ConvaTec Q1 Trading Update for the Three Months Ended 31 March 2021

Thursday, 29th April 2021

Transcript produced by Global Lingo
London - 020 7870 7100
www.global-lingo.com

Opening Remarks

Frank Schulkes

Chief Financial Officer, ConvaTec

Welcome

Good morning, everyone, and thanks for joining us today. It is a busy morning of reporting, so I will make a few opening remarks and then we can open it up for questions.

Cure Medical Acquisition

As well as delivering a strong performance during the first quarter, we continued to make good progress with our strategy as we pivot to sustainable and profitable growth, most notably with the acquisition of Cure Medical. The business, which is based in California, develops, manufacturers and distributes intermittent catheters. And consistent with the Focus and Innovate pillars of our strategy, we are investing in the United States, as well as enhancing our portfolio in one of our key categories.

This acquisition strengthens our position as a leading manufacturer of Continence Care products in the US. In addition, Cure has established relationships with a large number of partners beyond those already served by ConvaTec's Continence Care team.

Cure's portfolio of products is complementary to our proprietary and differentiated Hydrophilic GentleCath portfolio, and together, we can offer a comprehensive range of products and services to better serve the broad range of needs for patients and caregivers. Cure is being integrated into our Continence business led by Kjersti, and the Cure and ConvaTec Continence salesforces are beginning to market the combined portfolios to US partners and clinicians.

First Quarter Financials

Moving to the first quarter financials. Revenues rose 5.4% on a constant currency basis during the quarter. If we remove the $1.3 million of incremental revenues from Cure during the period and adjust for the disposal of the US Skincare business, which last year contributed to $6.8 million in the first quarter, then revenues rose 6.7% on an organic basis. We are pleased with this strong performance.

Now some of this is driven by phasing and weaker comparatives in certain places. So, let me try to help you unpack it slightly.

Advanced Wound Care

Starting with Advanced Wound Care. We saw particularly strong growth in the Wound business with revenues up 9.4% after adjusting for the Skincare disposal. This was primarily driven by a very strong performance in the global emerging markets and strong growth in Europe, both regions which had experienced some headwinds last year.

By contrast, we have seen some continued softness in North America, although the comparative was somewhat tougher given the stocking activity we saw in the US in Q1 last year. Elective procedures during the period remained below pre-COVID levels, although encouragingly we saw volumes of surgical cover dressings begin to improve in March.

If we adjust for the comparatives and one-offs during the period, notably phasing, we estimate that growth on an underlying basis was consistent with the market. Although slower than the headline organic figure, it is nevertheless a good performance with very good growth in Asia and Latin America and improvements in the US and Europe.

Looking forward, however, uncertainty around COVID persists. It is not yet clear how the developing third wave, particularly in the global emerging markets, will impact the business. We have already seen recent lockdowns starting to impact access to the hospital setting.

There are also questions over the timeframe for normalisation, given the variation in vaccination programmes, coupled with the advent of new variants of the virus. Near-term, however, we expect an even stronger headline growth figure in the second quarter, given we are lapping easy comparatives. As you will remember last year, we were down 13% in the second quarter as COVID took hold in all parts of the world.

Our second half growth expectations are much more moderate, given their comparative figure and the ongoing certainty. We expect to be able to provide better insight at the half year.

Ostomy Care

Moving on to Ostomy Care. As indicated at the full year results in March, we made a solid start to year in the Ostomy Care business and delivered 3% organic growth in Q1. This was in spite of a tough comparative. If you remember, last year we saw significant stocking activity. The growth this year was primarily driven by the global emerging markets and supported by modest growth in North America.

In Europe, meanwhile, we continued to experience some softness. And some of the growth in Ostomy Care related to phasing of orders and tenders. And on an underlying basis, we think growth was within the low-single digits.

Looking forward, the second quarter will also be reasonably robust against a soft comps as in Q2 last year, we had begun to see some of the inventory unwind.

