ConvaTec Q2 2019

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Introduction

Rick Anderson

CEO, ConvaTec

Welcome

Good morning. It is good to see you all this morning, and I see some familiar faces. First of all, welcome to our interim results presentation. I am joined by Frank, our CFO, and David, our President of Advanced Wound Care.

Interim Results 2019 – Key Points

And I am encouraged to say in the first half, we see an improving growth trend. Importantly, our Transformation Initiative is progressing well. So, we are on track and that is why we are maintaining our full year guidance today.

Now I am going to take you through the key points of our first half results. Then I will ask Frank to take us through the numbers and operations. Then I will give you a progress update on the Transformation Initiative, and David will tell you more about the turnaround of our US Wound Care business. After that, we will be happy to take your questions.

On slide 4, here are the key points from our interim results.

Group organic revenue grew 1% in the first half, and that is excluding the one-off provision as a result of the rebate change that we highlighted in Q1. I am pleased to say that we saw progress in the second quarter. Group organic revenue growth was 2.1% in Q2, and the growth was delivered across all franchises.

Our Transformation Initiative announced in February is on track. We anticipate an annual gross benefit of $130 million to $150 million in 2021, and I will talk more about this later. We have invested $14 million in the first half in the Transformation Initiative, and we have already seen some green shoots, particularly in the US Wound Care business, which David will cover.

Adjusted EBIT margin in the first half was 18.6% and we have maintained our interim dividend. And leverage is 2.6 times with continued good cash generation. So, we believe we are in a good position to deliver on our plans for the year. So, on that note, let me hand over to Frank.

Financial and Operational Review

Frank Schulkes

CFO, ConvaTec

Financial Highlights

Performance in line with internal expectations

Thanks Rick. Good morning. So, let me take you through our first half results in more detail starting with slide 6.

So, our first half numbers were in line with our expectations, and they reflected a more encouraging second quarter as we expected. Group revenue in the first half was $889 million, declining 3.5% on a reported basis. And taking out the impact of FX and M&A, organic growth was flat. And excluding the rebate provision, we were up 1%.

Adjusted gross margin was 58.6%, 70 basis points lower than last year. However, taking out the impact of FX and the one-off provision, we were flat year-over-year. And that is the result of positive net productivity, which helped offset price erosion and negative mix.

Our operating cost as a percentage of sales increased as expected, reflecting the investments related to the Transformation and MDR, which contributed 170 basis points of the total 280 basis points increase. We also continue to invest in commercial areas, regions and IT, partially offset by cost control in other areas.

As a result, our Adjusted EBIT margin was 18.6%, down 350 basis points from last year. We continue to deliver strong cash conversion, reaching almost 90% in the first half, and debt leverage in the business has continued to come down to 2.6 times from 2.8 times this time last year.

Revenue Performance

Moving to slide 7. As I said before, the second quarter was an encouraging quarter with growth across all franchises and an improving trend in Wound; Ostomy growth was modest, as expected; CCC continued to grow ahead of the US market; and we also delivered decent growth in ID.

For the first half, organic revenue growth was 1%, excluding the one-off provision, with reported revenue declining 3.5%. And the difference of 450 basis points between the two is driven by: 100 basis points from the one-off provision; and about 360 basis points of FX headwind with a small offset from M&A.

H1 2019: franchise performance

Advanced Wound Care

On slide 8. In Advanced Wound Care, we experienced an improving quarter-on-quarter with organic growth of 3.3%. Excluding the one-off provision, organic growth was flat in the first half.

Our AQUACEL Foam and anti-biofilm silver product performed well, but we saw continued challenges in our legacy products, in particular, base AQUACEL dressings and skincare. Overall, in the second quarter, our skincare business was less of a drag to growth compared to the first quarter. In the US, we have completed our move to a specialised sales force model, and lead indicators now show good momentum. David will provide more detail on that shortly.

AQUACEL Ag Advantage, launched late last year, has been positively received by clinicians. And although it is early days, we are seeing progress and are excited by the market opportunity for our disposable NPWT system.

Furthermore, we saw a good momentum in markets in EMEA and APAC, while the UK markets remained challenging.

Ostomy Care

Ostomy, organic growth was 0.3% in the second quarter. Excluding the one-off provision taken in the first quarter, organic growth in the first half was 0.6%. Overall, NPC remains resilient, but we are still seeing a downward trend in the US. We are in the process of improving performance of the commercial team. However, progress will take time given the nature of the business.

We continue to invest in and grow our me+ direct to consumer programme. And we see traction with our more recent Convex product launches such as Esteem+ Flex and Natura Accordion. We continue to execute our strategy to return the franchise to consistent growth with a good performance in the second quarter in a number of markets in EMEA and Latin America as well as Asia Pacific.

Continence & Critical Care

In CCC, revenue grew 2.8% on an organic basis in the second quarter driven by HDG. And excluding the one-off provision, organic growth in the first half was 3%. HDG continues to outgrow the overall US Continence market, albeit, at a low level of growth than in prior years. We have seen good volume growth, partially offset by the inclusion of the lower growth in Continence business from Woodbury, which is now in our organic growth numbers.

Patient testing of our next-generation female catheter against the market leader generated very positive feedback, and this will be incorporated into our launch activity in Europe.

