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Coloplast A/S (CLPBY.DK)

Q2 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Hello, and welcome to the Coloplast Interim Financial Statements for Q2 2022. Throughout the call, all participants will be in a listen-only mode and, afterwards, there'll be a question-and-answer session. And today, I am pleased to present Kristian Villumsen, President and CEO. Please begin your meeting.

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

Thank you, operator. Good afternoon, and welcome to our half year 2021/2022 conference call. My name is Kristian Villumsen, the CEO of Coloplast; and I'm joined by our CFO, Anders Lonning-Skovgaard; and our Investor Relations team. We will start with a short presentation by Anders and myself, and then open up for all other questions that you may have.

Please turn to slide number 3. In Q2 we delivered 7% organic growth and an EBIT margin before special items of 31%. We delivered a respectable return on invested capital of 25% after tax and before special items, which is naturally impacted by the recent acquisition of Atos Medical. Reported growth in Danish kroner was 16% and Atos Medical contributed 6 percentage points to the reported growth and delivered high single digit underlying growth and completely in line with expectations. I'm satisfied with the company's performance and most importantly that we continue to help more and more people living with intimate health care needs globally. All businesses and regions delivered according to expectations with the exception of China. China continues to be impacted by COVID-19 and has seen renewed lockdowns again in March. And we'll get back to that later, [ph] I'm sure

(00:02:04). In Ukraine and Russia, we continue to focus on keeping our people safe and ensuring that our around 100,000 users have access to products to manage their chronic conditions.

Before we move on to guidance, I'd like to mention a few highlights from our second quarter. Our Chronic Care business posted 7% organic growth driven by Europe and broad-based double-digit growth in emerging markets excluding China. The US Ostomy business delivered solid double-digit growth and the growth in new patients in the US Continents business normalized to pre-COVID levels towards the end of the quarter. Our Interventional Urology business delivered 9% organic growth driven by a strong recovery in elective procedures in the US towards the end of the quarter.

And with that, I'll move on to guidance. Organic revenue growth is now expected at 6% to 7% from previously around 7% due to the impact of COVID-19 in China. The recent lockdowns in China have resulted in reduced hospital access and the decline in procedural volumes towards the end of the second quarter. A significant share of our sales force is also under lockdown and unable to leave their home, let alone visit hospitals and drive sales. The impact has been more pronounced in our Wound Care business, which is mostly a hospital business. But we've also seen an impact on growth in new patients in Ostomy Care. Given the current zero tolerance policy in China, we expect that the negative impact we've seen in March and April will persist throughout the calendar year.

Outside of China, our outlook across business areas and geographies is unchanged, and this will take us through all the details later. But I'm pleased to say that growth in new patients in the Chronic Care business is now largely back to pre-COVID levels across all regions apart from China. Hospital access also improved across most geographies during the quarter and in Interventional Urology, elective procedures rebounded towards the end of Q2. Guidance on reported growth in Danish kroner is unchanged at around 15%. Atos Medical's full year contribution to reported growth is unchanged and expected to be around 6 percentage points.

The EBIT margin guidance before special items is still expected to be around 31%. The EBIT margin after special items is now expected at 28% to 29% from previously around 30% impacted by special items of around DKK 450 million, of which DKK 300 million relate to an increase in the mesh provision and DKK 150 million relate to the Atos Medical acquisition.

Anders will provide more details on the provision later, but essentially it's taking longer to settle outstanding cases, which has led to an increase in legal costs. We continue to make settlement progress and have now settled 99% of the MDL cases. The Coloplast MDL was closed in December 2020 and we are seeing a very low inflow of new cases. We remain committed to the women's health market and believe our mesh products improve lives and are safe and available options for surgeons who treat women with pelvic organ prolapse and stress urinary incontinence. Before going into the details of today's results, I'd like to provide an update on some of our strategic priorities within the Strive25 strategy.

Please turn to slide number 4. First the acquisition of Atos Medical, which was completed on January 31, as a new long-term growth compounder to Coloplast in a category with significant untapped market potential. Atos Medical has become a fifth business area for Coloplast under the name of Voice & Respiratory Care. The business is expected to grow 8% to 10% organically with an EBITDA margin in the mid-30s and contribute to Coloplast Strive25 financial guidance of 7% to 9% organic growth and a plus 30% EBIT margin. I'm very pleased to say that the integration of Atos Medical is progressing according to plan and the performance of the business is strong.

Second, Ostomy Care in the US and access to hospital has improved, and we're making good progress on contract wins on the back of improved GPO access and in a recent sales force expansion. Recent key contract

wins include AscenDrive, Allied Health Solution and NYU Langone Health. Third, we're making progress on the clinical performance program in both Ostomy Care and Continence Care. I'm pleased to share that the pivotal study on the new Ostomy platform, which aims to reduce skin complications, has been concluded and the targeted endpoints have been met. This marks a key step towards the launch of the new Ostomy platform, which is still expected in the second half of the Strive25 strategy. The pivotal study on the new catheter platform is currently in progress and we expect to launch the new portfolio before the end of 2023.

During the quarter, we also launched a new product within Continence Care, SpeediCath Flex Set. SpeediCath Flex a soft hydrophilic catheter for men with a dry sleeve and a flexible tip that's been a key driver of growth in market share gains. With the launch of SpeediCath Flex Set, we're now expanding our Flexible Catheters portfolio with a set solution that combines a catheter with a new integrated sterile back to cover the entire catheterization process.

