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# EDITED TRANSCRIPT

COO - Cooper Companies Inc at Robert W Baird Gobal Healthcare Conference

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SEPTEMBER 06, 2017 / 4:15PM, COO - Cooper Companies Inc at Robert W Baird Goba Healthcare Conference

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

## CONFERENCE CALL PARTICIPANTS

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

## PRESENTATION

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

All right, good afternoon. I think we're going to get started here. I have a few clock issues, so we'll try to stay on time without the board's going here. But -- my name is a Jeff Johnson, I'm the Senior Medical Technology Analyst at Baird and our next presentation this afternoon is from Cooper Companies, specialty medical device manufacturer serving the ophthalmic and Women's Healthcare markets. With us today from Cooper, we're pleased to have Senior Vice President, Chief Financial and Chief Strategic Officer, Al White. Are all those titles still right?

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

A lot of titles.

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

Yes, I know. Cool. A long list to get through here. In the audience, we also have VP of Investor Relations, Kim Duncan. Kim, thanks for being here with us. Al, I'll open with you. If you have a couple of remarks, and then we'll go straight into Q&A.

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

Sure. No, we can jump to the Q&A pretty fast, we just reported earnings last week. So hopefully people are aware of that. Reported another pretty strong quarter. Revenue growth and bottom line earnings and also strong free cash flow. So a number of quarters in a row here, we have some pretty good momentum in the business and hopefully it continues. I can imagine your questions, but I'll let you go ahead and jump in. I mean, why don't we go that route?

## QUESTIONS AND ANSWERS

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

Yes. All right, well anyone in the audience who does have a question, please feel free to raise your hand. We also have e-mail questions. You can send to Session 1, that's session, the number 1, at [rwbaird.com](http://rwbaird.com) either from the room or from the webcast, we can take questions through e-mail as well. First question, I do want to go back to the quarter a little bit, talk about some issues, maybe they came up on the call itself, but more pressing in my mind, just Hurricane Irma, 45% of the revenue generated in your Puerto Rican manufacturing facility, just what are you hearing? I know you kind of opened the Costa Rican facility recently to kind of take some manufacturing risk away from the story, which may in hindsight look like a good move, but what are we thinking on Puerto Rico at this point of the year?



SEPTEMBER 06, 2017 / 4:15PM, COO - Cooper Companies Inc at Robert W Baird Gobar Healthcare Conference

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

Yes. On Puerto Rico, the nice thing for us is that most of those storms pass along the northern part of the island, so it's pretty rare that we actually get any kind of impact to our actual manufacturing plant itself. Now having said that, we obviously have a lot of employees that live on the island that commute and so forth to the plant. So sometimes we'll get impact from that. But it's pretty rare that we get an actual disruption or any real disruption to the manufacturing or the plant. So based on where we are today, kind of knock on wood, fingers crossed, so to speak, it looks like that storm probably is moving along the northern part and then kind of move on and it'll pass and it'll have its normal disruption on our employee base, but it won't impact -- it won't really impact manufacturing at all.

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

Okay. Remind me, you're southwest of San Juan, right?

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

Yes.

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

On the complete other side?

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

On the other side, yes. On the other side of the mountain.

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

Okay. I mean, I know one thing I've read in stories, just obviously some infrastructure issues in Puerto Rico over the past decade of under-investment and that, but I've read that, now they're going to be without power, potentially for months and things like that. I mean, you have I guess, I'm sure, backup plans and a lot of that stuff?

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

Yes. We've had a number of storms, you can imagine, have come through. So we have multiple backup generators, all kinds of systems there and so forth to double, triple, quadruple check to ensure we don't have manufacturing issues.

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

Good. Well, let's start maybe looking at the business, the quarter. I want to start first with the contact lens market in North America, especially here in the U.S., the market has maybe been a bit mixed over the next couple of years. We've gone through periods where it's been growing below 4%, other periods, above 4%. Industry data over the last quarter or 2 seems like it's maybe growing a bit below that, but if I roll up the last 12 months, the last 24 months, we've been at 4%, 4.5% even in the U.S. So I guess just trying to figure out kind of where's your mind at, or where's your head at as far as what's going on in the U.S. market right now?



