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COLO B.CO - Q4 2018 Coloplast A/S Earnings and CEO Lars Rasmussen Steps Down Call

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PRESENTATION

Operator

Good day, and welcome to full year 2017/2018 financial results 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*

Thank you. Good afternoon, and welcome to our full year '17/'18 conference call. I'm Lars Rasmussen, CEO of Coloplast, and I'm joined by CFO Anders Lonning-Skovgaard and Executive Vice President of Chronic Care Kristian Villumsen and our Investor Relations team.

We'll start with a short presentation by Anders, Kristian and myself and then open up for questions.

Please turn to Slide #3. As announced earlier today, I have chosen to step down as CEO of Coloplast and the Board of Directors have unanimously appointed Kristian Villumsen as the new CEO, effective as of December 4. Being part of Coloplast for the last 30 years and leading the company since 2008 has truly been a great honor, and I'm incredibly proud of all we have accomplished over the past 10 years to build one of the best-performing and most profitable medtech companies in the world.

We have advanced the interest of all our stakeholders, including our employees, shareholders, and most importantly, the consumers with (inaudible) that we serve. The company and its employees have created excellent results and continues to deliver on the LEAD20 strategy, turning Coloplast into a true consumer health care company and positioning the company for continued success. I'm confident that Kristian, who has been a critical partner in running the company together with a broader executive management team and organization, will take Coloplast to new and greater heights in the years to come.

Regarding the announcement to change the Board of Directors, I would like to thank our Chairman of the Board, Michael Pram Rasmussen for rewarding collaboration and for the vote of confidence 10 years ago. I'm honored to be nominated as the new Chairman of the Board, replacing

Michael, who has chosen to not stand for reelection at the Annual General Meeting on December 5. I look forward to working with the board and the new management team to secure a strong platform for future growth.

With respect to the new executive management team, the current structure with 4 members will continue, and Coloplast has initiated a process to find Kristian Villumsen's replacement as Executive Vice President of Chronic Care.

I would now like to hand over to Kristian before we go to today's results.

Kristian Villumsen - *Coloplast A/S - EVP of Chronic Care*

Thank you, Lars. I'd like to start off by saying that I'm both humbled and honored to have been given the opportunity to assume the role as CEO for a company that I regard as strong and with a proven strategy and continued ability to year in and year out deliver above market growth. I have had the opportunity to meet many investors and analysts at our Capital Market Day events over the years, but for those of you that aren't familiar with my background, just a few remarks. I joined Coloplast in 2008, and I've held a number of senior management position across the company since then. And from 2014, when the Executive Management team was strengthened to include CFO and EVP Anders Lonning-Skovgaard and EVP of Global Operations Allan Rasmussen and myself, I became responsible for the day-to-day running of global marketing and the sales regions in Ostomy and Continence Care as well as the innovation pipeline for both of these areas. I've been part of developing the LEAD20 strategy together with the current Executive Management team and have spent the past 2 years leading the implementation of the strategy in the Chronic Care business. So the immediate path forward for me will be to focus on executing on our LEAD20 strategy and our ambition to accelerate growth. I look forward to meeting many of you in due course, as I transition into this new role.

Before I give the word back to Lars, I'd like to take this opportunity to thank him for strong leadership and mentorship over the last 10 years.

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

Thank you, Kristian. Now turning to today's results, which I'm very pleased with. Coloplast delivered a strong fourth quarter of 8% organic growth and a 33% EBIT margin in fixed currencies. For the full year, Coloplast delivered organic growth of 8% and a 31% EBIT margin in fixed currencies.

In November last year, we changed our long-term guidance and stepped up investments to accelerate growth. We have now delivered 6 consecutive quarters of 8% growth in a market that is growing 4% to 5%. This speaks to the solid underlying performance across the business and our ability to continue to take market shares. Growth continues to be driven by the launch of new innovative products like SenSura Mio Convex and SpeediCath Flex and strong commercial execution.

During 2017/'18, we initiated several growth investments in U.S. Ostomy Emerging Markets; Continence Care in Japan, Australia and South Korea; Interventional Urology; and Wound Care. We made investments in innovation focused on products, development as well as strengthening our competencies within preclinical medical marketing and market access.

In 2018/'19, we'll continue to focus on investing for growth and investment -- and invest up to 2% of revenues in incremental growth investments.

In September, we hosted our Capital Markets Day at our headquarters in Humlebæk in Denmark, focusing on innovation and commercial initiatives to drive growth. The day provided an opportunity to meet the strong management team that is executing on our strategy every day. For those of you who were unable to attend, the presentations and webcast are available on our website.

