Coloplast
Thursday, 29thApril 2010
14:00 Hrs UK time
Chaired by Lars Rasmussen

Lars Rasmussen

Thank you. Good afternoon and welcome to this first half-year 2009/10 conference call. I am Lars Rasmussen, CEO of Coloplast and with me as usual I have CFO, Lene Skole and the director of IR, Ian Christensen. We have about an hour so please turn to slide number three.

First half of 2009/10 fiscal year has been very positive for Coloplast. Our two biggest business areas: ostomy care and continence care have got a better sales growth momentum than they had last year and we see a strong cross margin development. Finally our EBIT margin remains at 20% and therefore I am very satisfied with the current performance of Coloplast.

We realised a 7% organic sales growth and a 6% reported growth in line with our guidance. For the second quarter in a row, we can report a very satisfying earnings development corresponding to an EBIT margin of 20%. The free cash flow remains strong from the good earnings performance and continued low capex.

We have made the following adjustments to our guidance for 2009/10: organic growth rate of 6-7% remains unchanged but with the present currency exchange rates, it now corresponds to 6-7% in Danish Kroner also.

We upgrade our EBIT margin expectations slightly from 19% to 19-20% in fixed currencies and in Danish Kroner and we lower our capex expectations to around DKK350 million so let's take a closer look at the sales growth and move to slide number four.

Revenues went up by 6% to DKK 4.6 billion, corresponding to an organic growth of 7%, which is in line with our guidance. Within ostomy care we saw an organic sales growth of 7%. The biggest growth driver in this business segment remains the SenSura product line and growth in the US is impacted by good sales momentum to major distributors and emerging market sales are also impacted by good sales in Brazil.

In urology and continence care, organic growth was 10%. Growth was driven by intermittent catheters, especially SpeediCath in Europe and Selfcath in the US. Collecting devices and Peristeen also performed well. The US and European urology business had a good quarter and both men's and women's health performed in line with expectations.

Within our wound and skin care businesses, organic growth was flat. No growth is clearly not satisfactory. We are now implementing on the new go-to-market model which will bring growth back into the business and we expect to launch community set-ups in UK, France and Germany soon. But until we have these organisational changes in place, expect limited or no growth in this business area.

Looking at the regions, the European sales ended at 6% organic growth, sales showed good momentum both within ostomy and continence care whereas the wound care business was impacted negatively. German sales ended the half-year slightly down following a positive Q1. We expect sales to stabilise with a positive trend. The organic revenue in the Americas went up by 14% and we saw satisfactory growth within continence care and improving performance within ostomy care. Revenue in the rest of the world improved by 6% organically. Growth remains negatively impacted by a lower number of tenders in this region and lower sales in Japan and Australia. With this, I will hand you over to Lene Skole for more details on the financial numbers. Please turn to slide number five.

Lene Skole

Thank you, Lars. And we are now at slide number five. Gross profit amounted to DKK 2.8 billion, equal to a gross margin of 61%. This is an improvement of almost 2.5 percentage points compared to the same period last year. Improvements in the production economy remain significant, especially due to better capacity utilisation in Q1 and lower cost prices.

The transfer of production of SenSura and Biatain film remains on track and now more than half of these products are produced in Hungary. The SGNA to sales ratio improved by three percentage points compared to the first half last year and ended up at 36%. The SGNA to sales ratio was impacted positively by sales force optimisation programmes as well as a continued focus on savings and efficiencies. The R&D to sales came in at 4% which is within the range of 4-5% previously estimated. This results in a reported EBIT margin of 20%.

Net interest bearing debt to EBITDA remains at 1.0 in line with last quarter. We have decided to put our capital structure policy under review and we will communicate further on this matter within the next quarters. Capex amounted to DKK 132 million, corresponding to a capex to sales ratio of only 3%. The capex remains low but major projects will begin later this year. The delay of these projects means that guidance on capex for the year is revised downwards. Return on invested capital after tax was 20% for the quarter compared with 13% in the same period last year and in line with last quarter. This is the result of the combination of increasing profit, lower capex and improving balance sheet items.

