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COLO B.CO - Q1 2020 Coloplast A/S Earnings Call

EVENT DATE/TIME: FEBRUARY 06, 2020 / 2:00PM GMT



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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the interim financial statements for Q1 2019 to 2020. (Operator Instructions) I must advise you all that the call is being recorded today, Thursday, the 6th of February 2020. And I shall now hand over to your speaker for today, Kristian Villumsen, CEO of Coloplast.

Kristian Villumsen - Coloplast A/S - President & CEO

Thank you, operator. Good afternoon, and welcome to our Q1 '19-'20 conference call. I'm Kristian Villumsen, CEO of Coloplast; and I'm joined by our CFO, Anders Lonning-Skovgaard; and our Investor Relations team.

We work with a short presentation by Anders and myself, like we usually do and then open up for questions.

Please turn to Slide #3. Coloplast started the year with another strong quarter, delivering 8% organic growth, a 13% increase in EBIT and a return on invested capital of 47%.

A few highlights from the first quarter include a solid start to the year in emerging markets driven by Ostomy Care and a strong performance in China, Latin America and tender deliveries in Russia.

Our smaller business areas, Wound & Skin Care and Interventional Urology, also posted solid growth rates for the quarter. As expected, Continence Care were negatively impacted by the French price reform. Overall, I'm very pleased with the balanced growth across both businesses and geographies.

We continue to focus on investing in new opportunities to drive growth. And this year, we will continue to invest in our large strategic markets, including China, the U.S., the U.K., as well as a number of our emerging markets.



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We're also moving ahead with important clinical work for our clinical performance program in both Ostomy Care and Continence Care.

At this point, I'd like to provide an update on the Coronavirus outbreak in China from our point of view. We're encouraged by the resolute actions and transparency presented by the Chinese authorities to mitigate the impact of the outbreak.

We're monitoring the situation closely, collaborating with the Chinese authorities and taking all necessary precautions, in particular with respect to our employees, of which we have around 2,000 in China.

At present, none of our employees have been infected with the virus. In the Guangdong province, where the Zhuhai production site and distribution center is located, the government has decided to shut down all manufacturing sites not working, with virus mitigation of food production until February 10. Under collaboration with the authorities, Coloplast has donated Wound Care products to the Hubei Red Cross as Comfeel Wound Care products have been reported to help health care professionals prevent pressure ulcers with extended wear of face masks.

The donation has ensured that our distribution center could open on February 3 to support health care professionals and patients in need of Coloplast medical devices.

All domestic business travel as well as international travel to and from China has been suspended, and all Coloplast employees apart from employees at our distribution center are currently working from home.

China represents around 5% of total Coloplast revenues. The situation is still very uncertain, and I'd like to emphasize that the impact and timing is very difficult to determine, but based on our current knowledge, we expect an impact on our Q2 sales as a result of lost hospital sales in both Chronic Care and Wound Care. People are being told not to visit hospitals, and in-hospital pharmacies and our sales reps are restricted from visiting hospitals in February.

We also expect a decline in new patient discharge due to cancellation and postponement of stoma surgeries and wound care procedures. We assume that a portion of this lost sales will be recovered in the second half of the financial year, but not all.

Putting all this together and assuming that the situation will normalize gradually during Q2, we expect to maintain guidance for the financial year. Hence, for the full year, we continue to expect organic revenue growth of 7% to 8% and 7% to 8% in reported growth. We continue to expect an EBIT margin of around 31% in constant exchange rate and a reported EBIT margin of around 31% in Danish kroner.

On a different note, at the beginning of the year, we were very pleased to announce that Coloplast has been awarded a position on the Premier Group Purchasing Organization in Ostomy Care. Premier is the second largest GPO with an estimated hospital market share of 25%. The win is a big milestone for Coloplast in the U.S. Ostomy business. We're invited onto the contract as a result of our innovative portfolio of products, large clinical demand for our products as well as competitive pricing.

The contract takes effect April 1, and we're very excited to seize this opportunity. In U.S. ostomy, it's important to win in the hospital, and GPO access is an important license to hunt, but it's also important to be strong in home health and in community through direct-to-consumer efforts.

We'll continue to focus on execution and strategic initiatives that strengthen our position across the ostomy patient pathway. Now let's have a closer look at the results.

Please turn to Slide 4. In Ostomy Care, organic growth was 9% for the first quarter, and growth in Danish kroner was 10%. Growth continues to be driven by our SenSura Mio and Brava supporting products in larger markets like the U.K., Germany and U.S. SenSura Mio Convex continues to be the main contributor to growth, driven by Europe and the U.S. SenSura Mio Concave is now available in 17 markets, and the portfolio continues to increase its contribution to the overall ostomy growth. France contributed to growth in the quarter despite a negative impact from the French price reform introduced in July last year.