SEPTEMBER 06, 2017 / 4:15PM, COO - Cooper Companies Inc at Robert W Baird Goba Healthcare Conference

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

Yes. It's a good question, because we talking about the market growing 4% to 6%, kind of global growth, and there's a lot of factors that drive that. And then there's -- always seem to be kind of something that's a little stubborn somewhere, and the Americas have been a little stubborn, if you will, here recently. Now it's hard to look at any individual quarter. On a trailing 12-month basis, we grew 6%, that's a pretty good number for us and that's kind of what we're plugging along. The market was only up 1%, this quarter -- this last quarter, again, 1%. You have J&J, at the end of the day, that's still 40%, 45% of the market here. They still have a very large market share. So it certainly looks like they're doing okay, and when we look to the fit data, we're doing well. It's certainly looks like J&J is also doing well. So it looks like there something else going on, right? That's the feeling. My guess is, is it's more associated with some channel inventory. J&J made some changes where they were distributing product through some distributors in the U.S. market or have been distributing product for quite a while. They were making some changes there where they were going direct a little bit more. So my guess is, is it's more linked to that, because when you look at the fit data and you look at our performance, the market continues to be driven by dailies and daily silicone hydrogels in particular. Those fits are continuing. Our momentum I think, will continue and we had a kind of an anomaly this past quarter. I think we'll bounce back here in Q4 and I think J&J's putting up decent numbers. So I think there's a little something else going on there. That's my best guess.

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

Yes, and when I look at some of the independent industry data that really kind of highlighted that weakness in the Americas. J&J reported the U.S. number, I think they were up 6% in 2Q, you guys just reported 6% Americas growth in your fiscal Q3, quarters don't quite perfectly overlap, but close. I think of that as a what, 20% share in the U.S., something like that, is that about right? So if I roll up 60%, growing 6%, I get 3.5 points of market growth right there, and yet the independent industry data says the market was up 1% this quarter. I just -- I don't want to throw Alcon under the bus, Bausch under the bus, but I also can't believe they're down as much as it would -- you would have to plug into a little spreadsheet just to convince yourself that all of a sudden, the market was only 1%?

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

Yes, I would agree with that. I would definitely agree with that. Those guys aren't big enough, even if they're declining, they're not declining that rapidly in order to make up for that delta. So we've seen this a couple of times in the past, so the market data that we provide, right? And trying to reconcile that, that's on a gross basis, everyone else is reporting net revenue number, so there can be a disconnect of 1 point there or something, but we do get this periodically, where we'll got a quarter or a short time frame where something just looks a little off, looks a little strange, and that's what it kind of feels like right now.

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

Yes, I would agree. And then if I -- one other question on that North American growth, you know you talked about that bouncing back or potentially bouncing back in your fiscal fourth quarter, was there was an anomaly in the third quarter there. The one thing we have seen is promotion and rebate activity has gone up a decent amount over the last year for Alcon, over the last 6 months for J&J, over the last 3 months for you guys. So I guess my question is, how much do think that heightened promotional activity, I think, on MyDay and clariti, went from \$60, \$70 a year, annualized rebate, to \$130 rebate here as of May 1. How much of that impacted the North American number -- the Americas number of up 2% for you, but if you're talking about it bouncing back in fourth quarter, my gut is that can't be the big explanatory factor or you would be so confident in this bounce back in SKU.

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

Yes, you're right. So there is an impact from that. I mean, J&J put out a big rebate. Alcon, I think started out with a \$200 rebate on DT1. We've had the rebate activity, so list prices have been moving up, so that's good news. Offset by that is the increase in rebate activity. Now a lot of that rebate activity is centered on kind of your premium daily silicone hydrogel market. And at the end of the day, I can make an argument that this activity is positive as long as list prices are trending up, because you ultimately remove the rebate activity and you'll get the pricing benefit from that. Having