Finally the free cash flow was forwarded in DKK 69 million compared with 286 million last year. The significant improvement comes mainly from the combination of stronger earnings, changes in networking capital and lower capex. Our financial performance remains strong and we continue to be impacted positively by the various efficiency projects throughout the organisation. As a result of that we have made adjustments to our guidance which I would like to comment on further so please turn to slide number six.

For 2009/10, we continue to expect growth of 6-7% organically but growth in Danish Kroner is now also expected at 6-7% from previously 5-6%. The change in guidance is primarily related to a slight strengthening of various minor currencies such as the Brazilian Real, Australian Dollars and Swedish Kroner which have appreciated since our previous guidance.

The organic growth guidance continues to be based on the trends we currently see in the market including the negative impact from the implementation of healthcare reforms in the UK. Late implementation of the price cut in certain wound care product categories in France means that we expect to see a limited impact on this year's numbers from that.

For 2009/10 we have made a slight upwards adjustment of the EBIT margin to 19-20% in six currencies as well as in Danish Kroner from previously around 19. We upgrade the EBIT guidance because we expect that the improvements achieved in the first half of the year will be sustainable for the full year. We will, however, be hit by the UK healthcare reform and we expect additional costs related to the transfer of production to China from Vadnais Heights.

Finally, we are considering adding more sales pressure in our wound care business in the second half of 2009/10. We expect our capex for 2009/10 to be around DKK 350 million, from previously DKK 500 million and this reflects continued optimisation of investment programmes and a slightly more delayed initiation of certain projects than previously expected. Finally, our effective tax rate is expected to be around 27%.

So summing up the first half of 2009/10 with a better sales growth momentum than last year within our two biggest business areas: ostomy care and continence care, the sales in line with guidance and strong gross and EBIT margin development, I'm also very satisfied with the current performance of Coloplast. This concludes our presentation of our results for the first half 2009/10. Thank you very much and operator, we are now ready to take questions.

Questions and Answers

***Vik Chopra** – Piper Jaffray, London*

Hi, good afternoon, thanks for taking my question. I have a couple of questions for you. Can you provide us with an update on your wound care business so, you know, which regions specifically in EU are you seeing negative pressure and when can we expect this business to return to growth 2011, 2012 timeframe?

Secondly, on the remaining 60 million of special items, when can we expect those to come through and can you also remind us when the production of the SenSura and Biatain is to be almost to Hungary? Thanks.

Lars Rasmussen

When it comes to wound care, we see pressure on the prices, especially in the southern part of Europe: France, Spain, Italy and we… it's of course a little bit hard to predict when growth will return because it is so much easier to plan for sort of haircuts (?) on the cost side than it is to plan when the things you do to get growth back is impacting, but the fact is that we have launched the silicone product now in four countries. It was launched during the quarter that we just ended. It has been very well received in the markets and that is launched into the fastest growing segment of the advanced wound healing market so that will have a positive impact once that sort of starts to get size.

The other part is that we are launching a community sales force in UK, France and Germany and we have never had a community sales force in the group before and of course that is going to address a segment of the market which we know is there but which is not a market that we have been used, that much at least, to work in.

So in that sense it will come and it takes of course time to establish this and also for it to start working and that is why we are saying that for the rest of this year we don't expect it to be a positive picture on the growth side but we expect that at some point in time next year we should start to pick up growth again.

Lene Skole

Okay, and you also asked about our special items, the total of 60 that we have guided. Now we have spent obviously almost all of it and the rest of it I would suggest you simply just split up over the next couple of quarters because, as we did at the beginning of the year and also at end of Q1, we prefer not to give you specific quarters simply because it's sensitive with regards to our employees.

You also asked about when we expect to complete the transfer of SenSura and Biatain. We expect the major part of that to be completed by the end of 2010 and there'll be just a few things running into 2011.

