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# EDITED TRANSCRIPT

COO - Q2 2017 Cooper Companies Inc Earnings Call

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**OVERVIEW:**

Co. reported 2Q17 consolidated revenues of $522m and consolidated non-GAAP EPS of $2.50. Expects FY17 consolidated revenues to be $2.110-2.135b and non-GAAP EPS to be $9.50-9.65.





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## PRESENTATION

**Operator**

Good day, ladies and gentlemen, and thank you for your patience. You have joined The Cooper Companies Q2 2017 Earnings Conference Call. (Operator Instructions) As a reminder, this conference may be recorded.

I would now like to turn the call over to your host, Vice President of Investor Relations, Ms. Kim Duncan. Ma'am, you may begin.

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

Good afternoon, and welcome to The Cooper Companies Second Quarter 2017 Earnings Conference Call. During today's call, we will discuss the results included in the earnings release and then use the remaining time for Q&A. Our presenters on today's call are Bob Weiss, Chief Executive Officer; and Al White, Chief Financial Officer and Chief Strategy Officer.

Before we begin, I'd like to remind you that this conference call contains forward-looking statements, 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 Cooper's Form 10-K, all of which are available on our website at cooperco.com. Should you have any additional questions following the call, please call our investor line at (925) 460-3663 or e-mail ir@cooperco.com.

And now I'll turn the call over to Bob for his opening remarks.

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**Robert S. Weiss** - *The Cooper Companies, Inc. - CEO, President and Non-Independent Director*

Thank you, Kim, and good afternoon, everyone. Welcome to the second quarter 2017 conference call. This was a strong quarter, and we continue to feel confident about the remainder of this year and into the future for both CooperVision and CooperSurgical having a lot of momentum.

On a consolidated basis, we reported $522 million in revenue and non-GAAP earnings per share of $2.50. CooperVision posted another strong quarter in all key areas with 4% as reported or 7% constant currency revenue growth. Daily silicone hydrogel lenses grew 43% while Biofinity and Avaira combined to grow 12% both in constant currency. CooperSurgical posted revenue growth of 23% or 3% pro forma. Fertility posted growth of 52% or 5% pro forma.

Moving to the details. CooperVision posted second quarter revenues of $408 million, up 7% in constant currency. By geography, the Americas grew 4%; EMEA grew 10%; and Asia-Pacific grew 9%, all in constant currency.

CooperVision's growth continues to be driven by a diverse portfolio of clariti and MyDay in the daily space, Biofinity in the monthly space and Avaira in the 2-week space.

Regarding daily lenses, our broad offering of silicone hydrogel lenses continues to drive growth. The daily market is critical to our strategy of gaining share, and we remain focused on driving success in this space. Our clariti portfolio of spheres, torics and multifocals leads the way as our mass market offering, and we continue to see very nice growth in all 3 regions. Our MyDay spheres and torics are also doing very well in the premium space as we continue to roll out MyDay toric in Japan and various parts of Europe.

Regarding Biofinity, we continued seeing success around the world with strong growth in all three regions. We also continued making progress rolling out our expanded offerings, which include Biofinity Energys and Biofinity Toric XR. These products are available in a number of different markets, and we'll continue rolling them out over time.

Within the 2-week space, we successfully transitioned wearers to Avaira Vitality from our legacy Avaira product. This is for both spheres and torics. Vitality is a nice upgrade, and our customers are receiving this change well. We expect this transition to occur through the remainder of the year and into next.

Turning to product categories. Torics grew a solid 12%, and multifocals grew 4%, both in constant currency. We are the global leader in these types of lenses with a highly diversified product offering, including both silicone hydrogel and traditional hydrogel lenses within the daily, 2-week and monthly modalities.

Looking at just silicone hydrogel lenses, these products grew 18% in constant currency and now represents 66% of the total CooperVision sales. These products are the drivers of our growth, and we believe they have a bright and long future. Our product portfolio is the broadest in the space and, I believe, offers the best options. This includes being the only company offering premium in mass market daily silicone hydrogel lenses, including spheres, torics and multifocal lenses.

Turning to the overall contact lens market. In calendar Q1, we took share, growing 2x the market or 10% against the market growth of 5%. Breaking it down geographically, we grew 8% in the Americas while the market grew 3%; we grew 10% in the EMEA while the market grew 7%; and we grew 16% in Asia-Pacific, with the market up 7%.