We're excited to launch the product across all key markets during 2022 and 2023. On our sustainability initiatives, we now recycle around 70% of our production waste due to a successful recycling partnership in Hungary. And during the quarter, we've also replaced the use of natural gas for heating purposes at our Nyirbator site in Hungary, we've replaced it with electric heating pumps. As a result, Scope 1 and Scope 2 emissions decreased by 10% in the first half of 2021-2022 compared to the same period last year. Finally, we look forward to opening our second volume factory in Costa Rica at the end of May.

Now, let's take a closer look at today's results. Please turn to slide number 5. In Ostomy Care organic growth for the first six months was 6% and growth in Danish kroner was 9%. In Q2 organic growth was 7% and growth in Danish kroner was 9%. Growth continues to be driven by SenSura Mio and Brava supporting products and our SenSura and Assura/Alterna portfolios continue to post solid growth in emerging markets.

From a geographical perspective, all regions contributed to growth led by Europe and especially the UK, where our manufacturer business and Charter delivery business are both delivering solid growth. The US also posted solid growth. Growth in emerging markets, excluding China was double-digit and broad-based led by Latin America. China contributed to growth, but was held back by COVID-19 as I explained earlier.

In Continence Care organic growth was 6% for the first six months and growth in Danish kroner was 9%. In Q2 organic growth was 7% and growth in Danish kroner was 9%. Growth continues to be driven by the SpeediCath ready-to-use intermittent catheters with a good contribution from the SpeediCath Flex portfolio, as well as SpeediCath Compact and standard catheters. From a geographical perspective, sales growth was driven by Europe, led by the UK. Emerging markets driven by LatAm also made a solid contribution to growth, and the US contributed to growth, but continued to be negatively impacted by lower growth in new patients. But on a positive note, growth in new patients in the US normalized at pre-COVID levels towards the end of the quarter.

In Interventional Urology, organic growth was 7% for the first six months, and growth in Danish kroner was 10%. In Q2, organic growth was 9% and reported growth was 13%. Growth in the quarter was positively impacted by a rebound in elective procedures in the US towards the end of the quarter after a softer start to the quarter due to the spread of the Omicron variant. Elective procedure volumes are now fully normalized. The US Men's Health business and our European business were the main growth contributors in the quarter.

In Wound & Skin Care, organic growth was 9% for the first six months and growth in Danish kroner was 12%. In Q2, organic growth was 6% and growth in Danish kroner was 9%. Contract manufacturing was the key driver of growth in the second quarter. The Wound Care business grew 2% organically in the quarter and 9% for the first six months. Growth in the quarter was impacted by a high baseline in Europe in Q2 last year, as well as some

quarterly phasing between Q1 and Q2 in key European markets. The underlying growth in Europe continues to be solid and driven Biatain Silicone and Biatain Fiber portfolios. Emerging markets was the main growth contributor in the quarter, growth in China was positive, but impacted by the ongoing lockdowns and the limited hospital access in the affected areas.

Voice & Respiratory Care contributed 3 percentage points to reported growth in the first six months and 6 percentage points in the second quarter, reflecting two months of revenue impact. The underlying growth for Voice & Respiratory Care was high single-digit in line with expectations. The laryngectomy business delivered solid double-digit underlying growth, and growth in laryngectomy was driven by an increase in the number of patients served in existing and new markets, as well as an increase in patient value driven by the Provox Life portfolio.

All regions contributed to growth led by Europe. The tracheostomy and ENT business also contributed to growth and grew mid-single-digit in line with expectation. The two noteworthy developments at Atos Medical during the quarter, the first clinical study on Provox Life was concluded and it demonstrated a significant positive effect on patients' pulmonary health from the use of higher performance heat and moisture exchanges. And second, in China, the Food and Drug Administration approved the registration of Provox heat and moisture exchanges, which marks a first important step towards market entry into China.

With this, I'll now hand over to Anders, who will take you through the financials and outlook in more detail. Please turn to slide 6.

Anders Lonning-Skovgaard

Chief Financial Officer & Executive Vice President, Coloplast A/S

Thank you, Kristian, and good afternoon, everyone. Reported revenue for the first six months increased by DKK 1.2 billion or 12% compared to last year. Organic growth contributed DKK 613 million or 6% to reported revenue. Acquired revenue for the first six months contributed DKK 314 million to reported revenue, of which DKK 298 million were related to the Atos Medical acquisition. Acquired revenue contributed 3 percentage points to reported growth in the first six months. Foreign exchange rates had a positive impact of DKK 250 million or around 3 percentage points on a reported revenue due to the appreciation of mainly the British pound, the US dollar and the Chinese yen against the Danish kroner.

Please turn to slide 7. Gross profit for the first six months amounted to around DKK 7.3 billion, corresponding to a gross margin of 69% against 68% last year. The gross margin was positively impacted by leverage on production costs and savings from the global operations Plan 5. The inclusion of Atos Medical and price increases also had a positive impact on the gross margin. On the other hand, the gross margin was negatively impacted by double-digit wage inflation in Hungary, increasing raw materials, energy and transportation prices, as well as ramp up costs at our new volume site in Costa Rica. The gross margin includes a positive impact from currencies of around 20 basis points.

