Company
Friday, 14 August 2009
15:00 Hrs UK time
Chaired by Lars Rasmussen

Lars Rasmussen

Good afternoon and welcome to this Q3 2008/2009 conference call. I am Lars Rasmussen, CEO of Coloplast, and with me today I have CFO, Lene Skole, and head of IR, Ian Christensen. As usual we have about one hour scheduled for this conference call, so let's turn to the slide number 3.

We have again this quarter obtained very satisfactory earnings with an underlying margin of 17% and an absolute growth in earnings of 11%. I believe I can say that this confirms the sustainability and positive effects stemming from our focus on efficiency gains and cost reductions. We realised 5% organic sales growth and 4% reported growth, which we find somewhat disappointing. I cannot say that we didn't expect this as we knew that the measures taken to turn around the situation in Germany takes some time to kick in. We are now through the changes in our German organisation and we expect to see performance improvement in this market. We realise that very strong free cash flow and our efforts to control and improve on our working capital is the main contributor behind this. In spite of this, the Board has decided to cancel the remaining part of our share buyback program. The main reason for that is our own wish to improve our cancer research to participate in potential acquisitions should the right one be made available to us.

We have revised our guidance for 2008/2009 slightly. Our guidance for organic growth this year remains around 6% and now 5% in Danish Kroner. Change in currencies has impacted estimated reported growth. We have slightly revised our expectations for the EBIT margin to now 16%-17% in fixed currencies from previously around 16%. The change is related to our continued cost focus. Our capex expectations are reduced again to now around 600 million due to lower sales requiring less capital equipment; and finally, the effective tax rate is unchanged at 28%.

Let's move to the next slide, which is slide number 4. Revenues were up by 4% to DKK6.6 billion. Currency impact reduced growth by 1 percentage point and the organic growth was therefore 5%. This growth is probably in line with or slightly below the current market growth, but if we exclude for Germany, organic growth was 8%. Within Ostomy Care we saw an organic sales growth of 3% to almost 2.7 billion Kroner, impacted by the lower than expected sales primarily in Germany. Reported growth remains flat. Excluding the German market, organic growth was 7%. The biggest growth driver in this business segment is still this SenSura product line. In Urology and Continence Care sales were also DKK2.7 billion; this equals an organic growth of 8% and reported growth of 7%. We saw high growth rates within intermittent catheters, especially SpeediCath and Selfcath and also satisfying sales of Peristeen and Conveen products. Finally, the sales were satisfying in the US and European Urology business.

This quarter we have launched two new products within Urology and Continence Care, SpeediCath Compact Girl, compact catheters for paediatric use and the Virtue Male Sling for surgical treatment of male incontinence. Our Wound & Skin Care business grew 4% both organically and in Danish Kroner to around DKK1.1 million. Growth continues to be driven by Biatain foam bandages. We continue to face price pressure in the main European markets and challenging market conditions within the hydrocolloid bandage segments. At the same time, consumer products were impacted negatively. During summer the French authorities has proposed a reimbursement cut on homecare products of 5.5% and consultants consultations are on the way and we will communicate further when there is a final result on this matter.

Looking at Europe, sales were DKK5 billion and the organic sales growth was 4%. Sales were affected by the declining sales of Ostomy Care products in the German market; excluding the German market sales grew as expected. Growth in the Home Care business remains under pressure from tough competition, but also from the fact that the revitalisation project covers a lot of ground deep within the Home Care organisation impacting performance. Revenue in the Americas rose by 22% to DKK1 billion and the organic growth was 12%.

We still realise satisfactory growth in all business segments and continue to see the positive effect of the improved reimbursement for catheters in the US markets. Revenue in the rest of the world, in which Japan and Australia represent the two largest markets, improved by 16% to around half-a-billion Danish Kroner, while organic growth was 9%. The restructuring of our Wound & Skin Care and our DSU or Disposable Surgical Urology business is progressing according to plan and the focus arrears are unchanged. Within Wound & Skin Care we have now finalised organisational restructurings and we are currently involved in cost reductions throughout the Wound & Skin Care business. Work has now been initiated with the aim of optimising the product portfolio. In our Disposable Surgical Urology business we are in the final discussions with our French Works Council about the future of up to 25 positions for the first layoffs have been initiated.