Today, the Board of Directors approved an ordinary dividend of DKK 11, amounting to a total of DKK 16 per share in dividends this year, an increase of 7% compared to last year, demonstrating the strength of our business and commitment to increasing shareholder value.

Our guidance for '18/'19 is an organic revenue growth of 8% in fixed currencies and 8% to 9% in Danish kroner, and an EBIT margin of 30% to 31% in fixed currencies and around 31% in Danish kroner. Anders will explain how we have arrived at this guidance. Please turn to Slide #4.

For the full year, our revenues grew 8% organically and 6% in Danish kroner and amounted to DKK 16.5 billion. Acquisitions of distribution companies contributed approximately 1 percentage point to reported growth.

In Ostomy Care, organic growth was 9% for the full year and growth in Danish kroner was 6%. For Q4 in isolation, organic growth was 9%. Growth continues to be driven by our SenSura Mio and Brava supporting the products in larger markets like U.K., Germany and U.S. SenSura Mio Convex continues to contribute strongly to growth. Our SenSura and Assura/Alterna portfolio growth was driven by satisfactory performance in markets like China and Brazil. As expected, we delivered on tenders in Emerging Markets in Q4 that we won in Q3, but did not deliver on. Growth for the full year was negatively impacted by the Greek price reform. And we continue to receive positive feedback from health care professionals and users who have trialed our new ostomy appliance, SenSura Mio Concave. We have now secured reimbursement and launched the new product portfolio in 10 countries. We will launch the new SenSura Mio Baby and Kids portfolio over the coming year, defining a new standard for pediatric Ostomy Care products. In Continence Care, organic growth was 8% for the full year and growth in Danish kroner was 7%. For Q4 in isolation, organic growth was 7%.

The SpeediCath ready-to-use intermittent catheter continues to drive growth, and especially the compact version has performed well in countries such as U.S., U.K. and France. So far, we have seen a limited impact from the expiry of SpeediCath ready-to-use patent. On the contrary, we continue to see healthy growth on the standard portfolio in particularly in the U.S. and emerging markets. Growth for the full year was negatively impacted by the Greek price reform.

SpeediCath Flex continues to contribute to growth in key markets like the U.K., France and Germany. And the launch of SpeediCath Flex Coudé Pro in the U.S. has been well received and will be a key growth driver going forward. Our Conveen collecting device portfolio posted positive growth, due to satisfactory growth in France and Emerging Markets. And finally, sales growth for Peristeen products remained satisfactory, driven by U.S., France and U.K.

In Interventional Urology, organic growth was 10% for the full year and growth in Danish kroner was 6%. For Q4 in isolation, organic growth was 10%. The growth was primarily driven by sales of Titan penile implants in the U.S. We see a satisfactory return on the last sales investments that we made into the U.S. Urology business last year and continue to invest this year. Our endourology business saw satisfactory growth in especially France and Germany.

In Wound & Skin Care, organic growth was 3% for the full year and growth in Danish kroner was flat. Organic growth for Wound Care in isolation was 5% for the full year. For Q4, organic growth for the total business area was 4% and for Wound Care in isolation, it was 6%. The growth in Wound Care was driven by stable growth in China and good growth across our European markets, driven by this Biatain Silicone portfolio. The newly launched Biatain Silicone Sizes & Shapes portfolio contributed meaningfully to growth. Overall, for the full year, the Greek price reform had a large negative impact on growth. The U.S. Skin Care business detracted from growth this year in fourth quarter due to a high comparison base last year. For the full year, the growth in Skin Care was flat.

Contract Manufacturing of Compeed contributed negatively to growth in the first half of the year, due to inventory reductions in connection to the sale of the Compeed brand from Johnson & Johnson to HRA Pharma. As expected, the DKK 30 million negative impact in the first half was regained in the second half of the year.

Turning to our geographical segments. We saw organic growth of 5% for the full year and 6% in Q4 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 11% for the full year and 7% in Q4. The U.S. Chronic Care business posted double-digit growth for the full year, driven by new product launches and the continued upgrade of the catheter market to hydrophilic. Growth in Q4 was negatively impacted by a difficult comparison period for U.S. Skin Care. Growth rates in Japan and Australia were -- remained very satisfactory. And growth in the U.S. for the full year was positively impacted by inventory reductions of DKK 70 million in Q1 last year.

Revenue in emerging markets grew organically by 14% for the full year and 14% in Q4. Markets like China, Brazil and Middle East continue to deliver very satisfactory performance. A number of smaller markets that we have recently invested in, for example, Poland and India, also delivered strong performance. And growth for the full year was negatively impacted by the Greek price reform. As mentioned earlier, we won several tenders in Q3 that we deliver on in Q4 in primarily Ostomy Care.

