THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

COO - Q1 2012 The Cooper Companies, Inc. Earnings Conference Call

EVENT DATE/TIME: MARCH 08, 2012 / 10:00PM GMT

OVERVIEW:

COO reported 1Q12 revenue of $326m and GAAP EPS of $1.12.

THOMSON REUTERS

CORPORATE PARTICIPANTS

Kim Duncan *The Cooper Companies, Inc. - Senior Director IR*

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

Greg Matz *The Cooper Companies, Inc. - VP Finance, CFO*

CONFERENCE CALL PARTICIPANTS

Larry Keusch *Morgan Keegan & Co., Inc. - Analyst*

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

Steve Willoughby *Cleveland Research Company - Analyst*

Chris Cooley *Stephens Inc. - Analyst*

Matthew O'Brien *William Blair & Company - Analyst*

Larry Biegelsen *Wells Fargo Securities, LLC - Analyst*

Kim Gailun *JPMorgan - Analyst*

Joanne Wuensch *BMO Capital Markets - Analyst*

Amit Bhalla *Citigroup - Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the first-quarter 2012 The Cooper Companies, Inc., earnings conference call. My name is Regina, and I will be your conference operator for today. (Operator Instructions). Today's event is being recorded for replay purposes.

I would now like to turn the conference over to your host for today, Ms. Kim Duncan, Senior Director of Investor Relations. Please go ahead, ma'am.

Kim Duncan - *The Cooper Companies, Inc. - Senior Director IR*

Good afternoon, and welcome to The Cooper Companies' first-quarter 2012 earnings conference call. I'm Kim Duncan, Senior Director of Investor Relations, and joining on today's call are Bob Weiss, President and Chief Executive Officer; Greg Matz, Vice President and Chief Financial Officer; and Al White, VP Investor Relations, Treasurer, and Chief Strategic 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 conditions, and integration of any acquisitions. 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 the 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 first-quarter results. We will keep the formal presentation to roughly 30 minutes, then open up the call for questions. We expect the call to last approximately one hour.

We request that anyone asking questions, please limit yourself to one question. 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 - *The Cooper Companies, Inc. - President, CEO*

Thank you, Kim, and good afternoon, good evening, everyone.

After a successful 2011, we started 2012 out strong. Our Biofinity and Proclear momentum continued. For the first quarter of 2012, we put up solid topline growth, plus 11% -- 11% also in constant currency. We delivered $326 million in revenue. Our gross profit margin achieved 65%. With a strong topline, solid margins, lower interest expense, non-GAAP earnings per share was up 32% to $1.12, 35% on a GAAP basis.

The soft contact lens market rebounded in calendar-year fourth quarter to 5% growth, with CooperVision at 7%.

Key takeaways from today's call. We again put up great results with strong revenue growth, good margins, a favorable impact from lowering interest expense, and a solid bottom line. The Biofinity global rollout continues with Biofinity Sphere in Japan and Biofinity Multifocal in the United States and Europe. This workhorse fueled 40% constant-currency growth in our silicon hydrogel family, Biofinity and Avaira.

During the quarter, given the strength of our balance sheet and free cash flow, $200 million on an annualized basis, we announced a share repurchase program of up to $150 million. We in fact executed on part of the plan buying [663,000] (corrected by Company after the call) shares for $46 million, a transaction that was $0.01 accretive for the quarter and will be $0.05 accretive for the fiscal year.

While we continue to put up solid results in free cash flow, we continue to invest. Our sales force expansion, marketing, and R&D expenses are up in the 17% to 18% range. For competitive reasons, we won't give the exact numbers, but our sales force expansion is up 22% in the past 15 months and overall 36% in the past 2.25 years. During the same 2.25-year period, our G&A headcount is up only 11%, so we are leveraging where we need to leverage.

There were no callouts. GAAP numbers equal non-GAAP numbers for the quarter.

Nothing major with the FDA on Avaira Toric. We have ongoing dialogue with them and still are hoping to relaunch our Avaira Toric in April of this year.

We made the decision to launch a single-use single silicone hydrogel this year and will begin manufacturing shortly. For competitive reasons, I won't provide any more details at this time.

Our silicone hydrogel family is driving our growth. During the first quarter, the family achieved $87 million in revenues. That equates to a 40% constant-currency increase versus the prior year. Silicone hydrogel is now 32% of CVI's revenues.

We continue to feel positive about the future of our silicone hydrogel sales, driven by multiple factors. This includes the success of Biofinity's Multifocal launch in the $150 million silicone hydrogel Multifocal market and the launch of Biofinity Sphere in Japan's $400 million silicone hydrogel market. While we are early in the game -- while we are early in both, the successes are obvious.

We continue to manufacture the Avaira Toric product and are hoping for the April relaunch, as I indicated. Once this happens, we'll be a lot more aggressive with our Avaira family in the two-week space, which is dominated by J&J.

But back to Biofinity. The sheer strength of this family of monthly silicone hydrogel Spheres, Torics, and Multifocals remains a source of pride. Biofinity has a long way to go before fully exploiting it on a global basis. That's in terms of years. It is and remains a proud calling card of our expanding CooperVision sales force.

