ConvaTec - Q3 2020 Trading Update

Wednesday, 28th October 2020

Opening Remarks

Karim Bitar

Chief Executive Officer, ConvaTec

Welcome

Good morning. Thank you for joining us on the call today. I am going to share with you some insights into the strategic and operational progress we have made. Thereafter I am going to hand over to Frank, our CFO, who will take you through Q3 trading as well as a revised guidance we are announcing this morning.

In summary, what I would like to do is to really highlight to you four key points. First, we have set a clear direction of travel with our FISBE corporate strategy in entirety has been well received by our organisation.

Second, we are successfully embedding our new operating model, which is delivering better line of sight to our customers in improving accountability. Thirdly, we are improving our execution via our transformation execution office with initiatives in R&D in quality and operations as well as our customer supporting and customer-facing functions.

Finally, we are tightening our guidance for the top line and revising our EBIT margin guidance, given a better-than-expected Q3 performance and following a review of the phasing of our costs and investments.

Key points

At this point, what I would like to do is to really share some thoughts with you about three different topics. First of all, how are we responding at ConvaTec in regards to COVID? Second, what kind of performance are we experiencing on the operational front. And thirdly and lastly, what kind of progress are we making on the strategic front?

COVID Response

So let us start off with COVID. In terms of COVID what I would say is our business has really risen to the challenge. We have continued to strengthen the resilience of our supply chain, including increasing capacity and production to meet strong levels of demand, most notably in Infusion Care.

On the demand side, there are two businesses which have been significantly impacted. Advanced Wound Care is down, because of restricted access to the acute and community setting. But to counterbalance this, we have benefited from a significant boost in demand for our critical care products.

At this point, I would like to take the opportunity to share a personal thanks with all my colleagues for their tremendous dedication and the hard work in the challenging times.

Operational Performance

Moving away from COVID, let's now focus on our operational performance. In Q3, we delivered a good performance in constant currency. Infusion Care delivered significant growth. Continence & Critical Care grew strongly. The Wound Care performance improved, while Ostomy Care was flat.

Revenue was better than anticipated for a number of reasons, including:

- First a step-up in demand for innovative infusion sets serving the smart glycemic control segment;
- Second a more rapid rebound of elective surgeries in the US;
- Thirdly some positive phasing of orders; and
- continued strong demand for our critical care products.

These revenue trends in essence have enabled us to tighten our revenue guidance towards the higher end of our 2% to 3.5% range.

Furthermore, when you really dig in and try to understand the underlying performance of our Group, we note that it’s really good, but we also note that there is variance amongst the various businesses. So let's try to understand this good performance but this varied performance by business.

Segment Performance

Wound Care is showing some signs of improvement. In the US, we saw elective surgeries rebound faster than expected. However, the chronic segment remains challenging. Ostomy Care was flat as we work on improving commercial execution in key markets and rationalising portfolio. In Q3, we saw some continued destocking following significant demand in Q1.

Our Continence Care & Critical Care businesses had a strong quarter. They benefited from continued strong demand for Critical Care products, albeit lower than earlier in the year. Our Continence business continued to deliver good growth with the Home Services Group performing well.

Finally, Infusion Care showed significant growth. We have established a leadership position as a provider of innovative infusion sets serving the fast-growing smart glycemic control segment of the diabetes market. This is a fundamental strength of ours.

Moreover, we have phased our investment spend in light of COVID. Various operating expenses this year are particularly low, such as travel or promotional spend for congresses and medical symposium. These lower expenses and the further proactive deferral of transformation investments are the primary drivers for enhanced EBIT margin expectations for the full year.

So now let us shift gears. We have talked a little bit about COVID. We have talked about our operational performance and how it has been good. But I would like to focus on the progress we are making from a strategic vantage point.

FISBE

And as we think about our FISBE strategy, they really drive this toward pivoting sustainable profitable growth. Now let me just remind you that FISBE fundamentally stands for Focus, Innovate, Simplify, Build capabilities and Execute. And I would like to provide you with some highlights during the period.

First, we completed the skincare disposal, thereby focusing the business on our four key categories:

- Advanced Wound Care;
- Ostomy Care;

- Continence Care; and
- Infusion Care.

On the innovation front, we are successfully launching our ConvaMax Superabsorbent product in the US and European advanced wound care market.

Transformation

Thirdly, we are effectively embedding the new operating model, which is giving us greater line of sight to customers and improved accountability. In the area of building capabilities, we continue to strengthen key areas such as marketing, corporate development. In fact, next week we will be welcoming Evelyn Douglas as Chief of Corporate Strategy & Development. Evelyn joined us from Becton Dickinson, where he successfully led this function for nearly a decade.

As I have shared with you previously, we expect to carry out bolt-on acquisitions to contribute to the growth of our business and Eve brings a wealth of expertise to lead us in this area.

Lastly, we continue to execute over 100 initiatives in R&D, quality and operations, customer supporting and customer-facing functions.

Summary

So let me try to summarise. We are making good progress in executing our business strategy, as we pivot to sustainable and profitable growth. Although there remains plenty to do, I feel confident about ConvaTec's long-term growth prospects.

At this point, I will go ahead and hand over to Frank to take you through Q3 trading and guidance before we take your questions. Frank, it is all yours.

