

Coloplast- H1 Financial statements 2008/09

Thurs, 11th May 2009

13:00 Hrs UK time

Chaired by Lars Rasmussen

Note from the transcribers:

Please note that audio quality deteriorated during the Q&A session making accurate transcription difficult in places.

Lars Rasmussen

Good afternoon and welcome to this first half year 2008/9 conference call. I am Lars Rasmussen, CEO of Coloplast and with me today here in Humlebaek I have Chief Financial Officer, Lene Skole and Head of Investor Relations, Ian Christensen.

This conference call is scheduled to last about one hour. As we now have more time between issuing the earnings release and holding the conference call, you have all had more time to read and digest the release. Therefore, we are trying out a slightly changed format where the numbers on the slides has been reduced; where the number of slides have been reduced to provide more room for questions. Let's see how that works out. Let's turn to the first slide, which is slide number three.

We realised a very satisfactory EBIT this first half year. Before special items, EBIT was up 27% and the underlying margin was 17%. We are very satisfied with these numbers and we believe our focus on efficiency gains and cost reductions are firmly on track. This supports the long term target of more than 20% EBIT margin in three to five year.

We realised 6% organic sales growth and 4% reported growth this first half; which is in line with the current market growth but below our expectations. If we exclude Germany, our organic growth was 9%, which is satisfactory. As mentioned, growth was highly impacted by the situation in Germany, where contrary to our expectations, growth did not return in Q2. We have been disappointed by the performance in Germany and I will present to you a couple of the issues we are facing.

First, as most of you know, we lost some of our staff to our main competitor in the homecare market and we are consequently seeing higher than expected conversions to competitor products. This has led to a lower than expected growth.

Secondly, the market in general is still uncertain with regards to the remaining part of the 2005 healthcare reform; which is the reform about tenders and lump sum payments, and no news is expected until after the election in the autumn.

We have had a new management in place in Germany since January. The team has spent considerable time turning every stone in Germany and formulating a comprehensive plan

for improving our business in Germany. We are starting to execute task office plan but the effect will take some time to show in the numbers. Amongst other things, we are reducing the complexity within our German organisation, both in our sales organisation and within our back office functions. This will increase profitability as well as sales.

We have revised our guidance for 2008/9 and our guidance for organic growth this year is now around 6%, down from previously 7 to 8%. The downward revision is due to the challenges in the German market. We have adjusted upwards our expectations for the EBIT margin. EBIT is now around 16% in fixed currencies from previously 15 to 16%. The increase in EBIT guidance reflects both improvements from efficiency gains throughout Coloplast, as well as specific cost cutting programmes.

Also, I'm pleased to say that our CAPEX expectations are reduced to DKK 700 million from DKK 750 to 850 million; which is due to a focus review of both the timing and the size of all planned investments. Finally, the effective tax rate is unchanged at 28%. Let's move to the next slide, which is slide four.

Revenues were up by 4 percentage points to DKK 4.3 billion. Currency impacts reduced growth by 2 percentage points and the organic growth was therefore 6%. This growth is in line with the current market growth but if we exclude for Germany, organic growth was well above the market at 9%. Within Ostomy Care we saw an organic sales growth of 3% to almost DKK 1.8 billion; impacted by the lower than expected sales, primarily in Germany. Reported growth was flat; excluding the German market, organic growth was 8%. The biggest growth driver in this business segment continues to be the ().

In urology and continence care, sales amounted to DKK 1.8 billion. This equals an organic growth of 8% and reported growth of 7%. We saw high growth rates within intermittent catheters, especially SpeediCath and SelfCath and also satisfying sale of Peristeen and Conveen products.

Finally the sales were satisfying in the US and European urology business. Our wound and skincare business grew 7%; both organically and in DKK to around DKK 750 million. Consumer products had a great quota and excluding this growth was 4%.

Growth continues to be driven by Biatain foam bandages. We continue to face price pressure in the main European markets and challenging market conditions within the hydrocolloid bandages sequence.

Looking at Europe, the organic growth rate was 4% and amounted to DKK 3.3 billion. Sales were affected by the declining sales of ostomy care products through the German markets. In the other European markets, especially our ostomy care and continence care businesses generated growth in line with expectations. The wound care business grew as expected. Revenues in the Americas rose by 21% to almost DKK 700 million and the organic growth was 12%.

We achieved satisfactory growth in all business segments and continued to see the positive effect of the improved reimbursement from catheters in the US markets. Revenue in Westerfalls (?) in which Japan and Australia represents the two largest markets improved by 19% to a little more than DKK 300 million while organic growth was 12%. The

restructuring of our wound and skincare business and the DSU business are progressing according to plan and the focus areas are unchanged.

