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PRELIMINARY TRANSCRIPT

COLO B.CO - Q3 2017 Coloplast A/S Earnings Call

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AUGUST 16, 2017 / 1:00PM, COLO B.CO - Q3 2017 Coloplast A/S Earnings Call

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PRESENTATION

Operator

Good day, and welcome to the Q3 report 2017 results conference call. Today's conference is being recorded. At this time, I'd like to turn the conference over to Lars Rasmussen, CEO. Please go ahead,.

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

Thank you very much. Good afternoon, and welcome to our 2016- '17 conference call. My name is Lars Rasmussen, I'm CEO of Coloplast, and I have with me today CFO, Anders Lonning-Skovgaard and our Investor Relations team. We will start out with the usual presentation by Anders and myself, and we will open up for questions.

Please turn to Slide #3. In Q3, we delivered a solid 8% organic growth, which I'm pleased with. The growth was driven by good performance in many of our markets and a positive impact from new products launches, including SenSura Mio, SpeediCath Flex Brava protective Seal.

In Q3, the U.S. recorded double-digit growth within Chronic Care. This quarter, (inaudible) a single-sourced Ostomy Care which is one of the largest home health organizations in the U.S.

We also experienced tailwind from market share gains in the U.S. throughout the business. With respect to the (inaudible), further was made to (inaudible) just issued a court stating that plaintiffs may no longer file claims against Coloplast in the ongoing MDL. This is a further closure and full resolution of the MDL.



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Performance in Wound & Skin Care was disappointing due to a large negative impact from pricing reforms in Greece and France, which reduced our Wound Care growth in Q3 by 6 percentage points. In addition, the rebound in Skin Care materialized with the expected (inaudible) contract losses in the U.S.

On a positive note, I am pleased to see continued market share gains in Europe and double-digit growth in the Chinese Wound Care business again.

Our product revenue in the third quarter has reduced by [DKK 90 million] due to a nonrecurring revenue adjustment related to an incorrect manage contract I with the U.S. affairs from 2009.

Coloplast have correctly restructured affairs to resolve the matter, and we are now in a dialogue concerning the final amounts. Our contract with has been renewed, and we have strengthened our internal process and organization around contract compliance. Together, with an external audit company we have been through, all of our U.S. contracts to ensure that they have and are corrected

Year-to-date, we delivered 7% organic growth, interest in line with our expectations. Our EBITDA increased 9%, and fixed currencies before the one-off adjustment for Affairs, and our EBIT margins in fixed currencies came in at 33% for the first 9 months for the one-off adjustments for Affairs.

Our organic revenue guidance for '16/'17 is unchanged for 7% to 8%. We expect to deliver in the low end of the range mainly due to weaker performance in Wound & Skin Care.

The organic revenue guidance is not impacted by the one-off adjustment related to the U.S. Affairs.

Our reported growth is now expected to -- at around 6% from previously, 7% to 8%. The difference is mainly related to the DKK 90 million one-off adjustment from Affairs and exchange rates developments. In particular, the fall in the U.S. dollar and the British pound against the Danish kroner.

Our EBIT in guidance in fixed currencies is unchanged at 33% to 34%. We expect to deliver in the low end of the range. Our EBIT margin in Danish krone is now restricted (inaudible) [at around] 32%. Please turn to Slide # 4.

Year-to-date, our revenue grew 7% organically, reported growth of 6% and amounted to [DKK 11.5 billion]

In Ostomy Care, organic growth of 7% and (inaudible) growth of 6% (inaudible) for Q3, an isolation organic growth of 7%.

Growth continues to be driven by our enSura and portfolios specially in the larger markets like the U.K. Germany and China. Since the new congress has now being relaunched in 16 markets and contributed significantly to the growth in the quarter.

Finally, our enSura portfolio shows growth driven by China and Russia.

In Continence Care, organic growth of 8% and (inaudible) growth was 7%. In Q3, the organic growth was 10%.

SpeediCath (inaudible) continues to drive growth, and especially the compact category performs well.

In the compact segment continued to see strong performance in markets like the U.S., France and U.K. SpeediCath Flex has been launched in 14 markets and contributed strong (inaudible) growth in the quarter.

Performance in our Conveen collecting device portfolio remains challenged by high pressure. And finally, we remain satisfied with (inaudible) products.

The Urology Care, organic growth was 11% and (inaudible) growth was 12% (inaudible) the organic growth was 10%. The growth was mainly driven by sales of female private health products, a segment in which we have gained market share after last companies have left the markets more than a year ago.



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We also continue to see satisfactory growth in this -- in sales of the Titan range of inflatable (inaudible) devices.

Finally, our business saw satisfactory growth in Europe, in particular in France.

The Wound & Skin Care organic growth was 0% and (inaudible) product growth was [1%] Organic growth for Wound Care in isolation was 3%. In Q2, the organic growth for the total business area was 1%, and for Wound Care, it was minus 1%. The growth was driven by Biatain sales, in particular Biatain Silicone in European markets, like the U.K. and Germany.

In Wound Care, the growth was challenged by price reforms in France and Greece, as well as we mentioned in a number of emerging markets, including Brazil.

On a positive note, the Chinese Wound Care business has returned to double-digit growth. The Skin Care business reported double-digit growth on an easy compared to last year.

