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COO - Cooper Companies Inc at William Blair Growth Stock Conference

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CORPORATE PARTICIPANTS

Brian G. Andrews *The Cooper Companies, Inc. - Senior VP, CFO & Treasurer*

CONFERENCE CALL PARTICIPANTS

Andrew Frederick Brackmann *William Blair & Company L.L.C., Research Division - Associate*

PRESENTATION

Andrew Frederick Brackmann - *William Blair & Company L.L.C., Research Division - Associate*

Hi, everyone. Good afternoon. My name is Andrew Brackmann. I'm a research associate here at William Blair on the medical technology and diagnostics teams. Before I begin, I have to let you know, for a complete list of research disclosures or potential conflicts of interest, please see www.williamblair.com.

With us today, we have The Cooper Companies. Management is Brian Andrews, the CFO and Treasurer; as well as Kim Duncan, Head of Investor Relations. With that, I'll turn it over to Brian.

Brian G. Andrews - *The Cooper Companies, Inc. - Senior VP, CFO & Treasurer*

Thank you, Andrew. Good afternoon, everyone. I think before I get started, what you're going to see today is an abridged version of our investor presentation. A couple of the slides I've moved around for the benefit of the fact that this is a generals conference. I've pushed some things up-front, just so I can talk about the company sort of more of at a high level. And then after this, I'll do some Q&A with Brian and potentially do a breakout afterwards, so happy to answer any questions once I'm done.

So just a little bit about myself. I've been the CFO for just over a year, been with the company for over 13 years. I've been doing -- prior to that, I was doing banking, corporate and investment banking out of New York and Boston. And I've been working with Al, our CEO, for the greater part of the last 18 years.

So with that, I'll begin. All right. So The Cooper Companies is a global medical device company. We have 2 primary divisions: CooperVision and CooperSurgical. CooperVision is about 75% of the revenues, and it is our contact lens division. It's primarily soft contact lenses. We've got a specialty unit that focuses on harder-to-fit eyes like scleral lenses and ortho-k and myopia management in general. As -- within CooperSurgical, it's a women's health care division. We've got 2 reporting units. One of them is our office and surgical division, where we've got devices like uterine manipulators, disposable hysteroscopes, surgical retractors, sort of office and surgical products for women. The other reporting unit is our fertility division. Our fertility has a whole host of products and solutions, including consumables and equipment. We also have a genomic, sort of a diagnostics part of that fertility -- the unit. As a consolidated company, we've got over 12,000 employees, and last year, revenues of just over $2.5 billion. And we've been a member of the S&P 500 since '16.

A little bit about CooperVision. We've had consistent growth over the past 3 years, growing 7.5%, 7% and 8%. Year-to-date, we've grown 8% through our first 2 quarters. We're split between the Americas, EMEA and Asia Pac: 40% of sales in Americas; 37%, EMEA; and 23% in Asia Pac with 5%, 8% and 14% growth pro forma, respectively, in the most recent quarter. Our specialty lens division, which I discussed a minute ago, is on a $55 million run rate, and it recently grew 35%.

I'll touch on a few of our products within CooperVision. In the silicone hydrogel -- or I'm sorry, in the silicone hydrogel daily category, we've got our premium lenses, which is MyDay. And in our mass market, it's clariti, where we've got spheres, torics and multifocals. The growth of this market, the dailies market and in particular the silicone hydrogel dailies market has been really what's driving the growth and will continue to drive the growth over the next many years. We've got a long runway ahead of us as people trade up from traditional lenses, FRP lenses to dailies and dailies to silicone hydrogel dailies. The growth of this market, the silicone hydrogel market over the last 12 months has been 32%. These 2 lens families together over the last -- over the year-to-date have grown 36%. And over the last 3 years, it was -- it's been growing in the 40s. As far as the market goes, 39% of the dailies market is silicone hydrogel. Just over half of the overall market is dailies, about 53% or $4.6 billion out of the $8.6 billion market. And CooperVision's share of this dailies silicone market is 27%.

