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COO - Q2 2016 Cooper Companies Inc Earnings Call

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OVERVIEW:

Co. reported 2Q16 consolidated revenues of $484m and GAAP EPS of $1.52. Expects FY16 consolidated revenues to be $1.929-1.960b and non-GAAP EPS to be $8.20-8.50.

CORPORATE PARTICIPANTS

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PRESENTATION

Operator

Good day, ladies and gentlemen. And welcome to the Cooper Companies' second-quarter 2016 earnings conference call.

(Operator Instructions)

As a reminder, this conference may be recorded.

I'd now like to introduce your host for today's conference, Ms. Kim Duncan, Vice President Investor Relations. Ma'am. please go ahead.

Kim Duncan - *Cooper Companies, Inc. - VP of IR*

Goods afternoon, and welcome to the Cooper Companies' second-quarter 2016 earnings conference call. I'm Kim Duncan, Vice President of Investor Relations. And giving prepared remarks on today's call are Bob Weiss, Chief Executive Officer, and Greg Matz, Chief Financial Officer.

Before we get started, I'd like to remind you that this conference call contains forward-looking statements as defined by the Private Securities Litigation Reform Act of 1995, including all revenue and earnings per share guidance and other statements regarding anticipated results of operations, market or regulatory conditions, and integration of any acquisitions or their failure to achieve anticipated benefits. Forward-looking statements depend on assumptions, data or methods that may be incorrect or imprecise, and are subject to risks and uncertainties.

Events that could cause our actual results and future actions of the Company to differ materially from those described in forward-looking statements are set forth under the caption Forward-Looking Statements in today's earnings release and are described in our SEC filings, including the business section of Cooper's annual report on form 10-K. These are publicly available and on request from the Company's Investor Relations department.

Now before I turn the call over to Bob, let me comment on the agenda for the call. Bob will begin by providing highlights on the quarter, followed by Greg who will then discuss second-quarter financial results. We will keep the formal presentation to roughly 30 minutes, then open the call for questions. We expect the call to last approximately one hour.

(Caller instructions)

Should you have any additional questions, please call our investor line at 925-460-3663 or e-mail IR@cooperCO.com. As a reminder, this call is being webcast and a copy of the earnings release is available through the Investor Relations section of the Cooper Companies website.

With that, I'll turn the call over to Bob for his opening remarks.

Bob Weiss - *Cooper Companies, Inc. - CEO*

Thank you Kim, and good afternoon everyone. Welcome to the second-quarter 2016 conference call.

Let me start by highlighting three key areas. First, I'm pleased to report strong financial results for our fiscal second quarter. On a consolidated basis we reported $484 million in revenue and non-GAAP earnings per share of $2.05. Second, CooperVision posted 9% revenue growth on both a constant currency and an as reported basis, and strong results in all key areas of the business. Single-use silicon hydrogel lenses grew 52%, while two-week and monthly silicon hydrogel lenses grew a combined 14%, both in constant currency.

Third, CooperSurgical had another strong quarter, posting revenue growth of 23% and pro forma growth of 6%. We also closed several strategic acquisitions since our last earnings call.

Moving into the details. CooperVision reported second-quarter revenues of $391 million, up 9%. This was our strongest quarter, growth quarter since 2014, and really shows the strength of our product portfolio. Regarding revenue by geography, the Americas grew 9% in constant currency, showing a nice rebound from last quarter.

Strength was seen in multiple categories led by silicon hydrogel products. Our enhanced Clariti lens has been extremely well received, and MyDay had another strong quarter. Our Toric and multifocals also posted strong growth, driven by the Biofinity family.

EMEA had another strong quarter, and sales grew 5% in constant currency. Growth was driven by our family of silicon hydrogel products, Biofinity, Clariti, MyDay and Avaira. We also launched Avaira Vitality in EMEA during the quarter and it is being well received. Avaira Vitality is our new two-week silicon hydrogel lens, which is an enhanced replacement for the original Avaira lens. It was developed using improved manufacturing processes, resulting in a higher quality product at a lower cost per unit. We expect to launch this lens in the US later this year, subject to FDA approval.

Asia Pacific had a very strong quarter, up 18% in constant currency. Growth was strong throughout the region, and Biofinity and Proclear 1-Day stood out in Japan. Also within Japan we began our MyDay launch during the quarter, and we're seeing early signs that MyDay could be a very successful premium offering in that market.

Turning to our product categories, toric and multifocals grew a healthy 13% year over year in constant currency. We saw very nice rebound in the US, which bolstered our strength throughout the rest of the world. We remain the global leader in specialty lenses.

Looking at silicon hydrogel lenses, these products grew 20% in constant currency and now represent 60% of our total sales. Within the two-week and monthly space, Biofinity and Avaira combined to grow 14% in constant currency. We remain under-indexed in the two-week and monthly silicon hydrogel space at 74% of sales versus the market at 79%, so we anticipate very nice growth for many years to come.