Operating expenses for the first six months amounted to around DKK 4 billion as DKK 632 million increase, or 19% from last year. Atos Medical contributed with DKK 187 million to operating expenses, of which DKK 39 million was related to the PPA amortization. Excluding Atos Medical, the increase in operating expenses was DKK 445 million or 13% compared to last year.

The distribution to sales ratio for the first six months came in at 29%, compared to 28% last year. The distribution cost increased by DKK 477 million or 18% compared to last year impacted by the inclusion of Atos Medical and increased sales and marketing and travel expenses as COVID restrictions eased, as well as higher logistics cost

and continued commercial investments in the US, Interventional Urology and consumer and digital initiatives. Distribution costs also include DKK 39 million in amortization costs related to the Atos Medical acquisition.

The admin to sales and R&D to sales ratio for the first six months came in at 4% of sales on par with last year. Admin expenses increased by 28% for the first six months, impacted by the inclusion of Atos Medical as well as facing of legal and consultancy and IT costs. R&D expenses increased by 18% for the for the first six months, impacted by the inclusion of Atos Medical as well as increased activity levels across all business areas.

Overall, this resulted in an increase in operating profit before special items of 7% for the first six months, corresponding to an EBIT margin before special items of 31% compared to 33% last year. The EBIT margin contains a positive impact from currencies of 40 basis points, mainly related to the appreciation of the US dollar and British pound against the Danish kroner. EBITDA for special items was around DKK 2.9 billion corresponding to an EBIT margin after special items of 27%. EBIT was impacted by special items of DKK 415 million Danish kroner, of which DKK 115 million Danish kroner as expected related to transaction cost in connection with the acquisition of Atos Medical and DKK 300 million was related to a further provision for the mesh litigation as Kristian mentioned earlier.

The reason for the increase in the provision is that it is taking longer than it previously expected to resolve outstanding cases, in part due to COVID-19, which has resulted in higher legal costs. The increased provision brings the total provision to DKK 6.15 billion.

Please turn to slide 8. Operating cash flow for the first six months amounted to around DKK 1.4 billion, compared with around DKK 2 billion last year. The negative development in cash flows was mainly due to an increase in inventories and other receivables due to phasing. Cash flow from investing activities was an outflow of DKK 11.1 billion compared to an outflow of DLL 1.5 billion last year impacted by the Atos Medical acquisition this year and the Nine Continents Medical acquisition last year. Excluding acquisitions, investments amounted to around DKK 470 million or 4% of revenue. As a result, the free cash flow for the first six months was an outflow of DKK 9.7 billion, compared to an inflow of DKK 446 million last year.

Adjusted for the acquisitions of Atos Medical and Nine Continents Medical, the free cash flow was an inflow of DKK 918 million, a decrease of DKK 536 million compared to last year due to a phasing of inventory and prepaid cost, including insurance and financing costs related to the Atos Medical acquisition. The trailing 12-month cash conversion for the first quarter was 81% impacted by phasing of inventories and receivables.

Net working capital amounted to 26% of sales at 31st of March 2022, compared to 24% at the end of September 2021. And this is impacted by phasing. We still expect the net working capital to be around 24% of sales for the full year. A share buyback program of DKK 500 million was initiated in Q2 of this year, and it was completed on April 21.

And today the Board of Directors approved a half-year interim dividend of DKK 5 per share, corresponding to a total interim dividend payout of approximately DKK 1 billion. In note 9, in today's announcement, you will find a preliminary balance sheet for Atos Medical at the time of the acquisition. Please note that a provision of around DKK 500 million is included, and I'll put, a few words to that. As part of the due diligence process potential billing issues related to billing processes in the US were identified. Atos Medical is now subject to an audit regarding billing compliance, which is the standard industry procedure. To be prudent, we estimate that the maximum possible exposure is around DKK 500 million and we expect feedback on the matter within the next six to nine months. Billing processes in Atos Medical will be strengthened to ensure full compliance going forward.

Now please turn to slide 9. As Kristian explained earlier, we have updated organic growth guidance to 6% to 7% from previously around 7% due to the impact of COVID-19 in China. Besides the updated outlook for China, the other key assumptions behind our organic growth guidance are unchanged. Overall, we assume a continued resumption of hospital activities across our business areas. For the Chronic Care business, the assumptions by region are as follows.

For Europe, we expect continued improvement in growth as a result of the normalized growth in new patients to pre-COVID levels. In the US, we assume a continued improvement in growth driven by the normalization of growth in new patient in Continence Care to pre-COVID levels during Q2. In emerging markets, our guidance assumes broad based double-digit growth, excluding China. As explained earlier, the recent lockdowns in China have resulted in a decline in procedural volumes and sales in the hospital channel within Ostomy Care and that is – and that's the reason for the revised outlook for the year.

Wound & Skin is still expected to deliver in line with our strides in five ambitions of above the market growth. However, the recent lockdowns in China have resulted in a decline in hospital procedures and sales and a revised outlook for the Chinese homecare business. Interventional Urology is still expected to deliver in line with Strive25 ambition of high-single-digit growth. We have no current knowledge of significant healthcare reforms that will impact 2021/2022.

