

Essity Aktiebolag (publ)
Interim Report Q3 2020
22 October, 2020
9:00 a.m. CET

Slide 1

Joséphine Edwall Björklund:

Welcome to Essity's Third Quarter Interim Report 2020. I'm Josephine Edwall, Head of Communications. And on today's call, our President and CEO, Magnus Groth, will go through the keynotes in the report, followed by a Q&A session, where our CFO, Fredrik Rystedt, will join. So with this, I hand over to you, Magnus.

Slide 2

Slide 3

Magnus Groth:

Summary

Thank you, Josephine. And to summarize, I guess, one of the highlights of this report is that we raised our target for adjusted return on capital employed from being above 15 to a new target to be above 17 by 2025 at the latest.

And we will do this through continued execution of our strategy, an acceleration of our digital transformation and also through accelerated cost savings and efficiency improvements following a manufacturing roadmap program that we are announcing today.

And of course, as previously already announced, the Board of Directors is proposing a dividend of SEK 6.25 per share. So that decision was taken during this fall.

Slide 4

Summary – Q3 2020 vs Q3 2019

Moving over to the numbers. We have a number of segments affected differently. Some are positively impacted by the pandemic, some are negatively. Underlying, we see a strong business performance with improving

market shares in most of our markets and category combinations, combined with high cost efficiency and savings.

Combined, this resulted in organic net sales 5.1% lower than the same quarter last year, but sequentially, a big improvement as the impact of the pandemic has gradually eased in the third quarter compared to the second quarter.

Adjusted EBITA was down 1%. But in this, we see a big negative currency translation effect due to the strengthening of the Swedish krona. And adjusted for that, adjusted EBITA would actually be up by 7%.

Adjusted EBITA margin improved to 14.4%, as we see one of the highest margins we have had over the last number of years. Operating cash flow was lower than third quarter last year. These are temporary impacts on working capital that we believe will gradually adjust going forward. And adjusted return on capital employed close to the old target at 14.7%.

Slide 5

Net Sales – Q3 2020 vs Q3 2019

The net sales bridge, organic net sales was negative 5.1%, with negative volumes in Professional Hygiene and Personal Care and positive volumes in Consumer Tissue.

Price and mix equaled out to 0. We had positive mix everywhere in all our three segments and positive price also in Professional Hygiene and Personal Care, while it was negative in Consumer Tissue.

Slide 6

Adjusted EBITA Margin – Q3 2020 vs Q3 2019

Moving over then to the adjusted EBITA margin bridge. We see a significant improvement in gross profit margin of 240 basis points. Of course, this is helped by lower raw material costs, but also important COGS savings that we're very happy about since we have, as you know, lower utilization in many of our production units.

And still, we were able to achieve SEK 235m in the third quarter, adding up to SEK 622m for the first nine months of this year. And these benefits were then partly offset by lower fixed cost coverage in our supply chain.

A&P, slightly higher, both in absolute terms and as a percent of sales. We have a lot of good innovation that we're supporting with advertising and promotion. While SG&A was lower on an absolute level, but due to the lower sales, higher as a percentage of sales, but still shows that the very strict cost management that we are implementing everywhere also applies to SG&A.

Slide 7

Positive Long-term Development

And we do see a positive long-term development. And I mentioned that sequentially, we saw a big improvement in the third quarter compared to the second quarter. Medical, for instance, improved by 27% in the third quarter compared to the second quarter. Professional Hygiene, 18%, and Baby Care, 14%.

And this shows then an improvement in sales, even though it's negative, it's a move in the right direction, and we are able to retain EBITA margins on and also absolute EBITA on historically high levels. So we're seeing a gradual improvement here going forward.

Slide 8

Target Raised for Adjusted ROCE

And this is, of course, one of the important reasons why we have decided to raise our adjusted return on capital employed target, one of our most important financial targets to above 17% by 2025.

And the previous target was to be above 15%, which seemed like a big challenge when we set that target at the time of the split 3.5 years ago. But we have concluded that over the last 12 rolling months we have been well above 15%, and that's a very strong foundation for setting a new target. And we will talk about all of this.

But basically, we see that we have a higher structural profitability level in Consumer Tissue. That's a good foundation for setting this higher target. Professional Hygiene will, of course, gradually recover as the impacts of the pandemic eases, and we see also improvement potential in Personal Care going forward.

And in addition, the benefits from the digital transformation program and the manufacturing roadmap. With all of this combined, we feel comfortable that

we will be able to move towards the new higher target of above 17%. And the other financial targets remain unchanged, where an important other target is to grow sales above 3% per year.

Slide 9

Accelerating Our Digital Transformation

So accelerating our digital transformation. Focus here is on enhancing customer and consumer value. What we see here is a big opportunity. We have invested significantly in our digital transformation over the last years, especially in e-commerce, in areas like procurement, in logistics, distribution and other areas. But we now see that we need to take the next step. We need to make bigger investments here in our digital platform.

And with this, we expect to achieve automation in many parts of the value chain, simplification, economies of scale, that we will have access to higher-quality data in real time, which gives us greater visibility and predictability to take the right decisions.