Geographically, foreign exchange movements have netted out during the most recent quarter. For CooperVision revenue -- for CooperVision Inc., revenue growth was 10% actual and 10% constant currency.

Regionally, we had solid results in constant currency with the Americas up 11%, Europe up 7%, Asia-Pac up 13%, and overall, once again, constant currency 10%.

Our growth drivers were in the Americas trading up to silicone hydrogel, including the success of Biofinity Multifocal, as well as solid performance in the one-day category by Proclear 1 Day Sphere. In Europe, essentially the same thing, trading up to silicone hydrogel, including Biofinity Multifocal, as well as the Proclear 1 Day Sphere.

And in Asia-Pac, success reflects the growth of silicone hydrogel primarily or particularly the Biofinity Sphere in Japan, as well as the Proclear 1 Day Sphere throughout the region.

The soft contact lens market was up 5%, while CooperVision was up 7% during the most recent quarter. This brings the full calendar year in at 4% for the market, while Cooper, on the strength of silicone hydrogels and Proclear 1 Day, grew 7%, or 1.5 times the market.

For the calendar year, the market growth was in silicone hydrogel one day or -- in silicone hydrogel one-day or single-use lenses, as well as specialty lenses, Torics, and Multifocals. Remember, in more established regions of the world, the market is a trade-up market. We trade you up to silicone hydrogel, which is roughly a 20% to 40% trade up, and trading you up -- or into one-days, which at the manufacturer level is roughly four to six times the amount of average revenue per wearer at the manufacturer level.

Worldwide, Torics and Multifocal lenses continue to grow solidly. These are much less penetrated, particularly outside the U.S. Geographically, each region had a respectable year, with the Americas and Asia delivering 4% growth, while Europe rounded up to 5%.

CooperSurgical, our women's healthcare franchise, had another great quarter. With $57 million in revenue, it was up 15%, 9% excluding acquisitions. Drivers continue to be surgical procedures, hospital and same-day surgery, where revenue was up 24% and now accounts for 40% of CooperSurgical.

Devices used by the gynecologists during laparoscopic procedures, such as closure systems, retractors, injectors, uterine manipulators, and related trays, are driving the growth in this area. Importantly, these are high-margin items, and CooperSurgical's overall gross margin percent during the quarter was a very impressive 67%, while its operating income hit 27%.

To say we're pleased and proud of our CooperSurgical franchise would be an understatement. We will continue to look for the ways to leverage this franchise, both in the United States, as well as through geographic expansion.

Importantly, CooperSurgical is an integral part of our global tax structure. It allows us the luxury of continuing to report and pay at a low effective tax rate. Without it, we disrupt our global tax balance, which to us, in keeping with our objective to maximize total shareholder returns, or TSR, is strategic. Simply put, any money that goes to the government is not available for reinvestment or to pay dividends.

We generated -- we are generally sticking to our guidance range, except for the increase in earnings-per-share guidance. As Greg will get into further, we delivered strong results in Q1 with a favorable tax settlement outcome offsetting some negative costs associated with the Avaira recall. These costs impacted sales and operating expenses.

The strong bottom-line results in Q1 and the accretive effect of our stock buyback are contributing to the overall improvement in our earnings-per-share guidance. Our guidance assumes stable foreign exchange rates, the ongoing investment in sales force, R&D, and geographic expansion. We also anticipate some drag on our gross and operating margins as we accelerate investments in China and other developing countries and launch single-use silicone hydrogel and relaunch Avaira Toric later in the fiscal year.

On strategy, we are continuing with our successful strategy. We believe it is solid and it has delivered results. CooperSurgical is putting up outstanding results and is leveraging its infrastructure. This franchise was built on a solid understanding of the value of critical mass in a women's healthcare market targeting the OB/GYNs. We follow the profession wherever they go, office, surgery center, hospital, or IVF centers. Although the call points are different for each, the leverage is considerable.

CooperSurgical's Q1 2012 gross margin was 67%, our operating margin 27%, and due to minimal CapEx, CooperSurgical is a significant contributor to free cash flow. We are dedicated to this strategy and will continue tuck-in acquisitions to leverage the CooperSurgical infrastructure.

At CooperVision, strategy is more complex. It is much more global in nature. In the $6.9 billion soft contact lens industry, because of the uniqueness of our manufacturing platforms and product portfolio, we are the only participant that promotes both silicone hydrogel and non-silicone hydrogel, that is the Proclear family.

We emphasize branded and nonbranded products, but private label does not mean lower gross margin or price. Actively, we promote both special -- actively, we promote and specialize in custom lenses with a high gross profit, of course.

We support all modalities that the eye care professional prescribes, one day, two week, and monthly lenses. And we support all types of lenses, Spheres, Torics, and Multifocals. We're close to 30% share in the high-growth specialty lens categories, Torics and Multifocals.

It is acknowledged by the eye care professional that we are pretty good at specialty contact lenses. Few would challenge why the success of Biofinity Toric for astigmatism. Put a great design together with a great material, and great things can happen. We have seen early successes for the same reason with Biofinity Multifocal, which hit the market in the middle of last year.