Financial Performance

Frank Schulkes

Chief Financial Officer, ConvaTec

Trading Update

Thanks Karim, and good morning, everyone. As Karim mentioned, we delivered a good performance in the third quarter with Group reported revenue up 6.5% to $493 million or up 5.6% in constant currency.

Growth for the nine months of the year was up 4.8% at constant currency. This was driven by significant growth in Infusion Care, strong growth in Continence and Critical Care, and improved performance in Wound and a flat performance in Ostomy Care.

The performance in the quarter was overall negatively impacted by COVID, but this was more than offset by the good underlying growth in the business, coupled with stocking activity, mostly in Infusion Care and beneficial phasing of orders during the period. Overall, the underlying growth of the Group was encouraging.

Advanced Wound Care

Now let me walk you through each of the businesses in more detail. Advanced Wound Care revenue of $149 million increased 0.8% on a reported basis and declined 0.6% in constant currency. This was a better-than-expected sequential improvement from the second quarter, which was down over 13% in fact. The quarter benefited from some advanced purchasing and a stronger-than-expected rebound in elective surgeries. However, the chronic care segment remains challenging as COVID continues to limit activity in the community setting.

Some markets performed well with continued strength in Latin America, progress in certain Asia Pacific markets and improved performance in certain European markets. Overall, the estimated underlying growth remained in the low single digits. This is lower than the overall wound markets and partially relates to our underexposure to the foam segment, which is proving relatively more resilient in this pandemic.

Foam is an area of focus for us and we're investing to strengthen our commercial execution, while the R&D teams are working to enhance our product portfolio.

Looking forward into Q4, we currently expect a weaker growth rate for the following reasons:

- First, the disposal of the skincare business will impact year-on-year growth as it contributed approximately $8M of revenue in the fourth quarter of 2019;
- Second, some of the Q3 growth was advance purchases; and finally,
- although the COVID-related impact is difficult to accurately predict, we are more cautiously looking forwards, given the rise in infection rates and additional restrictions being seen in recent weeks.

Ostomy Care

Ostomy Care revenue of $132 million increased 0.4% on a reported basis, and 0.1% in constant currency. We had good growth in global emerging markets in both Latin America and key Asia Pacific markets such as China. This was offset by some COVID destocking, continuing challenges in certain European markets in the US, coupled with the planned rationalisation. The estimated underlying growth remained in the low single digits.

While we continued to expect similar levels of underlying growth in the fourth quarter, tough 2019 comparatives and the impact of planned rationalisations will result in a lower constant currently growth rate.

Continence & Critical Care

Continence & Critical Care revenue of $124 million increased 7.7% on a reported basis and 7.2% in constant currency. As expected, we saw some moderation in growth from the second quarter, although demand for Critical Care products remained strong due to COVID.

Our Continence Care business continues to perform well with our Home Services Group in the US continuing to achieve good growth. Looking forward, we expect to trend back to market growth, given how well stocked hospitals are.

Infusion Care

Infusion Care revenue of $88 million increased to 28.2% on a reported basis and 26.7% in constant currency. This was driven by strong demand for innovative infusion sets, which are a core element of the rapidly growing smart glycemic control segment of the diabetes market. During the quarter, we added capacity to respond to this strong demand addressing some backlog which had developed earlier in the year.

And some of the demand was due to our customers building resilience in their own supply chains, although, the primary driver is our leadership position with our innovative infusion sets.

Looking forward, Q4 growth is expected to slow compared to Q3, but should still be double-digit. Longer term, we are excited about the potential of the smart glycemic control segment and think high-single-digit underlying growth should be achievable, although this year's performance will of course produce a tough comp.

Outlook

Looking ahead for the Group as a whole, as set out in this morning's announcement, we now expect Group revenue growth to be towards the higher end of our guidance range of 2% to 3.5% in constant currency. Clearly, forecasting is more challenging during this pandemic. So based on what we are seeing, we do not currently anticipate growth in the fourth quarter on a year-on-year basis. And let me take a minute to help you understand why.

The first reason is that the skincare disposal was completed at the end of the September, so will be out in Q4, as I have mentioned already. Another reason is that there are tough comparatives in Q4, particularly in Ostomy Care.

And as I mentioned, part of the growth in the third quarter was driven by advance purchases in Wound Care which last year featured in Q4. And then finally, we are more cautious due to the recent rise in COVID infection rates.

Regarding our adjusted EBIT margin guidance, we now expect to be between 18.5% and 19%. And this is primarily driven by two variables. First, our decision during year to proactively rephrase some of our transformation investments in light of COVID. We have now deferred a further $10 million of recurring transformation investment to 2021 such as our sales force expansions in China and selected European countries, and on top of that investments towards the scale up of GentleCath Air.

This is in addition to the $10 million announced at the half year. And as a consequence, we now expect recurrent transformation spend this year to between $40 million and $45 million. And we currently continue to expect $75 million of recurrent transformation investments in 2021.

And the second, in this COVID environment, certain operating expenses are just lower than expected, for example, in travel as well as in advertising and sales promotion. Together the investment phasing and subdued operating expense are expected to benefit the annual EBIT margin rates by a couple of 100 basis points in 2020.