And also eventually, over time, and we're already implementing this in many areas, advanced analytics to improve everything from forecasting to planning to, as a follow-up of course or a consequence of that, higher service level and better customer service.

We will invest SEK 2.6bn, of which costs during 2020 to 2024 over the next five years, but already started this year. And we will have a capital expenditure of SEK 1.2bn. We expect to start seeing positive impact from this investment in 2022. And in the short term, we will work to offset the costs by savings in other areas. So a very important priority for us going forward.

Slide 10

Manufacturing Roadmap Program

The manufacturing roadmap program, many of you remember the tissue roadmap that we initiated six years ago and that has significantly improved our tissue footprint, but also the efficiency in the individual mills.

And now we're taking the next step, including also our Personal Care plants and our medical plants and logistics and distribution. We aim to optimize and streamline all of our 60 wholly-owned facilities with the aim of achieving world-class cost efficiency, world-class quality and world-class service levels.

And in many areas, we're already world-class. But of course, this is a moving target, and we see many areas for improvement here. And we believe that doing this will also contribute to our science-based target initiative to reduce carbon emissions.

Slide 11 *Innovations – Launched in Q3*

We always talk about innovations, and this is a quarter with a very high amount of product launches based on innovation and work done over the last couple of years. And I will dig into a few of the examples here.

Slide 12 *Washable Absorbent Underwear – Feminine Care*

Also on the cover of our Q3 report is the washable absorbent underwear that we're launching and have already launched in Latin America. This is very exciting. It is a product that has the same performance as a liner.

But since it is then washable and reusable, the environmental performance is great, up to 77% lower environmental footprint than a liner and of course, a much lower usage of products. And we will launch this also in Europe beginning of next year in most of our key markets.

Slide 13 *Face Masks – New Product Offering*

Face masks, this is a new product offering as a consequence of the pandemic, something we had not contemplated nine months ago. So it's one of the fastest product development programs that we've done.

We see that there are many face masks around in most markets, but there is definitely a need, both from consumers and from customers/retailer's for high-quality face masks supported by trusted brands and also to create order in this new category that is quite confused in many countries at this time.

So we believe that this is an opportunity where we can build on our strong distribution, our strong retailer and customer partnerships and on our trusted brands.

Slide 14

TENA SmartCare – Digital Solutions Improving and Facilitating For Users, Relatives and Caregivers

And an innovation that we've been working with for a long time and that I'm really excited about - TENA SmartCare. And we have been providing sensors in incontinence care products for a number of years, but quite cumbersome and expensive products that have not really been suited for simple use.

But now we are launching something that's incredibly simple to use and it creates fantastic customer and consumer value. And you can see there to the right 94% reduced time spent in an incontinence product nearing saturation and 86% reduction in unnecessary sleep interruptions. So quite fantastic improvement opportunities here.

And we believe that this removable and reusable sensor is so easy to use now with the apps that, of course are linked to this, that we are launching this, not only in professional care, but also in homecare. And we believe that sometimes, big innovations like this are more difficult to actually launch in a professional environment because of reimbursement systems and so on.

While we do see that this will be the new normal in a few years' time also in homecare for, for instance, caretaking relatives. So we're really excited about this, and this is launching now on a broad scale, both in Europe and in the US.

Slide 15

Personal Care – Q3 2020 vs Q3 2019

Then moving over to the numbers here, starting with Personal Care. Organic net sales decreased 1.5%. And as you can see there at the right-hand bottom, this was in all product segments, except Feminine Care, which was more or less flat. And sales were negatively impacted by COVID-19 and lockdowns.

I want to underline again the significant sales improvement from Medical Solutions. And actually, behind this, we see some very encouraging signs where in the quarter, the wound care part of the business actually grew compared to last year.

And in one of our key markets, where we've been working hard to restructure and to improve in Germany, we also saw higher sales than a year ago. So

we're seeing very encouraging signs here in Medical Solutions and a big improvement to the previous quarter.

We had lower volumes, but we had higher prices, better mix and cost savings in most areas and also supported by lower raw material costs. Sales and marketing costs were higher as a percent of sales.

We continue to invest behind all these categories. And part of the explanation of the lower organic net sales is the exit of Baby Care in Russia, our latest cure or kill effort and actually also in North Africa, where we were working through a joint venture since many years that we left after the end of the quarter.

Slide 16

Consumer Tissue – Q3 2020 vs Q3 2019

Consumer Tissue, organic net sales increased by 2%. Volumes were significantly higher. Price/mix negative. We have now been working in our consumer tissue business for quite a number of quarters here with quite low pulp prices and with high market prices.

And gradually, we are adapting our price levels. The impact on price that you see here is a combination of lower prices that were already agreed in earlier quarters. So there is no changes there. There are no new price negotiations and higher promotional levels, partly in Europe and partly in China, while we saw higher prices in Latin America following currency depreciation. And as you can see up in the right-hand corner there, adjusted EBITA margin remains on a historically very high level, 16.3%.