On a modality basis, single-use lenses continued driving growth, with CooperVision up 17% and the market up 13%. For non-single-use lenses, we grew 7% with the market down 1%.

For the trailing 12-month period, CooperVision grew 9% while the market grew 4%. So another strong year where we more than doubled the market. Going forward, we are still targeting 4% to 6% market growth, driven by the continuing shift to improve technologies such as a wider suite of silicone hydrogel lenses; the continuing trade-up of dailies and specialty lenses, such as torics and multifocals; geographic expansion; and the expansion of the wearer base, particularly outside the United States. And given our strengths in these areas, along with the broad private-label offering, we continue to grow faster than the market.

Moving to CooperSurgical. We reported second quarter revenues of $114 million, up 23%, driven by organic growth and acquisitions. On a pro forma basis, we grew 3%, with fertility leading the way, up 52% or 5% pro forma. Within fertility, we experienced some disruption this quarter from aggressively consolidating distributors associated with past acquisitions. Having said that, we started seeing some upside from recent sales and marketing activity, so getting this activity transferred in-house is the right move.

Overall, within IVF, we're continuing to execute on our growth strategy as a global leader in medical devices and genetic testing within the fertility space. Our fertility growth is driven by a diversified portfolio of medical device products, capital equipment and lab services, and we believe our portfolio is the broadest in the space.

Our office and surgical products business grew 1% for the quarter. Similar to our IVF business, we expect growth in Q3 and Q4 to improve based on momentum with new product rollouts led by EndoSee, our disposable hysteroscope, and new business that we've recently won.

Finally, on CooperSurgical, we're making a lot of progress integrating acquisitions, including having completed a significant portion of our distributor consolidations. We probably have roughly another 12 months of integration activity in other parts of the business, as things are moving along well. Given this progress, we expect improved top line growth for CooperSurgical beginning in the third quarter. Overall, I remain very excited about the future of CooperSurgical, and we believe we're on the right path.

With that, I want to express our appreciation to our employees for all their hard work and dedication. They truly drive the success of our business.

And now I'll turn it over to Al.

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**Albert G. White** - *The Cooper Companies, Inc. - CFO, Chief Strategy Officer and EVP*

Thank you Bob and good afternoon everyone. Most of my commentary will be on a non-GAAP basis so please refer to today's earnings release for a full reconciliation of GAAP to non-GAAP results.

Bob covered revenues so let me focus on the rest of the financials and guidance. For the quarter, consolidated gross margins were very strong at 66%, up from 63.2% last year. CooperVision's gross margins were 67.1%, up from 62.8% last year, driven by the weakening of the pound due to Brexit last summer, product mix-shift gains led by Biofinity and manufacturing efficiency improvements.

Regarding the Pound, remember our inventory turns every 6 monthsso this was the first quarter we experienced afull quarter impact of Brexit. On product mix, the message remains the same. The shift to silicone hydrogel lenses, especially Biofinity and now Avaira Vitality, is having a positive impact on our overall gross margins. Lastly, on manufacturing efficiencies, we've been seeing improvements within our manufacturing environment for some time, and this quarter really illustrated that. We've discussed this activity in prior quarters, including the negative impact from items such as inefficiencies with idle equipment and inventory write-offs, which have been negatively impacting us roughly $0.10 per quarter above normal. This quarter showed a marked improvement with a negative impact of roughly $0.05. So this is a discussion topic we can now put behind us as we move back to normal operations.

CooperSurgical's gross margins were 61.7%, down from 64.8% last year due to our genetic testing acquisitions, which carry lower gross margins. Having said that, we've now annualized those acquisitions, and we've been integrating them within our business. So we expect stable to improving gross margins on a year-over-year basis moving forward.

Consolidated operating expenses grew 8.8% in the quarter, slightly above our reported revenue growth of 8%. This was driven by investments such as additional sales personnel, along with expenses layered in from acquisitions. There's not much to highlight here, but it's important to remind everyone, we're continuing to invest in infrastructure in both of our businesses to support continued long-term growth. We've made nice progress on the sales and marketing side, along with some key hires and other support areas, so we're in fairly good shape but we'll continue to invest as we see opportunities. Operating income growth was very strong, up 18.9%, driven by our gross margin improvements. Operating margins were 26.8%, up from 24.3% last year.