In terms of phasing, I expect growth in the second half to be similar to the first half. Due to the positive currency developments, our reported growth guidance in Danish kroner is still expected to be around 9%. The impact of Atos Medical acquisition on reported growth for 8 months is still expected to be around 6 percentage points. In total, reported growth in Danish kroner is still expected to be around 15%. For 2021/2022 reported EBIT margin before special items is still expected to be around 31% and includes around DKK 150 million in amortization charges related to an eight month impact from the Atos Medical acquisition. The reported EBIT margin after special items is now expected to be at 28% to 29% from previously around 30%, and is impacted by DKK 300 million in special items related to the mesh provision in Q2, as well as one-off transaction and integration costs related to Atos Medical unchanged at around DKK 150 million.

The gross margin is expected to be positively impacted by operating leverage and efficiency gains through the Global Operations Plan 5, as well as price increases, currency tailwind and the acquisition of Atos Medical. The gross margin is expected to be negatively impacted by cost inflation, including a mid-single-digit increase in raw material prices and double-digit rates inflation in Hungary, as well as increasing energy and transportation prices.

On raw materials, the key pressure on prices is coming from plastics and paper. Overall, I still expect our gross margin to be around 68% for the year. The EBIT margin guidance reflects an increase in operating costs related to the resumption of business activities as the impact of COVID-19 recedes, as well as some pressure on freight costs. Overall, I expect that operating costs will grow in line with the reported growth before Atos Medical. The EBIT margin guidance also reflects additional investments, incremental investments of up to 2% of revenue for innovation as well as sales and marketing purposes. This year we are investing incrementally in all business areas and regions with a key focus on the US, Europe, Interventional Urology and digital initiatives.

We still expect our net financials to enter the financial year 201-2022 at around minus DKK 350 million, including impact from Atos Medical unchanged at around DKK 150 million. For the interest costs on the debt financing of Atos Medical, we are still expecting an interest rate of around 1%. CapEx guidance for 2021-2022 is unchanged around DKK 1.3 billion and includes the impact from Atos Medical CapEx and integration CapEx related to the acquisition. Our effective tax rate is still expected to be around 23%. The tax rate is positively impacted by the

increased deductibility on R&D costs in Denmark, partly offset by one-off tax payments related to the acquisition of Atos Medical.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from the line of Hassan Al-Wakeel from Barclays. Please go ahead.

Hassan Al-Wakeel

Analyst, Barclays Capital Securities Ltd.

Q

Hi. Good afternoon and thank you for taking my questions.

I have three please. Firstly, can you talk about the trends that you're seeing in China in March and April where a new patients versus Index 100 on the Ostomy side and can you detail the impact that you're seeing on the Wound Care business? It'd be very helpful to know the decline in the China business in March and April and the expectation for the rest of the year in China?

Secondly, also on China, can you talk about the lower average value per patient in the Ostomy business, and whether this is at all gotten worse throughout the quarter or have lockdowns mainly impacted new patient flow? And then finally on margins, could you help us reconcile the lower top line expectation with the reiteration of your margin expectation? Could you walk us through some of the puts and takes on the costs side and the heightened inflation that you've seen there and how that said all changed since you updated guidance last quarter? Thank you.

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

A

Thanks a lot, Hassan. Why don't I get us started with China. So really, we're basing our revision of top line on what we're seeing here in March and in April. And what you can see is we've got a decline on the Ostomy side in the inflow of new patients. So depending on how – what type of patient you look at, we're looking at something on the order of Index 80 to 90, depending on the week. But we've basically taken the lower value of that and extrapolated that to the end of the year. The average consumer basket size is – has not really changed that much, so this is really something that has to do with the inflow of patients. Wound Care is harder hit. And remember, Hassan, Wound Care for us in China is it's almost exclusively a hospital business. So there we are just affected by the overall decline in activity in the hospital channel. The way we're thinking about this – the way that we're thinking about this is we've basically taken the what ourselves out figures look like for the rest of the year, we have assumed no improvement for the remainder of the year and here all of calendar year.

We have, and I don't know if there is any way to be hopeful about this, I don't have a better crystal ball than anyone else. We do hope that once we get to the fall and presumably the Xi Jinping is re-elected, that we may see some changes. But for now, we have – we don't know.

Anders, do you want to talk margin?

Anders Lonning-Skovgaard

Chief Financial Officer & Executive Vice President, Coloplast A/S

A

Yeah. So thanks for your question, Hassan. In terms of our margin, so our reported growth remains unchanged so around 15%, as I explained earlier. And also, our EBIT margin remains unchanged before special items of around 31%. But there are a number of moving parts. So rest of the year, I am expecting that the gross margin will decline compared to the first half as a result of the increasing raw material prices, energy prices. But what I also mentioned earlier, we have a number of things on the positive side as well, but we are expecting the gross margin that will decline in the second half versus the first half.

On the other hand, I'm also expecting that our cost increase will be at a lower level in the second half versus the first half because last year in the second half and especially in Q4, started to see that our cost became more normal versus the pre-COVID levels. So, that's why we are still looking at an EBIT margin of around 31%. And please also remember, as I mentioned, after our first quarter results, we are also seeing a tailwind from occurrences in the level of 50 basis points for the year.

Hassan Al-Wakeel

Analyst, Barclays Capital Securities Ltd.

Q

That's very helpful. Thank you. If I could just follow up on China, I think you've achieved 10% growth in the first quarter. And it sounds like most of the second quarter as well. How should we think about the run rate coming out of Q2 and into fiscal Q3, given that you're talking about low-single digit for the full year? And also, can I clarify, Kristian, whether you said calendar – the calendar for the impact on China? So I'm just wondering if you expect the impact to move into fiscal 2023 as well. Thank you.