Slide 17

Professional Hygiene – Q3 2020 vs Q3 2019

Finally, Professional Hygiene. Organic net sales decreased 21.4%. And I want to underline that 80% of our business in Professional Hygiene is very much impacted negatively by the pandemic.

And these 80% consists of hotels, restaurants and catering; 39% commercial buildings; 26%, such as offices; public interest, such as universities and schools; and then, of course, we have airports and other places that are also significantly impacted by lockdowns and by restrictions.

So all of that said, we think the organic net sales decrease of 21.4% is, of course, a big setback, but very much a consequence of market conditions. And actually, I think that the organization is doing a fantastic job, and we'll get back to that in mitigating this and then also managing price/mix that you can see is positive here and taking initiatives to gradually come out of this.

And we saw that already in the third quarter compared to the second quarter, an improvement with 18% in sales. And as you can see, that mature markets and emerging markets were almost similarly affected with big local variations during the quarter.

Slide 18

Professional Hygiene – Focus Areas

So a few more words about Professional Hygiene and the actions we are taking to recover. One is, of course, to shift our segment focus towards segments like health care and industrial, where there is still a high consumption and to some extent, an increase in consumption; to drive services and solutions where we have a big competitive advantage with our sensor enabled solutions, for instance, compared to competition; accelerating e-commerce.

There is a big shift, and we are following or taking the lead in that shift; accelerating skin care, currently, 3% of sales, but we see a big opportunity here going forward; and we do see that there's a higher usage of soaps and other skin care products. And, of course, recovering in hotel, restaurants and catering and taking the opportunity to grow market shares even further there, anticipating the gradual improvement in that area.

Converting air dryers. Last quarter, we reported that we had converted air dryers to hand towel dispensers to an annual business value of EUR 5m, and we achieved another EUR 5m in this quarter. So that adds up to EUR 10m so far this year.

New product launches and, of course, very much supporting Tork PeakServe, which grew 66% in the quarter compared to last year and cost reductions to protect margins.

Slide 19 *COVID-19 Impact on Visitors – Examples Based on EasyCube® Data for Commercial Buildings*

And I thought this slide could be interesting to show. We're starting to get substantial data now from our sensor-enabled dispensers, and these are just some examples. So you can see an airport up there in the left-hand corner and the consequence of lockdowns and reduced traveling underneath office buildings.

More or less empty people working from home. I guess many of you listening today are working from home. You see this, you experience this also privately. While slightly more encouraging trends there in a department store and shopping in entertainment center.

And of course, this is very, very useful data, not only for the customer, the facility management company, but also for us. And one new service that we are launching this quarter that we're excited about is automatic replenishment service. So the system sends a signal to the facility manager when it's time to replenish the professional hygiene tissue stocks.

Slide 20 *Increased Awareness of Hygiene and Health – Leveraging Our Leading Solutions*

Here's some other outcome from that data. This is the consumption per visitor in a number of -- in thousands of dispensers that are in use then, in buildings that are actually in use.

And it's interesting to see that per person, there is a significantly higher consumption of skin care products. So that's hand sanitizers and soaps and also hand towels.

And I guess that the reduction in toilet tissue per person, is not that the individual is using less toilet tissue when needed, but that they enter the washrooms actually just to clean their hands and then to leave again. So a lot of interesting data coming out of our products now.

Slide 21 *Increased Awareness of Hygiene and Health – Converting Air Dryer Customers to Tork PeakServe*

And of course, we are working hard to continue our air dryer converting campaign, and here are some taglines “gambling with hygiene”, “making the safer choice”, “play it safe” and so on, which is very much playing to the benefits of paper towels.

And approximately 20% of the hand drying market today is jet air dryers and hot air dryers. So that's an opportunity of about EUR 1bn that we are gradually then eating into with these types of campaigns.

Slide 22 *Summary*

So to summarize, we have today raised our target for adjusted return on capital employed to above 17% by 2025. That's up from the previous target to be above 15%. The other financial targets remain unchanged.

We will accelerate our digital transformation with an investment in a new digital platform that will transform how we work in the company. With higher automation, better data quality, all leading to an improved customer and consumer experience.

We are also launching a manufacturing roadmap program, looking at all our approximately 60 fully-owned plants.

And we do see a strong underlying business performance in a challenging environment where different categories and product areas are affected in different ways. And of course, the dividend proposal that will be decided in an extra shareholders meeting next week on Wednesday. Thank you for listening.

Joséphine Edwall Björklund:

So thank you, Magnus. And operator, please open up for the Q&A session.

Operator: Your first question comes from the line of Sanath Sudarsan at Morgan Stanley.

Sanath Sudarsan: A couple of questions from me. First, more on the longer-term question. You've just upgraded your ROCE target from 15% to 17%. If you could just help us understand of this 15%, how much do you think is far more sustainable? You've spoken about Consumer Tissue margins also structurally being higher, but it's currently at a much valued level than you would expect historically. So could you just tell us how the mix will improve going forward?

