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COLO B.CO - Q2 2018 Coloplast A/S Earnings Call

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CORPORATE PARTICIPANTS

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

Lars Søren Rasmussen *Coloplast A/S - CEO and President*

CONFERENCE CALL PARTICIPANTS

Alexander Matthew Gibson *Morgan Stanley, Research Division - Research Associate*

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

Carsten Lønborg Madsen *SEB, Research Division - Research Analyst*

Martin Parkhøi *Danske Bank Markets Equity Research - Senior Equity Analyst*

Niels Granholm-Leth *Carnegie Investment Bank AB, Research Division - Co-head of Research of Denmark & Financial Analyst*

Scott Bardo *Berenberg, Research Division - Analyst*

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

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

Yi-Dan Wang *Deutsche Bank AG, Research Division - Research Analyst*

PRESENTATION

Operator

Good day, and welcome to the Coloplast H1 2017/'18 Conference Call. Today's conference is being recorded. At this time, I would like to turn the conference over to Mr. Lars Rasmussen, CEO. Please go ahead, sir.

Lars Søren Rasmussen - *Coloplast A/S - CEO and President*

Good afternoon, and welcome to our Q2 '17/'18 Conference Call. My name is Lars Rasmussen. I am CEO of Coloplast, and I'm joined by CFO, Anders Lonning-Skovgaard, and our investor relations team. We will start off with a short presentation by Anders and myself, and then we will open up for questions.

Please turn to Slide #3. Today, for the fourth consecutive quarter, Coloplast delivered 8% organic growth, and I'm very pleased to see continued strong underlying performance across the business. Based on improved momentum in Emerging Markets and the realized expectation of the impact of the patent expiry from DKK 100 million to DKK 50 million, we have upgraded our organic growth guidance for the year from around 7% to 7% to 8%. Consequently, our guidance in Danish kroner is now around 6% from previously 5% to 6%.

Our EBIT margin guidance is unchanged in fixed currencies at 31% to 32% and in Danish kroner at around 31%.

In Q2 -- Q2 was a busy quarter in the U.S. We have just launched SpeediCath Flex Coudé Pro, which is a redesigned version of our Flex catheter specifically developed for the U.S. market. I'm excited to be launching this innovative product into the fastest-growing catheter segment in the U.S.

In Ostomy Care, we have secured a single-source contract with Cleveland Clinic. Cleveland Clinic is one of the largest and most well-renowned hospitals in the U.S. known for its focus on clinical excellence. Cleveland Clinic selected Coloplast after conducting a clinical evaluation on the SenSura Mio portfolio that demonstrated leakage reduction.

In Wound Care, according to plan, we have just launched the full Biatain Silicone portfolio in the U.S. for treatment and prevention purposes, which is a key milestone for our U.S. Wound Care strategy.

The quarter has also seen organizational changes in the U.S We now have new management in place in Chronic Care in the U.S. to lead our organization as we invest to accelerate growth in this important region. Manu Varma joins us from Philips Health Care in the U.S. where he served as General Manager of Philips Global Enterprise Telehealth business, with the main focus on the U.S. Ed Veome takes on a new role as VP of Sales for the Chronic Care in North America.

In Emerging Markets, the increase in momentum is broad-based across the region. We see sustained healthy growth in key markets like China, Russia and Argentina as well as improving momentum in the Middle East and Brazil. We have also invested in several smaller markets and -- that are delivering a healthy return on investments.

EBIT in the first half of the year declined by 3%, and our EBIT margin came in at 30%. This development was expected and reflects FX headwinds and the planned initiation of incremental innovation and commercial investments across the business in Q1. I am excited about our plans to build on current momentum and drive long-term growth in revenues and earnings.

Today, the Board of Directors approved an interim dividend of DKK 5 per share corresponding to a total interim dividend payout of approximately DKK 1 billion.

Please turn to Slide #4. Year-to-date, our revenues grew 8% organically and 5% in Danish kroner and amounted to DKK 8 billion. The acquisition of Comfort Medical and Lilial contributed approximately 1 percentage point to (inaudible) product growth.

In Ostomy Care, organic growth was 10%, and growth in Danish kroner was 6%. For Q2 in isolation, organic growth was also 10%. Growth continues to be driven by our SenSura Mio and Brava and SenSura's portfolios in larger markets like the U.K., Germany and U.S. SenSura Mio Convex continues to contribute strongly to growth. Our Assura/Alterna portfolio growth was driven by satisfactory performance in markets like China, Russia and Argentina.

Growth continues to be negatively impacted by the Greek price reform. On a positive note, our distributor has welcomed aboard many new Ostomy users after one of our competitors left the market last quarter. In the initial month of the premarketing, we have received positive feedback from healthcare professionals and users who have trialed our new Ostomy appliance, SenSura Mio Concave. We have now secured reimbursement and launched product in 7 countries.

In Continence care, organic growth was 9% and growth in Danish kroner was 7%. For Q2 in isolation, organic growth was 8%.

The SpeediCath ready-to-use intermittent catheters continue to drive growth, and especially the compact versions performed well.

In the compact segment, we saw strong growth in the U.S., U.K. and France. We continue to see healthy growth rates in Japan, Australia and South Korea where reimbursement for intermittent catheters was introduced 1 to 2 years ago. So far, we have seen a limited impact on the expiry of the SpeediCath standard ready-to-use patent. Growth continues to be negatively impacted by the price reform in Greece.

SpeediCath Flex has now been launched in 16 markets and continues to contribute to growth in key markets like the U.K. and Germany.

Our (inaudible) collecting devices portfolio posted positive growth due to satisfactory growth in France and the Emerging Markets. And finally, sales growth for (inaudible) products remains satisfactory.

