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CORPORATE PARTICIPANTS

Robert Weiss *Cooper Companies, Inc. - President & CEO*

CONFERENCE CALL PARTICIPANTS

Andrew Hanover *JP Morgan - Analyst*

PRESENTATION

Andrew Hanover - *JP Morgan - Analyst*

Good afternoon, everyone. I'm going to go ahead and get started. I'm Andrew Hanover on the JP Morgan healthcare team, and we have presenting, or I'd like to introduce the company's president and CEO, Bob Weiss, of the Cooper Companies. After this presentation, we will go to the breakout session in Olympic. Bob.

Robert Weiss - *Cooper Companies, Inc. - President & CEO*

Thank you, Andrew, and good afternoon, everyone. Hopefully, you're happy to be inside and not outside. If you've watched any of the weather today, it's definitely out there. Welcome to San Francisco.

The Cooper Companies is a New York Stock Exchange company. We've been on the exchange since 1983, 33 years now, and we basically have two great businesses. I think everyone's familiar with forward-looking statements, so I won't read that to you, probably because I couldn't read it from here anyway.

CooperVision is our contact lens business. It accounts for about 80% of Cooper. We're a $2 billion company, so 80% CooperVision and 20% CooperSurgical.

CooperVision is in the soft contact lens business. It's about a $7 billion worldwide business. It's very much like a cottage industry. There are three players, four players which account for essentially 95% of the world market of soft contact lenses.

The industry is predicated on one thing -- myopia. Myopia happens to be one of the increasing things around the world, particularly as the world goes more and more digital. Today, about 30% of the world market is myopic. It is projected that between now and 2050, while that's a pretty far projection down the road, it will move from 30% myopic to 50% myopic.

Translated another way, today, 30% of the 7 billion people on the planet are myopic, so over 2 billion people, and that will grow, even in a no-growth scenario, to 3.5 billion.

Why do we think that migration will continue? Well, it's moved from about 20% to 30% fairly rapidly as people move on to digital devices, move into the service industry, and move from the outside to the inside. So it's both what you're looking at, as well as the fact that you spend less time outdoors.

CooperSurgical is our other business, 20% of the business. It's split into women's health care, about 50%, which is primarily US OB/GYNs, obstetricians, gynecologists in the office and in the hospital practice. The other half is IVF, in vitro fertilization, and that splits a little into diagnostics, which service the IVF centers, as well as the IVF centers.

Cooper is an October 31 year-end company, so we came out with our year-end results in December, and we reported solid 2016 growth, up 9%, overall 7% pro forma. Pro forma reflects the fact that we have basically treated acquisitions as if we own them at the beginning of the period.

We reported $8.44 in earnings per share, up 14%, and free cash flow of $357 million. We had a very solid fourth quarter, up 10% pro forma, reported earnings per share of $2.28, and that was up 14%. And importantly, we generated $158 million of free cash flow.

Strong track record, compounded annual growth rate of 9.3%. You'll notice that in 2015, it kind of flattened out a little as the dollar strengthened against the rest of the currencies, and we took about a $1.76 hit just in 2015 alone. Said another way, if we used the same currency rates as at the beginning of the period 2013, we would have grown 15% in our earnings per share. So, solid results, somewhat aggravated by a foreign exchange headwind.

When we reported our earnings in early December, we also gave guidance. Our guidance was for $2.09 billion to $2.13 billion, ballpark $2.1 billion. That is basically guiding CooperVision from 6% to 8% organic growth next year, and CooperSurgical basically 6% to 8% organic pro forma growth in 2017.

We also guided our earnings per share to a midpoint of $9.15, and that $9.15 came in around $0.40 light compared to what consensus was at the time. Of that, about $0.10 was foreign exchange headwinds. We took off $57 million on the top line and $0.10 on the bottom line for the headwinds. It also reflected the fact that we were taking our effective tax rate, which in 2016 was 8%, up to 10%, a more normalized tax rate, and that we were investing $10 million in expansion of sales and marketing in 2017, and I'll get into that in a little bit down the road.