Infusion Devices

Finally, ID. Revenue grew 1.9% in the second quarter and 0.8% in the first half despite a tough comp. We saw a strong order from customers during the first half, driven by continued growth in the insulin pump market.

Looking ahead, as we have mentioned before, we expect to see growth below historical market levels in ID in 2019 as a result of our customer, Animas, exiting the market.

Margin and cost overview

On Slide 10, you can see more detail on our gross margin and costs in the first half, starting on the left with gross margin.

Gross margin

This was 58.6% in the first half, down 70 basis points from 2018. If you adjust for foreign exchange and the one-off provision, gross margin was flat year-over-year. And as I mentioned earlier, we saw a positive impact from net productivity gains, which helped offset the negative impact of price and mix.

Operational expenses

Our OpEx grew to 40% of revenues in the first half, driven by the investments in Transformation and MDR, as well as continued investments in commercial areas, regions and IT. In the first half, we invested $14 million in transformation out of an anticipated full year spend of about $40 million, and this was largely booked in G&A. We expect investments to increase in the second half as projects move from planning into execution.

Total OpEx as a percentage of sales grew 280 basis points. Transformation and MDR accounted for 170 basis points with the rest, a combination of commercial investments in HDG in China, in IT, as well as labour rate inflation.

Good cash conversion and reduced leverage

Moving to cash and leverage on slide 11. Cash conversion in the first half improved to almost 90% from 75% in the first half of 2018. Leverage was 2.6 times EBITDA. And for 2019 year-end, we expect leverage to be broadly flat versus 2018 due to the investments in Transformation and MDR. And overall, this demonstrates the strong cash generating ability of the company, and we continue to target 2 times leverage over the medium term.

2019 Guidance maintained

Organic revenue growth

Finally, slide 12. As Rick mentioned earlier, we are maintaining the guidance we outlined in February, which is 1% to 2.5% for organic revenue growth, including the negative impact of the one-off provision. We expect to see the improvement in the top line we experienced in the second quarter to continue in all franchises. And there will, of course, be some quarter-over-quarter movement.

Adjusted EBIT margin

For Adjusted EBIT margin rate, we continue to expect to land between 18% and 20%, including Transformation and MDR, as well as the one-off provision, with FX slightly worse than we planned.

As we told you in February, we expect to spend about $15 million across Transformation and MDR in 2019, which is second-half weighted. Therefore, our guidance, excluding these investments, remains 21% to 22.5%.

Finally, below the EBIT line, we expect the book tax rate to be about 16.5% and net interest to be a couple of million lower than prior year.

And with that, I will hand back to Rick. Thank you.

Transformation Update

Rick Anderson

CEO, ConvaTec

Recap: Pivot to Growth

Thank you, Frank. So, to recap briefly, on slide 14, what we said to you in February that our execution model needed to Pivot to Growth. And these are the principles that we talked about: Simplify; Innovate; Segment. All three of these are supported by our commitment to invest in the business.

First, Simplify. We want an organisation that makes quicker decisions, more responsive to the market opportunities and has a lower cost operating model. In the future, we have more focused franchises in leading positions, and we will have a clear ConvaTec way of doing business to ensure operational excellence and consistency.

Next, Innovate. We will spend more in R&D and spend it better. We will invest more in value-based clinical evidence to support product development. So, in the future, we will see more consistent pipeline of new products and services.

Thirdly, Segment. Our goal here is to focus on premium markets, premium segments and attractive geographies. We will back our winners more heavily and be able to focus our firepower on the biggest opportunities, and we will manage our portfolio more actively.

Clearly, this plan requires investment. So, we will increase our investment in key areas such as selling, distribution and R&D. And at the same time, we will be more efficient and effective with our current spend and leverage our back office to reduce our G&A cost over time.

Recap: Transformation Initiative

To make all that happen, we launched a Transformation Initiative. We have four work streams that we explained to you in February. Each of these is headed up by a member of the executive committee.

Commercial excellence will drive more effective product launches, improved pricing and ensure we are focused on our customers. And David will take you through the elements of this in his presentation.

Operational excellence includes our efficiency programme, which is already delivering benefits as Frank outlined.

Business service transformation will deliver savings in the back office.

And the portfolio optimisation will move our focus into the high-growth, high-margin segments and geographies.

Transformation office established – embedding our new execution model

We said we are going to invest an additional $150 million in Transformation over the next three years with a split between OpEx and CapEx, and we expect the pay back to be over a two to three-year period. In the first half, we invested $14 million out of an anticipated full year spend of $40 million. We will invest more in the second half as projects move from planning into execution.

Additionally, as we told you in February, we will also have recurring costs of about $15 million per annum by 2021, building from $15 million this year. These will be related to our investment in US Wound, our global catheter launch, our APAC expansion and our next-generation Ostomy products. And in ID, our continued expansion outside of diabetes. Key to delivering our plans has been the setup of our Transformation Office as a centre of excellence. This is providing support and expertise to accelerate and amplify projects.

We have put in place clear accountability for delivery of projects and robust governance with detailed tracking of key milestones and weekly reviews of the programme by myself, Frank and the executive team. Allocation of investment and resources is tightly controlled. And what I am seeing is a high “say/do” ratio. When people say they are going to do something, they do it. The Transformation Office will provide a model to embed more discipline and better execution into the business.

