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Coloplast A/S (CLPBY.DK)

Q3 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to the Coloplast Q3 Conference Call. Throughout the call, all participants will be in listen-only mode, and afterwards, there'll be a question-and-answer session. Please note that this call is being recorded.

Today, I am pleased to present Kristian Villumsen, President and CEO; and Anders Lonning-Skovgaard, Executive Vice President and CFO. Please begin your meeting.

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

Thank you very much, operator, and good afternoon to everybody, and welcome to our third quarter conference call. My name is Kristian Villumsen. I'm 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 questions. So, if I could ask you all to please turn to slide number 3.

In Q3, we delivered 11% organic growth, a 33% EBIT margin, and a return on invested capital of 42%. For the first nine months, we delivered 6% organic growth and 33% EBIT margin before special items. Today, we maintain our organic growth guidance for the full year of 7% to 8% and EBIT margin of 32% to 33% before special items. Anders will take us through the details later, but we now expect to be in the lower end of the organic growth range and the upper end of the EBIT margin range.

Our operating environment is not yet back to normal, but the situation is improving across all our regions. Hospital access improved substantially over the summer, especially in the US and our larger European markets. We're keeping a close eye on developments surrounding the Delta variant, especially in China and the US, but at this stage we do not see widespread cancellations of elective procedures or significantly reduced hospital activity or access.

Our growth this year' impacted by several baseline effects and one-offs. But if we take these out of the equation and look at the big picture, we're looking at a Chronic Care business that is recovering with Ostomy Care recovering faster than Continence Care. Most importantly, growth in new patients increased over the summer in both business areas. In Ostomy Care, we're back to pre-COVID levels across pretty much all markets. And in Continence Care, we're approaching pre-COVID levels. Our two smaller businesses, Interventional Urology and Wound & Skin Care continued to post solid underlying growth rates.

If we take a closer look at Chronic Care for a minute, I'd like to describe what we're seeing by geography. In Europe, we saw an improvement in underlying growth from Q2 to Q3, and we expect to see a further pickup in Q4. The development is encouraging and is driven by an effective rollout of vaccines and the resumption of cancer screening programs and treatment for chronic conditions. In the UK where the situation has been particularly severe, the growth in new patients in Ostomy Care is back to pre-COVID levels, and it is approaching pre-COVID levels in Continence Care. Our China business is doing well and gaining market share.

Moving to the US, the situation is also improving, but this is not yet visible in our results. Last quarter, we talked about weakness in our Continence Care business and this continued into Q3. The growth in new patients is improving and close to normalizing now at pre-COVID levels, but our Q3 results reflect the effect of a prolonged period of time with lower growth in new patients.

The Q3 results are also somewhat skewed by distributor buying patterns, but the US will post growth again in Q4. Next year, we expect to be back on track in terms of delivering according to our ambition of more than a 10% organic growth in the US. This assumes a continued normalization of growth in new patients in Continence Care and a positive impact from our growth investments.

In Ostomy, the Vizient GPO went live on July 1, and we have already seen a number of early sole-source wins at large teaching hospitals. The sales force expansion is also on track and we aim to hire and train all new sales reps before year end.

In the emerging markets, we delivered 8% in Q3, which reflects the timing of orders. The tenders are confirmed for Q4, and we expect a solid double digit growth for EM in Q4 and for the year. Broadly across all our markets we're seeing continued market share gains. And, before we dive into our results in more detail, I'd like to just spend some time talking about strategy.

Please turn to slide number 4. We're executing on our strategic priorities within the Strive25 strategy. Today, I'd like to mention a few highlights on innovation and sustainability. We're making solid progress with the Clinical Performance Programme within Ostomy Care and Continence Care. In Ostomy Care, we have received the CE mark for our digital ostomy tool developed to avoid leakage accidents. Payer pilot studies, in both Germany and the UK, are on track to be initiated in Q4 of 2021.

We're also working on a new ostomy platform designed to reduce skin irritation. If you recall, our first pivotal trial showed insignificant results. We've now completed the root cause analysis. We've optimized the device design so that we can initiate a new pivotal study toward the end of 2021. In Continence Care, we've made a solid progress

on the product design and performance of our new catheter platform. We expect to run a pivotal trial in 2022 and we're now looking at launch later.

Now, moving on to sustainability strategy. Last week, the Intergovernmental Panel on Climate Change released their report concluding that human influence has unequivocally warmed the atmosphere, ocean and land. It was yet another reminder that we all need to act and we need to act now.

At Coloplast, we're committed to ambitious science-based climate action for a 1.5-degree Celsius future in line with the Paris Agreement. During Q3, the company conducted a scope 3 emissions screening to find out where in the value chain our emissions lie in order to determine where to focus our reduction efforts. By year end, Coloplast will submit scope 1, 2 and 3 emission reduction targets for official validation through the Science Based Targets initiative.

As part of the company's Inclusion and Diversity efforts, Coloplast has signed the Confederation of Danish Industry's Gender Diversity Pledge, committing to a target of a 40/60 gender distribution in management and our board of directors by 2030.

Finally, to provide increased transparency in tax, our board of directors has decided that Coloplast will publish country-by-country tax reporting together with our Annual Report this year.