And what are the drivers that you really highlight to get from 15% to 17%? Does that include light space opportunities like face masks, those kind of things. So just a better level understanding of how we expect to move on these growth targets.

And then, secondly, on the near-term perspective. Could you just give us a sense more on the pricing dynamics in terms of Consumer Tissue specifically in Europe and China. And also, more broadly, is there any pressure given weak demand across Personal Care part of the portfolio?

Magnus Groth: Okay. Thank you, Sanath. I'll start with the first question. Of course, we have looked at our long-term financial plan and see that we are able to reach above 17%. But we also think it's a good initiative to raise the bar also to challenge ourselves, which we have to do now that we are stabilizing around 15%.

And I think the components are very much what we've already seen. So working very hard with innovation, improving our mix has helped us to achieve the 15% as has ongoing cost and efficiency programs like the tissue roadmap that you also referred to that has improved our structural cost position in Consumer Tissue considerably. So we will continue with that, and that will definitely help.

And then we will look at opportunities to accelerate efficiencies and savings through the manufacturing roadmap and also through the digital transformation program, where we see that we will, starting from 2022, see benefits mostly on efficiency on the cost side, but also eventually, we believe that this will improve our competitiveness through higher service levels and improved quality in our relations with customers.

So all this taken together, we think that a 2% -- I mean, most of this will come from a margin improvement to start with that because we do think that we will continue to invest in growth. So capital employed, that's not what we're going after. We will continue to invest on a level we need to grow our business.

So that's regarding the 17%. Then the second question was about price pressure in Consumer Tissue. And currently, we are not in any negotiations in Europe. That's done, and you see the impact here in the numbers we have.

And in China, we did see a higher promotional pressure during the third quarter, which we have typically maybe not seen historically because it's in between quarter three and quarter four that have these big annual sales events 11/11 coming up in a few weeks' time.

And we expect that -- which is typically the case. There will be high promotional pressure also during this campaign in China. But of course, we do see historically, as you also said, very, very high consumer tissue margins across the board actually in our consumer business globally.

Sanath Sudarsan: And can I just come back on the ROCE part. Just because it's interesting that you're spending good money in digital upgrading your business. But it seems much of that is to kind of have the capabilities to be more efficient rather than actually speed up top line. Can you just give a sense more sense on if there is any benefit we should think about from a top line perspective on this investment?

Magnus Groth: We're very much focused on top line, and that's, of course, the quickest way also to improve efficiency with better capacity utilization. And we are retaining our target of above 3% growth, which before the pandemic was an attainable, but challenging target, which meant gradually growing market share. We are sticking to that target.

Of course, over time, we hope that we should be able to do better than that. The target is to be above 3%. And this needs to come from a combination of volume, price and mix. And maybe I focused very much on the price and mix

improvements coming from innovation, product launches, market share gains. But of course, volume is an important part here.

And that's partly why we are also launching now in new areas like the washable underwear, like everything from face masks, which will not be maybe a big business, but maybe a very value-adding business, skin care in professional hygiene and also focusing very much on emerging markets, where eventually, we expect to see a higher growth on average than we see in mature markets.

So top line is a top priority for certain. That remains unchanged going forward. And maybe even more important now, also as seen from all these initiatives when we have some structural challenges, especially in Professional Hygiene.

Operator: And your next question comes from the line of Iain Simpson at Barclays.

Iain Simpson: A couple of questions from me, please. Firstly, thinking a little bit about pricing in your Consumer Tissue business. Would I be right in thinking that price negotiations usually take place sort of December to February?

Because clearly, in the last pricing round, expectations where the pulp prices would come up in the second half of the year. It now looks like everyone's expectations for pulp prices to remain low for the foreseeable future. Does that mean the upcoming pricing round could be more challenging?

And secondly, you flagged just a few quarters ago now that overall consumption of some of your personal care categories, diapers, fem care and inco care that fallen under lockdown due to sort of lost precautionary change motivation.

It would be great if you could give an update as to how you see overall market growth trending in your personal care categories in your main markets?

Magnus Groth: Okay. I will start then, and Fredrik maybe can help me out. And we have annual negotiations, especially for our branded assortment in Europe.

So first of all, we just recently increased prices in and have an improved pricing component in Latin America, which is the smallest market for us. In Europe, we are entering the annual negotiations for a majority of our branded sales.

We are not that concerned because we believe that we have a very, very strong assortment. We have strong brands that are benefiting from online sales, trusted brands. And we have a differentiation and a premiumized assortment that we think deserves and can support a higher margin than previously. So we feel in good shape there.

While, as you know, the private label part of our Consumer Tissue business in Europe is renegotiated at more or less at any point in time, when one of the parties see that there's a need or a reason. And currently, there is not much going on in that area.

And when it comes to China, I think I would refer to Vinda's announcement. But of course, in China, we have also seen historically high margins, but also an incredibly fast premiumization by our subsidiary, Vinda, that's quite impressive with 4-ply products, Tempo products becoming every quarter a bigger part of the portfolio and of course, making them also more protected to swings, both in raw materials and in promotional pressure than many of the competitors.

