ConvaTec 2018 Interim Results

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Introduction

John Crosse

Vice President, Investor Relations, ConvaTec Group

Opening remarks

Good morning everybody. Welcome to our interim results presentation for 2018. I think most of you know me, but for those who do not, I am John Crosse, VP of Investor Relations.

This morning I am joined by Paul Moraviec, our Chief Executive and our CFO, Frank Schulkes. Paul is going to start by taking you through the key points of the first half and a franchise review, and then Frank will give you the financial update and then Paul will come back to conclude with a summary, and then of course we will be happy to take your questions.

Before I do hand over to Paul, just can I bring to your attention the forward-looking statements in our announcement this morning? Without further ado, Paul.

Operational Highlights

Paul Moraviec

Chief Executive, ConvaTec Group

Solid Group performance in H1

Thank you, John, and good morning everyone. In the first half of 2018, we delivered a solid performance. Our Group revenues were in line with expectations, we have made good operational progress across the Group, we have reduced backorders during the second quarter and they are now at normal levels, as we planned. Furthermore, we are making real progress with our cost-out programmes, which Frank will cover later. In terms of franchises, in Advanced Wound Care, our key growth drivers of AQUACEL Foam and our anti-biofilm technology, AQUACEL Ag+, delivered strongly. However, this momentum was offset by the performance of two of our older products: DuoDERM and base AQUACEL.

In Ostomy, we delivered ahead of our plans as we recovered momentum following the supply constraints of last year. And in the first half, we also delivered another strong performance from both CCC and Infusion Devices.

Turning to profitability, adjusted EBIT margin was in line with expectations, at 22.1% and we saw continued strong cash generation in the first half, with a further reduction in our leverage. Our guidance for the full year is confirmed.

H1 2018: Group key financial metrics

The key financial metrics for the first half are summarised on slide three. Revenue grew by 10.8% on a reported basis, 6.4% at constant currency, which includes contributions from Woodbury and J&R Medical. Revenue grew by 2.6% on an organic basis.

Adjusted gross margin declined 100 basis points. 30 basis points of this decline came from foreign exchange and 70 basis points came from operations, as we continue to work through the backorders from last year, along with stabilising and optimising our manufacturing operations.

We delivered our anticipated cost-out programmes. These were offset, as expected, by price mix, inflation and other costs. Adjusted EBIT margin, at 22.1%, declined 120 basis points year on year. However, as I said, that is in line with our expectations.

H1 2018: franchise summary

I will now move to our franchise revenue summary on slide four. Overall we grew at 2.6% on an organic basis in the first half, positioning us well for the guided full year. However, the mix is slightly different than we anticipated at the start of the year. Advanced Wound Care grew by 1% in the first half, reflecting headwinds which offset the strong growth from Foam and Silver. Ostomy Care declined 1% but with positive growth in Q2 and momentum returning quicker than we had anticipated. CCC grew by 5.7%, continuing the strong performance in Q1 and underlining the growing importance of this franchise, as well as the strength of our portfolio. In Infusion Devices, we grew at 9.2% in the first half, with lower growth in Q2, as expected.

Advanced Wound Care

I will now take each franchise in more detail, firstly Advanced Wound Care on slide five. Here we saw a mixed performance in Q2, so what happened? We did see some real positives. As I mentioned earlier, AQUACEL Foam and Silver performed well. These two categories are the strategic growth drivers in Wound; they make up over 50% of the franchise revenues, and we are pleased with this performance.

The third pillar of the growth strategy is Surgical Cover Dressing. Here, having resolved the supply issues, we have seen continuing improvements in performance. Finally, in terms of positives, we are very pleased to have received 510k approval for AQUACEL Ag Advantage. This is the brand name for our Ag+ anti-biofilm dressing in the US, which we expect will further accelerate our Silver growth in the US.

However, we encountered some headwinds. We experienced lower sales with certain of our older products. As you know, DuoDERM was affected by last year's supply constraints. It is a great brand, but last year we lost some business and some accounts. As we told you in Q1, it has taken us longer to recover than initially anticipated. We are now, however, starting to rebuild momentum. As we exited Q2, we have seen sales growth improving.

Our base AQUACEL business was impacted in Q2, primarily by softer market conditions and the competitive environment. However, we remain very clearly the market leader, with a stable market share position.