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

A

Yeah. So if I start with you, even the question, Hassan, as we are right now – right now we're saying that we think this looks set to continue for the remainder of the year, so it may stretch into next year. We would be positively surprised if things fare better earlier than that. But, we'll take that positive surprise if we get it for now. We're seeing a calendar year. So it will stretch. It will stretch into next year. We're basically – when we're saying low-single digit for China for the full year Ostomy is going to be in low-single digit territory for the full year and we're going to see negative growth in the Wound Care for the second half. So that's how the math works. But of course, we – as you'll recall, normally pre-COVID, this is a business that grows 15% – between 15% plus. When we started the year, we look set to do 10% and then this has really taken us significantly downwards.

Hassan Al-Wakeel

Analyst, Barclays Capital Securities Ltd.

Q

Perfect. Thank you.

Operator: And the next question comes from the line of Patrick Wood from Bank of America. Please go ahead.

Patrick Wood

Analyst, Bank of America

Q

Perfect. Thank you very much. I'll keep it to two, please. I guess you obviously talked about the primary endpoints on the new Ostomy platform, and just curious if you could put any meat on the bones around what you guys are seeing there, whether it's on PSC reductions or anything like that? And how confident – what kind of confidence

levels that gives you that you'll get paid for the innovations, any kind of update that would be great is the first question?

And then I guess the second question would be on the pricing side of things, any view as to, if the current environment continues further price hikes as we move through the year or is that something you plan to keep relatively stable? Thanks.

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

A

Thanks, Patrick. I'll start by saying that, even, I mean, you can read up on the trials at ClinicalTrials.gov . And if you want to search for it it's called the Randomized Controlled Clinical Investigation, evaluating a flat Ostomy barrier with a novel skin protection technology. And there you get a complete description of it. It is a full randomized controlled comparative crossover investigation, multicenter with two test periods we've got a bit more than 80 people. And if you look at the inclusion criteria, we've really taken people who are experienced users, but also people, I'd just say, at the high level people with experience of leakage. So people who have had trouble and skin problems and when you look at the type of endpoints that we're talking about that have been met they're really related to skin complications. So this would include itching, burning, pain in the [ph] peristel (00:34:01) malaria and then there's also pretty good data on quality of life.

At the high level what I look at here is if you ask the people who've been in the trial whether they want to use the product against the comparator, yeah – yes, they do. And so you can see more online about the details of the study. But clearly to me this now validates that we have a concept that works and we have a path to market, which is encouraging after the setback that we had with the first concept. I'm optimistic, of course, that there is also a path to get paid for it, but this will be the next part of the work. And then I'll say this is also just for flat products in Ostomy, we now need to also test the concept for both Convex and Concave products but very, very important milestone for us. Thank you.

Anders Lonning-Skovgaard

Chief Financial Officer & Executive Vice President, Coloplast A/S

A

And, Patrick, in regard to the second question around the pricing, as we have mentioned earlier this year, this is a key focus area for us, and as a consequence of the high input cost, we have been focusing a lot on various pricing initiatives. And we continue to do that and we are working on a lot of different initiatives. In total it's around 70, and we actually see some impact that is you can see impacting our business positively and it's across all business areas and across all regions. And then in some markets, and I think we also talked to that earlier this year, we also get there's some kind of inflation adjustment to the reimbursement prices and the main market that's the UK. So we are seeing some impact to our business from the various price increases. And we also are working further with this also into to next year.

Patrick Wood

Analyst, Bank of America

Q

Very clear. Thanks so much.

Operator: The next question comes from the line of Christian Ryom from Danske Bank. Please go ahead.

Christian Sørup Ryom

Analyst, Danske Bank

Q

Yes. Good afternoon. A couple of questions from me. First one to the Chronic Care business. So, as I understand it, you've now seen new patient inflow recover to pre-COVID growth rates across most of Europe and the US. And my question is whether you are seeing any evidence of pent-up demand. So that would essentially suggest a period of above trend growth in new patient inflow. And my second question is of somewhat similar nature but goes to what's Atos. And the other question is this essentially particularly for the European region where new patient inflow currently stands relative to the pre-COVID trajectory? Thank you.

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

A

Yeah. So, Christian, two good questions. We're very encouraged to see this development on the new patient side. I'd be careful – we're certainly careful forecasting any type of pent-up demand principally because the capacity isn't there. So if you look at across all healthcare systems, the capacity in terms of personnel, and in hospitals, it is what it is. And so we are not forecasting Christian any type of pent-up demand. Atos Medical, to your question, a strong patient acquisition momentum, a significant part of the growth that we're seeing particularly for the laryngectomy business has come through for all practical purposes, COVID impact and the acquisition momentum is really driven by the introduction of the new Provox Life platform and the launches related to that on the one hand and on the other hand also really good performance in the emerging markets business.

Christian Sørup Ryom

Analyst, Danske Bank

Q

Okay. Great. Thank you.

Operator: Next question comes from the line of Graham Doyle from UBS. Please go ahead.

Graham Doyle

Analyst, UBS AG (London Branch)

Q

Brilliant. Thanks for taking my questions. Just two for me. Firstly, on China, your assumption that the headwinds continue through the year seems quite bearish versus pretty much everyone who has commented so far in Q1 on China. And it does feel like the business is probably disappointed versus your expectations for about 18 months now. So is there anything in your outlook here that maybe reflects additional pressure beyond COVID? And then just a question on Atos, could you just describe a little bit more in detail what is this medical billing audits? And was this something you were aware of during the DD process? Thank you.