Moving to items below operating income, we reported $7.7 million of interest expense, and our effective tax rate was 6.6%. Non-GAAP EPS was $2.50 with roughly 49.5 million average shares outstanding.

Regarding shares outstanding, we repurchased 150,000 shares in the second quarter at an average price of roughly $197 per share, which totaled $29.5 million. We believe share buybacks are an effective way to maximize long-term shareholder value and we'll continue executing on them in an opportunistic manner.

Moving to the balance sheet total debt decreased $38 million in the quarter to approximately $1.39 billion. This pay down was primarily driven by operational cash flow generation offset by share buybacks.

Moving to free cash flow, we had a strong quarter, posting $103 million of free cash comprised of roughly $132 million of operating cash flow, offset by $29 million of CapEx.

Regarding guidance. We are raising fiscal 2017 consolidated revenue to $2.11 billion to $2.135 billion. This includes raising and tightening CooperVision's revenue guidance to $1.645 billion to $1.665 billion or roughly 7% to 8% constant currency growth while lowering and tightening CooperSurgical's revenue to $465 million to $470 million, which equates to roughly 4.5% to 5.5% pro forma growth.

For CooperVision, we expect growth to be driven by our diverse portfolio of products led by Biofinity, Avaira, clariti and MyDay. Regarding CooperSurgical, a significant portion of the integration activity which negatively impacted revenue is behind us, and we expect improved growth in the second half of the year.

Operating margins are now expected to be around 25.5% for the year, supported by slightly stronger gross margins. Interest expense is to be slightly higher at around $31 million, which assumes an additional 25 basis point rate hike this month, and the full year effective tax rate is forecasted to be around 8%. This rate is lower than prior guidance primarily due to the new accounting for employee stock-based compensation which we adopted in Q1. Although we forecast the positive impact to be much less in Q3 and Q4 due to the vesting schedules for the majority of our equity grants, the impact in the first half of the year is driving our full-year tax rate lower by roughly 150 basis points.

Regarding FX, we have seen an overall favorable move in currencies since we last reported earnings. We're now forecasting a roughly neutral impact to EPS for this year versus last quarter's full year forecast of a negative $0.16.

Regarding revenues, we're forecasting a negative impact of roughly $46 million for the full year, down from last quarter's full year forecasted impact of a negative $61 million. Incorporating all this information, we are raising our non-GAAP EPS for fiscal 2017 to $9.50 to $9.65, assuming 49.4 million shares outstanding.

One final comment for modeling purposes, we expect Q3 EPS to be slightly lower than Q4 due to lower sequential gross margins at CooperVision. This Q3 reduction is fairly common for CVI as inventory turns every 6 months and production levels in December and January decline due to our annual manufacturing shutdowns to upgrade and retool our plants which results in a slightly higher average cost per unit due to lower overhead absorption. This should be somewhat offset by our Q3 effective tax rate, which is normally lower than in Q4.

Lastly, we continue focusing on delivering consistent annual performance. We're forecasting over $400 million in free cash flow this year and north of $2 billion of cumulative free cash flow over the next 5 years while targeting consistent improvements in operating margins to reach 28% or higher in 2021.

And with that, I'll hand it back to the operator for questions.

## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions) Our first question comes from the line of Jeff Johnson of Robert W. Baird.

**Jeffrey D. Johnson** - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

I was wondering if I could ask first on market. I guess it'll be a 2-part question. One, Bob, just looking at the independent industry data, it looks like the market has picked up a couple points here the last couple quarters. Just any commentary you can make there on what you're seeing out there? And then also when we look at the clariti and MyDay rebates that you guys offer, it looks like they did go up on May 1 by a decent amount. With a healthy market and as you guys continue to do well, what's the rationale there? And then maybe how do we think about the impact that could have on the top line as those rebate dollars maybe impact here over the next couple of quarters?

