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Coloplast A/S (CLPBY.DK)

Q4 2021 Earnings Call

CORPORATE PARTICIPANTS

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

Anders Lonning-Skovgaard

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

OTHER PARTICIPANTS

Patrick Wood

Analyst, Bank of America

Lisa Bedell Clive

Analyst, Bernstein Autonomous LLP

Martin Parkhøj

Analyst, Danske Bank A/S

Hassan Al-Wakeel

Analyst, Barclays Capital Securities Ltd.

Veronika Dubajova

Analyst, Goldman Sachs International

Christian Ryom

Analyst, Nordea Bank Abp (Denmark)

Maja Pataki

Analyst, Kepler Cheuvreux SA (Switzerland)

Niels Granholm-Leth

Analyst, Carnegie Investment Bank AB (Denmark)

Mattias Häggblom

Analyst, Svenska Handelsbanken AB

Yiwei Zhou

Analyst, SEB Enskilda (Denmark)

MANAGEMENT DISCUSSION SECTION

Operator: Welcome to the Coloplast Full Year Financial Results 2020/2021 Conference Call. Throughout the call, all participants will be in listen-only mode and, afterwards, there'll be a question-and-answer session.

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, operator, and welcome, everybody. Good afternoon, and welcome to our full year 2021 conference call. I'm Kristian Villumsen, CEO of Coloplast. And I'm joined by our CFO, Anders Lonning-Skovgaard; and our Investor Relations team. We're going to start with a short presentation by Anders and myself and then open up for questions, like we usually do. Please turn to slide number 3.

I'm very satisfied with this year's result. We delivered 7% organic growth, a 33% EBIT margin before special items, and a return on invested capital of 45% after tax and before special items. Broadly, across all markets, we continued to take market share. In Q4, we delivered 10% organic growth and a 32% EBIT margin. These are solid numbers in a year where our growth within Chronic Care has been challenged by the pandemic. At Coloplast, we are united around a strong purpose, to make life easier for people with intimate health care needs. And I am particularly proud that this year, we helped make life easier for more than 2 million people.

To start off, I'd like to go through a few highlights from our full year results. We saw an improvement in the underlying growth in the Chronic Care business as the year progressed, driven by an increase in growth in new patients, in particular in Europe. Growth in new patients in Ostomy Care is back to pre-COVID levels, and Continence Care is approaching pre-COVID levels. The Emerging Markets delivered a solid 15% organic growth. The growth was broad-based and driven by Ostomy Care and a solid performance in both China and Latin America.

Interventional Urology delivered a 19% organic growth, driven by the resumption of elective procedures, led by Men's Health in the US and impacted by a low baseline. Wound Care delivered 11% organic growth, driven by Europe, China. And, today, we've provided an organic growth guidance for 2021/2022 of around 7% and a reported EBIT margin of around 32%.

Anders will take us through the details later. Overall, we're encouraged by the continued recovery across all our business areas. We expect a stronger growth in Europe next year. Our Wound Care and International Urology businesses are expected to deliver in line with our Strive25 ambitions.

We're still challenged in our US Continence business where the growth in new patients has not yet fully normalized. Similar to what we saw in Europe, intermittent catheterization treatment and bowel management treatment has been deprioritized as these treatments can be postponed and there are alternatives. The accumulated impact of the low level of growth in new patients over the last year will impact our growth this year.

We also continue to see some weakness in China-related to the COVID-19 flare-ups and the economic uncertainty, which is impacting consumer sentiment. Growth in new patients in China is currently back at pre-COVID levels. We believe that the dynamics in US Continence Care and China are transitory, and we continue to focus on the commercial initiatives and investments that will drive our growth beyond the pandemic.

Our operating environment is not yet back to normal, but hospital activity and hospital access continues to improve across all markets as vaccines are rolled out and the pandemic wanes. We continue to keep a close eye on the developments surrounding the Delta variant, in particular in the US and China.

Before we dive into our results in more detail, I'd like to spend some time talking about strategy. Please turn to slide number 4. One year into our new strategy, I am happy to conclude that we've made good progress on our strategic priorities. Our Strive25 strategy is based on four key pillars innovation, growth, operational efficiency and sustainability.

Let me just mention a few highlights from the past year and start with innovation. We aim to set and raise the standard of care in the categories we compete in. A few words on Chronic Care. With user needs at the center, we've made good progress on our Clinical Performance Program in Chronic Care. Program marks the start of an important transition to outcome-based innovation, which forces us to think differently. We need to demonstrate value to wider set of stakeholders, including consumers, clinicians and not least payers. Clinical evidence and data will be critical, and I'm certain we're going to discuss this in our Q&A session later in some more detail.

In Wound Care, we strengthened our product portfolio with the launch of Biatain Fiber now at nine markets. And in Interventional Urology, we've taken steps to build new growth options into the pipeline through the acquisition of Nine Continents Medical, an early-stage technology company within the overactive bladder market. The pivotal trial clinical protocol has now received approval from the FDA, and we expect to begin enrolling patients in late

calendar 2021 and anticipate momentum in the trial beginning in 2022. So, as you can hear, this year will be an important year for pivotal studies, both within the Clinical Performance Program and for Nine Continents Medical.

Let me now move to growth. It's been a tough year for health care systems. Despite challenging market conditions, I think we've made good progress on our commercial growth agenda. In Chronic Care, we seek to continue to drive growth above the market with a strong contribution from our US and Emerging Market regions. We're working on a number of initiatives across different time horizons.

