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Coloplast A/S (CLPBY.DK)

Q4 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by. Welcome and thank you for joining the Coloplast Full Year 2021-2022 Earnings Release Conference Call. Throughout today's recorded presentation, all participants will be in a listen-only mode. The presentation will be followed by a question-and-answer session. [Operator Instructions]

I would now like to turn the conference over to Kristian Villumsen, President and CEO. Please go ahead.

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

Thank you very much, operator. Good afternoon and welcome to our full year 2021-2022 conference call. I am joined by our CFO, Anders Lonning-Skovgaard; and our Investor Relations team. We'll start with a short presentation by Anders and myself, and then we'll do what we'll usually do, open up for questions. Could I ask you all to turn to slide number 3?

We delivered 6% organic growth and a 31% EBIT margin before special items for the financial year. Return on invested capital after tax and before special items was 27%, impacted by the Atos Medical acquisition. In Q4, we delivered 5% organic growth and a 30% EBIT margin before special items. I'm satisfied with this year's results. In this challenging environment, we again outperformed the market, delivered industry-leading profitability. More importantly, we continued to help more than 2 million people with intimate healthcare needs live better lives. This year, we also welcomed more than 0.25 million new users into our patient support program Coloplast Care.

We'll start the call with some key highlights from our Strive25 strategy. Please turn to slide 4. Two years into our Strivey25 strategy, I'm happy to conclude that we continue to make good progress on our priorities focused around four key pillars: growth, innovation, operational efficiency and sustainability. Let me start with innovation. In our clinical performance program in Chronic Care, we're making solid progress on our new catheter platform, Luja, and the new digital leakage notification system in Ostomy Care that we call Heylo. Luja, our new catheter platform with Micro-hole Zone technology is expected to launch in the second half of 2022-2023 backed by a comprehensive clinical program. The world's first digital leakage notification system, Heylo, is in a pilot launch in Germany and the UK and it has received very good user feedback. The clinical studies are on track and the product is expected to launch in 2023.

We've also had to make some difficult decisions. We're discontinuing the development of the new Ostomy Care platform, with the skin protecting technology under a new medical device regulation guidance which was published in April this year, the platform would be categorized as a Class 3 medical device. Since then, we've conducted a very thorough investigation involving external counsel to determine if we had a viable path to market. And the conclusion has been to stop the project as the new categorization results in a significant delay in the launch of the product and fundamentally changes the cost profile of the project as well as the product and it's also not in line with our regulatory strategy for Ostomy Care.

We remain committed to solving for unmet user needs with our innovative products and will reallocate the resources to other projects in the pipeline. This change in focus does not impact our Strive25 guidance. In Interventional Urology, we continue to build new growth options into the portfolio and expand into adjacent segments. With the launch of our first laser equipment, Thulium Fiber Laser, we're entering the attractive lasers market worth an estimated DKK 3 billion.

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Next, I'll zoom in on growth. A key highlight from 2021-2022 was the acquisition of Atos Medical, the biggest acquisition in the history of the company. The business is expected to grow 8% to 10% organically, with an EBITDA margin in the mid-30s. Both performance and integration are on track. There are many similarities between Coloplast and Atos Medical. We're undisputed market leaders in our core categories. We serve chronic users and we have a strong commercial model centered around innovation, partnership with healthcare professionals and a direct-to-consumer setup. Both companies also serve markets where many more people should have access to better products, technologies and services. This makes me optimistic about the long-term potential of our categories. We're well-positioned to seize the growth opportunities in the market and help even more people with intimate healthcare needs.

Next, let me put a few words to operational efficiency. We continue to strive for unparalleled efficiency and industry-leading margins. This year, we opened our second volume factory in Costa Rica. Ramp up is ongoing and by the end of Strive25, Costa Rica is expected to account for around 25% of volumes, allowing for a more robust and global production network. We're also making solid progress on our automation program, which is on track to deliver FTE neutrality in 2022-2023 with a net impact of around 1,000 FTEs. Our Coloplast Business Center in Poland and our IT infrastructure continued to drive positive scale effect in our business support organization and support the ongoing integration of Atos Medical into the group.

Finally, some key highlights from our sustainability work. I'm very pleased to release this year's sustainability report together with the annual report. Within sustainability, we continue to work on our three priority areas: improving products and packaging, reducing emissions and responsible operations. We continue to make solid progress across all three and this year, I am particularly proud of the achievements within reducing emissions. In 2021-2022, we've reduced our Scope 1 and Scope 2 emissions by 8%, driven by the installation of electric heat pumps at our production sites in Hungary and China.

At the end of the year, we also entered our first power purchase agreement, securing renewable energy for 100% of our electricity consumption in Denmark from 2023-2024 onwards. During the year, our carbon emission targets were approved by the Science-Based Target initiative, an acknowledgement of our efforts to contribute to the targets set out with the Paris Agreement. Before we take a closer look at today's results, I'd like to say thank you to our more than 14,500 employees at Coloplast for the continued commitment and hard work in another challenging year. In a dynamic labor market, our voluntary employee turnover rate remains stable and the employee satisfaction score continues to be well above the healthcare industry benchmark. I would also like to thank our users, clinician partners and investors for their confidence in our company.

Please turn to slide number 5. Now let's move on to performance. I'll start off with a few highlights from our full year results. Our Chronic Care business delivered a good year with solid growth contribution from all regions excluding China. Strong year for the US Ostomy Care business with double-digit growth and market share gains in the acute channel. Broad based growth in Interventional Urology with solid contribution from all businesses and all geographies.