Continence and Critical Care

And Continence and Critical Care revenues increased by 5.6% on a constant currency basis. And if we remove Cure Medical, the revenues rose 4.5% on an organic basis. This was driven by continued strong demand for Critical Care products in January. And overall, Critical Care grew 7.5% during the quarter, although it is worth noting that in the later part of the quarter we saw the business began to decline year-over-year. And this was anticipated as 2020 was inflated by COVID-driven incremental demand and we expect things to normalise in our key markets.

The Continence Care business showed more moderate growth, which was largely anticipated given the first quarter last year had benefited from some stocking. And we are now beginning to see the impact of the lower new patient starts across the segment during the pandemic.

Looking forward, we do expect Critical Care to continue to decline, while, as previously indicated, Continence Care will be growing at a slightly slower pace than last year.

Infusion Care

Infusion Care continued to grow strongly, up 11.7% on an organic basis. This is primarily driven by the continued strong demand for innovative infusion sets for diabetes patients, coupled with some stocking. We also saw a good growth in our non-diabetes business, albeit, of a small base.

I am pleased that earlier this month, Medtronic announced the launch in selected European markets of our new proprietary and differentiated extended-wear infusion set, which can last up to seven days.

Looking forward, we expect a slowdown in overall infusion care growth from here, given the particularly tough comparatives in the second half.

Outlook

I have given you a sense of expected phasing for the remainder of the year. At the Group level, given the ongoing macro uncertainty and the declines being seen in Critical Care, coupled with relatively tougher comparatives in the second half, our guidance remains unchanged with organic revenue growth of 3-4.5% and EBIT margins on a constant currency basis to be between 18% and 19.5%.

Given currency movements so far this year, it is worth noting that we are currently facing into an FX margin headwind of about 80 basis points compared to last year.

My comments have hopefully addressed a number of questions, but we will now open it up to Q&A. And given it is a busy morning for reporting, I ask that each person only ask one question. Thank you very much.

Q&A

Amy Walker (Peel Hunt): Morning, great quarter. Frank, could you just quantify for us in USD terms, please, the benefit from the phasing in the first quarter in Wound and in Ostomy? And then I think you also mentioned stocking in Infusion Care. That would be helpful.

Frank Schulkes: Yeah. Well, if you just look at the overall growth number, for instance, in wound business, just over 9%, we think that we grew in line with the markets, which means 4%, probably a little better than that. So, you are really talking about 450-500 basis points. And, of course, that is a function of some destocking that happened last year, which made the comp easier and some stocking this year. And that is probably a 50-50 split for the Wound business.

Ostomy Care last year, we saw, of course, the stocking happening, which was largely COVID-driven, which helped last year's growth rate. On top of, of course, we had the rebate benefit last year but you have to discount that because that was a 2019 event. And we saw an impact that was slightly higher and was a combination of stocking but also some phasing. We saw some tenders, for instance, in Russia and in Latin America that happened the last year in the second quarter, were now happening in the first quarter. Overall, that impact net-net was smaller because we think that the underlying growth rate of Ostomy Care is low single digit. So just below the 3%, but not massively below the 3%. So therefore, the impact net-net is pretty minimal.

And then finally, in the Infusion Care business. I think the Infusion Care business, you will see growth rates move a little bit quarter-to-quarter, given the patterns from last year. And you have to think about this business that over the long-term, this business clearly has the capacity to grow higher single digit on a sustainable basis. But there will be some movements between the different quarters and you can expect, for instance, in the second quarter that the business will not grow at a double-digit rate and will be below that.

And that is just the movement of certain order patterns. So that is how we have to think about the movements between the different quarters and stocking and destocking activity. I hope that helps.

Amy Walker: It does, thank you.

Patrick Wood (Bank of America): Interesting question. I guess, on Cure Medical, I am just curious, how much does the product platform overlap with you guys? And therefore, is this acquisition is little bit more about getting those relationships that you did not have before? Or is it really also that the products do not overlap much and you have got complementarity there? Just help me understand a bit more about the split there. Thanks.