Finally I would like to mention that Coloplast has launched two new products recently. First we launched SenSura Uro, for people with an urostomy and just weeks ago we launched SpeediCath Control for men with a reduced dexterity in the hands. With this, sales overview, I will hand you over to Lene. Please turn over to the next slide which is slide number 5.

Lene Skole

Thank you very much, Lars. Gross profit amounted to DKK 2.5 billion and that's equal to a gross margin of 58%. This is down one percentage point which is approximately equal to the impact we had from lower currency rates in DKK. If we exclude the effect of currencies, the gross margin was in line with last year.

Price development especially in the market for wound and skincare products, continued to put pressure on the gross margin. In addition to this, production cost for SenSura and the new generation of Biatain foam dressings are still higher than expected.

Finally, the production capacity has not been fully utilised due to lower than expected sales. All of this however, has been set off by improvements in the production economy resulting from the relocation of production to Hungary and China.

The gross margin in Q2 was almost two percentage points lower than Q1. The main reasons for this were lower sales in Q2 than in Q1, less favourable exchange rates and finally higher sales within consumer products which have a lower gross margin.

We continue to see significant improvements of SG&A to sales ratio, which improved by four percentage points. This is a very satisfactory development. The distribution to sales ratio dropped one percentage point to 31% of revenues and reflect, among other things, the work we are doing in our sales force efficiency programme. Our admin to sales ratio has dropped three percentage points from 11 to 8% this period due to savings, efficiencies and cost containment throughout the organisation. This development cements the positive development that we saw in Q1 and thereby also confirms that we are well on our way to deliver our long term profitability target.

Finally, the R&D to sales increased slightly to almost 5%. The result of all this is a reported EBIT margin for 15% and an underlying margin of 17%. We report a healthy balance sheet with net interest bearing debt to EBITDA of 1.9 which is down from 2.1 last year. This is impacted by the postponement of our share buyback programme. The return on equity was 32%. The working capital to sales ratio improved one percentage point to 29% of revenues compared with first half last year. This is the first visible result of our efforts to reduce working capital, but we still have some way to go.

CAPEX amounted to 289 million corresponding to a CAPEX to sales ratio of 8%. CAPEX was primarily spent in equipment investments for the factories in Hungary and China and also in our US headquarter. Finally, the free cash flow was 286 million reflecting both the higher EBIT as well as DKK 165 million on account payment of tax in the first quarter of 2008/09.

Please turn to slide six. For 2008/09, we expect a growth of about 6% both organically and in DKK. This is a downward adjustment from the previous 7 to 8% and is a result of the situation in Germany that Lars described earlier on.

Apart from Germany, we remain confident in our growth expectations. Our previous guidance expected the market situation in Germany to stabilise. This had unfortunately not been the case and we don't expect this to change for the remainder of this fiscal year. As stated, also in Q1, expectations to gross within wound and skincare remain low for 2008/09 due to the execution of our wound and skincare strategy. This is included in our guidance and we still expect revenues to be impacted by 1 to 2% negatively in '08/09.

On the back of the profitability improvements that we have seen in the first half of the year, we have increased our expectation to the EBIT margin and now expect an EBIT margin of around 16% in fixed currencies, or 15% in DKK. This is an increase from previously 15 to 16% in fixed currencies and 14 to 15% in DKK.

We are also able to lower our CAPEX estimate for 2008/09 to around DKK 700 billion from previously DKK 750 to 850. Lower sales expectations led to lower requirements for investment in new machines and we have also carefully reviewed first the need and the timing of other investments in the organisation.

Our effective tax rate is expected to be around 28% and this is unchanged from the previous guidance.

This concludes our presentation of our first half year results. Thank you very much and operator we are now ready to take questions.

Questions and Answers

Jesper Breigenstien

Hi, good afternoon, it's Jesper Breigenstien from Canny Copenhagen. Two question: firstly on Germany. You indicated that it would take some time for the initiative to take effect. Can you give any indication, the timeframe, how long will it take and when will we see a stabilisation of the growth and when will we actually see growth coming back?

The other issue is on the gross margin. When do you expect that to come up and when will you have solved the problems with the SenSura efficiency?

When it comes to Germany, we are not really able to give you a firm quarter time when we see turn coming. We have been doing a very through analysis. We are quite clear on what we want to do there. We also know that this is, just to put things a little bit in perspective; this is actually a very important market. It is a market where we have a very high market share. To turn things around in the current situation where there is implementation going on of a new way of paying for services in Germany, it's hard for us to say exactly when we come out with what cost (). So we cannot give you that detail on it and we are not really in a position that we want to give you all details of the plan because as you do know the situation is that most of our competitors are owned by other

companies and we do not even know how they are doing. When it comes to the gross margin question, it is hard on long term. We are moving out of Denmark to Hungary and also to China so we will see that our gross margin is picking up. What is really hampering us this year is currency and also the price pressure on wounds and skincare, but on the line we actually have a positive development on that one.