Now, let's take a closer look at today's results. Please turn to slide 5. In Ostomy Care, organic growth was 5% for the first nine months and growth in Danish kroner was 2%. In Q3, organic growth was 4% and growth in Danish kroner was 2%. Growth continues to be driven by our SenSura Mio and Brava supporting products. Our SenSura and Assura/Alterna portfolios continue to post solid growth in emerging markets.

As explained earlier, growth in Q3 was positively impacted by an improvement in underlying growth in Europe, driven especially by higher growth in the UK, as well as a lower baseline due to destocking last year. The quarter was negatively impacted by lower growth in new patients and distributor buying patterns in the US, and timing of tenders also had a negative impact on growth in the quarter. And as mentioned earlier, these tenders are confirmed for delivery in Q4.

In Continence Care, organic growth was 4% for the first nine months and growth in Danish kroner was 1%. In Q3, organic growth was 5% and growth in Danish kroner was 4%. 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 our SpeediCath compact and standard catheters.

In Q3, growth was driven by an improvement in growth in new patients in Europe as well as a lower baseline due to destocking last year. And as explained earlier, growth was negative in the US due to the impact of COVID-19 on growth in new patients and distributor buying patterns. Similar to what we saw in Europe, intermittent catheterization treatment and bowel management treatment has not been prioritized fully during the pandemic in the US as these treatments can many times be postponed and there are real alternatives.

In Interventional Urology, organic growth was 22% for the first nine months and growth in Danish kroner was 16%. In Q3, organic growth was 82% and reported growth increased by 73%. Growth in Q3 was positively impacted by the rebound in elective procedure as well as a lower baseline. Men's Health continues to lead the recovery and accounted for a significant share of the growth in the quarter. Women's Health also contributed to growth as elective procedures continued to resume and our single use devices business in Europe also contributed to growth.

In Wound & Skin Care, organic growth for the first nine months was 6% and reported growth in Danish kroner was 2%. The Wound Care business in isolation delivered 11% organic growth for the first nine months and 20% organic growth in Q3.

The Biatain Silicone and by Biatain Fiber portfolios were the main contributors to growth driven by France, Germany and Spain. Biatain Fiber continues to deliver solid contribution to growth, and also China posted another quarter of good growth which was also helped by a weaker comparison period last year. Our Skin Care and Compeed contract manufacturing businesses returned to growth after several challenging quarters due to COVID-19.

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, over to you.

Anders Lonning-Skovgaard

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

Thank you, Kristian. And good afternoon, everyone.

Reported revenue for the first nine months increased by DKK 372 million or 3% compared to last year. Organic growth contributed DKK 840 million or 6% to reported revenue. Foreign exchange rate had a significant negative impact of DKK 481 million or around minus 3% on reported revenue as expected due to the depreciation of the US dollar and several emerging markets currencies against the Danish kroner, in particular, the Argentinian peso, Brazilian real, and Russian ruble. The depreciation in the US dollar accounted for approximately 50% of the negative currency impact.

Please turn to slide 7. Gross profit for the first nine months amounted to around DKK 9.8 billion corresponding to a gross margin of 68%, which was on par with last year. The gross margin was positively impacted by leverage on production costs and savings from Global Operations Plans 4 and 5. On the other hand, the gross margin was negatively impacted by increasing costs in Hungary due to salary inflation and labor shortages as well as extraordinary costs related to COVID-19 outbreak and ramp-up of costs at our new volume site in Costa Rica.

Increasing raw material prices had an immaterial impact on our costs. Raw materials account for approximately 50% of our cost of goods sold, which amounts to an annual spend of around DKK 3 billion. We are monitoring raw material prices closely and we have seen some pressure in particular on plastics and recycled paper. Based on our current knowledge, we expect to see continued pressure as we move into next year, but again it will not – or it will have an immaterial impact on the overall cost base.

The gross margin includes a negative impact from currencies of around 40 basis points. The gross margin in Q3 was 69% and benefited from positive product mix due to stronger quarter from Men's Health and Interventional Urology. The distribution to sales ratio for the first nine months came in at 28% compared to 29% last year. Distribution costs increased by DKK 40 million compared to last year, which reflects cost savings from lower travel and sales and marketing costs due to COVID-19, which were partly offset by growth investments.

The admin to sales and R&D to sales ratio for the first nine months came in at 4% of sales on par with last year. Overall, this resulted in an increase in operating profit before special items of 7% for the first nine months corresponding to an EBIT margin before special items of 33% compared to 31% last year. The EBIT margin

contains a negative impact from currencies of 60 basis point mainly related to the depreciation of the US dollar against the Danish kroner.

Please turn to slide 8. Operating cash flow for the first nine months amounted to around DKK 3.3 billion compared with around DKK 3.1 billion last year. The positive development in cash flows was due to an increase in operating profit before special items of DKK 323 million and a gain on financial items, which was partly offset by one-off tax payment related to the acquisition of Nine Continents Medical last year. Cash flow from investing activities was impacted by increased investments in [ph] automatization (00:14:37), IT and the new factory in Costa Rica. CapEx investments amounted to DKK 730 million for the first nine months, or 5% of revenues which is on par with last year.