Finally, contract manufacturing have completed impacted growth negatively. Turning to our geographical segments, we saw organic growth of 5% year-to-date, and 4% in Q3 in our European markets. The growth was primarily driven by U.K. Germany and France.

Organic revenue growth in other developed markets was 9% year-to-date and 14% in Q3. The strong performance in the U.S. provider driven by strong demands for high catheters. We are also experiencing tailwind from market share gains in the U.S. Urology business. Growth rates in Australia and Japan remain satisfactory.

Revenue in emerging markets grew organically by 10% year-to-date and 14% in Q3. Year-to-date, we saw a strong growth in markets like Russia and Argentina. In China, Ostomy Care posted strong growth and we saw improving momentum in the Chinese Wound Care business. Negative growth in Greece following health care reforms from performance.

I would now like to hand you over to Anders, and please turn to Slide #5.

Anders Lonning-Skovgaard - Coloplast A/S - CFO and EVP

Thank you, Lars. Good afternoon, everyone. Gross profit was up 5% to DKK 7.9 billion. This equals our gross margin of 68%. We continue to see improvements in efficiency at our volume sites, in particular, a positive impact from the relocation of SenSura Mio Compeed to Hungary, which compensates for the negative gross profit impact from the launch of new products where the production of the economy is not yet fully optimized. The gross profit was negatively impacted by wage inflation in Hungary, increasing depreciation levels, and costs associated with relocation of production to Hungary.

In addition, the gross profit was negatively impacted by to [DKK 15 million] in restructuring costs related to the reduction in the number of production employees in Denmark.

The distribution to sales ratio came in at 28% comparable to last year. The ratio was impacted by incremental sales investments in primarily, the U.S. and U.K.

The admin to sales ratios came in at 4% of sales, and up DKK 45 million compared to last year. The increase is related to patent litigation costs as well as [DKK 7 billion] to transaction costs related to the acquisition of Comfort Medical. The (inaudible) sales ratio came in at 4% of sales compared to 3% for the same period last year. The 15% increase reflects higher activity levels.

Overall, this resulted in an increase in operating profit of 4% and 7% in fixed currencies, which cost (inaudible) EBIT margin of 32% in both fixed and actual occurrences.



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In Q3, in isolation, the EBIT margin came in at [52%] in both fixed and actual currencies. Excluding the DKK 90 million savings one-off adjustment related to the U.S. Veterans Affairs contract, the EBIT margin in actual and fixed currencies was 33% for the first 9 months, and 33% for Q3.

Operating cash flow amounted to almost DKK 1.7 billion, and was down 2% compared to last year. The currency impact from higher absolute earnings was offset by payments on escrow accounts to settle these case. Year-to-date, missed payments totaled DKK 1.7 billion, in total, these payments to date now amount to DKK 4.1 billion.

Cash flow from investing activities was impacted by the acquisition of Comfort Medical for approximately DKK 1.1 billion and capacity expansion in machines for the production of existing and new products, and the site expedience in Hungary.

Investments in intangible assets and property, plant and equipment amounted to DKK 423 million year-to-date.

Sale of bonds provided [DKK 167 million] of cash contribution.

Adjusted for payments made in connection with the and the acquisition of Comfort Medical to free cash flow amounted to approximately DKK 2.5 billion compared to DKK 2.9 billion last year. The differences is explained by lower tax payments last year, which means that the underlying cash flow is in line with last year. Finally, the second half of the share buyback program of -- in total DKK 1 billion was finalized at the end of July.

Please turn to Slide 6. Our organic growth guidance for '16/'17 is unchanged at 7% to 8%. As mentioned, previously, we expect to end the year in the low end of this range primarily due to weaker performance in Wound & Skin Care.

We expect a strong fourth quarter due to continued stable growth rates in Europe and strong growth rates in North America. We expect the continued acceleration in emerging markets both driven by China -- and our guidance assumes a positive impact from recent product launches. Our growth expectation for Wound & Skin Care for the year is now low single digits. The impact of price reforms in France and Greece is larger than previously anticipated. And the rebound in Skin Care will not materialize to expected levels contract losses in the U.S.

Our reported growth is now expected at around 6% from previously 7% to 8%. The change in our reported growth guidance is explained by DKK 90 million one-off adjustment for Veterans Affairs, and exchange rate developments.

The currency impact is based on spot rate as of August 14, 2017, and the negative impact compared to last quarter is mainly a result of the depreciation of the U.S. dollars and the British pound against the Danish kroner. The acquisition of Comfort Medical is still expected to contribute 4.5 percentage points to our reported growth.

We continue to expect a negative pricing pressure of around 1 percentage point on our top line. Year-to-date, we have seen moderate pressure from pricing reforms within Wound Care in France and Greece.

For '16/'17, we continue to expect EBIT margin of 33% to 34% in fixed currencies. We expect to end the year in the lower end of this range. We now expect around 32% in Danish kroner from previously around 33%. The change in EBIT margin guidance in Danish kroner is explained by the adjustment for Veterans Affairs and exchange rate developments.

Higher growth from our new product launches still meets pressure on the gross margin, but we continued to relocate manufacturing out of Denmark to Hungary -- and have reduced the number of production employees in Denmark by 100 in the first 9 months of the year. We expect the benefits to be absorbed by the cost of relocation and restructuring costs in 2016/'17. We also expect depreciation to increase at the same level as last year as a consequence of the last couple of years increase in CapEx.

