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Half Year 2020 Ansell Ltd Earnings Call

EVENT DATE/TIME: FEBRUARY 17, 2020 / 9:00PM GMT

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PRESENTATION

Jocelyn Petersen ***Ansell Limited - VP of Global FP&A, Treasury and IR***

Greetings. Hello, everyone. Hello. Greetings from Melbourne, Australia. My name is Jocelyn Petersen. I'm the Vice President of Global Finance, Treasury and Investor Relations for Ansell. To those of you joining from Australia and the APAC region, a very good morning. To those of you listening in from the U.S., a good afternoon. And to those that are joining from Europe, a very good evening to you. I'm delighted to welcome you to Ansell's Half Year Fiscal 2020 Earnings Results. Joining me on the call today in Brussels is Magnus Nicolin, our Managing Director and CEO; along with Zubair Javeed, Ansell's Chief Financial Officer.

Today's earnings release and accompanying investor deck has been posted -- has been lodged rather with the ASX, and they should be available on ansell.com within the Investors section of our website.

If we can just take a moment to read Slide 2, which is a typical disclaimer recapping that the materials should be read in conjunction with Ansell's full financial statements. We have forward-looking views as we share our outlook on future performance and expected results. There are uncertainties beyond Ansell's control.

And then once we all recognize that, I would like to hand the mic over to Magnus Nicolin. And at the very end of the presentation, we will open up the lines for Q&A. Thank you.

Magnus R. Nicolin ***Ansell Limited - MD, CEO & Executive Director***

Thank you, Jocelyn.

So this is Magnus Nicolin. I'm very happy to be addressing you this morning or today, this evening. What we're going to do is take you through a quick review on what's been accomplished in the last 6 months. And I'm starting by recognizing the team, as always. Nothing ever happens without the team being focused and committed and driving hard, and they have indeed been driving hard this past half. And we'll share some of that with you.

Starting on Page 5. As you all know, we're a safety company, and we continue to reinforce the safety message within the company, with our customers, in our plans and essentially in everything we do. We continue to report very low accident rates in the Ansell facilities, as illustrated by this chart. And we continue to run training programs and activities to make sure that we are safe and that we take care of our people as well as taking care of the employees of our customers.

Going to the next page really summarizes our statutory results. And this year, as many years, not all that meaningful to compare 1 year against the other from a statutory point of view, but suffice to say that we've had a solid half contributing to our ability to again take up our dividends and this time by 4.8%.

Going to the next page, 7. We, here, adjust for many of the items affecting comparability. And in blue text, we highlight the adjusted development of EBIT and EPS. And as we can see, some really solid numbers here: double-digit growth in EBIT, profit attributable and EPS based on a constant currency growth of sales of 5%.

And then moving on to the next page, Page 8. And this is where we really hone in on the key performance indicators of the company. So sales up, as you will have noted, 3.9%, 5.3% constant currency and 2.4% organic. And the organic growth is a little bit below our longer-term guidance for the half. But as we will comment on a little bit later, we're confident that we will see further uptick in the organic growth going forward.

When it comes to EPS, pretty solid constant currency, 25.7% growth. If you don't adjust for currency movements, it is 8.7%. And that, of course, makes it very clear that currency has been a significant factor in the half. And this, of course, in spite of the fact that we hedge as we always have. And Zubair will, in fact, comment on this a little bit more later.

ROCE is improving essentially as planned. We see EBIT up 5% or 17% constant currency. Dividend has taken up. As I commented on, our leverage ratio remains very low, and the increase here is primarily driven by the new lease accounting standard. And profit attributable, I commented on, up solidly. Cash flow and cash conversion very high. Last year, we had about 90%. This year, we have 93%, and we adjust for seasonal flows. But even without that, a very strong cash conversion and with the expectation that, that will continue.

And then finally, we have bought back about $40 million worth of shares or 2 million shares or thereabouts in the half. So all in all, when we look at our key indicators, most of them are looking pretty solid.

Next page, we step back a little bit and compare this against the financial goals we set on our Capital Markets Day 2.5 years ago. And as we can see, we are falling a little bit short in the half on organic, as I mentioned. But a little bit of a mixed situation region to region, and we're particularly pleased with the solid performance in EMEA and, of course, from the Healthcare business, whereas the Industrial business is a little bit more cyclical and impacted by the global economic uncertainties. And we'll come up on that shortly.

When it comes to financial goals, we have, as a long-term guidance, 5% to 10% EPS growth. And on a constant currency basis, obviously, 25.7, way above the top end of that guidance range. And this, in fact, is the third year in a row when we have double-digit constant currency EPS growth. ROCE, the target is to the 14% to 15% range, and we expect to get there as we close on this year.

And then finally, we've simply stated, strong cash flow generation. And we think you will agree with us that 90% cash conversion is pretty solid, even in an half that doesn't benefit from the strongest cash flow-generative part of the year, which, of course, is the second half. So all in all, we're meeting or beating most of our long-term targets.

Next page, we talk a little bit about what's happening in the global economy from our point of view. You will follow the developments in the world, and you will be very familiar with this. What we have seen, of course, a number of signs of stabilization or emerging strength in the global economy compared to prior year. We highlighted for ease of reference in the lower right, 2019, obviously, primarily declining versus prior year and 2020 mostly increasing from prior year in the emerging markets. And when it comes to the major mature markets, we've also seen a relatively stable situation.

Now this may all be adjusted a little bit based on the coronavirus impact. It's hard to judge at this point. And it's going to be a little bit mixed, a little bit different on the Healthcare business versus the Industrial business, and we'll comment on that a little bit later.