With this, I'll now hand over to Anders.

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

Thank you, Lars, and good afternoon, everyone. Before I go through the results, I would like to say thank you for Lars for the strong leadership and good collaboration. I would also like to say that I'm excited that Kristian has been selected as the future CEO, and I'm looking forward to continuing to work with Kristian in his new capacity.

Reported revenue for the full year increased by DKK 921 million or 6% compared to the same period last year. Most of the growth was driven by organic growth, which contributed DKK 1.2 billion or 8% to reported revenue. Acquisitions contributed DKK 185 million or 1% to reported revenue. Foreign exchange rates had a significant negative impact of DKK 584 million (sic) [DKK 583 million] or 4 percentage points on reported revenue, primarily due to the depreciation of the US dollar and Argentinian Mexican pesos against the Danish kroner.

The Argentinian economy is now defined as hyperinflationary and, therefore, Coloplast will apply hyperinflationary accounting principles to its Argentinian subsidiary, which represented 0.7% of revenues in '17/'18 with effect from Q4. The depreciation of the Argentinian peso had a negative impact of around DKK 120 million for the full year, of which DKK 45 million relates to the application of other inflationary accounting principles and this included in the reported growth for Q4.

Reported revenue growth was positively impacted by the DKK 90 million one-off revenue adjustment to the U.S. Department of Veterans Affairs in our third quarter last year. The matter did not affect organic growth for the year.

Overall, for the full year, the Greek price reform implemented in October last year in Ostomy Care, Continence Care and Wound Care had a negative impact of around DKK 75 million. Please turn to Slide 6.

Gross profit was up by 5% for the full year to around DKK 11 billion. This equals a gross margin of 67% compared to 68% last year. FX had a negative impact of 20 basis points on the gross margin. Fixed currencies and adjusted for the DKK 90 million Veterans Affairs payment in Q3 last year, the full year gross margin was flat compared to last year at around 68%. The gross margin was positively impacted by improvements in production efficiency at our volume sites and the relocation of SenSura Mio and Biatain Silicone 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.

In Q4, we had an additional DKK 20 million in restructuring costs related to the reduction of employee, production employees in Denmark, bring the full year amount to DKK 50 million versus DKK 20 million last year. As mentioned last quarter, we have accelerated the closure of the Thisted factory in Denmark, resulting in an increase in the restructuring cost this year.

Distribution to sales ratio came in at 29% compared to 28% last year. The 8% increase 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 the new incremental investment cases for this financial year were approved in Q1 across our business areas and regions. Overall, new investments remain on track, and we have seen a return on some of these investments already. 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. 11% increase in R&D costs reflects a higher general activity level.

Net operating income amounted to DKK 39 million compared to DKK 21 million last year. The increase was mainly due to nonrecurring income from a patent settlement in Interventional Urology in Q1. For the full year, our operating profit in fixed currencies increased by 4%, corresponding to an EBIT margin of 31%. The numbers are adjusted for the DKK 90 million Veterans Affairs payment in Q3 last year. Natural currencies and adjusted for the Veterans Affairs payment, the development in operating profit was flat. Corresponding to an EBIT margin of 31%. Operating cash flow amounted to DKK 4.4 billion compared to DKK 3.3 billion last year. The increase is primarily explained by higher mesh payments last year compared to this year. Total mesh payments for this year -- for the full year amounted to DKK 0.5 billion. Total mesh payments to date amounted to DKK 4.7 billion.

Cash flow from investing activities was impacted by the site expansion in Nyírbátor, Hungary, and the acquisition of a plot of land in Costa Rica as well as capacity expansion in machines to produce new and existing products.

Investments in intangible assets, property, plant and equipment amounted to DKK 669 million for the full year. CapEx to sales amounted to 4%. Adjusted for payments made in connection with the mesh litigation and acquisitions, including Comfort Medical and Lilial, the free cash flow amounted to approximately DKK 4.1 billion, which was approximately the same level as last year. Our cash conversion rate, calculated as a 12-month trailing average, was 99%.

Net working capital amounted to 23% of sales compared to 25% at the start of the year. Full year return on invested capital after-tax before special items was 44% against 47% last year. 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 '18, '19, we expect to pay out the remaining DKK 500 million of the -- in total DKK 5.25 billion provision. Please turn to Slide 7.

For '18, '19, we expect revenues to grow around 8% organically in fixed currencies and 8% to 9% in Danish kroner. Acquisitions are expected to contribute 0.4 percentage point to reported growth. Our guidance assumes stable growth trends across our regions as well as a continued positive impact from new product launches and commercial investments.