So notwithstanding the deferral, as Karim said, we remain fully committed to driving forward our transformation as we focus on pivoting to sustainable and profitable growth and we feel positive about the long-term prospects for the Group.

With that, I will hand back to the operator. And we will take your questions.

Q&A

Patrick Wood (Bank of America): I will keep it to two. So the first question within Infusion Care just quickly wondering if CMS put a proposal out there for potentially changing and including some incremental benefits for infusion devices and care within the durable medical equipment bidding process. I am just curious if you guys think there is any potential impacts either positive or negative from that proposal on that side? So that would be the first question. And then second question. Just picking up on your comments, kind of interested on the Wound Care side, your commentary around foam holding up better in a COVID environment. Just curious why you think that is and just a little bit more detail on that would be great.

Karim Bitar: Sure. Patrick, thanks for your questions. And what I will go ahead and do is just answer the first question in regards to CMS and I will ask Frank to handle the foam question.

In regards to, look, when you think about smart glycemic controls so just intersection of continuous glucose monitoring, infusion sets and the insulin pump and then you think about how these three now are sort of intertwined by a software becoming smart, clearly from a clinical vantage point and from a patient vantage point, there is a lot of benefits.

But historically one of the challenges had really been access and affordability. And so I think that depending upon what happens in general in terms of access and affordability, that could have an impact on the growth rate of this segment.

Frank, you want to take the second question on the foam?

Frank Schulkes: Yeah. The main reason for foam to be holding up a little better than some of the other segments is that foam in a lot of cases is used in a preventive way, and therefore, we believe that therefore it is a little bit more resilience and less negatively impacted by Covid so its prevention that this foam is used for.

Patrick Wood: Super. And maybe if I can just slot one more very quickly in. But I am just curious if you could give some sort of colour around the net benefit from the stocking effects that you guys saw in the 3Q? And so we can help understand that translation into the fourth quarter, that would be great.

Karim Bitar: Frank, do you want to take that question?

Frank Schulkes: Yeah. So stocking was largely in the Infusion Care business. And as you could see that we grew 27%, which is extraordinarily high. And there were two really impacts in Infusion Care and it was a backlog that had been building in the first part of the year with extra capacity we could take care of that and the second indeed was stocking.

In total, our estimation of underlying growth of the Infusion Care, to give you at least an idea, we are still going to be sort of in the low teens, so 12%, 13%, 14% range. And the rest I think was related to indeed stocking activity as well as taking care of that backlog that had developed before. So I hope that gives you an idea around underlying performance of the business in the third quarter.

Amy Walker (Peel Hunt): Karim, I understand what you were saying about trends in glycemic control, and also Frank's comments about there being a backlog. But it still feels like this has been a pretty big shift all of a sudden in Infusion Care given your allusion to the market now potentially growing in high-single digits rather than mid-single digits. Is there some specific event that happened in the last six months that is, I do not know, related to change of behaviour in COVID or Medtronic's released some major new product line. Maybe I misinterpreted it, but it just feels like there is a very big step-up all of a sudden.

Karim Bitar: Yeah. No, Amy, I think it is a really good question. I think, look, we have known for a while in the diabetes market, frankly, for over three decades from the DCCT study that if you could keep your blood sugar levels in very tight control, you would avoid complications like retinopathy and nephropathy and neuropathy, right, in your kidneys, in your eyes and your legs and all the various macrovascular complications. But it has been really, really challenging for diabetes patients to be able to keep their blood sugars tightly controlled.

So you can imagine particularly for type 1 diabetes, who get the diabetes at young age and produce no insulin. So historically what have these patients done? They have really been using multiple daily injections. So they are administering subcutaneous injections continually. And yes, it's true that we have had insulin pumps for sometime, right, so folks like Medtronic really brought about this sort of innovation. It used to be called actually MiniMed and then it was acquired by Medtronic.

But the reality is there was never a linkage and did not really have a sort of an artificial pancreas. And so I think what is happening right now is we are shifting from, and I will describe it to be, as the flip phone age to the smartphone age. And that is why we are calling it smart glycemic control.

And so really Tandem Diabetes in particular along with DexCom are taking a lead whereby now they have been able to integrate the pump with the continuous glucose monitoring using software, whereby a patient actually knows continually what their blood sugar levels are, and then at the same time in a very smart way depending upon what that patient is using or eating, I should say, different amounts of insulin are administered, right?

And so now the patient has very tight control. The patient can actually go ahead and be proud when he or she talks to diabetologist or an endocrinologist because the doctor is like, well, you are in tight control. The patient feels lot better because maybe in the evening you are getting sleep. You are not having to urinate and go to the bathroom.

And frankly the payer, right, we were talking a little bit about CMS before, is also pleased and encouraged because you can avoid these complications. And so I think the advent of smart glycemic control, which is really coming about this year, particularly with Tandem driving that, is sort of changing the dynamics, whereby there is more demand now for, what I call, the smart glycemic control offering relative to multiple daily injections.

And our infusion sets which are highly innovative, they are highly reliable, they are very simple to use, are an integral part. So you need the pump. You need the continuous glucose monitoring and you need the infusion sets. And so we are part of that triumvirate. Does that answer your question, Amy?