Next page, we do wanted to mention specifically on coronavirus, and Ansell, of course, is heavily engaged in supporting efforts to produce personal protective equipment to keep people safe. That's our mission in life. And we have a significant range of products that play a role here. And we are, in fact, working very closely with Chinese authorities to provide suits and gloves and masks and so forth to help in this fight. And we're also making sure that our plant in China, in Xiamen has been brought up to speed quite rapidly. And contrary to most other plants in China and with help from the Chinese authorities, we were able to get our people back faster than almost anybody else and have been producing at full capacity for the last few days, which we're quite pleased with. And that, of course, helps quite a bit. We've also focused a lot on keeping our teams safe. And at this point, all Ansell employees are safe. And we continue to pay very close attention to our people, not only in China but around the world and have provided protective equipment to our people to make sure that they will remain safe throughout this very difficult period.

Next page, we have our usual summary page on what we see in terms of organic growth, and we put a little bit of a historical perspective on this. And as you can see, there's a slight acceleration from the prior 2 halves with the 2.4%. And most of that is driven by a very strong Healthcare business. And of course, in this half number, there is no impact of any virus-related activity.

When it comes to the emerging markets, we continue to see pretty solid growth there as well and primarily in Russia, China and India as well as OLAC in Brazil. Whereas Mexico after many, many years of strong growth, have taken a bit of a step back primarily related to the automotive business in Mexico. Expectation is, though, that with the new trade agreement signed with the U.S. and Canada that, that will facilitate for Mexico to return to its historic growth pattern. So a lot of positive developments here.

Next page, 13, we talk about the Healthcare GBU. And as you can see here, first of all, a solid organic growth, 3.4%, and an even better growth in emerging markets. And what is interesting is, in particular, the very strong performance of the Surgical and Safety business. This is probably the strongest growth we've seen in Surgical organically in a long, long time. And of course, again driven by the synthetic conversions that continue at full speed. And this is now -- are getting to be a pretty big part of the total Surgical business, and it still grows at a very high rate.

Life Science continues at a good clip as well, 9.5%. It's slightly below what we have seen. We do expect, though, that the Life Science business will continue to grow in the low double digits going forward. On the EBIT side, a nice pickup, 130 basis points improvement. But as you can see in the top right, really big impact from FX again. So it weighs a little bit on the step-up in margin.

On the next page, 14, we have a couple of highlights. And the most important ones here, other than what I've already said, is a number of new products have taken off in the marketplace and is contributing to this growth in the top-right area. And in the bottom right, we're seeing some really interesting developments in the Surgical business. And partially for that reason, we recently announced the acquisition of 50% of Careplus to give us more capacity and more flexibility to drive this business at a higher pace than we have historically been able to do. So we're very pleased with this deal. We have a great partner and expect that this will contribute to this business and its growth for many years to come.

On the next page, Industrial GBU. We have 11% constant currency EBIT growth. But here, we have the full brunt of FX and impacting on the Industrial business more than it impacts on the Healthcare business primarily depending on where the production locations are. But even so, we have seen the chemical business delivered some solid developments. And we see the multi-purpose category within mechanical doing quite well. But a temporary step back, if you will, on the cut side of the portfolio. We expect that, that will correct as we go forward. We're also quite pleased with the recent acquisition, Ringers, performing strongly, well in line -- or actually slightly ahead of our business case for that business. And EDGE, our basic brand, continues to perform at a high level.

We want to comment, though, on the fact that the big transformation program, while delivering on the savings to the bottom line, has created a little bit of complexity for us in the half as we were ramping up our production in the receiving locations and getting those products on the border and on the way to customer. So we have seen back orders with customers higher than we would like them to be, and that's cost us a little bit of momentum in the Industrial business. We're well on our way to having addressed that and expect the effects going forward to be minimal and maybe even reversing some of the drag that we've seen in the first half. So all in all, we expect to achieve all of the savings that we've communicated to you before on transformation.

A couple of highlights. I mentioned Ringers being a very solid contributor here. We're very pleased with the FORTIX platform. It is taking share in the marketplace. It is the most abrasive-resistant, multipurpose platform in the market. And it's winning new customers left and right. And we have been ramping up production capacities to keep up with demand in this particular area with big investments in Sri Lanka and Vietnam and further investments coming. And the final comment on chemical is it's getting to be a really interesting business. And the combination of gloves and suits and our beautiful chemical glove and suit selection tools are delivering an enormous amount of value to our customers. This is exceedingly complex, and there are millions of different chemicals and chemical combinations. And we are the best adviser in the marketplace for customers in finding the right solution to protect their people.

Next page, 17. We have talked to you about this before. We have adopted a more comprehensive corporate social responsibility and sustainability platform, and we see ourselves serving 9 different communities, if you will, or different needs in the global marketplace. We work actively as a company to affect a better society, a better environment and, of course, better business; and in particular, on better society, a strong focus on employee and workforce safety and the role we play with our communities; and on the better environment, a lot of focus on producing the products we have with far less use of water and energy; and to eliminate waste to landfill in our facilities. And we've all specified that in our recently released report in this area.

Next page, 18. We have put quite a bit of effort into taking another step-up in making sure that we are leading the PPE and health care industries in responsible human rights. And as part of that, we have improved our tracking tools to monitor compliance in all of our plants. We have increased wages in a couple of areas to make sure that we have a high level of retention with the best employees. We have hired additional workers to be able to take down over time and have a long-term sustainable pattern of shifts and shift systems that is working better for our employees. And we've seen a very strong positive response from customers to Ansell's aggressive approach to how we manage labor standards. And this, of course, as you know, with many customers around the world is a very important selection criteria for what supplier they elect to work with.

So with that, I'm going to hand over to Zubair to take you through a couple of the key financial commentaries and observations. Zubair?

Zubair Javeed *Ansell Limited - CFO*

Thank you, Magnus.