In the US, we achieved a key milestone by securing access to the largest Ostomy GPO. In China, we have initiated a large project with hundreds of Ostomy clinicians across the country aimed at raising standards of care for Ostomy users.

A good example of one of the market development initiatives we've supported to raise standard of care is in Poland, where reimbursement for hydrophilic catheters has been significantly improved for adults and children with neurogenic bladder and is now on par with the European standard of care. In Interventional Urology, our focus has been on enhanced commercial activities within Men's Health, focusing on patient awareness and education programs.

Next, a few words on operational efficiency. We continue to strive for unparalleled efficiency and industry-leading margins. Our ambitious three-year Global Operations Plan 5 is off to a solid start. Our extensive automation program is on track, and our first volume factory in Costa Rica opened this year. Our second volume factory in Costa Rica will open next year. And by the end of Strive25, Costa Rica is expected to produce between 25% to 30% of our global volumes, ensuring that we have a more balanced global production network. We also continue to see a positive scale in our business support organization driven by the further utilization of our Coloplast Business center in Poland.

Now, let's talk about sustainability. Very pleased to release this year's sustainability report together with the annual report. Last year, Coloplast made sustainability and enterprise theme. We have three priority areas: improving products and packaging, reducing emissions, and responsible operations.

On improving products and packaging, we've already exceeded our 2025 waste recycling target of 50% due to a significant technological breakthrough. We now recycle 58% of our production waste and have set a new waste recycling target of 75% by 2025. Reducing emissions is another priority for Coloplast. The latest report from the Intergovernmental Panel on Climate Change underlines the need for action to fight climate change and limit the global temperature increase to 1.5 degrees as listed in the Paris Agreement.

Our ambition is to become net zero in Scope 1 and 2 and use 100% renewable energy by 2025. By 2030, our ambition is to reduce Scope 3 emissions per product by 50%. Our targets have been submitted to the science-based target Initiative for validation. Coloplast is committed to running an ethical, transparent, and responsible business. This is tied to our company values of respect and responsibility. This year, we increased our tax transparency by implementing country-by-country tax reporting for EU countries.

Before we take a closer look at today's results, I'd like to say thank you to all the employees in Coloplast for your continued commitment to build our company and deliver on our mission. In the most recent engagement survey last month, the score was 8.2, which continues to be above the health care industry benchmark and in the top 25th percentile. This, I believe, is a great result. Thank you to all of our 12,500 employees who persevered through a difficult year. I'd also like to thank our users, clinician partners and investors for your confidence in our company.

Now, please turn to slide number 4. Sorry, that's slide number 5. In Ostomy Care, organic growth was 6% for the full year and growth in Danish krone was 4%. Q4 organic growth was 10%. The growth in Danish krone was 12%. Growth continues to be driven by our SenSura Mio and Brava supporting products. SenSura and Assura/Alterna portfolios continue to post solid growth in Emerging Markets. At the product level, SenSura Mio Convex was the main contributor to growth. From a geographical perspective, Emerging Markets was the key contributor to growth followed by Europe.

Growth in Q4 was driven by Europe, led by the UK and Germany as a result of an increase in growth in new patients and a lower baseline. Growth in Emerging Markets was lifted by tender phasing between Q3 and Q4 in Russia and the Middle East. China saw some impact in the quarter from lower growth in new patients due to the Delta variant, as well as some impact on the average value per patient due to the economic uncertainty.

In Continence Care, organic growth was 5% for the full year, and growth in Danish krone was 3%. In Q4, organic growth was 8% and growth in Danish krone was 9%. Growth continues to be driven by the SpeediCath ready-to-use intermittent catheters with a good contribution from the SpeediCath flex portfolio, as well as SpeediCath compact and standard catheters.

From a geographical perspective, sales growth was mainly driven by Europe, led by the UK and France as a result of an increase in growth in new patients and a low baseline. In Q4, growth was driven by Europe, in particular France and the UK, driven by an increase in growth in new patients, as well as a low baseline.

In Interventional Urology, organic growth was 19% for the full year and growth in Danish krone was 14%. Compared to 2018/2019, the full year growth was double digit. In Q4, organic growth was 10%, and reported growth increased by 9%.

During the year, elective procedures resumed across regions and business areas. Men's Health in the Inter Urology business returned to pre-COVID growth levels during the year. Women's Health is recovering at a slower pace, but the trend was positive in the second half of the year. In Q4, the outbreak of the Delta variant in the Southern US states resulted in some cancelation of elective procedures. Towards the end of the quarter, the level of elective procedures largely normalized again.

In Wound & Skin Care, organic growth for the full year was 8% and reported growth in Danish krone was 6%. The Wound Care business in isolation delivered 11% organic growth for the full year and 12% organic growth in Q4. The Biatain Silicone and Biatain Fiber portfolios were the main contributors to growth, driven by France, Germany, and Spain. China posted solid growth for the year, also helped by a low baseline.

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

Anders Lonning-Skovgaard

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

Thank you, Kristian, and good afternoon, everyone. I'm very proud of the strong results that we announced today. Thank you to all our employees for your dedication and commitment. Our reported revenue for the full year increased by DKK 882 million or 5% compared to last year. Organic growth contributed around DKK 1.3 billion, or 7%, to reported revenue.

