LOWELL, BLAKE & ASSOCIATES
INCORPORATED

To: LBA Clients
From: LBA Research Department
Date: October 12, 2017
Subject: **Coloplast A/S Class B (COLO.B-DK)**

Common Shares Out: 216 million

Curr. Price	12 Mos. Range	5-year Range	Div.	Yield	EPS* 2016	EPS* 2017E	EPS* 2018E	P/E 2017E	P/E 2018E	Debt Ratio
$88	$95-68	$95-43	$2.16	2.5%	$2.35	$2.92	$3.13	30	28	0%

One Danish Krona (DKK) purchases 0.16 U.S. Dollars (USD) at the time of this writing
*Fiscal year ends September 30th; Core earnings to reflect underlying performance; not in accordance with IFRS
Coloplast maintains American Depository Receipts, with a 10:1 ratio to the Danish-listed shares

Sector & Industry: Health Care; Health Care Equipment & Supplies

Company Description

Founded in 1957 and based in Humlebæk, Denmark, Coloplast is a leader in the development, manufacture, and sale of medical supplies. The company specializes in what management calls "intimate healthcare", meaning very private and personal medical conditions. The company sells its products globally to hospitals, institutions, wholesalers, and pharmacies. In fiscal 2016, the company generated sales of DKK 14.7 billion (or $2.2 billion), 7% above 2015 on an organic basis. By geography, 63% of sales are derived from European markets, with Germany being the largest, at 12% of sales. Emerging markets make up 15% of sales and other developed markets round out the remaining 22%. The company's single largest market is the United States, at 15% of 2016 sales. The company is divided into two main divisions: Chronic Care and Strategic Business Units. Within Chronic Care exists two product segments: Ostomy (40% of 2016 sales) and Continence (35%), wherein Coloplast is the world leader in both categories. Two more categories exist under Strategic Business Units: Wound & Skin Care (14%) and Urology (10%). Over the past several years, research and development (R&D) has averaged 3% of annual sales.

The ownership structure of the firm is divided into two share classes: A and B. The founding family controls all A shares, which represent 10 votes per share, and 41% of all listed B shares, leading to a 46% ownership stake and 69% of the voting rights. Niels Peter Louis-Hansen, the son of the firm's founder, serves as the Deputy Chairman and maintains 21% ownership and 41% of the voting rights.

Performance Update

Coloplast delivered strong results for the first nine months of the fiscal year through June 30. Revenues rose 6%, to DKK 11.5 billion, and, excluding currency and acquisitions, revenues grew 7%. By segment, Ostomy rose 7%, Continence 8%, Urology 11%, and Wound & Skin 0%. Gross profit growth was limited to 5%, due to a slight contraction in the margin, to 68%, most of which was due to negative product mix, restructuring of production staff in Denmark, and wage inflation in Hungary (70% of production by volume). Distribution costs rose just under 5% and made up 28% of revenues, administrative costs rose 10% and made up 4% of revenues, and R&D rose 15%, making up 4% of revenues. All-in, operating profit rose 4%, as the margin contracted 50 basis points, to 32%. The net income gain was limited to a 2.5% increase, attributable to a large jump in foreign exchange losses, and earnings rose 2.7%, thanks to the benefit of a slight reduction in the share count, to DKK 13.13 per share (USD 2.10 at the current exchange rate).

Coloplast elects to distribute excess cash to shareholders primarily through dividends, having paid one every year since 1985, raising it 35% in just the past four years. The dividend is paid semi-annually, in May and December. In calendar 2016, the firm paid DKK 13.50, or 74% of our 2017 earnings estimate. We believe future increases will be commensurate with earnings growth, due to the high payout ratio. Coloplast maintains a strong balance sheet. The company carries no long-term debt and minimal other long-term liabilities on the balance sheet. At the end of June, the company maintained DKK 1.4 billion in cash and marketable securities, versus DKK 6.8 billion in current liabilities, the latter of which trumped current assets 1.05:1.

Outlook & Recommendation

We are drawn to Coloplast, due to its leading position in the healthcare consumables space, a stable and growing industry. All four of the company's product categories are positioned to benefit from an ageing global population. Ostomy Care (40% of sales) markets products to people with stomas, which are generally caused by surgical operations for those with colorectal cancer and diverticular diseases. Both conditions increase in prevalence as one ages, with recent data suggesting up to 50% of individuals over 60 suffering from colonic diverticula. Management estimates this market will grow at a 4%-5% rate and Coloplast holds 35%-40% share, globally. Continence Care (35% of sales) addresses bladder control issues, which are most prevalent in the elderly, and the market is slated to grow at a 5%-6% pace, with Coloplast commanding a dominant 40% share. Wound & Skin Care (14%) and Urology (10%) address a broader demographic but are vital pieces to the firm's growth equation, with 4% growth rates, each, and market share of less than 15% in each category. In addition to the healthy growth profile, Coloplast exhibits recession-resistant characteristics. Through the last recession, Coloplast grew revenues and operating earnings at an admirable 6% and 17% annual rate, respectively, on a purely organic basis.

Long-term, management sees annual organic revenue growth of 7%-9% and margin expansion of 0.5%-1%, leading to annual operating profit growth of approximately 9%. The company seeks to reach these targets through continuous new product launches from its internal R&D platform, direct-to-consumer (DTC) marketing and outreach efforts, and manufacturing efficiencies. We believe the company can meet these targets through continued end-market growth and modest market share gains.

At present, Coloplast ADR shares are trading near their all-time high and at a pricey 28x our 2018 earnings estimate. Nonetheless, we believe shares of this high-quality healthcare firm can provide both growth and further stability to our overall healthcare package.

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