And already, the lead indicators are encouraging and a ConvaTec way is emerging. But it is still early in the programme. There is plenty more for us to do. But so far, I am encouraged by what I see.

Transformation Initiative – progress in first six months

So what progress have we made with the Transformation Initiative in the first six months? We are now fully up to speed. And as I said, during the first half, we have established the Transformation Office. We have identified and prioritised opportunities across all four work streams. We have begun execution in the first wave of those projects. We have business plans in flight with clear accountability from delivery of projects and robust governance.

Our commercial excellence programme is helping us drive more targeted and effective sales force in the US Advanced Wound Care marketplace. There are opportunities to drive contract and pricing excellence to improve focus on top accounts.

Operational excellence delivered net positive productivity in the first half, as Frank mentioned. In supply chain, we achieved $2 million run rate savings on ocean and air freight by changing suppliers and reducing express shipments. Another $2 million run rate savings was achieved in manufacturing through direct material savings.

In business services transformation, we have completed a detailed design phase.

And in portfolio optimisation, the analysis is ongoing with the opportunities identified, and we will provide further detail in due course.

Attractive return on our investment plans

So, pulling the Transformation Initiative together on slide 18. As you know, we are investing $150 million. Overall, we anticipate annual gross benefits between $130 million and $150 million per annum in 2021. And that is an attractive gross return over three years of around $250 million.

And as the full benefit of all the investments materialise, the annual benefit will continue to grow. For example, in operational excellence, we told you in February, we expect an $80 million annual benefit in 2021 and that is to grow to $120 million by 2023. These benefits, of course, will be somewhat offset by inflation, price and depreciation, the usual headwinds we face every year. And you will remember that we are also increasing our recurring OpEx by $50 million per annum by 2021.

So, we expect our investments to drive margin expansion over the medium to long term, and our aspiration should be to be in the top third of global med-tech companies. Currently, those companies have an EBIT range of 25% to 27%.

So now let me hand it over to David to give you some more detail of what we are doing in our US Wound business. I have known David for more than 20 years. I was really pleased to recruit him into the business. His decisive leadership is already making a real difference in our Advanced Wound Care business.

US Wound Update

David Shepherd

President, AWC, ConvaTec

Introduction

Thank you, Rick, and good morning. I joined ConvaTec eight months ago with a clear mandate to turn around the performance of our Wound Care business. It is a good business with sound fundamentals, but it has not fulfilled its potential, and my job is to ensure that it does.

But before I jump into that, I just wanted to share a little of my own personal background. I spent my whole career in the world of medical devices. Prior to joining ConvaTec, I spent 26 years with the Johnson & Johnson medical device business. In that time, I was fortunate to work across many different regions and in many different medical specialities, giving me a broad insight into the medical device world.

My most recent roles were the Area Vice President for Southern Europe, running all of the different Johnson & Johnson businesses from surgery to orthopaedics to cardiovascular. And prior to that, I was based in the US for five years, where I was the US President for the Cardiovascular and Specialty Solutions business and also President of Biosense Webster, the J&J Electrophysiology business.

So, I have got a broad experience, which provides useful perspective on how to address some of the issues at hand at ConvaTec.

US Advanced Wound Care

So, moving to the US market on slide 21. As you can see, the US Wound Care market is a crucial market for us. It accounts for almost 30% of our Wound Care franchise revenues. But in recent years, our performance has not been good enough. We have been too focused on the acute segment at the expense of post-acute, and we have been too reliant on Surgical Cover Dressing.

Our commercial model has been deficient with insufficient commercial discipline and insufficient focus on driving end demand in the marketplace. And as a result, we have clearly underperformed in what is a good and growing market.

Overview of strategy for acceleration: progress update

So, what are we doing about it? Well, it is very early days in our journey, but I am pleased to report that we are already progressing well with our plans.

Firstly, we have got targeted alignment on our top accounts. We rolled out our CRM tool to ensure we have the teams focused in the right places based on clear criteria about business opportunity and size and on the current contracting status in those accounts. And that allows us the opportunity for quicker wins. We have completed the restructuring of our US field force into specialty-focused teams with a clear channel focus on acute and chronic wounds, and each team has a clear portfolio focus, the priorities, the needs of their customers. So, we have got the right people, focused on the right accounts with the right frequency. And we track this on a weekly basis.

The combination of the targeting and the new sales structure, along with the increased familiarity of the team to the new model, has already allowed us to increase our call volumes by over 20% from Q1 to Q2.

Secondly, we have hired and trained new territory managers to support our new footprint. And our overall field infrastructure is now significantly bigger than at the year-end 2018, driven by those customer-facing positions.

Thirdly, a new hire training programme has been revamped. We have doubled down on the amount of time spent in-house to ensure that our new starters are better prepared once they reach their territory. And this first training wave completed in June. These new starters are now out in the field completing their field training and transitioning to their new territories.

Fourthly, through the Transformation office and our US commercial operations team, we have also been able to drive more focus on pricing and compliance, which is another great area of opportunity for us. Again, we are in the early stage of our journey here, but we have seen a slowdown in our price decline in the first half of 2019. We will need to continue to build on this in the second half and beyond as this will be an enduring headwind in the field of medical devices, but we are pleased with the progress.