Voice & Respiratory Care delivered solid high-single-digit underlying growth, driven by laryngectomy, which grew double digit. Now let's dive into the details by business area. Ostomy Care organic growth was 7% for the full year and growth in Danish kroner was 10%. In Q4, organic growth was 5% and growth in Danish kroner was 9%. Growth continues to be driven by our SenSura Mio portfolio and Brava supporting products.

At the product level, SenSura Mio Convex was the main contributor to growth, driven by the US and Europe. From a geographical perspective, growth in Q4 was driven by Europe, led by the UK. The US also made a solid

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contribution. Major markets excluding China grew double digit, led by Latin America, despite a high baseline in Q4 last year.

China detracted from growth and continued to impacted by COVID-19 and the dynamic zero-COVID policy, which resulted in lower procedural volumes and significantly restricted hospital access. Elsewhere, growth in new patients was largely normalized at pre-COVID levels throughout the year. In Continence Care, organic growth was 6% for the full year and growth in Danish kroner was 9%. In Q4, organic growth was 6% and growth in Danish kroner was 11%. Growth continues to be driven by the SpeediCath ready-to-use intermittent catheters with a good contribution from SpeediCath Flex as well as our SpeediCath Compact and Standard catheters. SpeediCath Flex Set, a new addition to the Flex portfolio, is performing well and also contributed to the growth in the SpeediCath portfolio.

Growth in the quarter continued to be negatively impacted by backorders in collecting devices due to supply shortages experienced by a raw material supplier. The backorders on collecting devices are expected to persist into the first half of 2022-2023. From a geographical perspective, all regions contributed to growth in Q4, led by Europe. The US Continence Care growth continued to improve, driven by the normalized growth in new patients at pre-COVID levels. Except for the US, where growth in new patients was below pre-COVID levels in the first half of the year, growth in new patients elsewhere was largely normalized throughout the year.

In Interventional Urology, organic growth was 9% for the full year and growth in Danish kroner was 16%. In Q4, organic growth was 12% and growth in Danish kroner was 23%. Growth in the quarter continued to be broad based. The US Men's Health business was the main growth contributor, driven by the Titan penile implants. In Wound & Skin Care, organic growth for the full year was 4% and reported growth in Danish kroner was 8%. In Q4, organic growth was negative 5% and growth in Danish kroner was 1%. The Wound Care business in isolation delivered 4% organic growth for the full year and negative 6% organic growth in Q4.

The negative growth in Q4 Wound Care was mostly driven by emerging markets and was impacted by a high baseline in Q4 last year due to tender phasing and negative growth in China, which continued to be impacted by COVID-19 restrictions. The European Wound Care business was impacted by backorders due to sporadic raw material shortages. The underlying momentum in the European business remained solid, driven by Germany and the Biatain Silicone portfolio. Voice & Respiratory Care contributed six percentage points to reported growth for the full year, reflecting eight months of impact and nine percentage points in the fourth quarter.

The underlying growth for Voice & Respiratory Care in the quarter was high single digit, driven by the laryngectomy business. Laryngectomy delivered solid high-single-digit underlying growth 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 as well as a solid contribution from the US and the Tracheostomy and ENT business also contributed to growth with mid-single-digit underlying growth, in line with expectations.

With this, I will now hand over to Anders who will take you through the financials and next year's outlook. Please turn to slide 6.

Anders Lonning-Skovgaard

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

Thank you, Kristian, and good afternoon, everyone. I'm also pleased with the solid results that we delivered for the full-year 2021-2022. So I would also like to thank you to all our employees and the dedication and contribution. The reported revenue for the full year increased by around DKK 3.2 billion or 16% compared to last

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year. Organic growth contributed DKK 1.2 billion or 6% to reported revenue. Acquired revenue contributed DKK 1.2 billion or around 6 percentage points to reported revenue for the full year, the vast majority related to the Atos Medical acquisition. Foreign exchange rate had a positive impact of around DKK 700 million or around four percentage points on reported revenue due to the appreciation of mainly the US dollar, British pound and the Chinese yuan against the Danish kroner.

Please turn to slide 7. Gross profit for the full year amounted to DKK 15.5 billion, corresponding to a gross margin of 69% on par with last year. The gross margin includes positive impact from the inclusion of Atos Medical, leverage from production cost and efficiency savings from the Global Operations Plan 5 and price increases. Impact from currencies on the gross margin was also positive of around 50 basis points.

On the other hand, the gross margin was negatively impacted by the increase in raw materials, energy and transportation prices, double-digit rates inflation in Hungary and ramp up cost at our sites in Costa Rica. In Q4, the gross margin was 69% and benefited from the inclusion of Atos Medical and positive impact from currencies.

Operating expenses for the full year amounted to DKK 8.6 billion, an increase of around DKK 1.7 billion or 24% from last year. Atos Medical contributed with DKK 754 million to operating expenses, of which DKK 152 million were related to the PPA amortization, included under the distribution costs. Excluding Atos Medical, operating expenses increased by DKK 907 million of 13% compared to last year. The distribution-to-sales ratio for the full year was 30% compared to 28% last year. Distribution cost increased by DKK 1.3 billion or 24% compared to last year, impacted by the inclusion of Atos Medical and increased sales and marketing and travel expenses as COVID-19 restrictions eased. Higher logistics costs and continued commercial investments in the US Interventional Urology and consumer digital initiative also contributed to the increase.

