ConvaTec 2020 Interim Results & Update on Strategic Transformation

Thursday, 6th August 2020

Introduction

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Director of Investor Relations, ConvaTec

Good morning and welcome ConvaTec Group 2020 Interim Results presentation. My name is Mark Reynolds and I am the head of Investor Relations at ConvaTec. To begin I would like to draw your attention to the disclaimer on the first slide regarding the forward-looking nature of some of the commentary in today's presentation. I am joined on the call by Karim Bitar, our CEO and Frank Schulkes, our CFO who will provide strategic and financial updates.

Financial Review

Frank Schulkes

Chief Financial Officer, ConvaTec

Financial results – Solid first half performance

Good morning and thanks for joining us on the call today. Let me take you through our financial results in detail. Our performance in the first half of 2020 was solid with revenue growth and increased operating profit. Revenues came in at $908 million, increasing 2.1% on a reported basis. Taking out the negative impact of FX movements, constant currency revenue growth was 4.3%. We expect this to be at a reduced level in the second half, which I will explain later. Adjusted gross margin of 60% was 140 basis points higher than last year, including a 40 basis point tailwind from FX and another 40 basis point tailwind from the prior year rebate provision. Operationally, we achieved a 60 basis point increase year-on-year driven by net productivity gains, which were partially offset by some modest price and mix headwinds. I will provide further detail on this in a minute.

Our operating costs as a percentage of sales at 40% was flat year-on-year. As expected, there were higher levels of transformation cost as well as the costs associated with implementing the new Medical Device Regulation, which is MDR in short. However, this was offset by lower operating expenses driven by circumstances related to COVID-19 as well as cost management. The material part of this reduction is of a temporary nature. Again, I will provide you with more details on these elements in a minute.

As a result, our adjusted EBIT margin was 20%, up 140 basis points from last year and up 90 basis points in constant currency. We maintained our interim dividend of 1.7 cents per share and we continued to deliver robust cash flow with cash conversion of 73% versus 90% in 2019. As I mentioned at the full year results, we did expect cash conversion to reduce given last year's inventory reductions coupled with higher capex spend in 2020. Finally, net debt leverage in the business has continued to come down to 2.2x from 2.6x at the end of June last year.

H1 2020 revenue – Overall demand resilient but mixed

Overall demand although resilient in total, was a mixed picture. As communicated earlier in the year, Wound Care revenue growth was negatively impacted by both reduced elective surgeries and hospital and wound clinic visits, impacting both the surgical as well as the chronic segments. Ostomy Care growth remained low single digit with stock building in the first quarter partially offset by destocking in the second quarter. Continence & Critical Care as well as Infusion Care grew strongly. The former driven by elevated demand for critical care products as a result of COVID-19. Reported revenue increased 2.1% and 4.3% in constant currency. The FX headwind of $19 million or 220 basis points was a result of the US dollar strengthening against most currencies, most notably the euro, Brazilian real and the British pound.

AWC & OC – Impacted by reduced volumes and customer stocking activity

Turning to each of the business units, in Advanced Wound Care revenue declined 4.8% in constant currency in the first half of 2020 driven by a decline of 13.2% in the second quarter as expected. This was due to significantly lower surgical volumes but also by lower chronic volumes as hospital and wound clinic visits were significantly reduced due to COVID-19. The overall decline was broad-based and COVID-19-driven with North America, Europe and Asia Pacific within global emerging markets all declining. Latin America continued to deliver good growth, although COVID-19 cases have been growing there significantly recently. In terms of brands we continue to see good growth from our ACQUACEL Ag+ / AAA brand with our legacy products challenged. We estimate that Advanced Wound Care grew roughly in line with the first quarter, excluding the impact of COVID-19 and last year's rebate provision.

In Ostomy Care we grew 3.1% in constant currency in the first half of 2020 with a 2.7% decline in the second quarter. Growth in the first quarter benefitted from a weaker comparator because of last year's rebate provision, as well as inventory building, which partially reversed in the second quarter. Excluding these items, we estimate that the underlying growth was again low single-digit, consistent with recent quarters. We saw good growth in some key emerging markets such as China, Brazil and Colombia. In Europe, Central and Eastern Europe as well as Southern Europe continued to perform well, while we experienced very modest growth in the US. From a brand perspective, growth was driven by continued traction with our more recent Convex product launches, Esteem+ Flex and Natura Accordion.

CCC & IC – Robust growth, strong COVID-19 related demand for Critical Care

In CCC we grew 11.5% in constant currency in the first half of 2020 and 12% in the second quarter. With elevated levels of growth driven by strong COVID-19-related demand for critical care products. Continence care continues to grow mid-single digit driven by Home Services Group in the US with GentleCath Glide growing strongly. Infusion Care grew 12.6% in constant currency in both the first half and the second quarter due to a good performance in the growing insulin pump market in which we saw strong growth for our new Mio Advance infusion set.

Margin & Opex review – Continuing to invest in strategic transformation

Starting on the left with gross margin, the gross margin rate was 60% in the first half, up 140 basis points year-on-year. Versus the first half of 2019, we saw the positive impact from the prior year rebate provision of 40 basis points and also a 40 basis point tailwind from FX movements. Operationally, we came in 60 basis points higher than last year driven by net productivity gains and partially offset by a modest negative impact of price and mix. The operational excellence workstream delivered between $15 million and $20 million in gross project benefits in areas like procurement, waste reduction and better overall equipment effectiveness. This was partially offset by the usual headwinds of cost inflation, depreciation, implementation costs as well as some COVID-19-related expenses, which we will continue to incur in the second half.

Moving to opex on the right, our opex as a percentage of sales was flat versus 2019 at 40%. However, if you strip out non-recurring transformation investments and MDR costs, opex as a percentage of sales was 36.2% versus 38.3% in the prior year, down 210 basis points. The first half of 2020 also included a step-up in the recurring transformation investments of about $60 million versus last year. The underlying opex run rate was materially lower than 2019 and this was largely driven by COVID-19 circumstances, as well as cost management. We expect this temporary lower run rate to start reversing in the second half. For the second half we expect a step-up in recurring investments versus the first half but for the total year we estimate the recurring transformation investments to be between $50 million and $55 million versus the $60 million and $65 million that we estimated in February, as we are proactively rephasing some of our transformation projects.