In Urology Care, organic growth was 10% and growth in Danish kroner was 4%. For Q2 in isolation, organic growth was 9%. The growth was primarily driven by sales of tightened penile implants in the U.S. We made large investments into the U.S. implant business last year and continue to invest this year. Our endourology business saw satisfactory growth in especially France and Saudi Arabia.

In Wound & Skin Care, organic growth was negative 1% and growth in Danish kroner was negative 5%. Organic growth for Wound Care in isolation was 0%. For Q2, organic growth for the total business was 3%, and for Wound Care in isolation, it was 8%. The stronger growth in Q2 in Wound Care was driven by China, which rebounded after a weak Q1, and France, partly due to price reforms in the baseline.

The growth in the first half of the year was negatively impacted by price reforms in Wound Care in Greece. This negative development was reinforced by a strong Q1 last year due to inventory buildup at our Greek distributors because of price reforms.

On a positive note, the Biatain Silicone portfolio continues to pose double-digit growth, driven by Europe and the launch of Biatain Silicone Sizes & Shapes.

The U.S. skincare markets -- skincare business contributed to growth in the quarter and grew in line with market growth of 4% to 6%.

Contract manufacturing of Compeed contributed negatively to growth by DKK 30 million year-to-date due to inventory reductions in connection with the sale of the Compeed brand from Johnson & Johnson to HRA Pharma. We expect a pickup in momentum over the next quarters.

Turning to our geographical segments. We saw organic growth of 4% year-to-date and 5% in Q2 in our European markets. The growth continues to be satisfactory across the portfolio of countries and in particular in key markets like the U.K. and France.

Organic revenue growth in other developed markets was 13% year-to-date and 8% in Q2. The underlying growth in the U.S. Chronic Care business remains satisfactory, and we continue to take market share. Growth rates in Japan and Australia remain satisfactory. Growth in the U.S. year-to-date was positively impacted by inventory reductions of DKK 70 million in Q1 last year. And revenue in Emerging Markets grew organically by 16% year-to-date and 21% in Q2. Markets like China and Argentina continue to deliver very satisfactory performance. We also saw heightened activity in Russia and in Brazil. New tenders were opened and delivered on. In addition, we delivered on a tender in Algeria.

Growth year-to-date was negatively impacted by the Greek price reform. As expected, growth in Wound Care in China rebounded in Q2 after a weak start to the year due to hospital budget constraints.

With this, I'll now give the word to Anders, and please turn to Slide #5.

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

Thank you, Lars, and good afternoon, everyone. Reported revenue increased by DKK 354 million or 5% compared to the same period last year. Most of the growth was driven by organic growth, which contributed DKK 598 million or 8% to reported revenue. Acquisitions contributed DKK 82 million or 1 percentage point to reported revenue.

Foreign exchange rate had a significant negative impact of DKK 326 million or 4 percentage point on reported revenue, primarily due to depreciation of the U.S. dollar and dollar-related currencies against the Danish kroner.

Please turn to Slide 6. Gross profit was up by 3% to around DKK 5.4 billion. This equals a gross margin of 67% compared to 68% last year. FX had a significant negative impact of 60 basis points on the gross margin. In constant currencies, the gross margin was 68% compared to 68% last year. The gross margin was positively impacted by improvements in production efficiency and our volume size and the relocation of SenSura Mio to Hungary. The gross margin was negatively impacted by product mix due to the launch of new products where the production economy is not yet fully optimized. Increased depreciation levels also had a negative impact on the gross margin. In Q2, DKK 5 million in restructuring costs have been included related to reduction of production employees in Denmark.

The distribution to sales rate came in at 29% compared to 28% last year. The 10% (sic) [1%] increase in -- is in line with our long-term guidance of increased investments to drive further growth over the next couple of years. The clear majority of new incremental investment cases for this financial year were approved in Q1 across our business areas and regions.

Overall, all our new investments are on track, and we can already see in particular investments into Emerging Markets translating into accelerated growth.

The admin to sales ratio came in at 4% of sales, on par with the recent trend. The R&D to sales ratio came in at 4% of sales, in line with last year. The 11% increase in R&D costs reflects a higher general activity level.

Other operating income and expenses amounted to DKK 29 million compared to DKK 5 million last year. The increase was many due to a nonrecurring income from a patent settlement in Urology Care in Q1. Overall, this resulted in an increase in operating profit in fixed currencies of 4% and a decline of 3% in actual currencies, corresponding to an EBIT margin of 31% in fixed currencies and 30% in actual currencies.

Operating cash flow amounted to DKK 1.4 billion compared with DKK 558 million last year. The increase is primarily explained by higher missed payments last year compared to this year. Total missed payments year-to-date amount to DKK 0.4 billion. Total missed payments to date now amount to DKK 4.6 billion.

Cash flow from investing activities was impacted by the site expansion in Nyírbátor in Hungary and capacity expansion in machines to produce new and existing products. Investments in intangible assets and property, plant and equipment, amounted to DKK 327 million year-to-date, up DKK 65 million compared to last year. Adjusted for payments made in connection with the mesh litigation and acquisitions, including Comfort Medical and Lilial, the free cash flow amount to approximately DKK 1.4 billion compared to DKK 1.3 billion last year. The increase is mainly due to improved working capital management. Our cash conversion in Q2, calculated as 12-month trailing average, was 101%. With respect to the mesh litigation in the U.S., we have settled more than 95% of the known cases. We still view the provision as sufficient, and we are in the final phase of the mesh litigation. In '17/'18, we now expect to pay out DKK 700 million of the remaining DKK 1 billion of the total DKK 5.25 billion provision.

Finally, the first half of the approved share buyback program of in total DKK 1 billion was initiated in the second quarter is -- and is on track.