But with regards to the efficiency and Biatain and SenSura, when do you expect that to get up at normal levels?

I think that is one of the things that we are working very hard on and we see improvements all the time. I have also seen significant improvements already this year on the progress there.

Okay. Thank you.

Klaus Madsen – Handelsbanken, Copenhagen

Just a follow up question on Germany - the weakness you see in organic growth in that particular market in the quarter, can you try and decompose or discuss how much is the impact of pricing pressure on pricing and how much is the impact of you basically giving away market share on the conversion and also of course you do not want to give the details of your plan but could you maybe in broad terms discuss what you are aiming at to stop this reversal or negative momentum?

First of all the primary reason for the development in Germany is commercial and it is () that we gave away last year that are now sitting in a new situation and they are not as such obliged to just prescribe Coloplast products. So that is really what we do see. It is not so much price pressure that we will see in Germany. So that was the first part of your question. And with regards to the plan, it is very hard to spell out details for you on it but it is of course you know part of it is very, very classic where you just make sure that you are visiting the right customers in this situation and you make sure that you are - that your sales forces are really focussing in on that. Then we are of course looking very much into how to best support the business, both from the local back office but definitely also from the functions that do happen in Humlebaek, so we have aligned all of our managing powers behind Germany and there is no doubt that we have a very comprehensive plan for that.

And there have been made any changes to the field staff sort of say in the German market?

Some months ago we looked at how to best organise ourselves in the situation that we have in Germany so we did do that at that point in time.

And then does that imply any up or downscaling of the reps?

We will make sure that we keep the highest possible pressure on the sales or sales pressure in the market. So if we are talking about anything in Germany we can talk about how we make sure that we support the market in the most efficient way but the sales pressure will have to remain high and as a market leader that is what we continue to do.

Okay. Thank you. Then on the cost levels we see in Q1, Q2 on sales and marketing and the admin, are these levels - and of course especially the lower levels we see in Q2 - are they likely to be sustainable for the full year or should we anticipate some levelling off in these lines?

So just on a general thing I think as I mentioned last time we certainly expect them to stay well below the 10% but obviously with what we have in the first half if we were to end at 10 we would have to spend a lot of the second half so actually we think that what we are seeing is relatively sustainable also for the remainder of the year.

If it lies in the question if we have pushed ahead or in front of us...

And we have not

...or some spending that we have been going through to cater for in the next quarter that is not the case.

No, no it is

It is a case of structure basically that we have done.

Okay. Thank you. Then on your gross margin issue, the production costs economy that should be improved on Biatain and SenSura - well I understand from primarily conference calls that it will consist of I guess a productivity component and of course the potential for relocating the direct labour part of that production on a longer term - but the actual productivity improvement in the current location, why do we not see that come through and what is the issue here?

As a look into how we make the numbers for this because we put a saving to this, the product on it and then we basically multiply the saving by the number of the product that you do and since our sales are a little bit lower, the savings are also a little bit lower on this one as a number but actually we are seeing an improvement in the current location and, as we also mentioned, we are going to move these products innovation (?) to a country with a lower labour cost.

What is the timeframe here?

We are going to issue that a little later this year because we have to take some internal considerations there. But until about the sort of the updated move-out plan later on in June so that final, it will also be easy for us to communicate that.

I think the key thing also is that the actual improvement that is happening in the production economy is being hidden by the hit that we saw on the currency rate because we are actually seeing an improvement. But obviously the lower sales makes it a bit more difficult to improve as much as we would like to do. There is also a delaying factor in when we actually see the improvement for instance of the restructuring that we did in January as we are selling the oldest products first, so to speak. So there is always a delay in seeing the improvement.

Okay. Then just finally, the conversion base for this second quarter was fairly even adjusting for Germany. It seems like sales momentum is somewhat lower than we could have hoped for. Are there any observations in the other key markets that we should be aware of de-stocking or general, well cautiousness, that presumably brings market growth to a slightly lower level than the historical levels?

We do not see any specific weakening. We think that we see is the normal strength that you will see when you have stockings and de-stockings in the market. We do not get any signals from other markets that we are facing some major challenges.

Okay. Thank you.

Martin Sikorski - Cheuvreux, Stockholm.

Good afternoon. It is Martin Sikorski with the Cheuvreux in Stockholm. Thank you for taking my questions. I have two questions; first all I would like to get back to the issue in Germany and I understand that you cannot go into the details on what you intend to do there to improve the situation, but just so that I understand this a little bit more, to what extent is a German turnaround relying on for example a new product in order to regain market share? Secondly, if you could update me a little bit on what is happening in the US with your distributor Mekesan(?) and how they are progressing in terms of gaining market share and strengthening your market share in urology and continence care in the US market? Thank you very much.