Klaus Madsen *– Handelsbanken*

Yes, hello. It's Klaus Madsen from Handelsbanken. My first question is on the sustainability on the gross margin level, which is impressive in Q2. How much exactly do you think is non recurring in Q2 and hence recurring for the rest of the year? The other question is the… if you could be more specific on the initiatives (?) that should dilute profitability in the second half according to your guidance which, of course, looks very conservative in the light of first half performance. You did point to some initiatives but could you be more specific on timing and magnitude of the cost components of these initiatives? Those are my main questions.

Lene Skole

Thank you, Klaus. First of all I'm glad that you think we are conservative because that must mean that you believe in us so that's good to hear.

If we talk about the gross margin, there was a steep pick up in Q2 compared to Q1 but when you compare those two numbers then in the first quarter we produce sort of less capacity so we utilise from our stocks, we reduced our stocks. In the second quarter we did the opposite.

That's quite natural because we do start sort of building up stocks now for the summer holidays and that means that Q1 was probably artificially low and Q2 artificially high. So for the first half, the 61 we have achieved there, we do believe that that is sustainable for the year and when you then say, you know, why isn't it more, then only the grossh margin, there are a couple of things that flow through to the gross margin.

Obviously the health care reform in the UK will also have an impact on the gross margin and then the transfer of production from the US Vadnais Heights to China is a new decision that was made in the second quarter. Luckily we're in the situation that we will be able to contain the cost of redundancies within the guided 60 million for restructuring costs but there are also other costs that are related to transfer just like with Hackdem (?) in Denmark and that we will be able to have within sort of our gross margin and still be able to deliver the 19-20%.

And then specifically in addition to the two things that I've mentioned is that with the growth or the lack of growth rather that we're seeing in the wound care, then Lars and I have asked the whole organisation say in the wound care, say can you come up with some initiatives that can help us get more growth in that business while we are, you know, completing the programme we have for improving the wound care business and we want to be able to fund that as well so that is also… to fund such initiatives as well so that is included also in our guidance. I hope that answers your question, Klaus.

Yes, it does but it still looks like you would then be ready to significantly spend on driving growth in wound care and I was just curious exactly what kind of ambition or what kind of spending level will you accept to drive growth here because obviously it was like a shrink to grow exercise which drove up profitability but are you now willing to basically risk the gain profitability level in order to return to growth?

We're not ready to risk that. There are certain levers that one can pull within wound care that can help which is such as having lease sales forces which is commonly used within the wound care business and which is something that you can put in place relatively quickly and as I said it's something we've asked the organisation to look out for so we don't sort of have specifically how much cost that that would drive but if we can see that we can get more growth and without obviously deviating from the plan that we have for wound care, then we would like to be able to do that.

Okay, then a couple of other questions: the growth in Germany, which seems to be on a negative trend in Q2 and I guess you indicate negative in Q2, could you decompose that on the homecare business and the rest of the German business and the growth acceleration we see in the US, what are the main drivers here and is the trend sustainable?

Lars Rasmussen

When it comes to Germany, actually we see a little growth in… on the ostomy side so that is very positive because that was really where we were sort of hit last year and where we have a little hardship in Germany is on the wound care side. So in that sense we are investing to get growth and have been investing sort of consistently to get growth in our ostomy and continence care businesses across the globe and that works.

We are in a very different situation than what we were in last year when it comes to the ostomy and continence care businesses in Germany, especially the ostomy business because we have, I would say, at long last customer relationship with the biggest customers there. We don't see hostile attacks like we did and we see a steady improvement and a trend which is going in the right direction on the chronic care business

and then of course we have some issues on wound care but overall we do expect that the growth trend for Germany will be positive.

When it comes to the US, it's… I think you see fluctuations a little from quarter to quarter but… and therefore you… it's very hard just to take two sort of consecutive quarters and then take a trend out of that. We are doing many things in the US to improve growth and we are launching a number of activities also during this summer to even enhance growth on the chronic care business and we think this is just a sign that things are going in the right direction but it's not a sign that you should see that it's jumping like this every quarter but you also see a trend there which is pointing in the right direction.