On the capacity front, with the exception of Avaira Toric, we are ahead of plan to deliver considerably more product where we had previously been supply constrained. The Biofinity family, Proclear 1 Day, our 1 Day Torics are all ramping up nicely.

On pricing, we, like the rest of the soft contact lens industry, have a trade-up strategy. Our new wearers and existing wearers are targeted for silicone hydrogels, the Proclear family, and the one-day or single-use lenses. Each creates more revenue per patient. A one-day modality, for example, results in four to six times more revenue per wearer.

While this strategy sacrifices the gross margin percent, it generally creates three to five times more profit per wearer. Of course, the strategy competes head on with the lens care space, since we are shifting the wearer's resources from lens care to contact lenses only. Competing for lens care dollars is more of a problem for some of our competitors.

In my opinion, we can either be the most focused company in the industry, lacking many of the distractions that some of our competitors are now going through. I might add with Biofinity, Avaira, and Proclear, we have a lot to talk about with our eye care professionals around the globe.

As we look down the road the next several years, we expect to continue improving operating margin and delivering above-average TSRs. We expect to continue to deliver double-digit earnings-per-share growth, while investing in geographic expansion, sales force expansion, and new product development.

In today's market, we have a solid product portfolio to leverage in all modalities, multiple materials, all lens types, and we retain our expertise to emphasize custom lenses for the 10% to 20% of lens wearers who require other than standard lenses and more unique sizes and designs.

We have a lot to work -- a lot of work to do before we come close to having exploited our number one contact lens family, Biofinity. This is particularly true when it comes to geographic expansion and fully developing its family of Torics and Multifocals around the world.

The same applies to Avaira, where Avaira Sphere is anxiously awaiting the relaunch of Avaira Toric. The combination will put us in much better position to exploit the U.S. two-week space owned by J&J and to also exploit our private-label strategy more aggressively with this family.

While we are already pretty respectable when it comes to gross margins and operating income margins, from a cost perspective we have considerable upside yet to be fully developed. Upsides include the elimination of silicone hydrogel royalty in September 2012 -- I'm sorry, 2014 in the U.S. and

March 2016 in the rest of the world; the reduction of our manufacturing costs by getting alcohol in our silicone hydrogel production; improving molding cycle times; increasing capacity utilization; and improving yields in general.

Given the considerable amount of free cash flow we generate, we will continue to look for tuck-in acquisitions and geographic expansion opportunities in our two businesses that exceed our hurdle rates. Given the fact that the markets (technical difficulty) women's healthcare and soft contact lenses are so much less developed outside the U.S., and we generate a considerable amount of cash outside the U.S. due in part to our level of manufacturing outside the U.S., we will continue to aggressively invest in global expansion opportunities. With over 95% of the people on the planet outside of the United States, we believe we will find opportunities to invest there for decades to come, thereby retaining our low effective tax rate indefinitely.

And as was the case in the past quarter where the stock was suppressed, we even demonstrated we are willing to buy in some of our own stock at times.

In summary, before I turn it over to Greg, the first-quarter 2012 got us off on the right foot for having another in a string of successful fiscal years in 2012. We again delivered a solid topline, gross profit percent, operating income percent, earnings per share, free cash flow, and even a stock buyback to enhance total shareholder returns.

Our silicone hydrogel family, even in the middle of a recall, continues to perform, delivering 40% constant-currency growth above already respectable prior-year comparisons.

While we accomplished a lot, we have a long way to go before we fully exploit our silicone hydrogel families and our excellent one-day Proclear 1 Day.

Japan's silicone hydrogel market, BRIC geographic expansion, a large rapidly-growing silicone hydrogel Multifocal market, a royalty expiration starting in 2014, a very leverageable CooperSurgical with ongoing opportunities, and many, many more global opportunities signal we have many opportunities to grow our operating business and maximize TSR. Whether in -- whether the soft contact lens market accelerates in the 6% to 8% range or bumps along at 4% to 5%, we clearly see the opportunities.

Finally, our people are our number one asset. They have continued to deliver. As a quality-of-life company, we remain focused on keeping our employees and their families healthy and productive. To them, once again, a big thank you for all that they have done and continue to do. With that, I'll turn it over to Greg.

Greg Matz - *The Cooper Companies, Inc. - VP Finance, CFO*

Thanks, Bob, and good afternoon, everyone. Bob has given you a pretty thorough view of our revenue picture, so let me start with gross margins.

But before I go there, I want to provide some color on the Avaira recall expenses in Q1. By the end of Q4, we had accrued for about $20 million in recall costs. In Q1, we had an additional $2.9 million in what we consider operational costs directly related to the recall, which were split about roughly equally between revenue for things like customer concessions and operating expenses for things like reviewing all Avaira Sphere fitting sets to ensure that there were no lenses impacted by the recall in the fitting sets.

At this point, we believe the majority of the costs are behind us, but we expect we could have some small charges hit over time until we have Avaira Toric back in the market.