Regarding our silicon hydrogel 1-Day lenses, Clariti and MyDay, they combined to grow 52% in constant currency. We remain very optimistic about these products and are committed to our growth strategy which includes a two-tier approach, with Clariti positioned as the mass market offering and MyDay as the premium offering. Remember, the biggest driver in the contact lens market in is the 1-Day growth, and we strongly believe we have the best product offering in the space as the only company with premium and mass market lenses including a full portfolio of 1-Day silicon hydrogel, sphere, toric and multifocal lenses.

Before finishing with the market data, let me make a quick comment on integration matters. We continue to finalize our soft-line integration activities, and we're very close to being done. You'll note CooperVision had a very small non-GAAP adjustment this quarter, or a smaller non-GAAP adjustment this quarter of roughly $9 million excluding amortization. We forecast similar charges in Q3 and Q4, mostly within cost of goods, but these should end this fiscal year.

Now let me comment on the overall contact lens market. And remember, this information is on the last page of the earnings release. For calendar Q1, we continue taking share, growing 9% with the market up 3%. Geographically, CooperVision grew 9% in the Americas while the market was flat. In Asia Pacific, CooperVision grew 14% with the market up 5%. And in EMEA, we grew 6%, in line with the market.

On a modality basis, single-use lenses continued driving growth and CDI, with CDI up 14% and the market up 9%. For non-single-use lenses, we grew 6% while the market declined 1%.

We also see -- as you can see, our growth remains diverse and strong. On the trailing 12-month basis, CooperVision grew 8% and the market grew 5%. Going forward, I expect the market to continue growing 4% to 6% over the next five years, and most likely closer to 6%. The drivers will continue to be the shift to dailies, geographic expansion, and an expansion of the wearer base. We expect to continue taking market share, led by our strong silicon hydrogel portfolio.

Moving to CooperSurgical. We reported second-quarter revenues of $93 million, up 23% year over year or up 6% pro forma. Our fertility products led the way, up 60% or 8% pro forma. And our office and surgical products grew 5%.

We continued executing on several initiatives, which are driving success, including transitioning to a geographic sales model, adding sales representatives in under-penetrated areas, and increasing our focus on high growth areas such as IVF and genetic testing. These moves are clearly gaining traction, as we saw growth throughout our business in Q2. Going forward I believe we'll continue to see solid growth as the business keeps moving into a more aggressive and efficient business model.

Regarding acquisitions, we completed several over the past few months. So let me touch on those and the strategic rationale. At the beginning of April we added Genesis Genetics, a genetic testing lab company focused on pre-implantation, genetic screening and diagnosis used during the IVF process. This is a nice addition to our existing genetic testing platform.

At the beginning of May we added complementary IVF capital equipment products through the acquisition of K-Systems, a small acquisition. It's roughly $7 million in revenue per year. And finally, we added the assets of Recombine last week. Recombine is a genetic testing company specializing in carrier screening, which is a great fit within our IVF and genetic testing franchise as it adds the number one carrier screening test sold to the IVF clinics.

As you can see, we are very focused on combining a full-service provider within the IVF global market. And we truly believe this strategy will yield success for many years to come. These deals are all incorporated into our updated guidance.

With that, let me touch on our guidance details. We are raising our FY16 revenue guidance for CooperVision to 5.5% to 7% constant currency growth. Our CooperSurgical revenue guidance is also raised to 6% to 8% pro forma growth, or up 24% to 27% on an as-reported basis. We're also raising our non-GAAP EPS guidance to $8.20 to $8.50.

In conclusion, I'm very pleased with our results and remain optimistic about the underlying fundamentals of our business. I believe we're well positioned to deliver solid results the remainder of the fiscal year and beyond. With that, let me express my appreciation to our employees, our number one asset. Their hard work and dedication to creating value is the backbone of our success.

And now I'll turn it over to Greg to cover the financial results.

Greg Matz - *Cooper Companies, Inc. - CFO*

Thanks Bob, and good afternoon everyone.

Bob provides an overall summary of our performance, including a review of the market and our revenue picture. I'm going to focus primarily on our non-GAAP results for the quarter. For the reconciliation to GAAP numbers, please refer to our earnings release.

Looking at gross margins. In Q2 the non-GAAP gross margin was 63.2% compared with 63.4% in the prior year. Although CooperVision had positives from currency and strong Biofinity sales, its margin was lower than expected. The primary items driving this were a negative margin impact from stronger Asia Pac sales where we have higher 1-Day sales, and charges associated with idle equipment and legacy hydrogel inventory.

Regarding these last two items, let me cover them separately. We have made a lot of progress improving our manufacturing operations, including some very recent successes. For competitive reasons I won't get into specifics, but our production per line has increased materially resulting in lower cost per unit and a lesser need for future CapEx. This has resulted in idling some equipment, which hurts us in Q2 and will also negatively impact Q3 and Q4. We anticipate this being a short-term negative, as we will grow into this production over time.