Our guidance assumes an annual negative price pressure of up to 1 percentage point.

As highlighted in previous quarters, a reimbursement review for Ostomy Care and Continence Care is currently underway in France. The impact and timing of the proposed cut is still uncertain, but we currently expect that the impact will be in the second half of the financial year. We also expect a smaller reform in Switzerland across all businesses -- business areas and the pricing pressure among health insurance companies in Holland. The guidance in Danish kroner is impacted by the appreciation of the US dollar against the Danish kroner. The currency impact is based on spot rates as of October 30, 2018.

For '18/'19, we expect an EBIT margin of 30% to 31% in fixed currencies and around 31% in Danish kroner. The EBIT guidance in Danish kroner is impacted by the appreciation of the US dollar and the depreciation of the Hungarian forint against the Danish kroner based on spot rates as of October 30, 2018.

On our operating expenses, we expect broadly stable trends into '18/'19. We will again invest up to 2% of sales in the incremental investments into innovation, market access and sales and marketing initiatives in the U.K., Emerging Markets and the U.S. across all business areas. We will also invest to ensure compliance with the EUs new medical device regulation by 2020. Most of the investments will be initiated in Q1, hence, I expect the quality phase similar to last year.

High 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 we will close the factory and reduce the number of production workers in Denmark by approximately 200 people in '18/'19. We expect restructuring cost of approximately DKK 25 million in '18/'19 compared to DKK 50 million in '17/'18. We expect higher single-digit wage inflation in Hungary in '18/'19. Overall, our expectation is that the gross margin in fixed currencies will be in line with '17/'18.

The Global Operations Plan IV is on track and it is still expected to deliver an EBIT margin improvement of 100 basis points in '19/'20 and 150 basis points in '20/'21. We currently expect our net financials to end the financial year 2018/'19 at minus DKK 75 million, primarily due to hedging losses on US dollar against Danish kroner. CapEx guidance for 18/'19 is expected to be around DKK 750 million and is driven especially by investments in more capacity for new and existing products as well as factory expansion in Costa Rica and a new distribution center in U.K. 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) We will now take our first question from Patrick Wood from Bank of America.

Patrick Andrew Robert Wood - *BofA Merrill Lynch, Research Division - Director in Equity Research and Head of the EMEA MedTech & Services Team*

I have 3, please. The first would be just around the general appetite for M&A, given your balance sheet and a lot of the assets, both because of what the market has done, but also individual assets have clearly become quite dramatically cheaper of late. I'll be curious to see if you have any sort of strategic review or intent change on that side? And the second one is really on the Wound & Skin Care business. Q4, the margin stepped up quite handily year-on-year, which was very different from first 3 quarters of the year. Is there anything we should be reading into the margin inflection in the fourth quarter? And in general, it'd be helpful to gather some views you have on the Wound Care market, given obviously, you have some competitors out there cutting price, so it'd be helpful to understand how that will work?

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

All right. Let me start out by saying, by the way, that Kristian did present at the beginning of the meeting, but he will not take further questions today. He will take questions in connection to the Q1 results, when he assumes his new role in December. And then back to your questions, the -- you're right, we have a good balance sheet. We also have a strong leadership team in place, a very experienced leadership team in place. So we think we have the fundamentals. They are -- if the right opportunities comes off, we have quite consistently pointed to the fact that if we were to strengthen our business, it would be in Wound Care and it would also be on distribution on the Chronic Care side. So that would be what you would be looking for, but we, of course, do not have any plans. So this is just a general comment that we have the balance sheet and the organization needed should opportunities exist. And then on the Wound & Skin Care side, you're right, we are stepping up and seeing nice results. We had a quite negative impact for the full year of the Greek health care reform. So this basically speaks to the fact that when you're looking at (inaudible), in general, we have nice performance. We also have good performance in Emerging Markets, northeast and China. And then we are waiting to create a stronger platform in the U.S. And then when it comes to the profitability side, I don't know, if you'd like to add anything further to that, Anders.

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

What I can add is that, that you're right. We had a stronger Q4 profitability compared to the previous quarters. There are a couple of reasons for that. One reason is the Greek, that impacting -- the Wound Care profitability quite negatively in the first quarters of the year. And then secondly, we had an okay quarter in China and then also a good quarter related to our Compeed business that is also part of the Wound & Skin Care franchise. So that's the main reasons.

Operator

We will now take our next question from Michael Jungling from Morgan Stanley.