Please turn to Slide 7. Our organic revenue guidance for '17/'18 is now an organic growth of 7% to 8%. Our reported growth in Danish kroner is now expected to be around 6% from previously 5% to 6%. Acquisitions are expected to contribute approximately 1.3 percentage point to reported growth.

As Lars mentioned earlier, we have upgraded our full year guidance for organic and reported growth due to a broad-based improvement in momentum in Emerging Markets, and we have reduced the expected impact from the patent expiry from around DKK 100 million to around DKK 50 million.

We continue to expect a negative pricing pressure of more than 1 percentage point on our top line due to healthcare reforms in Greece. In October, price cuts of around 25% were incremented for Ostomy Care, Continence Care and Wound Care at the distributor level. Since then, we have appealed to the Ministry of Health, but the actual reform outcome and impact remains uncertain. We continue to assume an impact of DKK 100 million in our guidance.

In Q2, we sold products to our distributor to meet market demand. We have lowered our prices to our distributor, but the final prices are still undetermined. We still expect Wound Care to deliver full year growth in line with market growth of 2% to 4%. Due to timing effects, the Compeed contract manufacturing business were negatively impacted by DKK 30 million in the first half of the year. The growth in the contract manufacturing is expected to rebound in the second half of the year. The guidance in Danish kroner is significantly impacted by the depreciation of the U.S. dollar as well as the dollar-related currencies against the Danish kroner. The currency impact is based on spot rates as of April 30.

For '17/'18, we continue to expect an EBIT margin of 31% to 32% in constant currencies and around 31% in Danish kroner. The EBIT margin guidance includes the impact of our assumptions around SpeediCath patent expiry and healthcare reforms in Greece as well as acquisitions.

Our guidance assumes a proportionally higher absolute EBIT in the second half of the year compared to the first half. This will be a function of higher nominal sales and leverage effects on fixed costs as well as broadly stable trends on our operating expenses since the EBIT margin in fixed currencies has bottomed out in Q2 and will improve over the next 2 quarters.

Higher growth from our new product launches still means pressure on the gross margin. But as previously communicated, we continue to relocate manufacturing out of Denmark to Hungary and be on track to reduce the number of production workers in Denmark by additional 100 people in '17/'18.

We expect the benefit to be absorbed by the cost of relocation and restructuring cost of approximately DKK 20 million in '17/'18.

Of the DKK 20 million, DKK 5 million have been included in Q2. We expect high single-digit rates inflation in Hungary in '17/'18. We also expect depreciations to increase at the same level as last year because of the last couple of years increase in CapEx.

Overall, our expectation is that the gross margin in fixed currencies will be in line with last year at around 68%.

We now expect our net financials to end the financial year '17/'18 at around DKK 0 million primarily due to hedging gains on the U.S. dollar, offset by expected currency translation losses on Argentinian pesos and Brazilian real.

CapEx guidance for '17/'18 is expected to be around DKK 700 million and is driven by investments in more capacity for new and existing products as well as the Nyírbátor expansion, which is expected to be operational during Q3.

A key event in the quarter was the decision to locate our next volume factories in Costa Rica. We have purchased land, which is included in this year's CapEx, and we expect the first volume factory to be operational by the end of 2020.

Finally, our effective tax rate is expected to be around 23%. This concludes our presentation. Thank you very much. Operator, we are now ready to take questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from Martin Parkhøi from Damsky Bank.

Martin Parkhøi - *Danske Bank Markets Equity Research - Senior Equity Analyst*

Martin Parkhøi, Damsky Bank. I'll just ask 2 questions, maybe 3. Firstly, can you elaborate a little bit more on the Cleveland Clinic that you have won? Of course, I guess this will have a significant positive impact on your new patient you charge in U.S. but will also demand some additional investments in the beginning in order to set up programs to make sure that these patients actually also say on Coloplast after they have left the clinic? And when should we actually -- can you comment on when we should see a financial impact from this? And then secondly, on Emerging Market growth, which picked up quite nicely in the second quarter, how much of that pickup do you ascribe to the investments you have done in new initiatives? And should we expect -- could we even expect, like, acceleration in the second half?

Lars Søren Rasmussen - *Coloplast A/S - CEO and President*

Okay, so the Cleveland Clinic is a win that we are really happy with because Cleveland Clinic is kind of -- that's one of the poster institutions in the U.S., and they have around 5% of all Ostomy surgeries in the U.S. It's -- we are particularly proud of it because they decided to do a clinical trial to figure out which companies to go with, and the combination of our products and our services meant that we basically were reducing readmissions to the hospitals. And based on that, we ended up in a situation where we are the sole source for Cleveland Clinic. And we were not part of the program before in Cleveland Clinic, so we think that's a major win. We also, in a sense, feel that, that is kind of showing to other institutions what kind of quality we're having because it's not any organization that have chosen to do this move. So that part of it, we are quite happy with. Now we are going to implement, of course. And that means that for every single hospital, we have to train the staff. We have to make sure that our products are in the computers across the board, and we also have to make sure that our products are available all over the place. So in that sense, it's part of the launch up plan for the U.S. We're already going double-digit in the U.S. This is just underpinning that. And I can't say how much is going to kick in at what point in time, but this is significant to us for many different reasons as something that you will appreciate.

On the Emerging Markets side, we talked about the investments that we have done, and we have done that quite consistently over the last quarters. And we see, as I also mentioned in -- early on, we see this as broad-based. It's -- there's a number of countries where we have invest, and we really see that we -- the good effects from the investments that we have done. We have said earlier on that we are expecting high growth out of the Emerging Markets going forward, and that is in the level of 15% to 20% at least. And that is what we are seeing here. We -- of course, China means a lot, russia means a lot. Argentina also, as I mentioned, means a lot in this area, but we also have a number of smaller markets that we had invested in that we now see impact from. But mind you, it's many different sources for the sales growth, but we have really good momentum also in Emerging Markets.

