KEYBANK

KBCM-Hosted Investor Call with The Cooper Companies CEO, Robert Weiss
Moderator: Matthew Mishan
October 16, 2015
10:00 am CT

Operator: Good day everyone and welcome to the KeyBank Conference Call with Cooper Companies' CEO. Today's conference is being recorded. At this time I would like to turn the conference over to Matt Mishan. Please go ahead.

Matthew Mishan: Hey, good morning. My name is Matthew Mishan. I'm the senior analyst covering medical products for KeyBank Capital Markets. I'm pleased to be joined today by (Robert) Weiss, President and CEO of Cooper Companies; as well as Kim Duncan, VP Investor Relations.

I want to welcome everybody on the line to our KeyBank Management Access Investor Call. For those of you who have not participated in one of these in the past, this call is strictly Q and A. There's no associated presentation, but as you go the investor relations section of the Web site, you can find it there.

If you would like me to ask a question for you, please email me at mmishan@key.com. That's M-M-I-S-H-A-N at key.com. And with that, (Nicki), why don't you give instructions on how to ask a question to start us off?

Operator: Thank you. And if you would like to ask a question at this time, please press star 1 on your touch-tone telephone. If you are using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Again, press star 1 to ask a question and we'll pause for just a moment.

Matthew Mishan: Okay, great. Well, Bob, what I'm planning to do first is use the first fifteen minutes to walk through some of the near term noise that may be causing some of the volatility in the stock, then open it up for questions from there.

And first off, thank you very much for joining us.

Bob Weiss: It's my pleasure, Matt.

Matthew Mishan: So let's start with the reduction in the daily silicon hydrogel guidance for 2015. I think you cited a lack of an inventory build, but to me I think this was a culmination of a series of events throughout the year.

Why don't you just frame it first and say when did you first give the guidance? What was the impact of FX on the number?

Bob Weiss: Yes. We initially gave guidance almost a year ago in December year-end conference call of the $175 million. And many may recall that about that time currency was really in a deep dive and from that point forward that dive continued pretty much throughout the first calendar quarter. But it was $175 million and we then took it down ultimately in September of this year. And it was a series of events going on.

You're correct. Foreign exchange was probably the biggest factor - ballpark around $15 million of negative impact on that $175 million. And then we actually didn't bring it down in March when we talked about first quarter results. We stuck with the $175 million.

The catalyst of that was our biggest question mark when we gave that guidance - was how good - could we go much beyond there, given capacity limitations?

Well, the good news is capacity was spectacular. It was the ease of adding new lines was great. So when we got to the end of the first quarter, we basically said no, we can make it up in volume and good shipments, and things were looking a lot more optimistic in terms of the rollout and the US market. We were having some glitches, and I'll get into that, but the optimism surrounding the product overshadowed and eliminated the foreign exchange hit as we got through the - into that March timeframe.

When we got to the second quarter in June, we basically looked at things that were going a little softer than we had thought in the Americas. But as we thought about that, we said, gee, we know we're doing a consolidation. Distribution centers in Europe were building up some inventory for Europe as a buffer, but also still have our robust manufacturing process.

And we expected that the pipeline would expand in the US as we basically got inventory out there in front of the continuation of building demand.

When we finally got to September, we said, well, you know that pipeline doesn't look like it's expanding quite as we thought. And we took numbers down. With hindsight at that point in time, we're saying the two catalysts really was the foreign exchange $15 million and pipeline of about $10 million.

Matthew Mishan: Just to follow up on that, in the middle of the year you also replaced the head of the Americas. Why did you replace him and what changed after that?

Bob Weiss: Yes. We made a change in March. We weren't totally - let's see -- humming when it came to the rollout in the US for a couple reasons. But the background noise and the reason for the change as much as anything was the sideshow of UPP, which is Unilateral Pricing Policy.

And that was creating a dynamic in the market that was a lot more challenging, if you will, in general for the entire marketplace. The market had gotten soft. There was a rift between the independence - there's always been a rift, if you will -- the independents on the one side and the retailers and internets on the other side. And that got widened by the whole concept of UPP.

It became obvious to us that we needed a fully experienced contact lens executive. We had one on the bench that was doing a lot of other work for us, which was (Jerry Warner). We put him into that role and made the change, just to really step it up to what was required in the marketplace by way of the experience factor.

Matthew Mishan: Okay. And then from - so the lack of an inventory builder, a pipeline -- why do you think your customers didn't give you more visibility to changing order patterns and how they're looking at their business? Were they playing hardball waiting for some wholesale discounts?