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

I would like to ask 3, please. Firstly, a question about sort of the CEO change and the management premium. Lars, since you became CEO, I guess, through excellent execution, you've added material sort of valuation premium to Coloplast. How do you safeguard this premium as the future Chairman? How involved will you be in the detail and the decision-making of the organization? Question number two is on gross margin. And what drove the Q4 gross margin expansion for the group, when, for the previous 3 quarters, we saw significant declines, and I'm talking about the gross margin adjusted for restructuring charges, this fourth quarter just seems to be incredibly good compared to the first 3 quarters. And question number three is on sales growth. In your guidance, you highlight that it's 8% constant currency growth, but over the last 2 years, you've made acquisitions of about 1 percentage point. Should this perhaps mean that the organic growth rate is going to be more like 7%, if this M&A-type bolt-on stuff continues, i.e., is the organic growth rate below the 8% for the next fiscal year in your guidance?

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

On the CEO change, it's -- I think it's -- maybe I should start with, what is it -- I mean, I've been CEO for 10 years, and I would also like to have a change to do something else in my professional life. So I'm looking at a professional career or professional board career because I think that I'm young enough for that still. And I can do that at this point in time because I think the leadership team across-the-board in Coloplast is really strong, and Kristian was ready to step up to become CEO. So I think that the timing was very good. And then as I was explaining that to my (inaudible) Michael Rasmussen said that he wanted to -- they actually were having the same consideration, so whether I would be willing to take responsibility as Chairman of the Board. And for me, the -- I would like to do that, but given that there was a board that 100% agreed, that would be a good idea and that the Board would discuss that without me and they would also discuss it with Kristian, if he could then see that role also, because there is a risk that when you have had a successful run that you would like to see that everything is going to be the same as it used to be. But we have to be mindful that what we try to do with this company is to create more value every single year. And to create more value 5 years from now, I'd say, that we do all the things that we do today. So the mandates that I go into this new role with is that we are going to create further value. And therefore, I expect changes to happen, of course. I'm no longer in an operational role, so I will be in a board position. With my board colleagues, we will put all the pressure that we can on the Executive Management to deliver further growth and the profitability. But that will be in that capacity. I will not be an acting Chairman of the Board, who will oversee or try to run out or run around in the company every single day, that's not what is in the future. I'm going to resume responsibility for a board and that's basically it. When it comes to gross margin, would you like to add to that?

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

Yes, so in relation to the gross margin development in Q4, Michael, the main reason for the strong gross margin compared to the 3 previous quarters, the leverage effect. Because we have had a high absolute revenue in our fourth quarter, so the leverage effect on the fixed costs have been higher than the previous quarters. And then we also had, you can say, lower impact from currencies. So that's the main reason. And could you repeat the last question, please?

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

Yes, the last question is that your guidance for sales growth is in constant, so the 8% is in constant currency, but you don't give us an organic growth number. And given that you've made acquisitions for the group accounting to about 1%, I'm just thinking whether the organic growth rate that you mean by 8% in constant currency is actually less.

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

The 8% is an organic number.

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

Okay, okay. So the acquisitions that you've made, they're not 1% in the past that comes on top of those, on top of the 8%?

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

So Michael, the way you should look at it, so our growth guidance for '18/'19 is an organic growth of 8%, then we are expecting the acquisitions that is coming in with Q1 impact is around 0.4. And then -- and that gives us reported growth guidance in the level of 8% to 9%.

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

Okay, great. And may I quickly follow up on the CEO change? You held your Capital Markets Day very recently, and there was no mention of a transition process. And I'm just curious as to why that happened. And also why -- is this an indication perhaps that you've done this on a fairly short notice? Because you're still looking for a successor for Kristian, if it was planned, wouldn't you had a successor for Kristian already in the announcement today?

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

The way I understand this, Michael, is that the day you decide that you are going to do this, you also inform the market. So when I mentioned to my

Board of Directors that I wanted to step down as CEO, they -- Chairmanship then said, "Would you consider to be Chairman of the Board?" And that part of it had to be discussed at the Board Operations because I only wanted to take it if it was 100% consent from the rest of the board members, and therefore, they needed to be together, which they were today. So the final decision was made today at the board meeting, and then we could inform the authorities.

Operator

We will now take our next question from Annette Lykke.

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

I wondered if you could share a little bit more insight into the growth rate within Continence Care? If we look into the growth rate in Q4...

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

Into the growth rate for what?

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

For Continence Care. I wondered in the light of your launch in the U.S. in May with the Coude Pro version of SpeediCath Flex, as well as we can see in the U.K. you have a very solid growth rate in U.K. as well, I'm just wondering what it takes to get you into a bit higher than the Q4 numbers of 7%. And also, should we expect the competitive landscape for Continence Care to be slightly different with ConvaTec launching also products into the market fairly soon? And are you expecting a lower growth rate? In other words, I could also say are you expecting a lower growth rate for Continence Care than you do for Ostomy Care?