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Our Sensura and Assura portfolio growth was driven by solid performance in markets like China, Brazil, Argentina as well as tender deliveries in Russia. Overall, emerging markets had a strong quarter in ostomy in Q1.

In Continence Care, organic growth was 6% for the first quarter, and growth in Danish kroner was 7%. The SpeediCath ready-to-use intermittent catheters continue to drive growth. SpeediCath Flex contributed positively to growth, especially in the U.S. and across the European markets. SpeediCath Compact catheters continue to drive growth in countries like the U.K., France and Germany. SpeediCath Navi, the new hydrophilic catheter specifically designed for emerging markets and lower price developed markets, has now been launched in 6 markets.

Sales growth for Peristeen products remains satisfactory driven by France, U.S. and the U.K. Sales growth in France was flat in the quarter due to the negative impact from the French price reform introduced in July, which dampened the growth, primarily in Continence Care in the first quarter.

In Interventional Urology, organic growth was 9% for the first quarter, and growth in Danish kroner was 12%. The growth was driven by sales of Titan Penile implants and Axis Biologics portfolio in the U.S.

Sales of disposable surgical products also contributed positively to growth driven by Europe. We've seen a good return on the sales investments we made into the U.S. Interventional Urology business last year, and we continue to invest also this year.

In Wound and Skin Care, organic growth was 10%. Growth in Danish kroner was 11%. Organic growth for Wound Care in isolation was 8%. The growth in Wound Care was driven by the Biatain Silicone portfolio in Europe, where markets like the U.K. and France posted solid growth.

The Biatain Silicone Sizes and Shapes portfolio also continues to contribute meaningfully to growth. The U.S. Skin Care business had a solid first quarter driven by key products like InterDry and EasiCleanse. Likewise, contract manufacturing of Compeed contributed positively to growth.

Turning now to our geographical segments. We saw organic growth of 5% for the first quarter in our European markets. The growth was driven by key markets like the U.K. and France. France contributed to growth despite the French price reform, which had the largest negative impact on the Continence Care business in the quarter. Organic revenue growth in other developed markets was 10% in Q1. The growth was driven by the U.S. Chronic Care business as well as good quarter for Interventional Urology and Skin Care. Growth rates in Japan and Australia remain satisfactory.

Revenue in emerging markets grew organically by 16% for the first quarter. The growth was driven by China, Argentina, Brazil and tender deliveries in Russia, and with this, I will now hand over to Anders. Please turn to Slide 5.

Anders Lonning-Skovgaard - Coloplast A/S - Executive VP & CFO

Thank you, Kristian, and good afternoon, everyone. Reported revenue in Q1 increased by 9% compared to Q1 last year. Most of the growth was driven by organic growth, which contributed 8% to reported revenue.

Foreign exchange rate had a positive impact of around 1% on reported revenue, primarily due to the appreciation of the U.S. dollar and British pound against the Danish kroner.

Please turn to Slide 6. Gross profit was up by 11% to around DKK 3.2 billion. This equals a gross margin of 68% compared to 67% last year. The gross margin was positively impacted by operating leverage driven by revenue growth and improvements in production efficiency through the GOP4 program. The gross margin was also positively impacted by the DKK 17 million in restructuring costs in Q1 last year, whereas this year we have no restructuring costs.

The gross margin was negatively impacted by product mix as well as increasing cost in Hungary due to salary inflation and labor shortages. The distribution-to-sales ratio came in at 30% compared to 29% in Q1 last year. The 13% increase reflects increased investments across business areas and several markets, as Kristian explained earlier. The admin-to-sales ratio came in at 4% of sales, on par with the recent trend. The 6% decrease was mainly related to a number of one-off costs incurred last year within IT and legal.

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The R&D-to-sales ratio came in at 4% of sales, in line with last year. The 7% decrease in R&D cost is mainly related to phasing of spending on innovation projects in this financial year. Overall, this resulted in an increase in operating profit of 13%, corresponding to an EBIT margin of 31%. The EBIT margin contains a positive impact from currencies of 70 basis points.

Operating cash flow amounted to around DKK 1 billion compared with DKK 772 million last year and includes a positive impact of DKK 47 million related to a reclassification of lease payments following the adoption of IFRS 16.

The positive development in cash flows was mainly due to an increase in operating profit of DKK 175 million as well as a decrease in trade receivables. Cash flow from investing activities was impacted by investments in automatization, IT and manufacturing equipment.