**Robert S. Weiss** - *The Cooper Companies, Inc. - CEO, President and Non-Independent Director*

Thank you, Jeff. The point on the market at 5%, that's perhaps a little bit more normalized than we've had over the last couple of years. It's been a little uneven. It started way back in September of 2015 when J&J kind of went off UPP and did a lot of things with their product line that led to some pipeline [sell] as they rolled out the new OASYS 1 Day modality. So ever since then, it's been a little uneven. But on a trailing 12-month basis, 4%, a solid 4%, and clearly, the most recent quarter, at 5% with solid results in Asia and in Europe. As far as clariti, you're right. There's been some pricing changes that have occurred in the industry. And not only has there been pricing changes, but there has been the -- for the most part, a post-UPP era, ex Energys, our one new product and novel product. And what you're seeing in the industry, not only in Cooper, is we're really working hard to get new fits. Everyone's doing it. We believe clariti is well positioned, by way of rebates, to convince more and more people to go to the Energys, changing from one product to the other. We're clearly winning the battle with clariti on trading up from hydrogels -- silicone hydrogels. We're winning the battle of new fits very well. We need to work a little harder on converting others in the mass market. And some of our competitors have created an environment that makes that opportunity more ripe right now, and we're seizing the moment. Obviously, clariti has done very nicely, and MyDay has done very nicely, up 43% for the quarter. So we're putting up good numbers, but we want to do better yet.

**Operator**

Our next question comes from Matthew O'Brien of Piper Jaffray.

**Matthew Oliver O'Brien** - *Piper Jaffray Companies, Research Division - MD and Senior Research Analyst*

Just on the gross margin side. Al, you mentioned 3 different buckets that impacted the CVI number in the quarter. Can you just break down a little bit where some of that improvement came from, especially on the durability side from manufacturing and mix? And then if I understand things right, I think you're saying that the inventory impact -- I think you had said $0.30 for the year is kind of behind you at this point. So that should be more of a tailwind on the bottom line for the full year. Is that the right interpretation?

**Albert G. White** - *The Cooper Companies, Inc. - CFO, Chief Strategy Officer and EVP*

Yes. So 2 pieces on that. The kind of $0.30 we were talking about, which was $0.10 going down towards 0 was -- let's call it $0.10 going down to $0.05, right? And maybe it's $0.03 or $0.02 next quarter, something like that, and going down to $0.01 or whatever and then kind of disappearing. So it definitely made a nice step in the right direction here, in that positive move kind of impacted even the Q2 gross margins. If you look at it, it's, to some degree, kind of half and half there. It's -- a little bit more than half is driven by the product mix and those efficiency improvements we're talking about. And then a little bit less than half is coming from currency. When you look at the sustainability, it's there. I mean, there are some things that are moving around in terms of our production and so forth. And currency as it flows through, the pound moves and so forth. But this was a pretty strong, legitimate quarter and kind of shows what the business can do when it's hitting on mostly all cylinders.

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**Operator**

Our next question comes from Joanne Wuensch of BMO Capital Markets.

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**Joanne Karen Wuensch** - *BMO Capital Markets Equity Research - MD and Research Analyst*

Two questions really. One is at the end of last year, you started more aggressively hiring and building out your sales force. Can you give us a little bit idea of where you are in terms of new salespeople, but also what geographies they are going into? And this relates to my second question, which is your EMEA and your Asia-Pacific sales growth was really quite strong. Is there anything in particular that's helping you out there?

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**Robert S. Weiss** - *The Cooper Companies, Inc. - CEO, President and Non-Independent Director*

So our hiring is global, and it's split in both divisions, so both Surgical and Vision. The emphasis in Vision is likewise global. So you are seeing expansions in the geographic areas. Importantly, we wanted a lot of attention in the U.S. market where we're immensely under-indexed. And so we made good progress there. I won't cite exact numbers. But I will say that year-over-year, our sales force expansion, feet on the street and in-house combination, is up 16% in Vision, 15% overall. So balanced between the 2 units and good solid growth. I think you're seeing some of the results of that in pretty strong U.S. and Americas performance basically were the driver of the market growth in the Americas right now, were up 8% over the last 12 months while the markets up to translated were it. So I think the feet on the street, the product portfolio we have is working very nicely. Since we are doing it in Asia-Pac and in Europe, you're likewise seeing solid numbers there also.

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**Operator**

Our next question comes from Larry Biegelsen of Wells Fargo.

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**Lawrence H. Biegelsen** - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

One on revenue. One on margins. So Al, I think the implied second half top line growth is 6% to 7%. Correct me if I'm wrong. But the question is, why would revenue growth slow in the second half? I think it was about 8% in the first half. And then on the margins, Al, 2 parts here. How much more room is left here? Currency, idle equipment, mix. And the second part of the margin question is I think you did 27% this quarter. Your goal, I think, is 28% in fiscal 2021, I believe. So you're almost there. Do you -- are you -- when are you going to be in a position to update the new -- the long-term margin goal? Sorry for the long question.