Foreign exchange rate had a significant negative impact of DKK 450 million, or around 2% on reported revenue, as expected due to depreciation of the US dollar and several Emerging Market currencies against the Danish krone, in particular, the Argentinean peso, Brazilian real, and Russian ruble. The depreciation in the US dollar accounted for approximately 60% of the negative currency impact.

Please turn to slide 7. Gross profit for the full year amounted to around DKK 13.3 billion, corresponding to a gross margin of 69%, compared to 68% last year. The gross margin was positively impacted by leverage and production cost and savings from the Global Operations Plan 4 and 5. On the other hand, the gross margin negatively impacted by increase in cost in Hungary due to salary inflation and labor shortages, as well as extraordinary costs related to COVID-19 outbreak and ramp-up costs at our new volume site in Costa Rica.

The automation program, which is a key component of the Global Operations Plan 5 is on track and contributing to maintaining at that level of blue collar workers while ramping up the volume site in Costa Rica. The gross margin includes a negative impact from currencies of around 40 basis points. The gross margin in Q4 was 69% and benefited from the leverage and the efficiency gains from Global Operations Plan 4 and 5.

The distribution to sales ratio for the full year came in at 28% compared to 29% last year. The distribution costs increased by DKK 168 million, or 3%, 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. In Q4, the distribution cost increased by 10%, which reflects the continued growth investments, and as well as resumption of sales and marketing activities as the impact of COVID-19 recedes.

The admin to sales and R&D to sales ratio for the full year came in at 4% of sales and on par with the last year. Overall, this resulted in an increase in operating profit before special items of 9% for the full year, corresponding to an EBIT margin before special items of 33% compared to 32% last year. The EBIT margin contains a negative impact from currencies of 50 basis points, mainly related to the depreciation of the US dollar against the Danish krone. The net profit before special items increased by 19% compared to last year.

Please turn to slide 8, operating cash flow for the full year amounted to around DKK 5.3 billion in compared with around DKK 4.8 billion last year. The positive development in cash flows was mainly due to an increase in the operating profit before special items of DKK 501 million and the positive financial items, which was partly offset by a one-off tax payment of approximately DKK 400 million related to the acquisition of Nine Continents Medical last year.

Cash flow from investing activities was impacted by increased investments in automation, IT and the new factory in Costa Rica. CapEx investments amounted to DKK 1.16 billion for the financial year or 5% of revenues, which is on par with last year. As a result, the free cash flow for the full year was an inflow of DKK 3.3 billion against an inflow of around DKK 3.9 billion last year. Adjusted for the acquisition of Nine Continents Medical, the free cash flow was an inflow of DKK 4.5 billion, up by 18%. Our trailing 12 months cash conversion for the full year, excluding the Nine Continents Medical acquisition was 93%.

Net working capital for the full year amounted to 24% of sales. Prior to COVID-19, we increased our inventory on strategic raw materials and products. Inventories are now around 12% of sales. And this is the level we expect to remain at going forward.

Please turn to slide 9. For 2021/2022, we expect revenues to grow around 7% organically and around 8% in Danish krone. The guidance assumes a continued resumption of hospital activity across our business areas. For the Chronic Care business, the assumptions by region are as follows. For Europe, we expect continued

improvement in growth now that the growth in new patients has largely returned to pre-COVID levels. In the US, our guidance assumes a continued improvement in growth driven by gradual normalization of growth in new patients back to pre-COVID levels, especially in the Continence Care, which has been more severely impacted.

In Emerging Markets, our guidance assumes broad-based double-digit growth. China is expected to remain impacted by COVID-19 and economic uncertainty, which has impacted consumer spending. Our smaller business areas; Interventional Urology and Wound & Skin Care, are expected to deliver in line with our Strive25 ambitions. We have no current knowledge of significant health care reforms that will impact 2021/2022.

In terms of phasing, I expect a slower start to the year in Q1 due to tough baseline in our European and US businesses. Growth is expected to accelerate in the following quarters. Due to the appreciation of mainly the US dollar and the British pound and a number of Emerging Markets currencies against Danish krone, the reported growth in Danish krone is expected to be around 28%. The currency impact is based on spot rates as of October 29.

For 2021/2022, we expect the reported EBIT margin in Danish krone of around 32%. The gross margin is expected to be positively impacted by operating leverage and efficiency gains through the Global Operations Plan 5. The gross margin will be negatively impacted by cost inflation, including a low-single-digit increase in raw material costs and double-digit wage inflation in Hungary. On raw materials, the key pressure on prices is coming from plastics and paper.

The EBIT margin guidance also reflects an increase in operating costs related to the resumption of business activities as the impact of COVID-19 recedes, as well as some pressure on freight costs. The EBIT margin guidance also reflects additional incremental investments of up to 2% of revenue for innovation as well as sales and marketing purposes. As the impact of COVID-19 is lessening across the world, we are able to execute on our investment cases. Next year, we are investing incrementally in all business areas and regions, which is a key focus on the US, Europe, Emerging Markets, and digital initiatives.

We expect our net financials to end the financial year 2021/2022 at around minus DKK 150 million. CapEx guidance for 2021/2022 is around DKK 1.2 billion, and our effective tax rate is expected to be between 22% to 23% due to the increased deductibility of R&D costs in Denmark.