CapEx investments amounted to DKK 223 million for the quarter, up DKK 92 million compared to last year due to timing of investments.

As a result, the free cash flow was an inflow of DKK 816 million against DKK 658 million last year.

Adjusted for the DKK 47 million positive impact from IFRS 16, the free cash flow was up by 17%. Our cash conversion in Q1 calculated as 12 months trailing average was 98%.

We are following developments around Brexit in the U.K. closely. We remain committed to the U.K. market, and we are maintaining a stock level of around 8 weeks to ensure that we have adequate supply in the U.K.

In Q2, a new share buyback program is expected to be launched, totaling DKK 500 million and to be completed by the end of this financial year.

Please turn to Slide 7. For '19-'20, we continue to expect revenues to grow 7% to 8% organically and 7% to 8% in Danish kroner.

As Kristian mentioned earlier, the guidance assumes that the Coronavirus outbreak situation in China normalizes during Q2. Aside from this, our guidance assumes stable growth trends across our regions as well as continued positive impact from new product launches and commercial investments.

Our guidance assumes an annual price pressure of up to minus 1 percentage point. We expect the price pressure to be closer to the full 1 percentage point for '19-'20 due to the French price reform within Ostomy Care and Continence Care, which was implemented in July last year. The full-year impact of the French price reform is estimated at DKK 100 million. We have successfully mitigated half of the impact from the 9% price cut.

We're also seeing price pressure from smaller reforms in Switzerland and Holland. With respect to the phasing of tenders in emerging markets, Q1 saw a good contribution to growth from tender deliveries in Russia. We expect to deliver another solid quarter in Russia in Q2.

Last year, the Russian tenders fell in the second half of the year, which means that we will have a tougher comparison period in the second half of this year due to Russia. The guidance in Danish kroner reflects a positive impact from the appreciation of the U.S. dollar and British pound against the Danish kroner, which is partially offset by the depreciation of the Argentinian peso and Brazilian real against the Danish kroner.

The currency impact is based on spot rates as of February 4.

For '19-'20, we continue to expect an EBIT margin of around 31% in constant currencies and around 31% in Danish kroner. The EBIT guidance in Danish kroner is impacted by the appreciation of the U.S. dollar and British pound against the Danish kroner.

The currency impact is based on spot rates as of February 4. On our operating expenses, we expect broadly stable trends this year. We continue to invest for growth and invest up to 2% of sales in incremental investments into innovation and sales and marketing initiatives.

The gross margin will be positively impacted by operating leverage and the Global Operations Plan 4, which is on track to deliver 100 basis points EBIT margin improvement in '19-'20. The positive impact is expected to be partly offset by product mix and cost pressure in Hungary. We continue



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to see high single-digit wage inflation in Hungary, and given labor shortages in Hungary, we have hired around 400 production employees from Ukraine, which has put pressure on costs. We will not incur any restructuring costs in '19-'20 compared to DKK 43 million in '18-'19. Overall, the expectation is that the gross margin will improve in '19-'20 compared to '18-'19. We now expect our net financials to end the financial year '19-'20 at minus DKK 125 million, from previously minus DKK 100 million, primarily due to hedging losses on U.S. dollar and British pound against Danish kroner, as a result of the appreciation of both currencies against the Danish kroner.

CapEx guidance for '19-'20 is still expected to be around DKK 850 million and is driven by investments in more capacity for new and existing products as well as the factory expansion in Costa Rica, automatization initiatives and IT investments into digitalization.

Finally, our effective tax rate is expected to be around 23%.

Kristian Villumsen - *Coloplast A/S - President & CEO*

Thank you, Anders. Before we move to Q&A, I'd like to mention on the call here that we are hosting our Capital Markets Day at our headquarters here in Humlebaek in Denmark on June 24. At the event, we'll present the new strategy for the company, and a lot of good work is currently ongoing to shape the new strategy. So we hope to see many of you in person in June.

Thank you very much. Operator, we are now ready to take questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question is from Veronika Dubajova from Goldman Sachs.

Veronika Dubajova - *Goldman Sachs Group Inc., Research Division - Equity Analyst*

I will keep it to two, please. My first question is just -- I'd love to get your thoughts on Premier and how you're preparing for the opportunity as of April 1, both in terms of investments and kind of commercial activities. And, Kristian, maybe you can also comment on whether you've seen any competitive response whatsoever from your peers and competitors in that space? And my second question is a China and Coronavirus-related question. Very helpful to get some of the disclosure around the revenue. It would be helpful also for us to understand if there is any supply chain risk that you see further upstream to the business, either in terms of pieces of equipment as you build out your capacity or anything else that's coming from China?