Bob Weiss: That's a great question, and I would say there was a lot of factors. And that is clearly one, that we basically in years gone by - it was not uncommon for that dialogue between the - I'll call them the middle men, the distributors, and the manufacturer to have a hardball discussion to see who would blink.

Pretty much we stopped blinking the last couple years and not reaching any accommodation. So that is the factor where inventory has contracted; that being one reason.

The other reason is as that debate continued with the distributors, the give and take was a more efficient system. And by that I mean, for example, our distributors would tell us you're the number one company in toric lenses and specialty lenses. You have a more complicated product line and you put more demands on us because of that. What can you do to make the system more efficient?

And in the give and take process, there was a lot of shifting from asking the distributor to carry the complete line of products to more and more the manufacturer, in our case, taking the torics and the complicated non-bell-curves -- the more low demand SKUs -- and going direct to the purchaser, which in the past had been the independent eye care professional.

And that's now a changing story. With the whole of all the mergers going on and alliances where you have companies like an internet company and a large retailer allying, or an insurance company and a retailer alliance, and things of that nature going on -- the whole dynamic of the distribution channel is evolving and changing and becoming more efficient.

There was some consolidation of distributors that came into play, and that consolidation led to improved efficiency and less distribution locations. There is now the evolving concept of direct to the consumer, which is similar to a model that's been in Japan and to a lesser extent in Europe. But the US is just starting to catch on.

There's been some history why there's been reluctance to go direct to consumer and share patient-based database between the independent practitioner and anyone. They're now developing techniques that make them more comfortable. And of course, that is a more efficient distribution channel and one where the consumer who, by and large, is someone that may be a teenager under twenty and they're very savvy on how they buy stuff on the internet.

So to keep up with that evolution, the industry and the practitioners are stepping forward with new models. Those models are leading to contraction of the inventory and the pipeline. For example, we have some retailers and some doctors no longer carrying inventory. They're basically saying I'll take - I'll have a fitting stat and I'll fit a patient. And then the lenses will arrive at your house.

So there's good news and bad news about that. The good news is it's a very efficient distribution channel. The people earning less money are clearly going to be the - all of the people that had been servicing in the middle. And then, of course, UPS and those that deliver direct tot the house are going to still do alright from their perspective, but there's a lot of packages arriving every day on a lot of doorsteps.

Matthew Mishan: And Bob, what's your sense on how long that's going to take to play out?

Bob Weiss: Well, I think that there are parts of this that have played out some. I didn't mention UPP. UPP was the dynamic that is now anniversaried. And when we saw the ((inaudible)) numbers, that's indicative of the fact that a little over a year ago that became a factor that led to shrinkage. The consolidation of distributors - more consolidation and more distributors - a lot of that has played out.

So we'd say a lot of the bulk has played out. What has not played out is just how much of a shift will go from the traditional way I go to my doctor and pick up my lenses to the new way, which will be - and I get a sample size and then my order arrives at home. That will play out really and evolve over years, I think.

So what you'll have is basically the underlying market being stronger than the out-the-door manufacturer. And how big that spread is remains to be seen, but there will be - the market is much stronger than it appears as we track manufacturer data, if you will.

Matthew Mishan: Okay. Can you talk about how Luxottica - the 1800Contacts - I believe they had some level of agreement -- what they're doing there and whether that played - is that playing a role in some of the inventory challenges?

Bob Weiss: Yes, I can't get into the specifics of any one account. And you're right. There was an alliance, if you will, between Luxottica and 1800 that continues to play out. But from the point of view, my comments on market dynamics and sharpening the pencil on the efficiency factor, and going direct to the consumer -- I think that all plays into - that would be just one example where the model is a work in progress.

And it clearly - I think clearly you have to work harder to see through the market and say the market is really trading up fantastically well and there's noise level. And alliances like that create some noise level and distortion, which is...

Matthew Mishan: Okay.

Bob Weiss: Ultimately, probably good news for the consumer, good news for the doctor because if the distribution channel is more efficient, that could be good news for the independents as well as the retailers. But short term, the manufacturer -the appearance at the manufacturer level may be a little softer than the on-eye reality.

Matthew Mishan: Okay, that's fair. Then, moving on, there's been a couple of sell side notes recently in this adjusting, some challenges in the consolidation of some of your distribution centers in Europe. I think last quarter there was also a lot of chatter out there that you were building some inventory ahead of the consolidation, and that was one of the reasons why Clarity would be more skewed toward the fourth quarter.

On your last call, you said that we integrated several soft lens distribution centers in this past quarter and we're in good shape to finish all the integration activity impacting operating expenses shortly.

Could you just elaborate on some of the consolidation activity you're doing, where you're at with it, and so forth?