The other item is our legacy hydrogel inventory, where we wrote off more than we planned, as our silicon hydrogel sales were very strong and we're forecasting that to continue. This hurts us in Q2 and we expect it will negatively impact Q3 and Q4. To be clear, we're not excluding these items from earnings, so they are negatively impacting our non-GAAP earnings per share.

CooperVision on a non-GAAP basis reported gross margin of 62.8% versus 63.3% in Q2 of last year. The factors which impacted margin were the items I just mentioned. CooperSurgical had non-GAAP gross margin of 64.8%, which compares to Q2 2015 of 63.5%. Strength in the OB/GYN and IVF product families drove this quarter's margin.

SG&A on a non-GAAP basis, SG&A increased approximately 6% to $171.6 million, or 35% of revenue, down from approximately 37% of revenue the prior year. Primary driver behind this leverage was strong SG&A controls.

Now looking at R&D. In Q2 R&D on a non-GAAP basis was $16.6 million, or 3.4% of revenue, flat in dollars and down from 3.8% of revenue in the prior year. We're seeing investment in CSI offset by synergies from the Sauflon acquisition in CVI.

Now moving to operating margins. For Q2, consolidated GAAP operating income and margin were $89.8 million and 18.6% of revenue versus $71 million and 16.3% of revenue in Q2 last year. Non-GAAP operating income and margin were $117.6 million and 24.3% of revenue versus $96.7 million and 22.2% of revenue for the prior year. Primary difference in operating margin year over year is the operating expense leverage.

In Q2 CooperVision's non-GAAP operating income and margin were $102.4 million and 26.2% of revenue versus $88.8 million and 24.7% of revenue in the prior year. CooperSurgical's non-GAAP operating income and margin were $26.6 million and 28.8% of revenue versus Q2 2015 of $18.8 million of operating income and 25% of revenue.

Moving onto depreciation and amortization, in Q2 depreciation was $33.7 million, up $1.5 million year over year. Amortization was $14.3 million, up $2 million reflecting our recent acquisition activity. Interest expense was $7.6 million for the quarter, up $2.9 million year over year, primarily due to higher debt and interest rates associated with acquisitions. Looking at the effective tax rate, in Q2 the non-GAAP effective tax rate was 9.4% versus a non-GAAP effective tax rate of 8.4% in Q2 2015.

Earnings per share. Our Q2 earnings per share on a GAAP and non-GAAP basis was $1.52 and $2.05 respectively versus $1.23 and $1.72 for GAAP and non-GAAP in the prior year. Non-GAAP earnings per share on a pro forma basis, which adjusts for currency and acquisitions, grew approximately 13% in the quarter. Now looking at FX, net currency impact on earnings per share year over year for Q2 was a favorable $0.10.

Moving onto the balance sheet, in Q2 we had cash provided by operations of $97.8 million less capital expenditures of $41.1 million resulting in $56.7 million of free cash flow. Excluding integration costs of $9 million, adjusted free cash flow was $65.7 million. Total debt increased within the quarter by $64.1 million to $1,441.4 million, primarily due to higher Average cash balances and acquisitions, partially offset by operational cash flow.

Inventories increased from last quarter approximately $2.7 million to $433.6 million. This is entirely driven by CSI acquisitions. In CooperVision we saw inventories decline, as growth in silicon daily inventory to support our product launches was offset by reduction in our hydrogel inventory. For the quarter we're seeing months on hand at 7 months. Days sales outstanding is at 54 days, which is down 3 days from the prior quarter and 2 days from last year.

Turning to guidance, for our main currencies we are using 1.10 for the euro, JPY1.12 for the yen and $1.46 for the pound. The consolidated revenue range is being raised to $1.929 billion to $1.960 billion, or approximately 5.5% to 7% pro forma growth. CooperVision's revenue range is being raised to $1.545 billion to $1.567 billion, or roughly 5.5% to 7% constant currency growth. CooperSurgical's revenue range is being raised to $384 million to $393 million, or roughly 6% to 8% pro forma growth. Note that roughly half of the increase in guidance is from currency while the other half is primarily from acquisitions.

We expect non-GAAP gross margin to be around 63% for the year. This is a reduction from the previous guidance of around 64%, as it incorporates the CooperVision items I mentioned earlier, along with lower gross margins from CooperSurgical associated with recent acquisitions. Having said that, we still expect improving Q3 and Q4 gross margins of around 64% each quarter. OpEx, expected to be around 39%. Operating margins still expected to be around 24%. Interest expense is expected to be around $28 million. Our effective tax rate is expected to be around 8%.

Our expected share count will be around 49.1 million shares. And our non-GAAP earnings per share is expected to be $0.20 higher on the top and bottom of our range to $8.20 to $8.50, which equates to a pro forma earnings per share of 10% to 14% growth.