And finally, we are staying true to our focus on our key product priorities. AQUACEL Ag Advantage, which launched at the end of 2018 is doing very well, driving up overall the AQUACEL Silver family at above market growth rates. And here, we still see significant opportunities for further penetration. Customer feedback on the product has been very positive. In Surgical Cover Dressing, we have arrested the decline we saw towards the end of last year. And whilst it is still very early days for Avelle, which we launched at the start of the year in the US, I am excited by this market opportunity.

Summary of progress to date

So, to summarise on slide 23. It is fair to say that we are pleased with our early progress. We can see some green shoots, but there is still a lot more to do. We need to continue to build on the core momentum in the second half by sticking to the plan, which we are confident, is working, even in this early stage. And as we see the benefit of the extra field force starting to make their contribution, especially in the fourth quarter once they are fully established, we expect to see call rates in our target accounts continue to increase. And again, we will stay laser-focused to track this.

This relentless focus on execution is going to be key for us as we drive the business forward. And as we move ahead, we will track our performance against the pipeline of sales opportunities we have already identified.

So, we look forward to giving you further updates as we continue our exciting journey. Back to Rick.

Summary and Conclusion

Rick Anderson

CEO, ConvaTec

Summary and Outlook

So just to take a step back, when I was with you in February, I gave you sort of a candid assessment of my view of the business. And if you remember, I said to you that I think ConvaTec is in very, very good markets. We have very good brands, and our challenges have really been around execution. And as our results indicate today, we are making progress there.

I would tell you that we have done a ton of work in the last six months, and I am encouraged by how the employees of ConvaTec have leaned into our effort around Transformation. And we believe that we are seeing the beginnings, the very beginnings of what we believe to be a ConvaTec way emerging of the way that we are going to do business. It is early days. It is very early days, but it is a step in the right direction.

We are encouraged by that and we think that this absolutely sets the stage for Karim's arrival at the end of September. And I would just put one word of caution. I would not get out ahead of us here on this because I do think it is early days. We are doing everything that we can to manage our business in a more disciplined way, and because the business that we are running today is a very good business, that there is a take there and we are making a difference in patients' lives around the world and it is one foot in front of the other. And we are excited about the future for ConvaTec.

So with that, Frank and I and David are happy to take your questions.

Q&A

Sebastian Walker (UBS): So two, if I could. One, on the growth in the second half. So you are expecting continued improved momentum. Could you maybe talk about that within the different divisions? And maybe, David, if you could comment within Wound. I know, the headwinds within Skincare was slightly lighter in the second quarter. How do you expect that to develop? And when do you expect to start see the US acceleration come through in the second half? So that is the first one. And shall I leave it there and then –

Frank Schulkes: Sure. Yeah, let us not overload our rams. So growth, second quarter and then translating to the second half. Let us click through the different franchises. So if you look at the change from Q1 to Q2 in Wound, there are really a couple of reasons for that.

First, the comps were easier in the second quarter. Okay? Then we saw good performances in several parts of the world, in Asia Pacific, for instance. We see several markets in Europe improving. And at the same time, we also saw a couple of areas being less of a drag that they were in the first quarter. The UK, still not good, but less of a drag. As you perhaps remember, we had destocking going on in the first half in the UK with a big distributor. That impact was bigger in the first quarter and less in the second quarter, so they are further drag.

Skincare, as we discussed, had a 200 basis point drag in the first quarter and that drag normalised to something lower than 100 bps, and this is what we have seen in prior years. So also a normalisation there. And then third, the US business. Although it is still a drag, but it was also less of a drag.

So those are the three main reasons. An easier comp, good performance in APAC, EMEA some markets, and then several areas less of a drag. So we expect that we are going to see a pretty decent second half but you have to remember there will be quarter-to-quarter variability.

As a reminder, just a million shift is 80 to 100 bps, right? So I prefer to look at the business, not so much from a quarter-to-quarter, but look at sort of six months rolling averages to take out some of the noise that we always will see.

Ostomy Care, low growth. We expect that low growth will continue. We have seen some very good performances in several markets, in emerging as well as the smaller markets in Europe. The US is a drag. We are addressing that. But as you know, this is a business that moves at a certain glacial speed, so it will take time. So we are in line with what we said before. It is going to be very low single-digit growth for Ostomy.

CCC, about 3% in the first half. We expect that to improve in the second half because, of course, the journey hazard testing in the second half last year, which we do not have this year anymore. And we expect a little bit better growth rates in HDG in the second half as well.

And then the ID business is a very lumpy business. For the total year, because of the Animas dynamics, that business will grow, but it will grow below our historical growth rate of about 4%, 4.5%. And we continue to believe that that is the right number for the full year. It will be lumpy. One quarter will be negative and then it will be positive. So again, looking at four quarters, that is how we have to think about it.

Sebastian Walker: And the second question was just on cash. So cash conversion in the first half was very strong, but I think there was some working capital inflows. CapEx was maybe a little bit lighter than what I would have expected. So how does that develop in the second half?

Frank Schulkes: I think that the conversion of 90%, I do not think we will maintain that given that we will see more cash flow in terms of CapEx, for instance, happening in the second half. Key thing here is that our expectation for the leverage will be plus or minus similar to what we experienced at the end of 2018. So as I have said before, the decline in leverage will sort of slow down because of our investments in Transformation and MDR. And then after '20, I think we will start to delever very quickly.