In total in the first half we spent $43 million of non-recurring investments in transformation, of which $25 million was operational costs, mainly booked in G&A, $12 million was capex and $6 million are cost items like severance excluded from adjusted EBIT. Our recurring opex investments totalled about $16 million and additionally we incurred $9 million in relation to MDR all booked in R&D. Further details on this can be found in the appendix to the presentation on slide 22.

Cash and leverage – Robust cash generation and lower leverage

Cash flow remains robust with cash conversion at 73% versus 90% last year. The reduction in cash conversion was driven by favourable inventory movements in the prior year, coupled with an increase in capex in the first half of 2020. Net debt leverage came in at 2.2x from 2.6x at the end of June last year and 2.5x at 2019 year end.

H2 revenue and opex driving EBIT reduction versus H1

Finally from me, some considerations on second half dynamics in both revenue and opex. In terms of revenue we expect the Wound business to decline versus 2019 as elective surgeries as well as hospital and wound clinic visits although sequentially improving will still be materially lower than pre-COVID-19 levels. We expect lower revenue growth in Ostomy Care due to some further destocking, the impact of lower new patient starts and some portfolio rationalisation. In Critical Care we expect growth to normalise to low single digits with possibly some destocking as well. Continence Care and Infusion Care should continue to perform well. Then in opex we expect a step-up in strategic transformation investments, in particular in recurring transformation opex. We expect to start to see a reversal of the first half temporary low opex run rate. As a result, we expect a lower EBIT rate in the second half than the first half and for the full-year we expect to be in line with our guidance. Furthermore, as we are proactively rephasing some transformation projects and investments as a result of COVID-19, which I highlighted earlier, we now expect the 2021 benefits to be between $130 million and $150 million. Finally, there continues of course to be elevated risks and uncertainty in our markets as a result of COVID-19 developments so we will stay vigilant. Thank you very much.

Update on Strategic Transformation

Karim Bitar

Chief Executive Officer, ConvaTec

Frank, thanks a lot for that very helpful summary of the overarching financial performance in the first half of the year. What I would like to do now is really focus on our strategic transformation and really highlight to you two overarching points. The first one is that the strategic transformation is progressing well and is very much on track. We have been able to go ahead and drive the strategic transformation in the context of COVID-19. Secondly, what is important to note is that as we have been executing our strategic transformation, we have really gone ahead and done that via our corporate strategy which we have developed an acronym for, FISBE. Focus, innovate, simplify, build and execute. What I would like to do here shortly is to explain to you how we are driving the strategic transformation agenda via the FISBE corporate strategy with the ultimate goal of achieving sustainable and profitable growth, very much with a 3-5 year planned horizon.

What is important to note is that as we have been driving forward making progress on our strategic transformation, we have been confronted by the COVID-19 challenge. That has really been top of mind. We have dedicated a lot of time, effort and energy to our number one priority which has been to safeguard the health and safety of all of our employees. In addition, we have gone ahead and really reinforced our supply chain and put in place a whole series of interventions whether those are in regard to social distancing, whether these are in regard to screening and testing or whether these are in regard to hygiene practices. We have tried to be very proactive and make the appropriate investment and training. As we have done that our focus has been to ensure that our supply chain becomes more and more resilient and therefore can serve our customers on a global basis. Knock on wood, up to this point we have been reasonably successful in going ahead and doing that.

Transforming by Pivoting to Sustainable and Profitable Growth

What I would like to do now is maybe shift gears a little bit and talk a little bit more about how it is that we are going to achieve sustainable and profitable growth. It is important to highlight that when we use the word sustainable what we mean there is that we need to be able to achieve consistently a 4%+ revenue growth year-in and year-out. Real market demand of 4%+. When we talk about profitable growth what we really are focused on is growing our earnings. Obviously, if we are able to do that we will be able to improve our free cash flow picture. This begs the question of how exactly we are going to be able to do this.

The first thing we have done is defined what our vision is. This is our true north. Our vision is very simple. It is captured in these ten words: pioneering trusted medical solutions to improve the lives we touch. These ten words capture three key ideas. First and foremost is pioneering. We want to be R&D-driven and innovation-driven and I will be speaking a lot more about that. Second, our view is that fundamentally we want to provide solutions. We want to go out and integrate a device with digital and service and by doing that what we will be able to do is actually improve the lives of the people we touch, socially, emotionally and functionally. It is critical that these solutions be trusted, i.e. be of high quality. We have had challenges with that topic in the past. If you take those three concepts of pioneering, trusted medical solutions and improving lives we touch you have then got to translate that into what your strategy is. What is it that you will do and what is it that you will not do? Where will we compete and how will we compete? Hopefully, our corporate strategy will answer that question for you.

Number one is we are very focused on some key markets and categories. We have identified 12 key markets that are really important to us. Two in particular stand out, the United States and China. We have to win in those two marketplaces because frankly if we win in all the other marketplaces and do not win in the USA and China, we do not win overall. Second, there are four categories we have identified that we want to focus on: Advanced Wound Care, Ostomy Care, Continence Care and Infusion Care. We will talk more about how we are actually executing on these strategic areas in focus.

Innovation, I will talk a lot more about this but we are ramping up our investment in innovation and we are going to be doing that in a very significant manner and in a very deliberate manner. Simply, we are looking to frankly simplify how we are organised. We have moved to global business units and I will talk to you more about the six global business units. We are also simplifying some key functions such as the area of Finance or IT, trying to break the log jam that we have historically experienced. Fourthly, we need to build some core capabilities. We have underinvested in core capabilities in areas such as sales and marketing and I am going to try to share with you some examples to give you a sense of the progress we are making. Then lastly, we need to execute with excellence. Here again, we are working with our transformation office to ensure that we do have business cases, we have clarity as to who is doing what by when and we track the implementation of all these interventions. There again you will see that we are making good progress.