Finally, as we have mentioned before, our performance in the US post-acute channel continues to be a drag on growth.

What are we doing about this? Our priorities for H2 are very clear. Firstly, we will continue driving our growth platforms. We will continue to drive growth in AQUACEL Silver and Foam; we will also launch AQUACEL Advantage in the US. We will also continue our rollout, with our focus on driving account penetration; we are now building momentum and revenue is growing. Secondly, we are going to continue to win back Surgical Cover Dressing accounts and we are rolling out a national US Wound acceleration plan following a successful pilot. Thirdly, we will further stabilise base AQUACEL and consolidate the recovery we are starting to see in DuoDERM. We anticipate Wound performance will improve in the second half.

Ostomy Care

Let us move to Ostomy on page six. We continue to execute on our strategy to return the Ostomy franchise to consistent growth. Momentum is returning and we have driven a good performance in the second quarter, particularly in Latin America, Asia-Pacific and some European markets. As I mentioned, we made good progress on reducing backorders in the second quarter, which are now at normal levels. We saw continued momentum in our me+ direct-to-consumer programme. We gained good traction with our recent product launches: Esteem+ Flex Convex, which is performing better than plan, our Natura Convex Accordion Flange and EuroTec's Varimate strips, which we are rolling out across our footprint.

I am also delighted to announce that Stephan Bonnelycke has just started as our new Global President of Ostomy Care. He joins us from Hollister; he brings a deep knowledge of the sector and a track record of senior leadership at a global level.

For the second half, our focus will be on continuing to execute our Ostomy strategy. Driving momentum in the new products and in me+, we will maintain and build on the positive trends we are seeing in new patient capture in key markets. We will also further leverage our GPO and GHD contracts in key markets.

Continence & Critical Care

I will now move to Continence & Critical Care on page seven. Within CCC, our Home Distribution Group continues to perform very well. Organic revenue growth was 5.7% in the first half and that includes the planned product rationalisation which reduced revenue by $1 million. At constant exchange rates, revenues grew 23.4%, which reflected the contribution from Woodbury and J&R Medical.

GentleCath Glide continues to perform really well in the US, following its launch in early 2017. Woodbury and J&R have increased our growth momentum. Together with our other HDG companies, we have consolidated our position as the leading US distributor.

I should also mention that during scheduled testing of certain legacy Critical Care products manufactured in our Slovakia plant, we found an issue with some product packaging. To uphold our high standards of patient safety and care, we have decided to temporarily withdraw the affected products. We are now in a process of changing the packaging. This is not anticipated to be material to the group but it may have an impact on CCC growth in Q3.

Our focus on H2 is to continue to expand and innovate our GentleCath portfolio. We will continue to leverage the reach of our Home Distribution Group and recent acquisitions. We will continue to drive consumer engagement through our me+ direct-to-consumer programme and HGD referrals.

Infusion Devices

Finally, let us move to Infusion Devices on page eight. As we have seen in previous years, this franchise can be somewhat unpredictable due to customer inventory movements. 2018 is no different. We saw very strong orders in Q1. As a result, growth in the second quarter was lower, as expected. We also expect a lower growth in H2. For the full year, we expect to grow in line with the market at 4–5%.

In terms of new products, we are very excited about the positive feedback to the launch of MiniMed Mio Advance with Medtronic, one of the most successful we have ever had. We

continue to see good underlying demand in the insulin pump market. We also continue to develop opportunities for other subcutaneous indications with new partners.

In H2, we will focus on further expanding our strong and long-term partnerships with insulin pump manufacturers. We will also continue to develop innovative products for both insulin and other drug-delivery therapies.

Positive response to new products

I will give a few words on R&D and new product feedback on page nine. Our purpose at ConvaTec is to improve the lives of the people we touch. We are continuing to deliver innovation that is well received in the market and that really makes a difference to patients' lives. You can see a few examples of the very positive feedback we have received from both patients and clinicians on our recent product launches in this slide.

Looking forward, we have a healthy pipeline and we will continue to innovate across all of our franchises.

Video

Just before I hand over to Frank, we are going to show you a short video which gives you a good feel for the difference that our products can make.

[VIDEO]

This is the product that we have just got 510k approval for in the US. Let me hand over to Frank.