We now expect our net finances to end the financial year '16/'17 at around minus DKK 75 million, impacted primarily by cash flow hedging gains on the British pound and U.S. dollar, partly offset by losses on the Brazilian real and Argentinian peso.



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CapEx guidance for '16/'17 is still expected to be around DKK 700 million, and is driven particularly by investments in market patenting for new and existing products, including SenSura Mio, Biatain Silicone and SpeediCath Flex, as well as expansion, which is expected to be operational during the first half of '17/'18. And a new distribution center which is operational as of Q4.

Finally, our effective tax rate is expected to stay around 23%.

This concludes our presentation. Thank you very much. Operator, we are now ready to take questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We'll now take our first question from Annette Lykke of Handelsbanken.

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

I have 2 questions. First of all, you have increased your capacity for your SenSura Mio and have a (inaudible) downwards in the capacity restricted until end of month this year. When would we see this more materializing in increased growth rates for the Ostomy area? And then my second question is on Wound & Skin Care. This is about a year ago, you announced a precious investment program for the division in the (inaudible) You're going to make a geographic expansion as well as increase your innovations or your investments and innovations. However, correct me if I'm wrong, if a patient said that the innovations you were looking for were like having the capital, having the complete portfolio of products. Is this ambitious enough? Will you be able to follow market growth or take market shares, if you don't have a superior portfolio?

Lars Rasmussen - Coloplast A/S - CEO and President

Thank you, Annette. On the Africa, I actually think that the are seeing a pretty strong contribution. It takes a little while after you launch and before you can -- full effect. We have also a pretty strong pace to compare up against us, yes. So I think that if you take the market growth of Ostomy Care, and then the growth you're heading, it's a very strong performance. So I would not feel bad about the performance that we have now. And I also think that there's more to come, but yet -- I'm pretty happy with what we have here. And when it comes to Wound Care, I think it's worth to mention that it is 6 percentage points that we are missing out on this quarter, simply because of 2 markets -- Greece and France due to health care reforms. So it also means that we have another markets where we're actually growing very strongly. But you are right, that we are coming from a situation that we do not have a lot of market shares. It's not big nominal amount -- and we needed to grow a lot and the offices and difference from what we had in base line. And so as we are growing, we will need a better and better portfolio to face the growth -- and we also investing on this. So if I look investing in (inaudible) compared to what we've invested [2] years ago, it's a complete different story.

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

But how can you say that you think the current performance is it -- this could is good if you adjust towards the situation in France and Greece? You were looking for growth rate, 10% to 15% a year ago.

Lars Rasmussen - Coloplast A/S - CEO and President

Fair enough, okay. We would like to -- need to have more growth to fulfill the condition that you're having, so that's fair enough. But we are in a situation now where we winning market shares again in most of the markets again in Wound Care. So do we need more? Sure.



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

And I didn't see you answered questions on what type of products because you have previously said that you were sort of expanding shares and some areas are more than for complete, new innovations. Is this is still your strategy here -- is to -- more fill in gap rather than making innovations?

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

If we -- I think I have to come back to the answer that again which is if we take what we are investing today, it's significant was before and we think we have not areas vers, which was speak in the U.S -- my colleagues -- so it's technically -- I don't think that we growth out, so if you -- if what you say with small efficiencies with what we already have, I think it's of pending, of course, we also have to bring all or stuff on the markets.

Operator

We will now take our next question from Christian Ryom from Nordea Markets.

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

This is Christian from Nordea. A couple of questions from me. On the U.S, first of all, you say that you're seeing double-digit organic growth in the U.S. Chronic Care business. Can you confirm whether you're seeing organic -- double-digit organic growth in both continents in Ostomy in this quarter? That's my first question. And then the second question is on Comfort Medical. And whether you are seeing a notable contribution to your organic growth from Comfort Medical through, either value upgrade of your sales through this channel or through increased share of wallet in the channel.

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

Could you repeat the last question, please, because to us -- some hiccup in the connection when you said that.

David James Adlington - *JP Morgan Chase & Co, Research Division - Head of Medical Technology and Services Equity Research*

Sure, sure. So my second question is on Comfort Medical -- and whether you are seeing a contribution to your organic sales growth in Continence Care from Comfort Medical, either through upgrading sales in terms of the technology that you have through this channel or through increased share of wallet in the channel.

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

Yes. When we are looking at the our sales out numbers in Ostomy and Continence Care, they are denominated in the U.S. so I can confirm this. When it comes to Comfort Medical, there is no doubt that we are seeing that Comfort Medical is contributing to our growth. And I can also say that we are a little bit ahead up (inaudible) Comfort Medical when we made the basis that we invested from. So I think that it's a positive.

Operator

We will now take our next question from Mr. Sebastian Walker from UBS.



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Sebastian Walker - UBS Investment Bank, Research Division - Associate Analyst

I've got 2, please. One, within Ostomy Care. Are you see increased competitive or increased competition across any major territories? And if so, how are you responding there? And then secondly, on the reimbursement cut deflects. I'm surprised that the higher reimbursement level could be so easily overturned. And so is this prompting any kind of change in the strategy? I mean, how do you plug it to the higher reimbursement codes and if you can kind of that going forward?