Bob Weiss: Well, you're right. There was a lot of activity from our perspective that was taking place, really, from, let's say, the mid calendar year anticipated toward the end of the calendar year with the bulk of it - some of it rolling, maybe, into early next year.

We will do an update in December, so I'm not going to get into a lot of the sound bites as far as which locations and how. I did comment in the third quarter that we had pressed the go button and were going through a series of consolidation, and indicate that is the interface with the customer when you shift a location from A to B. And let's say were that to add even a day to the distribution channel because it's at a different location and it's a work in progress, expect some noise level. There is no such thing as an invisible shift in the distribution channel with your customer.

So we're going through that process. It's obviously the right long term division from an efficiency point of view. You've just got to get through it as quickly as you can and as efficiently as you can. Sometimes you throw bodies at it to make sure you're minimizing that temporary disruption. So we're in the middle of that. I will obviously - we're also in a quiet period, so I'm not going to get into anything along the lines of refreshing guidance or implications.

But suffice it to say, in December on our year-end call we'll be putting some air time on the whole of that consolidation process.

Matthew Mishan: Okay. With that, (Nicki), I'll open up to the queue.

Operator: And there are no questions in the queue at this time. But, everyone, as a reminder, it is star 1 if you would like to ask a question and please make sure your mute function is turned off. Star 1.

Matthew Mishan: I guess - again, I don't want to - I'll just do one follow-up question on that. And were some of the disruptions you were talking about contemplated in your full-year guidance?

Bob Weiss: Well, certainly when we were there in September we knew we had started that process and were well into it. So we obviously at that point in time factored where we were. And what I've indicated - we're not really going to refresh it. Basically at that moment in time we were at a point that was factored into the guidance at that time.

Matthew Mishan: Okay. So you indicated in august the quarter was off to a good start. You were a little bit conservative on what you were thinking about from the Americas, but then you saw a really strong number from Johnson and Johnson in the US. What was your first impression of the Johnson and Johnson quarter? And do you think the US market is maybe beginning to normalize a little bit here?

Bob Weiss: Yes. I think it was - when I thought it was - I told you so, kind of thing. They a year ago - their US market, for example, declined about twelve, thirteen percent. And comparable prior quarter - now it's gained twelve, thirteen percent. If you put the two together, they're flat, if you will, from a two year perspective.

So that decline - clearly the huge decline was the function of the step they took - well, there are two reasons. The step they took regarding UPP takes their entire product portfolio, their franchise products, Oasis and Moist, into the UPP theater. Whereas every other manufacturer was doing it differently. They were doing UPP but only for new products predicated on the fact that the independent eye care professional would have to invest a lot more time in converting a patient into a new product, with respecting that time and energy.

J and J then came along with the different model and that upset the apple cart, particularly the reaction from the entire retail distribution channel. So they got a reaction. That is now annualized and so you're - so I expected a clearly - some bounce on that.

Matthew Mishan: Okay. And then the way I'm looking at the market now is I think it's a lot of growth being driven by daily silicon hydrogel over the next five years. And I was just hoping to frame it here and quantify what the opportunity is and walk through some of the numbers, and see whether or not you have any pushback on the math or not.

So current market is about seven and a half billion dollars, and over the next five years that goes to about ten. And the current market share for dailies is about forty percent of that. And apparently that could go up hopefully, maybe, to fifty percent and get you up to about five billion dollars of total market size on the dailies.

The daily silicon hydrogel is about thirteen percent of the mix currently versus seventy percent of the overall market. Can daily silicon hydrogel approach thirty to fifty percent of that over time? I'm thinking you're putting in place somewhere in the area of ten to twenty percent of global market share with the move to daily silicon hydrogel.

My question is what is the pushback on that math?

Bob Weiss: I certainly in general - the comments you made I would agree with -- number one, that the driver in the marketplace for the last two years, last three years globally, has been the one day modality. And there is no doubt that the one day modality is getting a lot of momentum in the United States now. With the push, particularly out of two weeks moving into the one day and a little bit into the one month; but mainly into the one day from the two week space.

The two week space, by far, is the bulk of the wearers. They're the noncompliant wearers that buy a two week lens and see if they can get away with wearing it longer than two weeks and up to a month.

So the push out of two week into the one day is all about trade-up. For example - and that's why the catalyst of the industry is the one day. If I'm trading up a patient that at the manufacturer's level generates sub-seventy dollars in revenue per year and probably sub-sixty dollars, quite frankly, in the two week space, and I'm moving them to a one day where they're using 730 lenses instead of, maybe, more like twenty-four, that is a huge trade-up on numbers.