Focus

In terms of focus, we are rationalising the portfolio across product categories and markets. In terms of product categories one thing that we are going ahead and doing in Ostomy Care is to streamline our SKUs. In fact, we have already eliminated approximately 200 SKUs in the first half of this year. Not only are we looking within product categories to be able to rationalise the SKUs but we have also looked at which product categories are maybe not core to us. One of those categories is the Skin Care business. We did make the decision to divest the Skin Care business and have decided to sell that business to Medline. This is a business that represented about $30 million of revenues and we sold it for approximately $29 million. You might be asking why we decided to sell this business that was part of the Advanced Wound Care unit. Fundamentally, for three reasons. A) this business had been experiencing historically negative revenue growth. B) the gross margins were unattractive to us within the context of our portfolio and C) and maybe most importantly we did not feel that we were positioned to be able to win in the marketplace and that a better and more natural owner would be Medline.

Not only are we focused on narrowing the scope of the categories we compete in and the portfolio that we offer, but we also need to pick the markets we want to serve. I mentioned to you that we really are focused on 12 key markets globally and we did make the decision that we were going to exit or serve indirectly approximately 35 markets. We shared this with you back in February. We have now exited approximately 26 of these 35 markets and amongst these markets are places like Algeria, Albania and Venezuela. What is important to note is that in terms of revenues these are modest revenues and maybe most importantly by doing this it allows us to reduce complexity from a commercial perspective and from a supply chain perspective. Hopefully, you are getting a sense that we are very, very much committed to this pillar of focus and again the reason we are doing this is to go ahead and position the business for sustainable and profitable growth medium-term.

Innovate

On the innovation side we are increasing our investment significantly. What we are looking to do short-term is to go ahead and refresh our product portfolio. There really is a need to refresh the portfolio and longer-term we need to focus on how we can differentiate our solutions and make those available to customers around the world. As part of that endeavour we went ahead and opened up a new Innovation Centre in Boston in the USA. You might be saying, 'Why did you do this?' Fundamentally, we have got some very good R&D capabilities in the UK and Denmark but we need to augment them in the single most important market in the world from a commercial vantage point but also a market where there is tremendous talent and leading healthcare and technology partners that we want to collaborate with. We have opened up this Innovation Centre and we will be further expanding it during the course of the next 12 months.

As we do that and we think about our innovation footprint and capabilities, we have decided that there is a series of capabilities that we need to be able to leverage across all business units, across the entire portfolio. We have specifically identified four of them. The first one is this concept of user-centred design, really focusing on the patient, having an obsession with how that patient thinks, feels and interacts with the solution we are providing them with. There is a whole methodology behind this. Two is the area of advanced biomaterials and design for manufacturing. Back in February, I alluded to you that one of the key challenges that we have had is that we have not had a capability in terms of process development or design for manufacturing. We have not dedicated time, resources and efforts to think through that we fundamentally produce single unit devices that are disposable. These single unit disposable devices that are disposable are made in very, very large quantities. It is imperative that upfront we design for quality and we design for cost to manufacture. We are starting to build that capability.

Mechatronics and sensors are fundamental and vital. If we are going to go ahead and move into providing solutions these are capabilities that we need. Then lastly, we really see software as a medical device. We want to incorporate software into our solution and by doing that all of the sudden the software starts acting as a clinical decision tool which can basically help a patient, improve the patient's outcomes, can help the provider ensure that he or she is doing a better job of treating that patient and potentially provides the opportunity to go ahead and reduce costs from a payer vantage point. Hopefully here you are getting a sense of two things. One, we are significantly increasing our investment in innovation to refresh the portfolio short-term and longer-term further differentiate, but also trying to build capabilities that we can leverage across our portfolio. Again, why are we doing this? We want to achieve sustainable and profitable growth.

Simplify

On the simplification side, as you know, we have formed global business units and the reason we have formed these six global business units, Advanced Wound Care, Ostomy Care, Continence Care, Infusion Care, Global Emerging Markets and the Home Service Group, is to make sure that we have got a clear line of sight to our customers and that there is a clear accountability. There is one single individual can actually make the decision. In addition, we have also tried to go ahead and simplify how our functions work. Here is an example of what we are doing in the area of Finance and IT. We opened up our new Global Business Services hub in Lisbon. We did that this year in Q2 in the springtime. In fact, we recruited and onboarded virtually over 80 individuals. This facility is up and running. It is real and what it is starting to do is to improve not only the efficiency but also the quality of service for key processes such as purchase to pay, order to cash and record to report.

Build

Beyond simplifying we need to also build some key capabilities. Let us try to understand what we are doing on that front. Again, on the sales and marketing side, what have we done? On the salesforce side we have built a Centre of Excellence for the salesforce and what we are doing here is developing standards. For example, one standard global CRM system, one standard consultative selling system, relooking at our incentives and making sure they are aligned with the metrics that we want to drive, such as new patient starts. In terms of marketing, we are seizing the opportunity with the COVID-19 situation to respond to how customers want to interface with us, which is with much more of a virtual world. In fact, in May we went ahead and held a professional education event for healthcare professionals in the wound care space. Typically, we would have held this event in the United States and typically we would have had approximately 500 participants. This year we actually had 1,300 participants. We nearly tripled the number of participants. This was a week-long programme, some of it was live, some of it was offline and what was interesting was that we were able to have a global reach. Approximately 25% of our participants were from outside of the United States and in terms of cost to run the entire event, it was less than a third of what we would normally spend. You can see that in terms of reach and efficiency, tremendous impact and frankly the levels of satisfaction that we are getting from feedback loops that we put in place are very encouraging. Hopefully, you are getting a sense here that we are starting, and I want to underline the word starting, to build stronger sales and marketing capabilities. This is going to be a journey and again this will be a 3-5 year journey to drive that whole notion of sustainable and profitable growth.