The acquisition of Nine Continents Medical reduced the cash flow by DKK 950 million. As a result, the free cash flow for the first nine months was an inflow of DKK 1.6 billion against an inflow of around DKK 2.4 billion last year. Adjusted for the acquisitions, the free cash flow was an inflow of DKK 2.7 billion, up by 10%. Our trailing 12 months cash conversion for the first nine months, excluding the Nine Continents Medical acquisition, was 91%.

Net working capital for the first nine months amounted to 26% of sales due to an increase in inventories and trade receivables. For the full year, net working capital is still expected to be around 24% of sales.

Please turn to slide 9. For 2021, we continue to expect the revenues to grow 7% to 8% organically and 4% to 5% in Danish kroner. We now expect to deliver organic growth in the lower end of the range.

As the year progressed, our Interventional Urology and Wound & Skin businesses have performed better than expected, Chronic Care in Europe and in emerging markets has performed in line with expectations, and the US Continence business has seen a more severe impact from COVID-19 than expected at the start of the year.

The guidance assumes a double digit growth in Q4, driven by the continued resumption of elective procedures and hospital activities across business areas as vaccines are rolled out.

In the Continence Care business, growth in new patient is expected to normalize further towards the pre-COVID levels. In Wound Care, we expect continued solid performance in Europe and in China. And, Interventional Urology, we are on track to deliver solid double digit growth for the year.

Due to the depreciation of mainly the US dollar, Argentinian peso, and the Brazilian real against the Danish kroner, reported growth in Danish kroner is still expected to be 4% to 5%. The currency impact is based on spot rates as of August 17.

For 2021, we now expect the reported EBIT margin in Danish kroner before special items in the upper end of the range of 32% to 33%. This is due to efficiency gains and lower cost levels as a result of COVID-19, partly offset by our commercial investments.

The reported margin in Danish kroner is expected to be positively impacted by the Hungarian forint, but this is offset by a depreciation of the US dollar and a number of emerging markets currencies against Danish kroner.

The gross margin this year is positively impacted by operating leverage and the Global Operations Plans 4 and 5. We are making solid progress on GOP5 and have extracted efficiency gains. The positive impact is partly offset by cost pressure in Hungary from wage inflation and labor shortages, as well ramp-up costs at our new factory in Costa Rica. Overall, the expectation is now that the gross margin for 2021 will be higher than 2019/2020.

We now expect our net financials to end the financial year 2021 at around DKK 25 million from previously around DKK 0 million. Based on current exchange rates, the year-to-date gains and balance sheet items and cash flow hedges it'll be partly offset by losses on balance sheet items on a few emerging market currencies and losses on cash flow hedges on especially the British pound as the year progresses. CapEx guidance for 2021 is still expected to be around DKK 1.1 billion. And our effective tax rate is still expected to be around 23%.

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

QUESTION AND ANSWER SECTION

Operator: Thank you very much. [Operator Instructions] Our first question is from Patrick Wood from Bank of America. Please go ahead. Your line is open.

Patrick Wood

Analyst, Bank of America Merrill Lynch

Q

Perfect. And thank you very much. Hopefully, two quite quick ones. The first one, I'm probably late to the party on this, but I was interested in the transdermal work you guys are doing on postpartum depression. Is that an area that you're looking to push into more, not necessarily the depression side but more on the transdermal work with your Wound Care business. So it's just a surprise, so curious as to how you're feeling about that.

And then, second question, obviously the delay in patient starts in Ostomy has an effect on growth. But I'm just curious how we should think about that from your eyes going into 2022. On the one hand, you potentially got fewer reversals, but on the other hand, fewer absolute patients. So, I don't really know how to factor those things through in the next, let's call it, 12 to 18 months. I'm just curious if you are in our shoes, what kind of things are we thinking about in that topic. Thanks, guys.

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

A

All right. Patrick, thank you for the question. I'll start with the question number two on new patients. I'm sure there are a number of people on the line who are interested in this topic.

So, let me start with Chronic Care, and we have to answer this question I think by region. So, we are expecting Q4 to further pick up compared to Q3. We are also expecting this improving trend to continue into the new year. We are going to be up against an easier comparison period. But of course, some of that benefit will be offset by the accumulated negative impact of lower growth in new patients that we've also seen in the last 18 months. On the other hand, the company has continued to invest in the commercial initiatives in Europe, and we also have a few product launches underway.

On emerging markets, we are also expecting Q4 to come in significantly better here than Q3. We've got solid momentum. We also expect to deliver growth in the double digit range, so next year in line with Strive25. I should say, of course, that particularly for some of the markets here in EM we are monitoring the situation related to Delta closely not least in China.

In the US, we are expecting to deliver double digit growth in line with the Strive25. The improving trend and growth in new patients, we are expecting to drive a higher growth. We are expanding our OC sales force. I'll

remind everybody that Coloplast now, for the first time, has access to the two largest GPOs on the ostomy side in US and we have – we are underway with expanding the OC sales team, we also have a few product launches going into the US for the next year.

Again, you have a bit of the same dynamic that you have in Europe that, even though you have a favorable comparison period, you've also had a period where we've had a lower inflow to offset it. But net-net, we expect the US to post a double-digit growth, in line with the strategy.

If we move to the Interventional Urology business, just for Q4 we expect to see continued strong performance, we also expect high-single digit, low-double digit type growth in the business next year.