Financial Overview

Frank Schulkes

Chief Financial Officer, ConvaTec Group

Progress update

Thanks, Paul. Good morning. I have a couple of comments before we dive in. In February, I said that coming in as CFO I saw a business with strong fundamentals. That is still very much the case. At the same time, I mentioned there were some areas that needed improvement. I am pleased to say that we are making good progress addressing those, getting better operationally and building more muscle. In project management we have infused operations with new leadership and we have added capabilities specifically around operational excellence, driving lean manufacturing processes and cost-out projects. In business intelligence, we developed a clear strategy and delivered the global data warehouse which gives us the capability to get daily insight in sales to gross margin, starting in September. This is phase one of a multi-phase programme that will be delivered in the next 18–24 months.

Finally, we are making good progress in driving a cost-out culture at all levels. The teams have developed a strong funnel of cost-out projects in the following five categories: sourcing, supply chain, manufacturing excellence, footprint optimisation and simplification. We will apply stage gate management here: identifying new projects and pushing them through the stages of development, all the way to execution, resulting in the delivery of bottom-line benefits. The philosophy is that we generate a constant stream of projects. As we communicated before, we plan to discuss this in more detail later in the year.

Financial highlights

Let us turn to the financial highlights, where Paul said performance is in line with expectations. Revenues came in at $921 million, which is up 10.8%, reported. If you strip out foreign exchange, we grew 6.4% and stripping out the acquisitions we were up 2.6% organically. Adjusted gross margin came in at 59.3%. Operationally, we were down 70 basis points, so if you adjust for foreign exchange, the gross margin rate would have been 59.6%. OPEX came in at 37.2% for the first half, slightly higher than 2017 and we expect OPEX to be up 100–150 basis points for the year as a whole, as we continue to invest in go-to-market, R&D and the inclusion of acquisitions in line with what we said in February. Our adjusted EBIT was up 5.2%, and the EBIT rate came in at 22.1%. Adjusted for foreign exchange, this would have been 22.6%. We are confirming that we are on track to hit our adjusted EBIT rate guidance of 24–25% for the year. EPS was up, driven by a very strong 22% increase in net earnings. This was partially due to a significant reduction in foreign exchange charges following actions we took earlier this year to reduce our exposure to foreign exchange movements. Cash conversion remained strong, at 75%. Finally, we brought our leverage down to 2.8 times.

2017–H1 2018 revenue bridge

Revenue growth was 10.8% on a reported basis, with organic growth at 2.6%. Advanced Wound Care was slightly up, at 1% organic. Ostomy is seeing good recovery in the second quarter, coming in for the first half slightly negative, at –1%. CCC continues its strong run, growing 23.4% FX-adjusted and almost 6% organically. Finally, ID had a strong first half, coming in at 9.2% organic growth, in a good market, helped by easy comps. As Paul said, these will reverse in the second half.

The acquisition of Woodbury and J&R contributed $33 million in revenue. Foreign exchange provided a $37 million tailwind to the revenue line.

Gross margin overview – in line with plan

Gross margin came in at 59.3%, in line with our expectations. Excluding foreign exchange, this would have been 59.6%, which was 70 basis points operationally lower than 2017. On the right side you see the key gross margin drivers explaining the rate change. They are mostly in line with our overall plans for the year.

In the first half price was better than expectation and down less than 1% versus 2017, while mix was negative, driven by relative higher growth of lower-margin product. Cost-out projects are being executed as planned, delivering over $10 million in the first half. We plan to cover our cost-out programme later in the year so this is the only number you will get from me on this topic today.

As mentioned in my opening remarks, we have a strong funnel of projects that will continue to fuel good cost-out. However, this will not be a linear function. In some quarters it will deliver more and in some quarters it will deliver less, so there will be variation in the bottom-line contribution from these projects.

The cost-out benefits were offset by known inflation and headwinds. For instance, in the first half we saw the relatively high cost inventory which was produced in the fourth quarter of 2017. On top of that, freight costs were up and we occurred additional costs like maintenance and overtime largely as a result of activities to drive down our backorders.

Finally, we have labour and commodity price inflation, as well as higher depreciation, in line with what we said in February.

In the second half, we expect the cost reductions to outperform price and inflation as projects continue to deliver while headwinds will diminish.