And when you convert that to revenue dollars, it's a trade-up of four to six hundred percent in revenue dollars.

If along the way you're also talking about a double trade-up - if they're going from a hydrogel into a silicon hydrogel, then you would clearly be much more at the top end of that four hundred percent to six hundred percent trade-up.

So that dynamic - we see no slowing up of the shifting that's going on. All the manufacturers are pushing the concept of one day. You have really the FDA and the CDC also helping out because they don't like the fact that most non-one-day-wearers are noncompliant and tend to not do a good job with lens care regimen -- topping off their solutions and things of that nature, which is not good.

So you have the health factor. You have the factor of convenience because the consumer wants something. At the end of the day I just chuck them and I don't have to clean them. That's very convenient.

What you don't want to be is a lens care company right now in the middle of that evolving demographic or change.

So when we look at the market from now to, let's say, 2020, I'd buy into - a good chance to be in around that ten billion dollar mark. And it's a good chance that 50% of that market will be one day modality. It's gone fairly rapidly from like thirty-four up to now pushing forty-two, forty-three percent revenue dollar basis.

It is important to understand when I talk about that trade up from seventy dollars to four hundred to six hundred - well over - approaching three hundred dollars to upwards of five hundred dollars, that trade-up is more driven by a small percentage of wearers generate a lot of revenue dollars. So even though forty-three percent of the revenue dollars I'd say in the most recent quarter where the one day modality -- the one day revenue dollar modality -- that is far from forty-three percent of the wearers. At a minimum, cut it in half and probably more so.

So that's a factor that will continue. We have a long way to go in the shift from the two week modality to the one day modality.

Relative to silicon hydrogel, that story is really more - we know that the non-one-day modalities -- the two week and the monthly -- have heavily shifted into silicon hydrogel where I think 77%of the revenue dollars are now silicon hydrogel in that space.

That 13% of silicon hydrogel in the one day modality is now more like 17% in the most recent quarter. So there's a continuation of that shift of - we'll call it the double trade up because the trade up to silicon hydrogel is usually around twenty to forty percent trade-up above a non-silicon hydrogel. You're getting a double factor and we know that Total1 and TruEye and MyDay are all going to be in that premium category where people are less constrained by a budget.

We also know that most wearers are constrained by budgets. They're teenagers, they're twenty year olds. And they're - 75% of them are under thirty-five years old. So they're a lot more price conscious. There's only so far you can go with the convenience factor and the trading up factor that comes into play.

But we like the idea that that dynamic -- the double trade-up -- is going on. We'll shift the revenue dollars and continue to shift the revenue dollars towards the one day. And most likely if it's not 50%, it could very well be north of 50% of the revenue dollars by 2020 being in the one day modality.

And the only thing that is constraining how much of it will be silicon hydrogel one day is cost. So our belief -- and this is the Cooper story with Clarity. If you have a reasonably priced silicon hydrogel one day going head to head with the mass market in the one day, which we'll call Moist and Dailies Comfort Plus, those two are the bulk of the market right now.

If you could shift those wearers into silicon hydrogel, then Clarity has a huge upside. And we believe it's already demonstrated in the two week and the monthly space that the doctor wants to fit silicon hydrogel and hat the patient wants to wear silicon hydrogel.

I do not mean to say all patients because clearly some patients, as has been learned in the past, will push back on the silicon hydrogel and stick with their hydrogel lenses. So I think I've commented a lot. I'll take a breath and let you maybe come back around on any clarification you want.

Matthew Mishan: I just - we'll get to the competitive landscape next because it seems like there are a lot of new entries coming into the space at this point. But just first, are the independent doctors feeling that there's too much product coming at them at one time? We've heard some level of pushback from the doctors that we have too many options, almost, on silicon hydrogel at this point.

Bob Weiss: Well, on the one day silicon hydrogel I would say there's not all that much options. You have Total1. You have TruEye, and TruEye's probably being replaced by Oasis One Day. And then those two are in the premium category. And then you have MyDay just coming into the market in the US in the premium category.

In the one day mass market, you do not have a silicon hydrogel other than Clarity. You also do not have a toric and a multifocal silicon hydrogel in the one day space other than Clarity. So it offers a lot and doctors, by virtue of their habits, like silicon hydrogel relative to all their two week fitting and monthly habits, if you will. So it isn't about trying to convince a doctor that - isn't it true that you would rather your patients in silicon hydrogel than a hydrogel?

And so by and large the bulk of them -- and I always want to couch it by saying it's never one size fits all. There's always going to be hydrogel products because some people think silicon hydrogel are more like hard lenses than soft lenses. They can feel the lens. So you're always going to get some pushback from some wearers who have maybe hypersensitive eyes to awareness. And that will always be.