Execute

Let us see how we are doing in terms of executing all of our initiatives. We have over 100 initiatives across the entire value chain, whether they be in R&D, supply chain or in the commercial area. We are making good progress. We are measuring the impact and we can see the impact. I wanted to share with you two examples. The first example focuses on the supply chain in the area of Advanced Wound Care. What you see here is that the supply chain folks were able to figure out a way of reducing the amount of packaging that was going to be utilised, by about 18%. What that translated into was benefits to us as a company of $1.2 million per annum but in addition we were able to improve storage, transportation and extend the shelf life by a full year.

On the digital side, look at what we are doing in China. We had made plans to go ahead and add a significant number of salespeople that could maybe visit face-to-face with healthcare professionals. However, with the COVID-19 situation that has become more difficult and so again we proactively rephased our investments. Frank alluded to this earlier. What did we do? We invested less in folks actually going and calling on healthcare professionals in person and put the funds into two basic digital arenas. One was the whole social media area, which you can see on the bottom-left. That is a picture of a webinar that we held in China. We ran over 90 events here in the first half of the year and we have been able to interact with over 50,000 healthcare professionals and patients. On the right-side that diagram or picture is actually one of our e-commerce sites. Today, in China about a third of our revenues in Ostomy Care are actually being generated on the e-commerce site.

I am trying to give you a sense that we are tracking our transformation initiatives. We are being proactive in terms of thinking through when, where and how we make those investments. However, clearly we are starting to see some of the benefits being delivered to us.

Summary and Outlook

I am going to try to summarise. Hopefully, what you were able to observe and hear from Frank and my discussion today is that we grew our revenues and we grew our earnings to the tune of 4.3% and 9.3% in constant currency. We have gone ahead and declared an interim dividend consistent and in line with last year. That is the financial picture. In terms of the strategic transformation, you hopefully got a sense that we are making good progress and at the same time we are responding to the COVID-19 challenge. As we drive that strategic transformation once again, it is all about implementing the FISBE corporate strategy to achieve sustainable and profitable growth. Lastly, in terms of outlook we are basically anticipating that we are going to go ahead and grow our revenues 2-3.5% which will be a lower rate than the first half of the year. We will be growing our EBIT margin between 16% and 18% particularly as we are going to increase our investment in transformation.

All of this is very much in the context of COVID-19 and I think it is important to highlight that three still remains a significant amount of uncertainty as we go ahead and approach the second half of the year. On that note, thank you very, very much and at this point we will open it up for Q&A.

Q&A

Amy Walker (Peel Hunt): Good morning, thank you for taking my questions. Karim, I wonder if I could start by asking what the top priorities for the Innovation Centre are in terms of the specific product lines? You alluded to a few areas but specific product lines and capabilities. Importantly, when do you expect that these initiatives will deliver product launches that can move the needle on the top line?

Karim Bitar: What I would say is as Divakar Ramakrishnan has taken the reins of R&D, we need to remember that he is basically six months into the process. The addition of the Innovation Centre in Boston is part of the overarching complex. We will definitely be continuing to carry out some important and significant R&D on the outskirts of Copenhagen and Deeside, in the UK. You really need to think about this as a three-legged network being leveraged and we have a philosophy of discovery without walls. We are going to be looking to actively collaborate with other entities. They could be government, non-government etc. etc.

In terms of priorities, it is pretty clear we need to refresh our portfolio short-term. As I discussed with you guys last time, this is what I would call, for example, Avelle 1.5. We need to deliver that ASAP. We have had some quality challenges there with the whole pump system. There have been some leakage issues and so we are busily, busily working on that. The GentleCath Air, the compact product which we have been talking about for a while, we need to get that coming through. Those types of opportunities and I go down the line of what I call short-term. I think you will see those being rolled out during the course of the next roughly 12-24 months. I think that is probably the best way to be thinking about that. Progressively, we will be giving you more updates on explicit target dates. I have wanted to give Divakar a chance to frankly reflect and build some robust timelines that we can commit to and then obviously share more broadly with all of you.

Beyond that though, the capabilities that I shared with you there some of the four will be used short-term. For example, design for manufacturing I highlighted. We are immediately building that capability because we need it right now. We need that, for example, on Avelle 1.5 and we need it for Avelle 2.0. That will be impacting the portfolio short-term. We need it for our GentleCath Air immediately. What I would say is that some of those capabilities will be used short-term and some of them such as software as a medical device, will be a little bit more longer-term and more in the 24-48 months because there we are thinking about how we can go ahead and drive more differentiation as opposed to refreshing the current portfolio. I hope I answered your question, Amy.

Amy Walker: That does, thank you very much. My second question was for Frank I suspect. The guidance on the fixed costs is very clear, Frank, thank you, but I wondered if you could help us a bit with the gross margin outlook. Specifically, how much scope is there to drive more productivity gains in the short-term on the gross margin given that the base effects and the FX were quite big contributors? What more could be done to offset if those roll off in the short-term?

Frank Schulkes: First of all, we delivered some pretty solid net productivity in the first half, as you heard, $15-20 million in gross benefits and of course we will have the usual suspects of headwinds. The operational excellence programme is up and running and started really to deliver last year. It will continue to deliver this year and so forth in the outer years as well. This is not really a very linear programme. Of course, it will not be that every month there will be always a fixed amount of productivity gross benefits delivered. There will be a little variation in the gross benefit delivered quarter-by-quarter and there will also be variations in the headwinds. However, overall you can expect that also in the second half and in 2021 we expect a net positive contribution from productivity going forward to help in gross margin.

Amy Walker: That is great. As you have just named checked 2021, previously conversation indicated that 2020 would be a trough year for margins, or better off across the state. So, I think given what we are dealing with from a pandemic perspective. I know visibility is limited but I wondered what is your thinking about whether that is still the likely base case and what are the key risks to that potentially between now and next year?