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

No, we are not expecting a lower growth for Continence Care than we do for Ostomy Care. We have some strong comps in Europe last -- for the quarter that we compare against last year. So that's the only thing that are different in this quarter. So in that sense, we do see that, that is going according to plan. And the Pro launch is going really well. So we actually, if anything, expect the growth rate in the U.S. to be very strong going forward. So I see this as basically a comp issue in this quarter.

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

If I then follow up with a question on BBT. Once you are launching this product in a year's time, so should we see that as a, sort of, to come on top of the current growth, or do you expect the growth for the existing portfolio to sort of slow down and then you will compensate or bring closer to the 8% or 9% level with the BBT? Or should we see on top of what you already have right now?

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

It is primarily seen as a replacement product, sort of replacing the base product in -- the base SpeediCath product in many markets. So for us, it is a way to set a higher standard for what the -- what is the sort of the entry level category when you go into this market. So you should see it as a more -- it's a more defensive move, and we have some other things in the pipeline that are more offensive when it comes to that. But BBT is very much setting -- simply raising the bar for what it takes to compete in the hydrophilic-coated catheter ready-to-use space.

Operator

We will now take our next question from Lisa Clive from Bernstein.

Elisabeth Decou Bedell Clive - *Sanford C. Bernstein & Co., LLC., Research Division - Senior Analyst*

I have 2 questions. First of all, your strong growth in Wound Care in the quarter is in contrast to your larger competitors, who are clearly having a tougher time. So how much of this, do you believe, is market share gained due to their internal issues? I'm just trying to get a sense for how long this above-market growth can last. And then second question, following the reimbursements, I guess, a year or 2 ago, for single-use catheters in Japan, Korea, Australia, how far along are you in building out the sales force and really penetrating those markets? Or is there still

(technical difficulty)

way for greater adoption?

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

So the stronger growth in Wound Care is very much driven by -- the Biatain Silicone is driven by Europe, and we are taking market shares in -- with what we are doing. We have launched a number of new products. And I think that if you're looking at -- it sounded as if you said something about internal issues with some of our competitors. But if you're looking at the numbers that came out for Smith & Nephew, the numbers that you can also see with ConvaTec, it's -- most companies are growing -- it's flat or, at maximum, a couple of percentage points. We have a smaller business, but we also launched quite a number of new products. And the numbers that we are coming with is despite the fact that we have these issues in Greece. But we have a footprint where we are strong in Europe. We are strong in -- or have strong growth in Europe. we have strong growth in emerging markets, and we have -- we are building up our position in the U.S., so we think that if anything, we are not on a decelerating curve yet. It's on the contrary for Wound Care. So how long that's going to last? That's a good question. And you know we are not guiding on growth rates for each of the business areas that we're in. But we are guiding for the growth rate for the full business. And we once again, as you saw, have 8%

growth for the full year next year. And that also includes a good growth in Wound Care. And then your question about Japan reimbursement is, how much of the current potential are we covering with our sales force?

Elisabeth Decou Bedell Clive - *Sanford C. Bernstein & Co., LLC., Research Division - Senior Analyst*

Yes, effectively. And also Korea and Australia. I mean, those are fairly new markets for you, for Continence Care, and I'm just wondering how far long you are in penetrating that.

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

Yes, but maybe a good number would be approximately halfway. So maybe half of the current potential is covered by the sales force that we are having. But of course we start from going for the accounts where the biggest opportunities and then we are building from there because it is the sales, which is different from the sales that we do in Ostomy Care for example. But we are very pleased with the traction that we're having, and our growth numbers in those markets are up compared to where they were a couple of years back due to this.

Operator

We will now take our next question from Veronika Dubajova from Goldman Sachs.

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

I have 2, please. The first one's on the margin guidance for the full year. I'm a little surprised to see that there is a possibility that we might end up with a 30% constant currency margin for the year. If I reflect back on what we discussed at the Capital Markets Day, it seemed to me that the 30% really would only be a possibility if you carried out some incremental acquisitions. So maybe, Lars and Anders, you can talk about under what scenarios you'd end up at that 30% versus the 31% constant currency and elaborate a little bit on the investment opportunities that you see for 2019 if those have changed since the Capital Markets Day. My second question is just to push you a little bit more on the Continence Care growth rate. Because if I look at the group comparison, it really wasn't that difficult this quarter, and the growth here does seem to have slowed down. So maybe you can comment a bit more on the competitive environment that you're seeing and give us a little bit more -- a greater degree of confidence in that -- on that growth as we head into '19.