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**Albert G. White** - *The Cooper Companies, Inc. - CFO, Chief Strategy Officer and EVP*

Yes. So a couple of comments. The 28% goal, we update those annually. So we'll update that when we finish the fiscal year. The only thing I would say to that is we did update it, to some degree, if you will, by being clear that it was 28% or higher. We're clearly on a trajectory to be north of 28% and feel comfortable with that, but we do that once a year. So we'll do that again here in a couple of quarters. On the margin upside question, we're going to have gross margins a little bit north of 64.5% this year. So on a consolidated basis, it's pretty strong. We're -- we certainly have margin upside in CooperSurgical now that we're reset to lift that higher. On a full year basis, we're going to have margin upside in CooperVision also, all else being equal. That will be driven by kind of the same thing, excluding currency, which we'll have some upside in currency as we move through this year. But assuming currency holds steady, the manufacturing efficiencies that we have in place, the cost reduction programs, product mix shift, which is a positive, with items like we've talked about, Avaira to Avaira Vitality, the conversion from traditional daily hydrogels to clariti. All of those are kind of positive. So I won't put any specific numbers out there, but we do have margin upside here in the coming years from both businesses.

When you look at revenues, speaking -- I think you're speaking mainly of CooperVision. Yes. And we're kind of running in that 8% constant currency in the first half of the year guiding to 7% to 8%, obviously took the bottom of that away and pulled the bottom end up to 7% to 8%. We do have a challenging comp in Q4, you'll remember, from last year. So I think we feel good about revenues. We obviously put up a very strong Q1. We put up a strong Q2 against the tough comp. We feel good about the back half of the year, but it's prudent to remain in that 7% to 8% range and not get more aggressive.

**Robert S. Weiss** - *The Cooper Companies, Inc. - CEO, President and Non-Independent Director*

Larry, the only thing I would add to Al's comments is when you think of the 28%, you're comparing it to the second quarter, keep in mind that historically, we will have a lighter operating margin in the first quarter. And that -- as a result of that, year-to-date, our operating margin is more like 24.8%, 25%. But having said that, Al is correct that there's a lot of tailwinds, and we will refresh along the way.

**Operator**

Our next question comes from Anthony Petrone of Jefferies.

**Anthony Charles Petrone** - *Jefferies LLC, Research Division - Equity Analyst*

Maybe a couple of product questions and then just general share within contact lenses. In terms of Biofinity, Energys and the Toric XR, I'm just wondering, is there any supply constraints that are still out there? Or are you completely meeting market demand at this point? And then for Avaira Vitality, I'm just wondering what the conversion tailwind for that product looks like. And then, Bob, just an update on shares with Cooper, J&J, Bausch + Lomb and Alcon, that would be helpful.

**Robert S. Weiss** - *The Cooper Companies, Inc. - CEO, President and Non-Independent Director*

Yes. The supply constraint as far as Biofinity, which is growing solidly -- the combination of Biofinity and Avaira is up 12%, with Biofinity being at the higher end and Avaira, as it goes through the conversion, at the lower end of those numbers -- or of that number. Energys is still early in the rollout around the world. So it just -- it's made its entree into the U.S. initially, and it's gone into Europe now but has a ways to go in that conversion and rollout. It's not so much maybe production capability as it is the mechanics of rolling out a product around the world. As far as Biofinity Toric XR, that is kind of a made to order. We do not stock that product. So while we have reasonable capacity to support the orders that come in, it's -- both of those products are performing extremely well in the U.S. And we believe that's a good indicator of how that will translate around the world as we go deeper. As far as the conversion of Avaira to Vitality, it's gone well, I would say. In the U.S., more than half the revenue now is coming in from Vitality. So it's made some good progress and -- but still have the other half to go. And that's the sphere. The sphere part is the easy part. Torics are a lot more complicated. So look for both of those to roll out, as I indicated, throughout this year and into next year. And we'll be pretty much done as we get through next year with the conversion. As far as market share numbers, the J&J number included what they reported some of lens care that they picked up in the acquisition that they made of -- from Abbott. So factoring in, their number was a little less than the aggregate that they reported. But the share gainer -- with the market growing 5% and Cooper growing 2x the market, pretty much assume that Alcon is not gaining share and there's not a day that goes by that they don't talk about it at Novartis in terms of their frustration with Alcon overall. And so it's still a company that is as recently as I think was this morning, the CEO indicated they're evaluating what they're going to do with Alcon in the middle of that. J&J is holding its own clearly with its numbers. And then B&L continues to lose. So pretty much, we're closing the gap on #2, which is Alcon. We still have a little ways to go, but we would hope over the next couple of years, we will catch up with them and then pass them.