So turning to Slide 20 and beginning with our usual P&L format. You already saw the statutory P&L earlier, but the key message from this slide now is it's a whole load simpler compared to the last couple of years. You'll recall that we have concluded our Transformation Program, and so no more adjustments to the current year as promised in our previous earnings call.

As you'd expect, though, the F '19 results still carries the adjustment made in that year. And in the column labeled Transformation there in the middle of the page, you see just under $27 million adjusted out of EBIT. This aids comparability between the fiscal years. And you'll recall most of these costs related to the shutdown of our South Korea and Mexico manufacturing facilities. On a full year basis, we incurred just over $45 million of Transformation expense in F '19.

Turning to Slide 21. Here, we show a bit more detail, breaking out constant currency or organic underlying growth. So beginning with the revenue line. We grew 5.3% in constant currency terms, as Magnus mentioned, organic growth contributing 2.4%. And the benefit from the Ringers and Digitcare acquisitions being the difference.

You've already seen the continuing good performance and momentum with the Surgical sales and Life Sciences, and we remain particularly pleased with the trajectory of the Healthcare business unit overall. And we see no reason why this momentum wouldn't accelerate across the second half. And in this business unit, we continue to prove its resilience even through macroeconomic models.

In terms of our Industrial business unit, although we see somewhat of a recovery versus F '19, I would say it's still a fragile industrial production backdrop and especially in North America and Germany. As Magnus highlighted earlier, our team in China have reacted with considerable [acronymity] in dealing with the coronavirus outbreak and supplying necessary safety solutions, but that phenomena and the general subdued industrial production trends have kept us from tightening our EPS guidance range. Magnus will cover more of this in a moment.

So switching to gross profit after distribution expenses. Here, you see we grew over proportionally compared to the revenue line, up 12.5% growth on a constant currency basis. Even inclusive of the 120 basis points that, as noted, for FX headwinds, this lifts gross profit in the half 90 basis points from 33.2% to 34.1%. The benefit from our Transformation Program in the Industrial GBU contributes close to $5 million or 60 basis points, as we highlighted in August. And favorable raw material costs increased pricing in our Healthcare GBU, and the contribution from our acquisitions has more than offset the foreign currency headwinds and a little bit of increased labor costs.

I told you in our last earnings call back in August of last year, you should expect a higher run rate against our SG&A line versus where we concluded in fiscal '19. And you can see that now with SG&A coming in at 22% of sales in the half. There's some timing impact in this expense, and so you can expect a slightly lower percentage in the second half.

The final notable point, I would say, on this slide is the effective tax rate, clearly beating our guidance and coming in at just under 21%. This is 150 basis points better than the lower end of our original guidance. And given the current mix of our profits in the 35-or-so entities we operate across, I'd expect this rate to stay in this kind of range through the second half.

So wrapping up with the P&L. We concluded the half, as mentioned a couple of times, with just over $0.50 of earnings per share; in constant currency terms, just under 26% our growth versus the same period of the prior fiscal year.

So turning to Slide 22. We see the overview of the composition of our raw materials and corresponding price observations. A couple of key points from the chart in this slide. As you can see, the raw material mix remains fairly well balanced with fibers and engineered yarns, as called out in the commentary. And ultimately, this means we're more insulated than in the past from the vicissitudes of the market for natural rubber latex and nitrile costs. But with that said, the chart on the right shows the trends in NRL and nitrile costs from December '18, December '19. And in the chart, you can see the favorable pricing trends for nitrile, down about 13% versus the prior year, but offset somewhat with the 7% increase in costs in natural rubber latex.

You saw earlier in Slide 13 the HGBU gross profit margins reflecting some of the benefit of this lower nitrile pricing. But as we move into the second half, I think the prior year comparison becomes much tougher because this is when we start to anniversary the benefit of those lower costs. In terms of NRL, we still see seasonal increases in natural rubber costs in H2 and so another reason I'm not getting too bullish with raw material pricing expectations.

Turning to Slide 23 for an overview now of our cash flow. As we see here, our cash conversion is close to 93%, and that's after adjusting for a couple of larger cash items that were paid out in the half but really representing 12 months of expense. We spent another $25 million in CapEx, which is not too dissimilar to the prior year.

On the financing side, on the cash flow on the far right, you see the main cash flow item that has significantly reduced year-over-year clearly is our buyback activity. The $133 million-or-so delta there, representing about 7.5 million shares purchased less this half versus F '19 H1.

And concluding this segment of the call, I'll wrap up with the balance sheet and highlight one of the key metrics we track being our return on capital employed. So as you see, overall capital employed is up versus both H1 F '19 and the rest of the fiscal year '19 and the notable items driving this change. Firstly, we have the introduction of the new accounting standard, which capitalizes operating leases into right-of-use assets you see in the far-right column third number down. And secondly, you'll recall that we acquired Ringers in the second half of F '19, February '19, and the purchase accounting there bumping up the intangibles and working capital numbers when comparing to the first half of fiscal '19. So even with this higher average capital employed, we're pleased to being able to increase again our return on adjusted -- on capital employed, and that's after adjusting for the lease accounting. We're up to 13.4%, which is a 40 bps improvement over F '19 H1.

And then finally, in the table in the bottom-right corner of this slide, you see our net debt position still provides us with ample balance sheet flexibility with net debt-to-EBITDA remaining long term. And with our disciplined capital deployment policies, there should be no surprise. Moody's recently maintained our investment-grade rating at Baa2.

So that concludes the financial section, which just leaves me to thank you for your continued interest in Ansell, and I'll hand back to Magnus with the outlook for the remainder of the year.

Magnus R. Nicolin ***Ansell Limited - MD, CEO & Executive Director***

Thank you, Zubair.