Going the other way, we had done a accretive deal that we closed in November, Wallace catheter, that added to our IVF space, and that was $0.10 accretive.

Looking at the longer term, we continue to expect that we will grow our top line faster than market, both in CooperVision and CooperSurgical. We believe we have the products, we have the capacity. We've done seven acquisitions in CooperSurgical recently, so a lot of new products in the offering there, and a lot of new products within CooperVision to talk about.

We expect that we'll grow earnings per share faster than the top line, leveraging our cost of goods, ongoing reductions in cost of goods, operating cost, as well as leveraging free cash flow. We've set an objective for 2021 of 28% in operating margin. Today we're 24%. And importantly, we're going to generate about $2 billion in cash flow. This last year, we generated $357 million. Next year, 2017, we expect $400 million, so obviously we're arriving at a run rate of $2 billion.

Our intention with free cash flow is, one, to continue to do tuck-in acquisitions. Two, to continue to grow geographically, and that could include buying certain distributors along the way. As well as we have $1.4 billion in debt and have, in the past, been willing to go out into the marketplace and buy back our shares. We've set no parameters on that, but have done so frequently over the last several years.

An important part of expansion is global expansion. Obviously, China, the BRIC countries is a very big part of myopia. There is a greatly expanded pool of middle class that can afford contact lenses, so it's ripe. China is kind of arriving now, is doing very well. India maybe is a little further down the pike, maybe four or five years, but directionally is there.

We completed seven acquisitions the last 12 months, the last 15 months I guess, and our intention would be to continue to look for strategic acquisitions.

Looking at our operating margin, it's grown 10% over the last five years. This year, we finished 24.4% in 2016 and look forward to increase to 25%. Importantly, in 2015, it kind of flat-lined with the strong change in the euro and the yen in that year, which cost us about 280 basis points on the gross margin line and operating margin line.

As I indicated, we set a target for 28% in 2021, and a lot of the leverage will come from not only continuation of reductions in cost of goods, improving efficiency, and we've done a real great job in some of our new products the last 12 months, 18 months, generating yields beyond what we thought we could, we did such a good job that we actually created idle equipment in some of our new startup products, and so we're short-term-challenged in 2016 and 2017, where we actually have about $0.30 in our earnings per share, reflecting overcapacity and some related product rationalization with that. We will grow out of that. That's our star product, so look forward to what we can do with it.

Let's look at the contact lens business. It's $7 billion. 21% of it is torics. That is basically lenses that are used for astigmatism, more complicated lenses. 7% are multifocals, when your arms get too short or you can't see under low light conditions, or you're struggling like I am perhaps without my cheaters on. And then 72%, we'll call it the easy-to-fit, myopic patient.

Importantly, this doesn't translate to the wearer base. There are a lot fewer wearers in torics and multifocals than in the sphere category relative to the dollars into wearer base. That's trading up, so a toric lens costs about 50% more than a sphere. A multifocal lens costs about 100% more than a sphere. So think of it as a specialty niche area. Why is this important? Well, it's important because Cooper's number one in that area, and it also represents a high growth area. 8% growth forecasted in torics, 10% in multifocals. We have a long way to go in terms of penetration of those concepts outside the US, so a lot more maturity in the US than outside the US.

Geographically, EMEA, or Europe, is about 29%; Asia, 28%; and Americas, 43%. Importantly, on the growth side, Europe is about middle of the road, 6%. We're looking at the market growing 4% to 6%. I'll get a little into the details on that in a couple slides. What's going on, Europe is trading up to silicone hydrogel. The expansion into torics and multifocals, greater penetration there and Eastern Europe.

Asia-Pacific, which should be growing gangbusters with China in a high growth curve, is not, only because Japan is so big. Japan arrived at maturity in the one-day modality 15 years before everyone else. Why? Because they didn't like lens care, they didn't like chemical disinfection. They basically said boil the soft lenses every day. They don't boil well, so that didn't work out. And so the whole market shifted from the get-go into a one-day disposable modality. Consequently, China is taking over more and more the space. Japan is a low growth area, but as we go forward, the rest of Asia will matter more and more.