Lars Rasmussen - Coloplast A/S - CEO and President

Yes. I think that I'd like to say, just as a statement, that the we are in an area that is a competitive area that's Our competitors are globally, professional companies. And so we are always seen a competitor pressure no matter what countries we aim. Has that changed significantly over the last couple of years? I don't think so. So that is pressure on, and it's not a walk in the park to keep going on in the market share. So we have to launch new products, as we're doing all the time. And we also pressing in the the cost to us. We have (inaudible) to try the best products in the market and to have service level in the market that's what we're trying before everyday. So no, I don't see it changing. When it comes to Flex in the U.S., we applied for the (inaudible), we get into it. We have gains -- a lot of customers in this simply because it is the significant in the product, and products which are in the markets. They're trying to pick the products up that you see out there and try to look at demand and recent that it's I mean it's a -- it's not as painful to choose what we have compared to what is in the market today. So it is a really good product and it was supported -- it was -- tried to complain from a competition on this, and because of you and the -- sort of the cause that we're in overturned. And I'm not equally surprised that was possible -- in an process. But we keep the products in the markets, held with all of the customers that we have now, and that's countless. How we respond to this depends on the outcome of the process but we are going to respond to it.

Sebastian Walker - UBS Investment Bank, Research Division - Associate Analyst

Is there any idea on timing of how long do you expect that approach in the process?

Lars Rasmussen - Coloplast A/S - CEO and President

No. We're not trying to perform, to be honest so sorry, no.

Operator

We'll now take our next question from Chris Cooper from Jefferies.

Chris Cooper - Jefferies LLC, Research Division - Equity Analyst

So just firstly, on the VA overstatement, please. I'm just curious, if there be, I guess, the process in which on this -- and what made the issues having been apparently 7 or 8 years after the fact and how confident our guests with in isolated issue? And then just a follow-up on the SpeediCath reimbursement in the U.S. Can you just provide a sense of the proportion of segment of Flex relates to, and what you believe (inaudible) what you believe the tangible outcomes that would be (inaudible)

Lars Rasmussen - Coloplast A/S - CEO and President

I'm not sure I get the last half of your question. What is would you like to have the percentage of Flex's to the (inaudible) sales for the year?

Chris Cooper - Jefferies LLC, Research Division - Equity Analyst

Yes, correct. In U.S.



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Lars Rasmussen - Coloplast A/S - CEO and President

I'm not going to give -- that's a little bit too detailed for us.

Chris Cooper - Jefferies LLC, Research Division - Equity Analyst

I think you're misunderstanding.

Lars Rasmussen - Coloplast A/S - CEO and President

I have to take note of the fact (inaudible) months ago since we launched it. So the market rapidly but not isolated to how fast it grows in these markets (inaudible) is going to be capitalized in the U.S. And the other parts related to catheters, what was that?

Chris Cooper - Jefferies LLC, Research Division - Equity Analyst

Just on the appeals process itself. I mean, are we talking here about an expectation get back (inaudible) or you're more likely we have some kind of one-off payment (inaudible) like that.

Lars Rasmussen - Coloplast A/S - CEO and President

Yes. But I don't know. Really, we have (inaudible) the product baked into the [5-2] glass and (inaudible) And with regards to the VA, it was in -- actually, (inaudible) in the contract renewal process that we took a deep dive into the ground -- into the current contract. And we will see that it was not, in all cases, that we have been able to come with the lowest customer price. So maybe I should go out of it and explain what it is. Then you have a contract with VA, you just have an obligation to offer to VA your products at the lowest price to offer this product to any other customers and markets. And you have many hundred product accounts, and we have also a number of different price points in the market today and an have been area at process in a way -- an area in a way that it is (inaudible) so we have accumulated a say, an error, a year-over-year since [2009] and that is what something (inaudible) So we foresee that something was wrong. And we -- so that's some months ago, and we actual contracted Veteran Affairs and to them that we can see that we some errors and we are working on it. So we had an external -- other company (inaudible) the last (inaudible) of all the that we're having and we think that it is to the tune of [DKK 90 million] and this is what we have also now told Veterans Affairs. And we have been through everything the contract. We have -- reported this in good faith. And if we look at how this has potentially -- how the we think that this is basically how we -- should be handled, and that's also why (inaudible) in the contract. The contract that we deliver are originally starting to review for has been renewed and so we have a new contract buying with VA, so everything has been worked on with VA in a (inaudible) and (inaudible)

Operator

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

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

I have 3 questions in relation to SpeediCath. Firstly, on SpeediCath patent. I think, you probably have said in the past, and you stated that the patent expiry would not have a material impact on your business. Can you a bit explain why you would launch litigation against [10ba] to (inaudible) and Teletch desk for entering a few months for the expiry of the patent, if you could match why even bother spending time on this? And question number 2 is on SpeediCath patent. In the market in Germany, while there has been a reception of the competitive products have been launched, which you are now putting forth an adjunction? And thirdly, the SpeediCath maximum impact from patent expiry. Previously, you guided for a



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DKK 100 million that's sort of a maximum headwind once the patent expires in September next month. That's still the most relevant number that you have in mind?