Martin Parkhøi - *Danske Bank Markets Equity Research - Senior Equity Analyst*

Just as a follow-up and just because I'm a little bit curious, the documentation that Cleveland has done to the clinical documentation that they have done comparing your products with the competitors, is this something that you are allowed to share and use?

Lars Søren Rasmussen - *Coloplast A/S - CEO and President*

No, it's their evaluation. It is their evaluation. They have shared it this with us. The have shared why it is that they have chosen to go sole-source with us, but it's not our property.

Operator

Our next question comes from Annette Lykke from Handelsbanken.

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

I have two questions, one on the new products and another one on China. On the new products, could you maybe at this stage elaborate a little bit more than you did last time on how much you see Concave ostomy bags to be of the market? And how much of sales you will see for -- now you have launched in 7 different markets. And then also on new products in respect to your Compeed Flex Coudé, and congrats with that approval. How much of margin will this be? I'm trying to sort of figure out if these 2 new products are capable of moving the needle as such. Then in respect to China...

Lars Søren Rasmussen - *Coloplast A/S - CEO and President*

Can we take them first, Annette, and then come back to China? So on Concave, so now we have launched in 7 markets, and we have been able to get, on average, 50% uplift in the price compared to what we have on the standard products. We have said that we think that this new category will have the opportunity to grow to the same size as Convex is, and that is approximately 30% of the value of the market. So we had a very large launch in Denmark only a couple of weeks ago where we had more than 800 people gathered here who are inside of Ostomy Care. And especially my impression after that -- our assumption is that this have the potential to become at least same size as Convex, that's for real. This is a problem for a lot of people, and the product really works. So we think that, that's definitely doable. It's many years ago since we established a new category in the market, and therefore, I don't know how fast the uptake will be. I don't have a history, sort of, to back any quote on that up. So -- but what we see is a very large interest. We also see a lot of the people who try it out who basically swap whether they are from using Coloplast products or competitor products, they are interested in getting this new product. So we are quite positive on that.

On the new Flex Coudé, it's -- today, we have 20% share of this category. And the Flex Coudé Pro, the dealers are very enthusiastic about this. It's also because it's a financial incentive, of course, for them to go for that. And it's 40% of the total market. So it's a very, very meaningful category in the U.S. to us. And I think -- and also if you look at it, it's growing about 10% to 15% per year as we see today, the category. And of course, we did not have, really -- in the numbers for the first year, we don't have a lot of Concave sales because we just launched and we didn't have any Coudé sales at all. So the strong growth that we had in the first half will then be helped in the second half by the fact that we have these 2 categories even underpinning the strong growth that we're having. So we feel that we're in a very strong position.

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

Okay. And then just very shortly on China. It's just that, as you alluded to, Q1 was a weaker, soft quarter for Wound Care in China. Now it looks much better. How stable is this? I mean, it's been up and down, I think, for quite some quarters now. What's your view on that, Lars?

Lars Søren Rasmussen - *Coloplast A/S - CEO and President*

So when we talk about China and stability, then I think that we have to distinguish between the 2 different products areas that we have there. I think that we have a very, very strong and stable growth on Ostomy Care, and we have a market position to die for. It's -- we are the market in China when it comes to Ostomy Care. It -- where we see fluctuation is in Wound Care. And the difference between these 2 areas is that on Ostomy Care, it's a community business by far, and Wound Care is a hospital business for us in China, that's how we are driving it. So what we saw last quarter was that there was spend limitations in the hospital, so they basically did not purchase in the last period up to new year. And then they started purchase again in our first quarter, so after January, and that is what we see coming back now. So it is a bit more volatile in that sense. And we have less visibility on it as -- than what we have on Ostomy Care for good reasons. But what I -- we are coming back as we were also expecting when we talked last time.

Operator

Our next question comes from Sebastian Walker from UBS.

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

Seb Walker from UBS. Two questions if I could. One on the EBIT margin guidance. So you've delivered around 30% in the first half. What gives you confidence that you can regain that in H2? I mean, it's quite an aggressive step up there. And then the second question is on the rollout of Comfort. I was wondering if we could get an update there. How is that coming along? Do you feel that you'll need to make further acquisitions in the U.S. distribution?

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

So in terms of the EBIT margin, I expect a higher absolute EBIT margin in the second half, and that is due to higher sales in the second half. And that will give me a leverage effect on the fixed cost, and that will be both on the production side but also on distribution and admin. And the investments we have initiated, we have already allocated that from our first quarter, and I don't expect that we will allocate further investments in the second half. So overall, I expect that our EBIT in the second half will be -- absolute EBIT will be higher than in the first half.

Lars Søren Rasmussen - *Coloplast A/S - CEO and President*

And then on the U.S. side, and just -- you asked specifically about comfort. I'd like to maybe take one click up and then talk a little bit about what it is that we're doing in the U.S. because as we have also explained in our release, we are -- and as also mentioned during the opening, we are strengthening our organization in the U.S. And we do that because we are stepping up the game in the U.S. quite significantly, and especially on the service side. So the reason why we were buying ourselves into Comfort was to get much closer to the payers and to get a much better fix on what is -- how does the market work as seen from a dealer point of view. We think that we will be in a position and what we've tried to drive us into a position where we can offer a significantly stronger service in the U.S. than what we have today, and that is why Manu Varma have joined the company. He comes with a lot of experience with payers from what -- the work that he has been doing with Philips Healthcare in the U.S. And he will be leading the company in the U.S. going forward, taking us from being a very strong supplier of products in the market to also be a very strong supplier of services in the market. So that is what we are investing for. We don't have any plan at this point in time to further invest in dealers in the U.S., but we have plans to invest significantly to step up our service offering in the U.S.