Frank Schulkes: As you mentioned then, we talked about this also after our Q1 results, we still believe that 2020 is likely to be the trough but indeed the situation is very fluid of course. We are, as you heard from Karim, deferring some projects so that will have an impact on firstly the timing of the cost as well as the timing of some of the benefits. We are very committed. The overall transformation programme will deliver but developments related to COVID-19 add a level of uncertainty. It is likely to be. The biggest risk is really in our view how COVID-19 is going to further develop and if there is going to be a serious second wave that is going to impact our markets. That might mean that we are going to continue to rephase some of the programmes but in the grand scheme of things we are very committed to delivering the transformation programme. We will continue to invest and we will deliver the benefits. Timing of those is very much a function of how COVID-19 develops.

Amy Walker: Just to clarify and this is my last question, in a situation where you are presented with a choice between having to bite the bullet on making the transformation and then accepting that that is going to be a shorter-term headwind for margins, perhaps even bigger in 2021 than 2020, would that be your preference or would managing the margins on a more short-term basis be a bigger priority?

Frank Schulkes: Our strategic transformation programme is a 3-5 year programme so for us in the end we want to pivot to sustainable and profitable growth and therefore I think the strategic transformation in the end is a very important programme for us. The longer-term growth of the company including margin dollars will get priority, long-term.

Amy Walker: Got it. Thank you.

Karim Bitar: I was just going to second that. For us it is very clear, Amy. We have to get to 4%+. That is really what we are obsessed about and once we achieve that in a sustainable manner and we can see a whole string of semesters where real demand in the marketplace is 4%+ thereafter that gives us the opportunity to go ahead and expand the operating margin. However, we need to get out of this short-term focus and I wholeheartedly endorse what Frank just said.

Amy Walker: That is crystal clear. Thank you, guys.

Patrick Wood (Bank of America): I will ask the first two or three together because they are quick. The first one would be, please can you give us a sense of the July run rate? Generally what you are seeing as you move through into the latest month, whether at the Group level or divisional, I do not mind. The second quick question would be, the sustainability of ID which I think has been a lot stronger in the first and second quarter than perhaps we expected, is it reasonable to look at Tandem in the US and see what they are doing in the market conversion and use that as a general proxy for the way to think about some of the growth within that market?

Frank Schulkes: What we see in July is in fact very much in line with our expectation, how we assess the second half and how we in fact have modelled the second half. We do not see any fundamental issue and I explained during the presentation, our expectation that Wound is going to be negative in the second half. We expect a weaker Ostomy Care with destocking. We expect a more normalised Critical Care performance in the second half and Continence as well as Infusion Care to continue to perform well. That is basically what we see in the July numbers. It is very much in line with our expectation. However, we still have five months to go and COVID-19 of course brings a level of uncertainty and unpredictability. We are very prudent and we stay vigilant.

Karim Bitar: Patrick, on the second question in regard to the sustainability of the Infusion Care business you did provide the caveat that it can be a lumpy business because of the high concentration of customers. What I would say is two things. Within the diabetes arena, which is currently where the business is focused, clearly performances of companies like Roche, Tandem Diabetes and Medtronic does impact us because we partner closely with these enterprises. Looking at some of their offerings is certainly an important indicator. Having said that, we also note that there is also a large and growing disposable pump market and the question is, is that a threat or is that an opportunity for us in Infusion Care? We can discuss that. In addition, what we also need to be thinking about is, is there an opportunity to frankly leverage the Infusion Care platform beyond diabetes? Our view fundamentally is absolutely yes. We are busily working on how we can leverage it more broadly. I would say it is a strong business. There is differentiation in our offering and there is an opportunity to grow it both within diabetes but also outside of the diabetes arena.

Frank Schulkes: Can I add something to that? You were talking about the Tandem performance as a proxy. Of course, there is the dynamic if Tandem is taking share from a competitor and we are also selling to that competitor then of course you have got to be careful taking Tandem performance as a proxy for our business. On top of that if Tandem is replacing their own pump with a new version then of course there is also no additional growth for us. I want to make sure that you are not going to take that as a like-for-like because there is no like-for-like. There are several dynamics here.

Patrick Wood: Of course, nobody wants to double-count. If I could add one more, please. I am curious, you are either doing a lot of changes at once, a lot of rationalisation, an efficiency programme and salesforce expansion. There is a lot of tidying up of the business going on. How do you manage running all those things at once? Could you select a couple of areas that you find you spend the majority of your time on, whether that is because you are choosing to prioritise them or because they are prioritised for you? What is really absorbing the majority of your time out of this large collection of changes that are going through?

Karim Bitar: The reality is when you try to drive a transformation of this nature no one individual can do it. What is critical is that you have a strong leadership team. One of the things that Frank and I have been really working on is to strengthen the Executive Leadership Team and to further strengthen the leadership across ConvaTec. That really does absorb and take a significant amount of time. All of a sudden if you increase that leadership muscle tissue frankly there is a lot more that you can get done.

The second thing I would say is the way you drive this is by moving into the new operating model where you have got business units with very, very clear lines of accountability. There is only one individual who we hold to account for the Ostomy Care business and that is Mani Gopal. There is only one individual who we hold to account for refreshing the portfolio short-term and then driving the differentiation longer-term. That is Divakar Ramakrishnan. I can get more into that.

Then thirdly I would just say the way you do it is we have a transformation office where we have clear visibility on all of our initiatives and we have a clear prioritisation of those initiatives. We know which ones are having the highest level of impact and when. You go back to the classic 80:20 rule and that can help guide you as an Executive Leadership Team as to which ones are the initiatives that you want to be particularly focused on. That is what I would say.

Patrick Wood: Super, thank you very much.