The admin-to-sales and R&D-to-sales ratios for the full year were 4% of sales, on par with last year. Admin expenses increased by 32% for the full year, impacted by the inclusion of Atos Medical as well as increase in legal, consultancy, and IT costs. R&D expenses increased by 15% for the full year, impacted by the inclusion of Atos Medical and the increase in activity levels across all our business areas. Overall, this resulted in an increase in operating profit before special items of 9% for the full year, 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 around 70 basis points, mainly related to the appreciation of the US dollar, British pound and the Chinese yuan against the Danish kroner. EBIT margin – EBIT after special items was around DKK 6.4 billion, corresponding to an EBIT margin after special items of 29%. EBIT was impacted by special items of DKK 471 million, of which DKK 171 million are transaction integration costs related to the Atos Medical acquisition and DKK 300 million are related to the Mesh provision booked in Q2.

Please turn to slide 8. Operating cash flow for the full year amounted to around DKK 5.1 billion, compared to around DKK 5.3 billion last year. The negative development in cash flows was mainly due to an increase in inventories and other receivables due to expired hedges. Cash flow from investing activities was an outflow of DKK 11.8 billion compared to an outflow of around DKK 2 billion last year, impacted by the Atos Medical acquisition this year and the investment in Nine Continents Medical last year. Excluding acquisitions, investments amounted to about DKK 1.1 billion or 5% of revenue.

As a result, the free cash flow for 2021, 2022 was an outflow of around DKK 6.7 billion compared to an inflow of around DKK 3.3 billion last year. Adjusted for acquisitions, the free cash flow was an inflow of around DKK 4 billion, a DKK 597 million increase compared to 2021. The trailing 12-month cash conversion for the full year was 77%, impacted by the increase in inventories and other receivables. Net working capital amounted to 25% of

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sales compared to 24% of sales last year, impacted by an increase in inventories and trade receivables. The increase in inventories was mainly due to an increase in safety stock to accommodate for supply chain constraints and price increases. Based on our financial performance, in 2021-2022, the Board of Directors will propose a total dividend of DKK 20 per share at the Annual General Meeting in December compared to a dividend of DKK 19 per share last year.

Before we move on to guidance, a short update on the Atos Medical provision made in relation to potential billing issues in the US. We have reassessed the exposure and the provision is now updated to DKK 400 million from previously DKK 500 million. The difference has been set off against goodwill. We continue to have strong focus on strengthening the billing process in Atos Medical in the US and expect that the error rate will go down over time as the compliance rate goes up due to our strong focus on compliance within billing practices.

Please turn to slide 8, slide 9. For full year 2022-2023, we expect organic revenue growth in the level of 7% to 8% range. Reported revenue growth in Danish kroner is expected at 11% to 12%.

The reported EBIT margin is expected in the 28% to 30% range. I'll go through the detailed assumptions on the next slide. But at the high level, we are seeing significant headwind, especially from price increases on raw materials and electricity in Hungary. Our guidance range is wider than usual due to higher degree of uncertainty related to the development in input costs. For 2022-2023, I also expect around DKK 50 million in special items related to the integration of Atos Medical.

The net financials for 2022-2023 are expected at around minus DKK 450 million, including impact from the Atos Medical financing. The blended interest rate for the debt financing of Atos Medical is expected around 1.95% in full year 2022-2023 from around 1.25% in 2021-2022, impacted by the adjustment of the variable interest rate on the two-year bond issue. CapEx guidance for 2022-2023 is around DKK 1.4 billion and our tax rate is expected to be around 21% and includes a one-off positive impact related to the transfer of Atos Medical intellectual property.

Please turn to slide 10. The revenue guidance assumes limited impact from COVID-19 on hospital activities, except for China. The Chronic Care business, excluding China is expected to grow largely in line with our Strive2025 ambitions. The assumptions by region are as follows: For Europe, our guidance assumes continued good momentum. In the US, we expect sustained momentum in Ostomy Care and improvement in growth in Continence Care on the back of the normalized growth in new patients during the second half of 2021-2022. In emerging markets, excluding China, we expect broad based double-digit growth.

And in China, we expect continued impact from COVID-19 restrictions, with lower level of patient inflow and restricted hospital access, resulting in an expected growth for the business of well below our pre-COVID levels. Wound and Skin Care is expected to deliver in line with our Strive25 ambitions of above market growth. However, the Chinese Wound Care business is expected to remain impacted by COVID-19 restrictions.

In Interventional Urology, we expect high-single-digit growth, in line with the Strive25 ambitions. Voice & Respiratory Care is expected to grow between 8% and 10%, with eight months impacting on our organic growth. We have no current knowledge of significant health care reforms and we expect positive pricing impact in 2022-2023 at a similar level to 2021-2022. In terms of phasing, I expect a slower start to the year in H1 due to high baseline in China and impact from backorders in Collecting Devices and Wound Care. The guidance on reported growth in Danish kroner of 11% to 12% includes contribution from Atos Medical of around 3 percentage point and positive impact of around 1 percentage point from the appreciation of mainly the US dollar against the Danish kroner. The currency impact is based on spot rates as of November 4.

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The gross margin is expected to be negatively impacted mostly by raw material price increases, energy price increases and blue-collar wage increases in Hungary. In our biggest cost of goods sold category, raw materials, accounted for DKK 3.9 billion in 2021-2022. We expect a double-digit price increase. Energy costs, around 2% of cost of goods sold in 2021-2022, are expected to double in 2022-2023. We have now hedged around 60% of electricity consumption in Hungary for 2023 at a level of around €400 per megawatt hour.