From our last guidance, currency is roughly a $0.40 positive, and we have actually improved our operational performance by roughly $0.10. But we are expecting the idle and legacy inventory write-offs to negatively impact us by roughly $0.30. CapEx is expected to be around $200 million as we finish paying for equipment we have ordered over the prior year. And thus, adjusted free cash flow is still expected to be around $300 million.

With that, let me turn it back to Kim for the Q&A session.

Kim Duncan - *Cooper Companies, Inc. - VP of IR*

Operator, we're ready to take some questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question comes from the line of Matthew O'Brien with Piper Jaffray. Your line is now open.

Matthew O'Brien - *Piper Jaffray - Analyst*

Good afternoon. Thanks so much for taking the questions. One for Bob and one for Greg. On the increase in CVI, I guess the question is for Bob. Increase to CVI's outlook for the year, can you just give us a sense for how much of that is coming from improved manufacturing of MyDay, especially launching into Japan, or just disruptions into the markets that you're seeing? And then how much are you incorporating the J&J launch as far as somewhat of a headwind into your fiscal Q4?

And then for Greg, this is typically a really strong free cash flow quarter for you guys, but you're sticking with the $300 million outlook for the year. Can you just help us reconcile the little bit of a softness that we saw here in Q2 versus that outlook for the year?

Bob Weiss - *Cooper Companies, Inc. - CEO*

The foreign exchange, as Greg indicated, is a big driver of the top-line overall improvement. In terms of the constant currency growth, you're correct, there is a modest -- in the guidance there's a modest deceleration compared to what we had previously forecasted to anticipate, if you will, some impact of the J&J roll-out. Beyond that, it's pretty much the same range at the 5.5% to 7%. So modest at both.

MyDay impact in Japan is -- once again, we just rolled that product out in March of this year. So fairly minimal impact in terms of the overall -- any update on the guidance, if you will. And of course, we already knew about MyDay in Japan in our previous March guidance.

Greg Matz - *Cooper Companies, Inc. - CFO*

Matt, on the free cash flow, nothing really jumps out. The number isn't that far off of the prior year, and we did have a much stronger Q1. So as you look at kind of halfway through the year, we're actually probably ahead of where we were last year.

Operator

Our next question comes from the line of Jeff Johnson with Robert Baird. Your line is now open.

Jeff Johnson - *Robert W. Baird & Company, Inc. - Analyst*

Sorry about that, guys. Can you hear me okay?

Bob Weiss - *Cooper Companies, Inc. - CEO*

We can.

Jeff Johnson - *Robert W. Baird & Company, Inc. - Analyst*

All right, great. So Bob, let me ask you one question. Then I have a modeling question for Greg as well. But the question for you, just on the Biofinity and Avaira business. Obviously that bounced back very nicely this quarter. I think you said 14% constant currency in the quarter year over year. 7% last quarter. So kind of averaging right around double digits. Is that how we should think about that business going forward? Obviously, you've got the launch coming from J&J, as was referenced in the prior question. You also have Ultra kind of gaining some traction, it sounds like. How do you think about that Biofinity Avaira bucket over the next couple years?

Bob Weiss - *Cooper Companies, Inc. - CEO*

I think taking the two quarters, the 7% and 13%, being in around low double-digit is the right way to think about it.

Jeff Johnson - *Robert W. Baird & Company, Inc. - Analyst*

Great, that's helpful. And Greg, question for you. I think at the very end, did you say $0.30 is the EPS impact of the inventory write-off and that is included in your non-GAAP EPS guidance? Is that correct?

Greg Matz - *Cooper Companies, Inc. - CFO*

Yes.

Jeff Johnson - *Robert W. Baird & Company, Inc. - Analyst*

Okay. So for next year we should be thinking about adding, just kind of building off a base that's $0.30 higher, assuming you're not going to have those kind of write-offs next year? Would that be the fair way to take this year's EPS, add $0.30 back and build that off as our base assumption going into next year?

Greg Matz - *Cooper Companies, Inc. - CFO*

Jeff, it's probably a little early to get into next year's guidance, which we would come out later in the year and discuss.

Bob Weiss - *Cooper Companies, Inc. - CEO*

Keep in mind, Jeff, there's a balance between -- some of that is write-off, as Greg indicated. Some of it is idle equipment as we grow into it. So we're growing -- given the substantial growth of our one-day modality and our unit growth, we're anticipating that we'll start consuming more and more of that as each quarter goes by. But that's $30 million overall is both write-offs as well as idle.

Greg Matz - *Cooper Companies, Inc. - CFO*

And Jeff, just to build on that a little bit. I think, without giving guidance, I think we feel comfortable that we would see gross margins improve year over year.

Operator

[Our next question comes from the line of Joanne Wuensch with] BMO Capital Markets.

Joanne Wuensch - *BMO Capital Markets - Analyst*

Hi. Can you hear me okay?

Bob Weiss - *Cooper Companies, Inc. - CEO*

We can.