OPEX Overview

Let us go onto our OPEX. OPEX, as a percentage of sales, came in just over 37%, slightly higher than 2017. In dollar terms, OPEX was up just over 6%, FX adjusted, largely driven by the inclusion of acquisitions. On top of that, we continue to invest in go-to-market in the US and targeted emerging markets like China, partially offset by reductions in indirect cost, as well as keeping support functions tight. Our R&D investment also increased. For total year we continue to expect to be between 100–150 basis points higher than 2017. Just as a reminder, we have sales seasonality in the business, which means that OPEX as a percentage of sales is typically lower in the second half than in the first half.

H1 2017–H1 2018 EBIT bridge

In terms of EBIT, let me walk you through the bridge, starting on the left. First half 2017 EBIT was $194 million. Volume and associated gross margin added $26 million, which was partially offset by OPEX investments. Foreign exchange translation was a modest tailwind of $4 million. That takes us to a total first half 2018 EBIT of $204 million, up 5.2%. Our EBIT rate was 22.1%, which would have been 22.6% adjusted for FX, as we took a foreign exchange translation hit of 50 basis points here.

On the right side you see the key drivers of the year-over-year EBIT rate development. For the full year the driver dynamics are very much in line with what we laid out in February. We saw some price erosion, mix a little worse than we expected, cost-out programmes delivering, partially offset by inflation, depreciation and other costs, with the OPEX percentage up versus 2017. We expect foreign exchange to be a negative on EBIT rate this year. That gives a total adjusted EBIT rate between 24–25%, confirming our full-year guidance.

Good cash conversion and strong balance sheet

Our cash conversion remained strong, at 75%, similar to 2017. We had capital expenditures of around $35 million and net working capital investment of $21 million. These were driven by some July shutdown and safety stock builds, as well as a pre-build for our AQUACEL Advantage launch in the US, as well as timing of cash receipts. We paid a total of $55 million in dividends so far this year. We made a small acquisition and we improved our leverage from 3 to 2.8.

2018 guidance confirmed

As Paul already mentioned, we confirm our guidance for 2018, with organic growth between 2.5–3% and adjusted EBIT rate between 24–25%. The assumptions we had for our 2018 guidance framework are very much intact. You can see that things are mostly unfolding as we planned and we are executing in line with what we said in February.

There are a couple of things to note. We see some softer markets in Wound, probably a little worse than we expected. Price erosion is largely in line, to a little better, than the 1% mark and our mix is now likely to be negative. Finally, it is too early to report an impact of our US Would acceleration programme but early signs are positive. In terms of the EBIT rate

assumptions, beyond price and mix productivity will be modest and OPEX will be up. Again, this confirms our total year guidance.

Thank you, and now back to Paul.

Summary and Outlook

Paul Moraviec

Chief Executive, ConvaTec Group

Summary

Thanks, Frank. Let me sum up the first half of 2018 and our goals for the second half, on slide 22.

Overall, we made solid progress across the Group. In Wound, we will continue to drive performance in our growth products: Foam, Silver, Surgical Cover Dressing and Avelle. We will also ensure that we consolidate the recovery in DuoDERM and stabilise base AQUACEL. In Ostomy, we will maintain the momentum that we have established in new products and direct-to-consumer. We will leverage HDG and GentleCath in our CCC business. In ID, we will continue to build ever-stronger relationships with insulin pump manufacturers and build new relationships with new and exciting subcutaneous applications.

I am pleased with operational progress. With backorders at normal levels, our focus now turns to optimising our manufacturing and cost-out programmes. Our full-year guidance is confirmed.

Now Frank and I will be very happy to take your questions.

Q&A

Ian Douglas-Pennant (UBS): First, if we just start on the Wound Care issues, could you talk about the geographical exposure of that? Is it entirely or partially UK-centric? Are you seeing any impact in the US in particular and Continental Europe, abnormal from normal trends, please?

Secondly, on margins: you gave some positive commentary on gross margins for this year. However, do you now feel comfortable restating the potential cost-saving target that you gave at IPO? I think you shied away from restating that last quarter. Could you give us an update on the long-term OPEX to sales ratio?

Paul Moraviec: From a geography point of view, a lot of the challenge we have seen, particularly from a market point of view, has been UK-based. We are actually seeing decent growth in some of the other markets around the world. The UK is very flat this year. I think that is true of a lot of medical device categories.