Amy Walker: It does. Just one follow-up though. I am curious about how much visibility you have on the degree to which the continuous monitoring and the artificial pancreas is just replacing less sophisticated pumps in the segment versus actually making inroads into stick and vial. Do you have visibility on the difference between those two?

Karim Bitar: Look, I think it is difficult to say. And that is fundamentally a driver of how rapidly this segment is going to grow, right? The more you think you are just going to replace sort of previous pumps, you come up with certain assessments and the more you fundamentally believe that actually this category or this segment is going to grow and displace multiple daily injections. I think frankly, Amy, time will tell, but that is the sort of the key variable, right?

Amy Walker: And then my very last question, and I will give someone else a chance, is just given the Group margin is much better because of all these moving parts this year, is it still your expectation that 2020 is the trough margin year after the update today?

Karim Bitar: Sure. Frank, do you want to take that question?

Frank Schulkes: Yeah. I will take that. So Amy, clearly in the beginning of the year, we thought it was likely to be the case that 2020 was going to be the bottom. But of course since then we have taken the decision to defer recurrent transformation investments. And we are also seeing this lower spent as a result of COVID-driven lower activity and both benefit really the 2020 EBIT rate by a couple of hundred basis points, which is temporary in nature.

So clearly, in the future, we expect to see some normalisation of these COVID impacted costs, but we also, as we mentioned before during the discussion earlier, we are still expecting $75 million of recurring investments in 2021. So it is at this moment too early to provide 2021 guidance and we will be of course in a better position to provide an update in February.

But you basically see 2020 getting the benefits because of this OpEx phasing of a couple of hundred basis points and we do not see, at this moment, any material changes in transformation in 2021.

Amy Walker: Got it. That is very diplomatically put. Thanks, Frank. I will move on and let someone else have a chance.

Veronika Dubajova (Goldman Sachs): I have two, please. My first one is kind of a follow-on onto Amy's question. Just trying to understand the moving parts as we move into 2021 and in particular kind of your degree of confidence that you will get that recurring TI spent to $75 million. I mean, I think we all understand why you are deferring some of those investments this year. But as much as I would like to hope COVID disappears in 1st January 2021, I am just not true that is the realistic expectation at this point in time. So I guess Frank, Karim, if you can talk us through a little bit of how you are thinking, your degree of confidence that we do get to that $75 million next year or is there a chance that we really get to $75 million in 2022? And what are some of the investments that are being pushed out further of, if you can give a little bit more colour? I know Frank you mentioned some geographies, but maybe by division, that would be helpful. And my second question is just kind of current trading to the extent that you were able to talk to what you are seeing specifically in the elective segments when it comes to Advanced Wound Care as you think about October and whether you are seeing any impact from the growing COVID cases, that would be helpful.

Karim Bitar: Super. Frank, you want to take the first question and the second one. I will let you do both.

Frank Schulkes: Yeah. So Veronika, we are very committed to the transformation programme. We are very committed to our new strategy. And of course, with COVID, there is a heightened level of uncertainty. But what we can see today and what we can see today also in our programme funnel, project funnel and the phasing of all of that, we are seeing an investment in recurring of $75 million.

There is going to be perhaps a little bit more a mix shift less related to outside sales, but for instance more into R&D, more into technology, more into digital. But at this moment, we clearly can see that the $75 million is what we expect to spend in 2021. Again, there is of course because of COVID a level of uncertainty.

Related to the electives, basically what you could see if you go back in time after Q1, we saw a very significant dive, very negative response in electives. And indeed we saw a good bounce back in the third quarter. But also here because of some uncertainty and unpredictability related to COVID, there will be a gradual sort of a variation of certain volatility quarter-to-quarter.

So if you think about it longer term, we expect a gradual improvement of the electives overtime and we do not expect it to go back to this very negative drop in the second quarter, but there will be quarterly fluctuation. And therefore we have said, listen, Q3 was better than expected, bounce back, given rising infection rates, given restrictions to hospitals also on the rise, we expect that we might see a little bit of a decline again in the fourth quarter and then it might improve again in the first quarter.

So gradual, but quarterly fluctuations. That is how I would thread it.

Karim Bitar: Maybe just to add Veronika, just a little bit on the first point that Frank was making, so you try and get a little bit of feel for the likelihood of being able to invest the $75 million. I do think we are going to see us ramp up our R&D agenda next year. We have been ramping up capabilities across the board. And so for example now we have named a head of biomaterials and design for manufacturing. We have named now a head of the whole area of mechatronics.

We have put in place now a new of head of regulatory. We are in the midst of going ahead and then putting in place heads of software development as we think about software as a medical device and how can you actually develop clinical decision-making tools. And so there is a lot of activities in R&D, in investments which historically have not been made at ConvaTec. And I think frankly 2021, even just today, present a tremendous opportunity of that.

And also as you think about moving forward whether it is with our employees or whether it is with our sales force, within marketing effort, really the hybrid models here to be, right. It is here to stay. I do not think that is going to go away fundamentally. And so it is critical that we make the investments frankly in the appropriate and relevant digital platform to be able to engage with customers in that manner. And so that will require a fair amount of investment.

Veronika Dubajova: Ok thank so much for that and if I can just follow-up. I think Karim at the outset of the year when you brought in new head of R&D, you were going to give us sort of update on sort of what are some of the things that are in the pipeline that are exciting? It might be too early, but if you can share where we are three quarters later from an R&D perspective, major product launches to be looking out over the next couple of years, if you can give us a little bit of a preview of that, that would be great. And that is my final question.