So that was regarding price negotiations. I think we feel good about our consumer tissue business and the ability to protect our margins there going forward, even though there will be price pressure as a consequence of the low pulp prices.

Magnus Groth: So in incontinence care retail, in Feminine care and to some extent, in Baby Care also, we see slightly lower consumption rates, could be around 5% on average. So maybe using like one piece less per day. That's what we're seeing during lockdown.

But then we're seeing that as soon as countries, geographies are coming out of lockdowns and restrictions, that consumption goes back to normal again. Those are the patterns that we are seeing.

And currently we're not really seeing any stockpiling or restocking to any significant effects anywhere except in the third quarter for the continued destocking of Professional Hygiene, which accounted for about 5% of the decline of Professional Hygiene in the third quarter. But we believe that, that is now out of the system for the fourth quarter.

Operator: Our next question comes from the line of Charles Eden at UBS.

Charles Eden: Just two questions for me, please. Firstly, just again on the heightened promotional activity in Consumer Tissue. I just wanted to check whether there's any notable difference in the levels between branded and private label products.

And then my second question is actually on adult incontinence, which was broadly flat in the quarter. I noticed from one of your largest competitors, which reported earlier this week, they saw very strong growth in the quarter of around 20% for this category.

We know this competitor's historically been very promotional in the category since they entered the market. But have you seen a further step-up in that promotional activity from that competitor in the quarter, just given the variance in the performance between the two businesses?

Magnus Groth: The promotional intensity in adult incontinence, retail has been incredibly high over the last five or six years.

And we are countering that with innovation and, of course, increasing promotional pressure also from our side, but now supporting a much better assortment and in the markets where we are present, which is very much in Europe, in Latin America and to some extent, in North America, but that's a smaller part of it.

We are actually doing rather well when it comes to market shares and growing market shares in Latin America, stabilizing market shares in Europe and slightly losing market shares in retail in our smallest incontinence care market, which for us, which is the US and doing okay in Canada.

So it's not Essity that's being impacted by this growth that you referred to from one of the competitors. And I think part of the explanation could be entering new markets and growing significantly in markets where we don't have such a strong position.

So I don't see that we are negatively impacted by, to any significant effect, by those numbers that you referred to. And in general, in promotional activity, we expect higher promotional activity in Europe. But I can't say that we are really seeing anything in the third quarter of significance.

And in China, 11/11 will be a very important indicator. Always with high uncertainties. What we know is that Vinda is by far the leader in the online channel in China and typically has done really, really well during these types of festivals. So that's our expectation also this year.

Fredrik Rystedt: I think, Charles, you asked also if there is any difference between branded and private label, and there's no material difference. It's basically a European question because the rest of the world is largely branded.

So if you take Europe, it's no material difference. In general, we have a better kind of own control of pricing when it comes to branded. So we control that slightly more. But in general, no material difference at this time.

Operator: Your next question comes from the line of Karel Zoete from Kepler.

Karel Zoete: Yes. I have three questions. The first one is with regard to your overall market share position. I think at the Q2 event, you said that you're gaining shares in around 60% of the markets where you play. Where do we stand in the third quarter?

The second question is on the raised return on capital target. You say it's -- the improvements will be based mostly on profit margins that should go up structurally as your asset turnover and capital base will not change too much.

If I think about the EBIT margin improvement, is it fair to assume that it's going to be mostly gross margins that should increase because also, SG&A will go up given the investments you're doing in the business?

And then the third question would be on the near-term outlook for input costs. Can you help us what you're seeing for the business in the fourth quarter?

Magnus Groth: Input costs, we see largely flat input costs for the next quarter when it comes to pulp, fluff pulp, recycled fiber and also oil-based materials. So no big changes. There could be some variations up or down, but basically quite unchanged.

So any impact would then maybe be more related to swings in currencies when it comes to input costs. Overall market share, yes, this is the case. We continue to grow market share in Fem care in most of our markets.

We're doing extremely well in Consumer Tissue in Europe, in Latin America. We are number 1 with unchanged market shares in China. We are losing a little bit of market share in inco retail, but gaining market shares in all our B2B areas in inco health care and in Professional Hygiene, where we're doing really well.

Those market shares are, of course, not measured by Kantar or Nielsen, but something that we follow very closely. And in Medical, we expect to gradually recover. It's very difficult to follow market shares right now because of the big volatility in different markets and in our different segments there. So that adds up to the over 60% of market category combinations where we're growing.

And the second question about how to improve return on capital employed, I leave to Fredrik, who will talk about structural margin improvement and growth.

Fredrik Rystedt: Yes, it's absolutely correct that it's a gross margin issue because you're right that, of course, as we pick up cost in the digital part of what we do. We've already had a lot of digital cost in the last few years here. But of course, this will accelerate it further.

So we are, of course, at this point, when volumes are fairly low, the SG&A and A&P to sales is also high as volumes start growing again and also cost pickup, we expect, of course, levels to be largely stable and perhaps somewhat increasing, but on the longer perspective. So it is exactly, as you say, a gross margin issue.