The only other market that I would probably call out is the US. Whilst it is still a good market and growing very strongly, you do have big distributors, like Medline, that are quite challenging from a low-cost product point of view.

Frank Schulkes: On the margin, as you know, we now guide to annual organic revenue and EBIT rates. We are targeting a lot of cost-out and we are going to update everybody later in the year on that. We have the good funnel but there are a lot of other variables between

revenue and EBIT that we don't control in the same way we control cost. We are not, therefore, planning to give a hard medium to long-term target for that. However, at the same time, as I said, we have a great funnel of cost-out opportunities that will drive very positive momentum in gross margin.

In terms of OPEX, as part of that overall framework from revenue to EBIT, we expect OPEX, as a percentage of sales, to go up, as we also said in February. It will go up in 2019. Medium to long-term it will flatten and then it will become also a source for EBIT rate expansion for a couple of reasons. We still have opportunities to take cost out of, for instance, our back office that we can then use to reinvest in the frontline, as well as in R&D. It is therefore sort of self-funded OPEX. Then, over time, with our revenue line expanding as well, OPEX should become also a source of EBIT rate expansion. If you add up these two on the medium to long-term, we expect a material opportunity for EBIT rate expansion. However, as I said in the start of the answer, we are not going to provide a hard target for that at this stage.

Ian Douglas-Pennant: One more: you have alluded to a Capital Markets Day several times. Can you just give us a rough timing on that?

Frank Schulkes: Sorry, can you repeat that?

Ian Douglas-Pennant: You have alluded to a Capital Markets Day a number of times today. Can you give us some rough timing on when to expect that?

Frank Schulkes: Yes, whether it is going to be a full-blown Capital Markets Day or something different we have not 100% decided yet. However, it is going to happen in the fourth quarter. That is what we, at least, plan.

Patrick Wood (Bank of America Merrill Lynch): Hi, just two from me if I can, please? One would be on the Ostomy side. Obviously, a bit better than I think most of us expected. What would you really put that down to? Would you say, outside of restocking, was it Convex more? Was it the accessories market? It is usually quite hard to turn that business around quickly but it was a bit of a better result, so it would be good to know on that side what you really feel drove that.

The other side would really be on the Would Care side. You obviously talked about the acceleration programme in the US. Could you maybe just give us a little bit more details in terms of what really that looks like on the ground, what you are actually putting in place to help drive that business? Also, how much of that softness in that market do you think comes from Medline and the others trying to sort of disintermediate the cheaper products? How are you addressing that? Thanks.

Paul Moraviec: From an Ostomy point of view, there are two drivers. Number one is new products. I would say that is the most important driver and the biggest driver. As you rightly point out, that is things like Convex and the Accordion Flange; accessories are also adding to that. Also, geographically, in places like LATAM and Asia-Pac, particularly China, we are seeing very good growth. We have a very strong team in both of those markets.

From a Wound point of view, with the US, this is a pretty comprehensive programme which we actually piloted. It consists of additional salespeople but a very detailed approach to segmentation and targeting, messaging and re-messaging on all of our products, basically, to

get the precision there. A lot of it is about sales force effectiveness, follow up and key metrics. It is the sort of classical sales-effectiveness type of programme that you would put together. Everything is built into that, basically, with the addition of additional salespeople to improve the performance in the US. We piloted it to find out what sort of response we could get to this. We saw the needle move and so that gave us a lot of confidence that we can invest, so we are investing pretty heavily behind this.

Patrick Wood: If I could just do one cheeky follow-up on that: for the typical Wound Care sales force, how much of their incentive structure is based around unit share? What are these guys typically focusing on in terms of how they get paid at the end of the year?

Paul Moraviec: I cannot get into detail on those things, naturally. However, at the end of the day, that whole incentive programme is designed around exactly what we want them to do. Examples of that could be the call rates, how good that targeting is, how many samples they are getting in, those types of things. There is no rocket science there but it is very well thought through.

Veronika Dubajova (Goldman Sachs): Thank you for taking my questions. The first one is actually on the CCC business. You continue to see very good momentum there, adding back the portfolio rationalisation you are growing in very healthy high single digits. I would love to get your colour on what is driving that, your degree of confidence in maintaining that momentum through the second half and maybe a comment on the Slovakia packaging issue, to what extent will that impact growth?