Lars Rasmussen - Coloplast A/S - CEO and President

Thank you. So why do you take patents? So you do that technology (inaudible) And it's very costly to take out the patent. And once you get the -- and the meaningful -- I also think that we need to defend it all the way through. It is both, I think, a good criteria, but I also think it's that would take patents seriously. We have a situation where some of our competitors have (inaudible) for years. And now that the early sort of our way so there's no doubt that for many years, some of our competitors have been creating our patents. It also means that they have a rightful in an unrightful manner, obtained a significant sales and margin based on that. And we would like to become (inaudible) And that is why we for it right away, because this is basically what puts us parties about -- particularly, you're right. So what I think more although there's not -- that not many months on this And we go for it because that's also how you put your best possible is once you need this result, the customer would have to be resolved in the quarter. So that's basically what it is and I think when it comes to the -- our expectation of the impact, we have evaluated that, again, of course, and we still think it's to the tune of DKK 100 million, and that's obvious. It's obvious judgment.

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

And can you comment on what you have seen in Denmark and Germany where compared to the launched products, that patent, did you . . .

Lars Rasmussen - Coloplast A/S - CEO and President

But they're launched in 8 years ago some much.

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

Okay. And the DKK 100 million of headwind?

Lars Rasmussen - Coloplast A/S - CEO and President

So Mike, it's very important to understand, it's not just a few months. It's actually years of sales and creating and business and creating that has been sort of (inaudible) and that's what we see in competition for, so that's of course, also why we are creating and

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

And then on the DKK 100 million SpeediCath, when you guide for fiscal year of -- for your next fiscal year as part of Q4 results, and should we take the DKK 100 million as the headwind to growth in that year? Is that a right way of looking about the DKK 100 million for this SpeediCath?

Lars Rasmussen - Coloplast A/S - CEO and President

It will be part of the guidance for next year. It will be very specific as part of the guidance.

Operator

We'll now take your next question, Michael Nielsen, SEB.



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Michael Nass Nielsen - *SEB, Research Division - Analyst*

Michael Nielsen, SEB. Just a follow-up question to the previous question on the double-digit sales growth in continent in the U.S. market. Lars, you mentioned, that phased out is probably positive proposed growth segments. And I'm asking -- this person that read you -- would thought you're actually not mentioning U.S. on the Ostomy Care. So should I understand your answer in a way that product -- big difference between phaseout and (inaudible) actually report in any organic growth for the quarter, or did I misunderstand something?

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

Yes. So all I understand that you can always take small parties, and drive in 1 more time. But I think that what you should take note of when it comes to Ostomy Care is that we have had a significant number of good wins, and also have one of the biggest ones that in existing in the U.S. So we have a very, very strong performance there in the U.S. And so that's far as I would go at this point.

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

Okay. And then maybe to Anders, on the soft margin development there. You have a really strong, falling on the underlying firms, and even when adjusting for the DKK 90 million and FX et cetera, there's still very little market development. We're actually seems like it's -- items below the gross margin, maybe distribution costs are impacting that -- the EBIT margin -- negative compared to the impact you're seeing on the gross margin. So any comments you have -- are you still guiding for quite optimistic for long-term development?

Anders Lonning-Skovgaard - *Coloplast A/S - CFO and EVP*

Yes. So overall, our underlying EBIT and margin is developing as we expect to. So if we exclude the Veterans Affairs, our EBIT margin is actually -- or EBIT is actually increased by 9% year-to-date. And for the full year, we are expecting to deliver within our guidance of 33% to 34%. And I expect also, as fourth quarter due to a high nominal revenue, but also I expect that our gross margin will also improve in the fourth quarter. And then that it will continue to have a tight cost control also in the last quarter. And we had combined -- I would expect that will be able to in the guidance and also, including the Veterans Affairs and [DKK 90 million] amount. So that is my expectation for the remaining part of the year. In terms of your question around the costs or our distribution costs, we have increased our for this year 5 [%] and that is in alignment with the strategies that we announced last year, that we are willing to increase our activity levels within IT, and that's also what we have (inaudible) We have been, in the admin, we have included costs related to the Comfort Medical acquisition that we made earlier at this year. And we are also -- have included costs related to patent litigation cases that Lars talked about earlier. And the underlying EBIT before FX are -- we are very satisfied there.

Operator

We will now take our expression from Veronika Dubajova, Goldman Sachs.

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

I have a 3, please. The first one is on the two-day reimbursement issue. I just want to understand that -- you obviously have a pretty strong position in the market already with some of the historical products that you've been selling. If you are not able to get back to the [6 60] for the SpeediCath Flex, if you're going to pull the product from the market and just resort back to selling your older portfolio? And I guess, I mean just walk us through, how you're thinking, what will you do if you do not get back to the 6 60 reimbursement rate? That, I think, would be very helpful. My second question is just to push a little bit on this SpeediCath patent, DKK 100 million impact on next year. I think what you said for this is that 10% to 15% of sales that you would see exposed. I mean, DKK 100 million would've had very minimal decline in those revenues, so can you maybe give us a little bit more color on as to what still gives you confidence in the DKK 100 million? And then my last is just a financial one. And to Anders, if you have any guidance for the net financial impact for this year is in the hedging costs?



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Lars Rasmussen - Coloplast A/S - CEO and President

Right. On the side, as we have actually, in a short while, have seen many customers on Flex in the U.S. so we will keep the products in the markets, no middle what. With me, then think about our position when it comes to how it positions us today, and whether we can put more to get into that category, yes, of course, we do that. But I mean, you being the market leader, having presented some things to the market is significant over and above with the experience in Japan with the car parks in the category. And then of course, we go for it. So we don't pull it (inaudible) on the products also.