SEPTEMBER 06, 2017 / 4:15PM, COO - Cooper Companies Inc at Robert W Baird Global Healthcare Conference

said that, for a short term, yes, it's a negative on that. Everybody is kind of in a grab to try to get the premium silicone hydrogel wearer, and get them in their lens. Once you get these wearers in your lenses, you'll have them in -- wearing your lens for, on average, about 7 years. So getting that land grab, getting people is important. That is a negative impact on the overall market, would negatively impact us also, with some of the heightened rebate activity. Having said all that, it's not that big of an influence. It's not that big of a number. It's still kind of a smaller segment of the market, smaller segment of our sales, it doesn't have that big of an impact on the results. You get bigger impact from things like, I mean, it could be as simple as a retailer or a distributor or someone who's ordering product in 1 quarter or they usually order at the end of a quarter, and that gets pushed into the beginning of the next quarter. Activity along those lines will frequently drive up or drive down growth by 1 point or 2 in the quarter.

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

Okay, that's helpful. And then as we think about the Americas market, you know, this rebating activity has gone up, but I think -- I agree with you, you get this long tail of maybe you give them a discount year 1, but then hopefully, years 2 through 7 or whatever, they're locked into these higher price points. They're not going to trade back down to something less convenient. But as I think about kind of the U.S. market, it's been under leveraged to dailies for a number of years. I think the daily market today is what, maybe 45% to pushing almost 50% of the worldwide market? Where are we in the U.S.? And then how much more catch-up do you think we get? Where do you ultimately think dailies, maybe as a percentage of revenue, not necessarily fits, but as percentage of revenue goes in this market over the next few years?

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

Yes, that's a good question. I mean, it's continuing to grow. I mean the growth in the marketplace, whether we're talking about the Americas, where it's definitely true, but the growth throughout the world is driven by dailies. That's why we're seeing growth in the contact lens industry. That whole movement within that daily shift is the shift to daily silicone hydrogel lenses. Now you're really seeing that in the U.S. market because the penetration of dailies is so much lower in the U.S. than it is around the rest of the world. But we're right around 50% from a revenue perspective of global sales of contact lens being dailies continuing to grow. I mean, I don't know where that number goes to. Does it go to 60% or 65%? It could. It's clearly continuing to move in that direction. Our product portfolio is obviously perfectly positioned for that, and there's a lot of numbers you can kind of throw around, it can get a little bit confusing, but at the end of the day, you're talking about, growth is driven by that, growth in the Americas and maybe dailies are in the low 30s, are going to be continuing to grow and moving towards where they are in Europe and where they are in Asia Pac, which is in the 60%, 70% kind of range. So whole market's going to continue to shift there, we probably have, I don't know maybe 5, 6, 7 years, something like that left, and we talk about this shift from traditional hydrogels to daily silicon hydrogels within that segment, same thing. You're probably talking 6, 7, 8 years' worth of growth in front of us. So if you believe as I do that the market is going to continue to grow driven by dailies, and specifically silicone hydrogel dailies, you're going to see that in the Americas, you'll see more of that in Europe and you'll see the largest beneficiary of that being us. That will be with today's portfolio.

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

Yes, and as we're looking for explanatory factors in the U.S., why the growth maybe has been a little more volatile or kind of not as good as we expect the last quarter or 2. Is there any chance people are buying the 90 pack of dailies and now they're set for 1 year or 2, they're just wearing them a few days at a time instead of throwing them away every night? I mean, that's the one risk that's a little hard to account for.

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

Yes. I don't think so. I mean, we've been our work. The most compliant patient out there by a long way is the daily patient. They don't have solutions, so they're putting lenses in, they're throwing them out, next day, they're using a brand-new set. Monthly patients are pretty compliant, beginning of every month, you can toss them, 2-week patients, as you know, are the least compliant. Now it's a fair question to challenge though, as to whether people are buying a year's supply of lenses, I mean, when the economy is good and so forth, usually you'll see a little bit more of that kind of activity



SEPTEMBER 06, 2017 / 4:15PM, COO - Cooper Companies Inc at Robert W Baird Global Healthcare Conference

and people buy a year. Is the economy really good, and people are like "Hey, I'm just going to do 90-days supplies at a time or something" and the amount of inventory out there is kind of depleted a little bit, that's possible. That's possible.