Operator

Our next question comes from Veronika Dubajova from Goldman Sachs.

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

I have two, please. My first one is actually on the gross margin, Anders. If I look now, we struggled around this -- or we've been stuck around this 68% for quite a long time. I know there are moving parts, but I'm just wondering, do you still believe in the algorithm that you've communicated a while ago that you should be able to get roughly 50 basis points of gross margin expansion over the year? I've just seen you deliver that. And I know you're having a great problem, which is your new products growing very fast and driving growth, but I'm just wondering what your confidence is on the gross margin progression, not just this year but beyond it into the medium term. My second question is congratulations on the very strong organic revenue growth. If I go back to November, when you revised your guidance, you were talking about this 100 to 200 basis point of incremental spend. It looks like you've only about spent 100 basis points. You've already seen growth accelerate to 8%. So I'm wondering why you're not maybe going towards the 200 basis points of spend and see even more growth. Is it that you lack the capacity? Or is that maybe something that we'll see next year?

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

Okay. Thanks, Veronica. On the gross margin, yes, as you know we are impacted negatively on the gross margin due to the mix because we are having higher growth on the new launches. We are, however, working on optimizing our production further. So as you know, we have launched our innovation excellence program in Denmark where we are working on bringing down the number of production FTEs from 700 to 400 by the end of this year, and we are on track of doing that.

Then secondly, we have initiated our Global Operations Plan IV, which will drive further EBIT margin improvements of up to 150 basis points in the 2021, and that program will include a number of activities. And one activity is that we are going to consolidate our innovation factories in Denmark. Secondly, we are also believing that we will improve our efficiency in our volume size, especially in Hungary. And then thirdly, we are also working on optimizing our procurement of raw material even further. So I am expecting that we are going to deliver on that plan by 2021, and the majority of that impact will improve our gross margin. But as we have been talking about over the last couple of years, we are negatively impacted by the launches of new products. But we are on track with the programs we are working on, both for this year and also for the coming years.

Lars Søren Rasmussen - *Coloplast A/S - CEO and President*

And if you look at what we are spending on growing more, Veronika, it's -- what we're saying is that it's 1% to 2% of sales that we want to spend, and not just 1%. And if you take what we are spending on R&D and then also what we do on distribution and sales, then we are that level. So it's not only investing in new sales people and in utilizing the service experience and so on. It is also on innovation, and we have stepped up quite considerably on innovation. So as we have spoken about, we'll reduce a lot of great launches right now. But we have a pipeline of launches coming up, which is -- that comes with products that can do significantly more than the products that exist in the markets today, and we're investing in that as we are speaking. So that is also part of what we are investing in.

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

Okay, that's very clear. And do you see scope, I guess, if you were to invest more? I'm sure you have lots of projects that you have identified. Is the limiting factor the P&L? Or is the limiting factor just management capacity and capability at this stage?

Lars Søren Rasmussen - *Coloplast A/S - CEO and President*

It's -- I -- then I would have to say it's management capacity because of -- you -- of course, you need to have a great local management, but you also need to be able to follow up on all of the investments that we're doing. It's not one place that we do it, it's more places. So for example, if you look at the U.S. right now, it's -- I think it's a very good example to use today. Then we have, basically, invested in new competencies with Manu coming on board. And we also expect that with Manu in the U.S., we will also be able to launch new investment initiatives in the U.S. that we could not launch before, basically because we have a different competency level, and that is what we're building in that part of the organization. So in that sense, you need to be ready, because otherwise, you will just be spending the money without getting the results that you desire. So I think that we have found a reasonable balance. We are investing more, and I think that's very obvious when you look at the numbers. And we are bottoming out this year as Anders is saying, but we are also getting already now more growth. So I think it's a reasonable balance that we are getting.

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

Okay, that's very clear. And a quick follow-up for Anders on the gross margin. So just to recap what you said, you are confident in your ability to improve gross margin on a 3-year view towards the 70% mark. And I guess, when would we see the inflection? Is it next year? Or is it closer to 2021?

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

So what I'm saying is that with the plans that we have initiated, so Innovation Excellence one, and now the Global Operations Plan IV, I expect that we will see an improvement from that over the years, and it will start with around 100 basis points in '19/'20 and then 150 basis points in '20/'21. So that is what we are focusing on.

Operator

Our next question comes from Alex Gibson from Morgan Stanley.

Alexander Matthew Gibson - *Morgan Stanley, Research Division - Research Associate*

I have two, please. The first one on the SpeediCath patent expiry. For the decrease in the anticipated impact from that, is that an extrapolation of the impact you've seen so far? Or is that an anticipation for the impact for the rest of the year? Just some color around what you're seeing in the market to date would be useful. And then I have a second after.

Lars Søren Rasmussen - *Coloplast A/S - CEO and President*

Okay, but we don't see much activity in the market. Of course, we are very much following what is being launched. But we had expected that, that we'll be products ready from the date that the patent was expiring, and we have not seen that. And that is -- then we say "Okay, so the first half year." The DKK 50 million that we set aside for that we have not seen, but of course, we keep it for the second half year. Let's see how that goes.

Alexander Matthew Gibson - *Morgan Stanley, Research Division - Research Associate*

Okay. Yes, very clear. And the second one is on Ostomy growth in the quarter. It was nice improvement in comp-adjusted growth. Has any of the improvement that you've seen being driven by competitive wins against those who have had supply disruptions? And as a whole for the year, do you think it's plausible to achieve double-digit growth for Ostomy in 2018?