**Operator**

Our next question comes from the line of Larry Keusch of Raymond James.

**Lawrence Soren Keusch** - *Raymond James & Associates, Inc., Research Division - MD*

Bob, I wanted to just touch on the multifocals. And if I have my numbers right, I think you guys were up 6% constant currency in the first half. Can you give us some sense of sort of what you think that category is growing and sort of your results relative to the market?

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**Robert S. Weiss** - *The Cooper Companies, Inc. - CEO, President and Non-Independent Director*

Yes. Sure. The category is growing nicely. There are a lot of new products coming in from us as well as all our competitors. And so that category has been growing basically double digit, probably about 12% to 14% worldwide over the last several years. Toned down a little maybe the last quarter, but still close to double digit. We put up a lesser number, as you've indicated, 6%. I think the important thing to remember with us is we had some pretty tough comps. If you're looking at the numbers we had a year ago, it was like 13%. So a solid prior year comp that we were hurdling, if you will, in this last quarter. Overall, the market is now 8% of the world market. So it continues to grow faster than the spherical market and almost -- and basically, off of a small base, it's growing faster than the toric market. But still, the toric market is 3/4 of the specialty market. So toric market is about 22% of the share of the contact lens market; multifocal's about 8%; all up 30% in specialty lenses where we're #1. And we think we have the right product portfolio.

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**Operator**

Our next question comes from Jon Block of Stifel.

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**Jonathan D. Block** - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD and Analyst*

I've got 2. I'll ask both up-front. And maybe just first, a follow-up on the reps. And maybe you can talk about the investment this year. Does that take you to where you want to be, Bob? In other words, can you give us a little bit more color on the return you're seeing? Or does the heightened spend continuing into fiscal '18? And then, Al, just sort of 2-part on the gross margin. CVI was big, above our expectations. Am I correct in thinking the stepped-up level is sustainable in 2H? And then sort of on the other side, for CSI, I thought previously, the trough was thought to be fiscal 2Q. But is it correct to now start thinking that, that trough is fiscal 3Q?

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**Robert S. Weiss** - *The Cooper Companies, Inc. - CEO, President and Non-Independent Director*

So on the return on the reps, other than to say that it's still early in the game given how many people we have hired, but so far, so good. We are so indexed -- under-indexed against our 2 largest competitors that we will keep -- we will continue to hire as long as it makes sense in the right areas. So it's geographic-specific, and we are monitoring it. And we're at the point now where a lot of these reps start becoming quite productive. But feet on the street and coverage where we were not covering a lot of accounts, obviously, the feet on the street gives us the horsepower to get into more and more locations where our competitors show up and we don't. And there's quite a few of those. So we're not done yet. I would say, we will continue to grow our sales and marketing faster than the revenue at least for the balance of this year, and we'll see about next year.

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**Albert G. White** - *The Cooper Companies, Inc. - CFO, Chief Strategy Officer and EVP*

Yes. And on the margins, I'll comment on both of them. CooperVision's gross margins, they are sustainable subject to our normal variability, if you will, by quarter. So as I mentioned in Q3, we had the plant shutdowns, which drives up our cost per unit back in the kind of December, January. You see that in the third quarter. So it wouldn't surprise me to see CooperVision's gross margins, as an example, come back towards 65% in Q3. Q4, again, should be a pretty good quarter. The pound has moved back a little bit back up towards $1.30 that starts to flow through our P&L. So we're probably 66% or something like that in Q4. It wouldn't surprise me. But the core basis there of sustainability through the mix shift and manufacturing efficiencies is indeed there. There was nothing to highlight out of this quarter saying, "Hey, this was unique or onetime." That was not the case. This is a very strong gross margin quarter. If we look at CooperSurgical, the trough is here in -- or was here, I should say, in Q2. So we accelerated some integration activity there. We pulled force on distributor consolidations and so forth into this quarter, got more aggressive on that based on some of the stuff we're seeing out there, some positive momentum that we're seeing. So I think what you'll get now is yes, we took a hit in Q2 for CooperSurgical. That's okay. It was done for integration-related reasons and for long-term strategy. You'll see the gross margin come back in Q3. You'll see the sales, the pro forma revenue growth come back in Q3. And that will continue going forward now. So that was more onetime in nature, if you will, the accelerated integration activity.