The type of performance that we have now compared to pre-pandemic levels is quite solid. It's a very strong commercial pipeline. And, of course, again, here, I will say, we are closely monitoring the situation in the US related to COVID, but we don't expect any widespread lockdowns. You will see things happening from time to time at the hospital level, but it's not something that materially impacts overall surgical activity levels, nor access.

On the Wound side, we are, I would say, for next year – I mean, we are very happy with where the business is at the moment. We are expecting the growth trajectory to continue into Q4. I'm happy to see the Skin Care and contract manufacturing business also back to growth. So, for next year, we are expecting it to continue to do to grow above-market around mid-single digit-plus type growth levels.

Again, Patrick, I will just say we are, of course, monitoring for impact from COVID, Delta, in particular, for China.

On your first question, Patrick, I'd just say we're not present in this part of the market, so I would say we are – we're not pursuing that type of opportunity.

Patrick Wood

Analyst, Bank of America Merrill Lynch

Q

Okay. I thought I found some clinical trials suggesting otherwise. And I appreciate it. Thanks, guys.

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

A

Operator, we are ready for next question.

Operator: Thank you. Our next question is from Martin Parkhøi of Danske Bank. Please go ahead. Your line is open.

Martin Parkhøi

Analyst, Danske Bank A/S

Q

Yes. Good afternoon. Martin Parkhøi at Danske Bank. A couple of questions. First on the margin side. Anders, can you just talk about what – if we look at the – you ending on high end this year but [indiscernible] (00:25:05) maybe of a nonrecurring nature. What should we expect just the underlying base for the EBIT margin when looking into next year?

And then, just on the – and on that note on the gross margin where you now are – are somewhat more positive on the development this year than previously, is that sustainable going into the coming years as well?

And then, maybe also again on the China development. Can you just talk about – now of course saw emerging markets being lower this quarter but not due to China. Can you talk about the development and also maybe some details about – we've talked about earlier that people now are actually maybe buying fewer products, which means a lower value per patient. And how you see that development, and why this is the case right now?

Anders Lonning-Skovgaard

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

A

Yes. Let me start with your first question, Martin. So, thanks a lot. Around our EBIT margin development, so as I said earlier, we are delivering a strong EBIT margin so far this year, and we are expecting before special items to deliver an EBIT margin in the level of – or in the upper end of 32% to 33%. That is driven by strong gross margin and actually also stronger than I had expected previously due to – that we're on track with our Global Operations Plan 4 and 5. We are seeing quite a strong contribution. But we have also, especially in the third quarter, seen quite strong contribution from mix, especially from Urology.

This year, we are also impacted by the extra costs related to COVID, also high salary inflation in Hungary. So, we also have some headwinds.

If we look into next year, there are also a number of things I would like to highlight, so without giving guidance for next year, of course. When we look at the gross margin, the outset is strong but we are also looking into some headwinds. I talked a little bit about it, but we are seeing an increased pressure on raw materials – raw material prices. And as I said earlier, we have a total purchase of raw materials in the level of DKK 3 billion. And we are seeing some raw material price increases probably in the level of 1% to 2% coming into next year.

The other challenge we are facing for next year is ongoing salary increases in Hungary. We are seeing high salary inflation. So that's another headwind. But, of course, we will also see a contribution from our Global Operations Plan 5, the efficiency gains we have seen this year will continue. So it is – there are both positives and negatives coming into 2021/2022.

And then on the costs side, this year we have seen savings related to COVID. We have not done as many sales and marketing activities. We still had throughout the year global travel ban. And we are starting to see a normalization of those cost categories, especially here in Q4 and into next year as well. And this combined with increased investments into our commercial organization we are expecting that our costs next year will be higher than our growth. So those are some of the underlying dynamics when we look at the 2021/2022.

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

A

And then, Martin, to your question on China, I'd say the overall inflow in terms of patients to the business has been healthy. So, if you look at the Ostomy side we are back to pre-COVID levels, very strong performance in the hospital channel, and our Care program in China working well.

If you look at what's happening in the in the online space, also that the teams had very strong performance over the past quarter, but what we can't see is that the average order size going through the business has declined. And you'll recall that China is an out-of-pocket market. And so, we view this – and as does our local team – we view this as a part consumer sentiment given where the country is at the moment. I am, of course, following very closely the development on the COVID side, the Delta variant, and how the Chinese authorities are managing this.

And, I think, I can safely say that they are on the ball. We see quite swift action and very large scale testing and isolation of any infected that the authorities find. So, where we've seen outbreaks, we also see then pretty fast decline, but we do see it, Martin, in consumer sentiment. So, the average basket size from consumers is down, but it's in the single digit percentage territory.

Martin Parkhøi

Analyst, Danske Bank A/S

Q

Okay. Thank you very much.

Operator: Thank you. Our next question is from Maja Pataki of Kepler Cheuvreux. Please go ahead. Your line is open.

Maja Pataki

Analyst, Kepler Cheuvreux SA (Switzerland)

Q

Hi. Good afternoon. Just one question with regards to Delta and what we should expect – and I understand, Kristian, that you are very closely monitoring what is happening, and nobody really knows where the ball is going to go. But do you have anecdotal evidence from your salespeople when they're talking to reps at hospitals that there has been also a learning curve at hospital settings where this time around, even if hospitals start to fill up more from where we are today that there is going to be a different way to deal with patients – with patients ex-COVID, so in a sense, saying that even if COVID hospitalizations continue to rise, we should not see an impact on your revenues as hospitals are better equipped, or better managing what is happening. Thank you.