Now looking at gross margins. In Q1, the consolidated GAAP and non-GAAP gross margins were 64.5%, compared with 60.2% and 60.9%, respectively, for Q1 last year. CooperSurgical had a GAAP and non-GAAP gross profit margin of 67%, which compares to Q1 2011 of 64%. This improvement was mainly due to manufacturing efficiencies and favorable product mix, especially in our surgical space. Products like closure systems and uterine manipulators, to name a couple, have done well, and they also have better-than-average gross margins.

CooperVision reported a GAAP gross margin of 64% versus 59.5% in Q1 last year. On a non-GAAP basis, gross margin was again 64% versus 60% in Q1 last year. As you can see, we had a strong gross margin quarter. The increase was attributable to many different components, like the completion of our Norfolk closure effective last year, which contributed over one percentage point, or roughly 120 to 130 basis points, to our gross margin.

In addition, we had favorable product mix with silicone hydrogel sales now representing 32% of revenue, up 39% from last year, up 40% on a constant-currency basis. We also had lower idle costs and favorable manufacturing variances carrying forward into Q1 from last year, reflective of our inventory turns.

All this being said, and looking at the remainder of the year, we believe that our gross margins will be lower than Q1 starting with the increased Avaira costs related to modification of some of our production processes related to the recall. In addition, the anticipated relaunch of Avaira Toric startup cost, with a new Biofinity line in Puerto Rico coming up in early Q3, and the introduction of a single-use silicon lens will also impact gross margins.

We see these latter events as positive for our business in the long term, and as typical, there will be drag on margins for manufacturing and efficiency type variances in the earlier periods.

To further build on the cost of the single-use silicon lens, our experience is that new material or derivatives of materials always face a steep cost curve as we start production. High-volume lines or products that utilize high-volume lines are the most susceptible. Our first single-use silicone hydrogel is no exception, and we expect to be in a situation of higher costs in the short term as we ramp up production. For these reasons, we are staying with our previous gross margin guidance of 62.5% to 63% range for the year.

Now looking at operating expenses. SG&A in Q1 on a GAAP basis, SG&A expenses increased by 16% from Q1 last year to $131.7 million, and were 40% of revenue versus 39% in Q1 last year. This is generally attributable to the added investment we've been discussing over the last year, which has resulted in increased sales and marketing expenses for commissions, new hires associated with generating higher revenue, and expenses for new product launches.

We have seen increased selling investment in both CooperVision as well as CooperSurgical. Last year, we highlighted that we would be investing. That investment really did not ramp up until the March/April timeframe, which, when you look at year over year, leads to some higher expense growth rates. So with our growth rates in SG&A and R&D, we will see a run rate impact on spending.

On the R&D front, we have talked about investing in our business, and R&D is one of those areas where we continue to make investments. In Q1 on a GAAP basis, R&D increased by 17% year over year to $11.4 million and was 3.5% revenue, up slightly from 3.3% in Q1 2011. This increase is mainly attributable to adding staffing in both businesses.

Moving to operating margins, just a reminder we adjusted Q1 2011 for the $6.1 million gain on settlement of a pre-existing relationship related to the Aime acquisition. We originally had recorded it in Q1 2011 and reversed in Q3 2011. If your models are based on non-GAAP, there should be no change, but if you're using GAAP, be aware of the change from last year's Q1 financial statements. And if you need more information on that, you can refer to the Form 10-K and Note 14 of our financial statements for 2011.

On a GAAP and a non-GAAP basis for Q1, consolidated operating income and margin were $61.7 million, or 19% of revenue, versus $48.7 million, or 17% of revenue, in Q1 2011 on a GAAP basis. And then, in Q1 2011 on a non-GAAP basis, operating income was $50.8 million, or 17% of revenue. This represents a 27% and a 21% increase in operating income over Q1 2011, GAAP and non-GAAP respectively.

A couple of points for your models. If you're looking below operating income, you will see in other income we have roughly $700,000 of income, approximately $200,000 related to an FX gain compared to $700,000 loss last year, and the remainder is related to a gain on sale for an investment which we picked up as part of the Aime acquisition last year.

Interest expense, that was $3.7 million. It was $3.3 million, or 47%, lower than Q1 last year. This reflects reduced borrowings and lower interest rates resulting from financing and the redemption of the senior debt at the beginning of Q2 2011. Included in Q1 was additional interest expense associated with the repurchasing of shares and some nonrecurring operational discrete items. We expect interest expense in the $12 million to $14 million range for the year.

Move on to effective tax rates on a GAAP and non-GAAP basis. In Q1, the effective tax rate was 7% versus Q1 2011 GAAP of 4.4% and non-GAAP of 6.7%. As we've discussed in the past, the effective tax rate continues to be below the U.S. statutory rate as the majority of our income is earned in foreign jurisdictions with lower tax rates. This also continues the trend of income earned in foreign jurisdictions increasing as a percent of the total as compared to income earned in the U.S.

In addition, we are seeing some foreign jurisdictions dropping their rates.