Within our FRP space, that's our 2-week and monthly, we've got 2 really strong silicone hydrogel lenses with Biofinity; and Biofinity Energys; and Biofinity XR, our extended range monthlies; and Avaira Vitality, which is our 2-week lens. This market is not growing quite as fast. It's kind of in the low single digits. We've been growing these 2 lens families recently in the last year-to-date at 6%, but the silicone hydrogel percentage of the FRP market is 82%. So while this is a great category for us and it has been for some time, and we're going to continue to support it, a lot of the growth that we're seeing -- that we're all seeing in the market is in dailies. We've got a 31% market share in this FRP market with these lenses.

Some of the drivers of growth in the soft contact lens market, the -- like I mentioned, the global transition to dailies, the trade-up to silicone hydrogels. Wearer base expansion, not everywhere, but certain parts of the world, we're seeing some wearer base expansion, especially in Eastern Europe and Asia. Myopia is an epidemic, and we've got a great lens that we're -- we've got -- we've done 5-year clinical trials on called MiSight, which we believe is going to make a huge impact in treating and reducing the progression of myopia in children. As far as geographic expansion, in the BRIC countries, Eastern Europe and Asia Pac, huge potential and big growth, diversified growth in those markets. While there's a global trend towards dailies in some of these markets, some traditional hydrogels do really well, monthlies do really well, FRPs, so it's really diversified growth. And then again, growth in specialty, hard-to-fit eyes and myopia management.

Just a quick slide on market stats. CooperVision has grown consistently faster than the market year after year. For the last 15 years, this has been the case, including even in recessionary times. Back in '08 and '09 when the market only grew 2.7%, CooperVision grew 4.9%. That's about -- that's been about the slowest the market has grown in the last 15 years. So right now, we're seeing robust growth in the market. We're approaching our third year in a row of market growth exceeding 5%, and we intend to exceed that market growth.

CooperVision's market share has increased year after year. We recently tie -- we recently have become tied with Alcon at 24%. So the -- you can see here the industry is largely made up of 3 players: Johnson & Johnson, Alcon and Cooper. And we continue to grow our share in dailies and daily silicones.

Moving to CooperSurgical, the 25% of our business. Again, we've got those 2 reporting units, office and surgical, make up about 60% of the sales, largely driven by PARAGARD, which I'll touch on a little later; and then fertility, which is about 40%. Traditionally, the office and surgical group has been a low single-digit grower, but with PARAGARD, and more recently, it's really propelled its growth and it's been now in the most recent quarter up 7%. And fertility was up 5% in the recent quarter.

Just to touch on PARAGARD. We acquired PARAGARD from Teva about 18 months ago. It's the only nonhormonal IUD in the U.S. market. In the U.S. market, the U.S. penetration for IUDs is about 10% to 12%, which lags Europe at 15% and Asia Pac at 30%. When you look at nonhormonal IUDs outside the U.S., market share in certain countries vastly exceeds this 17%. You'll see in some places 30%, even upwards of 50% market share of nonhormonal IUDs in certain markets. PARAGARD is considered a pharmaceutical product in the U.S., even though there's no drug admissions associated with it. It's considered a pharma product, so there's a high barrier to entry to get into it. It's got strong gross margins, strong operating margins. And over the last 5 quarters, it's grown 11%, 9%, 20%, 10% and 11%. So we're going to continue to invest in this business. We're going to continue to add salespeople and do some marketing and promotion, advertising, do some training and education and continue to build this product line.

Touching on fertility. Over the years, we've acquired a number of companies to enhance the moat, if you will, around fertility. This includes everything from needles and catheters to fertility equipment, like workstations and incubators, lasers and micromanipulators, IVF media and a number of consumables that surround an IVF treatment. So really, from the egg extraction to the fertilization of the egg to the transfer of the embryo, all the way through to baby delivery, we essentially cover all of those areas with the exception of sort of the drug admission part that starts kind of a fertility cycle.

Just going to touch briefly on our financial performance. We've had consistent revenue growth in both businesses with a CAGR of 10% since 2015. Both last year and in the most recent quarter, the consolidated sales was up 7% pro forma. $675 million is the midpoint of our guidance range for CooperSurgical and $1.975 billion is the midpoint of our Vision guidance range. Free cash flow has always been strong at Cooper. We expect free cash flow this year to be pretty similar to last year despite elevated CapEx to support the growth of the silicone hydrogel franchise, so the daily silicone hydrogel franchise. Earnings growth similarly has been consistent and growing since 2015. We're up 13% with the midpoint of our guidance being $12.25 for 2019.