Karim Bitar: Yeah. I mean, I think it is a little premature, but what I will basically highlight to you is two things. One, we are investing building the capability, which I was just describing to you, right. And so lot of this is actually putting in place the leadership, the systems, the processes and governance to go ahead and do that.

And so for example just with the Avelle 1.5, we have been endeavouring to improve the performance of our disposal negative pressure in wound therapy. We have made adjustments from a design, from manufacturing perspective. And our initial reactions from the marketplace are actually encouraging or positive.

But if you look out what I would say basically is to highlight to you really two different areas. I think the first one I would highlight to you is a little bit this whole reference to the foam area. The foam segment is clearly an area where it is a very large segment. It is actually the largest segment of the Advanced Wound Care marketplace. And you know we are basically at this point in time underexposed.

So we are busy frankly trying to work as to how can we go ahead and improve the quality of our offering. And so we are endeavouring to go ahead and do that. It will be the first area that I would go ahead and highlight.

And I think frankly in the area of Infusion Care, look, I mean, that is a very interesting and growing arena and we do have a leadership position there with a differentiated offering. But again, we are looking to frankly keep on driving the level of differentiation. And one of the interesting things in the marketplace and it is really needed, can you use your infusion sets maybe not for three days and maybe closer to a week.

And being able to use them for a week has a whole series of benefits to the patient in terms of could you then link it maybe to the whole area of continuous glucose monitoring. Could you integrate those? And so I think that that whole extended wear of an infusion set is also an interesting area.

So hopefully you are getting a sense that fundamentally we are building capabilities and hopefully getting a sense of it is clearly clear to us where is it that we are trying to go ahead and make sure we got a competitive product offering and where is it that we want to go ahead and sustain or drive further differentiation.

Veronika Dubajova: That’s very clear, thank you guys.

Hassan Al-Wakeel (Barclays): Thank you for taking my questions I have a couple, please. So in Wound, could you please talk about the underlying growth here before any benefit of stocking and what you are seeing in October and whether this is a driver for your conservatism on Q4, or is it more a function of uncertainty? And any colour around the different parts of this business, acute versus chronic, would be helpful. And then secondly, in the US, could you please talk about your progress as it relates to the commercial organisation within Wound and any early signs of improvement here? And then also within Ostomy, any changes in NPS by region? Thank you.

Karim Bitar: Okay. Why do not I ask Frank to take the first question, underlying growth of Wound, and then I will tackle the US question.

Frank Schulkes: Okay. Yeah. So on the underlying growth in Wound, our estimation varies. It is low single digits, so 1.5% to 2% or so. And the reason for that is as follows. If you look at the quarter three, we indeed saw a sequential improvement in electives and it was clearly better than the second quarter, so a very clear bounce back.

At the same time, we still see that chronic is challenging. So if you look at the different patterns, chronic is improving but more gradually, while electives bounced back very fast. So the overall impact, if you take the COVID impact out and there was a little bit of a phasing order that was placed last year in Q4 was now into Q3, we again get to that low single digits underlying growth rate.

Now for the fourth quarter, as I already mentioned, there is the impact of skincare, which is 550 basis points. But there is indeed a level of uncertainty arising from the increased infection rates. And we already know that several countries in Europe are driving more restricted or shows some restricted access. Think about Spain, UK, France. There is nothing yet in the US. Of course, you hear about that might also come starting in the North East. But we are therefore a little cautious there and expect that some of the growth rates will, in fact, go the other way in the fourth quarter besides of course the skincare impact, which is a separate phenomena.

And that is how we look at it. So it is caution at this stage given that we see just more restrictions, already starting several big countries in Europe and plus also in different states in US.

Karim Bitar: Super. Thanks Frank. Hassan, look, good to hear from you. I will say on the US front. Let us start with Advanced Wound Care. I think it is fair to say that the organisation is settling in, right, as you recall we have sort of split up our commercial organisation into three units. We have got a dedicated unit just for long-term care. We have got a dedicated unit with the commercial folks focused on the whole chronic segment and the one focused on the surgical segment.

So that organisation frankly is really settled in. And I think focus is actually helping us in terms of our ability to interface with those respective segments. The leader now of that unit, Joe Talanges has been in role now, coming up toward a year in December. And so there is just an element of the Group settling in. They are learning how to work the hybrid model, which is basically a combination of face-to-face selling, inside sales, using a whole series of digital tools to frankly interface with customers.

So I would say that when we look at the productivity metrics, the number of contacts, the number of contacts that are digital versus in-person, what is the impact that we are having with these contacts, I would say that that is encouraging. And those are operational metrics. And it is quite difficult frankly within the context of COVID to really appreciate and see some of the benefits, right?

So we will see that hopefully during the course of 2021 and beyond that some of these operational improvements bear full fruit.

On the Ostomy Care side, I would say the story is a little different in terms of new patient starts. We are clearly challenged in that area. We have regions whereby our net patient starts or our new patient starts, I should say, have been declining. We have regions where it is flat and we have regions where it is growing. So it is very much of a mixed situation. And we have just put in place a new commercial leadership here in the last month and a half. And so we really to let Matt sort of settle in with his team and really review the go-to market strategy, strengthen the commercial capabilities.