Frank Schulkes: Yes, a couple of things here. Indeed, first and foremost, of course, if you think about our strategy, focus on investing in four key categories, Continence being one of them. And then, of course, focus and invest in our key markets of which the US is a priority market. So, first of all, it is hitting the sweet spot there.

Second, there is indeed good product alignment, very complementary portfolios. And that will allow us to really respond to a broad range of needs. And Cure has, in fact, a very interesting strong track record of constant and consistent product enhancement, which fill product gaps in the GentleCath range while, of course, GentleCath continues to meet the need for the Hydrophilic end of the range with our FeelClean Technology.

So, there is a good complementary portfolio. On top of that, as you mentioned, indeed, Cure has an extensive network of partners in the US, DMEs, so that gives us terrific access to that. And therefore, we see a clear opportunity to leverage both salesforces with the Cure salesforces, adding the GentleCath products and vice versa. So, it is a combination of it.

Paul Cuddon (Numis Securities): Just one really on emerging markets. You have called out the strong performance in Wound Care and in Ostomy. And to what extent does this reflect some of your transformation investments over the years? Or do we have that to come? Thank you.

Frank Schulkes: So, if you look at the emerging markets, a couple of years ago, we made a leadership change there. And since then, this new leadership has brought in new leadership, specifically in the Asia Pacific region. In Latin America, we already had a very strong performing team. So, with that new team, the focus really has been to work on the commercial execution, to focus on driving in-market demand, to up the game and create really a professional education capability in the region with the caregivers, the nurses, the docs. And if you add it all up, it really starts to pay off.

So, we start to see the returns of that improved commercial execution with that new leadership and that focus on in-market demand. And we have seen that clearly in Q1. And it has been broad-based, so Latin America as well as Asia-Pacific in Wound as well as in Ostomy Care.

Now, at the same time, I have been clear, there has been some phasing in the first quarter because there were some tenders that normally were coming in the second quarter, were pulled into the first quarter. Nevertheless, that does not take away that execution is improving and we are really very pleased with the progress we are making in the emerging markets.

Hassan Al-Wakeel (Barclays): My question is on the back of a really strong quarter, you have obviously maintained guidance despite comps getting easier throughout the year. Is the top end of the guidance range more likely now on growth, but also margins, given some operational leverage that you might enjoy throughout the year? Thank you.

Frank Schulkes: Yeah. Well, first of all, it is very early in the year, so it feels premature to really start talking about moving guidance at this stage, to be honest. And as I said, there is a lot of uncertainty around COVID with new waves popping up. Parts of the emerging markets are worsening, devastating what is happening in India. Tokyo is in lockdown. We see similar things happening in Latin America, Brazil. And also we see in certain European country, in fact, access is going down.

So, with that uncertainty and that it is very early in the year, it is just too premature to talk about guidance. And if you look at the difference business units, the Critical Care business will decline in the second half and we have seen a positive in the first quarter. On the Infusion Care, the comps will get tougher in the second half versus the first half. And the Wound business enjoyed easier comps in the first half than we will see in the second half.

So, if you combine all of that, again, it is too premature, and we will know more at the half year.

Then second part of the question was around margins. Of course, there are lot of variables at play when we talk about margins - think about price mix and inflation, cost and so on. But, if we grow faster, typically that helps operating leverage. It also depends a little bit where the growth is coming from. Of course that is the mix element.

But on top of that, we intend to keep on investing in the business. So, my point is it helps for sure but it is not just the simple, one-dimensional equation.

Michael Jüngling (Morgan Stanley): I have a question in relation to GPOs. How do you feel GPOs will be impacting your business for the rest of the year? And part of this question is also how you feel about the upcoming tender of a large GPO in the US? And whether that is something that is currently preventing you from perhaps giving you a little bit more room for upping your guidance for this year?