Here, you've got our guidance ranges. We recently took up the lower part of our guidance range within CooperVision and within CooperSurgical to 7% to 8% pro forma growth this year and 4% to 6% pro forma growth for CooperSurgical with a $12.25 midpoint on EPS.

Long term, we've got a number of objectives. And that's to grow faster than the market, grow EPS faster than revenue, generate $2.5 billion cumulative free cash flow, expand geographically and continue to evaluate strategic acquisitions and continue to grow the company where it makes sense with a disciplined approach for those acquisitions that fit in nicely into our core portfolio. We set an expectation of low 30s operating margin by 2023, so we expect operating -- continued operating margin expansion in the years to come.

And I guess with that, I'll turn it in.

QUESTIONS AND ANSWERS

Andrew Frederick Brackmann - *William Blair & Company L.L.C., Research Division - Associate*

Great. Yes. We're going to open it up for questions here. We'll also be doing a breakout for that. That is at the end of this fireside chat sort of session.

And I guess I'll just kick it off with the first one. And I guess my first question would be what level of confidence do you have in the ability for silicone hydrogel on the daily disposable side to continue to move towards those levels that you see with the FRP? You talked about 80% or so on the FRP side being silicone hydrogel, and that number is in the high 30s, I believe, on the daily side. So what gives you the confidence that those markets are the same or that you're going to get there? And then over what period of time do you think that takes?

Brian G. Andrews - *The Cooper Companies, Inc. - Senior VP, CFO & Treasurer*

Sure. Yes. So you're right. I mean I've mentioned a stat earlier. 82% of the FRP market is silicone hydrogels. Now silicone hydrogels were introduced into the FRP market in the early 2000s or in mid-2005. And over time, you've seen silicone hydrogels grow to 82% of the market. Now 53% of the market is dailies. 39% of the dailies market is silicone hydrogel. So when you talk about the potential for where silicone hydrogel could go within dailies, we feel confident that we could continue to move closer to those 80s percent over the coming years. And I think it's a long runway ahead of us. A 5- to 10-year horizon of the trade-up is expected.

Now when you look at the -- even though 53% of the market is dailies from a revenue perspective, only 25% of wearers are in dailies. Now when you talk about the trade-up, when we mention trade-up, we're talking about trading up an FRP wearer into a daily, the revenue per patient for the manufacturer is 2 to 3x more when you trade up an FRP wearer to a daily. When you trade up that daily wearer to a silicone hydrogel daily, that's a 20% premium. So over time, as we all have success in converting wearers to dailies and silicone hydrogel dailies, the market's going to grow. And as a percentage of sales, silicone hydrogel will increase as a percentage of the market.

Unidentified Analyst

Could you comment on the competitive landscape, including what might change following the recent spin-off of Alcon from Novartis?

Andrew Frederick Brackmann - *William Blair & Company L.L.C., Research Division - Associate*

Before you answer, could just repeat it for the audience?

Brian G. Andrews - *The Cooper Companies, Inc. - Senior VP, CFO & Treasurer*

Yes. So the question was to comment on the competitive landscape and some feedback or some thoughts I have around the spin-off of Alcon from Novartis. All right. Yes. So it's been a competitive industry forever, and there's product launches all the time. We feel confident in the breadth and diversity of our products. We've got the most robust product portfolio in the daily silicone hydrogel space between clariti and MyDay. We have spheres, torics and multifocals, and we've got a ton of capacity to be able to serve this growing market.