And going to Page 26, where we headlined our reaffirmation of guidance. And part of the reason for that is, first of all, we're seeing a --

as I said before, a slightly more solid global environment when it comes to GDP growth and activity level. And on the other hand, the emerging coronavirus has injected some new uncertainty into the global marketplace. And that causes us to reaffirm guidance in the $1.12 to $1.22 range. As you recall from prior meetings, we have communicated that this, of course, includes an improving rate of organic growth versus '19 and significant EBIT growth contributions from a variety of business initiatives, Transformation being the biggest, but also pricing, raw material effects, product mix and so forth.

We do have some offsets, and FX has been the biggest one in the half. It may become a little bit more muted going forward, depending on what happens to the euro. And the other one, of course, is the -- a relatively small impact of interest cost. And we expect to continue our opportunistic buyback program through the second half.

On the right, we have laid out what we have done in the last few years and restated the F '19 into constant currency. And against that, we expect to deliver a 10% to 20% constant currency increase in EPS also this year. So all in all, we feel that we're on our way here to deliver a pretty good result for our shareholders.

Going to the next page, what you should expect from us. First of all, on the left, we reiterate our strategic model. This is the model by which we manage the company and the flow from operation that we reinvest in the business or return to shareholders, as the case may be. So what we expect going forward is organic growth improving and improving further and continued margin expansion driven by commercial and operational excellence. And there's a whole lot of these activities ongoing. The Transformation is delivering what we expected to deliver. ERP, supply chain and digital investments will continue. We expect further ROCE improvements, and a strong cash conversion will continue. We see a large number of attractive capital deployment opportunities, and we expect to take advantage of them going forward. And we also expect a significant number of automation opportunities to present themselves, and we will pursue them as well. And we will cover much of this and some of the longer-range and exciting opportunities in the Capital Markets Days coming up. And we hope to see you at either in Sydney, in London or in New York City on the dates indicated. And at these events, you will, of course, get to hear from some of our colleagues in the management team and how they lay out the plans for the 2 GBUs as well as for the further developments of our global operations organization and as well as a few other people.

So that's essentially what we wanted to cover with you today. And with that, we're going to turn it over to you with questions. So operator, if you can help orchestrate our Q&A. Thank you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Jocelyn?

Jocelyn Petersen ***Ansell Limited - VP of Global FP&A, Treasury and IR***

Thank you. So first on the docket, we do have Andrew Goodsall with MST Marquee. So over to you, Andrew.

Andrew Goodsall ***MST Marquee - Healthcare analyst***

First one, was just trying to understand the operating environment. I'm just going to ask if you could sort of recap your thinking around the tariff and the sequencing of that, particularly into the second half. And then perhaps just a little bit more in corona, sort of -- I guess, sort of how that -- I mean not putting any impact through your guidance. So just how you're sort of thinking about that and maybe even to the following year on production.

Magnus R. Nicolin ***Ansell Limited - MD, CEO & Executive Director***

Yes. So first of all, on the international trade environment, as we all know, some of the duty programs rolled back in January, and that will benefit some of the product categories. But we were seeing a bit of a bite from these, especially in some medical products. So that's now more muted.

As we have said to you before, we have relatively less exposure to China. And that, therefore, has been less of a burden to Ansell than to many of our competitors, if we just stay with the duty situation. We have, of course, taken some price increases to compensate for duty impact. We have pushed back on our suppliers in China to have them absorb portions or elements of this duty effect. So all in all, we feel that we're in a pretty good place when it comes to managing that exposure, and especially now that it's a little bit less acute.

When it comes to corona, it will probably have a slight positive impact on the Healthcare business and a slight negative impact on the Industrial business. And the reason for that is, obviously, the Healthcare businesses are directly contributing to providing product to protect people who are fighting the fight, whereas the industrial products are used in manufacturing. And manufacturing may actually slow down as a result of this, and we're seeing it obviously in China, where our plants are late in starting up. And there are many plants that are not going to be running at all for about a month longer than what was estimated.

But even beyond China, we expect to see impact on manufacturing, for example, in Germany. Why? Well, because for about a month, China has not been buying too many Mercedes, BMWs. So that will have a bit of an impact on production, and it will take a little bit of time before it works its way through the system. But nevertheless, there will be a small negative impact on the Industrial side and a small positive impact on the Healthcare side. And that's why we're concluding that net-net for Ansell, minimal net financial effect but significant swings and challenges and work going on behind the scenes to be agile and flexible in how we deal with this and support not only the Chinese government but all kinds of players in the marketplace.

Andrew Goodsall ***MST Marquee - Healthcare analyst***

That was comprehensive. And my second question is just on the -- it's actually a question for Zubair just on the commentary on Slide 35 on cash flow, just more clarification. Just to understand that the transition of AASB 117 has meant that you've taken a $11.3 million charge to the operating lease -- operating cash flow is a lease payment. I think the commentary suggested the other way around to financing cash flow. So just clarifying the impact of that.

Zubair Javeed ***Ansell Limited - CFO***

Yes. So -- I mean the operating lease there is the -- what used to be -- I mean effectively, it's the cash payment of the operating leases so you see the offset in EBITDA. Clearly, you see a higher EBITDA, so it's coming out in operating cash flow. And then the interest piece is what's running through the financing cost.

Andrew Goodsall ***MST Marquee - Healthcare analyst***

I see, the cost -- so the interest -- yes, yes. Okay. I think the commentary might be the other way around, but the data there is correct, so that's terrific.

Zubair Javeed ***Ansell Limited - CFO***

Okay.

Jocelyn Petersen ***Ansell Limited - VP of Global FP&A, Treasury and IR***

Great. Thank you, Andrew.

Next on the line, we do have Sean Laaman with Morgan Stanley.