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

A

Yeah. No, thank you, Maja. Of course, it's a critical question. I fundamentally see the world in a very different place today than it was 12 months ago. The vaccines really matter. Sometime into the future when we look back at this, I mean, in some sense, what happened over that 12-month period on developing vaccines for all of us probably go down in history as one of the biggest achievements in healthcare ever.

At the practical frontline level, we have, I'd say, overall, Maja, we have pretty good access. In China, we have improving access. In Europe, we also have improving access. And much more broad-based access in the US. We're also quite confident that hospitals have learned a lot. So, one thing is that depending on the country that you look in at – of course, the absolute level of admissions is, of course, nowhere near what it was, at least when you look to Europe, I am conscious that we now have states in the US where we are seeing admission rates go up. But even in those states and where you might see hospitals cancel elective procedures, surgeons and teams have learned a lot. They're finding alternate sites to conduct the surgery. So, we're not seeing broad-based lockdowns and impact in the making.

I'd also say one requirement that we are expecting is that the industry authorities are going to require from industries that people who want to work with the hospitals and have access to hospitals that they're going to document that they have been vaccinated for credentialing. So at the very high level, Maja, definitely improved, lots of learnings that I think also make it highly unlikely that we're going to see anything close to what we went through 12 months ago.

Maja Pataki

Analyst, Kepler Cheuvreux SA (Switzerland)

Q

Thank you. So, Kristian, then we should maybe just think about it potentially, adding a couple of months to the normalization in patient discharge levels, something like that. If things get worse, then it might take one or two months longer until we get back to where we were in pre-pandemic levels.

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

A

Of course, we have to monitor this and see whether this starts to generate a lot of admissions. But if I look at admission levels broad based in Europe, things are improving week-on-week.

Maja Pataki

Analyst, Kepler Cheuvreux SA (Switzerland)

Q

Okay. Great. Thank you so much.

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

A

And discharge rates are improving week-on-week. And we're seeing the same pattern for US even with the development on Delta that we've seen in some of the Southern states.

Maja Pataki

Analyst, Kepler Cheuvreux SA (Switzerland)

Q

Okay. Great. Thank you very much.

Operator: Thank you. Our next question is from Veronika Dubajova of Goldman Sachs. Please go ahead. Your line is open.

Veronika Dubajova

Analyst, Goldman Sachs International

Q

Hi, guys. Good afternoon. And thank you for taking my questions. I'm kind of going to circle back to some of the themes that have already propped up. Apologies for that. But just want to push you a little bit on kind of some of the moving parts. And, I guess, just – my first question is, Kristian, for you. Your degree of confidence on being able to hit the 7% to 9% organic sales growth as you look at 2022 that you've guided for in the midterm. And I guess as you think about it, what are some of the variables that you think represent upside risks versus downside risks?

And then, I just want to confirm, Anders, your comments on the margin pieces. Am I right to think that you'd expect margins to contract as you think about 2022 versus 2021? Thanks, guys. I have a follow up after that, but maybe get these out of the way first.

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

A

Thank you, Veronika. Of course, lots of moving parts. I'd say, at the high level, I feel more optimistic about the future than I did 12 months ago. Of course, if we – if I just walk through the different business areas, I'd say on the Chronic Care side, we have an accumulated negative impact of lower NPDs for the pandemic period. And we believe that that's going to probably more or less cancel out the weaker comparison period, right? So, we are objectively looking at a lower comparison period that would help us, but we expect the impact of lower NPD to cancel that out.

We expect improvement in growth in Europe versus 2019/2020, US around double digit. And this is really on the back of the investments that we're making – the increase in – in patient recruitment momentum, and also the product launches that are coming underway.

And then, for EM, we expect that business to deliver double digit growth. It's going to deliver double digit this year and we expect it also to do that next year. Wound Care, around mid-single digit – mid-single digit-plus, and IU high-single digit to low-double digit.

And then, if you ask what are some of the sensitivities for me? Of course, back to Maja's question also, if we see – if we see serious scale-up of Delta that could affect how things pan out, but we really regard this as unlikely for the main markets at this stage.

On the positive side, definitely, I have – we have a few product launches coming that I expect to contribute. I expect the investments that we've made into both Europe, our digital initiatives, and the US to also contribute. So, I hope that answers your question.

Anders Lonning-Skovgaard

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

A

All right. Veronika, your question related to our margin. So, I gave some of the moving parts into next year at – earlier in this call. And then, please, also bear in mind that when we upgraded the margin guide before special items back in our second quarter from 31% to 32%, to 32% to 33%, I also mentioned back then that half of the guidance upgrade back then, that it was related to permanent savings, and the other half was more a lower spend due to the COVID situation. And so that is also important to take into consideration.

Veronika Dubajova

Analyst, Goldman Sachs International

Q

Okay. Thank you. No, that's very clear. And then, sort of a follow-up for me, just very quickly, and I know this is a very tough question to answer. But, obviously, while vaccination rollout has been a huge success in US and in Europe, and it seems to be making a difference, rest of the world is very, very far behind. And Kristian, I am just kind of curious how you are thinking about that. And maybe just remind us, China aside, what are some of the other key markets for you on the EM side that have been key drivers of growth that we should be watching for as we move into 2022, especially if it comes to normalization? And that's it for me. Thanks, guys.