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

Yes, I would agree. All right and outside of Americas then, it's actually Europe and Asia Pac has been really strong, 6%, 7% growth. What do you think is driving the strength outside of the U.S. over the last couple of years? Is it still just the dailies move? Or is there more to it than that.

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

Yes, and the dailies are definitely a factor. Now those markets, especially Asia Pac, has a lot higher penetration of dailies already, but you are getting the conversion there where you're getting daily hydrogels converting over silicone hydrogels in higher price points. In Europe, you're still getting some of that shift, and then there's other factors. You're getting geographic expansion, so as you move into Eastern Europe, and there's obviously China and other countries within Asia Pac that are driving growth. The other thing you see is, there's a much higher penetration towards the multifocals in markets like the Americas and really developed markets. So you're seeing growth in some of the specialty lenses outside of the U.S. in greater degree. So there's a number of factors outside of the U.S. that are driving growth, which is fantastic. And I think that's one of the reasons you're seeing kind that of the stronger, consistent growth around the rest of the world, where the Americas, the wearer population in the Americas is relatively stable. So that's coming from the trade-up. That's coming from the switch to dailies and then the switch to daily silicones. You don't have all the other factors that are helping driving growth.

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

Okay. Fair enough. And then, the 4-ish percent market growth that we've seen over the last couple of years, it sounds like you feel pretty comfortable that's sustainable. You think it's 4% to 5%, 4% to 6%? Can we still get kind of in that 4% to 6% range for the market? And you guys have been growing 1.5x, even 2x the market over the last couple of years. Would you rather have the market growing fixed and you grow 1.25 the market? Or would you rather, the market growing 4% and you grow 2x the market, gets you to about the same number, but I would think a better market probably is good for you.

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

Yes. A better market's good. I mean, I might answer that a little differently and say I would much prefer to grow 9% in a market that's growing 6%, than 8% in a market growing 4%. At the end of the day, a strong market is a good thing. We have that strong market outside of the U.S., it looks like Europe is going to continue to be strong. It looks like Asia Pac is going to continue to be strong. It'd be nice to get a little a bit of better growth here in the Americas. I think when we talk of 4% to 6%, that 4% is a pretty good number, and we've kind of come down to that 4% a couple of times here, but we always kind of hold the 4%. And...

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

For the market?

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

For the market. And we get individual growth, even for the market that will get 5% or 6% in some quarters. I think you can see that. We need that strength in the Americas to come back up. If it does, we'll move back towards 5%, and maybe even get to a 6% on a trailing basis.



SEPTEMBER 06, 2017 / 4:15PM, COO - Cooper Companies Inc at Robert W Baird Goba Healthcare Conference

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

Yes, and you brought up some of the benefits of -- or in Europe and Asia Pac, of driving some toric demand, things like that, but I think the interesting thing in your numbers over the last year or 2, or 1.5 years, has been your toric business has come back to some strong double-digit growth. And when I think, maybe at the start of this year, turn of the year, I was a little worried, yet Bausch was just launching, what, ULTRA toric and Biotrue toric, I think. J&J, I think was just coming out with, it wasn't Beta toric, right? It was the 1-Day. It was the OASYS 1-Day toric, I think, was it?

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

Yes.

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

Yes, so. You've had some competition out there in the last quarter or 2, and yet you just put a double-digit growth on top of the double-digit comp in toric in that. I mean, what's the sustainability of your toric business, do you think, going forward?

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

Yes. I think that's definitely true for torics, also true for multifocals, where there's been some heightened competition out there. But when it comes to torics, we have some great lenses, some great lens designs. Biofinity, we don't spend enough time talking about Biofinity, our monthly lenses, it's a fantastic product, it's doing really well all around the world, and Biofinity toric is growing nicely, it's a subsegment of the Biofinity family. Also MyDay toric. MyDay toric, which we launched in Japan, and we're now rolling throughout Europe, is being received really well. Part of that is because that toric design from MyDay is the same as the Biofinity toric design. So docs are receiving that very well. It's a great-fitting lens, it's a very comfortable lens. So between products like Biofinity toric, clariti toric, which is a really nice product that's doing well at a great price point, and MyDay toric now, and rolling out throughout the rest of the world and it'll be coming to the Americas at some point, our toric franchise is pretty strong. And we have a very large market share there, probably #1 player in the global market in torics, but continuing to put up strong numbers and focused on that. So it's product set driven. It's nice to have some of the best products in the market.