With this sales overview I will hand you over to Lene; please turn to the next slide which is slide number 5.

Lene Skole

Thank you Lars; and we are now on slide number five. Gross profit amounted to DKK3.8 billion, and that is equal to a gross margin or 58%; this is down 1 percentage point from last year. If, however, we exclude the effect of currencies, the gross margin is slightly better than last year. We still see price pressure, especially in the market for Wound & Skin Care products, and this continues to put pressure on the gross margin. In addition, production costs for SenSura and the new generation of Biatain foam dressings are still higher than expected. We expect the production costs for these products to normalise when we have transferred production to Hungary by the end of 2010.

Finally, we are still producing below capacity due to lower than expected sales. All of this, however, has been offset by continued improvements in the production economy resulting from the relocation of productions to Hungary and China. We continue to see significant improvements to the SG&A to sales ratio, which is a very satisfactory development. The distribution to sales ratio is bout 31% of revenues and this quarter impacted negatively by severance payments. Apart from these, we are still able to keep this ratio stable despite sales being below our previous expectations. Our admin to sales ratio continues to decline; in this quarter we realised 7%. This is due to continued focus on savings, efficiencies and cost containment throughout the organisation. The development submits the positive development throughout the year and supports both current short and long term profitability targets. Finally, the R&D to sales remains around 5%. The result of all this is a reported EBIT margin of 15% and an underlying margin of 17%. The balance sheet remains healthy and our net interest bearing debt to EBITDA is now 1.6, which is down from 2.1 last year.

As you can see we are getting very close to the bottom of our net debt to EBITDA range and we could very well drop outside the range by Q2 next year. As Lars mentioned, we want to build up capital reserve so that we will be ready to pursue any suitable acquisition. This could mean that we would be below the lower range of the target. We have nevertheless decided to maintain the range as this still reflects a reasonable range in the long run. We will obviously monitor our capital structure closely with a view both to our range, our belief in acquisition candidates actually turning up, and the general market availability of funding.

Return on invested capital after tax was 14%, which is the highest over at least the past 10 years. The working capital to sales ration continued to improve and is now at 28% of revenue, compared to 31% at the end of the same period last year. Compared to the end of Q2 we have seen a 1% reduction of working capital to sales. We continue our efforts to improve this ratio further. The main underlying improvement this quarter came from a reduction of stocks. Capex amounted to 473 million, corresponding to a capex to sales ratio of 7%. Capex was primarily spent in equipment investments for the factories in Hungary and China and in our US headquarters.

Finally, the free cash flow was DKK748 million compared to 239 million last year. This significant improvement comes mainly from the fact that last year we tied up cash in working capital whereas we have been aiming to release cash from working capital in this period. Higher tax payments in 2008/2009 have impacted the cash flow negatively compared to last year due to the fact that cash tax payments were extraordinarily low in 2006/2007 and in 2007/2008 as a consequence of the Mentor acquisition.

We now turn to slide 6. For 2008/2009 we continue to expect a growth of about 6% organically, and now 5% in Danish Kroner. The change in guidance in Danish Kroner reflects the combined impact from deterioration of Coloplast's main currencies against Kroner; especially the British Pound and the US Dollar have depreciated against Danish Kroner.

And now just a few comments on our growth guidance; we currently expect to end the year in the low end of the guidance. The reason for keeping the guidance despite a 5.3% realised growth year-to-date, is based on expectations that market conditions in Germany start to improve in Q4. We continue to build on the profitability improvements we have seen in the first nine months of 2008/2009 and raise our forecast slightly. We now expect an EBIT margin between 16% and 17% in fixed currencies and 15% to 16% in Danish Kroner. We lower our capex estimate for 2008/2009 to around DKK600 million from previously around 700 million. The excess production capacity that I mentioned earlier has led to lower requirements for investments in new machines at the same time as we continue to optimise our investment program. Our effective tax rate is expected to be around 28%, which is unchanged from the previous guidance.