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

QUESTION AND ANSWER SECTION

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

Patrick Wood

Analyst, Bank of America

Q

Perfect. Thank you very much. I'll keep it at two, please. So first question, please, on China. I'm just curious what you guys mean about the weakening sort of consumer landscape. Is that about consumers mix shifting down in terms of whether it's catheters or Ostomy bags, so mix shifting to lower ASP systems? Or is it something else that's going on there? So that's the first question, China.

And then maybe on the second question, I'm just curious, you mentioned obviously some details on the fewer patients starts in 2021 and the impact on 2022. I guess two parts to it. One is within catheters, and, apologies, I should know this, but how do you end up with fewer patients starts? Like, what are the conditions that are delayable in order to keep people on something else? Presuming you've got a trauma, or spina bifida or something you still need to be catheterized. So what are the delayable conditions? And how do we think about that within as we move through 2022? Is there a catch-up effect from those patients who are left behind as we go through the year? Awesome. Thanks.

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

A

Thanks, Patrick. Two good questions. I'll take a stab at answering then, and Anders, please supplement if you have anything to add. On China, really what we're seeing, Patrick, when we talk about consumer sentiment, it's not consumers twining down, they're buying less products. They're maybe postponing purchases a bit. The bargain hunting and maybe most importantly, the part of the Ostomy package that's been important for you in terms of accessories, you're willing to use a little less accessories.

So all told, we get, at the end of this quarter that we just closed, we saw the absolute volume of patients looking like pre-COVID levels. But if I look at the average order size, it is just – it is down, so depending on channel, anywhere from 5% to a little more than 10%. So they are buying a little less and that we've seen it before when the economic situation in the country becomes a little more uncertain that we can see it reflected in the consumer channel relatively quickly.

On the Continence Care side, we are certainly not talking about a spinal cord injured and spina bifida. You're absolutely right, Patrick. Those are – in patient volume terms, the smaller segments, of course, are very, very important customers, but we really are seeing procedures that are related to – or initiations that are related to, for example, multiple sclerosis, benign prostate hyperplasia. You will see people not be put on to the treatment or simply postpone or put on alternatives. And you will also, for the part of the business that relates to bowel management, the sad truth is that people's – patient's way through the care continuum is very long and arduous. And for somebody who's been years underway, getting yourself postponed another half of full year, that's just what happens.

So, we're not forecasting any catch-up effect when it comes to patient recovery, but we are forecasting a gradual recovery throughout the year and that's also what's borne out in current trading.

Patrick Wood

Analyst, Bank of America



Very clear. Thanks for taking the questions.

Operator: Thank you. Our next question comes from the line of Lisa Clive at Bernstein. Please go ahead. Your line is open.

Lisa Bedell Clive

Analyst, Bernstein Autonomous LLP



Hi. Just a comment on the – or a question on the guidance. It's, once again, at the bottom of the range that you just set a year ago. Is this primarily due to the lingering effects from the COVID-19 pandemic? And I suppose what is required to reach the middle or the high end of that growth range versus what you are doing today? Second question is what would the growth have been in the quarter had the tenders not shifted from Q3 into Q4? I'm just trying to get a sense of the underlying performance.

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S



Thank you. So, it's true that the headwind that we're facing now, which you can also see in our guidance, is mostly attributable to COVID-19 effects. It is mostly pronounced in US Continents. But we have also, as we've talked to throughout all the past year, seen it in the gradual recovery in Europe. So, it has affected the Chronic Care franchise.

And I just commented around Patrick's question on China. So, certainly, COVID's had its impact. I'll just remind you that prior to the pandemic, we had 13 quarters of 8% growth. And so, we continue to believe that the long-term growth or the long-term guidance is solid. There's nothing in our mind when we look at the underlying markets, the underlying incidence rates, treatment or the types of procedures that get done that would fundamentally shift.

To get to the high end of guidance, we'd like to get past COVID and get back to full access and normal patient inflow. And then, of course, we need to see all of our regions pull through and also our clinical performance program and innovation to deliver its contribution to growth. But no change view on long-term guidance. You have to repeat the second question for me, what was that about

[Multiple Speakers (00:29:12)]

Lisa Bedell Clive

Analyst, Bernstein Autonomous LLP



Yeah. Okay.

Anders Lonning-Skovgaard

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



I can take that question.

Lisa Bedell Clive

Analyst, Bernstein Autonomous LLP



Great.

Anders Lonning-Skovgaard

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

A

So, the question was around phasing Q3, Q4 in relation to Emerging Markets. So, as we announced when we had our Q3 announcement, we also said that there was some, you can say, tender delay from Q3 to Q4 and as I recall it was around DKK 40 million. And our Emerging Markets growth in Q4 ended around 21%, so actually a very strong quarter and just in line with our expectations. So if I remove those around DKK 40 million then we're getting to around 15%-ish.

Lisa Bedell Clive

Analyst, Bernstein Autonomous LLP

Okay. Thanks. And one quick follow-up question. How far along are you are in access to hospitals in the US? And, obviously, that's very important given the GPO contract wins.

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

Q

So is this a question for all business areas or just Chronic?

Lisa Bedell Clive

Analyst, Bernstein Autonomous LLP

Q

I think most importantly Chronic.

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

Q

Yeah. So it is – the truth is, it is a little bit of a mixed picture by state. But our sales teams are back in the field. We – if I look to the Continence Care business, the key target customers are urology clinics where we have with good access.