And so I would say that there is a fair amount of work to be done in the Ostomy Care area in geographies like the US, frankly in the UK, where we need to really improve our commercial execution in addition to rationalising portfolio, in addition to refreshing the portfolio.

Hassan Al-Wakeel: And Karim, if I can please follow-up, just in terms of that NPS and Ostomy in the US. I think you have said in the past that you see some regions that are actually growing NPS

Karim Bitar: Correct.

Hassan Al-Wakeel: relative to others that are shrinking. When you delve deeper into the reasons behind that, do you think that you could get to a place where you could actually stabilise the trends without product introductions?

Karim Bitar: I think the short answer is yes. And I think frankly we have evidence of being able to improve new patient starts both within the US, but also frankly outside the United States with the current portfolio. That does not say at the same time though that we do not need to refresh the portfolio. We do not need to streamline the portfolio. But I would say that is the short answer to your question is yes.

Michael Jüngling (Morgan Stanley): I have three questions please. Firstly on organic sales growth. Does the slow hiring of sales people in 2020 provide you now with a materially more challenging growth dynamic for fiscal year 2021? Question number two is on the R&D progress. Could you comment on how COVID is impacting your ability to roll out your R&D programme and running clinical trials? Are you being put back? And is that perhaps causing a delay in products and organic sales growth in the future? And then the final question is also on organic sales growth. I would love you to comment on the progress that you are making in the timing of inventory rationalisation and how the reduction of SKUs is going to be impacting your organic growth in the fourth quarter? And how you are thinking about this in 2021? That is all. Thank you.

Karim Bitar: Yeah. So I will try to take the first two, Michael, and ask Frank to comment on the inventory rationalisation.

I think on the first one on organic sales growth and the impact of sort of not expanding the sales teams as rapidly. I think it is difficult to say just being candid with you there, Michael, right. I think that from one vantage point in certain geographies like China where we have not been at scale, there really is a need to expand the sales force. And frankly, we have now gotten on the case and we are actually adding sales people, right.

So there basically was a delay of about six months in doing that. And that was the right thing to do. But as you know, the situation in China at least today seems to be more positive and more optimistic than say maybe Western Europe or Europe and the United States. So we see those situations where you need that sales force, so you can sort of see that there is a lag of about six months in putting in place in those investments.

Having said that in other geographies I would say the whole hybrid model makes a lot of sense, right? We are balancing at the digital interface with the in-person approach. And so I think it is difficult frankly to say at this point in time because the model frankly is to how the interface with the customers is changing. So I would obviously say question-mark. And I could argue one way, I could argue the other. But I would prefer to basically say, look, difficult to assess at this point in time.

On the R&D progress, I would say actually making good progress there. I do not think fundamentally COVID has slowed down our focus in our investments frankly in striving to refresh our portfolio to make it more competitive and frankly to start driving to differentiation agenda.

We continue to run our labs. We continue to sort of build capabilities. And so even when it comes to clinical trials, we have not seen limitations at this point. So there I would say I am actually cautiously optimistic that we are on track. This is obviously a long-term gain that we are planning on the R&D investment front but encouraged by it. Frank, you want to take the question on inventory rationalisation?

Frank Schulkes: Yeah. So the rationalisation, this is really very much related of course to our Ostomy Care business. And earlier in the year, we have talked about this. We have rationalised some of sort of contracted or did not make any profits. And that has an impact on the growth rates for Ostomy Care one of the reasons would be basically go for a flat in Q3. We think it is low single digits underlying, piece of that was destocking and the other piece is really the rationalisation impact.

So it is limited. It is less than 100 basis points, but it is probably 80, 90 basis points. Now in Q4, we are going to see a little bit of a increase in that impact because we are starting to see the SKU rationalisation starting to gain momentum. So our expectation is that probably in Q4 it will be just over 100 basis points of negative impact, could be even a little more than that.

And then we are sort of ramping that activity into 2021. So at this moment, it is too early to comment on what exactly the impact is going to be in terms of basis points. But that is how you have to think about it, SKU rationalisation and plus the market rationalisation is starting to ramp up in 2021 and it will have an impact on the growth rate of Ostomy Care.

Michael Jüngling: Okay, great. And just to briefly follow-up on the sales force expansion. With this hybrid model that you are talking about, are you now suggesting that perhaps the way forward is to invest less in sales people just because the world is changing and therefore maybe the investments need to be split more evenly between, I do not know, call it a virtual world versus sort of the human world?

Karim Bitar: Yeah. I think the short answer is yes. I think that the marketing mix, if you go back to fundamentals and you start looking at promotional mix in fact, right. What is going to be in-person feet on the street versus the virtual site. I think that is definitely going to be changing. I think we see that in our own personal work practices, right? And it is a matter of calibrating what is that mix going to be. And I think there is going to be variance by geography. I think there is going to be variance frankly also by category in which we are competing in.