Michael Jungling (Morgan Stanley): I have got two questions. So the first question is about the new CEO appointment. We are getting pretty close to him starting, and as a result, the question I have is have you discussed already, to some degree, how you feel about 2020, the probability or so of making greater investments in research and development and also in selling. Is that now looking increasingly likely as we move towards the commencement date of the new CEO? And then secondly, on the portfolio. Can you provide an update where you stand with respect to the SKU rationalisation, meaning how much organic growth have we lost in the second quarter and how much growth do you think could be impacted also in 2020? And then also on the portfolio CCC. Any updates as to whether we will see a divestiture by the second half of this year?

Rick Anderson: So Michael, Karim starts at the end of September. So just to take it back just a little bit back to what we said in February, which was that we sort of ran a not normal recruiting process. As part of the recruiting effort, Karim had line of sight to the same raw data that Frank and I saw for part of my assessment, and we had shared that with him for a very specific reason.

We want to get his insight and his view as part of the interview process, about what he would think about what we should do about that. And specifically what came out of this is the transformation. So as you know, we are investing heavily in our transformation effort at the $150 million, $40 million of it this year and the rest of them in next two years. And those investments are targeted very much to selling and distribution, to R&D, how are we going to do that.

I will tell you that, Karim, the time that I have spent with him, he is passionate about the portfolio, about the products that we will put in the portfolio, specifically in the area of R&D. And I will leave that to him to talk about when he gets here. But he is very passionate about that. And I think that on the sales and marketing area, he and I have had detailed discussions specifically about in the markets where we choose to play, the segmentation that we have talked about as part of transformation that we will not be outmanned, not outgunned in those marketplaces where we choose to play and win. And that is a very much a segmented approach as we have described in the pivot to grow.

Frank Schulkes: On the portfolio, the SKU rationalisation diagnostic is ongoing. We have not cut SKUs in the first half. We have done a lot of analysis and we are getting closer. We also have to realise that at the end of every product, there is a patient, so you just cannot cut off the SKUs because you cannot leave a patient hanging out there. And therefore, you need to expect that whatever we are going to do in SKU rationalisation, the impact will be largely a 2020 type impact. And at this moment, I really cannot comment on the overall size on that.

Michael Jungling: And a question in relation to the portfolio for a divestiture?

Frank Schulkes: Well, basically a similar type of answer. We are doing the analytics, and we are not, at this moment, at a point to get into a decision mode.

Amy Walker (Peel Hunt): I have three questions, if I can. I might also do those with a break in between them, so you have to write them all down. But just, Rick, can I pick up on your answer to Michael about R&D? I mean, I accept that you do not want to steal Karim's thunder. But just in general terms, where do you see the big return on investment opportunities for R&D investment, because when we came into the IPO process, there have been a lot of hole plugging I think in Ostomy. There were obviously a lot of things on the launching pad in Advanced Wound Care. So where are the holes that you think you could get good returns on, please?

Rick Anderson: Let me break this down by franchise because I think it actually matters versus some sort of omnibus answer. And I will ask David to comment on Advanced Wound Care. In Advanced Wound Care, we think there is a tremendous opportunity given the sort of patient burden and the cost burden associated with that to sort of create a family of products that are smart devices that communicate with caregivers, etc. And I will let David talk about that in a minute. So I will come back to that.

In Ostomy, we are obviously investing in a new platform and that work is ongoing. In CCC, we have a tremendous opportunity with our next-generation catheters that are targeted to the $800 million European market where that is all blue ocean for us. So we are super excited about what that means for the business. The product is in our pilot market. It is going head-to-head with a market leader and doing quite well in the early stages of our pilot. So we are planning appropriately for that. So we are super excited about that. And we think that family of products will be different. We are all differentiated in the marketplace.

And then in ID, the question for us and the big question we face with our franchise is the growth outside of diabetes. And our teams have worked very hard. We are in the middle of launching new products that are targeted to pain, to epilepsy, to other diseases that use pump technology. And we think that is very, very promising. So we are investing heavily there as well.

So in the R&D portfolio, we have lots of opportunities to sort of filling up and our teams have identified clear opportunities. And David, maybe you want to talk about the Wound portfolio.

David Shepherd: Yes. I think in the short-term just looking in the technologies we have today and how we can leverage more of those, and we have some great platforms where we think we can do more that will give us a boost in the short-term. And then as Rick said, I think if you look at the world of wound care and the onset of small or digital technology, that is an area where we see great opportunity. It is a little too early to kind of say exactly where that will be. But that is the kind of the future strategy we say how will wound care take off in the future.

Amy Walker: And actually speaking up on maybe something that is a bit more trackable near-term. We have highlighted the 20% increase in core volumes. How should we think about what that translates into in terms of growth in the business? Is that 20% uplift already fully reflected in the 3.3% underlying growth we have seen, or is that a leading indicator for some follow-on growth? And what else beyond that 20%, how much more could you do? Could the 20% increase go to 50% just if you could quantify?

David Shepherd: So I think what we have been able to do is really two things. One is on the 20% is driving better efficiency with the base people that we have today, so the current sales team. So it is how do we make sure that they are effective in the right places, that they are familiar with their new territories based on the new structure? And I think it would be unreasonable to jump to the conclusion that that is driven the short-term growth because wound care is a slow mover. And so the work you are doing today manifests itself further down the line.