Lars Søren Rasmussen - *Coloplast A/S - CEO and President*

It's very hard to answer the -- actually both of the questions that you have there because we don't know with this little product, if it's because of backorders or quality issues with one of our competitors. We -- you tend to know your own issues on delivery and quality and so on, but you never hear about it in -- from the competitors unless you are in a situation where something is being shut down, so there's a complete lack of supply from one of the competitors. So I couldn't answer that because we hear more about it when the competitors are reporting what kind of issues they have, then what we see ourselves in the market or what we hear at least in the market. And I would be very careful trying to answer the last part of your question because then suddenly I have given the guidance for Ostomy Care for the rest of the year, and we have changed our guidance for the group.

Alexander Matthew Gibson - *Morgan Stanley, Research Division - Research Associate*

Okay, sure. And If I could just follow up on that, the first one. You have the DKK 50 million impact for the remainder of the year. Are you going to keep that DKK 100 million in totality just rolling forward and until you're certain that there's no products either coming out there to compete? For example, could we see that roll into 2019?

Lars Søren Rasmussen - *Coloplast A/S - CEO and President*

No, I don't expect that.

Operator

Our next question comes from Yi-Dan Wang from Deutsche Bank.

Yi-Dan Wang - *Deutsche Bank AG, Research Division - Research Analyst*

So just a question on the EBIT margin and the sensitivity of that to your top line. I mean, you said earlier on that the 100 to 200 basis points of investment is a good balance. But that leaves us with a question that should the top line do better than what you anticipate, what we should expect to see for your EBIT margin if you don't have the management capacity to invest that? And then the second question is on the Wound Care business. Clearly, the other 3 divisions are doing extremely well, but Wound Care continues to fall short of it. And your target for Wound Care to double its market share initially I think by 2020, but then it got pushed up by a couple of years. But given the new time line, it seems unachievable at this stage, given what we have seen and what you delivered. So what are your thoughts there? And when could we expect some new targets, some more realistic targets being issued for that division? And yes, we'll start with those.

Lars Søren Rasmussen - *Coloplast A/S - CEO and President*

I think -- I actually think it's a very difficult question that you start out with on the EBIT margin where it's hard to sort of give you a one-liner. Because what we said when we changed our guidance, our long-term guidance was that we felt that we are sitting in a situation where we're saying, no, thank you to very good investment opportunities, things that would really make us -- or put us in a position where we were taking market shares at a higher rate, just because we had some EBIT margin targets that were maybe too hard for the innovativeness of the company. So with the current guidance, I think we have a good balance. We are in a position where we are able to fund the initiatives that we have at the table, and where we think it's -- there is a very good balance on what we invest and what we get out of it. This is -- of course, we learn every day, and what we think now is that our EBIT margin have bottomed out, and we are also able to grow more. And right as we speak, we are investing in the next set of new products that we think will move the needle even more than what products are that we have right now. So we think this is sufficient. But it's hard for me to give you a different answer to what you asked about because we have a good balance right now, and I think that we are delivering on the investments that we are doing. There's a very good payback on what we are doing already now. And as long as we see that, we are happy, and we'll continue to work within this frame. I don't know if that answers what you were after, but for us, it's all about that we are able to really go for the opportunities that we think are -- that you would always go for if you own the company.

Yi-Dan Wang - *Deutsche Bank AG, Research Division - Research Analyst*

Right. So basically, all I'm saying is if either the framework that you've built, is that -- from memory, that wasn't just for this year, right? That was going up to 2020 over the medium term.

Lars Søren Rasmussen - *Coloplast A/S - CEO and President*

No. That's right. That's correct, yes.

Yi-Dan Wang - *Deutsche Bank AG, Research Division - Research Analyst*

So over the next -- so all the new products, like the Concave product, the Flex product, that you're launching, the investment required for those are incorporated in this 100 to 200 basis points of investments that you plan to make? So looking at your numbers now...

Lars Søren Rasmussen - *Coloplast A/S - CEO and President*

Yes. And also, what -- we are having this whole new portfolio where you haven't seen much, but maybe we'll talk a little bit more about it at the Capital Market Day. So developing that portfolio and making that ready to start launching from 2020, that is also in what we are investing right now.

Yi-Dan Wang - *Deutsche Bank AG, Research Division - Research Analyst*

Right, exactly. So -- but looking at the numbers that you've printed and fast forward a few quarters, you could end up with a top line that's growing maybe somewhat faster than what you've guided for. And if you don't have the need to invest more, should we expect to see that margin fall through, is the question.

Lars Søren Rasmussen - *Coloplast A/S - CEO and President*

Yes, so you're right. If we don't invest more, then, of course, the margin will go up. But we have -- with the guidance we have, we have the opportunity to invest in viable business cases that have been brought forward to us.

Yi-Dan Wang - *Deutsche Bank AG, Research Division - Research Analyst*

Right. But if your top line grows 7% to 9% and you exceed 9%, the 9% -- 7% to 9%...

Lars Søren Rasmussen - *Coloplast A/S - CEO and President*

Then we are very happy, and we have some very different issues to discuss.

Yi-Dan Wang - *Deutsche Bank AG, Research Division - Research Analyst*

Okay. We'll discuss then. And then Wound Care?

Lars Søren Rasmussen - *Coloplast A/S - CEO and President*

Then on Wound Care, so first of all, I think it's -- please allow me to say that we actually do have a very nice growth in Wound Care in this quarter. So what -- well, we report a number of things together when report, and we also had the minus DKK 30 million from Compeed in the numbers. But if you look at Wound Care in isolation, it is actually growing 7% to 8%. So it's coming back, and it is China that is helping it up. And we have this healthcare reform in Greece that have hit us massively because we have such a big market share in Greece on this. So the numbers that we are coming up are very good. I think that what have also tricked us a little bit from when we set the original targets is that we see everybody reporting weak numbers. So the market growth is somewhat lower than what we anticipated when we set out the numbers. But you are right. Compared to what we want to do, we are somewhat behind our plan, and we will talk in details about that when we meet at the Capital Market Day. Having said that, actually, I'd like to then add to it that we see quite nice growth across the board, and we also see that our pipeline is much better than it was last time we had a Capital Market Day. So I think that we are in a better positioned than for a very long time in Wound Care.