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

Remind me of the opportunity in Japan. I mean, that market historically for astigmats, for those with astigmatism, was a hard contact lens market. Obviously, we're going to soft, you need a toric lens for soft. It's also a high-end silicone market, were MyDay is well-positioned. So is that kind of a key Japanese driver, you think, over the intermediate term?

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

Yes. That's always been one of the markets that's been hard to crack from that perspective. And you're exactly right, the RGPs that are out there and so forth, that have compressed the cornea has kind of done the job. But that market is shifting. It's clearly shifting, and the fact that there's premium daily silicones there, and that people are willing to pay the amount of money that needs to be paid to get those premium products, and especially a premium toric is fantastic. So we are definitely seeing growth there that's nice to have, arguably, the best daily toric in the marketplace there right now. So we'll see how that plays out. I try to kind of always temper my enthusiasm there, because that could be a large market that can be really exciting. We'll see how it plays out, but early signs are pretty positive.

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

Yes, and as toric growth has accelerated the last couple of years, multifocals have bounced back. CVI gross margin over the last 2 quarters, back above 65%, I think that's the first time since the Sauflon deal you got back above 65%. FX is obviously has been a nice contributor there, just with

SEPTEMBER 06, 2017 / 4:15PM, COO - Cooper Companies Inc at Robert W Baird Gobal Healthcare Conference

some of the pound issues from last summer, but you're calling now for CVI gross margin of 66%, I think is what you talked about last week on your call, was just in fiscal Q4. But is there anything that prevents us from staying in that 65%, 66% or even an upward trajectory from that on the CVI side over the next year or 2?

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

Yes, well. I mean, a couple of comments: one, CooperVision's gross margin should be stronger, certainly here in Q4. We had a strong Q3. We came back a little bit in Q4 -- I'm sorry -- strong, really strong Q2, came back a little in Q3. A lot of that was tied to inventory turn and manufacturing variances that were -- that resulted in higher cost inventory coming through the P&L in Q3. We have that visibility in Q4. I think you can see consolidated gross margins at 66% or higher -- even a little higher than that in Q4, and obviously that's going to mean even higher for CooperVision as they pull up the overall companies, or as CooperSurgical's lower, so CooperVision's higher to get to that number. Yes, I think when we move forward right now, and we look at next fiscal year, we should see gross margin improvements on a year-over-year basis. The factors that drive that or we get a full year worth of the currency benefit, especially Q1 where we didn't have the full benefit this year, our product mix shift, which means more product, more Biofinity being sold, some of the specialty lenses, more clariti, that's all a positive mix shift for us. And then the other things is the manufacturing variances themselves. As we drive more volumes through the plant, we utilize our equipment better, we have less idle equipment or downtime equipment and so forth, that's going to result in lower cost inventory and lower cost manufacturing product rolling through the P&L. So I would expect right now that yes, fiscal '18 gross margins for both Vision and Surgical would be higher on a year-over-year basis.

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

Okay. Any questions from the industry -- or from the audience, I'm sorry? So then, let's look at the OpEx side. So gross margins continue to move up. Obviously we've all -- talked in many notes in the past, we won't go into now, but some of them might -- what (inaudible)

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

Avaira.

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

Vitality, right?

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

Yes. Vitality. Avaira Vitality. Yes.

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

Some of the margin benefits on Vitality, some of the margin benefits on the torics and multifocals, we've walked through all that before, I think there's truly a big gross margin story here. One of the surprises maybe on last week's call was some of the OpEx investing you're going to be doing then over the next year or so. Sounds like maybe about \$12 million annualized run rate on the distribution center expansion, is that kind of a number to be thinking of? And then what -- let's start with what advantages these investments or what drove the need for some of these investments on the distribution side.