Kristian Villumsen - *Coloplast A/S - President & CEO*

Thank you, Veronika, 2 good questions. We're super happy about the Premier win, and all of you who've followed the company for a long time, you know that this has been a priority for us for a long time. And symbolically, it means a lot. We believe that we are invested properly in terms of sales rep coverage, marketing spend, and if you will, commercial muscle to make the most of this. So right now, all of our efforts is gearing up that we have a detailed operational plan to implement. It's probably too detailed to go into the types of activities that were in there, but we basically plan waves of accounts that we will address to roll out the implementation of our commercial plan. And I'd say, in terms of competitive response, our view is that the competitive intensity is pretty high and not that anything unusual has happened in the wake of the announcement of our win.

On the Coronavirus, of course, that situation is uncertain in its nature. Our focus is to collaborate with the authorities. By the instructions that we're getting, I am encouraged that we are able to supply through our distribution center, and that's been open now for almost a week. And we plan to open our factory on Monday as per the instructions that we have from the authorities. Our core focus is, of course, our 2,000 employees, and keeping them safe. So the people who are being called in for work are only the people that absolutely need to be there to keep the wheels spinning. Most



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of the people are working from home. And then, of course, because this is happening in the wake of the Chinese New Year, we have a fair number of people who are stranded in other locations in China and are basically barred from traveling. But the lights are on, we're shipping products, and we can meet the demand that's coming into the distribution center. And a lot of good work is happening there. We're preparing to put the lights on in the factory on Monday.

Revenue impact, there will be some. It's too early to gauge exactly how much. But right now, we cannot visit hospitals. And the current planning is through the month of February. So that will be most impactful in our Wound Care business, which is almost exclusively a hospital business, whereas Chronic Care, as you know, a part of that business also is more direct-to-consumer and online, but it will also have an impact on the Chronic Care business. We'll follow it as we move through the weeks, and if there's any information in there that leads us to think that our current guidance is not appropriate, of course we will be vocal about it.

Supply chain risk, good question. Right now, we're planning to start production again on Monday, like I said. If the authorities will order a continued shutdown at the manufacturing site, we have a stock in market and also from the productions that we make in the factory and transit globally that we -- I feel good about the coming quarter, but of course if it continues for much beyond that, it generates issues for us. I hope that answers your questions, Veronika.

Veronika Dubajova - Goldman Sachs Group Inc., Research Division - Equity Analyst

That's very helpful. And can you comment on sort of what happened to China revenues so far year-to-date? Have you seen any impact in January? Or you're not able to share that with us?

Kristian Villumsen - Coloplast A/S - President & CEO

January is fine.

Operator

Our next question for today is from Annette Lykke from Handel.

Annette Lykke - Handelsbanken Capital Markets AB, Research Division - Medtech Analyst

I just have one question. It's in respect to the organic growth of a healthy 9% for the Ostomy Care division. That's a bit on the high side taking the French health care reform into account. Could you share with us how important the tenders in Russia has been in terms of the Q1 growth?

Kristian Villumsen - Coloplast A/S - President & CEO

Well, EM had a good quarter. And, as you know, EM is still predominantly an ostomy business for us. China had a very strong Q1, which contributed strongly to growth. Latin America had a strong Q1, which also contributed to growth. And also, the Russian tenders contributed to growth. And then there's actually a very nice tail of Emerging Markets that did well in Q1. So that was important.

Annette Lykke - Handelsbanken Capital Markets AB, Research Division - Medtech Analyst

But you cannot share with us how much of this -- it is meaningfully large, the Russian tender you had in Q1?



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Kristian Villumsen - Coloplast A/S - President & CEO

No, I'm not going to break down related to the individual components of the growth, but EM, of course, played a key role here. You should also remember that when we think of the French health care reform, the bigger business in France is Continence Care. So the biggest impact from a business area point of view from that reform was in Continence Care.

Operator

Our next question is from Christian Ryom from Nordea.

Christian Sørup Ryom - Nordea Markets, Research Division - Senior Analyst

I have two, please. So can you elaborate a little bit on the outlook for your distribution costs over the year, whether the investments that you've made here in Q1, whether we should expect that to be the level going forward into the next few quarters or whether we should expect further increases in distribution costs? And then my second question is to your growth rate in Chronic Care in the U.S. and whether you achieved double-digit growth in Chronic Care in the U.S. in Q1 given that you also had strong growth in your Skin Care portfolio?