Yi-Dan Wang - *Deutsche Bank AG, Research Division - Research Analyst*

Okay. I was going to say you haven't launched a significant new Wound Care product for a while so more to come on that front.

Lars Søren Rasmussen - *Coloplast A/S - CEO and President*

We've just launched the Sizes & Shapes on Silicone in the U.S.

Operator

Our next question comes from Carsten Madsen from SEB.

Carsten Lønborg Madsen - *SEB, Research Division - Research Analyst*

Two questions. Firstly, in the U.S. market where you now launched the Coudé Pro product, what will likely happen with the installed base, if you can say, on the old Coudé products? You say it will be replaced, but is this something where patients just switch throughout the patients' names, et cetera? So just to understand whether you've come up with...

Lars Søren Rasmussen - *Coloplast A/S - CEO and President*

Yes, the current Flex product will be phased out.

Carsten Lønborg Madsen - *SEB, Research Division - Research Analyst*

When will it be phased out?

Lars Søren Rasmussen - *Coloplast A/S - CEO and President*

In -- yes, in the U.S.

Carsten Lønborg Madsen - *SEB, Research Division - Research Analyst*

In the U.S., and patients will be put on the new one?

Lars Søren Rasmussen - *Coloplast A/S - CEO and President*

Yes.

Carsten Lønborg Madsen - *SEB, Research Division - Research Analyst*

Yes. And then on GOP4, you mentioned all the costs that you have included that will also -- you will -- all the cost you will take and you'll pay for new development and new products, et cetera, and still expect the EBIT margin of 100 to 150 basis points. But how about contribution from these -- all these new higher-priced products that you have. It should also (inaudible) that these products performed well? Or is that, I mean, icing on the cake?

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

So what we have been doing and is still doing, we are moving machines from Denmark to Hungary. And we have most recently completed the move out of our Convex machines, and the next phase is to move the Concave machines also to Hungary. So I am expecting that production economy on those, the product categories will improve when they are in Hungary, and then thereby, also contribute to the targets we have in our Global Operations Plan IV.

Carsten Lønborg Madsen - *SEB, Research Division - Research Analyst*

That what we say, the Plan IV is mainly because exercise. But if you also have a better mix in terms of higher-priced products being launched, then that will contribute maybe even more?

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

No, the way I see it -- the way we see it is that the Global Operations Plan IV, when that is completed in 2021, it will add around these 150 basis points that I talked to earlier. So that's how I see ...

Lars Søren Rasmussen - *Coloplast A/S - CEO and President*

Are you talking about the clinical performance programs? So when we're launching all of the new products that have a significantly different performance than what we see today? But then we are out in -- on the other side of 2020. We are launching in '20, we think the first ones after. And that's of course -- that's products where we are going for -- they have a much better clinical performance than what we have today, and we're going for higher price. So it's the same as we see now with the Concave that we have to go market by market and establish a category for them because these products will have their own separate category. That's the only way that they will get a place in the market where they will be a payment for the quality that the products are having. So that's what we go for there. Of course, we do this in order to make sure that we create more value for the patients. But at the same point in time, we also try to create more value for us.

Carsten Lønborg Madsen - *SEB, Research Division - Research Analyst*

Yes, I was thinking about the Coudé Pro or the Convex and the Concave...

Lars Søren Rasmussen - *Coloplast A/S - CEO and President*

But they are not at all -- that is not the clinical performance program. These are great products. But what we talk about with the clinical performance program, those are a completely different level of products that can do significantly different things and at a much higher level than what you see today But this is just a teaser.

Operator

Our next question comes from Scott Bardo from Berenberg.

Scott Bardo - *Berenberg, Research Division - Analyst*

So first question, please, just relates to the historic growth of Coloplast, which has been excellent, but I think around 7% or so organic growth for the last 12 years. So the question really is that is it too early to say that your investments are accelerating growth, given that the 8% organic growth in H1 was on the back of 6% organic growth in the prior year? So I just wonder if that's more normalization effect or that's just an evidence of some step change, if you like, in your growth profile. If you could just sort -- share some thoughts there. Also just a sort of technical question on drop-through for margin. I think there's always been excellent operational leverage in the business. And the fact that you've taken a slightly more optimistic top line for the full year, not change your investment program or your gross margin expectations, a bit confused why you haven't changed your EBIT margin expectation for the full year. So perhaps, again, if you could just talk through some of the moving parts there. Last question, please, just on SpeediCath, and just following up from a previous question, which I didn't quite understand. If the expectation was that competition will come in and will be impactful to your business to some degree, but that competition hasn't come in yet, why is it not that the can is being kicked down the road to another year if that competition eventually materializes?

Lars Søren Rasmussen - *Coloplast A/S - CEO and President*

Yes, so I think I'll take #1 and #3 of your questions. So we now have 8 -- 4 quarters with 8% growth. That -- I don't think that, that means that we automatically will get 8% in the coming quarters. Not at all. I think that we are fighting hard for every inch of length that we are gaining because we are gaining in the current environment, of course. I think that we are having a strong product offering and also a stronger service offering than what we have had in the last few years. And we have been able to get 8% growth in the first half year. And as you said, in the first quarter, we had a positive impact from easy comps in the U.S. due to stock issues the year before. We are, however, going into the next quarters with Concave, which is being -- having a very, very nice reception in the market, and also with a better product offering than we have had for a very long time in the U.S. We also have launched the Sizes & Shapes on Silicone in the U.S. and Wound Care. We also launched special injury prevention products in the U.S. within Wound Care. And thus -- and then we have all of the investments that we have basically just kicked off that will also help us. So I think that we have a number of initiatives that make me feel good about the growth that we're looking into. But we are guiding for the rest of the year and not for the longer term, but our ambition is to grow at the higher end of the 7% to 9% in this plain period. That's what we are going for, that's what we are investing for.