Joanne Wuensch - *BMO Capital Markets - Analyst*

Wonderful. I think what a couple people are trying to get at, and I know in speaking with investors, the big concern right now is the J&J monthly launch starting at the end of June, beginning of July. How do you think about that product launch, and how do we get comfortable that we're not going to see a similar hiccup to what happened last fall?

Bob Weiss - *Cooper Companies, Inc. - CEO*

Well, without knowing exactly what J&J is up to -- in hindsight we know what they did is, they filled the pipeline a lot, and then we saw it in their negative US results in the most recent quarter. So, no one's going to say they can't do that again. Having said that, this is a product coming into the monthly modality. It's basically coming in with only a sphere, not a toric and a multifocal. So it's not a family of products going against a family of products.

And that is a big distinction as contrasted to the pipeline, dragging everything in under one umbrella as they did their whole family of products and going after a sphere, going after a sphere. In that case, it was Oasis, the one-day going against Total One primarily in that space. But it consumed -- it took all the air out of the -- a practitioner's office, if you will, or filled up all the space. And there clearly is no guarantee they wouldn't try flooding the market again.

As far as the way we think about it longer term, Biofinity's a very established product wherein we continue to expand the offerings under that umbrella. It's a very global product. And it's one where it's good in the monthly, and we also have Avaira/Vitality coming out in the two-week, which is the sweet spot of the market in terms of the number of wearers. There are more wearers in the two-week part of the market than there are in the monthly.

Quite frankly, as some of you know, I've always held the view that it's a good strategy for J&J if they're intent on trading up and basically migrating the noncompliant wearer base they have in the two-week space into a compliant monthly modality, that would be good trade-up in modalies because a noncompliant wearer is one who is basically only using 24 lenses a year compared to a monthly using 24. And conversely they're getting the price point of a two-week wearer. And that's a pretty big part of that two-week modality.

So we think yes, we'll continue to see that market grow, the monthly, and we'll get our fair share with Biofinity. In the meantime, we'll be more active down the road in the two-week space. And we'll basically neutralize it for the most part.

Operator

Our next question comes from the line of Steve Willoughby with Cleveland Research. Your line is you now open.

Steve Willoughby - *Cleveland Research Company - Analyst*

Hi, guys, can you hear me okay?

Bob Weiss - *Cooper Companies, Inc. - CEO*

We can, Steve.

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Steve Willoughby - *Cleveland Research Company - Analyst*

Okay, Bob. Just regarding the charge, the idle equipment and inventory write-off that you guys took in the quarter, a couple of questions regarding that. I guess first, the idle equipment, is that -- the idle equipment charge relates to newly purchased equipment that you don't need quite yet, or is that existing equipment that you're idling for some reason?

Bob Weiss - *Cooper Companies, Inc. - CEO*

So to qualify as idle it's basically been put in production and then is taken out of production. I'll answer the question with a little color. It could be very new equipment that was put in production. Example, our facility in Hungary where they got real good at making it and all of a sudden we parked the equipment because so much product was coming off of the other line. So, as yields go up and costs are coming down; that's the good news. The bad news is, if you put equipment that you were using and you idle it, it becomes a direct period charge as opposed to moving through with the inventory.

Steve Willoughby - *Cleveland Research Company - Analyst*

This is sort of what happened with Avaira and then Gen 2 line a number of years ago, then?

Bob Weiss - *Cooper Companies, Inc. - CEO*

Absolutely.

Steve Willoughby - *Cleveland Research Company - Analyst*

Okay, and (technical difficulties)

Bob Weiss - *Cooper Companies, Inc. - CEO*

So what happened is our manufacturing people got very good at what they were doing. We always knew that if we -- that they would deliver. We just didn't know how well they would deliver. So they're delivering a lot more units per dollar spent of capital. That's the good news. But it also turns short term into the bad news. As I think Greg indicated, we'll grow out of that fairly quickly when you look at the rapid unit growth in many of these areas where we have become very efficient. And that includes MyDay, that includes Biofinity, that includes Avaira, that includes Vitality, and that includes Clariti, in the bucket. All of those products became -- the costs are going down through efficiencies and yields by our manufacturing people.

Operator

Our next question comes from the line of Lawrence Keusch with Raymond James. Your line is now open.

Unidentified Participant - - *Analyst*

Hi. This is actually John in for Larry. Good afternoon. I just had a quick question. What's the right way to calibrate expectations for MyDay in Japan? You obviously just launched it in the quarter. Maybe shorter term and then maybe a little bit longer term in 2016 and 2017?

Bob Weiss - *Cooper Companies, Inc. - CEO*

You can see some of the numbers we're putting up in the region. And Japan has certainly been stellar within that region, also. Right now we have a good portfolio of three products with MyDay being the third one in. But Biofinity's doing very well. Proclear 1 day is doing very well, as well now, MyDay. We will be -- we're early, 1.5 months into the launch, if you will, through the end of April. And very pleased with the progress we're making.