And of course, as Magnus has already alluded to, very much on Professional and Personal Care and perhaps more remaining over the longer perspective at high structural rates in Consumer Tissue.

And of course, just to emphasize what's already been said here, we have continued for many years to improve our mix on the back of innovation. And of course, this is the assumption also going forward that we will continue to do that as well as we have done in the past.

Operator: Your next question comes from the line of Oskar Lindström at Danske.

Oskar Lindström: Two sets of questions for me. The first one is on Medical Solutions segment, where you had a less negative development in Q3 than you had in Q2, and you say that you are positive in the wound care segment overall. I mean, what is your target organic growth in this segment? And by when should we expect it? That's question A.

And the second one here is, I mean, what -- are you still taking actions to improve organic growth here? Or have the sort of most of the restructuring actions already been taken, and you're now waiting for the effect of them?

And then, finally, on Medical Solutions, I mean, could you say a few words maybe about your acquisition strategy in this segment? And do you feel that you can -- that you're ready to make any more significant acquisitions in Medical Solutions already now? Or would you need to sort of see organic growth improve more before you make add-on acquisitions here?

Magnus Groth: Okay. So our target is to grow medical solutions above 3%. And we were very much expecting that to happen this year, that this would be the kind of breakthrough year before the pandemic.

The pandemic is influencing all three subsegments negatively. Wound care was very much negatively impacted by hospitals, of course, postponing scheduled surgery and treating COVID patients instead.

And as that has subsided and many hospitals have come back to then managing other pent-up demand in surgery, we've seen an improvement in underlying wound care growth, and we've also benefited from that. But in a few markets, including Germany, which is the most important market for us in wound care, we have actually also gained market shares in this quarter.

And then on explaining this, how to achieve the 3%. When it comes to orthopedics, it's very important that people are able to get outdoors and be active because that's when they break their legs and sprain their ankles and need our castings and orthopedic soft goods and so on.

And as you can read in the newspapers, that's moving back and forth, but we see an immediate improvement in demand as soon as countries come out of restrictions and lockdown. And thirdly then, the compression part of the industry, where we are the global market leader.

Again, very, very dependent on the shape of the health care system because these products that are medical products need to be fitted by a professional fitter that is typically then in a medical device store or in a health care setting in a hospital or in another ward.

And typically then this has also been held back and delayed due to COVID restrictions. But again, we saw big improvements in markets where things were opening up. But of course, the demand for all these segments remain the underlying strong positive structural growth drivers in all these three areas remain. And we will see how quickly you'll get back to above 3% growth, I think, very much depending on how the pandemic develops.

We're in much, much better shape than we were a few years ago when it comes to assortment, go to market, brand equity, and we've also recently been very agile in moving from feet on the street, very much meeting with

customers in hospitals and other facilities to a blended selling, where we also now make sales calls online, of course, and that's worked really, really well.

But of course, we're continuing to strengthen our offering in all parts of medical. But I feel that we are in good shape and at the point where we should be able to achieve in a stable environment above 3% growth.

And acquisitions based on that previous statement, if there are opportunities, I think we are ready to look at that. And of course, there's also a big uncertainty when those opportunity arises. But definitely, part of our strategy going forward from now.

Oskar Lindström: And if I may just follow up on that last point about acquisitions and opportunities in this segment. I mean, do you see your targets that you were interested in coming up for sale as a consequence of problems relating to COVID that maybe some competitors are willing to sell some businesses now that they were not willing to sell before or?

Magnus Groth: We can't really get into that. We never really talk about our ongoing or not ongoing acquisition work. So I can't really comment on that.

Operator: Your next question comes from the line of Karri Rinta of SHB.

Karri Rinta: Firstly, on the Professional Hygiene business and the comments that you made regarding destocking, and it had a 5% negative impact on your organic growth in the third quarter. Then if I take that comment and if I look at the data that you provided, of the consumption rates in different categories.

So that would seem to suggest that the run rate, excluding destocking at least for the near-term likely to remain pretty much unchanged from the third quarter levels. Am I missing something? Or is this a fair assumption? And could there be an element of restocking among some of your distributors in the near term? That's my first question.

Fredrik Rystedt: Yes, Karri, let me try and answer that. We don't have, of course, all the data, but I think you're right. Most of the destocking is done or if not all, most of it. And the run rate, of course, is much depending on whether there's further

lockdowns or further restrictions or anything, but the run rate is probably there.

But we have also, as Magnus already alluded to, compensated by increased skin care and, of course, continue to sell a lot of dispensers in various parts. So we are compensating whether the demand situation will continue to improve as it has done Q3 versus Q2, it's hard to say at this point of time. Clearly, it's still low, but we are hoping for improvement.

Karri Rinta: All right. Fair enough. And then about the working capital. I see that the inventories are up quite significantly from last year. Is there something specific that is pushing up inventories?

Fredrik Rystedt: Yes. We have a bit of more inventory in the Group now of raw material, actually. So that's the main reason. There is a little bit also finished products inventory that's slightly higher. But in general, it's relating to raw material.