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

A

Yeah. Two good questions. So I'll say China for us listen, it's all COVID. It's all COVID. We've if when we have extraordinary data for how our business is running and what our position looks like. We feel very confident about the position. And we are – you can maybe say that we're pessimistic, but we're basing our assumptions on what we're seeing.

Order – I'll just reiterate that order sizes of baskets are the same, but we have seen patient inflow on the Ostomy side come down and the Wound Care business be materially impacted. And then one thing to bear in mind when you compare Coloplast to others is, just remember that our footprint in Ostomy and Wound Care is quite different compared to competition, we have a very large Ostomy business and this is also globally our largest Wound Care business.

And then to the second question on the billing issue with Atos. So the billing discussion was part of the negotiations. So this is certainly something that we've been aware of the audit has come along. It's a standard industry audit. So this is, if you run a DME in the US, you will be subject to these standard audits from time to time. The provision basically reflects that we haven't worked through all the claims that work is ongoing. And we are telling you with this that the worst thing that could happen is if you have a 100% error rate for six years' worth of business, including lawyer bills and this is what it looks like. We will know a lot more in six to nine months, but so it's – that's how basically you just think of the number.

Graham Doyle

Analyst, UBS AG (London Branch)

Q

Okay. That seems quite minor on the Atos side. Just on China, just a quick follow-up on the Ostomy market then in particular, what sort of growth rates do you think now are achievable for the premium market as a whole, so not just yourself or just that market as a whole?

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

A

I'm sorry. Could you repeat that ? Sorry.

Graham Doyle

Analyst, UBS AG (London Branch)

Q

Yes. So what sort of growth rates do you think are achievable for the premium Ostomy markets in China on a sort of four to five year view? You know, has that changed?

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

A

No. So I'll say I think very long term about this. I haven't changed the way I think about China at all. We now have COVID, the Chinese are working their way through COVID differently than anyone else. It is painful. They are locking cities down, keeping people in their apartments. And it's causing a lot of chaos, frankly, in many sectors there. If I look at the underlying demographics of the country, I look at the clinical standards, I look at our position in the market, I am not changing my thinking at all. This will be if you think 5, 10 years ahead, this is going to be one of the single biggest drivers of the Ostomy market globally.

Graham Doyle

Analyst, UBS AG (London Branch)

Q

Okay. Very clear. Thanks a lot, guys.

Operator: And the next question comes from the line of Oliver Metzger from ODDO. Please go ahead.

Oliver Metzger

Analyst, ODDO BHFAG

Q

Hi. Good afternoon. Thanks for taking my questions. Two I have. The first one is about [indiscernible] (00:42:48) key account wins in Ostomy Care. So over years you've gained some experience with key accounts in the US for some of like Cleveland Clinics as you now mentioned the new wins. Should we assume a similar, let's say ramp up of incremental sales to these chains? Also potentially a few words where you are in these chains have you been presented there before or are these exclusive wins?

Second question is on Men's Health and Interventional Urology. Historically, you talked about the link between economic cycle and procedures. So basically they are fully covered but just due to patients fear to this job, there is some dependency. Now we see on the global level that factors like consumer confidence is deteriorating, so have you recognized any underlying decrease in demand or more of the potential patients are a little bit more reluctant? A few comments on that would be great. Thank you.

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

A

So thanks Oliver, two good question. So really the momentum in the US Ostomy business is on its way up and it basically reflects the wins that we've had on the two GPOs. You can also see the three wins that we mentioned here, AscenDrive is part of the Premier GPO. This is now – this used to be a sole source Hollister account. This now a dual source with us with on there and the other – the other two wins are also are also important. And I am certainly expecting that we will continue the strong momentum. We have very strong growth in the acute channel in in Ostomy in the US. But as you know from following us over the years, it's not enough to win the hospital, you also have to close the loop through home health, continue to run strong patient support programs, et cetera. But we are definitely seeing the momentum come up.

So you should expect a strong Ostomy growth going forward. This will be a good year. We're also expecting a strong year next year and this is a key focus area. On the Men's Health side, remember Oliver, this is almost exclusively a US business. There is some activity in Europe but not that much, this is mostly a US business. And when I look at the momentum, really, we're looking at the pipeline of surgical activity, it looks healthy. And so it really picked up here late in – it's picked up late in Q2 and so we expect that we're going to see good contribution to growth for the remainder of the year.

Oliver Metzger

Analyst, ODDO BHF AG

Q

Okay. That's good to hear. Thank you very much.

Operator: And the next question comes from the line of Niels Leth from Carnegie. Please go ahead.

Niels Granholm-Leth

Analyst, Carnegie Investment Bank AB (Denmark)

Q

Hey. Good afternoon. First question on raw material prices. Last quarter, you mentioned that you expected mid-single digit growth in raw material prices. Could you provide an update on this statement? And also how this would feed into your gross margin in the second half of this year? And then just for housekeeping here, so how come you were able to charge the DKK 500 million charge related to Atos Medical billing processes outside the P&L? Thank you.