Anders Lonning-Skovgaard - Coloplast A/S - Executive VP & CFO

So if -- I'll take the first one, Christian, in terms of our distribution costs. Yes, we have initiated a number of investments across our commercial organization in Q1. As Kristian talked to earlier, we have initiated investments this year in Emerging Markets, China, Latin America, U.S., the U.K., and we initiated those in Q1. And we will continue those investments throughout the year, as we have done in the previous years. So my view for the year is that we will be in the range of 28% to 30% in percentage of revenue.

Christian Sørup Ryom - Nordea Markets, Research Division - Senior Analyst

Is it fair to say that the profile would be more flat after this -- the big step-up we saw here from -- in the first quarter?

Anders Lonning-Skovgaard - Coloplast A/S - Executive VP & CFO

Yes. So in terms of over the coming quarters, that is my expectation. So we have initiated a number of new things, as I just said, Christian. And so that is fair, a fair assumption.

Kristian Villumsen - Coloplast A/S - President & CEO

And Christian, I'll take your second question. We are satisfied with the growth we are sitting now, around double digit. We've had good momentum on the Continence Care side still, driven by Flex, and I also think a decent momentum in Ostomy Care driven by the Mio portfolio. Of course, the job now for the U.S. team, given that we won Premier, is that we need to take that opportunity and turn it into growth. So our ambition is definitely that we will see that in the business not necessarily this year because of the pricing effect that you also see from the deal and the implementation time that we're going to see, but from medium-to-long term this needs to drive growth for us.

Operator

Our next question is from Maja Pataki from Kepler.



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Maja Pataki - *Kepler Cheuvreux, Research Division - Head of Med Tech Devices Sector*

I have 2 questions as well, please. One, Kristian, on China, you're very helpful in providing as much information as you have. But just with regards to your comment, and say like, as we expect things to normalize in the future, what are you considering a normalization? If we see the lockdown basically lifted, do you think that's going to be enough to restore confidence in patients to return to the hospital? Or do you think there is going to be like basically 2 steps, first, the big lockdown is going to be lifted, and then it will take a couple of weeks to see consumers or patients daring to go to the hospital, just to understand what do you think there?

Kristian Villumsen - *Coloplast A/S - President & CEO*

I wish I could give you a very precise definition of how we would see these things normalize. When we say normalization of business, it means that we can distribute from our distribution center and take orders. So normally, as we do from customers, which we can now, that we can manufacture from our manufacturing facility, so we can continue to supply both China and the components or the products that we make in China to the global supply chain. And then, of course, that access to hospitals will gradually be restored, so our salespeople can meet customers in the hospital setting. We are already now serving users directly on online channels, so -- via WeChat and Tmall and via our mail order business. So the -- I think the key is that hospital access is restored.

Maja Pataki - *Kepler Cheuvreux, Research Division - Head of Med Tech Devices Sector*

Okay. And then my last question is around phasing of R&D spend? Because you've mentioned that you have a lot of studies ongoing. And is there anything on color that you could provide us how to think about the spending over the quarters? Is it going to stay flattish? Is it going to be lumpy in one quarter and then going down again? How shall we think about that?

Anders Lonning-Skovgaard - *Coloplast A/S - Executive VP & CFO*

So, I will take that question. In terms of our R&D, yes, we had a decrease in our absolute R&D in our first quarter. I'm expecting we will increase it over the course of the coming quarters. So it is -- the situation in Q1 is more a phasing thing. So we -- for the end of the year, we'll be around 4% of sales.

Operator

Our next question is from Michael Jungling from Morgan Stanley.

Michael Klaus Jungling - *Morgan Stanley, Research Division - MD, Head of MedTech & Services and Analyst*

Can you hear me?

Kristian Villumsen - *Coloplast A/S - President & CEO*

Yes.

Michael Klaus Jungling - *Morgan Stanley, Research Division - MD, Head of MedTech & Services and Analyst*

Great. Sorry. And on -- I have 3 questions, please. Firstly, on gross margin. Can you please provide some color on the impact on gross margin from French health care reform in the first quarter? Secondly, for tenders, besides Russia, are there any other tenders coming up for the remainder of the fiscal year that could materially impact growth, organic sales growth? And then thirdly, when it comes to wound management, I think in Q1



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of fiscal year 2010, you received a meaningful boost as a result of H1N1 from your hand-cleansing products, are you starting to see impact on demand as the virus spreads?

Anders Lonning-Skovgaard - *Coloplast A/S - Executive VP & CFO*

Thanks for your questions, Michael. I will start with the first 1 in terms of our gross margin. We have some impact from the French health care reform on the gross margin. As we have said previously, the overall impact from the French health care reform is around DKK 100 million, and it is more or less equally spread over the quarters. And some of that is, to some extent, also impacting the gross margin. But the main negative impacts, that we have also talked to quite a bit, is the challenges in Hungary in terms of higher sales -- higher inflation. We are having salary inflation in the level of 10%. And then the labor shortage issue, we have also talked to previously. We have around 400 people from Ukraine and now in Hungary to support our production.