My second question is on Wound Care. Reading the press release this morning it sounds like you already saw improved momentum in the business in July. Maybe you can give us a sense for what that was, even if it is just qualitatively. How should we be thinking about the pace of growth as we move through the third and fourth quarter there? Thanks.

Paul Moraviec: On CCC, the growth comes predominantly out of the US at this point, with our HDG group. We continue to drive market share in the US marketplace; we continue to invest in that business. It is a great business and by adding the additional companies to that, it is becoming even stronger. I am absolutely delighted with the team that we have there and the integration that has taken place. It is really paying off from a top-line growth point of view. GentleCath Glide is also doing extremely well there.

The packaging side is relatively straightforward. During some scheduled testing, we had some failures. We have a fix in place already for this, so we are working through that at the moment. We have already tested more than 80% of the products that we needed to. The impact of that is therefore not going to be material and it is all built into our guidance, effectively.

On Advanced Wound Care, one of the things about this business is a shift of a couple of points of growth, quarter to quarter, in Wound can be $2–3 million, so it is not huge. Q2 was a weak quarter. However, in July we have seen good orders come through, particularly in our older products. It is therefore encouraging. I do not think it is going to change overnight. However, I think it will see a gradual increase as we go through the second half there.

Paul Cuddon (Numis Securities): Just continuing along the US distribution theme, to what extent is the EBIT margin impact a mix effect of US distribution versus targeted investments

in Ostomy and Wound Care? Secondly, can you quantify the backorder fulfilment in Ostomy benefit in Q2, please?

Frank Schulkes: I will take the mix one. Mix is a little bit more complicated than one business versus the other. For instance, there is mix between the different franchises because there is a difference in margin rate between the franchises. However, within the franchises we also have quite some mix; certain brands are higher margin than other brands. Then, on top of that, you basically have regional mix and you have even customer mix. We calculate the different angles and for the first half, as I said, the mix was a negative driver of gross margin rate.

Paul Moraviec: We estimate the impact is about $1.5 million.

Paul Cuddon: Just if I can continue on that mix impact, long term should we see an opportunity to flip out third-party products in the US distribution for Convatec products? What margin impact could that have?

Paul Moraviec: Maybe we can do a bit of both, actually. The answer is yes, particularly as we launch new catheters, the more advanced catheters that we will be looking at launching in Europe. Those obviously have a good place in the US as well. The answer is yes.

Frank Schulkes: We are not going to disclose the margin impact. However, it is pretty material if you move to your own products.

Amy Walker (Peel Hunt): Can you talk a little bit, Paul, about Avelle's contribution to Advanced Wound Care revenue? If you are not able to share the precise revenue number, can you say when you would expect the product to start to move the needle on the organic growth rate, perhaps?

Second, in Infusion Devices, is the second quarter growth rate a good run rate for the second half? I was just a bit unclear on whether you expected further sequential moderation in this division or if you think the Q2 level can be maintained? Thanks.

Paul Moraviec: From Avelle's point of view, we are still getting very good feedback from the market in terms of the key attributes of that product. These are things like the wound interface, which is AQUACEL, the flexible skews, and the longer life. That is going extremely well and we are continuing to improve that product as well, as we gain more experience in this segment that we have not been in before. The sales are ramping. I would say that they are a moderate contribution today: several millions. However, it has ramped up significantly from last year, and we expect that to contribute more in the second half and even more next year. I think the sort of improvements that we have been putting in place are going to accelerate that even more. We are very excited about Avelle, actually. I think the opportunities for that product are growing as well. That is a segment that I think will get bigger and bigger so it is going to be a key component of the drive as we go forward.

Frank Schulkes: Amy, On ID in the first half, we had a very easy comp. Last year, in fact, the growth was negative in the first half. That exactly flip-flopped. In the second half the growth last year was big double digit. You can expect for ID to come in for the full year in line with market, which is 4–5%. That means, if you do the maths, the second half could be flat to slightly negative.

Nick Keher (RBC): Hi, I just wanted to focus on the acquisitions you have made in the period and the benefit you have had. You had $33 million of revenue coming from the acquisitions. However, you have not split out, necessarily, the gross profit in terms of margin, if this is a drag or a benefit there, then also to EBIT as well? I am quite keen to understand if this actually was a drag on your business in the first half, in terms of the margin potential and if you can increase on it from there.