SEPTEMBER 06, 2017 / 4:15PM, COO - Cooper Companies Inc at Robert W Baird Goba Healthcare Conference

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

Yes. So you're exactly right. And we've been putting dollars in the distribution. We're growing the business nicely, we have been for many years. We forecast great growth for many, many years in front of us, so we want to be in front of that from a distribution perspective and you've heard and other people have heard, where we've had a few distribution snafus, and a lot of that was tied to integration activity that's completely behind us, but we need to make sure we're in front of that. We need to make sure we're on top of all our distribution activity. Our manufacturing is going great, our product portfolio is great. Our new fit data is looking strong. So we need to make sure that we can get product shipped out there, and that includes working with retailers out there and how they want products shipped. It used to be a little easier to get a pallet of lenses and ship them to somebody's warehouse and let them do the work. Then it gets a little bit more difficult when they want to shift to multiple warehouses, and then you get it to the next level, where you're shipping to multiple warehouses and stores. And then ultimately, you're taking it to the next level, which is shipping it to individual patients. And you see more of that activity in Europe probably than you do anywhere else. But anytime you're cutting that down, and cutting down your order quantities, so that you're getting more and more shipments out there, it's more complex. So combining the demand, greater demand rolling through, more shipments going out the door creates a more complex environment. Now that can be a positive, that can be a negative. It can be a competitive advantage, which is where we wanted to be, which is get in front of that, right? There's a lot of companies who have changed the world. And you look at Amazon and some of these other companies, we want to be in the forefront of that distribution, to be able to provide our customers out there, our retailers and so forth, the maximum amount of shipping. Now we'll do that in exchange for maybe it's longer-term contracts, maybe it's volume increases, a variety of different things that's going to allow us to manufacture more product and drive cost per unit than the cover that kind of stuff. But we want to be in the forefront of that. And keep in mind, when you're doing a new distribution center, like we're looking at 1 or 2 new distribution centers, that's easy. And we'll put a new system in place, the latest and greatest racking and packaging and everything else. I'm going to put in a new IT platform in price. It's different when you have distribution centers that are large and running and you're kind of trying to change the tire on the car while the car is driving, all right. You need to make sure you do a good job on that. You can't screw anything up, all right? You're going to end up with some duplicative cost and so forth. You work through that process to make sure you're on the forefront of everything. So that's where we are. Now, it's not always easy to do that. We've had currency as a negative for a number of years. It's flipped, currency is a tailwind right now, it's a positive, right? And it's a pretty decent positive, as a matter of fact. So we are taking some of those dollars and we're looking at reinvesting those and trying to get not -- we are up-to-date, but beyond up-to-date, trying to get in front of that stuff so it's a competitive advantage for us.

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

And the one thing I conceptually struggled with last week, and you and I have talked it out, I think I feel better on, but you invest that \$12 million, but you also had, in '17, in the current fiscal year, \$5 million a quarter or so, I think the number was of idle equipment cost that should've been coming off. You do have the currency tailwinds next year. Why don't the idle equipment costs that are coming out of the model more than offset these distribution center investments? It seems like to me there could be a really nice operating margin story, not just gross margin story, next year. And yet, that seemed like that it got talked down a little bit last week. And then maybe that's just conservatism, but it seems like there's as much coming out of the model as going in.

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

Yes, you're right. We did have some -- last year and then in the beginning of this year, Q1, and even into Q2, here we add some heightened above-normal charges running through cost of goods associated with idle equipment and inventory write-offs, some of that kind of stuff. We do hurdle that. So yes, if it came across -- it should not have come across any other way, I guess, the neat thing, "hey, I'm comfortable at 10% to 12% EPS growth next year." Does that mean that we're going to do that? Not necessarily. Can we do better than that? Yes, we have a lot of positives. We'll see where currency comes out. We do, we give our annual guidance in December, we'll see where currency comes out at that point. I mean, I'd be more optimistic obviously if the euro holds at \$1.19, or where it's at right now, that's for sure.