Could you be more specific on what kind of initiatives should drive growth further in the US?

It's… I think it's no secret that we are losing a number of especially ostomy patients downstream so we have a higher new patient discharge here than our market shares and of course we're not satisfied with that so to handle that situation we need to make sure that those that follow through, where we make sure that we are holding hands with the patients right from they are sort of having the operation in the hospital and then until they're satisfied with the solution that they have with an ostomy pack. And to be able to handle that you need a certain organisation but you also need a certain IT backup because there is so much information in that loop and that is in place now and is going to be launched during summer.

Those were my questions. Thank you very much.

***Stephen Gaspeyger** – Jefferies*

Hello there, Stephen Gaspeyger, Jefferies. Thank you for taking my question. Just a question on Hungary: could you give us some colour (?) please on how unionised the environment for your workers is there, how much you have to deal with trade unions and are there any major claims for wage increases there on a regular basis? Any more colour would be appreciated. Thank you very much.

Lars Rasmussen

It is… that's a good question. We don't… we didn't really have it before to the best of my knowledge and that's what I have to say here, if we are not unionised in Hungary, we have normal salary regulations once a year. There are no sort of automatic levers built into that and so far we have seen a very reasonable way… sort of appreciation of the wages and basically, as it is, the fact really is that the Hungarian labour market has not been able to keep up with at least the Danish labour markets so we actually see a bigger difference in the salaries between Danish Kroner and Hungarian Forint, a bigger difference in the wage levels today than we saw it… than when we actually started out in Hungary nine years ago so in that sense it's… I think that's what you're after, how fast is the gap closing. We don't see that the gap is closing actually. On the contrary.

Thank you very much.

***Jacob Thrane** – Standard & Poor's*

Yes, good afternoon. Thank you for taking my question. Most of them have been answered already but just a trend in we've seen in ostomy in sort of non European markets, is that something that we could expect that that is sort of sustainable or we're a sort of one-off influencing that number? Thank you.

It's, well, I did comment on the situation in the US. I think that the only other place where there's a special situation would then be Japan and in Japan I actually think that I mistakenly in the last quarter's presentation, said that we expected growth in the second quarter and that should have been in the second half because it has to do with a comparison number. So we have had a lower growth in the first half of the year than we expected in the second half of the year.

Okay, thank you very much, Lars.

David Adlington *– JP Morgan*

Yes, thanks for taking my question. I've got a few actually. I suppose really the first one is just on margins more generally beyond this year. You've had a fantastic delivery on gross margins so far this year but you've clearly got some further cost savings to come through. Your… I think you had a margin target to achieve 20% within the next two years. It looks like you're going to do that this year. I just wondered if you were going to give us any sort of further steer in terms of where margins go to beyond here. Slightly offsetting that, clearly we've got… an ongoing feature of the industry is pricing pressure and I just wondered what you thought the outlook for that in the medium term was given the European potentially funding crisis for all the various governments. Thirdly, just on your capital structure, there's some commentary in your release that you're going to be taking or assessing your capital structure given the strong cash flow. I just wondered if you could elaborate on that please.

Lene Skole

David, maybe if I start with the capital structure and I can very briefly comment on your question on margin and then maybe Lars can take the pricing pressure afterwards. With regards to the margin beyond this year, I mean we have a long term target saying at least 20 on the EBIT and we really want to achieve that fully before we start talking about what is then beyond that so I can't really comment more and I don't want to comment more on that one.

With regard to the capital structure, then you know, clearly we are below the target we have given and we are actually considering what we should be doing. I mean one has to remember that this starts sort of in a positive; ie, we create… we generate a lot more cash now than we used to. We have a share buy-back programme of half a billion this year and that obviously will continue. Then we need to think about what should we do. Should we, you know, should we reconsider our dividend policy, should we pay back some more loans, should we try to sort of keep a little bit more, build a war chest for any potential acquisition. All of these things are things we're debating right now but where we haven't come to a conclusion, so that is really what we mean by saying we are having this under review and we will obviously let you know once we've done that and once we have discussions with the board and they have approved a suggestion.