Anders Lonning-Skovgaard

Chief Financial Officer & Executive Vice President, Coloplast A/S

A

Yeah. So thanks for the question, Niels. So as I mentioned earlier, the raw material prices for the year we are expecting those to increase mid-single digit, and we will see an additional increase here in the second part of the year. But overall we are expecting that the gross margin in isolation for the year will be around the 68%. The second question around the billing challenge we have within Atos and it's part of the opening balance that we have now included as part of our Q2 accounts.

Niels Granholm-Leth

Analyst, Carnegie Investment Bank AB (Denmark)

Q

So had it been discovered when you owned the asset, it would have been taken over the P&L?

Anders Lonning-Skovgaard

Chief Financial Officer & Executive Vice President, Coloplast A/S

A

Yeah. So it's something we have, as I mentioned earlier, and as Kristian mentioned, it's something that we identified as part of the due diligence. So that's the reason.

Niels Granholm-Leth

Analyst, Carnegie Investment Bank AB (Denmark)

Q

Great. So just to understand your gross margin guiding for 68%, you would essentially need to see a gross margin decline in the second half of this year. So is this correctly understood?

Anders Lonning-Skovgaard

Chief Financial Officer & Executive Vice President, Coloplast A/S

A

Yeah. And that's also what I mentioned earlier. We are expecting the gross margin to be declining in the second half of the year because we will see additional effects, raw material prices, energy prices, as I mentioned earlier Niels.

Niels Granholm-Leth

Analyst, Carnegie Investment Bank AB (Denmark)

Q

Okay. Great. Thank you so much.

Operator: The next question comes from the line of Craig McDowell from JPMorgan. Please go ahead.

Craig McDowell

Analyst, JPMorgan Securities Plc

Q

Hi. Good afternoon, guys. Thanks for taking my question. Just on Atos on the Chinese approval of the heat moisture exchanger. Congratulations on getting that approved. And given your assumption on the underlying market, how are you feeling about commercial launch timeline and what implications could that have to Atos financial guidance? Linked to that, how is the build out of the Atos salesforce in China going in light of lockdowns there? Thanks.

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

A

Thanks, Craig. So yeah, we're pleased with getting the HME registered. Please remember, this is only part of the portfolio that we need to go to market with. We need to register the voice prosthesis portfolio also. This is a higher regulatory class product. So this is taking a longer time, but really the trigger for a commercial investment will be the voice prosthesis. We are in the process of preparing, if you will, the go-to-market investment case. So you should expect that when we start, it will be with a strong focus on probably the two or three largest cities in the country and then we work from there. That's also how we work through Ostomy Care originally. But really the trigger will be the voice prosthesis registration.

And I'm sure the follow-up will be, when is that? And the honest answer is we don't know. We don't know. It's still early days in the ownership, but we are full on with the process. And once that triggers, this is of course, something that will be probably one of the key investment cases in the Atos business.

Craig McDowell

Analyst, JPMorgan Securities Plc

Super. Thanks very much.

Q

Operator: The next question comes from the line of Yiwei Zhou from SEB. Please go ahead.

Yiwei Zhou

Analyst, SEB Enskilda (Denmark)

Hi. It's Yiwei from SEB. Thank you for taking my question. I have three questions here. And I'll do one at a time. Firstly, it's on the Interventional Urology and I realize the in the quarter on the margin level which you could calculate it from the second reporting actually declined. Could you elaborate a bit here?

Q

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

Yeah. So thanks for that question, Yiwei. It's because the costs are increasing. So we are spending more in the quarter versus the last year. And one of the things that we are spending more on that is R&D, and so we are ramping up our R&D within Interventional Urology, as a consequence of the Nine Continents acquisition a bit more than a year ago. So the costs are increasing and that's having an impact on the margin in the quarter.

A

Yiwei Zhou

Analyst, SEB Enskilda (Denmark)

Great. Thanks. And my next question is on the new [indiscernible] (00:51:43) launch. And so could you maybe comment a bit on the pricing and also the reimbursement for this new product?

Q

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

Yes. So, we're excited about the concept the pivotal trial work is ongoing and the trial work is ongoing and we – sorry was the question related to Flex?

A

Yiwei Zhou

Analyst, SEB Enskilda (Denmark)

Yeah, the Flex Set.

Q

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

Oh. I thought you were asking about the new catheter platform. Sorry about that. So Flex Set that that basically lands into established pricing points in all major markets.

A

Yiwei Zhou

Analyst, SEB Enskilda (Denmark)

Is it fair to assume there would be a premium to the Flex version or it would be the same?

Q

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

A

So this depends on market. So the, the reimbursement, for example, in the US is a significantly higher reimbursement because it's a category known as [ph] 53 (00:52:44). In general, sets are typically higher reimbursement products because the products are more expensive to manufacture, but the volumes are also lower because if you will, the relevant patient population is also smaller.

Yiwei Zhou

Analyst, SEB Enskilda (Denmark)

Q

Okay. Great. And lastly, a follow-up question on the margin. So you have mentioned a few moving parts already on [indiscernible] (00:53:12). But maybe you forgot to mention that the DKK 50 million less amortization relating to Atos Medical. I mean, if you do the math, it will give you more than 50 bps support on the margin. And this in combine with the FX tailwind, it actually sort of support you to deliver the margin, the full year guidance. But on the other hand you now still keeping the margin unchanged. Is there anything else you haven't mentioned over the last two or three months since Q1, which has sort of put more pressure on you?