Kristian Villumsen - *Coloplast A/S - President & CEO*

All right. I'll -- let me take the second question, Michael, about tenders. And so the tricky bit about forecasting the EM region is that it is affected by tenders that are sometimes not completely forecastable, I'll say, particularly in Russia, where demand visibility is only a few weeks. And -- but what we can see now is that, of course, we've got Q1 in the books. With good activity, we can also see a very good tender activity for Q2, and that phasing is different than we had it last year in Russia. So the comps will be a bit more tricky in the second half. And then I'd say, in general, to the EM business, there are number of tenders that happen throughout the year in the Middle East and Latin America, but no dramatic expected changes to those. And then for that final question about the hand cleanser? Or what was it? You're going to have to repeat that.

Michael Klaus Jungling - *Morgan Stanley, Research Division - MD, Head of MedTech & Services and Analyst*

Yes, I was just looking at some past records, and you had a pretty good quarter in Q1 of fiscal year 2010 as a result of, you mentioned, strong demand for hand-cleansing products as a result of, back then, H1N1. So I was just curious whether this is something that is relevant for the Coronavirus at the moment.

Anders Lonning-Skovgaard - *Coloplast A/S - Executive VP & CFO*

Yes. So if I take that, Michael. So, this year, we're also off to a good start with our EasiCleanse Bath, if that is what you are referring to in -- but we are off to a good start with that. But we are not -- the other thing you're talking to, no, there is not any impact specifically.

Operator

(Operator Instructions) The next question is from Hassan Al-Wakeel from Barclays.

Hassan Al-Wakeel - *Barclays Bank PLC, Research Division - Research Analyst*

I have three. So firstly, following up on Emerging Markets, given the acceleration to 16%. Are you more optimistic on growth here? Or do you think that that is more a function of phasing around the tenders that you've talked about? Additionally, on Emerging Markets, how is North Africa performing? And this is something that you've highlighted, where you've seen a slowdown in demand at the back end of last year. Secondly, what are you seeing in terms of the continent market from competition? There have been some new launches out there in the market for some time, which don't seem to be gaining traction in the U.K. as far as we can see. But I wonder if this is different elsewhere in the markets that you operate in? And then finally, again on the gross margin, could you talk about the headwind from salary inflation that was obviously more than offset by FX, and you've called out some of the sizes of the positive impact. So I'm just trying to understand what the size of the negative impact would be?



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Kristian Villumsen - *Coloplast A/S - President & CEO*

Thanks, Hassan. Let me start by taking the EM questions. We're happy with the Q1, obviously, sitting at 16%. And I want to reiterate that this is not just Russia. Russia helps, of course, but China had a very strong quarter, and Latin America had a strong quarter, and a number of smaller markets also had good performance. We have passed the issues in North Africa. And so we're now looking ahead there. And then when it comes to outlook for EM, I'd say the uncertainty with the Coronavirus is, of course, an uncertainty that affects EM performance. So exactly how that's going to pan out, I think we'll know a lot more in the coming weeks.

On Continence Care, I think post the patent expiration of SpeediCath, we've seen well over 20 products launch. We've also had a number of product launched over the last 12 months. We monitor these launches very carefully. We look at every single product that gets into the market. It gets torn apart inside this company. We understand the technology choices that are made. We understand the performance of the product. And, of course, we try and help our sales people talk to the best of their ability about our strength and the offering that we have compared to competition. It's probably still early days, but I'll tell you that we take all of this extremely seriously, that we protect our leadership position. And you'll also see in -- the ambition for the innovation pipeline that we have for catheters is, of course, to present a completely new level of performance from this type of products in our next generation.

Anders, do you want to comment on gross margin?

Anders Lonning-Skovgaard - *Coloplast A/S - Executive VP & CFO*

Yes. In terms of the gross margin and the headwind from Hungary, so if I should give you a little bit more insight to it, around 80% of our total production volume is in Hungary. Around 9% of our cost base in Hungary is -- for the Group is direct salaries. And if you then multiply that with around 10% in terms of salary inflation, then you get a flavor of how much extra costs this is driving. And on top of that, we are having around 400 Ukrainians in Hungary, and that is driving extra cost in terms of housing allowance, HR, recruiting and other things. So it is a quite some headwind we have on our production and the production cost in Hungary from these elements.

Operator

Our next question is from Kate Kalashnikova from Citigroup.