This concludes our presentation of our results for the first nine months of 2008/2009 and thank you very much. Operator, we are now ready to take questions.

Questions and Answers

David Adlington - Cazenove

Thanks guys, thanks for taking a question. Really just on your decision to fully cancel the share buyback program and build up some cash for acquisitions; I presume you are looking at something on the Wound Care side and I just wondered if you could give us some idea on maybe timing, potential size and maybe any appetite for additional capital, whether that will be debt or equity to fund such an acquisition.

Yes David, just a few comments on that. We are not looking at anything in particular now on the acquisition side. We have previously said that there are various areas that could be of interest, among those the Wound Care and, as I said, we don't have anything on the radar screen right now, but given the fact that the credit markets are still more tight than they used to be, then we feel that it is right for us to build up a capital reserve so that if anything should come up within our core business areas we would be ready to react on it immediately.

So you wouldn't be looking at adding in new areas?

We are thinking about our core business areas.

That is great. That is clear; thank you.

Wi-Tan Wang – Deutsche Bank

Thank you very much. I have a number of questions, but I will ask them one at a time. Would you be able to give us a bit more colour on the dynamics within your Ostomy business in the quarter that ended June? It seems that the Ostomy business outside of Germany has slowed quite a bit, but in Germany improved significantly. It would be helpful if you can give us the rate of Ostomy sales gross in and outside of Germany, specifically in the quarter; and on Germany, what are you doing to address the issues in Germany and what kind of benefits should we expect in the Fourth Quarter and also through next year? Thank you.

I think that when you are speaking about the Ostomy growth in Germany improving significantly, what we see is that we have gotten the situation under control and we do see that we are not continuing to decline in sales in Germany, so we see that the trend is moving in the right direction; it is not going fast, but it is moving in the right direction, not just on one month, but more months.

I think that what you see when you are hinting at what is going on outside of Germany, I think that you need to see it in the longer perspective than just a quarter. It is simply too little to comment on it outside of Germany. What we do see is that we are winning markets, yes, as soon as we are outside of Germany and I think that we are quite positive there. It is of course hard to say how long time it takes for us to be back on the usual track in Germany, because it is a big machine we have there, but I would expect it to take sometime for us before we are seeing growth in Germany, but what we see is that, what we can observe now is that the negative trend that we have been having in Germany for quite some time has turned around and we are moving in the right direction.

Are you actually flat in Germany or are you still declining in Germany, but just not at a great rate of decline as you were seeing before?

I would like to say that we have stopped the decline in Germany.

Stopped the decline. Okay, and then the issues outside … I mean I am not saying that there is an issue, sorry I shall rephrase that. Is that more just because you have fewer sales days in this quarter, so on a same sales day adjusted basis, you are actually still delivering growth that are largely on par with what was happening before?

I think it is always a little bit difficult with the sales days, but you are right that when we are talking sales days in our company it's of course invoice days that we are talking about, so there are too fewer sales days and thereby also too fewer days that we could invoice in this quarter compared to last year's Third Quarter, but it is not something which popped up on our radar screen that should be anything of significance we are talking about.

That does make sense. My second question is how significant will SpeediCath Compact Girl and the Male Sling become in the next few years; how fast should we expect these sales to ramp up? How different is your Male Sling compared to the others on the market and what sort of share do you expect to capture in this market, which is really just a one company market right now?

I think, first of all, that the innovation, which you might see cover some ground, would have to be SpeediCath Control, which we launched last quarter. SpeediCath Compact Girls is a small thing and it is just to show our dedication to the paediatric segment inside of catheters of course. When it comes to the sort of Male Sling, I would like to be very cautious at this point in time, because as you say it is a one company market. It is a market where you really see for the time being that these surgeries are postponed, so it is pretty hard for me to say much about it, because I would need to cover a little bit more ground before I start guiding on it, because that is basically what you are asking me to do, and I am not prepared to do that right now.

How different is that product relative to the competitors' product?