The development in blue collar wages in Hungary assumes a double-digit increase. The negative impact from input cost increases is expected to be only partly offset by operating leverage and efficiency gains through the Global Operations Plan 5, positive impact from price increases, positive currency impact and four months of incremental impact from Atos Medical. The EBIT margin guidance assumes prudent cost management of operating expenses, expecting to grow below reported revenue in Danish kroner, excluding acquired growth. The EBIT margin also includes around DKK 230 million in amortization charges related to the Atos Medical acquisition. Currency FX is expected to contribute positively to the EBIT margin with around 50 basis points.

With this, I will hand over to Kristian for final remarks. Please turn to slide 11.

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

Thank you, Anders. I remain optimistic about our future. We're committed to continue growing above the market with 7% to 9% organic growth, while delivering industry-leading profitability with an EBIT margin of more than 30%. Overall for 2022-2023, I'm looking at a business that's expected to largely grow in line with the ambitions set in the Strive25 strategy except for China. Despite the current challenges in China caused by COVID-19, we believe in the long-term market potential beyond the pandemic and remain committed to building better standards of care for our Chinese users.

We're also entering a year in which we will bring two exciting new technologies to the market, with the launches of Luja and Heylo. Our EBIT margin guidance for 2022-2023 reflects the challenging macroeconomic environment that the world is facing at the moment. We expect to be back at our long-term guidance once the inflationary pressure on input cost eases.

Thank you very much. Operator, we're now ready to take questions.

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QUESTION AND ANSWER SECTION

Operator: Ladies and gentlemen, at this time, we will begin the question-and-answer session. [Operator Instructions] And our first question is from the line of Hassan Al-Wakeel from Barclays. Please go ahead.

Hassan Al-Wakeel
Analyst, Barclays Capital Securities Ltd.

Q

Thank you for taking my questions. I have three, please. Firstly, can you help us understand the building blocks in terms of margins for next year and what the key scenarios for the upper and lower end of the range are? Secondly, could you walk us through the bridge from next year to your mid-term outlook also in terms of margin and your confidence here? And when do you expect to get back there and if this could potentially impact your incremental investments that are normally around 2% of OpEx? And then finally, could you talk a bit about the weakness in Wound and the extent of the decline in China and how we should think about the recovery in full year 2023 in this business? Thank you.

Anders Lonning-Skovgaard
Chief Financial Officer & Executive Vice President, Coloplast A/S

A

Yes. Thanks, Hassan, for you three questions. I will start with the two first ones related to margin and then Kristian will continue with the last one. So, in terms of your first question around our building blocks for 2022, 2023 margin outlook, so the way we see it is that we are expecting organic growth in the level of 7% to 8%. On top of that, we have acquired growth and we are also expecting tailwind from FX. So, that is the first assumption. The second assumption that is related to our gross margin and here, as I said in the beginning, we have more uncertainty than usual. I am assuming our raw material prices will increase around double-digit. That is my best knowledge at this stage.

Of course, if we are assuming less increase in our raw materials, we will be impacted positively and vice versa. The other assumption I have on gross margin that is electricity costs, that has impacted us some in 2021-2022. But as you might recall, we are, to a large extent, have been hedged. But for next year, at least until now, we have not been hedged, but over the last week or so, we have hedged around 60% at a euro/megawatt hour of around €400. So that is my base assumption around the electricity side.

So the remaining 40% of our electricity consumption in Hungary, if we are going to buy that on the current spot prices, then I will have some tailwind here as well. And then on the cost side, so the remaining operating expenses, my assumption is to be at a growth that is slower than the top line growth. So those are the main building blocks into our 2022-2023. You can see EBIT margin guidance and it's also worth mentioning, I'm expecting tailwind from currencies of around 50 basis points with the spot prices we are having today, mainly driven by the US dollar and the Hungarian HUF. So that was the question number one.

Question number two, as I understood it, related to the remaining part of the Strive25 margin guidance outlook. So we are still comfortable we will deliver above the 30% over the period. We are expecting to outgrow the market over the period and we are also expecting to see positive impact as the input cost increases will start to normalize. If you just look at the electricity spend alone, then if I use the forward rates on the euro per megawatt-hour for 2024, you already have quite a significant tailwind as an example. So we are still comfortable that we will deliver the 30% EBIT margin over the Strive25 period.

With that, Kristian?

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Kristian Villumsen
President & Chief Executive Officer, Coloplast A/S

A

Thank you. So Hassan to your question on Wound Care and Wound Care performance in the quarter, a few things to keep in mind and really what drives performance to where it is in Q4 is significant negative growth in China and also quite strong baseline from tenders last year in Q4, particularly in the Middle East.

And then we're also calling out that we have seen some level of backorders on the Wound Care side, mainly impacting our business in Europe to the tune of about DKK 10 million in the quarter. We are expecting, when we look into the year that we have opened now that we are going to get the business back to growing above market. For China, we're expecting that the business will come back to low-single-digit growth and that we are expecting the backorder situation to be temporary, but it will persist at least through Q1.

Hassan Al-Wakeel
Analyst, Barclays Capital Securities Ltd.

Q

Perfect. Appreciate the detail.

Operator: The next question is from the line of Graham Doyle from UBS. Please go ahead.

Graham Doyle
Analyst, UBS AG (London Branch)

Q

Great. Thanks for taking my questions. Just one for me, when we look at revenue growth in your guidance for 2023, is it fair to say it's sort of second half weighted? It's just you've got an easier comp, Atos comes into the second half organically and then you've got sort of new products as well launching. So how should we think about that phasing just between H1, H2? Thank you.