The Q1 effective tax rate was lower than our 10% to 12% annual guidance, mainly due to a settlement with the IRS which resulted in the release of certain reserves and a cash payment of approximately $50,000. It would not be appropriate to get into any of the specific details of the settlement, but we now believe that an effective tax rate in the lower part of our full-year guidance, which was 10% to 12%.

Depreciation and amortization in Q1, depreciation was $20.2 million, up 11% year over year, and amortization was $5.6M , 18% year over year, for a total of $25.8 million. I know we have not generally talked about amortization expense, but amortization expense increased to reflect the increase in amortization on intangibles on several deals we completed last year.

For those interested in the stock comp number, Q1 stock comp was $7.3 million.

Earnings per share, as Bob mentioned, in Q1 earnings per share was $1.12 on a GAAP basis and non-GAAP basis, versus $0.83 and $0.85, respectively, in Q1 2011. Favorably impacting our current quarterly EPS is our share repurchase program and our settlement of the IRS tax case.

As previously discussed in prior earnings calls, the Internal Revenue Service issued a note of deficiency to the Company on April 1, 2011. It asserted that the Company was subject to additional taxes for 2005 under the anti-deferral provisions of Subpart F of the Internal Revenue Code. In January, we settled the matter and agreed to a net deficiency of $50,000, as mentioned above. Due to the settlement of the tax case, we released certain reserves, which were largely offset by the additional Avaira recall costs I mentioned a few minutes ago.

On December 15, 2011, we announced that the Company's Board of Directors had authorized a share repurchase program of up to $150 million. As of the end of the quarter, the Company purchased approximate 663,000 shares of the Company's common stock for $46.1 million at an average purchase price of $69.60 per share. This had, if you round up, about a $0.01 impact in the quarter, and we expect the impact for the year to be about $0.05.

Looking at the balance sheet and liquidity, in Q1 we had cash provided by operations of $41.6M, capital expenditures of $20.0M, insurance recovery of $1.6M, which resulted in a $23.2 million of free cash flow. The two major items impacting free cash flow from our perspective were the one-time $10 million payment for the Rembrandt settlement we talked about in Q4 2011 and an increase of inventory in the quarter of about $19 million. Avaira Toric makes up about 40% of that inventory increase as we rebuild our stock in anticipation of a relaunch in the future.

The insurance settlement relates to an October 28 incident in which a pipe broke in our fire suppression sprinkler system, causing water and fire retardant foam damage in part of one of our manufacturing buildings in the UK. This incident did not have an impact on customers.

Total debt increased by $29.9 million to $410 million. Debt as a percent of capitalization is now 17.5%, up from 16.4% in Q4 and down from 26% in Q1 2011. This leaves us with approximately $600 million of total credit available. AR continues to be closely monitored with DSO at 59 days, down from 61 days last year.

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

Kim Duncan - *The Cooper Companies, Inc. - Senior Director IR*

Operator, we are ready to open up the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Larry Keusch, Morgan Keegan.

Larry Keusch - *Morgan Keegan & Co., Inc. - Analyst*

Hi, good afternoon. Thanks for all the detail. Just -- if I'm looking at the numbers correctly, growth in your single-use lenses in the fourth quarter was about 8%, and the market grew 11%. So I'm wondering if you could just talk a little bit, again, about your strategy there and what you can do to accelerate the growth there to at least market rates, if not greater.

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

While we, in fact, were a little lighter in the fourth quarter, I think when you look at it from a first fiscal quarter basis, we were up 10%, 14%, all up 10% constant currency.

So I think a lot of it is -- we continue to do well with our Proclear 1 Day. We are, as I indicated, going to be coming out with a silicon hydrogel one day, not that I think that it's moved much beyond a little niche, but I think that's a fact of just joining and being a participant with the crowd, so to speak.

I still think that Proclear 1 Day will be the driver of our global business and reasonably hold its own out in the marketplace, not only in Japan where it's done well, but also in the U.S. where you see J&J putting a lot of their energy to develop that market.

We're, of course, going to ride the coattails of their work as they expand that market. Right now, it doesn't take too many wearers to move the needle quite a bit from a dollar point of view, and that market in the U.S. has gone from around 10%, 11% a couple years ago to 17%, 18% now. So they're clearly hoping move that tide. Next question.

Operator

Jeff Johnson, Robert W. Baird.

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

Thanks. Good evening, guys. Bob, just wanted to ask a question on the gross margin guidance. At 62.5%, the low end of your guidance for the year, it looks like you are implying kind of flat to maybe even down a little bit over the back three quarters of the year relative to last year, which just -- I hear what you're saying on some of the expenses, but if you could flesh that out a little bit. It just sounds a little bit hard to believe at this point.

And then, Greg, just a very quick question on the reversal in the tax rate. Where your comments meant to mean it was about $2.5 million reversal in the tax rate in the quarter? Thanks.

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

I'll comment first, then I'll let Greg amplify both the gross margin and then the spot on the taxes.

You're right. We came in with a very solid gross margin. CooperVision was 64% compared to a year ago, 59.5%. That showed the value of Norfolk, which is ongoing, of course, the value.