And then on top of that, we had the new sales team, the new sales force coming in. They joined in June, that I think will start to contribute and really start towards Q4 and then really give us the boost in 2020.

Amy Walker: So given the comps are not particularly demanding in the second half, 3.3% is a minimum that we should expect going forward?

David Shepherd: I would not want to jump to that conclusion. As Frank says, we have the quarterly swings. They comparators do vary and I think it is too early to call based on what we have seen that we could guarantee this. So we are positive about where we are, but I think we would not want to get carried away. We need to make sure that we bed down the execution and keep driving this forwards.

Frank Schulkes: Also have the impact of the French reimbursement in the second half. On top of that, I do not know if you follow the press, but the German Bundestag has basically taken decisions about silver reimbursement in Germany. That is still not 100% worked out at this moment. It is very complicated but it might go away. And therefore, that is probably going to be official next year but we already expect some behaviour in the markets with doctors that they are going to switch to other type of products, non-silver type products. So those are two impacts in the second half that will basically damp overall growth for the business in Wound specifically.

Rick Anderson: It is a little bit dangerous to draw a straight line because it is very early days in our execution model. We have seen the X's, the amount of activity that David described, putting firepower on the target. I am encouraged by that. But I would like to see the Y, the outcome associated with that, and it is just early to call that.

Amy Walker: For one last one, and then I will give out to somebody else. Just on the step-up in the H2 execution that was alluded to, there are a couple of specific projects mentioned from the first half, $2 million here, $2 million there. Are there two or three very significant big ticket initiatives that the big step-up is attached to, or some of these in the order of magnitude many, many, many single-digit million projects?

Rick Anderson: Let me just make a broad comment, then Frank gives some detail. Look, our Transformation Initiative, if you want to think about it on a Pareto basis of like programmes, it is more about a lot of small things versus betting the ranch on delivering on one or two big deliverable projects. That is not to say these are not meaningful projects. They are. But our strategy has been to go after the small things that make a big difference because if we can add the discipline associated with that. So that is a broad comment.

Frank Schulkes: Yeah. And in terms of types of projects, we, of course, already have the operational excellence in flight, so that will continue. And what you will see is more commercial type programmes starting to get into execution phase in the second half and that will continue into 2020. While business services transformation, a lot of activity is there, a lot of spend there, but that is further out where we will see the benefits. I do not think anything will happen there before the first half of 2020.

Paul Cuddon (Numis Securities): Two questions, really. You cited a major hospital win in the US Ostomy segment in kind of patient support that you are giving through HDG as well. So just wondering if you are set up for more of those types of wins integrating with HDG and Ostomy? And then just secondly, on the potential impact of MDR next year on your kind of base AQUACEL type portfolios. So now the ranges is a market leader. Do you think you would be a net beneficiary of higher regulatory standards?

Rick Anderson: So it is part of our strategy to go hunt for big game and the integrated delivery networks in the US is where that is, where you could have the opportunity to partner with that customer at a different level. We believe the HDG opportunity to provide world-class service to our customer, is a real opportunity inside of our Ostomy business in direct support of that, and they are a market leader in the US by any measure, whether it be by external measures, their service offerings. So we think that is fertile hunting ground for us to leverage that into the future. David, do you want to comment on –

David Shepherd: Yeah. I do not think we expect to see any major upsides in the short-term. I think most of ourselves and our competition are preparing for MDR. And so whilst maybe in the long-term, higher regulatory standards will help. I do not think we would see a short-term boost.

Christoph Gretzler (Credit Suisse): Most of my questions actually have already been asked now but maybe kind enough to come back on the R&D. And I noticed actually the adjusted costs were down year-over-year in the first half. Could you actually discuss where you see this R&D spend as a percent of sales in the medium to long-term because, I mean, at least from my point of view, it looks relatively low compared to your industry? So I was wondering if you could give some indication where you see this going in the medium-term.

Rick Anderson: With that, I will answer big picture. If you look at our investment in R&D, we think it is light as well. That is part of the transformation of our ability to redirect that. We have articulated that part of our funding strategy is not just transformation but it is also the reshaping of our P&L, where we move cost from G&A into R&D and sales and marketing. That process is in flight. We would like to see that number significantly higher. That is part of our planning going forward.

If you look at industry average for a company of our size, it is roughly between 3% and 4.5%, and our plans are to increase that in the future.

Frank Schulkes: Yeah. I would like to add as well that we have gone through some purging of R&D as well because there were too many little hobby projects going on, on the side. And for us, it is very important that we are focusing our R&D dollars and our R&D resources on the big projects that matter and that is where we are going through over the next couple of years, but that is one of the reasons. So we basically cut some R&D that we are going to redirect to bigger programmes going forward.

Rick Anderson: I will just make one comment and just ask David to comment. Part of the Transformation office's responsibility is this detailed tracking in the investments we are making and the rigor associated with that and the discipline that one goes into that. David, maybe you can just talk about your portfolio?

David Shepherd: Yeah. As a franchise, it is always great to have more money going into R&D. But I think what that Transformation Initiative is doing for us is driving better efficiency of the money we already have. And so as Rick says, the rigor and execution that the TI is bringing is putting all our current R&D projects to a much more accelerated process and I think that will help us on top of putting more money into the bank as well.