There's been a little less access on the Ostomy side where hospitals have been more reluctant to fully open. As you probably well aware, there is a certification needed for access around vaccination. But we've seen a more gradual resumption of access around OC, but we still have all of the team in field. We track the combination of in-person and virtual meetings. And the, if you will, the ratio to in-person to virtual continuous to increase month on month.

Lisa Bedell Clive

Analyst, Bernstein Autonomous LLP

Q

Okay. Thanks. That's helpful.

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

Martin Parkhøi

Analyst, Danske Bank A/S

Q

Yeah. Thank you very much. Two questions, firstly, just back on the guidance because you stated in the note that the market growth, which you normally would see at 4% to 5%, that you now see that in the bottom. So, let's say that the midpoint would normally be 4.5%, and then you cut off 0.5% of the market growth, but your own guidance is – the midpoint of a long-term guidance would be 8% and you are down at 7%. So, are there any – and this is due to your exposure to China that the impact on you are slightly higher than the impact on the market? And maybe, Anders, can you put a little bit more flavor on how soft do you expect Q1 to be?

And then, the second question on raw materials, where you're now maybe seeing a slightly higher price increase, and you have – yeah, that you have set before regarding 2021/2022. Can you maybe talk a little bit more on the longer term effect? And then also, just to be certain could there be any risk of an actual shortage of raw material?

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

A

Thanks, Martin. Let me talk market growth to begin with. It's true that we are seeing that the 18 months of pandemic has affected the market growth rates. So, objectively, if we look at the volume of surgery across all regions, they have been affected. And it's difficult with – if you will, with a full objectivity to parse out just how much, but you still have to remember the, if you will, the geographical mix of our business. So, if I look at – and you mentioned China, China is just 5% of the company at this stage, whereas US is about 20%. So, when we've got headwinds in both of these markets when they should take up a higher share of growth, it does impact the marginal growth rate that we have for the year, hence the guidance that we have for the year.

Anders Lonning-Skovgaard

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

A

Yeah. And Martin, thanks for your question around the first quarter. So, as I said earlier, we are expecting a soft Q1 and that is due to a strong baseline, especially in China, in the US, including our IU. So my expectation is something around a mid-single digit organic growth for our first quarter. And then from the following quarters, it will improve.

In relation to your third question around the raw materials. Yes, we are seeing a price increase across our raw materials. We have seen that starting in our fourth quarter and that is continuing into 2021/2022. And our view is and now it's going to be low-single digit increases, especially across paper, it's across the plastics. And we also see increased energy prices. So, those are some of the bigger categories.

And finally, you asked about the shortage. We are currently not seeing any bottlenecks as such, which means that we are not seeing any of our customers running into to back orders. When that is said, we are seeing a lot of work in managing the supply chain and making sure that we can supply to the demand we have. But we are – or our service levels and our delivery is spot on. And as I said, we're not seeing, at least so far, any back orders. So, I think that answered your questions.

Martin Parkhøj

Analyst, Danske Bank A/S

Q

Yeah, just on the long-term – on the price increases on the contracts you have beyond 2021/2022.

Anders Lonning-Skovgaard

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

A

Yeah. So, as you know, Martin, it is difficult to estimate when it's going to normalize again. What I am speaking to now is that we are expecting it will – so, the price increases we have seen recently, it will continue throughout most of this year. And so, that's how I see it currently.

Martin Parkhøi*Analyst, Danske Bank A/S*

Q

Okay. Thank you very much.

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

A

Thank you.

Operator: Thank you. Our next question comes from the line of Hassan Al-Wakeel of Barclays. Please go ahead. Your line is open.

Hassan Al-Wakeel*Analyst, Barclays Capital Securities Ltd.*

Q

Thank you for taking my questions. I have three, please. So, firstly, on growth guidance for next year and particularly in US Continence, where a new patient discharges here today, and when do you assume this normalizes in FY 2022? And what is your expectation for the US business overall in terms of growth versus your 10% ambition? And is there any offset from GPOs ramping on the Ostomy side in 2022, or is this a 2023 event?

Secondly, following up on China, could you quantify the decline in value per patients that you're seeing in China on average? What is happening to the frequency of bag use in Ostomy amongst patients? And how is this trending in fiscal Q1? And where do you see EM growth for the full year?

And then, finally, could you quantify the level of incremental investments, which is usually up to 2%, that you undertook in FY 2021? And I'd really appreciate if you could be a bit more specific on what is baked in at this point for those incremental investments in FY 2022 and if you could give us a flavor for some of those? Thank you.

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

A

All right. Hassan, I count that to four. But why don't I try and take a stab at the first three, and Anders will speak to investments. If we start with US Continence, we're expecting a gradual recovery as we move through the year. We have seen that recovery be a little slower than we anticipated a couple of quarters back. But we are seeing it improve. We're sitting at around index 90 and we are expecting for the US business as a whole to deliver something just shy of 10% this year.

We are expecting a strong year in Ostomy. The NPDs are back. We've won on the DPO side and we are well underway with the sales force expansion that we've talked to you about. So, there is a real difference between Ostomy Care and Continence Care this this year in the US. But on the whole high-single digits shy of the double digit growth, which is our ambition.

Now, in China, we're still expecting a good year and the business to grow double digit, but not as strongly as we've seen in the past. The decline in average order size or patient value differs a little bit by channel, depending on where people are buying and mix. But think of it as something in the order of around 10% plus minus a few

percentage points depending on channel. And really here in current trading this month, I'm not seeing a lot of change to that figure.