Kate Kalashnikova - *Citigroup Inc, Research Division - VP*

It's Kate Kalashnikova from Citigroup. Kristian, on Coronavirus impact, it's another question, yes. So are you starting to see any change in China Ostomy in terms of consumption patterns? Or any change in patient behavior? For example, channel switch away from hospital pharmacies more into e-commerce. And also, do you expect any potential negative impact in Wound Care from Coronavirus, potentially to be more significant and more pronounced than for ostomy?

Kristian Villumsen - *Coloplast A/S - President & CEO*

Thank you, Kate. Good question. It's -- you could say the massive thing that we see is that people stay at home. And you've probably all seen the videos from China with deserted streets. All of the intelligence that we get from China is that people stay home, they stay indoors. And so they are ordering their products online, and I am extremely happy that we over the years have built up both the mail order and direct-to-consumer business, because it now allows us to service that demand. That notwithstanding, the number of new patients will be affected by the Coronavirus because the hospitals will be closed and surgeries will be postponed. So exactly how that effect is going to pan out, I don't know. But right now, we're keeping up with demand on OC via the direct distribution channel that we have, both on Tmall and mail order business. Wound Care, contrary to Ostomy Care, is exclusively -- almost exclusively a hospital business. So that, of course, gets impacted right away when you don't have access to the hospital. So we will see a more pronounced effect on Wound Care compared to Ostomy.



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Operator

Our next question is from Scott Bardo from Berenberg.

Scott Bardo - *Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst*

So, first question, just related to the Premier Ostomy GPO. Just to understand, Kristian, if you wouldn't mind giving a little bit more clarity about the positioning of this GPO. Am I now to understand it's a multi-source contract between 3 vendors in the U.S., Coloplast being one of them? And just then to further extend the logic, if you were to take a little bit more market share than your current market share in this contract, does this necessarily mean something like 20% of 25%, so an incremental longer-term 4% share positioning for the business? Just help us think a little bit about how you think about your opportunity surrounding this contract would be helpful? Second question just relates to perhaps a little bit of update on the progress of some of your R&D initiatives. So I appreciate we've got a Capital Markets Day, but just maybe some signals. Are you seeing clinical data hit the sort of end-points that you hope for? The developmental time-lines on track? Or are there a few bumps in the road? It would be useful just to get some clarification. And, last point -- sorry, Anders, there's a lot of focus on gross margin, but one thing I didn't hear, so I apologize if you did mention it, was the currency benefit to gross margin this quarter. You called it out in the release. I wonder if you could clarify how much of a currency benefit was in your gross margin year-over-year?

Kristian Villumsen - *Coloplast A/S - President & CEO*

Thanks, Scott. Good questions. Premier, you're correct that it is now a multi-source agreement, which means that we're on there, ConvaTec is on there and Hollister is on there. Premier covers about 4,000 hospitals. And a number of the Premier members, we are, of course, already customers of ours, and these customers of ours will now get access to the Premier pricing. So for -- at least for some of these, this will be a benefit to these hospitals, they get access to lower pricing. So for us, there will be a negative pricing effect for some of these customers. Now what kind of an impact will it have on growth? Great question. So I'm not going to share the internal workings of our assumptions, but I can tell you this: that the clear demand on the U.S. team is that this must, of course, accelerate growth. We now have a level playing field on 4,000 important hospitals in the U.S., which means that converting a hospital as part of the Premier GPO is a significantly easier process now than it was before we had the GPO.

So I'm looking for acceleration. And acceleration, I think, will come down to our ability to execute. Now remember also that the patient pathway in the U.S., the acute value of the total market is about 5%. All of the patients that you win in these settings, you have to manage the pathway all through home health and in the community. So it's not enough that our team wins more hospitals, we also have to make sure that the hospitals that we win and the patients that we win onto our products that they also get home on a good routine, still using our products and not being converted at some path or at some place through the care continuum. On the innovation side, I think we're making good progress. So Scott, we're further ahead with Ostomy. We are moving into the big part of the -- or if you will, the bigger clinical program on ostomy this year. So this year, will be, I call it, the exam year, where we prove that we've actually got something. I'm optimistic. I think it -- I think the early results are encouraging, but of course the clinical studies need to be concluded. On the Continence side, we're starting up the smaller scale studies. And there, as you recall, what we're after are trying to prove a reduction in urinary tract infections and a number of other clinical end-points, but we are at an earlier stage there, but the clinical work has begun. So it's also going to be sometime this year, where we'll -- I think we'll know more about the path that we're going to take on the Continence Care platform. And then on the Innovation side, we're also -- this is also in the coming quarter, we're launching Biatain Fiber as part of the work that we've been doing in Wound Care on innovation that we also expect a good contribution from that. Do you want to answer on margins, Anders?