It is easier to install than the competitors' products and it thereby takes less time. Time is money in the operating theatre and that counts a lot in the US market, but we also have to be certain that when we see people are trained in this that they are actually able to also experience that and that is why I am a little bit cautious with it, because we know that if you can come up with better procedures, the doctors will prefer the solution that you are coming with, but we have proved it so far in the few procedures we have seen, but we need to see more procedures in order to say that this is really something that is moving the market.

Martin Sikorski – Cheuvreux, Stockholm

Good afternoon; it is Martin Sikorski with Cheuvreux in Stockholm, thanks for taking my question. I have one question and it relates to Wound & Skin Care and the overall reimbursement environment. I believe you mentioned earlier in this call that there was a proposal in France of a 5.5% reimbursement cut for Wound & Skin Care products. Can you give us an update on the overall reimbursement environment in Europe right now? Thank you.

When it comes to the over all reimbursement environment for Wound & Skin Care, the only change that we are aware of, of significant character, is the one in France and that is a 5.5% suggested cut on the reimbursement price. How that will play out, how much of that will have to be absorbed by the industry, how much is going to have to be absorbed by the distribution is hard to say right now. It is also something which has not at all been commented on or discussed with the authorities, but this is what they have put on the table right before summer holidays. We are not aware of any changes that would go in the same directions elsewhere, but we do see price pressure when it comes to timber, so there we see that price pressure, which is coming from the industry but not from the reimbursement authorise, so the only thing we are aware of from the reimbursement authorities right now would be this one in France.

That is very helpful, thank you. May I just have one follow up question? Is there any date in particular that we should bear in mind as far as France goes when it comes to a potential decision here? Thank you.

No, we don't have any date for it. We don't expect it is going to be a lengthy process like the one we had in the UK. It is not in the same magnitude at all either, so it is something which is very different from what we saw there, but we don't have a specific date on when this is going to be dealt with. But it is not, we don't expect it to impact our 2008/2009 numbers, but when we know something about it we will take it into the guidance for next year.

Clause Madsen - Handelsbanken

Hello, it's Clause Madsen from Handelsbanken. My first question relates to your reiterated organic growth guidance of 6%. You already yourself pointed to the potential acceleration in growth we need to see. I just wanted to hear if you could confirm that you already, in what you have seen on this quarter, see this acceleration that is needed to get you to close to 6% growth. My second question relates to the US market where there is a slight uptake in Q3 compared to Q2 in growth, and if you could decompose that, especially in the light of the disappointing sales you have seen in Skin Care, so obviously there must be other segments that moves positively.

Maybe if we start with the growth that Lene mentioned. What Lene said was that we do know that we are a little behind on the growth so far and we expect to see a slight pickup in the last quarter, and that is not least due to an improved situation in Germany. I also believe that what Lene said was that we are going to be the lower range or the lower part of the range that we are looking at, but still it is due to a reasonable growth momentum and due to a changed situation in Germany; so that I can confirm. In the US, I think that we had some healthy growth rates in all of our business areas with the exception of Wound & Skin Care as you mentioned. We grew … let me see if I can just remember what it was, because we are actually heading quite a nice growth on our Skincare and … I'm just trying to get back to here, hang on a second. I just had to dig out the numbers and the only thing that I can say is that we are exceptionally positive on Ostomy Care in line with what we want to get on Continence Care. Urology Care is nice, despite the fact that we see postponements on a number of the surgeries. The Wound & Skin Care part, we don't see anything which is market driven and the only explanation that we can come up with for it is that it is just because you are viewing it on a three months basis, so you can have some swings from last year to this year, but there is nothing there which is pointing to the fact that we should see overall a declining trend on the Wound & Skin Care side, not at all.

Then just finally on the geographic side, the rest of the world declined significantly sequentially from Q2 into Q3 and is that all related to the restructuring of Wound Care and this transformation or transition to distributors or are there other factors in play?

No, it is still because we are looking at a quarterly basis; there is nothing which is pointing towards an ongoing negative trend for these countries, not at all.

Then just finally on product launches for the year, I think you gave some kind of target, quite a bullish target for product launches throughout fiscal 08/09 and how far are we in your product launches, are there more to come in Q4?