For EM as a whole, we are expecting strong growth, strong double digit growth in this fiscal year, broad-based. And like I said, China is still a double digit, but not as strong a double digit as we are accustomed to. Anders, on investment.

Anders Lonning-Skovgaard

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

A

Yes. Thanks, Kristian. So in terms of investments, we are or have been starting up new activities and new commercial initiatives. We have talked to some of them or most of them already. We have decided to invest into the US. We have decided to invest into expanding our sales force in order to go for the GPO opportunities. We also decided to invest into a number of initiatives across Europe and the Emerging Markets. And we also continue our investment program within IU and Would & Skin. And so in 2021/2022, we will increase our incremental investments compared to last year, also as a consequence of a more normalization after, you can say, COVID. So, Hassan, it will be a more than 1%, but that also includes a normalization of the underlying spending within sales and marketing.

Hassan Al-Wakeel

Analyst, Barclays Capital Securities Ltd.

Q

That's really helpful. Thank you.

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

Veronika Dubajova

Analyst, Goldman Sachs International

Q

Excellent. Hey, guys. Good afternoon. And thanks for taking my questions. One, just wanted to sort of circle back on the Continence discharges in the US. And just kind of curious, ConvaTec said last week that they feel that the markets already normalized. And I appreciate you might not have 100% the same exposure, but just maybe curious if you have any thoughts on why they might be seeing a more normalized picture than you are. Is this just a function of definition or exposure by channel or is there something else going on?

And related to that, I think the other thing that they flagged on the call last week was that they do see some headwinds in Emerging Markets from normalized funding following some support through COVID-19 through the past 12 to 18 months. I'm just curious if you share that view and to what extent that also will play a role into your EM growth rate. So, that's my first question. Appreciate it has two parts.

And then the second one, just, Anders, if I can get you to commit to what you think the gross margin might be in fiscal 2022 or what is assumed within that 32% EBIT margin guidance? That would be very helpful for us for modeling purposes. Thanks.

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

A

Thanks, Veronika. Why don't I start with Continence US? So, what we're seeing is an inflow that's sitting around Index 90 still improving and a gradual recovery throughout the year. I can't really speculate about ConvaTec's view. I am very firm on what we're seeing, though. And, also, we're pretty confident with current trading that we're

going to see that normalizes as we walk through the year. We run – I'll just remind you, we run quite different businesses where ConvaTec, of course, runs mostly a dealer business and we run mostly a manufacture business.

On the EM side, we're not seeing the same level of headwinds. We are forecasting a double-digit growth here. We do this work very bottoms up and look at momentum at the patient level, at the hospital level, and have a view now broad-based also on the back of the Q4 that we just delivered that it's going to be a double-digit growth here again for EM.

Anders Lonning-Skovgaard

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

A

Yeah. And, Veronika, on your last question regarding the gross margin, so as you have seen in our results today, we delivered a strong gross margin for 2021 in the level of 68.5%. As a consequence of the headwinds I talked to earlier around the high wage inflation in Hungary and the price increases we are expecting the gross margin will drop a bit. But we also are expecting some tailwind from efficiency gains from GOP 4 and GOP 5, and also some tailwind from the foreign exchange. But I'm expecting the gross margin will drop a bit into 2021/2022.

Veronika Dubajova

Analyst, Goldman Sachs International

Q

Great. And, Anders, just a clarification. The 32% reported EBIT margin that you've guided for, what does that assume in terms of FX tailwinds or headwinds?

Anders Lonning-Skovgaard

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

A

Yeah. So thanks for that, Veronika. We are expecting some tailwind from the currencies on the EBIT margin. So we are expecting some tailwind on the top line where I said earlier we are expecting a reported growth of around 8%. And I'm also expecting some tailwind on the margin on the EBIT margin.

Veronika Dubajova

Analyst, Goldman Sachs International

Q

Okay. Got it. Excellent. Thank you both.

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

A

Thanks, Veronika.

Operator: Thank you. And our next question comes from the line of Christian Ryom of Nordea Markets. Please go ahead. Your line is open.

Christian Ryom

Analyst, Nordea Bank Abp (Denmark)

Q

Hi. Good afternoon. I have two questions as well. So the first question is to the guidance commentary that you made on both Europe and the US, where I understood you to suggest that you expect to see a continued improvement in growth. Can you qualify what that is – what that is relative to in terms of baseline? So, is that relative to the growth rates that we saw here in Q4? Or is it relative to, say, the growth rates that we've seen for the full year for the two regions?

And then my second question is, I believe you previously talked about or signaled that you would likely see operating expenses growing faster than the top line in 2022. Can you confirm that that is still the case? And if that's the case and does that not imply that we should expect only a fairly limited gross margin headwind if you ask to still defend an EBIT margin of around 32% to only around 70 basis points below what you delivered this year? Thank you.

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

A

So, Christian, thank you. Good question. We are – as you know, we've seen improving momentum coming out of both Europe and the US, Q3 to Q4. So, the baseline for the commentary should be the Q4 number, and we expect that to improve into next year.

Christian Ryom

Analyst, Nordea Bank Abp (Denmark)

Q

Okay, just to clarify on that, so the European growth of around 8% in the quarter, is that also -

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

A

No, I mean, underlying.

Christian Ryom

Analyst, Nordea Bank Abp (Denmark)

Q

Okay.