On SpeediCath, the assumptions that they are behind our -- the scenario that built is The vast majority of the markets, where we play, people are using first and foremost, large competitors which are not impacted by this. And secondly, a lot of the -- most of the markets to be -- are handled by prescriptions. So if you take up a prescription and you use that to get your products from, those of the company's distributor these type -- kind of products. We'll see same reimbursement approach, and thereby, no matter if it's a new product or an old product, it will be the same. And they would have a power to converge patients. So where we see the rest is in markets where you have a deal structure, where you have a tariffs set up. Some dealers can get products that are similar to their current state of street for a lower price, and thereby, have a higher-margin. And of course, also see a (inaudible) It's had, already happened in some markets because the products that are very, very close to this Care product where you just have to push product that we can (inaudible) and so forth. So a lot of the converge have happened and we see that basically off for some years. That is why we will leave that at a smaller number. Limited to impact but profits, I have to say. That is our judgment day -- the specific signs, which we all have the insights that we have in the markets -- market by market, where we're looking at how much have we already compared a better price and so on. That's of course, part of it. And we keep the innovation going, and so that's perfectly we have all of the year. The Compeed products, we have just launched the Flex products which is a significant upgrade from in the highest some people and So in essence, I can't give you a very precise number. I'm much (inaudible) into this, but this is what the physical missing on.

Anders Lonning-Skovgaard - Coloplast A/S - CFO and EVP

And Veronica, in terms of the mid Financials. So Based on the current exchange rates, I'm estimating a mid-financials for the full year of minus DKK 75 million (inaudible)

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

That's helpful. And Anders, can I just ask, I know you've not guided for '18 but if currency rate hold from here, is it fair to assume that you'll have another hit to margin next year from FX? Or have I miscalculated something?

Anders Lonning-Skovgaard - Coloplast A/S - CFO and EVP

So in terms of the net financials for next year?

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

No. I'm asking more about EBIT margin impact from currencies for next year. And I appreciate if you're not prepared to comment on it at this stage -- I just, directionally, it seems to me that you should still have a pretty comparable headland actually next year to profitably from currency -- if you're having this.



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Anders Lonning-Skovgaard - *Coloplast A/S - CFO and EVP*

Yes. But I'm not going to comment on guidance for '17 to '18. But the guidance that we are going to visit on, that is since the reported EBIT margin as we have guided for this year. And we expect that the EBIT margin for this year, including the FX is going to be around 32%. So that will be the basis for next year's EBIT margin guidance.

Operator

We'll now take our next question from Patrick Wood from Citi.

Patrick Andrew Robert Wood - *Citigroup Inc, Research Division - Head of EMEA Medical Technology and VP*

I have 2, if I may. The first is on of on your royalty segment of the margin, (inaudible) year-on-year. I'm just wondering, is that a function of just the operating leverage from the strong growth? Or are you seeing any change in the underlying pricing dynamics obviously, given competitive landscape there has changed the (inaudible) The second one is -- similarly on the combined division market with care. The margin structure there, even if I have a (inaudible) VA since a little bit light from Q3, is that actually a function of launched costs from and really just driving our combats -- if you can help to understand that.

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

So in terms of business, the second question around the margin for Q3, it also tied the increased cost related to the patent identification that I spoke about earlier. If you also -- continuing our investment program, do not only to (inaudible) talk to but also into commercial investments across especially into U.S. also into Wound Care. And so that's one of the other reasons as well. The first question, can you just repeat that of course related to Urology Care?

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

Yes. Similarly, for Urology Care, basically the margin structure there looks like it's up (inaudible) year-on-year, is that a function of pricing dynamics from the competitor's exit, or is that operating leverage?

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

So it's a combination of leverage. So we have been growing quite decent. So have been growing quite around for quite some time. So we are seeing quite a -- leverage effects, that's one element. We also seen on impact for mix in terms of our product portfolio.

So the combination of that is -- the main reasons for an improvement in our Urology Care margins.

Operator

We'll now take our next question from Rene Silva, Bank of America Merrill Lynch.

Unidentified Analyst

I think I have only 1 left, which is also on the margins. Which year-round, I'm not able to fully understand what impact from currency -- sorry, of currency on the margins. So could you tell us what it was, or if it was negative or positive I can't fully understand.



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Anders Lonning-Skovgaard - Coloplast A/S - CFO and EVP

So for the year (inaudible) our currency, or the currency impact is 0.3 on our EBIT margin. So that's the impact so far. And for the full year, we are seeing a currency impact, so the fixed currency EBIT margin guidance, as I mentioned earlier, 33% to 34% and in or reported EBIT margin guidance, including the VA amount, our reported EBIT margin guidance is around 33% to 34%.

Inês Duarte da Silva - BofA Merrill Lynch, Research Division - Associate

So just on the guidance for the year, the [30% to 34%] surely, that was also impacted by this one-off. So that has absolutely no impact in your guidance at constant rates or any comment that you will do.

Anders Lonning-Skovgaard - Coloplast A/S - CFO and EVP

So in the fixed currency -- EBIT margin guidance of the year of 33% to 34%, we have also included the one-off related to the Veterans Affairs.