And so I think that one needs to be very thoughtful. How does one build digital platforms that can be used across the board to allow you to interface with the patient, with the nurse, with the physician, with the appropriate guard rails right, all the privacy guard rails, or the security guard rails you need. But at the same time allow you to be nimble and agile and to really drive sort of this whole idea of omni-channel, how do I link the sales force with insight sales vis-à-vis virtual channels and how do I help frankly folks as they decide to choose, who do use, that they decide to buy, so think e-commerce.

And as they decide to do and you help to be serviced, right. So I think we are going to see a significant change in the commercial models that will be used to interface with customers.

Michael Jüngling: Great, thank you.

Lisa Clive (Bernstein): I have three questions. First one on the infusion devices market. My understanding is while demand for infusion sets is clearly increasing. There is also a dynamic in the market around assistant technology to patch front. Can you provide us with some high level commentary on the differences in the technology? How easier, hard it would be for ConvaTec to get involved in the patch front supply chain and have you made any moves to do so? And then can you also remind us of what the approximate your infusion devices sales today are to Medtronic, and if that has sort of shifted overtime? And then lastly, can you provide us an update on your product developments in Continence, when we could see a new product portfolio and your plans on moving into the EU market there?

Karim Bitar: Okay. I will take the first one. I will pass the second one to Frank, and I will take the third one. So maybe I will take one and three, and Frank pass to you the question about a proportion of sales to Medtronic.

Frank Schulkes: Sure.

Karim Bitar: But on the patch front, yeah, so look, so you have got historically this whole area, Lisa, which you are well aware, right, that is the sort of the durable pumps versus the patch pumps and they have got pros and cons. But fundamentally the market is perfect and more durable pump with patch pumps frankly growing more rapidly and more quickly.

So I think the dynamic that we see there is that there is going to be space for both and there is a need for both, right. So we do not see sort of one versus the other. I think the first question to what degree does one believe the patch pump is going to be playing in the smart glycemic control segment too.

Our assessment is that we will see patch pumps that would also be part of that smart glycemic control mix. And then to your specific question of, okay, is there an opportunity for the Infusion Care business in ConvaTec to partake in not only the, let us call it the durable pump portion of smart glycemic control but also in the patch pump area. I would say the short answer is possibly yes, but obviously for competitive reasons I am not at liberty to comment more or beyond that, okay.

All I will just say is sort of top of mind, but we clearly see and understand that the smart glycemic control segment is one that structurally we see important growth long-term and we think that from a technology vantage point, we can make an important contribution to our partners.

On Continence Care, what I would say, look, there, a little bit Frank alluded to this. It is unfortunate we have been talking for quite some time about GC Air, GentleCath Air, trying to develop basically a compact offering. And the reality is that we did go ahead and carry out a pilot launch, which is ongoing frankly in France. And from a customer receptivity perspective, the ideas behind the offering and the benefits are actually attractive and appealing.

However, unfortunately, we did not focus efficiently on design for manufacturing, really focusing on quality and really focusing on efficiency and cost of goods sold, right. And so what that has basically meant is that we are having to go back to the drawing board fundamentally.

And so I would anticipate that is going to take us approximately an additional 24 to 30 months to be able to go ahead and introduce a significantly more competitive product offering in that arena. So again back to some of the previous questions as to R&D spend, where do you see some of your R&D spend, that would be an example again of where we need to go ahead now and invest at the appropriate time, effort and energy to think, yes, about design from a human factor perspective, i.e., what is going to be appealing to the patient but equally importantly from a design to manufacturing perspective think efficiency and think quality. And then to also carry out the appropriate clinical trials to have sufficient data to be able to effectively move on.

Frank, do you want to take the question about Medtronic?

Frank Schulkes: Yeah, the Infusion Care. So if you look at our Infusion Care business, about 85% of that business is related to infusion sets. We are not providing specific percentage here, but you can say Medtronic is over 50% of that. And looking at the growth rate of the different players in the markets, that percentage is slowly coming down because we are providing infusion sets to basically all the major players in the market. So that is how you have to think about it. 85% of the total business is related to infusion sets and more than 50% is Medtronic, but it is coming down.

Karim Bitar: The one thing I would add to Frank's comments is clearly we are diversifying the number of partners that we are working with. Today, there is folks like Roche, there is folks with Tandem Diabetes, there is folks like Medtronic. I think it is also clear to us that there is going to be new players in the marketplace, particularly Asian players. So I think we are well poised to work with them.

And also it is clear to us also is that there are applications and opportunities for us to grow that business outside of diabetes care, so an area such as Parkinson disease, an area such as autoimmune diseases. There is an opportunity for us to go ahead and drive R&D agenda there. And clearly, those are areas which we are actively looking and are actively exploring.

Lisa Clive: And just a follow-up question on that. In order to access those new markets, I assume you need to be running clinical trials and sort of proving that the technology really is beneficial for these patients. How long of a timeline are we talking about here?

Karim Bitar: Yeah. So look, it really depends on the application, I think we will have an outcome during the course of the next 24 months, right. But that would be a very good example, the application of an infusion set for the treatment of severe Parkinson's disease and potentially all of a sudden now the infusion set, plus the pump, is not only impacting the patients from a convenience perspective but truly from a clinical efficacy perspective.

And so if you can frankly leverage the Infusion Care technology to help improve the clinical profile of things like biologics then that could be quite interesting.

Lisa Clive: Great, thank you.