Lars Rasmussen

Regarding the pricing pressure it's really hard for us to say more than what we have said. We have shared with you what we know. We are, as many people in Europe are, concerned about the situation in Greece and how that pans out is very hard to say but I think that the only long-term reasonable answer that you can come up with to pricing pressure is to make sure that you keep your innovation up and that you work with public affairs to make sure that you're also paid for innovation if they are reducing society cost.

And we have had a full stop on employment for almost two years and the only places where we have really hired people is on the sales force in some of the emerging markets and then on public affairs people to make sure that we are working with this in a diligent way but that's as much as I think I can say about it right now.

Okay, thank you very much.

***Kristian Marthedal** – Nordea*

Yes, good afternoon, ladies and gentlemen. Most of the questions have already been answered. I have a further two questions. In terms of future production relocation, could we expect at some future point in time that the Danish production goes beyond 15% of total manufacturing and my second question goes on France healthcare reform: I wondered if you could put some more light or some more flavour on how that would impact the revenues for the wound care business, thank you.

Sorry, could you repeat the second question? I was… I didn't get that.

Yes, the second question was in relation to the upcoming France healthcare reform and I just wondered whether you could be some more specific or put some more flavour on how you expect that to impact the revenues for the would care business for next fiscal year, thank you.

The… regarding the future production in Denmark, at the end of this year we will get to a level where we believe that we'll get to… I think we'll get to around 400 employees and that is blue collar and white collar employees, in Denmark and that represents approximately 15% of the total manufacturing workforce in the group.

I expect that number to be reasonably stable and that also means that once the company is growing, and we are growing on a year on year basis, the percentage points of the total number of employees that are located in Denmark, will be smaller and the reason for it is that we believe that, you know, the number of people that we have in Denmark on the manufacturing side, they are really, they are in order to support the… us being first from R&D to the market so it's all about creating processes for the new products.

And we actually have a pretty high number of new products coming out and therefore we don't expect that number to go up. It might be bigger products that come out but still it's probably something which is relatively stable and so therefore I'm not so sure that we… that that number would go up, which was how I understood your question. I think that the percentage points would go down because the number will be… remain stable.

Regarding the wound care or the health care reform in France, I'm… yes, could you maybe take that, Lena?

Lene Skole

Yes, I can, sorry. We're looking at approximately a 5% cut and we haven't seen any implementation yet so we don't really expect that it would have an impact on us for this year. If we go to next year, impact would probably be in the range of say 10, 10-12 million Danish Kroner or something like that.

Okay, thank you. That was all from me.

***Yidan Wang** – Deutsche Bank*

Thank you very much. I have three questions. The first question is on the wound care business, can you give us some idea of what you have actually done in that business this quarter? I understand you were testing the… your approach to the home care channels in France. How has that gone? It seems that you're more encouraged there and therefore extending your initiative to other countries in Europe.

The second question is on China production, just to tag onto the question asked earlier out Hungary, the wage differential there, how do you expect that to move forward given the faster inflation that's occurring there and the third question is on the US… on your US ostomy business; in addition to the initiatives that you've discussed there that could help you improve the retention of your new patient discharge, are there any other initiatives that you're also considering or are also thinking about implementing that would help your performance there? Thank you.

Yidan, your last question was on an entity (?)

So US ostomy business; in addition to the initiates that you've discussed earlier on the call, are there any other initiatives that could help you improve your performance in ostomy in the US?

All right, I think I actually covered the wound care thing at an earlier stage in the call because what we did last quarter was launching the Biatain silicone product successfully I would say first in France and then in Germany and then now it's happened also in Denmark also but that's just very lately and in that sense, that has been positive received and this is doing well in the market.