One of the real catalysts of our gross margin is mix, the fact that literally our growth is being sponsored by Biofinity, which, of course, is a high gross margin. So importantly, as we get back into the two-week market more robustly, that doesn't have the same theme, if you will, as Biofinity. Not that it has a bad margin, but I think the startup costs associated with getting into the -- relaunching Avaira Toric, as well as the startup costs of entering the one-day silicon hydrogel market, which from the get-go is not going to be much of a gross margin to talk about at all, and I think Greg alluded enough to the fact that you do start off a very steep curve in terms of high costs, and then you work it down over a period of literally years. That's a factor.

He did mention that we're now going to go through a startup phase for Biofinity in Puerto Rico, so we have basically, given the size of that product, have decided to bite the bullet and go through a startup. It's at a remote location compared to where all our other Biofinity is made, so there will be a cost to that. Those costs will be directly impacting the next three quarters.

So I think with that, I'll let Greg clarify anything else and then respond on the tax side.

Greg Matz - *The Cooper Companies, Inc. - VP Finance, CFO*

Bob, I think you've got -- the gross margin comments, I think that makes sense.

On the tax side, we don't get into a lot of the detail, but I think you can probably back into it based on the comments we mentioned earlier about Avaira and an offset between -- a likely offset between Avaira and the tax impact.

Operator

Steve Willoughby, Cleveland Research.

Steve Willoughby - *Cleveland Research Company - Analyst*

Thanks for taking the question. Bob, I was wondering if you could give us a little bit more color regarding the FDA, and the FDA going through your various facilities, and the letter you received last quarter, and just kind of any other color you could provide us regarding your discussions with the FDA.

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

Probably can't give you too much more than I said that we are going through a process with the FDA, responding to their questions -- no -- tough to say there's no red flag. We are cooperating with them, we are getting through their questions, and at this juncture we still expect to re-launch Avaira Toric in April.

But of course, that is totally dependent on whether or not the FDA has any further questions.

On the warning letter, we are responding to the observations made by the FDA, making good progress there. I think they're waiting on us to say we're complete with all the corrections, which is going to take several more months, and at that point in time they will come back in and reinspect. So that is down the road several more months.

Relative to the FDA showing up in the UK plant, you may recall they came into our plant in Puerto Rico. There were no observations. They came into our plant in Scottsville, no observations. And they have not been in our plant recently in -- or since the recall, anyway, in the UK. They have made no indication that they have imminent plans. They'll show up when they want to show up.

It is still our expectation that they will show up eventually, so when it happens, it happens. Beyond that, we're marching forward with Avaira Sphere and anxiously awaiting to get Avaira Toric back out on the market. Next question.

Operator

Chris Cooley, Stephens.

Chris Cooley - *Stephens Inc. - Analyst*

Thank you and good evening. Appreciate you taking the questions. Bob, you guys have done a great job with CooperSurgical, consistently delivering good growth there and margin expansion. When we look at that franchise now, is this the new normal for profitability, and when do we start to see some, I guess, some further development there on a more global basis? Any color that you could provide there would be helpful. Thanks.

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

Yes, Chris. We are very pleased with where we are with CooperSurgical.

I think I would point out that if we aggressively go globally, the margins that we're accustomed to seeing in the U.S., 67% gross margins at 27% operating margin that we've now gotten to, we will put some pressure on that. That will be an investment.

And I think obviously with the product portfolio, we now have north of 600 products, many of which have potential outside the U.S., it is worth exploiting that. We initiated activity last year. I would say where we are in Europe is slow going, mixed results, clearly not a wow factor at this juncture, but it is early in that cycle.

I think one of the ways that we would advance the ball with CooperSurgical would be acquisitions that are outside the U.S., and I would hope that over the next several years we at least advance the ball by having some of those to continue to leverage where we are with the franchise. Next question.

Operator

Matthew O'Brien.

Matthew O'Brien - *William Blair & Company - Analyst*

Good afternoon. Thanks for taking the questions. Just one quick clarification, if I might. You talked about this $0.05 of accretion from the share repurchase in the quarter. Is that just assuming that you don't do any further repurchases or the other $100 million essentially is not used?

Greg Matz - *The Cooper Companies, Inc. - VP Finance, CFO*

Yes, Matt, you're right. That assumes -- it's where we are at this point.

Matthew O'Brien - *William Blair & Company - Analyst*

And then, my primary question that I'm a little bit more concerned about is, you talked about, Bob, a little bit about Biofinity and this being multi-year rollout or opportunity that you see in front of you. Can you just provide a bit more color on why you think that's the case? Is a function of you still haven't even gotten to all of your customers with the product? Is it your sales force expansion? Is it the new market opportunities that you see there? I mean, why is this a multiyear process in terms of delivering a lot of growth from that specific family of products?

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

Number one, I would say we're early even in the United States, which is our most mature market.

Early, by that I mean the total of the totality of the family, where when we came out with Biofinity Sphere, it did good. When we brought out the Toric, the Sphere did even better. There's a halo effect. And when you come out with the Multifocal, there is a compounding halo effect.

So they feed on each other as a family of products in front of a practitioner who says, I'm very comfortable with the material. I know how it works in my sphere, love it there, now I want to migrate.