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

All right. Let me start with the margin guidance question, Veronika. So the assumptions we are using is an organic growth of around 8%, and that is going from 7.5% to 8.5% in terms of growth. Secondly, we are expecting next year to have a flat development in our gross margin, as I explained earlier. And then we will continue our investments into sales and marketing and innovation of up to 2%. And that gives an EBIT margin guidance in the level of 30% to 31%. I'm not -- it does not include further acquisitions.

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

Okay. So if I'm understanding -- sorry, just wanted to ask or clarify. So if I'm understanding what you're saying correctly, Anders, is if you end up at slightly south of 8%, you'd be at 30.5%, and if you do slightly more than 8%, you'd be at 31%? Is that the way to think about it?

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

Yes, so that is -- yes, you're right. So that is

(technical difficulty)

to think about it.

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

So if you look at the Continence Care growth comparisons, we had, for Continence Care, if you exclude FX and all of that, we had 5% growth in '15/'16, we had 7% growth for the full year '16/'17 and 8% in '17/'18. And then of course they can be a little bit lumpy based on what are we selling in emerging markets and so on. So what we see is that we see traction that is putting us in the right direction, and we actually see that we are more competitive now than we were 2 years back. But you are right that from quarter-to-quarter, there might be some swings, but it's not like we have basis for everything, "Oh, this is now going south," or anything like that.

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

Okay. And if I just may say, Lars, congratulations on the retirement. You will be very sorely missed. We wish you all the best. And Kristian, look forward to working with you.

Operator

We will now take our next question from Yi-Dan Wang from Deutsche Bank.

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

I have a couple of questions. So first of all, on the convex product, is there any reason why your share of convex products would not approach your share of flat products which, it would seem, is on a much higher level than your convex products? And then secondly, on the concave product, can you provide some color on how the buildup of concave has been versus your expectations and based on the launch experience of concave in the key markets so far? How long do you think it would take the concave products to get to the same level of sales as convex for example, that will be helpful?

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

On the convex side, well, there's no doubt that convex is picking up, and we will be approaching the same average rate that we have for the rest of the portfolio. I also think that we are competitors, so I don't see any reason why we should not be able to do that and how to go above it. When it comes to concave, it's a new category. We don't have a lot of experiences by building new categories. If I look at the forecast that we have in the group on what we -- was expecting from the individual countries that are launching, we are trending slightly ahead of those forecast. So we are doing a little bit better than what we thought. So things are going according to what we planned for and also what we hoped for. But it's still early days on concave, but we definitely see the need. And the feedback that we get from people who are using it is that many people who had frequent tickets issues beforehand, they are now not seeing those issues.

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

Okay. And then one quick question for Anders. Based on the current spot rates, what would you expect the FX impact on your margin be for the coming year?

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

Yes, so as I said before, the EBIT margin in constant currency, our guidance is 30% to 31%, but in reported currency, my expectation is around 31%. And it's very much driven by the development in the US dollar and the HUF, the Hungarian forint.

Operator

We will now take our next question from Christian Ryom.

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

I have a couple of questions. My first question goes to your ostomy business, or more specifically, the accessories. I can see that in your market commentary, you now assume a higher market share, which suggests that you've outgrown the market and also that the accessories business is growing significantly stronger than the rest of the Ostomy Care business. Can you first confirm whether this is correct? And then secondly, at -- how this impacts the profitability of your Ostomy Care business? And then I have a second question.

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

Why don't you take that, Anders?

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

Yes, so in terms of the -- your question around accessories, you're correct that we have seen again this year a strong accessories growth development. And again, we are taking market share. So our market share is now in the level of 30% to 35%. So we have a strong portfolio, and it's also because we have now launched most of our accessories portfolio in emerging markets, including China. So we are very satisfied with our accessories growth development. In terms of the profitability level, our accessories is also contributing to our profitability levels in ostomy, so yes, that is also having a positive profitability impact.

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

And if I'm may add to that, Anders, despite the fact that accessories is growing faster than the rest of the portfolio, we are also -- we are taking market shares in bags and plates.

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

Okay. That's very helpful. And the -- my second question goes to -- whether you can add any additional detail around where you will be increasing investment for the next year. So this year, we've seen you increase investment both in R&D and your sales and distribution costs. Should we expect that the increments that you will implement for next year will be -- will have a sort of similar distribution across your OpEx lines?