The Americas, ironically, which is the most mature of all the markets, is growing 7%, and that's because the Americas is the last to arrive in the concept of the one-day throw-it-away lens, compared to Japan, where they didn't like chemical disinfection. So consequently, that shift from the two-week and the monthly modality to the one-day modality, which happens to be a trade-up of about 400% to 600%, from the two-week and the monthly space, is driving a lot of top line growth in the Americas.

And now the real driver of the industry is really the lens modality. When do you throw it away? Today, 45% of the market is one-day throw it away at the end of the day and 55% is either two-week or monthly. So 9% growth going forward, that's kind of consistent with the last four years. There's been a dramatic shift from planned replacement two-week and monthly into the one-day modality. That will continue. And even though 45% is up there as dollars, that translates to about 28% in wearers, so there's a lot of wearers that have not arrived in one-day modality.

Coincidentally, I happen to be wearing two one-day lenses. One in one eye is MyDay, one in the other eye is Clariti, and it is fun throwing them away every night and not worrying about cleaning them, and then coming in the next morning with a fresh pair of lenses. So, truth be known, I love them, and they're great products, and once you're in a one-day modality and stop buying lens care and never carry the lens care, you're kind of hooked. You're not really going back. It's convenient, obviously, and eye care professionals get it, so it's a trend that has started a long time ago and will continue.

Here's the drivers of the contact lens business. Importantly, the wearer base, I talked about increasing incidence of myopia, going from 20% to 30% over the last 15 years, and now that we're at 30%, going to 50% between now and 2050. So, looking over a long horizon, it's going to be a great industry.

Why is that? We know digital devices are not going away. We know that people are moving out of rural into cities and service industries. When you leave being outside and come indoors, you give up some of your vision. The sun has a way of feeding good long-term far vision, and if you put everyone in a room like this and give them a digital device, then you're going to see more and more myopia. That's a fact of life. Obviously, that's what our industry is about, and it will continue.

The pricing and the modality thing, one-day lenses and silicone hydrogel lenses, is very important. When we look at the industry from 2000 to 2016, over a 16-year perspective, it's grown around 6.5%. And of that 6.5%, probably only about 1% to 2% at the most is the expansion of the wearer base. But most of the rest, I got asked the question in every meeting today, and every meeting talked about pricing. Well, most of the rest is not pricing, is the lens price going up or down. It's about trading up.

Our industry has done a masterful job of trading up since 1987 when J&J came out and said, I tell you what, why don't we start teaching them to throw away the lenses? Let's throw them away after two weeks or a month. So they started the whole thing of planned replacement, and we've been trading up ever since, whether we're trading up to silicone hydrogel, which is 20% to 40%, to one-days, as I mentioned, is 400% to 600%, to torics, I mentioned, and multifocals.

The last thing, of course, is geographic expansion, is the BRIC countries and Eastern Europe and Asia. And certainly, China has arrived. It's probably a $500 million market, now growing solid double digit. India's still struggling, but will get going because of its orientation towards a solid middle class and towards the service industry, so I have all the confidence in the world that all these dynamics will lead to a 4% to 6% growth, and closer to the 6% than the 4%.

It's not a one-size-fits-all market, so when we look at AsiaPac, we see the highest one-day penetration, 63%. We see the lowest monthly, and that's only because in Japan, they approve pretty much all our monthly products as two-weeks, meaning Biofinity and Oasis and everything is a two-week lens in Japan.

You look at Europe, Europe does not believe in two-week, because two-week is a noncompliant venue, and they look at one-day and monthly as the correct modalities. And then the US and the Americas is now 35% one-day. That was 10% in 2008. The two-week modality, which is now 30%, was 65% in 2008. Well, that tells you that if you're J&J and you're looking at the fact that you own that market, you own the two-week market, there are only two players there in the US, Cooper and J&J. And of those two players, one has 90% share, and that's not Cooper.