It's the biggest market by far in terms of the one-day modality anyplace in the world. And therefore MyDay is a very good fit in a very good market. And we think the combination of MyDay as a silicon hydrogel and Proclear 1 day as a hydrogel will be -- is a good entree into that market.

[I would] say is Japan has been historically pretty lethargic the last, I want to say, seven, eight years. It's showing a little bit more life than it has. And the only reason it's been lethargic is because it grew so rapidly in the prior decade compared to this decade. It got ahead of itself on the [one-day] modality, became the first to adopt that because they were very anti-lens care regimens and wanted the lenses to be boiled. And therefore everyone migrated into the one-day modality rather than boiling lenses every day.

So I'll just say that we're pretty excited about MyDay there. It's going to take some work. It's only a sphere thus far. So there will be other plans relative to how to leverage the MyDay experience.

Operator

Our next question comes from the line of Matt Mishan with KeyBanc. Your line is now open.

Matt Mishan - *KeyBanc Capital Markets - Analyst*

Good afternoon, and thank you for taking my questions. Bob, first on CooperVision, I just want to better understand the sequential improvement in growth this quarter versus the previous several quarters. Is it your sense that the impact of the Johnson & Johnson launch has now fully waned, or is there something that you've been doing to improve your results and to improve share? I'm just trying to get a sense of whether or not this is Johnson & Johnson or this is you guys doing something?

Bob Weiss - *Cooper Companies, Inc. - CEO*

I think it's a combination. I think the air that left the room is now back in the room of the eye care professional. He has room for products. And so it's more normalized in that sense. And that's obvious from the weak numbers that J&J put up domestically. And we already know Alcon put up weak numbers worldwide.

We, relative to our products, I think I'll make a point of saying that our numbers that we put up is not a function of any pricing or anything to do with channel fill. So it's a good quarter. The inventory on hand at distributors and the pipeline is very normalized. In fact, it's a little less than it was at the beginning of the period. So it's a reflection of pretty solid numbers around the world.

Operator

Our next question comes from the line of Brian Weinstein with William Blair. Your line is now open.

Brian Weinstein - *William Blair & Company - Analyst*

Hi, guys. Thanks for taking the question. It's a little bit of a longer-term question. But can you talk about what you expect longer term in terms of the split between Clariti and MyDay, and kind of what you think your share longer term is there? And then how do you think about manufacturing -- manufacturer pricing levels in the daily silicon hydrogel market longer term? Thanks.

Bob Weiss - *Cooper Companies, Inc. - CEO*

I think the split between Clariti and MyDay, it's easier to relate in US. In the US it's going to be primarily where Clariti is after the mass market and MyDay is after the premium market. I would have normally said, think of that as like a 75% mass market/25% premium market. And I think that's the US portion of the model. I think when you get into certain regions of the world, example, Japan where only MyDay is playing, then -- so if you're factoring that into the overall global results, you'll end up with MyDay outgrowing because it's coming off of a lower base and it's just getting into Japan; at least for the foreseeable future, outgrowing as a percent, getting more of its share of the bucket. So instead of saying 75/25, MyDay may move up that spectrum and get a higher portion in the interim. When Clariti is available throughout Asia Pac and around the world, that may come back more into the mass market/premium split.

But for now, one point is we're not capacity constrained on either of these products. We will continue, in the case of MyDay, expanding the portfolio offering. So that will help. Right now, it's a sphere competing with Clariti which has a sphere, a multifocal and a toric. And that will weight more towards the Clariti piece.

Relative to margins, we will continue to focus in from a pricing point of view, being keenly aware of the two-tier market, the premium market, which we'll call the players there as in the US, clearly: Total One, Oasis, and MyDay; and True Eye is the other one that's kind of there in that space. But Oasis will consume more and more of True Eye. And in the mass market, then, Clariti remains the only game in town relative to a silicon hydrogel in the one-day mass market. Then it's a function of watching the migration of hydrogels into the silicon hydrogel space in that mass market arena.

Cost of goods, gross margins, we expect, as we've indicated in the past, to have our 1-Day silicon hydrogel franchise, and most notably Clariti, not a drag on our overall gross margin. For the next several years anyway, MyDay is ramping up the learning curve, moving very nicely. And I would say the indicator of some of the idling, is the indicator of us having enough MyDay capacity is just how well that's ramping up. As it ramps up, cost of goods come down to yields and deficiencies. So we're very pleased with that. And we expect more than -- clearly more than 50% out of MyDay as we get down the road a couple years.

Operator

Our next question comes from the line of David Roman with Goldman Sachs. Your line is now open.

David Roman - *Goldman Sachs - Analyst*

Thank you, and good afternoon everyone. I was hoping you could just touch on, in a little bit more detail, firstly the strength in Asia Pacific. I think last quarter you had kind of said that you were ramping capacity in Japan. That wouldn't be a significant contributor until the much later part of the year and into the next fiscal year. But any other regions driving within Asia Pac that you could call out? And then secondly, on the 68% pro forma guidance for CSI, that is quite a bit above where those end markets, I think, are growing. So maybe you could just speak to the sustainability of that on a go-forward basis?