Kit Lee (Jefferies): Two questions, please. Firstly just a follow-up on Infusion Care. How should we think about the stocking activity of 4Q this year and also for Q1 next year? And then a second question is just on some of the new product in the near-term, including Avelle 1.5? Can you just talk about the progress there, and if those products are on track to be fully rolled out in the near-term?

Karim Bitar: Yeah. I will let Frank take the stocking activity question and then I will answer the Avelle question.

Frank Schulkes: So if we look at the stocking levels of some of our key customers and of course some of that happened because customers are expanding geographically, but also coming out with new products and therefore really filling their channels. If we, for instance, take a comparison versus fourth quarter of 2019, then stocking levels are somewhat up but at a pretty decent rate.

They are higher than Q4 of last year but not very significantly. Therefore, we believe that we do not expect any, at this moment, stocking dynamic that again is substantial material. And we expect similar levels in 2021, but of course things can change from now on. But that is our current view of those type of levels [inventory].

Karim Bitar: Yeah. Look, I think what I would say, look, on Avelle 1.5. I mean, look, it is an improvement we have made and that is just helping us to fundamentally just be competitive, right. So I would not sort of getting overly excited. I mean, something we need to do from a design from manufacturing perspective.

I think what is fair to say, look, on the R&D front, to improve and refresh our offering, that just takes time. And so historically we have really underinvested in area of R&D. And so it is going to take us several years frankly to build the capability, to refresh the portfolio and truly be competitive and drive differentiation.

And so I think what is fair to say is, look, we currently have a series of businesses where there is a fair amount of variance, right. And I think we have been pretty straight in terms of highlighting businesses like Infusion Care and Home Service Group, where there is a fair amount of differentiation. In the case of Infusion Care, that is product differentiation. In the case of Home Service Group, that is really service differentiation.

But there are other businesses such as Ostomy Care, the whole compact segment of Continence Care, part of the portfolio in Advanced Wound Care, where we need to really be working hard on improving that. And frankly, we really need to make the investments in 2021 and 2022 to thereafter be able to see some of the fruits of the hard work and that significant investment we are going to be making.

Kit Lee (Jefferies): That's great, thank you.

Chris Gretler (Credit Suisse): I have two questions left. One actually following up on infusion devices. Could you actually talk about the price mix dynamics in that business? If this is high-single digit growth you are projecting mid-term now? Is this volume growth or is there a significant price mix effect as well, as you essentially diversify away from Medtronic? The second question is just on your Critical Care business. I mean, looking into the current world and with this increasing COVID hospitalisation rates in developed countries, should not that business not see a major increase in demand over the next couple of months?

Karim Bitar: Yeah. They are both great questions. Let me try and answer both questions for you, Chris. In terms of Infusion Care, price and volume, is there a mix effect? I think fundamentally there is volume, right, for example the smart glycemic control segment I think is much more of a volume element.

I think that as you look at different applications, there probably is a mix in pricing opportunity, right, because you need to sort of understand how much value are you bringing to a specific application. And so the infusion set itself maybe using a very similar technology, but across different applications the degree of value you bring to bear varies. And so therefore how do you actually price based on value pricing, if that makes sense. So I think there is an opportunity there and I will leave it at that.

And I think I have given you two examples of diabetes in partial sense, which should help you think that through.

On the Critical Care one, look, I think you make a good point is look, Karim, Frank, these COVID rates are going up, would not you expect frankly utilisation if you look at care products to rise? I think the reality is that because of what happened in Q1 and Q2, whereby we saw some very strong growth in demand critical care offerings, at least our assessment right now is that frankly the hospitals are actually very, very well staffed.

And even though COVID rates maybe going up right now and I think most of us would say they are probably going to keep on going up unfortunately, right. No one is wishing that. If we assess from the knowledge that we have what are the current stocking levels that these folks have, they seem to be very, very well stocked. And so therefore, the commentary that Frank and I have been sharing with you.

I do not know, Frank, do you want to add to that at all?

Frank Schulkes: No, I think that is very accurate. There are very well stocks. And at this moment, our expectation is also having discussed that with the business and people in the field that we in fact do not need the same level of growth that we have experienced in the first nine months of the year. And that is our current assessment. And things can change of course but that is what we see.

Chris Gretler: Okay. Appreciate your comments.

Karim Bitar: Okay. Thank you very much. First of all, I just want to say thank you to everybody and I just want to highlight here two things as we wrap up. The first one is should you have any further questions about today's announcement, please do get in touch.

I want to share with you that we recently recruited Kate Postans as our new Vice President of Investor Relations and Corporate Communications. So she would be delighted to have catch-up call, if that is required. The best way to reach or to contact Kate is to email and the email you may want to go ahead and use or should use to contact Kate is IR. So pretty straight, forward, IR@convatec.com.

Second, what I would like to highlight to you is that we decided to conduct an investor perception study. So you may be contacted by someone at Revel in the next couple of weeks. We very much would like to hear your feedback and get your inputs and insights and hope you can find the time to participate.

On that note, I will sign off and say thank you for joining us today. We look forward to the next opportunity to present, which will be at our full year results and we are currently scheduled to hold that on 26th February. Until then, once again thank you. Goodbye and please be safe.

Frank Schulkes: Thank you very much.

[END OF TRANSCRIPT]