But from a doctor's point of view, the doctors -- and once again, I'm talking about the majority of doctors, not all doctors -- like the silicon hydrogel space. So are there a lot of choices and a lot of things evolving out there? Yes there are, more so than if we went back to the seventies and eighties where the choices were considerably more limited. But I would say that they like the direction it's going and as much as anything they're helping lead that direction it's going from the noncompliant wearer to the compliant one day wearer.

Matthew Mishan: So let's break the market into the premium market and then Clarity, and then the mass market. We'll come back to Clarity, but first let's start with the premium market where you have Dailies Total1 at the high end. You've just introduced MyDay and then J and J TruEye. And now you also have the J and J Oasis lens coming down to the daily.

So first, what do you know about the lens as of now as far as price point, quality, and its ability to become a toric - to round out the portfolio as a toric and a multifocal?

Bob Weiss: Well, we know that they're calling it Oasis One Day and they introduced the product recently. And the characteristics of the product at least from a material point of view - the way you would list it in a catalog if you were a doctor buying it are, essentially, the same as the Oasis two week product.

Now, there could be a design difference and things like that. We actually don't know yet at this point in time. We're obviously doing sampling and testing and all that, that manufacturers would do on each other -- relative to are there feature differences, et cetera.

Interestingly, they never admitted that it was the silicon hydrogel in that launch, which is a little confusing. But for whatever reason, they didn't say, oh, by the way, it's a silicon hydrogel.

They are obviously trying to move it into a space from a pricing point of view that would allow for a replacement of TruEye should they decide to replace TruEye. But more importantly, they're trying to retrieve back what TruEye lost to Total1. Total1 just absolutely killed TruEye in the US market; not necessarily true in Japan for whatever reason. It's a more established product, maybe slightly different for whatever reason in Japan.

So it isn't a global failure. It was a US failure of TruEye.

And so I would guess they think, number one, if their strategy is a trade-up strategy to bring Oasis two week wearers into the one day modality but to have enough distinction between the products -- one is a one day and one is a two week -- then that trading up, if you will - if you get, essentially, most of those wearers, it's a huge trade-up. That's six hundred percent trade-up.

So even if you only get half of them, you are so far ahead in that trade-up because there's the least profitable going to the most revenue and profitable.

To your question about can they do a toric and a multifocal -- their constraints are a little driven around cost structure. If you don't have the cost structure, you can't do it. And the beauty of Clarity - why is it low cost? There's about four good reasons.

One is no alcohol. Two is it's in a low cost environment -- Hungary and the future will be Hungary and also Costa Rica. Three is the cost capital equipment is less than one-third of traditional manufacturing equipment. And obviously at the end of the day, the capital cost enters into cost of goods.

So you have labor factor, alcohol factor, the simplicity of the interchangeability of our lines for Clarity so you can make a toric one minute and an hour later you can be making a multifocal. An hour later you can be making a sphere. The interchangeability is a huge factor, and if you don't have a flexible manufacturing process, then downtime to convert from a sphere to a toric becomes an enormous cost factor.

So there's a lot of good reasons why maybe toric and multifocal aren't going to be easy to do in the one day modality, but that's all speculative. I have no direct information about where they're headed and when they're going to get there, if you will.

Matthew Mishan: Okay. And then MyDay you've said in the past - MyDay's also going to be private label. I think Clarity is also private label with Vision Source. So how does that protect volumes? Second, how are you doing with the Clarity Vision Source contract?

Bob Weiss: Well, I'm not going to get into the details of any one customer, but suffice it to say there are a lot of customers that -- be it buying groups or retailers -- like private label. It gives them more protection in terms of the product. And so we've always had a model. And if we look back at the history of Cooper, that private label model was a major part of Cooper and Ocular Sciences that we both in 2004 where in that two week space there was a huge private label factor.

That private label factor atrophied, if you will, as the shift went to silicon hydrogel and Cooper was late to the game of silicon hydrogel. So while the retailer wanted the private label, it wasn't available to them from - in the same degree as it used to be in that modality.

So market shifted into more branded for a while, but it never really meant that the retailer wouldn't have taken it if they had it available. So private label is always going to be a big part of our strategy and it does have its challenges. I'm not going to say it isn't - you have to be more packaging-friendly and flexible than if it's - like one package fits all.

So that's a factor, but we've done it as a model for a living. And now that we have a family of silicon hydrogel that is very broad -- be it two week, be it monthly, be it one day -- we're certainly going to offer that up to our customers and competitive customers as an attraction.