So J&J has 90% of that two-week space. It's going away, what are you going to do? Maybe you come out and you take Oasis and you make it a one-week, and then you make it a one-day and you make it a monthly, and then you look at that market and you say, how do I accelerate it going away? And so, they see the handwriting on the wall. It's a good strategy. It's good for them, it's good for the market. And so, we, quite frankly, appreciate some of the work they're doing to put people in play. If you can trade a person moving from two-week to daily up 600%, you can afford to miss a few of those people that you put in play. So they're not too worried about that. And overall, now, the market is increased to 47% one-day.

As we look at our competitors, we can see that Cooper has done well. Actually, 10 years ago, we were 15% and now we're up to 23% market share, so we're clearly performing well. Our competitors, B&L, which, in 2008 was 16%, is now 9%. And J&J and Alcon are your number one and number two positions.

Each of our competitors is going through some interesting times. B&L, I think we know about Valeant and some of the portfolio of B&L. J&J, just mentioned their strategy of basically multiplying their products Oasis into many modalities. Good strategy. Alcon is part of Novartis. Alcon overall is 8% of Novartis. It's kind of the unwanted child within that family, and who knows where that will go and where it will take it. But we enjoy the fact that our competitors are, I won't say in all disarray, but we're more focused on the growth of the industry than perhaps all of our competitors.

Here's our scorecard. We've managed to grow 2X the market, not only the last five years, but the last 10 years, and finished last year up 8% against the market, up 3%. We think that -- we're not predicting we will repeat that level, but we are predicting we will continue to gain share. Why? I'll get into that in a moment.

When it comes to product innovation, Cooper has more new products out on the market than anyone. And importantly, things that we didn't have a year ago, Cooper has capacity in one-day, MyDay, in Clariti, as well as in Biofinity. So we have capacity in products that we think have a lot of legs, and we will seize the moment.

I mentioned we're spending about $10 million this coming year accelerating the growth of our salesforce around the world, and part of it is to reflect some of these new products, which include Energys, which is a product targeted towards those that use digital devices, and it's part of the family of our Biofinity. So there's a lot of new products, and importantly, don't create a demand for a product you can't make, you have in good capacity.

Just briefly, on CooperVision, good top line sales growth. This last quarter, we grew 11% constant currency, and that was the best quarter we had in the last 11 quarters, and a lot of that is driven by continued improvement of our one-day modality. Silicone hydrogel lenses grew 53% last quarter, our overall silicone hydrogel lenses grew 21%, and even our planned replacement, which is the two-week Avaira and the monthly Biofinity grew 14%.

We performed well in all geographic areas, Americas up 8%, Europe up 12%, and Asia up 13%. Importantly, we are approaching number one in Europe, ready to knock out Alcon, which is currently number one, but we're neck and neck. And in Asia, clearly, we're under index and have been playing catchup with a lot of good products, including MyDay. That's coming into Japan, both in the sphere modality as well as the toric.

In type of lenses, torics, we're doing well, 31% as I mentioned. We're number one in torics and multifocals, and the torics contributed 14% of our growth.

CooperSurgical is, as I mentioned, approaching a $500 million business. It'll be about 22% of our revenue. It kind of was in a lull in the 2015 timeframe, when we basically reinvigorated our acquisition strategy. It certainly has performed well, and this last quarter we put up 6% pro forma growth, split into office and surgical up 5% and fertility up 8%.

In the acquisition front, a lot of solid acquisitions the last 15 months, most of them in the IVF space and in the genetics testing space, which fits the IVF or in vitro fertilization centers. So into pre-implantation diagnostics and screening that come into play. So we're excited about how that fits on its way forward.

Wrapping up, we have two great businesses with huge barrier of entries. We have, and growing faster than market, have basically invested in the infrastructure and have great long-term objectives and a track record. And with that, I ran out of time.