Frank Schulkes: Yeah. So, I do not think there is going to be any material impacts related to GPOs in 2021. Of course, we have seen the Visiant GPO dynamic will not surprisingly move to multisource. Again, we do not expect any real impact, positive or negative, in 2021 related to any of the GPO dynamics.

Michael Jüngling: Okay. And is that impacting your guidance in any way, shape or form?

Frank Schulkes: No, nothing related to that.

Veronika Dubajova (Goldman Sachs): Wound Care momentum seems to have improved quite substantially I think versus what we have seen historically. And I guess you have had a couple of competitive launches against you in historical segments, where you have been strong. Just trying to understand a little bit what you are seeing in the market and what is driving that improvement. And is it really just emerging markets? Is there something happening in the portfolio? If you can talk to that, that would be helpful.

Frank Schulkes: Yeah. Well, indeed, Q1 of course had quite some puts and takes with some destocking last year, and stocking and public spending this year. But if you look at the notch up was really driven by the emerging markets. And then just coming back to why that was, we just see better commercial execution and a clear example was the emerging markets.

We are also seeing improved execution in Europe and the US, but we are not where we want to be yet. So, it starts to improve. We start to see some stabilisation of shares, but I would say that will take still some time. So give us through 2021. And at this moment, this part of the year, it was really driven by the emerging markets.

Christian Glennie (Stifel): Just to follow up on the elective piece to your commentary there. Some peers have reported a bit more of encouraging recovery in terms of elective. Electives through Q1 helped them. Just to understand a bit more whether there was any element or contribution in that return in Q1, or it was only towards the end of the quarter, and what your expectations are therefore in terms of recovery through the rest of the year.

Frank Schulkes: Yeah. So, first, indeed, electives has seen quite a rollercoaster ride; in the second quarter last year a complete deep dive and a very fast recovery in Q3, and a plateauing in Q4. We saw early in Q1, in fact, dipping it again a little bit versus Q4 and then only towards the end of the quarter we saw the electives and the associated surgical segment slightly improve.

So, at this moment, our view is that electives are still below pre-COVID levels, but we expect electives to improve throughout the year. How fast is tough at this moment to say. I think there is quite some variation in the different reports. I think we all agree that it is still below pre-COVID levels and we also agree that it will improve. How fast is a little bit the question here and we are watching that. But we have seen towards the end an improvement versus the prior quarters.

Odysseas Manesiotis (Berenberg): I wanted to ask on Germany, the reimbursement cuts for Wound antimicrobials. We have not seen much here since you first started talking about this. Have the regulatory discussions died off, or is it a pandemic-related delay? And a very quick on Ostomy, if you are happy to share, of course. Good to see HSG franchise having an impact here, could you essentially quantify this for us? Thanks very much.

Frank Schulkes: Okay. So, on German reimbursement, basically we are in a waiting mode here, so there has been a consultation. The implementation in October 2021 could still be pushed out. And to be honest, it is a little bit radio silence. The appeal is ongoing. And I really do not have a further update at this moment. So, we are in waiting mode from that point of view while the process keeps on going.

On Ostomy Care, I can say that if you look at the strategy that we are executing on Ostomy Care around commercial execution, of course, on the leadership side, the segmentation. And a third element is really team selling. And a big important part of that is the collaboration between our HSD business and the Ostomy Care business. And I really do not want to give you any quantification but we are very pleased with the progress that both teams are making.

And it is off of a small base that we see a very good growth coming through that team-selling combination. So again, it is relatively small but it looks positive and we are very pleased with the progress.

David Adlington (JP Morgan): Just a question on Continence Care. You have pulled out the impact of lower new patient starts, I think that is mostly through last year. But are you able to quantify that impact? And are you seeing patient starts start to improve again?