Matthew Mishan: Let's move on to Clarity. First just on pricing, it seems like you're pricing that above Moist and also above the Novartis Aqua ((inaudible)). What do you think the competitive response will be form J and J with TruEye? Do they have the ability to bring that down and compete against Clarity as a dual brand strategy?

Bob Weiss: I really think there's a pretty big gap between the premium category and the mass market. I think the reluctance in the dilemma that J and J would have, for example, bringing Oasis or TruEye down towards Moist is if you put a silicon hydrogel right next to a non-silicon hydrogel, it would be a mass shift from Moist into the silicon hydrogel process.

So they have to be careful on how they do that because at the end of the day they have the franchise. And then the question is - if it costs more to make, Oasis or TruEye -- than it does Moist, and you just are washing the two without much of a trade-up, it's going to cost you.

So I really don't see that and I think that's the barrier in it to begin with.

Matthew Mishan: Okay. And SofLens managed to remove the alcohol. It seems to be - it's a major competitive advantage as far as the cost and the breadth, but they managed to remove the alcohol from the manufacturing process. How defensible is that innovation? Is it a patented protected chemistry or is it IP? How difficult would it be for somebody to match that down the road?

Bob Weiss: We're not going to get into all the details of it, but obviously know-how is a big factor. And they have years and years of know-how. And as I mentioned, it's the whole platform. It's not only the material it would take to do it, but the equipment it relies on and the location that it's manufactured, and all of those things come into play. It took years for them to evolve a complete family going from spheres to multifocal to torics.

It's easier - it's a lot easier to say that than to do it. It takes multiple years. And that's why you'll even watch MyDay eventually will probably have multifocal and toric, but it isn't like - well now that I have a sphere I can do the next one. Cost in the one day modality - efficiency and cost is just a huge factor if you're going to be able to market the product at a price that someone can afford.

Matthew Mishan: How are you thinking about the longer term opportunity of migrating in costs for your manufacturing process through some of your other brands?

Bob Weiss: Well, rest assured some of the knowledge base that Sauflon has will translate into certain things we're doing going forward. Conversely, there is a lot of things that Cooper was a lot more efficient than Sauflon was. And that's why when we start talking about, for example, that by the end of next year - back half of next year we expect Clarity one day not to be a drag on the overall gross margin mix, which is a huge statement, if you will, in terms of where your cost structure is and is headed by way of improving efficiency.

Going the other way, when we look Biofinity and we look at Avaira -- not that easy to take certain material and do a conversion into a non-alcohol. So there may be new products that come along leveraging that know-how, but do not anticipate that you're going to wake up tomorrow and suddenly Biofinity is going to be the same product and it's going to be made without alcohol.

That would be a huge technological change and I don't want to say never say never. I don't want to say we're not going to continue to explore that option. But I do think that's a big hurdle and it would have to be a pretty big breakthrough that we made to get to that point.

Matthew Mishan: And then just on a couple of the other competitors, it seems like all the focus is on Johnson and Johnson. But what does Alcon do from here as far as the daily Total1 and how they're looking at migrating the portfolio?

And then also Bausch and Lomb - they don't have a daily silicon hydrogel, but I've heard on some other products they're basically discounting and giving away their lenses. What are you seeing in the market as far as those two?

Bob Weiss: Well, number one, Alcon and Novartis certainly is a formidable company with some pretty good products. Total1 - they certainly proved the model that there is a large enough wearer base that want -that buy Rolls Royce, Bentleys, and the top line Mercedes. So they're catering to that and basically saying that market is bigger than some people thought it would be. It's certainly bigger than I thought it would be a couple of years ago.

But I'm not a believer that there is, and it doesn't have to be high percentage of the wearers, but a high enough percentage of the wearers that really is not that price sensitive.

So my compliments to Total1. It's a good product. We also know that MyDay is going to give it a run for its money, if you will, because it's a good product also.

As far as Alcon is concerned, I think they will continue to leverage that model that they have surrounding Total1. Whether or not they can ever come up with a toric down the road or a multifocal down the road, they have some of the same challenges that, certainly, J and J would have and we all have in that premium space if you're using alcohol and you're using a more expensive location.

For example MyDay is made in the UK and there's no comparison - UK and Puerto Rico. And there's no comparison of the cost structure in the equipment cost between MyDay and Clarity. They - Alcon has to some degree that same challenge as does J and J, and that's not to say you can't find a virgin site to start to process some of the costs. But you still would have certain limitations surrounding those products.

As far as B and L, B and L continues to run with some non-silicon hydrogel products in the one day space -- Biotrue. That - clearly some of the fitters and some of the - get some business from a price perspective playing off price and basically saying you don't need a silicon hydrogel in the one day space, which is the argument if you don't have a silicon hydrogel in the one day space. You're going to try to say, you know, you don't sleep in the lens. Why do you need the oxygen?