And when it comes to SpeediCath, the reason why we are setting aside an amount for this year was based on the fact that we have never been in this situation where we have been discussing for a very long time a patent expiration because we had patents that expires more or less everyday. We have so many patents in the company. There are so many of our products that lose the patent protection year-over-year, and it's not been a big debate. But it's been a big debate on this one. And yes, SpeediCath standard is a very old product in our portfolio, and we launched a number of upgrades since then. But we were uncertain, we we unable to answer on the questions of what would the impact be because we have no history on it. And we have been discussing this forth and back. And of course, everybody just today understands that there is no price differential of a patented product and a unpatented product. So we thought that it was prudent to flag something that was the worst-case scenario that we could come up with. There will, of course, be competition going forward like there's always been, and -- but we just thought it was the natural thing to have it for the first year. And we don't think that we should carry it forward because why should we not then carryforward a -- some -- when somebody comes with a competitor to Concave or a new Convex products and so on. So we thought it would blur the picture. So this was a one-off for us, that was how we thought about it. And then the drop-through on the margin, Anders.

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

Yes, so in relation to our margin guidance for the year, so for the first half, we delivered a margin of 31% in fixed currencies, and our guidance for the year is between 31% to 32%. And the change of the top line guidance from 7% to 8% is not, you can say, significant enough in order for me to change also our EBIT margin guidance. So we feel -- we believe that we will -- or we still expect to deliver an EBIT margin guidance in the level of 31% to 32% in fixed currencies, and in reported currency an EBIT margin of around 31%.

Scott Bardo - *Berenberg, Research Division - Analyst*

Understood. I guess the only sort of come back from my side would be the difference perhaps is that SpeediCath is probably the largest single product (inaudible) in the company, which is why I think there's been so much focus on that particular expiry. But so I just wondered whether that situation was different from some of the expiries you see in the other portfolio, which is why I asked the question. Just maybe I'll just fault one on for that. Also, very good news with the Cleveland Clinic, clearly showing some good momentum and good quality of your offering and product. Now I just wanted to understand better, does this in your opinion, automatically default you to a 5 percentage points more of the U.S. ostomy market? Or are you still going to face the same legacy issues of having lots of forced conversion outside of new patient discharge in the U.S.? Can we talk through that a little bit more, please?

Lars Søren Rasmussen - *Coloplast A/S - CEO and President*

Yes, there is no doubt that the market in the U.S. is more financially driven than clinically driven, and therefore, the -- it's very important to get new patient discharges because you -- of course, you also in that setting have an opportunity to also work with the dealers, and dealer relationship between hospital and patient and the dealer. But that is -- it's not like in Europe where if you are the clinical choice, then you also very often become the choice afterwards. We have to be able to play in the whole value chain. So in that sense, nothing have changed. But that is also why we want to step up our offering because there is no doubt that being a healthcare consumer in the U.S. is -- at least when you're inside of Ostomy and Continence Care, it's tricky. And it's a place where people -- they could actually -- we can offer them a better service, and that's we are investing to give them. But we have to work on it, it's not just coming automatically. We don't anticipate that at all.

Operator

Our last question comes from Niels Leth from Carnegie.

Niels Granholm-Leth - *Carnegie Investment Bank AB, Research Division - Co-head of Research of Denmark & Financial Analyst*

Two questions. So could you just briefly comment on the sales contribution from IncoCare, which you recently acquired? And also just perhaps a comment on how sales is progressing regarding the Isiris Urology product.

Lars Søren Rasmussen - *Coloplast A/S - CEO and President*

I think that what you just say about IncoCare is that it's negligible. I can't even say it. You should not even think about it. Yes, It's so small that it's not in that sense something that means anything to the group. It's more local play, and we think it's a high-quality organization that we would like to build on, and that helps us give a little bit better numbers. I think that it's maybe more visible than what Lilial is doing because we are quite happy with that acquisition that we did in France. It gives us access to the payers. It gives us an opportunity to speak to the other dealers in the association, and thereby, also bring to the table the -- maybe the opinions and perspectives from another manufacturer. So I think that, that is -- there's probably more relevance to -- for us to speak about. But we are very happy with the implementation that -- and the speed of that, that we are seeing.

As with regard to Isiris, things are going according to plan. But please mind you that we are addressing sort of a niche segment with this product. But there is demand for this type of products, and we are progressing quite well on it.

Niels Granholm-Leth - *Carnegie Investment Bank AB, Research Division - Co-head of Research of Denmark & Financial Analyst*

Okay. But could you just talk about how the new distribution companies, Comfort Medical, Lilial, I presume that all of these assets are growing well above the group average?

Lars Søren Rasmussen - *Coloplast A/S - CEO and President*

Yes, that's correct. It's -- they are growing at a higher speed, but with a lower profitability. And for us, the most important thing about it is that we get a much stronger understanding of how we tailor our service offering so that it becomes really relevant to both other dealers but also to the patients, and that is -- that setup is not a uniform setup across the globe. It is different from the U.S. to France and to Germany and to the U.K., by the way. So in that sense, we need to be present in the team to really have this in-depth understanding. I think we have that by now, or getting that by now.

Thank you very much, everybody. And we're looking forward to seeing you in the coming weeks. Have a great evening.

Operator

This concludes today's call. Thank you for your participation. You may now disconnect.