Frank Schulkes: Yeah. So, indeed, the new patient starts during COVID has been going slightly down and you get a little bit of a delayed response because early on, the impact on revenue is negligible. It is rounding. But over time it starts to build. That is why we have seen some of that in the first quarter.

I would say we have seen the business grow 3% to 4%; in the past, it was more like 4% to 5%. So there was an impact. On top of that, there was also a tough comp. So to point exactly how much the impact was, I would say, it is less than 100 basis points. But the more important thing is this is a temporary event. We already have seen new patient starts starting to come back to pre-COVID levels, not exactly there yet, but that is going to happen within probably the first half of 2021.

And that means that after that dip in growth rates, we expect then towards the end of the year that things will start to normalise again. So it is a temporary event. It is very tough to pinpoint exactly a number to it. But it has impacted the first quarter. It will also impact the second quarter.

Charles Weston (RBC): What sort of adoption are you and Medtronic planning for with the new seven-day infusion set? And what is the impact for you on a volume price margin perspective?

Frank Schulkes: Well, first and foremost, of course, it is a truly innovative, differentiated product we brought to the market. And the first thing that I want to mention here is it is great for patients. Patients today will have to change their sets every three days. With the extended-wear infusion set, it can last up to seven days. So that is a very important part of us bringing this product to the markets, the patient's comfort.

How fast the pick-up will be, is very tough to assess. The launch first of all is only in a couple of selected European markets. And in the end it is up to Medtronic how fast and where they are going to launch and, of course, our growth rate will follow that. But given, it is great for patients, I think there will be a good uptake but it will of course start from a zero basis.

So, it will probably take some time. For me, very tough to say how big and how fast it will be. But for 2021 it is not going to be meaningful. And we will build from there.

From a margin point of view, I really cannot comment on that. It is in line with our overall margins. It is a different type of product and there will be less units but there is also different pricing associated. And so overall, it will not have negative impact and it might even have a little bit of a positive impact long-term.

Lisa Clive (Bernstein): Just a bit of a question on your wound management performance. Could you give us a bit of a breakdown in terms of the sales by region? What proportion of your sales are roughly in Europe, US, rest of world? And what were the different growth rates? And a longer term question, the US market is really underutilised as advanced Wound Care product. Could you just give us a comment on your views on the outlook for that market? And what is really needed, whether it is a lot more clinical data or something else to help drive further penetration in that market.

Frank Schulkes: Okay. So first, if you look at the overall distribution, probably the US is around 25-30% of our business in terms of Wound, and then Europe is probably around half. And then the rest is the emerging markets. That is how you will have to think about it. So, overall, Europe 50%, US 25-30% and the rest in the emerging markets.

Overall, growth rates for Wound in the segment that are addressable segments, probably around 4% with stronger growth in the emerging markets and more moderate growth in Europe and the US.

Second question was you said US is under-penetrated. Is that what you said?

Lisa Clive: Yeah. That is my understanding. And especially, if you look at the revenue distribution from the likes of you and Smith & Nephew, the sales coming out of US are just a lot lower than you would expect, given the size of the market. So, it just seems like oddly in the US, there is a lot gauze and iodine being used instead of proper advanced wound-care products.

Frank Schulkes: Well, I really cannot comment too much on that.

Lisa Clive: Or am I wrong on that?

Frank Schulkes: Yeah. What I can tell you though is that there are clearly differences between the two markets. The US markets, for instance, is much more a market for us that is focused on surgical COVID dressing. So, the percentage of surgical is much higher in the US than we, for instance, see outside of the US. So, there is a clear focus there. On top of that, the US market is basically very focused also on silver while in, for instance, in Europe, there is much more a mix. Certain countries do not have silver, like, for, instance France, or other countries have silver. So there is much more a mix. So I would not say it is under-penetrated. It is just a different distribution of types of products that are used.

Okay. Great. So thank you very much. I hope we were answering your questions and looking forward to our next update after first half results. Have a great day. Bye-bye.

[END OF TRANSCRIPT]