So Biofinity Multifocal, of course we just launched it mid last year, in June of last year. It has a long way to go. When I talk about we have -- we're far from exploiting it around the world, I mean geographically, I mean -- when we talk about the BRIC expansion, it is a good vehicle to get into some countries where perhaps we would be more challenged if we didn't have a product like that that is rapidly showing its presence in the silicone hydrogel space, which of course is the fastest-growing space.

All that takes work. You're right about expansion of the sales force. Putting in place more feet on the street is one of the limitations we have. And I guess I would just say the world is a pretty big place. It takes a while to get there.

Japan, for example, it's a $400 million market. I would say we have only just begun. We have been in that market since June of last year also. We have yet to introduce the Toric, which will probably be later this calendar year in that market, and we are even further away from introducing the Multifocal in that market.

So it takes time. In some cases, there is registration processes you have to go through also. Next question.

Operator

Larry Biegelsen, Wells Fargo.

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

Good afternoon, everyone. Thanks for taking the question. Just a two-part question on the guidance. First, CooperVision grew 9%, ex-Aime, ex-FX in the quarter, but the guidance is still, I think 4% to 8%. The market actually accelerated from 3% to 5%, so why not take up the low end of the guidance today, Bob? Is it just conservatism earlier in the year or is it something you're seeing?

And then, secondly, on CooperSurgical, the high end of the current guidance assumes basically that sales are flat sequentially. Is that a trend you would expect for the remainder of the year? Thanks.

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

Thank you, Larry. I think they are valid questions. We debated guidance. Quite frankly, one of the things that caused us a little pause was that foreign-exchange started moving against us the last -- it's volatile, it changes about every day depending on which way Greece blows on a given morning.

So as we were sitting here paper and pencil, it was one of those days where currencies were moving more stronger against us, so we were a little cautious as we rolled that into and factored into topline and bottom line.

On surgical, I think we are probably a little conservative. But having said that, the franchise at 9% -- 9% organically is -- they're good numbers. They're not what we would deem that franchise would normally continue and sustain at, at 9%. So we're a little bit more cautious than assuming the first quarter's strength of that organic growth. Next question.

Operator

Kim Gailun, JPMorgan.

Kim Gailun - *JPMorgan - Analyst*

Great, hey, thanks, guys. So, a question on margins. You talked a lot in the prepared comments about margin expansion, and most of the highlights that you gave relative to that expansion potential came at the gross margin line, from what I heard. So I guess what I'm curious to hear you talk about is how you think about SG&A leverage over the next few years against the backdrop of you've added 22% to your sales force, you're spending heavily on free lenses and fit sets with the new product launches. So when do we start to see some of that leverage flow through the SG&A line?

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

Clearly, you'll see some leverage first on the G&A distribution areas where we are -- as I indicated, that only grew really 11% while everything was growing substantially above that.

We are investing heavily, meaning we grew topline 11%. We grew our line items for sales and marketing, as well as R&D, more like 17% to 18%. We're investing now. We continue to expect to invest over the next couple of years, particularly tied in with geographic expansion, which plays into pushing operating costs, if you will, and the best areas by investing in the operating cost and investing in the structure.

An example of that would be we talked about China in the past. I didn't spend much time on China today, but China would be one we're still intent on going down our path of investing upwards to a drain of 40 to 50 basis points on our operating margin this year. And that is still part of our expectation in an area like that.

Now, when do you start getting the payback? Really, the payback is going to happen post-2012, post-2013, and then it becomes somewhat a question of if we think we're getting our money's worth by investing and expanding, we might enter more countries. We haven't really spent much time talking about aggressive investing in Brazil, aggressive investing or any investing in India, aggressive investing in countries such as Russia.

So, there are opportunities out there. Some of them we're not comfortable yet getting there, but I would hope two years from now we're talking about some of those countries more aggressively.

I'm not so hung up on -- we think a natural migration of our operating margin is going to be where we are to the mid-20s. And we can get there with a little bit of operating-expense leverage and the natural fallout of gross margins because of royalty expiration and what we can do in cost of goods.

So, the first point is improve your operating margins, waiting on cost of goods, continue to invest where it makes sense, and seeing just how good the product is. The underlying assumption is I got three products in each modality, 1 Day with Proclear family, two-week with Avaira, and a monthly with Biofinity, and it would be a shame to be shortsighted and not spent enough money to get the most out of those products. So, hopefully that will help you. Next question.

Operator

Joanne Wuensch, BMO Capital Markets.

Joanne Wuensch - *BMO Capital Markets - Analyst*

Thank you very much for taking my question. Two-part question. Of your silicone hydrogel revenue, what percentage of it is in the United States and what percentage of it is outside the United States?

And the CIBA royalty starts to roll off. Of that 8% gain, which you're talking about, which will help you get to those mid-20% operating margins, are you going to let it all roll through or can we expect some reinvestment?

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

I'll take the second one first. You can expect some reinvestment. We will take some of it to the bottom line, but I would expect in the neighborhood of half of that will be reinvested. That happens over a period of time. It doesn't just -- it's just not a cliff. So we'll have some opportunity to plan that out.