And then it's correct that we have been testing out the go-to-market for a community sales force and that is the sales or lease sales force that we are talking about so that they get up to speed earlier. It takes a little while to get them up to speed but not as long time as it takes if you have to find your own sales force. And also the models that we're using in the UK and in Germany in order to make sure that we get best for the market and that we also test out this model before we start spending money on our own sales force. And finally it is because you're sharing a sales force with other companies, the cost per sales call is significantly lower when you're using a leased sales force than when you're using your

own sales force so those are the things that we have been doing in this quarter together with of course implementing the necessary organisation to steer this.

On the China production, I think that what you have to bear in mind is that we have approximately a total cost of a Danish employee around DKK 350,000 per year and you have a total cost per year for a Chinese employee which is around 20,000 Kroner per year and therefore you can figure out that if we… if the salary increase in Denmark is 2%, then you can sort of find the difference and see how much does the salary need to increase in China in order for the gap between the two distances () to close and that is quite significant, what it has to appreciate in China for that to be a bad (?) business force.

And then you had a question regarding the initiatives (?) in the US ostomy business and I'm really sorry, it's late on the day, I can't recall what you asked (?) twice.

Sorry for US ostomy, basically you outlined various, well, some initiatives that would help you track these new patients which would help you retain a greater portion of your new patient discharge, so other than these initiatives, what other initiatives or what other possibilities are there out there that would also help you?

Okay, well, basically this is of course then all about what kind of distribution deals can you do because I think we're good at winning contracts but this is all about the () part of the market so it's all about which distribution chains are you able to get into and of course we're looking into that also.

Okay, I thought of one more question, if you can bear me, bear with me: in terms of the various developments that have happened this year or are going to happen in the second half of the year that you can see, other than the French healthcare reform, what other negative, you know, sort of things should we consider that would affect your margin?

Well, I think Lena mentioned the UK healthcare reform also and then of course we are a little bit cautious on Greece because it's an unclear situation to us and we knew that also when we did the guidance.

Okay, great, thank you.

***Jacob Thrane** – Standard & Poor's*

Yes, thank you for taking my extra question. I was just wondering, I was talking about all this, all the health care reforms, it's quite a while since we've spoken about the impact from Germany and I'm just wondering if there's any update you could share with us now that apparently looks like ostomy is sort of getting back on track now, then we have a drag on wound and skin care so what do we… what are we going to see there and secondly, on these set of sales force for hire people, do you actually buy a detailing place where these place now share the cost of the company. It would be sort of be a little lady (?) sitting with a dog and says I got this fantastic thing from Coloplast and then second lady, I've got this fantastic thing from Smith & Nephew.

So how does that actually work and are you actually also in the contract specifying the specific targets that you want them to achieve or how does this work? Thank you very much.

When it comes to Germany, I basically have no news on any moves on the healthcare reform side in Germany. I actually think that what we're reporting it's quite limited what we looking at right now when it comes to healthcare reforms but talking about the hired or the shared sales forces that we're using, they are, none of the sales forces that we are using and made contracts with, are of course carrying our competitors' products. They are carrying other products.

We are very, very detailed on who they have to visit and what they have to say when they're in front of the person and it is very… it depends from market to market but what typically it would be a home carers (?) they would visit and it would be home carers who also have a say on what products are on the shelf.

But that is simply from country to country and in the country, from district to district, there is… there are targets and there is a script what people have to say when they're in front of persons and so on. It's a very, very steered (?) process I would say, otherwise you get nothing out of it.

Yes, okay, so they are exclusively detailing Coloplast products, is that what you said initially?

Yes, so they would call doctors in the morning with some other products and they would call our nurses in the afternoon and that's all about when the time slots where they can visit.

All right, okay, thank you very much, Lars.

Closing Comments

All right, but then we'll say thank you for participating and thank you for your questions and have a nice weekend because it's weekend today in Denmark due to holidays, thank you.