Christoph Gretzler: Okay. That is very helpful. And then maybe now that I have you, basically could you discuss broader the price dynamics? Actually, particularly in the Ostomy and the Wound Care markets at the moment and I mean I noticed from some of your comments that basically you see kind of particularly also negative mix effect. Maybe could you discuss on that topic?

Frank Schulkes: Yeah. So price in Wound. I already mentioned that we will experience a reimbursement cut in France, which is in line with plan. It is just a little more compressed. So I think the overall impact for us will be something like 3.5% cut on Wound prices in France. We see in some other markets, Portugal, Poland, also some price pressure, and we talked of course about the UK market, where there is continuous price pressure.

However, all of these price pressures are factored in, in our overall 1% to 1.5% of price reduction that we see every year, which is about a 40 basis point impact on our gross margin rate. So nothing really out of the ordinary.

There are certain markets that will go through a reimbursement one year and then you will not see anything for a couple of years and the other markets will go. So it all is captured within that 1% to 1.5%. Within Ostomy, we see a lot less price erosion. So the majority of the price erosion is typically in the Wound markets and a lot less. There is a little bit of Ostomy price erosion in France as well as part of the exercise that the government went through in the last six months or so. And I think that Ostomy decrease is, what is it, John, 4% to 5% or-so. But it is, for us, a very small impact because Ostomy in France is not a very big business.

Christoph Gretzler: Very helpful. Have a great day.

Hassan Al-Wakeel (Barclays): I have got three, please. And if we can go through them in turn. Firstly, could you please comment on the recent launches in Continence from Hollister, which looked to be contributing to the strong growth at the company? Given Hollister and Coloplast are firing on all cylinders here, what gives you confidence of ramping this business in Europe, and how should we expect the scaling as your female catheter launch going forward?

Rick Anderson: I will take that one. So first of all, we should take it back to why we are excited. First of all, we think this is a terrific marketplace in general, and specifically in Europe, given our position today in the marketplace, which is very nominal, this is all blue ocean for us. We think there is plenty of room for competition. We like the way our product is differentiated in the marketplace in head-to-head sort of settings.

We have run a very detailed and thoughtful pilot programme. And to be candid, given our track record of execution the way that we have launched products, Frank and I, we have made a decision that this will be a very controlled way to come to market. We want to make sure that we understand the pilot. We ran our pilot. We have expanded our pilot. We have learned from that, and that will be applied in the launch planning as we go forward, as we compared to what I might describe as less than optimal planning for product launches in the past. So we are looking forward to entering that in that marketplace. We think there is plenty of room for growth for all involved.

Hassan Al-Wakeel: Great. And then secondly, could you please comment on your expectations for full year interest and earnings, please? I asked because your company combined consensus shows adjusted EBIT of $350 million for the full year and adjusted PBT is $319 million, implying interest of $31 million when I believe it should be higher. I appreciate that there are likely to be many adjustments in the mix. But could you please confirm if you are happy with consensus adjusted net income of $264 million given closer to $110 million in the first half?

Frank Schulkes: So let me correct that, indeed. We looked at the interest numbers, and I wish we could borrow at those type of rates that we find in consensus. I think that would be more than world-class. So those numbers are wrong. You can see that as well in our first half. We have about $31 million, $32 million of interest for first half. So you can basically double that for the year. So I think that needs to be corrected by some of the analysts in their models.

And furthermore, the other element of course, as part of this, is our adjusted book rate for tax, and we can confirm, as we said in February, that we expect that to be about 16.5%. So you can also update the models with that if you were not at that level. And that will then result into, I think, an earnings picture and that will be much close to reality.

Hassan Al-Wakeel: And so just to follow up on that, the earnings picture. I mean, are you happy with the $265 million, or do you think that the lower interest number should translate to a lower earnings number relative to that consensus number?

Frank Schulkes: Well, **a**s I said, I think the interest number is wrong. And we do not guide on that earnings. Our guidance is EBIT 18% to 20%. And we provide you some additional technical guidance here that the interest number is a couple of million lower than 2018. So you can do the math. And the adjusted book tax rate is 16.5%. And that is sort of where I want to keep it and leave it.

Hassan Al-Wakeel: That is very helpful. Thank you, Frank. And then finally, if you could just elaborate on US Ostomy following your efforts to flatten the organisation and segment the market here, and really whether we should expect any meaningful improvements here ahead of the new platform launch 12 to 18 months away?

Rick Anderson: So in Ostomy, the good and the bad news about this business, it moves in a glacial pace. But we have executed the same tactics that David has described in the Advanced Wound Care business and the Ostomy business as well. Where do we go, who we are calling on, how often we see them, what are we saying to them. And our newer offerings are doing quite well in the marketplace in the US. Specifically, outside of the US, we are seeing good steady growth in targeted markets, where we are targeting our resources and our firepower.

So we think we will see sort of steady improvement in our Ostomy business. But I will just put it into context, we are not calling out, nor are we expecting, any type of change and sort of extraordinary growth profile. So you can expect that we will continue steady and that is our expectation for the business.

Patrick Wood (Bank of America Merrill Lynch): Just one from me. When you are thinking of the return structure – and Hassan kind of touched on it. But the return structure from the OpEx programme, you have got most of your competitors putting extra money in R&D. Smith & Nephew is doing that, BD, Hollister. Most people are investing at this stage. When you are thinking of the returns in those programmes, did you factor and then think how did you think about the competitive landscape? Is it this category growth for everyone can accelerate or do you assume that there is a net loser out there?