Inês Duarte da Silva - BofA Merrill Lynch, Research Division - Associate

Okay. But you don't want to specify what that 33% to 34% range?

Anders Lonning-Skovgaard - Coloplast A/S - CFO and EVP

No. So it's impacting DKK 90 million but we are going to be in the lower end, as I talked in the beginning of the meeting.

Inês Duarte da Silva - BofA Merrill Lynch, Research Division - Associate

Okay. And sorry, can you just confirm the impact on the EBIT margin from FX in the quarter, please?

Anders Lonning-Skovgaard - Coloplast A/S - CFO and EVP

So I said earlier for year-to-date, the negative impact from currency is 0.3 and in the Q3, the impact from currency is 0.2.

Operator

We'll now take our next question comes from Baron (inaudible)

Unidentified Analyst

Firstly, just expect of this quarter, some contract wins and talked about in U.S. Home Care and in Wound Care contracts, so I wonder Lars if you can come back to -- talk a little bit more about those and perhaps -- cutting -- contracts that you lost, and that probably you had coming, please? And also, just with respect to Flex, and obviously, that's disappointing given significant R&D investment in costs (inaudible) have been described. Just to understand your comments of the further Lars. Is the anticipation that you'll continue to launch 6 products at posting even if it's a less profitable product -- and less profitable product (inaudible) compared to cytoplasm previous generation, it seems significant factor (inaudible) profitability in that product. But that's the first and I have a follow-up, please.



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Lars Rasmussen - Coloplast A/S - CEO and President

Yes. It's a -- it's of course nice when you can be -- when I can be very specific on what kind of cost assets could be won and so on. So the on Ostomy Care -- and we will report later on who it is but we are going to that joint in the press release with (inaudible) and it's -- they just preferred to be the first ones to inform the members before we go our So we just mentioned it because significant went to us and it did. It is in fact, when you were talking about Skin Care, it is a contract-driven business. So you win some hospitals, you lose some. You always have this obviously, contracts that are expiring and contracts that are either [won] or already the service and you think that relationship that was by from us infamous then and litigious here is that it is that is, at this point in time, slightly negative, so that's what we are talking about, but what could it be competitively different from now. And therefore, it's about time to side of the falling away, and then you have nothing to fill the void, it's not that kind of situation that we are talking about. It's more sharing a little bit more of how the nature of these businesses. It's much more pronounced when we talk about hospice care and Ostomy Care and so on also clear special in hospitals to community afterwards. Skin Care is business solely and that means that when you are in an institution that you are selling, or but you don't sell to people and so therefore, we must more rely on the contracts activities. So I hope that put some light on -- from what it is and the differences when you're talking about contracts in Continence Care contracts and Skin Care.

Scott Bardo - Berenberg, Research Division - Analyst

But for the profitability of Flex, even (inaudible) lower margin?

Lars Rasmussen - Coloplast A/S - CEO and President

Yes. We are in the end piece process with Flex. And I sort of made it very clear earlier in the call, that we are committed to stay no matter what the outcome is. Ultimately, the process. And I fully understand that puts the company in a (inaudible) worse negotiation position, because there are many people who are already using the product. But we are committed to lead the market, we cannot have a discussion whether we have our product or not. So the product is in the market to stay, and people who are prescribing the product, people who are using the products, they can continue to buy it and feel very confident that they will also preserve this product in a year. That's why we talk to it like we do here. The product is currently, of course, not as profitable as the other products. It's also more complex product, and that is why we need to look at how we can work with it, but it's not a unprofitable product. So it's not just as probable as the other ones. And as I said, as -- depending on what comes out on feed processes, we think that we -- also, in the category, the product and then we have soem -- (inaudible) go into follow a different process to make sure that we are not experiencing a similar situation once we might be there. I hope that makes it clear.

Richard Latz - HSBC, Research Division - Analyst

And just 1 last question. I think Lars, and this really reflects back to the last capital markets, and the update I think, a day before the (inaudible) Skin Care on obviously, the Wound Care business has not been progressing quite at expectation. And you also made an acquisition of Comfort Medical which, if you like, is an exciting growth opportunity for someone subscale. I just wonder whether there is -- or whether you could share any thoughts as to activities and not be essential or sub-type (inaudible) some more investments, and to realize that whole potential of the company, by from a top line, and from a market share division. I just wonder whether it's come to a point where -- are you willing to compromise margin a little bit to get growth back to where you seeing

Lars Rasmussen - Coloplast A/S - CEO and President

Okay. I think it's an excellent question. I think we have preferred some pages for it, and it's very much what we are going to make when we head to Capital Markets Day a couple of days, so the discussion on these (inaudible) answer that, because we have that just me end converse with you talk about it. But we'll have much more people to discuss this. And we think we have some very good answers for this, we also think that we have some pretty setting going on that we like to take a deeper dive on when we meet on Friday. So I'd like to postpone the answers because right, it's all about what the quality of your to the market growth also on the service side and we of whether (inaudible)



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Scott Bardo - Berenberg, Research Division - Analyst

Mid-financial targets would go, we should discount those come Friday?

Lars Rasmussen - Coloplast A/S - CEO and President

With -- so just to -- 100% clear, the Cancer Market Day is about what actions that we are going to do in the coming years to deliver on the promises that we had in the markets. Is a new set of targets that will then activities for set of activities to deliver on the market on what we have already (inaudible)

Operator

Our next question from Martin Parkhoi from Danske Bank.