Michael Jüngling (Morgan Stanley): Good morning, all. I have three questions, please. Firstly on Ostomy, can you talk about whether you feel that inventory stocking is now more of a possibility in Q3 after we are seeing a rise in COVID-19 infections. You indicated that July was in line with your expectations but with that trend, could you actually see the opposite trend of restocking? Secondly when it comes to the annual gross benefits, I think the deferral of around $20 million for 2021, is this a message to the sell side to adjust the consensus downward on EBITA? That would be helpful. Then the third question is in relation to the EBIT margin. Can you comment on what the FX impact is on the EBIT margin for the first half, you gave us the gross margin, and how the foreign exchange movements that we are seeing now, the strong ones against dollar/euro, dollar/pound, may impact your EBIT margins for the second half of this year? Thank you

Frank Schulkes: On Ostomy Care, we are expecting a destocking and we have not seen really the opposite happening. That does not mean with of course the variation and the uncertainty around COVID-19 that this might not happen later in the first [second] half but we have not seen any signs of stocking activity in the marketplace.

On 2021, of course we are not into guidance mode for 2021 but we have indeed reduced our gross benefits from 130 to 150 based on some of the proactive rephasing we have done. Yes, there is going to be some negative impact in that sense, specifically for 2021. We are still committed to of course the total benefit but it will come a little later. However, there are going to be a lot of other variables at play in 2021 that can help or hurt so at this moment I really cannot comment on that.

Then finally the EBIT FX, the FX impact was 40 basis points in gross margin and it was 50 basis points on the EBIT line in total. Of course, foreign exchange rates are moving all the time and, as you know, a stronger euro will help our top line as well as our EBIT. Whilst a stronger pound in fact will do the opposite given that we have more cost than margins in the UK. Assuming that the Danish krone is moving in parallel with the euro, we have a similar phenomenon there that a stronger krone is not really helping our bottom line. It depends. With indeed the euro strengthening that will help but if the pound as well as the krone strengthen then there will be a dampening effect. Does that answer your question, Michael?

Michael Jüngling: Yes, thank you. To follow up, did you say the EBIT margin in the first half benefitted 15 or 50 basis points?

Frank Schulkes: Five zero, 50.

Michael Jüngling: Five zero.

Frank Schulkes: Five zero. That is the rate.

Michael Jüngling: Yes. Okay, thank you.

Veronika Dubajova (Goldman Sachs): Good morning, thanks for taking my questions. I have two, please. My first is how you are thinking about the Wound recovery. I think Frank, a quarter ago you described the pace of recovery as accelerating, 3Q maybe still being negative but returning to growth in the fourth quarter. Do you still expect to have positive growth in the fourth quarter or has your thinking on this changed given some of your commentary earlier? Then my second question is, of course it is completely understandable that you delayed some of the investments but can you give us a bit of insight into which investments will actually take place this year versus what has pushed into 2021? It would be helpful to get a little bit of colour on that. Thank you.

Frank Schulkes: On the Wound recovery, I think all of you are seeing the surveys that are coming out and there is pretty good data on the US market. The outcomes of those surveys have been changing. The current view of life is that if you think about electives in Q3 that electives will still be only at 55-70% of pre-COVID-19 levels in the US and then not come back to pre-COVID-19 levels in Q4 but only 75-85%. Then even in 2021 it will not normalise to pre-COVID-19 levels because probably the capacity will be very different with new protocols. If you take that into account and add to that that we also still see a reduced level of hospital and wound clinic visits we expect therefore that the second half is going to be negative and we are not really splitting between Q4 and Q3 but what we know today, what we see out of those surveys I think it is prudent to assume that we are not going to see a positive number in the second half in either quarter.

Then in terms of what we have proactively deferred, I think Karim talked about that because of COVID-19 there are certain areas where if access to hospitals and customers in hospitals is very limited then it is logical that we are not adding at an accelerated pace a new salesforce. For instance, we have slowed down early in the year some of the expansions in China. Think in the area of proactively deferring, several projects are commercial type projects. At the same time, as Karim also said, we are upping our investment in the digital arena and we continue to execute projects as planned in, for instance, operational excellence. That is in the supply chain and in the plants.

Karim Bitar: Veronika, to keep it simple, I would say investment in R&D we are pressing right ahead. We are not holding back, if anything we are upping the ante. Investments in quality and operations, which Frank alluded to, again we are pressing right ahead. There is a series of efficiency plays to be put in place. There is a series of plays to improve resilience in the post-COVID-19 world which we are going ahead and doing. That can be increases in inventory, increases in capacity etc. etc. Initiatives in G&A to lower G&A, we need to do that. We are continuing to do that. We gave you the example of what was happening in Lisbon, the whole GBS situation. Frankly, the aspect where we are maybe relooking at the mix is particularly on the commercial arena, particularly a reflection of how much access can you actually have to the payers and the providers. There is a need to ship the mix at a rapid pace to be much more digitally-oriented. I hope that colour helps you.

Veronika Dubajova: Yes, that is helpful. I was actually going to quickly follow up on the US Wound Care salesforce expansion to check to see whether any of that has slowed down and how you are thinking given the pace of recovery in the US Wound Care market because that has been a big priority for you guys over the last 12-18 months?

Karim Bitar: Honestly, what we have done there is we had already fundamentally deployed the majority of the folks that were doing to be part of our three dedicated salesforces. One was much more focused on the chronic side, one on the surgical side and one on the long-term care side. What we are doing is two things. First is to ensure that we are upskilling all those folks so significant investment in training and development and a lot of it frankly is being done in the context of the virtual world. We are adapting to that new world. The second thing that we are also doing is not only improving the training but starting to experiment with many more digital approaches. Can we actually get our reps to be hybrid reps? This is just experimentation again but the organisation is embracing this idea. I can tell you there is a significant portion now of contacts that are actually being carried out with healthcare professionals in a virtual manner. You get into the question of, are you doing it often enough? Is it as impactful? We are learning that, Veronika, so I am not prepared to tell you that it is comparable to what we have done historically but I do think that in a commercial arena on a global basis in a post-COVID-19 environment that we will be leveraging digital capabilities to interface with our customers a lot more. That is what we see happening.

Veronika Dubajova: That is very helpful, thanks guys.