Sean M. Laaman ***Morgan Stanley, Research Division - Australian Healthcare Analyst***

Maybe -- just on the Healthcare segment, I think you called out 2.6% organic growth in the mature market. So I really appreciate some commentary on that, the price volume sort of discussion driving that number and help me understand some of the upside and downside risk going in the second half would be really useful.

Magnus R. Nicolin ***Ansell Limited - MD, CEO & Executive Director***

Yes. So we focus on the mature markets. As you know, there are essentially 4 subsegments within this business. One is the Life Science. And that is growing very rapidly, but it's a relatively small business. Number two is Surgical gloves, growing very nicely, also in mature. And it's a bigger business, so it's having quite a bit of an impact, and it's driving much of the top line growth we do see.

Then you have Industrial Single Use, and that's been a little bit more muted in the half than we have seen in prior halves but still growing. And then finally, we have the medical Exam type of products, and we have communicated for a number of years now, but this is the area where there's the least amount or the least opportunity for differentiation, and price is the main deciding factor. And we have tended to focus less attention on that business. And therefore, it is a bit of a drain. It's getting smaller and smaller, so it has less and less of an impact on the overall business, where the Industrial Single Use is becoming more and more important, supported by Surgical and Life Science. So that's how we view it.

Sean M. Laaman ***Morgan Stanley, Research Division - Australian Healthcare Analyst***

And just second and final question, would you be able to give us a bit of discussion on how you see the M&A environment at the moment?

Magnus R. Nicolin ***Ansell Limited - MD, CEO & Executive Director***

It's -- there are a number of opportunities in the marketplace that we're looking at. As you know, from past history, we have been quite disciplined about acquisitions and not paying too much. And that means that we're bowing out of a number of competitive bid situations when we think that the pricing is not reasonable and we're not going to get the return that we're looking for. And that is also true now.

Having said that, there are probably 3 or 4 opportunities that could yield a deal or 2 that we're actively pursuing. And I'm hopeful that we'll get 1 or 2 on the line, so to speak. It is a good way to drive value, provided we don't overpay, and we won't.

Jocelyn Petersen ***Ansell Limited - VP of Global FP&A, Treasury and IR***

Thank you, Sean. Next, we have David Low with JPMorgan.

David A. Low ***JP Morgan Chase & Co, Research Division - Research Analyst***

Just start with the service disruption. Magnus, can I get to talk a little bit about what exactly happened there? And I mean I heard the message that it's improving but just trying to understand what happened.

Magnus R. Nicolin ***Ansell Limited - MD, CEO & Executive Director***

Essentially, what happened is we moved 130 styles halfway across the world. And each style has a large number of SKUs, and each style has a large number of raw materials from different suppliers. And all of that needs to be closely coordinated to make sure that there is no disturbance. And while the team has done a really good job at managing this, it was in a couple of cases a bridge too far. And where individual teams in a plant or 2 struggled to consistently make the product in the way that we expected. So it took us a little bit longer to get this to settle down, and that led to some backorder situations, which is not very good. And obviously, customers don't like it at all. So we have paid a lot of attention to that, babysitting a lot of these processes to make sure that we get product to customers, in some cases, air freighting and those kinds of things to make sure that we hold the relationship. And as I said before, we are through the worst of this and are seeing improved service levels with our customers now.

David A. Low ***JP Morgan Chase & Co, Research Division - Research Analyst***

So with that backorder situation, does that generate revenues or sales in the second half?

Magnus R. Nicolin ***Ansell Limited - MD, CEO & Executive Director***

Yes. To a degree, it will because as we wind down those backorders, it becomes incremental revenue, if you will. So it is part of the reason why we're pretty confident that organic growth half 2 little bit stronger than half 1.

David A. Low ***JP Morgan Chase & Co, Research Division - Research Analyst***

Okay. I mean I hear you saying that the organic growth will be stronger. Are we talking for the half back into the -- your target range in both divisions?

Magnus R. Nicolin ***Ansell Limited - MD, CEO & Executive Director***

I don't think I should go into more specifics on it, but it will be stronger and that there are multiple contributors to this. And I also added the additional variable here on the corona effect, where you have a positive effect on the Healthcare and the negative on the Industrial in all likelihood, I mean we don't know completely yet. But bottom line is we expect a meaningfully stronger organic growth in the second half, and we certainly will be in our target range in the second half and maybe will take us into the target range for the full year.

David A. Low ***JP Morgan Chase & Co, Research Division - Research Analyst***

Great. And just the last question for me, you talked about labor costs in the presentation. It was also covered off in the social responsibility section. Just trying to understand if the increase in labor cost was primarily about Ansell's role in the community, doing the right thing. Or is this a broader increase in labor across perhaps in the U.S. market, et cetera?

Magnus R. Nicolin ***Ansell Limited - MD, CEO & Executive Director***

Yes. It is actually a little bit of both because we are very strict in how we apply these rules. And contrary to most of our competitors, it then causes us to have to either change the shift pattern to make it more attractive or to increase the hourly rate to hold on to employees who otherwise would just walk across the street to a competitor site where they're allowed to work as many hours as they want and which, of course, then results in more take-home pay for their families. So we apply restrict -- or very strict rules here to complying with all of the guidelines and regulations related to this.

On top of that, in certain countries, and I will quote Vietnam especially, labor cost inflation is increasing quite rapidly. Why? Well, number one, is what we just talked about, essentially the amount of overtime hours and so forth. And the other reason is the exodus from China, which, of course, started with the trade disputes, where a whole host of China plants essentially moved to Vietnam. And this put a tremendous amount of pressure on labor demand in China. And of course, with labor demand comes the need to pay higher salaries to hold on to the people. So those are 2 contributing factors, and it varies a little bit from country to country. And Vietnam is probably the worst of the labor cost inflation situation, but it has -- we have seen some effects like this also in Lanka and Malaysia and Thailand, to name a few.