Frank Schulkes: We do not disclose that. You can, of course, imagine that a distribution business probably will be a little lower margin than a non-distribution business. However, we do not disclose the numbers.

Nick Keher: Is there potential for this to be reversed to more of a ConvaTec-like margin in time?

Frank Schulkes: As I said before, of course, if the share of ConvaTec products that we sell through that distribution channel goes up, there is an opportunity to improve gross margin in that distribution business.

Nick Keher: I just have a follow up on M&A, in terms of opportunities going forward. You have obviously been quite good at making a few bolt-on acquisitions to support growth. In terms of opportunities ahead, are you seeing a steady pipeline of activity coming up or anything to talk on there?

Paul Moraviec: I think there are still good opportunities. We have a team that maps everything out for us and there is quite a long list that they have. We have been very selective and we will continue to look for these bolt-ons, either product, critical mass in a certain market or, as most of them have been at the moment, forward integration. I think you can expect us to continue this trend going forward.

John Crosse: Just for a second I am going to go to the webcast and then the phones. I will then come back into the room and take some more questions.

On my screen here I have a couple of questions that have come in online. I am going to bucket the first two together because they are broadly touching on the same subject. 'Frank, you mentioned in your presentation some softness in general in EMEA Wound markets. What are the reasons for this, please?' The other question was, 'Can you comment on the competitive environment?' We will take those together, as one question. I do not know if, Frank, you want to take that or Paul.

Paul Moraviec: The softness is largely driven by low-cost competitors coming in. I think this is natural. As certain markets mature and patents expire, there are low-cost products that come which are not as good as the actual product but there will be a segment which will emerge. I think that is what we have found in the Wound business as well, which we think has actually plateaued off at a reasonably low level. However, they do come in and it forces the larger manufacturers, like us, to soften up some of the pricing. This has not been huge but it does soften up the pricing and it slows the market now.

I think the other thing is, in the UK as an example, the NHS is driving price down pretty hard. We have seen that right across all sectors, actually, in the medical device area.

John Crosse: The other question we have had online was asking for an update on our new next-gen catheter in terms of clinical features. Are you still expecting to launch that for late 2018?

Paul Moraviec: Yeah, the first of those products is actually finished. It will be going into patients in the next few months. It will then be launching soon after that.

John Crosse: Okay, thank you Paul.

Chris Gretler (Credit Suisse): I have actually two questions, the first with respect with mix. I am not sure I fully understood; could you elaborate a bit more on how mix effects your gross margin, in particular, for example, if you look at geographic mix and franchise mix? For example, I guess in the franchise, ID and CCC are lower gross margin and geographically, you had a softness, relatively speaking, in Europe. How should we think about how that affects the overall gross margin, so that we have a bit of a better understanding?

Frank Schulkes: As I said before, if you have differences in gross margin rates by franchise, or specific brands within a franchise and your higher-margin brand is, one period, growing relatively slow then of course that will have an impact on your gross margin. We look at that, we calculate that and we look at literally all the angles, as I said before: franchises, brands within franchises, as well as regional mix. In the end, you get a total impact for mix. There are therefore a lot of variables at play here. I am not going to give you any specifics, what our margins are by brand or by region, or by franchise. However, that is how we have to look at it.

Chris Gretler: Of course I can understand the mathematics. However, I was wondering more in the specifics because I am not sure we have any good understanding what growth rate in what division would drive your gross margin, actually.

Frank Schulkes: Yeah but we do not disclose those. That is why, I am afraid, I cannot give you any more details.

Chris Gretler: The second relates to Ostomy in the US: could you give us an update on how you are doing there? I thought that you had, obviously, some good traction in some of the European markets. However, you did not mention the US so maybe if could come back to that?

Paul Moraviec: The US business is still doing very well, particularly on our direct-to-consumer campaigns. I think the business, obviously, was impacted last year because of the supply constraints. Our growth there was impacted but we have seen it coming back now. I think what is important is we have not seen major impacts in terms of NPC and share. There has been a little impact, of course. However, I think the business has proven to be actually very resilient so I am actually pretty confident that business will come back pretty quickly.

Chris Gretler: Maybe just lastly on that, could you actually remind us on when the GPO contracts that affect you would come up for renewal, by chance?