Anders Lonning-Skovgaard
Chief Financial Officer & Executive Vice President, Coloplast A/S

A

Yeah. So thanks for that question, Graham. That's fair to say. As I also mentioned in my opening statement, we are seeing a little bit higher comps in the first half, especially in China. We're also having the backorders. We are still expecting that to impact especially our Q1 and to some extent Q2. And then when we move into the second half of the year, we will also see organic growth contribution from Atos, the launches and some of the other activities we're working on. But overall, I don't see a significant difference between H1 and H2 from – you can say growth point of view, but it is fair to say it's more skewed towards the second half of the year.

Graham Doyle
Analyst, UBS AG (London Branch)

Q

Maybe just a quick follow up on US Ostomy down as well, in terms of the relative momentum Q4 on Q3, would you be able to comment on that? I think you said at the Capital Markets Day that was sort of strong double-digit growth in Q3 in US Ostomy. Could you just give us a sense as to where Q4 was relative to that?

Anders Lonning-Skovgaard
Chief Financial Officer & Executive Vice President, Coloplast A/S

A

Double-digit growth has continued. Really good year this year for US Ostomy Care.

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Graham Doyle
Analyst, UBS AG (London Branch)

Q

Thank you.

Operator: The next question is from the line of Martin Parkhøi from SEB. Please go ahead.

Martin Parkhøi
Analyst, Skandinaviska Enskilda Banken AB (Broker Denmark)

Q

Hello. Martin Parkhøi, SEB. Two questions from my side. Firstly, on the innovation side in Ostomy Care where you have to walk away from this platform due to this new medical regulation? Can you say does that change anything in your pipeline? Are there other products that you are working on which you now also feel is not commercially viable? And then second question, Anders, just on the – again on the margin side, because you have of course already seen a significant increase in raw materials in the fourth quarter. Gross margin was actually holding up quite well. And I also think it is better the gross margin Q4 than you have – that you've indicated previously. And then also you talk about slightly back-end loaded growth on the top line. What about the margins? Should we expect very low margins in the beginning of the year and then improve over the year as the comps, I would not say get easier, but becomes more different?

Kristian Villumsen
President & Chief Executive Officer, Coloplast A/S

A

Thank you, Martin. Let me start with a question on the pipeline. So it's important to keep in mind, Martin, that the decision that we've come to here is driven by an event where new guidelines have been issued that we're basically reacting to. We've spent some real time reviewing that because we like the technology; we know it works. But we don't want to take Ostomy Care into Class 3. It has many implications for cost development time, documentation and not least manufacturing that we've come to come to this conclusion. We've got quite a number of opportunities to reallocate resources toward in the pipeline, both in Ostomy Care and elsewhere. And we're in the middle of that process. So that's also why we feel there's no impact on the priorities that we set out in Strive. These things happen, unfortunately, but we still have plenty of good work going on in innovation and good things to allocate resources to.

Anders Lonning-Skovgaard
Chief Financial Officer & Executive Vice President, Coloplast A/S

A

Yeah. And thanks, Martin, for your second question. In terms of our gross margin in Q4, yes, it came in a bit better than I thought. It's mainly driven by currency. We had more tailwind on the currency side than I expected, especially driven by the Hungarian HUF and the US dollar appreciation versus the Danish kroner. And that will also impact us positively into 2022-2023, especially in the first half of the year. So, I expect that the EBIT margin throughout the year will be within our guidance of 28% to 30%.

Martin Parkhøi
Analyst, Skandinaviska Enskilda Banken AB (Broker Denmark)

Q

Thank you.

Operator: The next question is from the line of Maja Pataki from Kepler. Please go ahead.

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Maja Pataki
Analyst, Kepler Cheuvreux SA (Switzerland)

Q

Yes hi. Two questions from my side, please, as well. One, on the electricity costs, Anders, I was wondering where you can help us break it down a bit. Much appreciated that you gave us the hedging ratio for 2023 now at 60% around €400. But I mean, could you help us understand where you were hedging last year, the [ph] 75% (00:37:25) you were hedging? Because I'm trying to understand the significantly higher spot rates that you were exposed to and how you get to a doubling in electricity prices. That's question one.

And then the question two is also related to your pipeline or to the discontinuation of the Ostomy platform. My question is that it doesn't change your long-term guide [indiscernible] (00:37:49) Strive25 guidance on the top line. But I'm curious to understand is it because it would have been anyway at the later part of the period? And do you think it will have an impact on your top line growth acceleration beyond the Strive25 period? Or you think you can make up for that with something else? Thank you.

Anders Lonning-Skovgaard
Chief Financial Officer & Executive Vice President, Coloplast A/S

A

Yeah. So thanks a lot to Maja for your questions. I will start with electricity. So the average price that we have paid throughout 2021-2022 is around €200, €250 and therefore 2022-2023, as I said earlier, we have now hedged Q2 to Q4 in the level of around €400, so around double. And please remember, our first quarter here, it's at the level of last year and so the uncertainty we have for next year, that is the 40% that we have not yet hedged. So I hope that gave you a little bit more insight to the electricity building blocks.

Maja Pataki
Analyst, Kepler Cheuvreux SA (Switzerland)

Q

Yeah. Thank you for that.

Kristian Villumsen
President & Chief Executive Officer, Coloplast A/S

A

And yes, and on the discontinuation of the new Ostomy platform, good question, Maja, whether it would impact growth beyond Strive25 period. So of course the projects that we are reallocating resources toward now, some of them will actually get into markets sooner and some will also help drive growth beyond the period. But we have good things to work on, both in Ostomy Care and some of the other BAs that'll make up for the growth that we had set out for this project also medium and long term.