Jocelyn Petersen ***Ansell Limited - VP of Global FP&A, Treasury and IR***

Thank you, David.

We're going to shift gears and hand the floor over to Ms. Gretel Janu from Crédit Suisse.

Gretel Janu ***Crédit Suisse AG, Research Division - Research Analyst***

So just firstly, on the guidance. Can you explain what you factored in, in terms of the raw material benefits you expect in second half and then the FX headwinds?

Zubair Javeed ***Ansell Limited - CFO***

Yes. So Gretel in terms of the raw materials -- I mean, as I mentioned in earlier comments, we've seen, for sure, the tapering of the nitrile costs. So as I said, we're about to anniversary those nitrile costs. So the benefit we saw in the first half is not going to repeat in -- as much in the second half. And then natural rubber latex, we've seen a bit of a sequential uptick from the first half. So all in, I would say about half the benefit of raw material pricing that we saw in the first half will come through in the second half.

And in terms of FX, I mean it's really hard to call it at the moment. You've seen the euro -- but so basically, in terms of FX, where we saw a bit of a hit was the euro to U.S. dollar pair in terms of revenue. And on the cost side, we saw the Thai baht, it's running at 6-year highs versus the dollar in terms of appreciation. So that's nearly 7% appreciation. Both of those currency payers are hard to call where they're going to land. Spot prices are lower than where we anticipate and guided in this document, as we speak today. But that said, I think we're going to be a lot lower in terms of the FX impact in H2. And the way I'm looking at it at the moment, we should be at least half as low as the first half. But that all depends, as you know, in terms of the pricing and where those trends go. Hope that answers your question, Gretel.

Gretel Janu ***Crédit Suisse AG, Research Division - Research Analyst***

No, that's very helpful. Just to confirm, though, what actually was the benefits from raw materials in the first half to EPS?

Zubair Javeed ***Ansell Limited - CFO***

Yes. So I've not broken that out specifically. But I mean I'll give you -- I mean does it -- it could be between $2 million to $4 million. It's hard to see as it's going through our supply chain, but that's probably a good enough number for you to sort of model for H2.

Gretel Janu ***Crédit Suisse AG, Research Division - Research Analyst***

No, that's perfect. And then just in terms of the Industrial division, I'm just wondering if you can give a little bit more color in terms of what you've seen in terms of pricing for that division in the half.

Zubair Javeed ***Ansell Limited - CFO***

Yes. So -- I mean again in pricing, I think -- you know on the Industrial side, and we've said this in previous calls, we have 2 things going on there. We have our end-customer relationships where we can increase pricing, but then we also have channel development that, on the other side, where we have good relationships with the likes of Grainger, Fastenal, et cetera. So obviously, I won't pinpoint just for the reasons that competitive -- of competitive nature here what we actually do on pricing. But suffice it to say, we typically look for a win-win. So I would say on the Industrial unit, overall, you're going to net out to 0. It's mostly a volume-driven play there. But of course, our channel relationships are pretty key to that volume.

Jocelyn Petersen ***Ansell Limited - VP of Global FP&A, Treasury and IR***

Thank you, Gretel.

We're going to go over to David Bailey with Macquarie.

David Bailey ***Macquarie Research - Research Analyst***

Just from me, I just -- if I look at the second half -- I mean, there's a very wide implied growth for the second half, minus 4% to 11%. Can you just call out, just again, just so it's completely clear, what the key driver of that very wide range is for the second half? Is it really just the macro that's causing that dispersion?

Zubair Javeed ***Ansell Limited - CFO***

Yes. So -- I mean I'll pick up the final points and will let Magnus comment more broadly. But -- so the way we're looking at the second half, obviously, if you take the first half, we had some raw material tailwinds, as we pointed out, and Gretel's just asked about. We had our Transformation benefit, and we've had some general good volume through our Healthcare-related manufacturing facilities. So those 3 dynamics, we would pretty much see going out into the second half.

Where we're really uncertain is clearly this coronavirus impact. And specifically in the fourth quarter, it's very hard to call the impacts of that when it -- when all of a sudden doing -- and China [comes] back to work, we don't know what that real impact is. So -- and you've seen, we're at 1.3% growth in IGBU. So to even come in at the lower end of our guidance, you're going to have to see some sizable turnaround there in a subdued industrial production environment. So that's kind of where we're looking at it, and that's why there's still a broad range, and it's hard to pin down. But on the broader topic, I'll hand over to Magnus.

Magnus R. Nicolin ***Ansell Limited - MD, CEO & Executive Director***

I would add also the economic environment in Europe is quite fragile. So we're starting to see a little bit of a strengthening in Germany, France, even in the U.K. in the last couple of months. You've seen it in expectation for GDP and PMI indices and so forth. But any shakeup to the market during this period of fragility, you might have an outsized impact. And if you play out the corona effect on Germany, it really brings that message home because of the dependency of the German automotive industry to China demand, which, of course, has been at a standstill for a month now. And who knows how long it will continue for. We just know from our business, we've been able to get our production up and running but partially because we've been aided by the Chinese authorities that helped us get our employees back from various provinces around China because we're a top priority plant in China in that we produce critical protective gear.

But if you look at other manufacturers in China, they're not up and running yet. And it's now a week after they were supposed to be up and running. And many of them are saying, "We're not really going to be producing anything meaningful for another 2 or 3 or 4 weeks." And then on top of that, you can't even transport stuff in China now. We're seeing it ourselves. It's really hard to get components shipped from one end of the China to another because of -- all the provinces have artificial border set up and road blockages, and you need a special passport or a permit to be able to cross these borderlines.