Paul Moraviec: Yeah, we have Vizient and Premier that come up next year. As you can imagine, we are working hard on those. We have a competitive strategy. I would love to tell you all about it but obviously I cannot, just to say that I think that we are in good shape, from a GPO point of view. I think a lot of the conditions in which we were able to win them a

few years ago are still pretty much the case, particularly in terms of things like market share. I think we are comfortable that we are well positioned there.

Chris Gretler: Okay, thank you.

Yi-Dan Wang: I have three questions. First of all, on the management change for Ostomy, Paul, can you give us some sense on timing of when we could expect a new plan for the division and when we could see some improvements?

Paul Moraviec: I could not hear you, what was that, a new man?

Yi-Dan Wang (Deutsche Bank): A new plan for it. You have a new manager, I am sure he will have a new plan for the division. I would just like some sense of when we might see him finalise his plan and then, from then on, expect to see some improvement, hopefully?

Paul Moraviec: Sure, yeah.

Yi-Dan Wang: Then, secondly, a question to Frank. You commented on the margin opportunities, medium to long-term. What is your definition of medium to long-term and what do you expect margins to do while you are on your way to that medium to long-term ambition?

Thirdly, on the Wound Care business, can you give us some sense of how much of your revenues are from the base AQUACEL business and also DuoDERM? What has the organic growth been for the quarter? How do you expect those two to trend forward? Given that, for the base AQUACEL business, there is a lot of competition, I am somewhat curious on how you would stabilise that business. Some additional colour around those would be helpful.

Paul Moraviec: On the Ostomy, it is actually a good question because Stephan comes into this not as a very talented executive but from outside the industry; he is a very talented executive from within the industry. He has achieved some really big things within the Ostomy business that have made a big difference to Hollister. We are just starting off our strategic planning process. He will actually start adding value from day one in terms of working with our team to develop that competitive strategy. However, I think normally an executive would take 3–6 months before they are making an impact. I would think we are in that sort of timeframe before he knocks on my door and says, 'Hey, Paul, I want to talk to you about the Ostomy business.' I think that is that one.

I think, as far as Advanced Wound Care is concerned, the AQUACEL base is about 20% of our business and DuoDERM is about 13% of our Wound business. We do not disclose details in terms of growth by those areas. However, the way to think about it is that those were the areas where we had a soft performance. Obviously that was offset by the growth parts of our business. Think about the growth products being about 60% of the business and then those older products being around 40%. Growth is really growing very, very strongly and actually taking market share, then older products had a bit of a weak Q2.

Yi-Dan Wang: Then, for the management change, you mentioned great things that he has achieved. Can you give some examples of what he has actually achieved, or what he did achieve at Hollister?

Paul Moraviec: Okay.

Yi-Dan Wang: That would give us some confidence in what we hopefully might see at ConvaTec going forward.

Paul Moraviec: Yes. In terms of the older products, we would expect that to stabilise in the second half. We would expect that to come back.

As far as Stephan is concerned, one of the big changes that Hollister made in Europe was quite a comprehensive acquisition strategy, basically, on some of the big European markets. He was the head of that. He has also run their global marketing divisions; he has also run their UK business and also been active in their US business. He is a guy that has been around all the key markets and has put a lot of key strategies in place.

Frank Schulkes: Coming back to your second question: medium to long-term is 3–5 years. As I already said earlier on, I think the question came from Ian, the cost-out opportunity is very sizeable; it will have a very big impact on gross margin in a positive way. However, there are more variables between revenue and EBIT that we do not control in the same way we can control cost. Therefore, we are not giving out a hard target for the medium to long-term and EBIT rate.

In February 2019, you will get guidance on 2019 for revenue, organic growth and EBIT. That is basically our framework that we have discussed in February 2018.

Yi-Dan Wang: Should we expect the cost-out to largely offset, or to evenly offset, the additional investments you need to make?

Frank Schulkes: Again, later in the year we are going to talk in more detail what we are doing from a cost-out point of view. Of course, as part of that, we will also talk about the organisation, the operating mechanism, the capability to deliver, as well as the investments at a high level that we need to make to deliver those.

John Crosse: Thank you very much, everybody. As you know, Kirsty and I are here, obviously, to answer your questions in Investor Relations as well. However, thank you for coming and good morning.

Paul Moraviec: Thank you.

Frank Schulkes: Thank you.

[END OF TRANSCRIPT]