Karri Rinta: All right. And then finally, maybe a clarification on the Consumer Tissue comments regarding pricing. So you have seen higher prices in Latin America. You have lower prices in Europe, but that's due to the price reductions that were announced already in Q1. And then there's been promotional pressure in China. Is that a fair summary?

Magnus Groth: That's a very good summary. Very clear.

Operator: Your next question comes from the line of Faham Baig at Crédit Suisse.

Faham Baig: A couple of questions from me, if that's okay. Can I firstly come back to Sanath's question. I just want to understand the digital investment in a bit more detail, particularly because it seems to me that the majority of the investment is sort of in the back end rather than the front end of investment. Is my understanding correct?

And what I mean by front end, for example, is that, are we expecting to see investments accelerating in e-commerce? Are we expecting digital spend, digital media spend to increase? Are we -- should we expect some of the digital transformation to allow you to do greater innovation?

I just want to understand that more clearly because, ultimately, I would think the front end has a bit more impact on your top line versus the back end investments that you do with an analytics approach, et cetera. So that's my first question.

My second question is a bit more direct, but at the same time, a point of clarification. Over the last couple of years, you've been helped extremely by the raw material tailwind, of course, but also savings. You had the COGS saving. You also have the SG&A savings as well. That fallen through to the margin.

Given that the COGS savings going forward will no longer fall to the bottom line due to increased digital investment, would it be fair that the margin progression will be limited to nonexistent over the next couple of years as you make that investment? Or would you say that there are still various opportunities for you to drive margins higher in the next couple of years despite this investment?

Magnus Groth: The digital initiative will have a negative impact on margins. And I think you can calculate that if you spread out that additional cost over the next five years. I think it's a few tenths of basis points.

But as we also state, we expect to be able to compensate that to a higher lesser degree with additional savings in other areas. And we're also focusing very much on investments now that bring forward both growth opportunities and in terms of your first question, and also savings opportunities.

So growth opportunities are, for instance, investments in e-commerce, where we have invested significantly over the last couple of years, but we see that we need improved kind of basic systems in order to have the right data quality and the right speed.

But we continue to invest very much in e-commerce because that's where the growth is moving and where kind of the future competition is happening, and we're very well positioned there already.

Areas where we can achieve bigger savings maybe faster through digitalization is, for instance, indirect purchasing, where we see some easier saving opportunities. Distribution and logistics is another area where we have an opportunity, both for efficiency, but very much improving our customer service, which I believe can definitely improve our top line also because we know that this is -- we are immediately punished when we have issues, for one reason or the other with service level, being able to talk to retailers. Where are the products? Is it delivery in full? Is anything missing and so on?

And to be able to answer at the push of a button, that's something that will be a competitive advantage that will definitely help us drive sales also going forward. So those are just some examples where we're focusing both on top line and on efficiency improvements.

Fredrik Rystedt: Maybe just add to that Faham, just if I may add just one thing. It's always -- it's slightly easier, as you know, to kind of predict the impact on the cost side when you do things like this.

Whilst it's a little bit more difficult to predict, we're convinced, as Magnus says, that it will be beneficial for the growth part, the organic growth part with service levels are being available 24/7 for our customers, as an example, but not least, also, of course, enhancing our analytics capabilities being much better understanding what works, what doesn't work.

And of course, with strategic and tactical pricing and all of those kind of things that should be very beneficial from a growth perspective, but they're all very difficult to quantify, and that's why you perhaps hear more about the efficiency part, which is easier to envisage exactly how that will play out.

Operator: Your next question comes from the line of an Anubhav Malhotra at Liberum.

Anubhav Malhotra: Just a couple of questions regarding your investment into digital announced this morning. So firstly, do you have any plans to sell direct-to-consumer via subscription models, like other players in the industry do? And then, secondly, I mean, what does it imply for your M&A strategy going forward?

Would we see any kind of change because typically, investments into acquisitions end up hurting return on capital employed, at least in the short-term in the initial few years? So should we take any suggestion that large-scale M&As are of the charge not on the cards anymore?

Magnus Groth: Great question about subscription models where we worked extensively with direct-to-consumer concepts with the TENA brand for many years now, probably for ten years, and that's growing very well for us.

And we are using that knowledge and that concept now to also launch our own web shops in Medical, for instance, for JOBST. So that's a very important, the compression brands. So that's an important effort and investment going forward.

And we do see that in some markets that are less developed, historically, like Latin America that their own web shops are really creating value quite quickly. So we are starting web shops in many Latin American countries, also covering our normal consumer brands, even the consumer tissue and other categories.

We are also investing in web shops actually for Tork, Tork Direct, which looks it very simple for small family owned often distributors to order directly from us online. So that's another example, maybe not direct-to-consumer, but direct-to-distributor Web shop type of store that we're setting up. So actually, in many areas now, we're setting up our own web shops, and we see that this contributes to market share gains.

Acquisition. Of course, any large-scale acquisition will most likely then include, of course, taking on intangibles and goodwill. But after any such acquisition, of course, you need to look at the kind of the operational capital employed and not intangibles and goodwill to make it a fair comparison. So we would adjust for that. So no, this does not preclude us from doing large scale M&A.