Bob Weiss - *Cooper Companies, Inc. - CEO*

So relative to Asia-Pac, I would emphasize that the numbers you see are very little to do with MyDay. It's very early in the game, so it didn't -- so the strength you're seeing there is just how well some of the geographic expansion's going, how well Japan is going ex-MyDay, and then the MyDay launch. But it is not the driver of that 18%, which -- and MyDay was only launched mid-March. So really it's only got a 1.5 months in Japan in that period -- in the quarter.

Relative to what to expect in that region, we certainly expect continued robust numbers out of Asia Pac for the foreseeable future. Number one, we're under [E] index. Number two, we're delivering a lot of these new products, Clariti coming into more and more of Asia Pac, and of course MyDay, which we talked about. So we're pretty optimistic that we'll see continued strength in that market.

Relative to surgical and the 6% to 8%, a lot of that growth is a reflection of, number one, the emphasis on really selling the product and the global realignment with the selling effort. We have some -- obviously, even some good products in the surgical side that are driving organic growth there. The acquisitions we've made are -- the expectation there clearly is double-digit in many of those acquisitions. We expect to drive a lot of the genetic testing and surround the IVF process so that we are the key player that the IVF centers are engaging with. And we're pretty optimistic about that, and obviously the last two quarters have indicated it's a pretty successful strategy. Going forward, the 6% to 8% reflects some of the more recent acquisitions having more organic top-line growth potential than our historic legacy products within CooperSurgical.

Operator

Our next question comes from the line of Larry Biegelsen with Wells Fargo. Your line is now open.

Larry Biegelsen - *Wells Fargo Securities, LLC - Analyst*

Hi, guys. Thanks for taking the question. Hey, Greg, based on the guidance, is the second half implied CooperVision guidance the midpoint about 5%? And should we think about Q3 and Q4 as similar growth, or would you expect Q4 to potentially be lower because the J&J launch comes in July?

And Greg, can you just tell us what the FX assumption is? It looks like you're assuming about for the year, 0 impact on EPS. Is that math right? What is it on sales, and is there some conservatism in your FX assumptions right now? Thanks for taking the questions, guys.

Greg Matz - *Cooper Companies, Inc. - CFO*

Larry, I think on the -- for CVI, the midpoint kind of growth for Q3/Q4 would be about 6.1%, I think, if you do the math. If you look at, from a seasonality -- we're not giving quarterly seasonality. But I think you could look at past seasonality for CooperVision. It generally is fairly consistent.

On the FX fronts, yes, I think you've got that right. When you look at FX, we basically for the year see about no impact on the earnings per share. On the revenue front, again, you're looking at about right around $30 million of revenue reduction.

Now, on the rates, are we being conservative? Well, if you look at today's rates, I think you could say we're being conservative. We did use the rates for the euro of EUR1.10, the pound at GPB1.46 and the yen at JPY112. And we start setting those rates a couple of days ago. The yen was at JPY111.3. The yen is kind of -- has basically strengthened the last couple of days. But those were the rates that the model was based on.

Operator

Our next question comes from the line of Mike Weinstein with JPMorgan. Your line is now open.

Unidentified Participant - - *Analyst*

Hi, this is Andrew in for Mike. Thanks for taking the question.

Bob Weiss - *Cooper Companies, Inc. - CEO*

Sure.

Unidentified Participant - - *Analyst*

I have two questions. The first being product-specific and the second regarding the market. So can you talk about, Bob, the slight design changes to the Clariti lens and what you're seeing in the way of market adoption with this design versus before the change?

Bob Weiss - *Cooper Companies, Inc. - CEO*

Sure, you want to ask your second?

Unidentified Participant - - *Analyst*

Yes, I could ask the second. The second is around UPP. So the US market growth in the quarter was probably the lowest in a while, I believe. And I was just wondering whether or not this was a result of some pricing war that's going on within the market? And just your general thoughts around UPP and how you think that might benefit you moving forward? Thanks.

Bob Weiss - *Cooper Companies, Inc. - CEO*

Sure. The product relative to the enhancement that we made to Clariti, I think you've seen the overall silicon hydrogel 1-Day numbers were 52% growth. So suffice it to say, the enhancement, as well as of course we had some activity in the fourth quarter regarding our integration process in Europe that caused some bumps. But suffice it to say, we're running on all cylinders now with Clariti in the marketplace, and the enhancement has certainly been beneficial in that process.

As far as UPP and the market, 3% growth in the market, as much as anything is probably much more influenced by the J&J cycles that they put the market through with a strong market two quarters ago. And that's followed by basically a void in the US in this quarter. So we're not for that, it'd be more normalized. The trailing four quarters is a much better gauge. That is approaching 5% worldwide.