There's no doubt we all started there, saying do you really need a silicon hydrogel in the one day space? And then J and J came along and proved in Japan - not a bad idea. It can create a $200 million market in Japan with a one day silicon hydrogel with TruEye.

And so we also know that 77% of the revenue dollars in the two week and the monthly space are silicon hydrogel. So basically the vast majority of the two week and monthly wearers are silicon hydrogel wearers. You're slimming up the dam, if you will, if you're trying to convince practitioners that have already bought into oxygen as important that is no longer is important because it's a one day wearer. And that's - they'll get some business and maybe the loyal B and L fitter, if you will, but I don't think it's going to surprise us, if you will, by getting a lot of momentum.

Matthew Mishan: Okay. We went for a while. (Nicki), are there any questions in the queue?

Operator: There are no questions at this time.

Matthew Mishan: Okay, perfect. On the second leg of daily silicon hydrogel growth, it seems like that's going to be Japan. Is there any reason to believe that Japan's a more defensible market for TruEye than it was in Europe and the US? And what do you - ((inaudible)) MyDay in 2016, and when is Clarity expected to hit there?

Bob Weiss: Well, the market in Japan is from a process option of view and a regulatory point of view - time enters the equation. So yes, we're getting and expect to get MyDay this coming year. Clarity is clearly further down the road. We haven't put a line in the sand on a date that we need to get it there. Really going after MyDay to it.

Japan has always been a more premium one day market. So the reason TruEye has done well there is because they've always paid a fair amount for their lenses in the one day modality. The reason the Japanese market is north of $1.2 billion even after a 30% devaluation, if you will, compared to where it was. So it's done well. It's by far bigger than any other market in the world ex the US.

And I think in the one day modality with TruEye, until we get enough competitive products in that space, we won't know for sure if the same thing that happened in the US will happen in Japan where TruEye was there in the US and then Total1 came in. and I would hope - and then MyDay came in, and those two kind of ate TruEye's launch.

If they're better products in the US, undoubtedly they're better products in Japan, meaning TruEye going head to head with MyDay and Total1. I would not pick TruEye to win the race if they were all starting out of the gate the same time.

How much annuity there is in that - because once you have them hooked in TruEye, they're hooked. All I can say is in the US there was not much of an annuity when Total1 was alongside the product. And that, to me, would say that there might be some mobility in shifting that will take place.

Matthew Mishan: Okay. I guess we'll move onto margins here with the final ten minutes. If you walked through some of the moving pieces to gross margin next year, I think I'm particularly interested in - because you seem like you have some certain positives that are going to help you out next year.

But I'm particularly interested in the magnitude. Is there any way you can frame the headwind in Costa Rica in 2016 and 2017?

Bob Weiss: The - clearly we have a lot of tailwinds that we've commented about in the past, basically the ramp up of Clarity in Hungary and just how robust it is in Hungary. If all we did was just say let's put all our eggs in one basket, we would have a lot more efficient story to talk about next year. There is no doubt that starting up a virgin site in Costa Rica at a remote location like Costa Rica -

and we also of course have one that we're starting up in the UK, which is called Speedwell in the Southampton area for MyDay.

So we have those two new plant startups. Even though one is close to other plants, it's still a plant startup. That is a drag on the gross margins in 2016 and will probably run into 2017 as you ramp up lines in Costa Rica. It will get more and more efficient as you consume more and more of that plant space and the people infrastructure it takes to run a plant because you obviously have maybe one plant manager running TruEye for a while and another in another plant - you have one plant manager running twelve lines.

So who's going to be more efficient? That's kind of obvious with their infrastructure.

The - we factored into our thinking that we do have this startup and we'll have more costly product, albeit a smaller percentage initially, into our thinking of 2016 when we basically said, you know, one day Clarity is no longer going to be a drag on our gross margin for CooperVision in the back half of next year. So it's kind of saying, you know, we've come so far and we have enough throughput in Hungary that it's going to beat out some of that startup ramp-up cost by the back half of next year. That's our expectation.

And then as you get to 2017, depending on how many lines are added in Costa Rica - and the variable is the efficiency factor is so good that it could dictate how many lines you need and how soon you need those lines. The beauty of the process is the flexibility and the short time frame from order to setup of a line for Clarity is a lot easier than not only the price three times difference or a MyDay, if you will, but the time factor is considerably less -- eighteen months dropping to sub twelve months from start to finish. Makes your life a lot easier.