Martin Parkhoi - Danske Bank Markets Equity Research - Senior Analyst

Martin Parkhoi. Actually going to back to the about earlier, I just wanted to confirm, again -- because previously, you stated that even with the DKK 100 million decline in sales on -- from SpeediCath expiring, then also be able to deliver on the long-term targets of 7% to 9%. But since you are, to be honest in every button buffer to still deliver on your long-term that you have a buffer to so deliver on your long-term targets despite this patent expiry? And then second question, just to settle your Q4, and expect the fourth quarter implied by your full year guidance, is that driven by improved performance or is it driven by easier comes from Q4 last year?

Lars Rasmussen - Coloplast A/S - CEO and President

So wound it comes to 7% to 9% growth expectation and the patent expiry -- and the answer to question is yes, we expect this to deliver on our guidance also with patent expiry. So just to be very clear on this. And then for the last quarter, then we need to [8%] growth in Q4 and the growth will come from growth rates in Europe and will come from high single-digit growth rates in other developed markets and by the way, we have somewhat of a strong baseline that we have against in Q4 in U.S. chronic and that it will come from an acceleration in growth in the middle markets, and that is sort of funded in the double-digit growth in China and the strong momentum that you can see in the couple of markets, including Argentina and Brazil. So that's basically the underlying assumptions and looking for.

Martin Parkhoi - Danske Bank Markets Equity Research - Senior Analyst

As I recall, there was also 1 of impacting Q4 last year in U.S. also fragilis are you have had back were DKK 30 million business, so is that to an easy comparison?

Lars Rasmussen - Coloplast A/S - CEO and President

[Nine-year].

Anders Lonning-Skovgaard - Coloplast A/S - CFO and EVP

That is also correct.



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Operator

Our next question comes from Oliver Metzger from Commerzbank.

Inês Duarte da Silva - *BofA Merrill Lynch, Research Division - Associate*

First of all, do some general question from SpeediCath Flex. You mentioned profit contribution to grow with you indication from your visit into SpeediCath Flex which are many generated from your existing patient base, or is it also a good opportunity to have new patients onboard? And my second question is Urology Care. So you continue to show performance, which is a story cover Ostomy Care miserable. So this point you name some impact on some products, could you also the overall dynamic is in general, in average a higher demand for product apart from (inaudible) implant? And my final question just on this general there, you market mentioned Macready from: Some color the general volume growth at a similar rate and do you see also affect?

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

The SpeediCath Flex, it's a -- I don't have with me here, an effect of how many comes from end of how many are overs but if I just take or about it, it's existing a very different technology to use than when used the kind of technology that we already have in the market. So that's it is. I think it's fair to say that it's using the (inaudible) and that's also how we launch, we are very much aware that this product will technology and therefore, we use the resolve to people who are today are using similar technologies and who have shown an interest in that in the conversations. And of course, we also injunction going on in the markets were for and so that's of course, also to us. With regards to Wound Care especially Greece end where we have price reforms for Presser from Sunday our impacting some products 6 percentage points growth goes into that will have had those impact. So that implies that our growth in the case very strong of market growth and however, our growth in China is significantly strong enough that it was a year ago so I think that overall outside of these 2 markets that are very (inaudible), we have quite products the performance. When it comes to Urology Care, I think I missed but what discussion was.

Oliver Metzger - *Commerzbank AG, Research Division - Analyst*

Just from to support this which you presented over last quarters and you specifically named mean that's related to also implants other than cajoles to the more in your portfolio that many driven by product is our was it more from of course?

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

It is primarily those 2 products that are driving it end that's always where your primarily and of course, specially in getting this year of the area because that's enough for after 1 of (inaudible) it is also what you think profitability because get more skilled in our business (inaudible) so significant and what is on the personal line. I think we have already last question. We are overtime.

Operator

And the final question (inaudible)

Unidentified Analyst

Lars, I would like to come back during the issue the scene and you've been very open about the profitability of the product also(inaudible)

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

The reimbursement in based on what?



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Unidentified Analyst

The SpeediCath, the Flex.

Lars Rasmussen - Coloplast A/S - CEO and President

The flex.

Unidentified Analyst

Yes, okay. What I was trying to and how important was a product with regards to growth that you are hoping to achieve in the U.S. or in other words, as long as we're at the 180, shall we think about your long-term growth, a guidance of 7% to 9% remaining more at the of that range -- and very helpful part from the of the think are help us how to think of that growth?

Lars Rasmussen - Coloplast A/S - CEO and President

Yes. Okay. Okay. So Flex is a very good product. It's not a product that may be proven wrong which is expected to the higher volume product like the conference back select this report next because giving the strongest security to because few of your you feel mostly, but it's also significantly is this more time to see another products and products. So in essence, is not being, this is 7% to 9% guidance at all. And it is a as I said is profitable of course, in the new categories of us are the ones I be able to explain our EBIT margin the way that we also with category as we are. So in that sense, it's not a product same kind of as this particular are some of the universal our volume products (inaudible) and (inaudible) turned obviously great products that would be great. I think that concludes our conference call for today. Thank you very much for your questions and we are looking very much forward to see Meadowview finally in London. So thank you for now.

Operator

That would concludes it is conference call. Thank you for your participation. Ladies and gentlemen, you may now disconnect.

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