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

A

Thanks, Veronika. Good question. So, of course, China is number one in our portfolio of EM markets. And I don't know if you're following that, but, I mean, of course, they're doing a massive vaccination program and continue also these, I think, quite hard-hitting measures to contain Delta whenever it pops up its head.

Latin America, we have a number of important markets, most prominently Brazil. Brazil has been stable through the pandemic irrespective of, of course, the impact that COVID has had on the country. Business has continued to be strong. Russia is an important market. And I'd say in general, when I say Russia, I'd also say Eastern Europe. We have a very, very strong presence. So, for all of those markets, we are following the development very closely. And then, finally, Middle East. So, all of those markets will – we're watching them closely, Veronika.

Operator: Thank you. Our next question is from Michael Jüngling of Morgan Stanley. Please go ahead. Your line is open.

Michael K. Jüngling

Analyst, Morgan Stanley & Co. International Plc



Great. Thank you. I have three questions, please. Firstly on the digital ostomy platform, can you comment on what it means by doing payer pilot studies in Germany and the UK? What are the endpoints that you are trying to achieve here that will also allow you then to say these products can be a success?

Question number two. If I look at some of the questions I asked earlier from companies including yourself about the mid-term margin opportunity post-COVID, many companies highlighted they could have a better margin after COVID because new selling ways seem to work. Can you confirm whether that situation is unchanged for you? Has COVID-19 given you the opportunity to have structurally longer term better margins?

And then, question number three is a little bit of a tough one and perhaps slightly unkind. But if I look at your organic growth comp adjusted, it's your second worst result since the pandemic, and yet we can see all around the world things are improving including vaccinations. How do you know that this is not an execution problem and rather something else which you've highlighted? What sort of comfort do you have that this is not a competitive situation that you are falling into? Thank you.

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S



Thank you, Michael. Three good questions. I'll take number one and number three, and then I'll hand it over to Anders.

So, let me start with your question on the new ostomy platform. We – sorry, the new ostomy digital platform. We're running payer pilots, Michael, because there's not a product like this out in the world today. There's not really a category in which it fits. And so, we basically have to prove to payers that we add value. I'll say there's been quite a lot of interest in getting this ball rolling, but because it's so new we are also – we're also doing quite a lot of data collection with the new platform.

So, when it comes to the endpoints, there are, of course, hard endpoints but we are going to look at with the type of skin issues that people would have. So, assuming that, if you have a significantly lower number of leakages, you will have fewer skin issues that are often quite painful and require treatment. We'll look at readmissions. But we're also going to look at a number of other KPIs that are related to how people are doing and how they are responding to the benefit of the product. So, it's going to be – I would have to say – somewhat exploratory to begin with. But, I think, we'll know quite early on whether patients like it. And, if they like it, I'm absolutely convinced that we're going to find also a path to value.

Now, when it comes to organic growth, and whether this is an execution issue, this is, of course, something that we are very, very close to, Michael. And when it comes to execution and relative performance, we look at leading indicators that are about patient recruitment, about hospital volume sales, and the share of hospital volume sales, and how that develops; we look at our care enrollments, we look at the performance in our direct businesses.

So, we feel quite confident that when we say that this has to do with the market and the baseline effects and the dynamics that we described in the US rather than execution. I feel good about the portfolio in the market today. And, our position, I also feel very good about the pipeline that's coming. But, of course, I understand that you have to ask this question, but we feel good about where we are.

Anders?

Anders Lonning-Skovgaard

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

A

Yeah. All right. Thanks, Kristian. So, in relation to your second question, Michael, around permanent savings, as I have communicated previously we are seeing some permanent savings as well. We are seeing that especially across our sales and marketing organization in relation to travel. We are not traveling as much. And our expectation is that going forward, we will not travel to the levels we did pre-COVID.

We will also have some more efficiency in the way we are operating our company. And that's why we – back in our second quarter announcement – announced an upgrade of the margin for this year, as explained earlier.

But please also remember, we are also allocating some of these savings into investments, into new commercial activities and we have invested or decided to invest into a number of areas especially in the US where we are expanding the sales force. We are seeing a normalized spend level within Urology where we had a very low spend level last year. So we are doing a number of things in order to drive the top line growth.

Michael K. Jüngling

Analyst, Morgan Stanley & Co. International Plc

Q

Great. Thank you. And just a follow-up on the digital ostomy platform. How long does this payer pilot study last? When can you report back some of the findings, whether the response is a positive one?

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

A

The total program, Michael, will run for about a year.

Michael K. Jüngling

Analyst, Morgan Stanley & Co. International Plc

Q

Great. Thank you.

Operator: Thank you. Our next question is from Oliver Metzger of Oddo BHF. Please go ahead. Your line is open.

Oliver Metzger

Analyst, Oddo BHF

Q

Yes. Good afternoon, gentlemen. Three questions from my side. The first one is on your guidance increase on the bottom line. Just from another perspective, so would you describe the higher end also to a certain extent, to lower-than-expected price pressure for your company in the current year?

The second question is on GOP5, your target about stabilization of the number of blue-collar workers in absolute terms, to which extent have you already reached your target and should we expect a similar positive contribution in the gross margin for the next fiscal year?