It's interesting, the contact lens market is a very sticky market. People tend to stay in their lenses for a long time. And I've gotten some questions today about why is it that the dailies market or the dailies percentage is so low still, especially the silicone hydrogel. Well, people, if you're comfortable in your lenses, they stay in their lenses. And so unless the ECP is pushing for a change, it's easier for the eye care practitioner to continue to sort of to just check your eyes and give you the same lenses over again. So the interesting thing now is some of our competitors are coming out with competitive products, and they're coming out with -- they're rumored to be coming out with a mass market daily. There's other daily silicone hydrogel lenses that have come out in recent past, and what that's doing is it's changing the narrative. It's changing the conversations with ECPs where we have been pounding the table. When we acquired Soflens in 2014 and picked up the clariti product line, we were going to ECPs saying, "Hey, guys, silicone hydrogel is much better for your eye, much more comfortable, much healthier for your eye. Why wouldn't you prescribe this?" And we weren't having a ton of success. We started having success when some of the other guys started launching their dailies. So we're taking share. We're growing the franchise. We've got a lot of capacity. It's hard for me to speculate sort of what's going to happen around Alcon and how they change and the dynamics around how they're going to launch their products. But suffice to say, we've got a nice head start. And we're focused, not only on branded, but also on customized solutions, which is a little bit of a difference from the other 2 bigger guys. What that means is it's not a private-label play. It's not taking an old lens and discounting it and winning on discount. But what it means is coming up with customized labels, customized packaging, working with them on logistical support, managing inventory, helping them with technology so that they can interact proactively with their patients. A high percentage of dropouts occur very soon after a new patient is fitted with a lens. So if we can impact those few weeks and help our key accounts reduce the incidence of dropouts in wearers, that will be huge for raising or increasing the category.

A few other things is we'll come up -- these multiyear agreements with these key accounts, we talk about key account strategy. We're setting up 5-, 7-, 10-year agreements with key accounts with the intent to really provide a full-service package solution where we help them advertise and promote and do all of these different things, these technology solutions. Even if they want a lens delivery service, we've got that technology that we've developed, and we'll even create a unique lens for certain customers if they give us that kind of a commitment. So -- and we're doing that.

So it's a little bit differentiated versus the competitors who tend to stay on that branded side. But again, to the extent that things change, we'll adapt. We'll pivot. And -- but in the meantime, I feel really good about our chances. We're executing in a great way, and we've had excellent execution over the many years. And that's helping to drive some momentum for us.

Unidentified Analyst

(inaudible)

Andrew Frederick Brackmann - *William Blair & Company L.L.C., Research Division - Associate*

Can you just repeat it before you go into that?

Brian G. Andrews - *The Cooper Companies, Inc. - Senior VP, CFO & Treasurer*

Yes. So the question is what is the mix of sales between branded and customized. I don't know that we've given that information out before. It's -- so I'm not going to comment on it. I mean speaking for our business, when we talk about sort of our key account strategy, which, as we define key accounts, it's global retailers, it's regional chains, it's buying groups, some of whom have influence over their eye care practitioners, some of them don't. So they come sort of in different shapes and sizes, if you will. And some of them will take our branded product, and they'll take -- and they'll want a nonbranded product. Some will want one or the other. So when we talk about our key account strategy, it's about 1/3 of our business. So...

Andrew Frederick Brackmann - *William Blair & Company L.L.C., Research Division - Associate*

The margin difference between the 2?

Brian G. Andrews - *The Cooper Companies, Inc. - Senior VP, CFO & Treasurer*

Well, the margin difference in our key account strategy, we definitely -- there's a bit of a pull-down from a gross margin perspective. The benefit is if we have a commitment over multiple years, the more volume that we can put through our plants, the more that we can impact yields, efficiencies and reduce cost per unit. We've been extremely successful doing that over the years with all of our product lines and we continue to be, and it helps to substantiate the investments we're putting into those relationships and those partnerships. We do manage those contracts and those agreements down to the operating margin level, so we are -- it is operating margin accretive. As it relates to margins, we are expecting gross margins to be up year-over-year from last year. We are expecting operating margins to be up year-over-year from last year as well. And we do expect, despite the investments we're putting into MiSight and PARAGARD in advertising and promotion, we expect operating income to be up in double digits constant currency year-over-year. And we expect to do that again next year.

Andrew Frederick Brackmann - *William Blair & Company L.L.C., Research Division - Associate*

What do you think your eventual share is in the daily silicone hydrogel market? I think you talked about being high 20% today. Where do you think you'll ultimately end up as that market kind of fills out as we discussed earlier?