Maja Pataki
Analyst, Kepler Cheuvreux SA (Switzerland)

Q

Thank you for that.

Operator: The next question is from the line of James Vane-Tempest from Jefferies. Please go ahead.

James Vane-Tempest
Analyst, Jefferies International Ltd.

Q

Hi. Thanks for taking my questions. First one, if I may, is the top line guidance of 7% to 8%. I'm just kind of curious. I know your longer-term guidance is 7% to 9%, but other than China, are there any other potential headwinds you saw why you didn't feel at this stage you could guide to 7% to 9% for next year. And also this

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year, are there any increase from backorders in Continence and [indiscernible] (00:40:16) may have been pushed into this year?

My second question is just on the margin guidance. The 28% to 30%, the bridge you've given is very helpful. I noticed you mentioned sort of in reinvesting at the lower end of the up to 2%, which you've given as part of your Strive25. Just wondering how that compares to how much reinvestment you did for the financial year that just completed. Thank you.

Kristian Villumsen
President & Chief Executive Officer, Coloplast A/S

A

Thank you for that. That just on – on top line, where it's sitting at the moment with 7% to 8%, clearly the largest detractor right now is China. So bear in mind, this is a business that has grown significant double-digit normally that we now have sitting at low-single digit and therefore really not contributing to growth. And on top of that, a fair chunk of backorders, particularly in our Collecting Devices business for the first couple of quarters in the business. We are expecting to launch significant investment in the second half of the coming year and that will drive growth also beyond next year. But really, the big detractor for the year is China.

Anders Lonning-Skovgaard
Chief Financial Officer & Executive Vice President, Coloplast A/S

A

And then James, on your second question around our investment level, I am assuming that we are investing in the low end of the up to 2% and that is also a bit lower than we did the last year. Where we are going to invest in 2023 or 2022-2023, we are going to invest into our Atos business. We also have initiated a number of things within our Urology where we have invested more into especially R&D as a result of, for instance, the [indiscernible] (00:42:00) acquisition. We also are investing in a number of other markets. But compared to last year, it will be at a lower level and at a lower end of the up to 2%. Also because we are a little bit more prudent on our cost as a consequence of the big uncertainty on the input cost.

James Vane-Tempest
Analyst, Jefferies International Ltd.

Q

If I could ask a quick follow up on that, if I may. So are you able to tell us what it was last year? So it was up to 2%, we're investing 1%, is it 1.5%, was that close to 2%? If it's sort of the upper end, just for us to try and understand what the saving that's potentially coming this year is from that. Because I guess with the margin bridge, if you've got I guess higher amortization from Atos, I guess the COGS are growing 10% in terms of, for the raw materials, which you said double digit, that's another half point. I'm just trying to understand what the mitigating factor is from that.

Anders Lonning-Skovgaard
Chief Financial Officer & Executive Vice President, Coloplast A/S

A

Yeah. So I'm not going to give you any more than we are investing at the lower end of the 2%. And I've also said that it is also a bit lower than we did in 2021-2022. So that's my main moving parts into 2022-2023.

James Vane-Tempest
Analyst, Jefferies International Ltd.

Q

Thanks very much.

Operator: The next question is from the line of Mattias Häggblom from Handelsbanken. Please go ahead.

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Mattias Häggblom
Analyst, Svenska Handelsbanken AB

Q

Thank you so much. I had two questions. So firstly, a question on the tax rate guidance of 21% for next fiscal year. So can you help me understand how durable the tax benefit from Atos Medical IP, which [indiscernible] (00:43:33) the lower tax rate is? Is this a one-year effect or should we think of 21% as the new long-term tax rate level for Coloplast? And then secondly, if you can talk about your cost base in China, as long as the government leaves its zero tolerance policy intact, your Ostomy and Wound Care business is hampered due to lower than anticipated volumes. [ph] How long (00:43:55) can you accept the continued run with a cost base that cannot fully absorb the current volumes? I guess, you're investing for the long term, but I'm curious to understand if FTEs in China was up or down on a like-for-like basis in the fiscal year and if it's meaningful to quantify the margin impact from the COVID-19 restrictions. Thanks.

Kristian Villumsen
President & Chief Executive Officer, Coloplast A/S

A

Hi, Mattias, thanks for your questions. I will just start with the first one around the tax. So this is a one-off. So you should see that as one-off benefit to 2022-2023 of a tax rate of around 21%. I expect in the following years to be back at the around 23% as earlier communicated. In terms of China, as a consequence of the low growth, we also have been looking into our cost base and we have also decided to allocate our cost in a different way. And we are not investing as long as we have the situation as we currently have with the low-single-digit growth. So that's how we see it. And we have done some reductions across our business in China.

Mattias Häggblom
Analyst, Svenska Handelsbanken AB

Q

Perfect. Thank you so much.

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

Christian Sørup Ryom
Analyst, Danske Bank A/S

Q

Yes. Good afternoon and thank you for taking my question. I have two as well. The first is regarding the discontinuation of the next Ostomy platform. So basically, how should we interpret your – in your understanding of this new or your conclusions on this new regulatory guidance? Does this imply that there is not really scope for radical innovation on the adhesive technology in Ostomy-base plates and therefore that we should not expect a successor to the SenSura Mio platform on the immediate horizon? That's the first question. And then the second question is, if you can talk a bit about the initial rollout of your new laser product, TFL Drive, how far advanced you are with that here as of Q4? And what are your expectations for this product in 2023? Yeah, that's it. Thank you.