So that's clearly a factor. We've talked about other tailwinds, the continuation of cost cutting with in the entire plant sites. Cooper - the royalty is a factor. They're all tailwinds. Even to a lesser extent the fact that in 2015 we still had $1.69 pound coming into cost of goods for - we still make a lot of our products in the UK. So in the first half of this year we had some drag from that. That's more neutralized going forward also.

Matthew Mishan: What about pricing? It seems like pricing seems to be a pretty big investor concern in the marketplace as far as the competitive landscape go. Based upon what you're looking at today in today's environment, can you - are you thinking pricing is a tailwind or a headwind next year as far as margins go - what you're seeing?

Bob Weiss: I guess I don't - pricing to me has been a factor twice in the last thirty years -- once in the early eighties, once in the ninety-seven timeframe. And beyond that, everyone has certain price strategies. Most of them are geared around new fits, trying to win a new fit. I don't call that pricing. UPP, which is of course the third party to the consumer price, was not about really cutting the manufacturers' price.

So it's all been more about how fast you can trade out, trade up. And if I'm taking someone from generating sixty dollars in revenue a year at a manufacturer level to $300 at the manufacturer level, whether it's $300 or $280 doesn't matter that much if I have the cost structure.

So - and private label - of course, some people say that it's not a pricing strategy. Private label is mainly a - someone likes their branded name better than they like yours. And that's okay because a lot of our retailers have pretty good branded names.

But playing it off a little on price, I don't know that anyone's doing that to a meaningful degree. And in the past, it hasn't really gotten you that much. The two price wars that - I'll use the word "wars" that did occur were very short-lived. Cooper started the first one in the early eighties and B and L finished it. That wasn't a good idea then and it's still not a good idea now.

Matthew Mishan: Okay. And then on free cash flow, I think you've indicated it's expected to inflect higher next year. A couple questions here -- how do you prioritize the use of cash going forward? It also seem liked the acquisition activity is going to pick up in Cooper Surgical. How are you thinking about the size of that and what's the right mix of CVI versus CSI for you over time?

Bob Weiss: As far as priorities to cash flow, you're right. We're expecting the free cash flow to step up in 2016 going forward. Part of that will be the flattening and ramping down of CAPEX. We've obviously spent a fair amount of money in both new plant startups as well as new product rollouts ramping up.

And we'll have a leverage factor going forward. So that will lead to better free cash flow. The benefits of the integration of Sauflon and some of that cost cutting will lead to better free cash flow. And we expect to be approaching the $300 million mark next year.

As far as uses of cash, they remain pretty much - if it's internal, a good project -- be it geographic expansion, be it deeper penetration into Eastern Europe, or be it new product - muscle behind new product rollout -- that would be - internal would be a first use of cash followed by we'd like M&A activity if the deal is - has the return on invested capital that we require.

So M&A activity - you're correct. I would hope that our Cooper Surgical business has more M&A activity in the next several years than it's had the last three years, which has been more on average one a year. And keep in mind surgical was built out of about thirty-five acquisitions over a twenty-year period, and in many of those years were two or three acquisitions that came into play.

And as far as size, many of them I would say will continue to be that middle of the road - if I could say the middle of the road on acquisitions - would be something in or around $50 million, plus or minus twenty or thirty. So that range of $10 million to $100 million will be where the bulk of the activity will be. But I wouldn't say never say never about some bigger mass if it were available and were the right fit.

As far as the blend between CooperVision - and by the way, just for emphasis, if Vision had a good transaction to be done there is no saying one has a higher importance than the other. It would be just as important if there was a vision acquisition to do the vision acquisition if it had a good payback. So it's more about ranking paybacks. The better deals get done quicker than the less better deals in terms of if they're all there at once.

Easier said than done relative to how many deals you can do and how many deals you have a willing seller on. So I don't want to overstate just how much we'd step up the acquisition activity. We're going to do it in an intelligent manner and one where we can handle and process what we're doing.

Relative to other priorities - paying down debt. If you don't have an acquisition, it's important. We've always been opportunistic in our buyback of stock approach. We've always been not enamored by taking a lot of cash and starting a dividend policy, which loses the flexibility, if you will, to do other things down the road. So that's still a lower priority, certainly, than a buyback strategy if all things are equal.

Matthew Mishan: Okay. Well, I've learned now how to ask four-part questions. I'll do that in our January conference call going forward too. And I just want to say thank you. We're out of time. Thank you very much for joining us, Bob. I thought it was a really great call and very good color.

There will be a replay of this and a transcript available. And thank you everyone for dialing in. And have a nice day.

Bob Weiss: Thank you Matt.

Operator: And that does conclude today's conference. Thank you for your participation.

END