Brian G. Andrews - *The Cooper Companies, Inc. - Senior VP, CFO & Treasurer*

Yes. So our market share, as you saw, is 24% of the market. In FRPs, we're 31% of the market; in daily silicones, we're 27% of the market. But in dailies, we're 18%. Well, why are we only 18%? Well, we were late to the game in getting to the dailies market, and so that really kind of set us back. Now we're in a position of strength. We've got a great product portfolio. That 27%, I would expect to rise up towards 31%, but I would expect it to even exceed that. We're executing right now. We're -- the demand is there. People love our lenses, so it's hard to say where we'll go. But suffice to say, when we look at the New Fit Data and we see, okay, what percentage of new fits are choosing Cooper or Cooper lens or Cooper daily silicone, the data is very promising. We're -- suffice to say, we're getting way more than our market share of new fits currently. So it's -- the data is promising, and we're going in the right direction.

Andrew Frederick Brackmann - *William Blair & Company L.L.C., Research Division - Associate*

This question has been asked -- I cover this from times in a couple of different ways, either on calls or in conversations we've had, but I still want to go back at it yet again. How should we be thinking about the pricing impact from the trade-up to dailies, as you talked about, and then in particular, the silicone hydrogel, in the context of a potentially worsening economic environment, right? We know that you guys have talked about in the last difficult time, from a macro standpoint, things held up fairly well. But you weren't in the middle of that big trade-up from a dollar standpoint from your user. So can you talk about how we should be thinking about if the economy does get a little bit worse, what happens to growth? What happens to that trade-up strategy?

Brian G. Andrews - *The Cooper Companies, Inc. - Senior VP, CFO & Treasurer*

Yes. It's a good question, and it's really hard to say. I mean, certainly, the prices of silicone hydrogel dailies have come -- have been -- there's a fair amount of rebating happening in the industry, taking down list price. And so net pricing, especially sort of in the mass market space, is coming more in line with some other options that are out there. The great thing about our business is we still have -- we have high profitability in virtually all of our lenses. And so if the market shifts a little bit and people change their preferences, and they want to go back to a 2-week or they want to go to a monthly or they want to go to a hydrogel, we've got a full suite and family of products all across the spectrum, including the harder-to-fit lenses on the outer ends of the spectrum to be able to fit for people. But what's interesting, though, is, and as I mentioned earlier, the stickiness of the business. I mean once people kind of get into their minds like how much it's costing them on a regular basis and they're comfortable, they don't want to mess with something that's comfortable for their eyes and that's healthy for their eyes. So where people will start cutting is probably in some of those discretionary places first. And depending on the length and the magnitude of any kind of recession, perhaps it starts to trickle down. But there's tons of options, and we've got plenty of lenses to provide.

Andrew Frederick Brackmann - *William Blair & Company L.L.C., Research Division - Associate*

With respect to CooperSurgical, we get the question often why does it make sense to -- inside of broader Cooper Companies, the tax situation may not be as beneficial. So can you just talk about the strategy and what the thought process is about keeping these 2 businesses together still?

Brian G. Andrews - *The Cooper Companies, Inc. - Senior VP, CFO & Treasurer*

Sure. I got that question today. It's -- they're both great businesses, and we have been investing in both through acquisitions and through internal investments over the years. We've now got that CooperSurgical business growing in the mid-single digits at 4% to 6% with high gross margins and high operating margins. The cash flow per revenue dollar for CooperSurgical is more than CooperVision. So we operate them as stand-alone companies. They've got separate management teams. There's -- with the new management team that's in place with Al and Holly and Dan, Bob and myself, we're spending a lot of time talking about how we can leverage both sides without disrupting momentum. There is certainly some things that we can do to support one another better and differently. But as far as the 2 of those businesses, from a capital deployment perspective, we've been able to invest in both business without harming the other. We've been able to grow both of those businesses, and we like them as being part of our portfolio.

Andrew Frederick Brackmann - *William Blair & Company L.L.C., Research Division - Associate*

Well, we're going to leave it there for this part of the discussion. The formal breakout will take place on the second floor in the Richardson room. Thank you so much for coming.

Brian G. Andrews - *The Cooper Companies, Inc. - Senior VP, CFO & Treasurer*

Sure.