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

A

Underlying growth. So, if you look at Europe, it's going to come back to something in the neighborhood of 4% to 5%.

Christian Ryom

Analyst, Nordea Bank Abp (Denmark)

Q

Okay. Great. And on the OpEx growth?

Anders Lonning-Skovgaard

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

A

Yeah. And on your second question, Christian, around the cost of growth, we are expecting, as I said earlier, that we would see a normalized spending level. We are also expecting to invest into some of the commercial initiatives that I talked to earlier. So, we are expecting that the cost will increase and it will be in the level of the growth or a bit above also because we have some tailwind from the currencies, as I mentioned earlier.

Christian Ryom

Analyst, Nordea Bank Abp (Denmark)

Q

Okay. Great. Thank you.

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

Maja Pataki

Analyst, Kepler Cheuvreux SA (Switzerland)

Q

Yes. Thank you very much. Two questions from my side. Kristian, you are – part of the guidance is that there is a continuous improvement in situation in Europe and in the US. And hopefully, as we're looking at COVID hospitalizations, the numbers are relatively moderate. But there are some voices concern out there that the flu season this year could be particularly bad because we haven't been exposed to it and there could be a high number of hospitalizations due to the flu season. Just to understand the dynamics, if we were to see a rapid increase in hospitalizations due to flu or respiratory symptoms in general, do you believe that this would have an impact on new patient discharge or is it really related to COVID only and infectiousness of the virus?

And the second question is you've mentioned in your press release that you're participating around the financing for Francis Medical, but that your share remains at 13%. Out of curiosity, was it not possible to increase your share or do you not have an interest at this point in time to increase your share? Thank you.

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

A

Thank you, Maja. It's a good question. I mean, on Europe, this is – and the US when it comes to a potential marginal impact, both of an increase in Delta COVID-related cases and some, God forbid, some type of accelerator from a flue, I think the answer to your question will depend on how severe it is. Of course, if it becomes severe and it takes up a lot of capacity in health care systems, we are not immune.

Maja Pataki

Analyst, Kepler Cheuvreux SA (Switzerland)

Q

Okay, great.

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

A

We are not immune. I'll have to say I regard it as relatively unlikely that we're going to see anything that would have an effect that will be comparable to what we saw with the original pandemic. But it could have an effect. So, we continue to monitor that and follow it by market. On the Francis Medical side, we chose to participate to just keep share at what it was. So, no, you shouldn't read too much into that. We believe in the technology and we're excited to be part of the team and we're following the development very, very closely.

Maja Pataki

Analyst, Kepler Cheuvreux SA (Switzerland)

Q

Thank you.

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

Niels Granholm-Leth

Analyst, Carnegie Investment Bank AB (Denmark)

Q

Thank you. My first question would be around the wage inflation in the US. Some of the other medical technology companies having reported Q3 numbers have referred to an increasing wage inflation in the US. Is this something that you can recognize?

My second question would be just a confirmation of your cost base in Hungarian forint. Given the currency sensitivity that you provide, I presume that your cost base would be DKK 1.2 billion. Thank you.

Anders Lonning-Skovgaard

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

A

Okay, Niels, so let me start with the wage inflation in the US. Yes, we also see that, and we are currently looking into it when we do our salary adjustments from next year. But we are still looking at something in the level of low-single digit. Our cost base in Hungarian forint, I have the cost base in relation to our salary in Danish krone, if that is what you're after, in order to calculate the impact from the salary. That's around 10% of the total cost of goods sold. So, it's around DKK 600 million. The other one I need to look into, Niels.

Niels Granholm-Leth

Analyst, Carnegie Investment Bank AB (Denmark)

Q

Okay. And...

Anders Lonning-Skovgaard

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

A

Is that what your question?

Niels Granholm-Leth

Analyst, Carnegie Investment Bank AB (Denmark)

Q

Yeah. But I was basically just using the currency sensitivity table, would you...

Anders Lonning-Skovgaard

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

A

Yeah.

Niels Granholm-Leth

Analyst, Carnegie Investment Bank AB (Denmark)

Q

...why you say a 10% change is DKK 120 million. So, from that...

Anders Lonning-Skovgaard

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

A

Yeah.

Niels Granholm-Leth

Analyst, Carnegie Investment Bank AB (Denmark)

Q

...I would presume that your total cost base in Hungarian forint was above DKK 1.2 billion.

Anders Lonning-Skovgaard

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

A

Yeah. That's true. Yeah. So, if you are using that, that's true. I can confirm that.

Niels Granholm-Leth

Analyst, Carnegie Investment Bank AB (Denmark)

Q

And then, just on depreciation and amortizations, those two lines both depreciation and amortizations are coming down quite a bit in fiscal 2021, which seems a bit counterintuitive given that you are opening new factories, et cetera. Why is that?

Anders Lonning-Skovgaard

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

A

Yeah. So, our depreciation and amortization for 2021 is more or less at a flattish level compared to – or it has been reduced quite significantly last year. And I'm expecting in 2021/2022, it will be also at a pretty flattish level compared to last year. There's couple of explanations for that. One of the explanation that's the Mentor amortization. That is basically more or less out. And the other one is also related to the Comfort Medical amortization that is also a more or less out from this financial year, 2021/2022. So, that is going to have a positive impact on our depreciation and amortization levels.

Niels Granholm-Leth

Analyst, Carnegie Investment Bank AB (Denmark)

Q

Okay. Great. Thank you.