No, there is not more to come in Q4. Actually, we are spot on. We have launched 100% of what we had planned to launch so far this year. I would also like to add that we have a portfolio of new products, which we are very satisfied, with within all of our business areas and I am personally very pleased with the way that our innovation machine is running. We are getting things through fast and we are launching on time to the markets, so I am very pleased for that part of it actually.

What is your current innovation rate? I don't think you have given it in this announcement, but is there any change in the trends there?

I don't have it at hand, but I think it is around 16%.

And that is slightly up, isn't it?

It is slightly up, yes.

Then just finally on acquisitions, do you see any increased frequency in potential deals that you are presented to and what do you see in terms of pricing and what you see proposed to you?

We see, as I think most companies see, a lot more visits by corporate bankers that want to sell us something, but in terms of actual deals we don't see any increase and it is very difficult to judge in terms of pricing, because there is actually very, very little going on.

Okay, thank you very much.

Niels Leth - SEB Enskilda

Good afternoon. According to the Danish media you are going to reduce staff in Denmark by around 400-500 a year of the coming few years; could you talk about the one-off costs associated with these staff reductions?

Niels, are any one-off cost that will come there will be included in our guidance as and when we give it for next year and the coming years, so we can't really comment on any of that.

In the UK healthcare reform it was mentioned that you would receive a temporary compensation for lack of price adjustments in the past two years, which if I remember correctly would take place from 1st October and then six months ahead; have you been able to calculate what kind of impact this is going to have on your business from October onwards?

Niels, I think there is a misunderstanding here, because it was not a compensation for something we haven't received, but before this whole consultation period started then there was in place a regulation mechanism linked to inflation. That regulation mechanism was put on hold during the whole consultation period and the only thing they are saying now, and that is of course very positive, is that they will re-introduce that inflation regulation that they used to have, so it is not a compensation for something that we have lost, it is just that this compensation mechanism that used to be there is now being re-introduced.

In 2010.

Yes, that will be 12 months after this takes effect.

Then just final question on your net financial items; when you look into your currency contracts are we going to see any substantial swings in your net financials here in the coming few quarters, assuming flat currencies from here of course; are you entitled to a lot of hedging gains still or are we back to a square level basically?

I don't think you will see it or you won't see as much as you have seen with given stable currency rates. If currency rates fluctuate a lot then you will see swings that primarily come from assets that we have outside Denmark on balance sheet items, like factories and so on.

Jesper Breitestein - Carnegie

Hi, it's Jesper Breitestein from Carnegie. I just had a question on the Wound & Skin Care business. At the beginning of the year you mentioned that the phase-out of the product would mean 1–2% negative on the growth rate for the full Group and we haven't seen that yet; should we expect some of that to come in the Fourth Quarter and will the rest come in the next year? And the second question on Wound & Skin Care is if you can get an update on the negotiations with the distributors in the different markets.

It is hard to say for us exactly how much the Wound & Skin Care have impacted the whole group, but it is for sure that we have been impacted on the growth rate on Wound & Skin Care this year with the things that we have been doing in the Wound & Skin Care business. We are also seeing that the Wound & Skin Care profitability is increasing and that was the whole aim of what we are doing here was to have a better bottom line on the Wound & Skin Care business. We are in the last phase of our programme to reduce costs in Wound & Skin Care and to improve the business and we expect that during the last quarter of this calendar year we are finishing off the things that we have planned to do and from there on we start to normalise the situation in this business area. Out of our whole portfolio of countries it is approximately half of the countries that we have been working with, maybe a little bit less than half of the countries where we have either left the market or where we have changed or are in the process of changing the distribution from ourselves to one of the external distributors.

I think at the beginning of the year the 1–2 % you mentioned was around 100-150 million and if we look at the run rate on a quarterly basis on the top line there has been really no changes; should we expect that the Wound & Skin Care turnover to come down by 100–150 million over the next coming quarters?

No, I don't think so.