Kristian Villumsen
President & Chief Executive Officer, Coloplast A/S

A

Thank you, Kristian. Great question. And so you should interpret this answer as this is a specific evaluation to the specific technical solution that we have been working with here. So without getting into too much of the technical nitty-gritty, there is a 27-page document from the authorities, which is basically an addendum to MDR, that set out how authorities will interpret, if you will, the interface between what's a medical device and what's a medicinal product. And it's basically the guidelines that are stipulated there that for our specific solution here would have taken us into Class 3 and we don't want to take Ostomy Care to Class 3.

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So that does not mean that there aren't other options for doing good work there. It just means that the, if you will, the choice of technology and raw materials here, basically, would push us into Class 3. So it is a decision that's based exclusively on this solution. On your – to your question on the laser product, after a great start, lots of interest, of course, it's early days, but we've got really, really strong feedback. And you should view this, as well as the other product introductions that we're making into the interventional business supporting high-single digit, low-double-digit type of growth in the franchise this year and beyond.

Operator: Thank you. The next question is from the line of Robert J Davies from Morgan Stanley. Please go ahead.

Robert J. Davies

Analyst, Morgan Stanley & Co. International Plc

Q

Hello. Thanks for taking my questions. The first I had was around raw materials. I noticed you obviously put that into your bridge. It's the biggest headwind. Could you just give us a bit of a breakdown in terms of the major components of your raw materials and where you're seeing kind of more or less price pressures there? Thank you. That was my first question.

Anders Lonning-Skovgaard

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

A

Yeah. And so thanks for that question, Robert. It's really broad based across our different kinds of raw materials. So paper, foil, injection molding, plastics, aluminum. So it's really broad based across our main, you can say, categories where we see higher price levels in the level of double digits.

Robert J. Davies

Analyst, Morgan Stanley & Co. International Plc

Q

Okay. And do you have any sort of backlog or inventory of this stuff covering you for any part of next year or not really? This is all done on a book-and-bill basis?

Anders Lonning-Skovgaard

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

A

So we have to build up inventories, as we have also been talking to throughout last year. But that has been primarily due to the supply chain constraints we have also seen. So we have built up a bit more inventories on a number of key areas in order to make sure we can produce and supply to the demand we see in the market.

Robert J. Davies

Analyst, Morgan Stanley & Co. International Plc

Q

It's great. Thank you. And then maybe just as a final one. I know you had a few questions around the sort of medium to longer-term margin potential. If I guess, just kind of looking across the different parts of the portfolio, where do you see sort of biggest levers for getting the margins back? Where are you seeing the biggest pressure at the moment from a divisional or a product standpoint? Thank you.

Anders Lonning-Skovgaard

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

A

Well, when we look across our business areas with the current knowledge, it's of course, I would say our Wound and Skin business is the main challenging business as a consequence of some of the challenges we are seeing

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right now. And that is also having an impact on our profitability levels within Wound and Skin. And so if I should call out one where we have the main challenges, that's the Wound and Skin. But on the other hand, we see nice profitability improvements within Urology. We also see it within our Chronic business, driven by our European business. So we continued to see a nice growth in Europe across the market growth and that is contributing to the scalability across the company. And I'm also continuing to expect that the Voice & Respiratory business will deliver mid-30s in terms of EBITDA and I'm expecting also to see the synergies of up to DKK 100 million at the end of this strategic period. So, there is a number of areas where we are expecting to see improvements, but short term, it is our Wound and Skin business that is more, you can say, challenged.

Robert J. Davies
Analyst, Morgan Stanley & Co. International Plc

Q

Okay. That was all my questions. Thank you.

Operator: The next question is from the line of Julien Dormois from BNP Paribas Exane. Please go ahead.

Julien Dormois
Analyst, Exane SA (Broker)

Q

Yes. Hi. Good afternoon, gentlemen. Thanks for taking my questions. I have three if I may. The first one relates to the [ph] volume site (00:51:45) in Costa Rica that you have indicated should be ramping up to towards 25% of volumes by 2024, 2025. I'm just curious whether you could help us understand how much of a contribution that will bring to the Strive25 objective and when we could see the early benefits from this relocation. And as a quick follow up on that one and then to follow up on Robert's question, is it mainly Wound and Skin Care that would be helped by this relocation or is it also helping other divisions? So that would be the first question.

Second question also relates to more of the near-term outlook and specifically focusing on the new products, for Heylo and Luja. Are they likely to make a meaningful contribution to organic growth from 2023-2024 onwards, in your mind? And last question is just a housekeeping one, sorry if I missed that, but have you provided a guidance for financial costs for this year, please?

Kristian Villumsen
President & Chief Executive Officer, Coloplast A/S

A

Yeah. So maybe I start with your questions to Costa Rica. It's true that by the end of the strategic period, about 25% of the manufacturing volume will be in Costa Rica. That has benefits compared to where we are right now with Hungary when it comes to energy and labor inflation. On the other hand, please remember that we still run a manufacturing network where each site manufactures for global demand. So, we do incur significant transportation costs on the volume that we have to Costa Rica. So we regard this site basically as, if you will, as a rebalancing of the manufacturing network. The first machines that we have moved out there or going to move out there within the period are going to be within Ostomy Care and Continence Care.

When it comes to Heylo and Luja, they are going to launch at the back half of this fiscal year, which also means that the contribution to growth will start to kick in meaningfully from the following year like you rightly point out and you should think of Luja as the more important and larger launch, at least to begin with for – of the two. We're excited about Heylo. But for Heylo, you basically have to build access in every single market and a path to payment. So it is going to be a longer haul there. But once you have it, you also have that subcategory basically alone. There's no one else out there who has a solution like that. Last one for Anders.

