we are able to offer our executives a competitive remuneration. We believe that is the best way to safeguard shareholder interests.

Already in the 2009/10 financial year, the members of the executive management agreed to swap a month's bonus with share options, and that is why the cash remuneration for the executive management actually fell slightly.

You will find a full report on corporate governance at Coloplast on our website, but a summary review is also set out in the management report on pages 13-15 of the Annual Report.

Let me now turn to our financial ambitions.

Now that our company has achieved its long-term goals, the Board has set out a new financial ambition for Coloplast. This means:

- that our company will aim to outgrow the market
- and deliver earnings margins in line with the best performing med-tech companies

This is an appropriate ambition for Coloplast now that we've completed our transition process and have lifted our earnings substantially since took the first steps in 2008. In other words, Coloplast is now ready to take on an even greater ambition, namely to earn a place among the most profitable med-tech companies.

Coloplast will continue to pursue a strategy with a "profitable growth" theme.

Our company's ambition is to:

- serve our customers better than anyone else
- provide end-user products and services better than anyone else
- run our business better than anyone else

We have attached specific activities to our ambition: For example, we need to spend more time with our customers and less time at the office, we must work systematically on preparing the markets when launching new products, and we must provide better follow-up on each individual end user by offering training and advice.

And now for our financial forecasts for the 2010/11 financial year.

For the 2010/11 financial year, Coloplast expects organic revenue growth of 6-8%.

We expect an EBIT margin of 23-25%, both when measured in foreign currencies and in DKK. The improvements we've achieved so far are a result of the initiatives that have already been launched.

Gross investments in property, plant and equipment is expected to amount to DKK 300–400 million.

The effective tax rate is expected to be about 26%.

Changes are underway on Coloplast's Board of Directors. Both Torsten Rasmussen and Ingrid Wilk have announced that they wish to retire after many years of service. I would like to thank you both for your diligent and competent efforts for Coloplast over the years. It's been a pleasure working with you both.

On this occasion, we recommend that the number of shareholder-elected board members be reduced from seven to six, because we believe that is an appropriate number for Coloplast's Board of Directors. Accordingly, we propose to fill only one of the two positions being vacated.

The Board recommends that Brian Petersen be elected as a new member of the Board. He brings many years' of experience from Procter & Gamble and other companies, and he will complement the Board's skills in terms of general management, marketing, sales, production and innovation. You can read more about Brian Petersen in the documents distributed ahead of today's general meeting.

There are also a couple of new faces among the board members elected by the employees. Coloplast's Danish employees have elected Torben Julle Rasmussen and Gitte Böse Andersen as new board members, while Thomas Barfod was reelected.

The election results mean that Knud Øllgaard and Mads Boritz Grøn, who have served for 20 and 4 years respectively, are no longer members of our Board of Directors. On behalf of the entire Board, I would like to thank you for your strong dedication and commitment.

And to the two new board members, I would like to say: Welcome! We look forward to working with you.

When I began my report, I told you that working at Coloplast has become more meaningful, exciting and challenging. That may sound strange given the many comprehensive changes made and redundancies announced. Nevertheless, I would like to document my claim to you.

Each year, we survey employee satisfaction throughout the Coloplast Group, and this year the response rate was as high as 92%. Once again, we improved on our three key parameters: First of all, our employees are more content with working at Coloplast than they were last year; second, they have become more committed in their work; and, finally, more and more of them are saying that they feel their job meets the Coloplast values: closeness, dedication, respect and responsibility.

In that light, I have to say that it's hard to suppress one's optimism.

Once again, I am very pleased with our performance during the past year. Coloplast has become a better company for everyone involved: shareholders, users, customers, employees and society in general.

Let me end my report by extending a big Thank You to all employees, managers and our executive management for a job well done. Thank you!