As far as silicone hydrogel, the majority of our revenue, actually the better half, is outside the U.S. But it's closer to 50%-50% at this juncture, and therefore, my opinion, you know that 33% of revenue in the soft contacts lens market is in the U.S. So two-thirds -- it should be two to one, so there's a lot of -- translated, there's a lot of leverage potential yet with silicone hydrogel outside the U.S. Next question.

Operator

Amit Bhalla, Citigroup.

Amit Bhalla - *Citigroup - Analyst*

Hi. Quick question on Europe and just a clarification on guidance. On Europe, I think last quarter you talked about it as a softening market, but it looks like it did bounce back. Can you just talk about the sustainability of what you're seeing in Europe?

And just second on the guidance clarification, so you took the midpoint up $0.13. Did I hear it right, $0.05 from the share repurchase, and that would leave about $0.08 from the lower end of the tax rate, or is there anything else that's driving the earnings revision upward?

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

Europe first. Europe is -- I call it a daily event. By and large, it's been okay for the contact lens industry. It was a little soft, as you can see, in the fourth quarter compared to how it did last year. For example, the contact lens industry in the fourth calendar quarter was at 5%.

The overall market was stronger than that last year. Actually, I guess it -- held its own, 5% and 5%. But it wasn't that bad for us in the first quarter. So it's not as robust as it was the prior two years where it was clearly the strongest of the three regions, but it's holding its own.

THOMSON REUTERS

On guidance, the best way to think of the $0.13 add is the accretion caused by the buyback is $0.05, relative to the midpoint. And the other $0.07 is -- there are two offsetting items, the tax going one way and then there were some recall-related expenses going the other way. Those washout, meaning we flush through the P&L certain recall expenses that impacted the revenue line somewhat and operating costs somewhat.

The pickup of the $0.07 is really the strength of the first quarter, so we came out $0.07 stronger in the quarter. We retain that in the guidance numbers you have going forward. We then keep the momentum of that $0.07 pickup in each quarter because we are investing, and we talked about all the startup costs that will happen as we roll out, relaunch Avaira Toric, and roll out (technical difficulty) silicone hydrogel, if you will. And then, have some startup costs with the manufacturing of Biofinity in Puerto Rico.

Any other questions?

Operator

Jeff Johnson.

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

Just two quick ones here. So, Bob, we've danced around gross margin and SG&A here, but just operating margin. Are you still assuming, then, maybe 100, a little north of 100 basis points for the year?

And then, did I hear you correctly? If you're moving some Biofinity manufacturing to Puerto Rico, some of that is even going to be outside of the main Juana Diaz facility, or just why would you be doing that outside of that facility?

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

Let me come back on that one first. We are not moving anything from the UK where we make Biofinity to Puerto Rico. We are expanding in Puerto Rico where they are starting up Biofinity production inside the plant. It's in the same facility. So it's not a new location.

Relative to gross margin and SG&A, the expectation is we will be able to improve operating margins this year in that range of 50 to 100 basis points. At the low end, it is a function of how aggressive we are with expansion in primarily China, and at the high end, it assumes that we're -- we get a little bit more out of leverage. So it's in the 50 to 100 basis points improvement this year. Operator?

Operator

Larry Biegelsen.

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

Thanks for taking the follow-up question. Bob, can you give us a little bit of comfort around some of the startup costs here, the new single daily -- single-use silicone hydrogel lens, Avaira Toric, and the Biofinity line? And I guess, maybe on the single-use silicone hydrogel lens, have you made this lens yet? I guess I'm just trying to understand the risk here that there could be significant startup costs here versus modest startup costs the remainder of the year.

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

On the single-use silicone hydrogel, there are going to be costs. It's not going to be a high gross margin from the get-go. And it's -- I would say the technology we're using to make it is a somewhat unknown commodity.

So, it will be somewhat controlled in that sense, and we're not trying to go aggressively into the market. In fact, I should've been clearer, if I wasn't, that it's a limited launch we are talking about. It's not going to be a global launch. And I didn't get into where and for -- to keep the competition guessing, we are not going to say where.

But the risk of startup costs being well beyond what we expect, I think, is fairly limited and controlled. Some of those other startup costs, there's no doubt -- I think Greg, when he gave his guidance on gross margin, 62.5%, I think, to 63%, kind of tells you we are -- what we expect will happen as we flush that into the P&L over the last three quarters, if you will.

Kim Duncan - *The Cooper Companies, Inc. - Senior Director IR*

(Multiple speakers). Sorry, we're at the top of the hour. We'd like to conclude.

Operator

Go ahead and make your closing remarks, then.

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

With that, I thank everyone for joining us in today's call. Hopefully, you're as pleased as we were with the results of the quarter and the progress we're making towards exploiting our family of products around the world, both gaining market share as well as the successes in women's healthcare. So with that, we'll look forward to talking to you in June.

Operator

Ladies and gentlemen, thank you so much for your participation in today's program. This does conclude the presentation and you may now disconnect. Have a great day.