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Anders Lonning-Skovgaard
Chief Financial Officer & Executive Vice President, Coloplast A/S

A

Yeah. So the last one is around the financial items as I understood it. So we are expecting negative DKK 450 million as a consequence of cash flow or hedges on our cash flow and then the interest rate for the debt we have taken as a consequence of the Atos Medical acquisition. And I'm expecting a blended interest rate for the year of 1.95%. So that's my assumption.

Julien Dormois
Analyst, Exane SA (Broker)

Q

Very clear. Thank you very much.

Operator: The next question is from the line of Veronika Dubajova from Citi. Please go ahead.

Veronika Dubajova
Analyst, Citi

Q

Hi, guys. Good afternoon, thank you for taking my questions. I'll keep it to two, please. One, just a comment, Anders, I was hoping you could make on wage growth and what your expectations are. Not necessarily in Hungary, but I'm thinking more across the entire organization. What are your assumptions in terms of wage inflation? What have you factored in? How is that shaping up for fiscal 2023? And then my second question is just on Atos, comment on your degree of confidence of the cost savings. And maybe just remind us of the phasing for 2023 versus 2024? Thank you.

Anders Lonning-Skovgaard
Chief Financial Officer & Executive Vice President, Coloplast A/S

A

So, thanks for those questions, Veronica. Your first question around salary regulation, so we are right in the middle of agreeing on our salary regulation for 2023 and we are regulating our company from January 1. And my overall assumption is around mid-single digit for the year and that corresponds to a bit higher in some European markets and then lower level in China. But we are not salary regulating our company at the level of the current inflation rates. So our assumption is mid-single digit. So that was question number one.

Question number two, that is related to our, you can say, our synergies as a consequence of the Atos Medical acquisition. So what we said when we acquired Atos is that we are expecting up to DKK 100 million in synergies and the areas where we are expecting to see synergies, that's especially on IT when we start to move Atos and the [indiscernible] (00:57:11) company to the Coloplast infrastructure and here we are progressing really well. We're also expecting synergies across a number of other business support areas like finance, quality and other insurance, et cetera. And here we're also progressing quite well. So we are on track and I'm expecting this year that we will see synergies in the level of DKK 30 million to DKK 40 million as a consequence of the activities that we have put in place.

Veronika Dubajova
Analyst, Citi

Q

Very clear. Thank you, guys.

Operator: The next question is from the line of Niels Granholm from Carnegie. Please go ahead.

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Niels Granholm-Leth
Analyst, Carnegie Investment Bank AB (Denmark)

Q

Thank you. First question is, on your R&D costs, are you expecting any unusual R&D costs related to your clinical evaluation programs for the coming year, such as [ph] line continence (00:58:11), et cetera? My second question would be on your anticipated 10% increase or plus 10% increase to your raw material costs in the coming year? Is that assumption based on the already known price increases that you have received, or are you even anticipating additional price increases on raw materials during the year? So I'm trying to get a view on if this is a conservative assumption that you have made or are you actually building in further price increases into your guidance here. Thank you.

Anders Lonning-Skovgaard
Chief Financial Officer & Executive Vice President, Coloplast A/S

A

Hi, Niels. Thanks for, for your two questions. The first question, as I understood, was related to our R&D. We are expecting to have an R&D ratio to sales for the year again of around 4%. So we will continue the various activities that we have within R&D, both on the Chronic side. So the clinical performance program, but also the activities we have put in place within Urology. But you should not see a significant change to the R&D ratio. So I'm still expecting around 4% to sales. In terms of your other questions around the raw material price increases, I'm expecting around double digit and that's given the current knowledge I have, the current assumptions.

Niels Granholm-Leth
Analyst, Carnegie Investment Bank AB (Denmark)

Q

Okay. So you're not building into your forecast additional price increases or price reductions, for that matter, coming in the later part of this fiscal year?

Anders Lonning-Skovgaard
Chief Financial Officer & Executive Vice President, Coloplast A/S

A

No, so right now, the best knowledge I have, that is around 10%. It can improve, but it can on the other side also be worse. And that's also why we are guiding overall a range in the level of 28% to 30% because we have more uncertainty on this specific cost item. But my view currently is around 10%, double digits based on the knowledge I have as of today.

Niels Granholm-Leth
Analyst, Carnegie Investment Bank AB (Denmark)

Q

And could you please then comment on which specific raw material items would cause the biggest uncertainty, would it be polymers, silicone, or which items would that be?

Anders Lonning-Skovgaard
Chief Financial Officer & Executive Vice President, Coloplast A/S

A

Niels, I don't know at this point in time.

Niels Granholm-Leth
Analyst, Carnegie Investment Bank AB (Denmark)

Q

Okay, okay.

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Anders Lonning-Skovgaard
Chief Financial Officer & Executive Vice President, Coloplast A/S

A

Because there are so many elements that are going into our raw material categories that I'm not into such a detail at this level. So overall, we are expecting around double digit as I said and that's my estimate at this point in time.

Niels Granholm-Leth
Analyst, Carnegie Investment Bank AB (Denmark)

Q

Great. Thank you.

Operator: So there are no further questions at this time and I hand back to Kristian Villumsen for closing comments.

Kristian Villumsen
President & Chief Executive Officer, Coloplast A/S

Well, thank you very much, operator. And thank you all of you for good questions. We hope to see many of you over the coming few days for more follow up and conversations. Have a good day.

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