And then to top that off, it's really hard to get products onto a boat and out of the country. So this is going to take some time to sort itself out, and this is a main reason why we were reluctant to commit to stronger numbers or tighter ranges because it is quite uncertain and very, very hard to predict.

David Bailey ***Macquarie Research - Research Analyst***

Got it. Okay. That just might lead into my follow-up question in relation to the decline you saw in the cut segment of the IGBU. I mean minus 2.9% for cut-resistant gloves, I mean, is that a reflection of some of the commentary you've just made? Or are there other factors to consider in relation to that number?

Magnus R. Nicolin ***Ansell Limited - MD, CEO & Executive Director***

No. I think we've hit on the main. I mean we've gone through a period of really solid growth for the last 3 or 4 years. And I think the category is probably due for a period of stabilization. And we've seen that. It is also somewhat related to timing of key product launches, and we have a few new cuts platforms just now launching but not having a material effect on sales yet. So I wouldn't read too much into it. I do expect us to get back to solid growth in the cuts category as we go forward.

Jocelyn Petersen ***Ansell Limited - VP of Global FP&A, Treasury and IR***

Thank you, David.

Next on the line, we have David Stanton with Jefferies.

David Andrew Stanton ***Jefferies LLC, Research Division - Equity Analyst***

Look, I wonder if I could dive into this -- your comments around the economic environment in the EU. You have in the past said or we've been able to figure out that the German automotive is about 10% of your business. Where do you see that going in the second half? Should we be thinking Industrial glove production for automotive will decline rather markedly?

Magnus R. Nicolin ***Ansell Limited - MD, CEO & Executive Director***

No. I don't think so. I think it's going to be a little bit soft, but it's not a disaster zone. It is not where we were a few years ago when most automotive plants were running 3-day weeks and stuff like that. At this point in time, we're seeing most of them running solid weeks, maybe a day a week or 2 shifts a week or something like that, that are not running. So it's not as acute as we've seen at some instances in the past.

The other thing that's going on, of course, is also a bit of a sea change in the reconfiguration of these manufacturing facilities to produce hybrid or all-electric cars. As they do, it changes the types of gloves that they need: less oily grip, less cuts, in fact and more multi-purpose and more electrical shock protection and more versatile products, multifunction products with touch screen capability and those kinds of things.

So we're obviously following all that. We have the right kind of products to offer. And we have a rapidly growing electrical shock protection glove business that we think is going to benefit from this quite markedly. And it's an area where we're investing heavily at this point in time. So net-net, we think that we have the products and the tools to continue to win in the automotive world of tomorrow, but it is a lot of change going on in a softish kind of environment that is on top of that impacted by global trade and virus outbreaks. So it's a pretty volatile mix of events, I would say.

David Andrew Stanton ***Jefferies LLC, Research Division - Equity Analyst***

Understood. And perhaps one for Zubair as my second and final question. I noticed in the August '19 PowerPoint you put out that you were talking about a negative tax impact of $0.05 to EPS. You've called that out unfavorable -- increasing unfavorable FX rates, but maybe I've got it wrong. But I thought when you talked to the tax rate on Slide 21 of this year's presentation, you basically said that we should expect first half '20 tax rate to equal second half '20 tax rate, which would mean that we're not going to see that circa 23% tax rate that you're calling out in August 2019. Is that correct?

Zubair Javeed ***Ansell Limited - CFO***

Yes. So...

Magnus R. Nicolin ***Ansell Limited - MD, CEO & Executive Director***

Let me jump in first. I think our team is doing some really good work in this area. What we saw 6 months ago was indeed a high likelihood for increasing net tax rates. But we have found some opportunities to plan our flow of product. And of course, we've seen a significant change in the mix of where products come from. And as we gain full insight into how that plays out, it does help us and contribute to the ability to achieve lower tax rates. So having said that, Zubair, what else...

Zubair Javeed ***Ansell Limited - CFO***

Yes. So -- I mean just building on Magnus' comments there, so our effective tax rate, just to remind you, it's driven by a couple of elements, right? So first, we enjoy the benefit of several tax concessions. And some of these concessions...

Magnus R. Nicolin ***Ansell Limited - MD, CEO & Executive Director***

Because of investments.

Zubair Javeed ***Ansell Limited - CFO***

Because of investments, so places like Sri Lanka and Malaysia, Thailand, these are concessions granted by the local authorities there because, like Magnus says, of these investments. Now when we set the guidance closer to the 23.5% range, some of these concessions were expiring. And it obviously led to rate expectations going up versus prior fiscal years.

And then second, the mix of our profits, as Magnus just alluded to, across the geographies we trade in -- and bearing in mind, this is, like I said earlier, about 35 entities. And so if you take a high region, like Australia, tax rate 30%, compare that to a lower region like the U.S. federal rate nowadays is 21%. So you only need a couple of million dollars of profitability swing in those geographies, and you can move 100 basis points or so on your tax -- effective tax rate. So that's kind of where we're at.

So the mix of how our profits look today is how we see it through the half and in H2, and that's kind of where we're at. But again, on a long term, I would caution it -- on the longer-term basis, we do expect to see some of those concessions rolling off and tapering down, so a higher rate.

David Andrew Stanton ***Jefferies LLC, Research Division - Equity Analyst***

Sure. Understood. And I just want to get an idea, so second half '20 should be around first half '20 in terms of the effective tax rate, bottom line?

Zubair Javeed ***Ansell Limited - CFO***

Yes. Well, we said 21%, right? So it's going to be close to that [20%], going to be closer to that.

Jocelyn Petersen ***Ansell Limited - VP of Global FP&A, Treasury and IR***

Thank you, David.

Next up, we have Steve Wheen with Evans & Partners.