**Operator**

Our next question comes from Matthew Mishan of KeyBanc.

**Matthew Ian Mishan** - *KeyBanc Capital Markets Inc., Research Division - VP and Senior Equity Research Analyst*

I got 2 for you. The first is on the difference between sort of the -- your fiscal year, which would be February through April, where you did 4% growth in the Americas and for CVI, and then the CLI data, which said you had 8% for the calendar year, which would be January through March. And I'm just curious, did things dramatically tail off? Did you start off the year like very strong in January and then see it tail-off through April? And then I guess, what are the trends so far like past that in May?

**Robert S. Weiss** - *The Cooper Companies, Inc. - CEO, President and Non-Independent Director*

Yes. The -- it is not unusual, and we get into this kind of discussion a lot, to have a 300 or 400 basis point swing when you add a month and delete a month for whatever reason, having to do with either the prior year or the current year. So I think that's the one reason we always shy a little from making much of an assessment on it and look at trailing 12 months when it comes to, particularly, the CLI data as a good indicator or a good secondary indicator. So I don't think I read anything into the comparison, which I understand what you're doing, the fiscal and the calendar quarters. As far as how May did, May is built into our guidance. And beyond that, we won't get into the specifics of May other than it left us, if you will, bullish about where we're headed for the year, as indicated by the step-up in guidance.

**Operator**

Our next question comes from Andrew Hanover of JPMorgan.

**Andrew Ronald Hanover** - *JP Morgan Chase & Co, Research Division - Analyst*

Al, I just want to start off with you real quick. Just [piecing] the onion back a little bit on the lower tax rate. It looks like it was there was a $0.10 difference versus where The Street was expecting the 10% and the guidance you gave. So is that all just stock-based comp? And then my second question is in terms of any color you can provide on consumer purchasing power trends and how this might compare to foot traffic through the ECP offices or retail chains?

**Albert G. White** - *The Cooper Companies, Inc. - CFO, Chief Strategy Officer and EVP*

Yes. I'll take the tax one first, and let Bob answer the second one. Yes. For the second quarter, about 200 basis points was the stock comp. So excluding that, we would have been about 8.5% to versus 6.5%. And if we look at the full year, Q3 is usually a little bit lighter. Kind of always it's a little bit lighter for a couple of different reasons, and then Q4 moves back up. I would expect that to be somewhere again this year. But as you know, from the other companies, that stock-based comp has been a nice positive for us.

**Robert S. Weiss** - *The Cooper Companies, Inc. - CEO, President and Non-Independent Director*

And can you repeat your second -- your other question?

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

He closed the line.

**Albert G. White** - *The Cooper Companies, Inc. - CFO, Chief Strategy Officer and EVP*

He closed the line.

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

Operator, can we get Andrew Hanover back?

**Operator**

Mr. Hanover, if you could queue back up, please.

**Andrew Ronald Hanover** - *JP Morgan Chase & Co, Research Division - Analyst*

Can you all hear me?

**Robert S. Weiss** - *The Cooper Companies, Inc. - CEO, President and Non-Independent Director*

Yes.

**Andrew Ronald Hanover** - *JP Morgan Chase & Co, Research Division - Analyst*

Okay. Bob, I just wanted to understand a little bit of just consumer purchasing power trends versus foot traffic and what you all are seeing.

**Robert S. Weiss** - *The Cooper Companies, Inc. - CEO, President and Non-Independent Director*

Okay. Yes. The consumer purchasing trend is -- it remains solid. Of course, the biggest driver in the marketplace continues to be the trading up; in other words, taking the existing consumer base and moving it from the 2-week modality into the -- primarily the 1 Day modality but, to a lesser extent, into the monthly modality. But consumer purchasing is -- has been reasonably -- it's fine, if you will.

**Operator**

Our next question comes from Steve Willoughby of Cleveland Research.