And the last one is on a comment you made earlier. So, why does Ostomy Care recover faster than Continence Care? So, to my understanding both [ph] Ostomy and Chronic Care (00:47:52) business and subject to medical conditions where you don't have a meaningful alternative. So, why is one develop differently than the other?

Anders Lonning-Skovgaard

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

A

So thanks, Oliver, for your three questions. Let me start with the number one and two, and then Kristian will take number three. So, as I understood your first question, it was around price impact or the healthcare reforms. As we have said previously, we are not seeing any bigger healthcare reforms this financial year. And, going into the next year, we are not seeing any bigger healthcare reforms either, except for a smaller one in France impacting our Wound Care business. So, I hope that answered your first question.

Oliver Metzger

Analyst, Oddo BHF

Q

Yes. Thank you.

Anders Lonning-Skovgaard

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

A

The second question around your GOP5 question. So, GOP5, as you know, we have a number of initiatives, and one of the key initiatives that's our [ph] automatization (00:49:01) program, where we have decided to allocate a significant CapEx amount into automating our machine lines. So far, this year, we are on track with the activities, and we are on track with the ambition we have of reducing the future need of blue-collar workers. And that is starting to contribute to our production economy. So, that is contributing also this year, and our expectation, it will also contribute to our gross margin development in the coming years. Kristian?

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

A

And then, to your final question, Oliver, about the differences in Ostomy Care and Continence Care. For the vast majority of the OC patients come in through either a cancer or some relatively painful chronic conditions, where there are really not good alternatives. And we've seen pretty consistently the – for example, colorectal cancer be one of the prioritized procedures across markets.

The IC – or the incontinence business, consists of a number of different product areas. So, one is intermittent catheters where – you're right, there are, for example, bladder cancer patients that go through surgery and will need to use intermittent catheters afterwards with no good alternatives. But there are also – there's a collecting devices business where there's a relatively high amount of hospital sales, when you've had lower hospital activity, you also see lower sales of some of the collecting devices going in to the hospital channel.

And then, there is a Bowel Management franchise where we basically sell products for transanal irrigation, and these are products that are sold for patients who have, I'd say, a very long path to treatment and where basically they can wait and they choose to wait. So, that's part of what's in the numbers and the differences in the development.

Oliver Metzger

Analyst, Oddo BHF

Q

Okay. Thank you. I've just a follow-up to my first question. Basically, I was interested in the impact of the lower price pressure on your EBIT margin. First, EBIT margin increased three months ago, and second also now we

see the upgrade that we – you look more towards the upper end. So, to which extent had lower and normal price pressure positive impact on your margin guidance upgrade?

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

A

Yeah. So, if you are talking about price pressure in terms of healthcare reforms then we are not having any impact if that is what you are referring to.

Oliver Metzger*Analyst, Oddo BHF*

Q

Yeah. But very basically, the lack of price pressure, reason why it was easier for you to increase the bottom line guidance.

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

A

Yeah. So, as explained earlier, Oliver, this year we are having around zero percent impact on price from healthcare reforms. So, we are not having any negative impact.

Oliver Metzger*Analyst, Oddo BHF*

Q

Okay. Yeah. Okay. Got it. Thank you very much.

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

A

Okay. Thank you.

Operator: Thank you. Our next question is from Yiwei Zhou of SEB. Please go ahead. Your line is open.

Yiwei Zhou*Analyst, SEB Enskilda (Denmark)*

Q

Hey. Good afternoon. Thank you for taking my question. I have two for now. Firstly, on the Urology Care, it's really nice to see a strong recovery. Would you please give us an indication now if you have seen any pent-up demand in this quarter contributing to the strong growth? Also, appreciate it if you could give us an update on the US launch of Endourology product.

My second question is on the China Ostomy Care. So we have heard recently your competitors ramping up investment in China. I mean, have you seen any changes in the market dynamics? Any comment will be appreciated.

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

A

Yeah. Thank you, Yiwei. Two good questions. So to IU, we're very pleased with the results. It's driven by both Men's Health and Women's Health, but most prominently Men's Health. We do not view it as a lot of pent-up demand. We have a very healthy pipeline, also locally. We're also seeing a pretty good pickup in the activity levels in Europe. And to your question on the Endo to US business case, it is progressing according to plan.

When it comes to China Ostomy, true, we are, of course, seeing ConvaTec invest and investing both in online investing in sales force and trying to build a stronger position.

I would say I feel very good about our position in China. And I say that on the back of the presence in the market of more than 30 years, hospital share probably in 60%-plus, online market share 70%-plus. We take share in the online channel. We have very strong performance in the hospital channel. So, it will give ConvaTec a run for their money. But, of course, we take all competition, Yiwei, super serious. And I know there are a lot of great people there trying to do a good job, but so are we.

Yiwei Zhou

Analyst, SEB Enskilda (Denmark)

Q

Great. Very helpful. Thanks. Thank you. I jump back to the queue.

Operator: Thank you. Our next question is from Niels Leth of Carnegie. Please go ahead. Your line is open.