Anders Lonning-Skovgaard

Chief Financial Officer & Executive Vice President, Coloplast A/S

A

Yeah. So thanks for that question a comment a way. So in relation to your first comment around our amortization cost. So now we have been working through our amortization cost, and our conclusion is that it's going to be around DKK 19 million per month. And yes, it is a bit lower than I thought earlier, but it's not DKK 50 million in total. But it is a bit lower than I earlier thought. And that is also included in our matching guidance of around 31% for the year.

Yiwei Zhou

Analyst, SEB Enskilda (Denmark)

Q

Okay. And you have talked out about the development in the – on the raw material cost. And could you maybe also comment a bit on the freight costs and other input costs? Have you seen any change in the – or maybe your expectation has changed a little bit since Q1?

Anders Lonning-Skovgaard

Chief Financial Officer & Executive Vice President, Coloplast A/S

A

Yeah. So in terms of the energy cost in Hungary, so we are largely hedged throughout the year. So we have hedged earlier this year for Q3 and also to a large extent before for Q4. So I know or we know the energy cost and that is of course also building. And in terms of the freight costs that is part of our distribution line. Yes, we have seen increases as I mentioned earlier, and that is also reflected in our second quarter result. And I expect the levels we have seen will stay at the – yeah at the current levels. Okay. Thanks.

Operator: The next question comes from the line of Kate Kalashnikova from Citi. Please go ahead.

Kate Kalashnikova

Analyst, Citigroup Global Markets Ltd.

Q

Hi Kristian, Hi Anders. It's Kate Kalashnikova from Citigroup. I've got a couple of questions. Firstly, can you comment on the exit rate in the quarter for Interventional Urology procedures in the US, how this compares to pre-COVID levels? Are you seeing good momentum in US Men's Health continue in April? And if so, could there be an upside risk to high single digit growth outlook in Interventional Urology for the full year? And what's actually

implied for Women's Health growth in this guidance, is low single digit growth for Women's Health a reasonable assumption? And then secondly, emerging markets, excluding China, emerging markets have been strong this year. How confident are you that this will continue into next year do you expect more favorable pricing that we've seen more recently to continue into next year?

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

A

So Kate, to your to your first question on Interventional Urology, we're seeing growth contribution from both men's and women's health but we look at the surgery levels. I think what we've seen now at the end of the quarter and also moving in here to April, we are seeing levels that are normalized. We are not projecting any upside to the – our – if you will our current talk track on the business. So you should expect high single-digit for the total business. If anything, Women's Health is probably around mid-single. I'm sorry I now completely missed out on the second question, what was that on?

Kate Kalashnikova

Analyst, Citigroup Global Markets Ltd.

Q

Yes. Emerging markets excluding China, should we think – should we expect strong growth to continue and more favorable pricing to continue likely since the last year or two into next year?

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

A

We have a very good momentum in the emerging markets business ex-China, it's broad based. A number of the key geographies that are doing very, very well, a number of the, if you will, Tier 2 markets are also doing very well. So we are projecting that EM will continue to grow strongly.

Kate Kalashnikova

Analyst, Citigroup Global Markets Ltd.

Q

And any comment on pricing given your discussions, have you spent...?

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

A

So, okay, I think like we've talked about pricing with you guys before the company does a lot of work on this. As you heard Anders talk about, I mean the entire pricing project portfolio at the moment stands at around 70 separate efforts across the portfolio of geographies and businesses. So, there's quite a lot going on. You should expect a similar activity level continue into next year and of course, whether we're going to be as successful next year as we were this year, we certainly hope so. But you should expect us to continue to work the pricing lever year in and year out.

Kate Kalashnikova

Analyst, Citigroup Global Markets Ltd.

Q

Understood. Thank you.

Operator: The next question comes from the line of Sam England from Berenberg. Please go ahead.

Sam England

Analyst, Berenberg

Q

Hi, guys. Thanks for taking the questions. Two quick ones from me. So in manufacturing, you've already seen a double digit wage inflation in Hungary. I was wondering whether there's any additional pressure to wage, to raise wages out of that or elsewhere in the business as you move into the second half of the year, given the inflationary environment? And if so, can you talk a bit about your ability to offset that elsewhere on the costs side?

And then second question linked to cost is that you said the automation program is proceeding according to plan, can you give us a sense for where you are now in that program and when we might see some of the cost reduction benefits automation begins to flow through? Thanks.

Anders Lonning-Skovgaard

Chief Financial Officer & Executive Vice President, Coloplast A/S

A

Yeah. So thanks a lot, Sam, for those two questions. In terms of the salary levels in, you know, Hungarian sites as we have talked to quite a bit, we increased the salary levels with the high teens from October 1, and that is billed into our financials and the outlook for the year. We are continuing to see a pressure on salary levels. So that is something we are evaluating, but for now we believe this is what we will do for this financial year. But it is something we are evaluating.

In terms of your second question around the automization program, it is a very important program that we initiated in, as – in our top five. So, that's almost two years back. And the program is running as planned and we are also starting to see impact in our financials. The program will continue into next year and that's also where I would expect that we will see the full impact of the program. Please remember the program is around automization. So, we are expecting to reduce additional hiring in Hungary of around 1,000 employees when the program is fully implemented.

Sam England

Analyst, Berenberg

Q

Great. Thanks very much.

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

All right. And then, I want to thank everybody for the interest today. This concludes our conference call. We look forward to talking to many of you on the road. Have a good day.

Operator: This concludes our conference call. Thank you all for attending. You may now disconnect your lines.

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