**Steve Willoughby** - *Cleveland Research Company - Senior Research Analyst*

Two things for you. First, Al, just wondering, did you guys bought back some stock this quarter? Just want to make sure or clarify, what's assumed in your guidance as it relates to future share repurchases? And what is your appetite given the strong free cash flow here for future share repurchases still this year? And then secondly, Bob. Maybe just wondering if you could comment on your thoughts regarding the importance of distributors in the industry as it relates to independent ODs and what -- given independent ODs are such a strong market for you guys.

**Albert G. White** - *The Cooper Companies, Inc. - CFO, Chief Strategy Officer and EVP*

Yes. On stock buybacks, there's nothing included right now in terms of our guidance. I guess I won't comment on what we'll do or when we'll do it or how much we'll do. But as you know, we are believers in stock buybacks to return value to long-term shareholders. So we'll continue to evaluate it certainly as an opportunity. And especially, as you just highlighted, we have some strong free cash flow coming in front of us.

**Robert S. Weiss** - *The Cooper Companies, Inc. - CEO, President and Non-Independent Director*

So from the point of view of distributors and their role in the equation, the independent distributors, there obviously has been debate by some over the years on the role and how much one would pay for that role. That debate continues. Some competitors taking more aggressive stance than others. Clearly, there is a service they render. They render a service by virtually the fact that most eye care -- independent eye care professionals are ordering from all manufacturers. And in so doing, rather than having all these packages arrive every day from all these manufacturers, there is a lot of opportunity to consolidate, and there is an efficiency factor that the independents bring to the equation. And that debate has existed forever and, I'm sure, will continue to be debated forevermore by all the various interested parties.

**Operator**

(Operator Instructions) Our next question comes from the line of Steven Lichtman of Oppenheimer.

**Steven M. Lichtman** - *Oppenheimer & Co. Inc., Research Division - MD and Senior Analyst*

Bob, 2 questions. First, just wanted to follow up on your comment earlier on pricing changes in the industry post-UPP. What are the types of changes that you're seeing? And then secondly in surgical. After being active last year, less so this year, which certainly made sense, given integration needs, should we look to you guys to be acquisitive again in surgical ahead with most of the integration activity behind you guys?

**Robert S. Weiss** - *The Cooper Companies, Inc. - CEO, President and Non-Independent Director*

First of all -- first, on the UPP or post-UPP era, for the most part. There were some price changes made by some of our -- by the industry, not only some of our competitors, but price changes made in the post-UPP era. There also was more activity, if you will, in rebates. When you look at the price increases, obviously, yes, there were, and they were fairly robust by the standards of norm, what normally has been the case in the last 15, 20 years in the industry. They -- any time there's price changes, that obviously creates some opportunity by various players, including yours truly. So we have been reactionary in some areas to what's going on in the industry. We happen to be -- have the only product that remains under UPP, which is Energys, which is a novel product. And we think the purpose of UPP is well served by a product like that, a new product where there's a lot of chair time and you're trying to incentivize a doctor to make a switch on a customer that may be comfortable to the current product they have. But overall, the pricing industry is favorable and rebates are favorable, and rebates are very much geared to the world of 'try it, you'll like it'. I want to incentivize you for a new fit. I want to incentivize you to move someone from product A to product B. And then from there, you follow on to a what hopefully is an annuity stream with less aggressive rebates for the new fit. Relative to Surgical, it made 7 or 8 acquisitions over the last 1.5 years or post 2 years now. Will we make any more? We obviously generate a lot of cash. We obviously are interested in continued geographic reach and tuck-ins, and we will do -- where deals make sense, we will continue to do them.

**Operator**

At this time, I'd like to turn the call back over to Mr. Weiss for any closing remarks. Sir?

**Robert S. Weiss** - *The Cooper Companies, Inc. - CEO, President and Non-Independent Director*

Well, I want to thank everyone for joining us today. We're aware it's near the school -- the end of the school year, so people have some priorities, frequently this time of the year, dealing with graduating students, getting kids out of class. So we appreciate that everyone took the time. Hopefully, you're as pleased with the results as we are and our outlook. And we look forward to updating you again in the end of August. I guess, August 31 is our next quarterly call, and we look forward to it. Thank you.

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**Operator**

Thank you, sir, and thank you, ladies and gentlemen, for your participation. That does conclude your program. You may now disconnect your lines at this time. Have a wonderful day.

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