Niels Granholm-Leth

Analyst, Carnegie Investment Bank AB (Denmark)

Q

Good afternoon. First question on the contribution from the tender orders in quarter four. Could you elaborate a little bit how much it's going to contribute in the final fourth quarter? And did I understand you correctly that you expect double digit growth for the group in quarter four, or was that just for one of your business areas?

And then, I have a second question regarding your raw materials. Did I understand you correctly that you expect raw materials to increase by 1 to 2 percentage points in fiscal 2022? Thank you.

Anders Lonning-Skovgaard

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

A

Thanks, Niels, for your questions. So, let me take both of them. And so, if we start with the second one around raw materials, so what I referred to, that was the raw material prices that I am expecting to increase in the level of 1% to 2%. Please remember, our ambition in the Global Operations Plan 5 was a 0% price increase. So, we are expecting some headwinds into next year.

In relation to your first question around Q4, we are expecting our organic growth to be around double digit for the quarter. It is also driven by strong emerging markets where we are expecting also double digit, partly driven by underlying growth across all our emerging markets regions. So, Latin America, China, Eastern Europe, et cetera, but also, some of the tenders that we have won, and that is specifically related to Russia and the Middle East. So, that's our assumptions for our fourth quarter related to emerging markets.

Niels Granholm-Leth

Analyst, Carnegie Investment Bank AB (Denmark)

Q

And how much should we expect the tenders to contribute in quarter four?

Anders Lonning-Skovgaard

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

A

I'm not going to be specific on that one, Niels, but it is quite some contribution. As you know, emerging markets, at least in some of our regions, the revenue and the growth is very much driven by tenders. That is something we are seeing and have seen in the past especially in the Middle East, especially in Russia, and that's also the

dynamics we see this year. And now, this year, we are having quite significant impact from tenders in our fourth quarter. That's our expectation.

Niels Granholm-Leth

Analyst, Corgie Investment Bank AB (Denmark)

Great. Thank you.

Q

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

Thanks.

A

Operator: Thank you. Our next question is from Scott Bardo of Berenberg. Please go ahead. Your line is open.

Scott Bardo

Analyst, Joh. Berenberg, Gossler & Co. KG (United Kingdom)

Yeah. Thanks very much for taking my question. And apologies if you touched upon this previously and I didn't capture, I was a little bit late to the call. But I think that you've been talking about the clinical improvement program for many years now and I think a strategy that I certainly have embraced. I think one of the flagship products and notions within this concept has been to develop an advanced technology catheter potentially carving out new reimbursement categories by making genuine clinical improvements for urinary tract infection.

Q

I note that you've communicated you now plan on launching these products within the first half of the Strive 2025 (sic) [Strive25] (00:59:10) plan, and it seems to me that that could only be possible if you have canned the prospect of running a urinary tract infection study. So, I just wanted to understand is it no longer your ambition to try and prove clinical advantage of urinary tract infection and the new launch here will be basically within the existing reimbursement structures like SpeediCath?

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

Thank you. Thank you, Scott. A great question. So, I'll say, our ambition is still to make a dent in urinary tract infections. That's still the ambition. And I'm not going to dive too deep, Scott, on this call into what the clinical strategy is. But we are progressing well with the development work. We're very, very excited about the platform. And we think it's going to make a meaningful difference. And we are also pursuing a price premium for the product.

A

As progressed, we also think that we are going to launch sooner than we were expecting. And here, we're also – we're also reflecting our optimism that we will get the product to market in the first half of the strategic period. But the ambition is still to do something about urinary tract infections and it's still to pursue a price premium for the product. And we are deep in the discussions of the clinical program and how to execute it to that effect. But I am not going to disclose exactly how we are going about that. But you can definitely quote me on saying, we're confident that we've got something really exciting coming.

Scott Bardo

Analyst, Joh. Berenberg, Gossler & Co. KG (United Kingdom)

Thank you. I appreciate that. I just like, perhaps, then to understand the nature of the decision to launch early. I mean, is it a technical decision that you need to think about redesigning the trial or attacking that trial in a different

Q

way? Or is it a commercial decision that you decide that, if you like, the world is getting more competitive and you want to launch a product, arguably a less validated product, a little earlier to regain momentum? I just wonder if you can help me understand the nature of the decision.

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

A

Yeah. So, a great follow-up, Scott. So the world's not black and white. So this is our judgment, of course. And we both have technical considerations and commercial considerations, we most often do when we make decisions on the innovation pipeline. It's a topic that I think is actually worthy a longer discussion at some point. So when we see each other next, maybe we can pick it up. And it's certainly also something we'd be willing to cover more of when we have our Meet the Management next year, definitely.

Scott Bardo

Analyst, Joh. Berenberg, Gossler & Co. KG (United Kingdom)

Q

No, I appreciate that. It's a very technical question. But in a sense, you can confirm then that, if you like, the slightly elevated margins that we're seeing now is not a reflection of lower than anticipated R&D expenditure that you outlined in Strive25.

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

A

Definitely not. Definitely not.

Scott Bardo

Analyst, Joh. Berenberg, Gossler & Co. KG (United Kingdom)

Q

Thank you. That's all for me. Thanks, guys.

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

Okay. I think on that happy note – we're a little above the hour. But on that happy note that the company is still completely committed to innovation and to our Clinical Performance Programme. I'd like to thank everybody for your interest in the company. We hope to meet many of you on the road or on calls here over the coming days and weeks. Have a good day.

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