Steven David Wheen ***Evans & Partners Pty. Ltd., Research Division - Executive Director of Healthcare***

Just a question on the Transformation benefits. Part of that program was to shift production, as you said, to Vietnam, which you've now highlighted has experienced some inflation or -- particularly on labor rates. Does that change the way you see the benefits that come out of that Transformation program?

Magnus R. Nicolin ***Ansell Limited - MD, CEO & Executive Director***

Well, the shift from Mexico was primarily to Sri Lanka and Canada, Malaysia and from Korea to Vietnam. Having said that, there is a little bit of a difference from the basis for our assumptions that we made 3 years ago when this program was launched. And that was, of course, before anyone knew what Donald Trump was going to do. So it has had more of an impact in Vietnam than we could have ever foreseen.

Having said that, we're -- we continue to be pleased with our Vietnam plant. It's a really good plant, a great management team, really productive and efficient employees, very committed employees. So we have no regrets whatsoever in having moved significant volumes from Korea to Vietnam. And we do have other ways to compensate for certain effects not materializing fully because the labor cost is now 10% higher than we thought they were going to be or something like that. So let me stop there. I think that probably addresses the question.

Steven David Wheen ***Evans & Partners Pty. Ltd., Research Division - Executive Director of Healthcare***

Yes. I mean this is part of sort of rolling into the next set of my question, which is just around your guidance. If you look at the $0.50 per share for first half, just on the annualization of that and looking at guidance, it's clearly a much bigger half. So I'm trying to kind of put the second half into some context when you're saying, I guess, calling out -- personally calling out uncertainty in the global economy but also the raw material benefits not being as great. How do you get that confidence for that uptick in the second half? And is it partly tax or partly buyback-related? I'm just trying to sort of think of all the parts that are giving you that step-up in the second half.

Magnus R. Nicolin ***Ansell Limited - MD, CEO & Executive Director***

The first part to the answer is the significant skew on the EBIT line, first half to second half, driven by the number of working days and so forth. So if you go back in history, you will always see on the EBIT line a fairly significant shift.

On top of that, you have some backorders that we talked about before that are coming off, so essentially incremental sales. And finally, on top of that, you have a number of new product platforms kicking in, in a more significant way in the second half than in the first. So we're quite confident that we're in a good place here. And the $0.50 starting point will stand us in good stead as we go into the second half. So I'm feeling good about how we're traveling and what this is likely to lead us for the full year.

Jocelyn Petersen ***Ansell Limited - VP of Global FP&A, Treasury and IR***

Thank you, Steve.

And last but certainly not least, we have John Deakin-Bell with Citigroup.

John Deakin-Bell ***Citigroup Inc, Research Division - Director & Head of Healthcare in Australia and New Zealand***

My question is just around the Healthcare -- a little more color on the Healthcare side. The last time we spoke about some disruption with one of your competitors. And I know -- if you look at your Surgical business growing at kind of 6-ish percent organically, it must be paying some market share. Can you just give us a bit more of an update, really, as to what's happening in the market with the disruption from that competitor?

Magnus R. Nicolin ***Ansell Limited - MD, CEO & Executive Director***

Yes. So yes, first of all, we're very pleased with how the Surgical business is developing. We have been taking share in North America. We adopted a slightly different plan of attack in how we work with IDNs and GPOs, and that's yielded some significant wins in the marketplace. We have also launched a couple of new synthetic platforms that are doing extremely well in the marketplace.

We continue to do extremely well in Japan. We have a number of very strong distribution partners there. Russia has come back in a significant way. As you recall, we had a little bit of a weakness temporarily in Russia, and that's come back in full force. And we have a great couple of partners in Russia as well.

Southeast Asia is doing well. India is on an absolute tear with tremendous growth, and our India team has grown quite a bit. Very deliberately, we have given the India team [the cut launch] to build the business further, and they're doing it rather well. The China

Surgical business is growing quite nicely and starting to become somewhat meaningful. And we have really nice growth in Latin America from a small base admittedly but nevertheless. And Europe is holding its own, and we're seeing some good growth in certain parts of Europe. So it's essentially all stars aligned here, and that's also why we're now focusing and looking further into the future to make sure that we have sufficient capacity not only to sustain and support this year's growth but for a couple of more years with good growth percentages. So looking pretty good.

John Deakin-Bell ***Citigroup Inc, Research Division - Director & Head of Healthcare in Australia and New Zealand***

Okay. And just so I'm clear here, the types of wins that you get there, are they multiyear contracts? Or are they typically a -- 12-month contracts?

Magnus R. Nicolin ***Ansell Limited - MD, CEO & Executive Director***

They're typically multiyear. There are a few 1-year contracts. But once you're in and provided you do your job and don't surprise the customer, even a 1-year contract very often turns into a long-term relationship. So I would see this as being a relatively stable business.

And to top this up, you've had a couple of competitors with significant challenges in supply. We had one major manufacturer in Malaysia going bankrupt and causing significant problems for some of the key distributors in various countries. We have a competitor in Europe, who's been losing momentum and share. So there are opportunities opening up because -- or at least partially because we are winning and because we're driving with innovation and injecting more focus on synthetic into the marketplace, and that's putting pressure on some weakened competitors. So it's again almost becomes a self-fulfilling prophecy. As you weaken some competitors, you get some more business and you weaken somebody else. So it's been a good run for a bit here. And we're now focusing the team and the strategy to keep this going.

Jocelyn Petersen ***Ansell Limited - VP of Global FP&A, Treasury and IR***

Excellent. Well, on that note, this is Jocelyn Petersen. I'm going to wrap up the earnings call. I thank you all for your participation, for your continued interest and support of Ansell. And we hope to see very soon at our Capital Markets Day event next month. Thank you.

Magnus R. Nicolin ***Ansell Limited - MD, CEO & Executive Director***

Thank you all.

Zubair Javeed ***Ansell Limited - CFO***

Thank you.