Operator: Thank you. And our next question comes from the line of Mattias Häggblom of Handelsbanken. Please go ahead. Your line is open.

Mattias Häggblom

Analyst, Svenska Handelsbanken AB

Q

Thank you, so much for taking my questions. I have two please. Firstly, on the initiative to make more of your products digitally viable, can you talk about what portion of revenues by 2024/2025 at the end of your Strive25 studies that will have a digital element to it? And link to this, if you could expand on the payer pilot studies on the Digital Ostomy Tool in Germany and the UK that were initiated in Q4 2021 and what you're trying to accomplish here?

And then, secondly, regarding capital allocation, I know the policy is to hand out the excess liquidity as a dividend or buyback. This year you made a meaningful acquisition in Nine Continents Medical, which consumed roughly 25% of your free cash flow. Assuming you hadn't done the acquisition, would you have been more likely to hand out more as a dividend then? I'm asking because I'm trying to understand what to expect in terms of the capital allocation going forward. Thanks so much.

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

A

Thank you, Mattias. So, I'm assuming that your first question is really about the pilots that we're running around the Digital Ostomy appliance, is that correct?

Mattias Häggblom

Analyst, Svenska Handelsbanken AB

Q

Yeah. I mean, you make enough emphasis around the digitalization as a part of your Strive25 strategy. So, I'm trying, to what extent – how far can you go in terms of product development and to what extent is it other tools you're trying to enable?

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

A

Yeah. And so, I'll answer that at two different levels. When it comes to digitalized products, so where the product itself is involved in generating data, this will not be a very high share of the revenue by 2024/2025. The pilots that we are running now, albeit they're off to a – an early promising start, they have to be concluded. It is about a year's worth of work in the UK and Germany, and the first data point, which is important for us to follow, is what the consumers say about working with that product, will they use the product? Do they see value in the product in a day-to-day use? And, so far so good, we've got a very positive feedback that replicates what we've seen in the development phase. But, of course, we have to scale up, right, we have to see that this is also true now once we start rolling on many hundreds of patients onto the product.

And then, the impact will largely depend on what it is that we find. We don't know that yet. So, we don't know what type of impact this is going to have on readmissions levels. We don't know what impact it's going to have on the types of complications people have with the skin and a bunch of other KPIs. We don't know that yet, so the out brief from at the end of the pilot and the level of evidence that we can produce there will be directly correlated to the type of premium or pricing that we can command. But we know that we are unique in the category. And that if there is a path to value that, of course, it will be important for us, we also know that it's going to be relevant for most [ph] ostomysts (00:57:32) out there, so not just people who use Coloplast products. But in terms of taking up a large share of our revenue by 2024/2025, it will not, right? It will not. So – and I certainly want to make sure that we conduct a thorough piece of work on building the category first.

From a digitalization of products point of view, when you think about how much of our products are sold through digital channels and e-com, that percentage will – it's just going to increase through the period. We're also investing significantly in digital tools both for health care professionals and for consumers, for training purposes and for people to manage their condition. So a relatively high amount of digital initiatives that are involved in, if you will, just giving people a good standard of care, but not something where you would say, where you have direct revenue, you will have an indirect revenue impact.

Second question, you want to take a stab at that, Anders?

Anders Lonning-Skovgaard

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

A

Yes. Thanks. So the second question was around capital allocation. And as you probably are aware that our policy is to pay out excess cash through dividends and share buyback. And our targeted payout is in the level of 80% to 100%. But in a year where we are doing acquisitions as we did in 2021, then the payout is a bit smaller. So, that's how you should see it.

Mattias Häggblom

Analyst, Svenska Handelsbanken AB

Q

Thank you so much.

Operator: Thank you. And our next question comes from the line of Yiwei Zhou of SEB. Please go ahead. Your line is open.

Yiwei Zhou

Analyst, SEB Enskilda (Denmark)

Q

Thank you for taking my question. I have two here and a follow-up question on China, but on the supply side. So, we have seen some restrictions on the production on some regional provinces due to the energy crisis, and this seems to be the issue we're also running to the winter season. Any impacts do you expect on your production? And my second question is back on the gross margin. You previously guided 6% to 8% in gross margin in the current strategy period and is this guidance still valid, considering the cost inflation? Thank you.

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

A

Thank you. Let me just answer quickly the first one. Really we have seen authorities intervene like you've seen, really not a material impact on us. We've scaled back the number of active days. So, right now, we don't produce Sunday nights, for example. But we think being in medical devices is an advantage, so we do not anticipate a material disruption from that front. Anders?

Anders Lonning-Skovgaard

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

A

Yeah. Again, question around the gross margin and as I said earlier, we will, in 2021/2022, see that our gross margin will come down as a consequence of some of the headwinds from raw material price increases and the high salary inflation in Hungary. But the soft guidance I gave when we announced our financial outlook for the whole strategic period of gross margin of around the 68%, that still holds – that's still our expectation throughout the Strive25 [ph] net (01:01:21) period.

Yiwei Zhou

Analyst, SEB Enskilda (Denmark)

Q

Great. Thank you.

Kristian Villumsen

President & Chief Executive Officer, Coloplast A/S

All right. I want to thank everybody for today, I think there are more people waiting to ask questions. So please, do not hesitate to reach out to us with any follow-ups that you have. And otherwise, we hope to see you in some of the follow-up meetings that we have in the coming days.

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