Anders Lonning-Skovgaard - *Coloplast A/S - Executive VP & CFO*

Yes. So the final question you had, Scott, around the currency impact on the gross margin. So the currency impact we have on gross margin is in the level of 70 basis points.



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Scott Bardo - *Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst*

Understood. So just to clarify that of the 100 basis points year-over-year, gross margin improvement, underlying improvement was only 30 basis points or so?

Anders Lonning-Skovgaard - *Coloplast A/S - Executive VP & CFO*

Yes, so it's around 70 basis points from currency, as I just said. The overall improvement on the gross margin is in the level of 120. And part of that is also lower or no restructuring costs.

Scott Bardo - *Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst*

Yes, understood. And maybe if I can sneak in one other question from me please, Kristian. Yes, just big picture, I mean, the -- you're generating a lot of cash now, underlying operations from the business clearly going well. Kristian, I think you've historically talked about further expanding the strategic opportunities for Coloplast. So I guess the nature of the question is, is the timing in the company's evolution right in your minds to do some bigger scale M&A? And perhaps you could share some thoughts actually as to the available opportunities in the market? Price is just too high? Opportunity is not there? Maybe just some thoughts really about how you see Coloplast as a potential consolidator at this point?

Kristian Villumsen - *Coloplast A/S - President & CEO*

Great question, but that I think that's a question for our June session here in Humlebaek when we talk strategy. But a nice try. I will say though, Scott, I'm optimistic about the growth prospects of the company. I think we've got a lot to work with in the categories that we have. And of course if you look at the, if you will, firepower of the company, we run a slim balance sheet and are highly cash generating. So should we see an opportunity to do something structural within any of the business areas, we have the capacity to do that, but we'll talk more about that when we see each other in June.

Operator

Your next question is from the line of Sebastian Walker from UBS.

Sebastian Walker - *UBS Investment Bank, Research Division - Associate Analyst*

Two, if I could, as well. So first, on the Wound business and actually on -- more on the market. We've seen now a few quarters of consistent recovery in underlying market growth. I think the pressure we saw previously was from value players. So could you maybe talk as to why we're seeing a recovery? Are those value players just not chasing opportunities in the same way they were before? Or has something else changed in the market? And then the second question was just on the fiber product. When would you expect to see revenue contribution? Is that, of course, this year?

Kristian Villumsen - *Coloplast A/S - President & CEO*

Well, so thank you. Let me answer that question. So first off, I'll say I'm really happy with the performance of the Wound Care business, that we continue good momentum, that we can -- we see the momentum being generated around the Biatain Silicone platform and technology. So I think that the performance you're seeing in our business is the result of the commercial focus that we have. When it comes to the underlying market growth and the value -- if you call them the value players -- our view is that they've always been there, they're probably always going to be there. There are always some customers that will see a value in that type of offering.



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Our focus is, of course, different. We are focused on premium products and quality and very much focused on building the Biatain Silicone on the 3DFit technology into the category that we believe it deserves to be. There's real demand for these products, and that's also what you see reflected in our growth. But underlying, our view of the market growth hasn't changed.

Sebastian Walker - *UBS Investment Bank, Research Division - Associate Analyst*

And then just on the fiber product, if you have any comment on?

Kristian Villumsen - *Coloplast A/S - President & CEO*

Oh. Oh, sorry. Yes, I missed that. Biatain Fiber will be launched here in Q2. And the first year uptake, it will have little-to-some impact on Wound Care growth rates. But, of course, we expect it to be a more significant year too.

Operator

And our next question is from David Adlington from JPMorgan.

David James Adlington - *JP Morgan Chase & Co, Research Division - Head of Medical Technology and Services Equity Research*

Just one left, really, just around the -- your announcement along -- around the share buyback, DKK 500 million. Given your balance sheet position and cash flow, it seems a little bit mean. I just wondered, why did you choose that level. And are you trying to signal anything, particularly with respect to Scott's earlier question on M&A?

Anders Lonning-Skovgaard - *Coloplast A/S - Executive VP & CFO*

So David, let me take that one. So, we are again this year running a share buyback program of DKK 500 million as we have been doing now for many years, and it is to honor our stock option program.

Operator

There are no further questions waiting, sir.

Kristian Villumsen - *Coloplast A/S - President & CEO*

Well, then I'd like to take this opportunity to thank all of you who have dialed in. We hope to see many of you, if not all of you at the Capital Markets Day in June. Have a nice day.

Operator

Thank you very much, sir. Ladies and gentlemen, that does conclude the call for today. Thank you all for participating. You may now disconnect.



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