Hassan Al-Wakeel (Barclays): Thank you for taking my questions. I have a couple. Firstly, to follow up on Wound Care, specifically in this business are there any green shoots that you are seeing by product or geography or where you are seeing the more significant improvements sequentially? Related to this, can you talk about the difference in performance between the chronic care, acute and post-acute side of the Wound business and how this is trending throughout Q2 and into Q3? Secondly, could you talk about what you are seeing from a new patient perspective in Ostomy? Are surgeries starting to ramp again and where do you think we are relative to pre-COVID-19 levels? Then finally on the guidance, given the strong result in the first half, could you update us on what you are assuming for the top and bottom end of the guidance in terms of growth and whether this is largely a function of the recovery in Wound? Thank you.

Frank Schulkes: In Wound first on the product side, because of COVID-19 there has been a pretty significant decline as we saw in the second quarter but I would say within that environment our AAA or Ag+ brand has performed and continued to perform very well. Of course, all the brands that are related to surgical specifically have been pushed down which is very logical because of electives coming down very significantly. Then there are several regions specifically I can highlight. Latin America continued to do very well and we have seen very strong growth in that specific area in Wound. Then if we talk about chronic surgical the surgical business is a much smaller business as a percentage of the total than the chronic business. It is 10-15% of the total. However, the electives have gone down very substantially. While the chronic business is 85% of our business or so, we have seen there a reduction that is less substantial but still probably around 10-20%. Therefore, if you do the maths of the reduction in Wound that we have experienced, this is a little bit of an art versus a science but our estimate that the surgical impact on the total Wound business was probably a quarter of that and three quarters was the impact on chronic. Again, because the chronic business is much bigger. Then, if you move to the second half of course it all comes down to how fast surgical and hospital wound visits are going to recover. As I said before, we are not going to see any levels close to pre-COVID-19 in surgical so in percentage numbers the reduction will probably be the lowest. However, again because of the relative size it is not necessarily going to be the biggest impact in terms of dollars.

Then new patient starts in Ostomy care, we have indeed seen a reduction in surgeries and therefore an overall reduction in the market of new patient starts. The impact on the revenue is very, very limited because of course it is a very small part of the market. At this moment, we see a recovery of surgeries. It is still going to be below but at the same time I have to tell you that the data on the Wound business and the electives there is much further developed than what we can see on the Ostomy side. We see a slight recovery in procedures but again the impact on revenue is very, very limited because it is 5% or 10% max of the total revenue base what has happened in the acute. The majority of revenue is in the community.

Guidance for 2020, as I said, given what we have seen in the first half and given how we are seeing dynamics in the second half in the different business units as well is our cost profile that I think I explained in the presentation. We are operating within the parameters of our guidance and that is 2-3.5% top line, 16-18% all in for the EBIT rate. We believe that that is a prudent outlook and a prudent guidance for the year.

Hassan Al-Wakeel: Thank you. Maybe just a follow-up on the guidance. I am curious to see what you think are the largest upside and downside risks mainly to the top line and if that is mainly a function of the Wound business?

Frank Schulkes: I would answer positive to that question. Indeed, I think Wound of course because of exposures to COVID-19 is probably the biggest variable in that equation.

Karim Bitar: I would concur. It has got the highest level of sensitivity to a post-COVID-19 world right now and that is what we are experiencing. I think that is a fair comment.

Hassan Al-Wakeel: Thanks, that is all.

Paul Cuddon (Numis): Good morning, guys, I have just got two. You have delivered 4% on a constant currency growth including through a pandemic at better than expected margins. With increased focus on digital, e-commerce and China, I am wondering whether 4% organic mid-term is really a baseline target or Karim, do you think this should be capable of more than that?

Karim Bitar: What I would say is I think 4% is spot on. I think it is the right target. In my mind we need six semesters in a row to be able to say you are actually sustainably and profitably doing what you were asked to do. I think it would be way premature at this point to be saying the number is higher. Now, obviously we have always signalled 4%+ with the idea that let us get to 4% and then we can revisit the question, Paul. However, I would say right now I think one would be jumping the gun and so I would rather stay grounded, do what we need to do in terms of the focus markets and categories, do what we need to do on the innovation side, refresh that portfolio and drive differentiation long-term. We need to embed the new operating model. We have just got it in place for six months which is very, very early still. There is a series of capabilities which we have not had for a long time so we are just starting to invest. Trying to instil an execution culture that takes a little while. It is early days and I think the 4% is a good target. Let us get it done and get it done consistently. That is Frank's and my focus.

Paul Cuddon: Okay, thank you. Finally, on the pieces of the jigsaw you are moving around, Skin Care has gone, I note Critical Care is not part of your focus areas so wondering what your intentions are there and whether there are additional pieces of the jigsaw that you would like to bring in?

Karim Bitar: It is very clear with us what are the areas of focus that we set, Advanced Wound Care, Ostomy Care, Continence Care and Infusion Care. We are very committed to going ahead and doing that. We need to make sure that we focus on those categories. In terms of the inorganic strategy I should think we shared this with you back in February, we are very focused on either opportunities to strengthen the current categories that we work in so we are fundamentally always actively exploring for bolt-on opportunities that could be maybe technology in nature that could help maybe add some critical mass, or allow us to access some core capabilities. We are building strength in that arena to proactively do that and that is the way we are go ahead and approach it.

Paul Cuddon: Thank you.

David Adlington (JP Morgan): Thanks guys, two questions please. Firstly in Ostomy, I wondered if you had seen any impact from Coloplast entering the Premier GPO from April. Secondly, on R&D it looks like your innovation is focused on new products. One of your key competitors is obviously investing more in clinical trials to prove clinical benefit of their products. I was wondering if that was something you were considering as well. Then finally in terms of the outlook of price oressure some companies are expecting or potentially fearing an increase in pricing pressure post-COVID-19. I wanted to get your thoughts on that, please.

Frank Schulkes: In discussions with our salesforce, we have not really seen any impact of Coloplast entering the Premier GPO. There is really nothing to report there and no impact seen. Then I will go right on to number three and then we will go back to the second question. There are some requests out there from some customers for certain reductions in price. I would say nothing has materialised yet but I think it is logical to assume that there might be some additional price pressure in the customer base going forward, given of course that COVID-19 put a lot of extra pressure on the healthcare system. However, to be honest nothing really materialised in terms of a material impact. It is just something that is on the radar screen. Of course, we will respond in a very disciplined way to those types of requests. I hope that answers your question.