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

Yes, so our expectation is that it will be a similar split. So most of the investments will impact our distribution to sales ratio. So we are continuing to invest into sales and marketing activities. As we also explained at the Capital Markets Day, we are going to invest into the U.K., we are going to invest into our continence business in the U.S. and we're also going to invest into selected emerging markets and also into Urology Care. And then we will also invest further into innovation. So as we have communicated also at the Capital Markets Day, we are expecting to have an R&D ratio to sales of around 4%. So we will also continue to invest into innovation in order to again launch great products also in the future.

Operator

We will now take our next question from Scott Bardo.

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

Just to say, Lars, it's been a great ride, congratulations on the promotion. And also welcome, Kristian. So first question for me, please, just to follow on, on the accessories performance. Obviously, this has been a strong success story going from a very small market share to over 30% in 4, 5 years or so. But I also understand this has been a very fragmented market with lots of different players and lots of different products. So my question is, is there room to further market share expansion in your mind, or have you now reached saturation point? And I'd also like to follow up a little bit on the performance in other developed markets for the quarter, which seem to have slowed somewhat to around 7%. I just wonder if you could give us some sense of whether that's North America not performing to expectation or if there is some other key developed regions that have been responsible for that slightly below trend growth?

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

Thank you for your comments, Scott. On the accessories, we think we can grow quite a bit more than what we have done now, because it is, as you said, a fragmented part of the market. And that means that this is a place where there is a vast opportunity to expand the market. And we have, for example, also recently started to really go into the emerging markets where we are building the category. So it means that it's not only can we take more market share because we have a portfolio, which is getting more and more complete, but we also now use it to expand the market. So you will see bigger market share, but you will also see a growing market. We are sort of adding to the growth of the market going forward. Does that make sense?

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

Yes, it does.

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

And then on the other developed markets. It's actually quite impacted this quarter by the fact that we had this very strong push on skin care last year because one of our competitors got closed down from FDA. So we don't have that effect this year. So all in all, that's actually enough to skew the number, so you see this. But apart from that, it's actually in line with what you saw last year, growth-wise.

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

Growth-wise. Just a follow up. You seem to be pretty confident that there'd be no real change in the price pressure dynamic, if you like, that the group sees on an annual basis but have pulled out or called out regularly this French reform impact. So I'm just wondering, have you got actually some visibility on timing and magnitude in France at this point? Perhaps you could just share a few more details there? And lastly, some of your competitors in the wound market have pointed towards the U.K. being an increasingly weak environment with increased tender patterns and price pressure. I just wonder, are you seeing those dynamics? Is that something that concerns you?

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

So there is this rumor about the French reform, and we also expect that should be in the second half of the year. And what kind of numbers that we will arrive at once that is negotiated, we don't know. Once we get clarity on that, of course we'll share it immediately. But this is going to be a negotiation situation. So as long as they'll be negotiated, I don't expect that we will have any further comments than what we have had all along, that there will be a price review.

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

And the other question on the U.K. wound?

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

Yes, on the wound care. Wound, what we see is that we're seeing increasing -- we see positive growth in the U.K. But as I said before, we have new products to work with, and we have a smaller market share, so of course we're probably not the first ones to feel all the movements that are going on in the market with the market share that we're having. But we are seeing a positive development in the U.K.

Operator

We will take our last question now from Ian Douglas-Pennant from UBS.

Ian Douglas-Pennant - *UBS Investment Bank, Research Division - Director and Analyst*

I would just like to add my voice to the echo of people saying congratulations to Lars. You've made a lot of money for your shareholders and I think you've probably made your patients' lives a lot better as well, so congratulations. And so firstly, on Kristian's replacement, are you looking internally or externally for that role and can you lay any other criteria that you're looking at there? And secondly, on the Vizient contract, or the GPO there, have you done any more work on what you could do differently next time to get a different result?

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

So we -- having had Kristian in the role before we have a pretty clear view on what we go for. And we are hoping, of course, for options both internally and externally. But we are looking into that, very concentrated right now, but I can't comment further on it at this point in time. And your second question, sorry, was about...

Ian Douglas-Pennant - *UBS Investment Bank, Research Division - Director and Analyst*

The GPO contract.

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

Yes, of course, we have taken -- we take it quite seriously about the GPOs because we think that that's the next level for us in the U.S. So we have all the measures in place on that. But nothing -- I mean, the only thing that really counts is that we are winning the GPO contracts, right? So, yes. So we do whatever we can.

Operator

It appears there are no further questions. I'd like to turn the conference back to our host for any additional or closing remarks.

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

Yes, thank you very much, everybody, for some very enjoyable meetings. And I will be roadshowing a little bit next week. So I know that I'm meeting some of you, so I'm looking forward to that. Thank you very much.

Operator

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