Your first question about Germany and to what extent the German turnaround is based on us bringing a new product to the market. I will say that if you are looking at the product () they may have just now this quarter that we speak about launched the (). I think I can safely say that we have the news, the most updated and the best documented products portfolio on the market; and what we see is not at all due to the product performance, it is basically due to () take place from our former sales force. So fortunately we do not have in that respect a () we () on the far side. When it comes to () in the US, I would not be concerned that we go down and give you guidance on each of our customers, as we also said in the presentation, we do feel that we have a () in the US and we feel that we have the () that we expected to have especially on the customer's care but also on the urology care where ()() very healthy.

Okay thank you very much, just a final follow up here on the US then; is it fair to say that in urology and continence care you are somewhere around a 5% market share and in () care also somewhere around 5% now or is it higher? Thank you.

Could you please repeat?

The question was is it fair to say that your market share in urology and continence care in the US is roughly 5% now and it is roughly 5% as well in () care?

It is fair to say on the urology side, but on the continence care side it is much higher, not least due to the fact that we are market leaders () capitalisation in the US.

Right okay, thank you.

Distinguish between the two markets urology and continence care in that respect.

Yi-Dan Wang – Deutsche Bank

Thank you very much this is Yi-Dan Wang from Deutsche Bank. I have a number of questions, first of all starting with Germany; can you comment on how much visibility you have on the development of the conversions and what sort of trends are we seeing there, is the conversion rate still increasing; what percentage of the conversions are you assuming that will occur in 2008 and 2009 that is being factored into your guidance and how shall we think about it going forward? A lot of questions I appreciate, but a bit of I think something that we need to understand clearly. And also how much of the slow down that we saw in () quarter was due to you guys taking initiative that perhaps created some disruptions in the market? If we could start from there that would be great. Thank you.

I think we would prefer to have your questions up front, so that you know where we are going?

Okay fine, my second question or second subject topic really is on the urology and continence care business. If I remember correctly in the same quarter a year ago, your growth rate in that business was actually pretty weak, you only achieved about 5% growth that quarter. My understanding at the time was that that was due to phasing of sales. So given the pretty weak comp it seems that the sales momentum in that business has decelerated so just wondering what other issues that you would like to highlight there to explain that deceleration? That will be all I will ask for now, thank you.

Regarding the visibility on the conversion development in the German markets; it is always hard to answer that question. We know of course the source of most of this conversion and we also know the turnover that we have with this source; but how much of that () and therefore it is not easy to give you an answer on this. I think the only answer is that ().

I think the only thing we can say that what we are guiding is really our best estimate after careful consideration and taking the whole situation in Germany into consideration.

How much of the turmoil(?) that we are responsible for ourselves, I guess that is your second question?

Yes, so basically how much of it is due to the fact that you are making various changes in the market which perhaps would have affected some of the business that was not converting?

Is that regarding Germany?

Yes that is also Germany.

I think as I have said beforehand, when you are in a big market like this and when you really are a big market leader there, then you're feeling the smallest things that are going on in the markets but actually the situation really is that it will remain we'll still have a high market in Germany. We have a very, very high () patient discharge rate also in Germany so we see some things going on, on the homecare side, we know what is going

on there and we are working with it, but it is something which is pretty isolated through that area; so we are not in a situation where we see declining trends in business coming out of hospitals with our products are anything like that it is actually a very, very healthy development in that regard. I understand your question ()() and at the same time defining new patients, then it would be quite uncomfortable but that is not the situation on the contrary. When it comes to urology and continence care, the only place where we see some weakening, is in the US where we have the elected procedures and we do see quite a high number ()() but a high number of these are being postponed. But that is the only place where we have disability so to speak, because as I said before most of our competitors are not () they are early statements and therefore we do not really know what is going on there. So far we can see that we have a good competitiveness in urology and continence care.

And I also think we need to be very careful not to judge each individual quarter in isolation if you look at the first half we actually had quite a healthy growth in that area.

Right okay thank you for that. Just to follow up on Germany I appreciate that may be difficult for you to call out how the conversion would end up at the end of the day, but are you able to provide some details on what percentage of that business have converted already and how that conversion rate has moved since the beginning of the year? I guess it is when you first saw pretty big issues appearing, so if you can comment on that it will be much appreciated.

This product is becoming a little bit too detailed for us to answer.

If it is but I kind of thought that would be something that you would have your hands on.

We certainly do.

But you do not want to comment publicly. So you know the answer but you do not want to say it.

That is right.

Okay, I can accept that. Thank you.

Closing Comments

Then we would just say thank you for participating, have a nice day. Bye.