Karim Bitar: I would just add a small comment to the pricing question. It is clearly a key variable that we are very cognisant of. We have our antennas up. I do think that healthcare systems in time will face even more pressure just based on the whole amount of money being put out there. At some point you are going to have to start paying it back. I think we are going to see more pressure there. We are in the midst of building a pricing centre of excellence to think through pricing strategically and tactically and to help us manage that much more proactively. It is top of mind as a variable that we want to go ahead and focus on.

On clinical trials, we are absolutely committed to clinical trials. We recruited our Chief Medical Officer, Dr Jacob Agris, so in our minds when I talk about new products and product development there are three components to doing that well. One is the traditional way of thinking about it which is I have got a new idea that could be quite appealing to a patient, let me go ahead and develop that. The two areas where we at ConvaTec have not dedicated sufficient effort and energy has been this whole area of process development or design for manufacturing. You can use those two terms interchangeably. Upfront a priority thinking through how you build in quality and how you design a single unit disposable device so that you can produce it very, very efficiently. Then thirdly you have got to have the clinical data. You have got to be able to demonstrate that you are actually improving a clinical outcome. You have to have the clinical data to show that from the health economics perspective you are actually contributing to stripping out cost and driving efficiency. To me product development, process development and clinical development are all intertwined and fundamental to our ability to refresh our portfolio and frankly develop a more differentiated portfolio longer-term. Did we answer your question, David?

David Adlington: Yes, thank you very much.

Chris Gretler (Credit Suisse): Morning Karim, Frank, Mark. I only have one question left on the channel stocking. Could you discuss your assessment particularly when it comes to Wound Care and also Infusion Devices? I understand in Continence and Ostomy you anticipate more destocking effects so I guess the channel is still overstocked. Is that the case as well in Wound Care and Infusion Devices in your view? Should we expect some headwinds here?

Frank Schulkes: I do not think there is a lot of stocking happening in the Wound Care business. Of course, a lot of that has been flushed out in the second quarter given that COVID-19 hit and levels have come down. If we look at distributor inventory levels they are really at pretty low levels if you look at history. I do not think there is any stocking activity going on in Wound. In the Infusion Care business first and foremost I want to highlight again it is quite a lumpy business. Our customers are doing well. The pump market is growing but at the same time we have to assume that our key customers are building some additional resilience in their own supply chain. However, this is not a stocking that is short-term type stocking where you see a boost in one quarter and then you see a destocking in the second quarter. I think this is much more a fundamental move towards a little bit more resilience within their own supply chains. Does that answer your question, Chris?

Chris Gretler: Yes, thank you. Maybe I have a follow up. Since we previously talked about GPOs, now I understand there are some other discussions coming up in health trusts. Is there any change in strategy here from your side in respect of that part of the business? How would you describe the competitive situation at the moment in this channel?

Frank Schulkes: Discussions indeed are going on and there is really at this moment nothing to report in relation to that. I do not see any different competitive behaviours like we have seen in other GPO type of discussions. It is indeed very limited what I can tell you at this stage, Chris.

Karim Bitar: I would say, Chris, on the whole GPO/IDN arena that scenario where we are building more capability, we have made some pretty significant changes in leadership about nine months ago that are starting to bear fruit. And knowing that bears fruit, we are thinking much more about our portfolio. We are being much more strategic at how to leverage our portfolio and we are starting to increase the level of coordination and integration between the commercial organisation, the sales and marketing organisations of Ostomy Care, Continence Care and Advanced Wound Care in the US with the organisation that handles our interface with GPOs and IDNs.

Chris Gretler: Okay, thank you, I appreciate your comments.

Kit Lee (Jefferies): Thank you, just two left for me, please. The first question would be on your product rationalisation in Ostomy. Can you talk about the impact in the second half of 2020 and also in 2021? Then my second question is on the new catheter launch in Europe. Can you talk about the progress and the update then?

Karim Bitar: Sorry, I did not hear the second question. Could you repeat that?

Kit Lee: It is about the new catheter that you are planning to launch in Europe. Can you tell us about the progress and the update there?

Frank Schulkes: On rationalisation of portfolio, in fact there are two areas there. First, as I mentioned in my presentation, it is really the contract rationalisation we have been doing in the first half and that will also have an impact in the second half. Overall on the Ostomy growth there probably was an impact of about 60-70 basis points. Then on the SKU rationalisation it is early days. Programmes are being developed. We are with the Ostomy team working through the financial case. For us, the rationale is very clear. We believe it is better for patients. We will be able to provide better products and it drives simplicity and productivity in the business. Early days, more to come in 2021 and 2022.

Karim Bitar: On GentleCath Air, this is the compact offering, I would say we are sorting through that. I think I was quite open with you guys in terms of the challenges that we have had from a quality perspective and also from an ability to efficiently produce the product. I would say that we are very much in transition, i.e. trying to sort through that. I think what you will basically be seeing in 2020 and 2021 is that we will continue to pilot and scale up the product, particularly with a focus on France. Those learnings then will be utilised to help us really understand what we are fully capable of. I would say that we are very much in that piloting phase, continuous improvement phase and I think that will be the case for roughly the next 18 months. Then thereafter we will have a lot more clarity as to how we can go ahead and further grow the GC Air offering in a more subsequent manner.

Kit Lee: That is great, thank you.

Karim Bitar: I am going to once again thank everybody on Frank's and my behalf. I think Mark maybe you have some closing statements you would like to make.

Mark Reynolds: I was going to say there are no further questions on the webcast either. If you do have any follow-ups please do contact me through IR@ConvaTec.com.

Karim Bitar: Thank you very much everybody. Have a wonderful day.

Frank Schulkes: Yes, thank you very much. Have a good day. Bye, bye.

[END OF TRANSCRIPT]