Rick Anderson: Well, first of all, if you look at our markets growing, if you blend it, right, across and you have to look at it by segment, if you look at it on a blended basis, the markets are growing 4 to 5%, so these are good markets, structurally sound. And there are issues in places UK Wound, that there is things moving around. But the truth is we are in very good markets. So there is plenty of room for that. As part of our analysis, we did look competitively of who is investing in what. And that is not to say that we are interested in getting in an arms race with anybody associated with investment, associated with either sales and marketing and/or R&D.

I think our focus has been on fixing our house and doing that and doing that extremely well as compared to trying to figure out how to put forward-invest against our competition. And we have plenty of opportunity to be able to do that.

Frank Schulkes: Yeah, I can add as well. If you look at our OpEx profile as a percentage of sales, we are way too heavy in G&A. And part of the Transformation Initiatives are focused on moving cost down in the enabling functions and reinvesting that in sales and marketing and R&D. So therefore, you will see our G&A moving to single digits, while we are going to see our sales and marketing moving from the lower 20s to the higher 20s. And that is how you have to think about. So there is a sort of a self-funding going on over the next several years.

Kit Lee (Jefferies): Two questions from me, please. I guess firstly, just to come back on product launches. How should we think about the impact for the second half? Are you still going to be in limited market release or should I expect a slightly more meaningful impact from, for example, over the next-gen catheter launched in Europe? And the second question is on the Ostomy Care business. Can you just remind us of the GPO renewal contract term line? When is Premier going to decide on the next round? And what is your stance on that? And can you say the same for the other two contracts as well, please?

Rick Anderson: So on the product launches, I do not think we are going to share the exact timing of our product launches. But in the second half of this year, we have products in the Advanced Wound Care, as well as in the CCC that will be entering the marketplace. So without getting into the exact timing, it will be in the sort of early stages of launches.

So on a material bases, I would not look at that as some kind of catalyst or some kind of just allows us to enter into, continue to build our businesses on a normal course.

As it relates to Ostomy and Premier, that contract is coming up right after the end of the year in the first quarter. We have been in discussions with them. Our view on the US GPO marketplace is that it is an important license to hunt in the US marketplace to be on contract. We have seen from our competitors who are not on contract, they have had just as much success contracting directly with IDNs. We have an entire effort in the US focused on the IDNs as well. And we think that is very fruitful for our business to be closer to our end-use customer and we have our teams deployed to be able to do that.

What I think that translates to is that there is less dependence from our perspective on the GPO contracts overall, and specifically the fees that we pay to GPOs and the benefit that we get, we are taking a really hard look at that.

Nils Leth (Carnegie): My first question would be about the US hospital contract when you announced. It this a sole source contract, or is it a dual source contract? And could you also inform us, which company used to have this contract? Secondly, when it comes to your testing of your next-generation catheter, could you elaborate on some of the aspects of this testing? So where is it that you actually see a positive feedback when it comes to the use of your new catheter?

Rick Anderson: I will take the dual source contract. Just specifically, Nils, you are asking about the Ostomy contract, correct?

Nils Leth: That is right.

Rick Anderson: Good. And then Frank, I will ask you to speak about the catheter. So dual source. Without getting into who the customer it is, etc, it is a dual source contract between us and one of our competitors to support that customer. Like most contracts in the Ostomy world, most of them dual or triple-source, because we still have physician and caregiver preferences.

We think that is actually the trend in the marketplace, which is that we are going to see the less, sort of dual source, probably the three of us will be on contract in those markets. It is just sort of a trend in contracting that we see. And then secondarily, the base of the competition that will be both product and service. And that is why we believe our HDG capabilities adds tremendous value to the discussion that we are having with our IDN customers.

We hope that we can build upon that going forward both in the second half and also into 2020 and beyond. So that is on the Ostomy piece.

If I understand your next-generation catheter business, you are asking us for sort of general feedback on the pilot. Is that correct, Nils?

Nils Leth: Yes, that is correct.

Frank Schulkes: We basically are doing these pilots in one big European market. And the pilot is as follows. We have the product in patients. In some cases, it is new patients. In other cases, it is patients who are using competitors' products. And we are gathering feedback and input from those patients about the different characteristics of the product and the usage of the products. We have received feedback, and as Rick mentioned, this was very positive feedback we have received. But it is a pilot. So every time we receive feedback, we go back, work with the R&D team, if necessary, and make some changes, and we are going through a very thorough process here before we are going for commercial launch. And as part of that, we are ramping up the sales force. When we get the green light, we will be ready to roll.

Nils Leth: And just a follow-up question from the US hospital contract. Was this contract at sole source contract before you entered the contract?

John Crosse: I think the question was the dual source contract we have in the US on Ostomy, was that a single source before we came on board or –

Rick Anderson: It was a dual source contract, and this is new for us. This is new for us.

John Crosse: Okay. Thanks Nil. Thanks everyone. I think we will bring it to a close there. Thank you for coming. As ever, myself and Mark and the IR team will obviously be happy to take any other questions you have. But have a good morning. Thanks very much.

[END OF TRANSCRIPT]