If I can just add something, Lars, because when we gave our guidance initially this was included in our guidance for the growth. Then I know we also have to reduce our guidance; that was because of Germany, and we are now in line with the guidance that we gave including the reduction for Germany, so actually as we see it, we are seeing the reduction that we expected.

To come back to the core of your question, which is are we about to see a worsening of the situation due to the activities that we are doing in Wound & Skin Care, which I think is what you are after; that is not how we see it, we are progressing as planned and we can see the end of the activities that we have to do.

Hans Bostrom – Goldman Sachs

Hi, this is Hans Bostrom, Goldman Sachs. I had a few questions and actually think I want to tag onto the previous question related to the Wound & Skin Care business, because it seems that the performance is actually in reported terms rather better than one would have feared given the reduction in subsidiaries that you have had. Can I just clarify that you actually do see the current run rate of revenue as some form of floor level from which you don't actually expect a further structural reduction in revenues because of the changes in your distributor model, is that correct? That's my first question.

I think in a way that you are asking for more clarity based on the quarters result than what we are able to give you. We have had a quarter here which was maybe better than what you would expect when you understand what we are doing with the business, but on the other hand we have also had some bad quarters, so what we would like to stress is that we are doing the things that we planned to do with this business area in order to improve future performance of it. It has had an impact on our top line and when you are viewing that on a quarterly basis it can come out either maybe a little bit more negative than what you expected and then also maybe a little bit more positive than what you expected, but all in all we do not expect to see that if you take this fiscal year's run rate that we have to go to further significant down before it starts to become better.

So effectively the restructuring of your distribution of Wound Care products should have been finalised by the end of this fiscal year; is that correctly understood?

Yes, that's correctly understood.

Then relating to some questions on your costs, one question I would have is relating to what impact the negative pricing in Wound Care perhaps in particular has had on your gross margins this quarter; do you have an estimate of that, because it seems to underwhelm my forecast a bit in terms of gross profitability?

No, we don't have and we don't give out information as to specifically how much competitive situation in Wound Care impacts the gross margin. As I said, there are the key things that impact our gross margin negatively; those are the production costs for SenSura and the Biatain products, but we didn't give out a number for how much the price index change impact we have in the individual business areas.

My understanding was that you actually expected an improvement Second Half or the First Half in the order of 200 basis points, perhaps even more than that, where clearly you haven't achieved any improvement in Q3, so either there will be a jumbo improvement in Q4, indeed there is something that has changed compared to your previous expectations; could you elaborate along the lines of that please?

I can say that first of all Q3, actually if you throw back currency impacts then there is a slight underlying improvement. The only thing that has changed from when we gave the original guidance for the year was that currencies have impacted us obviously more than what we expected.

And in terms of where you are with the manufacturing transfer, is this something where you should see considerable further improvement or is that not really a source of improvement on your gross margin from this level?

We still expect to see improvement in the gross margin, at least at some of the activities.

So if you could put in context where you started and where you are going to, how far along the way are we?

We still have some transfer to do, and I think we have been quite clear about that. And from what we have in Denmark right now we need to move about half of what we have left in Denmark and then we are done and this would mean that we get down to having about 15% of what was all produced in Denmark.

And where are you currently?

We're somewhere around 30.

Then with regards to your distribution costs that jumped considerably and they jumped considerably from last year, they jumped considerably compared to the First and the

Second Quarter; are there any peculiar effects that are of non-recurring nature in this and will this be an indicative level for coming quarters?

As I mentioned initially in this conference call that we have some severance costs that are included in this quarter and they are including it in that line too and this magnitude it is around DKK20 million, If you take that out then I trust you will agree that we see quite a reasonable development also in that line.

Thank you very much.

You're welcome.

Wi-Tan Wang – Deutsche Bank

Just one more question. On R&D what sort of R&D costs should we expect the business to incur, I suppose, in the Fourth Quarter given that you are somewhat below the 5%, around 5%, I suppose? That's all, thank you.

You should probably expect around 5%.

Yes, more or less.

5% in the Fourth Quarter?

More or less, yes, around there.

Closing Comments

Lars Rasmussen

If there are no more questions I would like to thank you all for participating and wish you all a great weekend. Thank you very much.