Operator: You have a further one from the line of Iain Simpson at Barclays.

Iain Simpson: So firstly, when you look at your plant performance, how far above-average efficiency would you say your absolute best-in-class factory might be now? I'm just trying to get a sense of how much scope there is to improve gross margins through further manufacturing optimization.

And then sort of completely different question, but you called out U.S. retail inco as having lost some share, if I heard you correctly. That business has been underperforming for a while, I think. And it's probably now under 5% market share, on my math. Have you considered exiting U.S. retail inco entirely in the same way you've exited various subscale diaper businesses over the years?

Magnus Groth: So when it comes to manufacturing roadmap, we are starting that work now with identifying the opportunities. Of course, we have a lot of strong hypotheses. So it's too early to tell.

If you remember, when we launched the tissue roadmap a number of years ago, we gave the vision of having the lowest cost and the best quality in service levels. And then we provided more information over time. And we expect to be able to do this also when it comes to manufacturing roadmap, but it's too early this quarter.

We are starting to do the analysis, and we'll come back on that. And inco retail U.S., yes, you're right. We are slightly below 5% at this point in time. While I always want to emphasize we're doing well in inco health care and actually slightly growing market share overall.

So we clearly believe that we have a reason to be still in inco retail in the U.S., but we will never be, of course, number one or number two or even number three. But we can fill an important niche, which is very much focused on caregivers, who know the brand and to leverage the brand equity that we have from the health care part of our U.S. TENA business. So that's still our effort.

And of course, TENA SmartCare is an important step in strengthening our retail position there. So don't expect us to see us fighting with light incontinence and the big volumes, but rather in a number of smaller areas where we believe that we have a reason to be.

It's also an area where we are making money. So it's not like some of the other cure or kill areas that we have announced over the years where we were clearly below the margins we wanted to achieve. So we're doing everything we can to improve market share and to come back in inco retail U.S.

Operator: You have a follow-up question from the like of Karri Rinta at SHB.

Karri Rinta: I just wanted to maybe get a bit more detail on the timing of the announcement when it comes to digital investment and its manufacturing roadmap because there's some other companies that I cover that also have announced quite big ambitious, long-term initiatives in conjunction with the third quarter numbers.

So financially, one could argue that you are sort of making this announcement from a position of strength. But I guess, more specifically, has the COVID-19 in some way impacted the timing or the scope of these plans or not?

Magnus Groth: No, I can't say that COVID has impacted. Of course, digital transformation has accelerated due to COVID. So from that perspective, we are investing more and doing more in that area. But such a big new platform that we're talking about is years in the planning.

So the reason why we're announcing this now is that we are announcing it internally to our staff, where we have already, you know, hundreds of employees working on this, and also because you will start to see the financial impact also going forward. So that's why we're presenting this now.

And manufacturing roadmap, we feel that with the big success of the tissue roadmap, that we've learned really so much, you know, on how to improve structural profitability, that we want to have a similar approach also in medical and in personal care.

Having said that, of course, Consumer Tissue was the biggest part and maybe also where we had the biggest restructuring opportunity. So we don't expect to see as much restructuring in this manufacturing roadmap, but big opportunities to, in general, improve our performance here.

And as with tissue roadmap, not only from a cost perspective, but also from a quality and customer service perspective. So yes, I think that's why we are launching these things now.

And the higher return on capital employed target. I think that once you are on a higher level, it's time to take the next step. It's just a natural move.

Operator: Your next question comes from the line of Virendra Chauhan, Alphavalue.

Virendra Chauhan: Just one from me. So that's on Professional Hygiene. So now that we have seen that the COVID stay at home restrictions are going to be in place for a while longer and offices as well as the travel industry is not going to recover in the foreseeable future.

What do you expect for this business, like what part of this lost business could be permanent or longer-term in nature? And have your expectations for the business changed?

Fredrik Rystedt: Yes. I can try and answer that. So thanks for the question. I mean, first of all, it will, of course, as things gradually move back to normal, and it will be bumps and variations. But of course, generally, demand will continue to come back, as it has done here, and it's hard to tell exactly when and how fast. But of course, it will gradually come back.

And then your question is something here structurally permanent and whether people will permanently stay more at home, for instance, or permanently travel less, it really is very, very difficult to anticipate the permanent or structural impact on the business. But of course, we will adapt in the segments where we are and make sure we have the appropriate setup.

And as we have already alluded to, we are working extensively in growing in segments where the impact may even be positive. And generally, as was shown here in the presentation, the impact on hygiene and health is, of course, also contributing. We are expanding with face masks.

We're expanding into wipers and skin care products. So we have good confidence, great confidence that the business will develop good over time. And we have been very positive to Professional Hygiene, and we remain very positive to Professional Hygiene.

Operator: There are currently no further questions. Please continue.

Joséphine Edwall Björklund:

So thank you very much. Then we conclude today's telephone conference. Thank you for calling in, and we wish you a good day.

END