Relative to the US and UPP, and whether or not there is any pricing post-UPP or a decline in pricing, I would say that certainly, I know that some vendors may have -- or retailers may have altered J&J prices. But by and large the market is -- continues to drive itself the way it has in the past. Pricing it not really a factor. It's all about trading up and shelf space and [for sits]. And it remains that way. The focus on getting a new fit in the marketplace, or where you have a new product trying to get a conversion onto your product.

There is a fair amount of stickiness to most of these products. So I would say the real driver of your product doing well is the new fit arena is a big contributor. Pricing, to me this market has traded up for 30 years and it continues to do a phenomenal job. And over that 30 years, there has been but maybe one or two price skirmishes. UPP was a fairly shallow attempt at a marketing strategy that was obviously beneficial to the independents compared to the retailers. Whether or not it was worth anything can be continue to be debated. There's obviously a lot of emotions on both sides of the table on that in the marketplace. If UPP went away tomorrow, it would not be the end of the world. If it stays where it is, it's okay also. So I don't see it as a material catalyst one way or the other in the marketplace.

Operator

Our next question comes from the line of Anthony Petrone with Jefferies. Your line is now open.

Anthony Petrone - *Jefferies & Co. - Analyst*

Thanks, and good afternoon. Maybe one for Bob on Japan and then one for Greg on margins. On Japan, can you maybe give us a recap of the size of the daily market in Japan, and maybe where Cooper's share is today and how MyDay can benefit that going forward?

And then for Greg, just a quick one on margins. I believe the CIBA royalty does roll off internationally toward the end of this year. I just want to confirm if that is the case, and what do you expect the margin benefit from that will be? Thanks.

Bob Weiss - *Cooper Companies, Inc. - CEO*

The overall market in Japan is around $1.2 billion at current exchange rates. Would have been a lot bigger than that, but obviously the yen kept sliding against the dollar for a number of years. Of that $1.2 billion, basically two-thirds, over 60% is the one-day modality. And our share in that market is still very under-indexed in that market. So if our overall market share worldwide is this most recent quarter, 23% worldwide, we are well in the mid-teens at best in Japan in that space.

Greg Matz - *Cooper Companies, Inc. - CFO*

Anthony, this is Greg. So on the CIBA royalty, it did roll off within the quarter. We're not really providing any kind of color on the rate itself. Again, we've talked about that over the last couple of years, that we have obligations in not disclosing that rate. And so from that perspective, we really can't share that.

Operator

(Operator Instructions)

Our next question comes from the line of Jon Block with Stifel. Your line is now open.

Jon Block - *Stifel Nicolaus & Company - Analyst*

Great, guys. Thanks, and good afternoon. Maybe first one, Bob, just CVI was strong and one of the better results since 2014. But to be fair, if you go back then, we were sort of hit after that with a series of quarters where there was inventory draw-downs that went against the Company. I just want to make sure and ask, if you would, sort of your level of confidence that this sell-in, if you would, in this particular quarter totaled the sell-out and demand?

Bob Weiss - *Cooper Companies, Inc. - CEO*

Yes, I think I mentioned a comment a while ago that relative to the quality of --was pricing or any pricing influencing or was pipeline influencing, the answer is no. In fact our pipeline, the inventory on hand, was slightly better than at the beginning of the period. In both cases kind of where we want it. So the draw-down, the inventory draw-down or the pipeline is where we want it.

Operator

Our next question comes from the line of Steven Lichtman with Oppenheimer and Company. Your line is now open.

Steven Lichtman - *Oppenheimer & Co. - Analyst*

Thank you. Hi, guys. Most of my questions have been answered. One follow-up on CSI. Bob, do you anticipate continuing to add to the portfolio through tuck-in M&A? Or are you feeling that the portfolio's where you want it to be at this point?

THOMSON REUTERS

Bob Weiss - *Cooper Companies, Inc. - CEO*

Well, we won't obviously get into a lot of color on what's in the pipeline. But suffice it to say, we're focused in on rounding out the portfolio in front of the IVF centers. It is a boutique area where there are little things out there to continue to buy up. And so don't be surprised if we don't continue to have some acquisitions on a go-forward basis.

Operator

That concludes today's question-and-answer session. I'd like to turn the call back to Bob Weiss for closing remarks.

Bob Weiss - *Cooper Companies, Inc. - CEO*

I want to thank everyone for joining us. Hopefully everyone is excited about our quarterly results, as we are pleased about them. Not only are we pleased where we've been, but very optimistic about where we're going as I think you would see from the guidance that Greg talked to. Yes, we have some short-term challenges with idle capacity. It's a silver lining problem because it means that, to some degree, our capital requirements on a go-forward basis will be somewhat less certainly than they have been in the past. So we look forward to updating you on our continued progress on our next quarterly call, which is September 1, I believe.

Thank you. That concludes, operator.

Operator

Ladies and gentlemen, thank you for your participation in today's conference. This concludes the program, and you may now disconnect. Everyone have a great day.