SEPTEMBER 06, 2017 / 4:15PM, COO - Cooper Companies Inc at Robert W Baird Goba Healthcare Conference

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

Yes, all right. And then back to the some of the distribution stuff, just for a second. So as you start holding more inventory, I mean, what I hear there is working capital going way up, and yet it seems like you're talking about free cash flow this year, I think, my model close to \$450 million of strong, strong growth year-over-year in free cash flow. And even with these investments and even with maybe holding some more inventory, you think free cash flow can still go up next year, year-over-year?

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

Yes, I do. We'll see, I mean, some of free cash flow is a component of CapEx, and when you actually write the check itself, it's a negative, right? So it depends what we'll do in Q4 versus Q1. But we're going to be well north of \$400 million this year in free cash flow and we should, because of growth in operating cash flow, be up next year, free cash flow wise, year-over-year even with incremental CapEx investment.

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

Yes. And outside of CapEx, so should we see the working capital or inventory going up as well as you expend these centers and maybe hold some of that inventory for the retailers?

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

Ideally, no. A big part of the strategy here is to say that we can get way more efficient in terms of our distribution network. Not just adding inventory in there, but becoming more, more efficient with the processing of that and so forth. So I think from an inventory dollar perspective, yes, it probably goes up, because our revenues are going up. But in terms of inventory turns and so forth, the receivables, payables, working capital, I'm not sure there's much of a negative there.

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

Okay. But -- last question, I guess, on that topic. As you've have really good success over the last maybe 5 years-plus going into some of these retailers, then either flipping some accounts or being able to just become the preferred provider in some of these big retailers from that. By direct drop shipping to patients and things like that, is that something these retailers are looking for? I mean, we seen these Hubble models going out and things like that, not that you're trying to compete with a small little company like Hubble, but does this at this give you some retail advantage as you go out there?

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

Yes, it does. I mean, being able to ship directly to customers and so forth is advantageous. I mean, you look at that, we see that a lot more around the rest of the world. We haven't really seen it here in the U.S., and Hubble came up, right, because the direct to consumer. I mean, Hubble's a different story. They're selling a really old hydrogel lens at frankly, kind of a higher price point, than equivalent products around that you can buy, including ours, at places like Walmart and a number of other establishments. But what is important is that distribution channel, which is the direct-to-shipment channel of that. So if you're a Walmart or a Costco or you're some of these retailers, I mean, from your perspective, you want the patient to come in, you want to fit the patient and then you want the patient to buy the lenses and walk away happy. Well in an ideal world, the manufacturer in this case, us, is shipping that product directly from the person's home and paying, and ideally they're paying on a Walmart credit card or whatever, right? And you're kind of linking all that stuff up. So that is a competitive advantage, right? And we want to stay in front of our competitors on that. We have J&J, Alcon and Bausch, and we feel like that's something we need to do.

SEPTEMBER 06, 2017 / 4:15PM, COO - Cooper Companies Inc at Robert W Baird Global Healthcare Conference

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

Okay. Last 2 minutes here. We'll spend one of those minutes on Women's Healthcare. On that business, connect it back to mid-single-digit growth. It's obviously struggled with some integration and basically going direct in some markets that have costs and transition issues. Gross margins finally starting to go up, do we start to see -- it sounds like there could be a gross margin story there over the next year as well.

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

Yes. So CooperSurgical came in a little soft, 4% organic growth this quarter, a little bit less than we were hoping for. Having said that, as reported, growth was 13%, operating profits were up 20% year-over-year. So we did have some good positives there from integration activity, some price increases and so forth, so did some of that offset potential top line growth? Maybe. I do think that the integration activity is rapidly getting behind us there for the stuff that's causing problems, which is some of the distribution-related items and you're going to see some bounce back on that business in Q4. And I think the same thing on gross margins, which is, we need to get all that back-office stuff around the world that we have integrated and humming to a much better tune that it is today. And we'll do that. We'll continue to see those advancements. We should see them as we move forward here, so we should have CooperSurgical posting a better year-over-year gross margin in Q4, kind of like they did in Q3 and I'd like to think some upside on that certainly as we move into next year.

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

Okay. And then all of the free cash flow we've been talking about, just the prioritization for use of that, and I'm kind of hoping here you don't say generic drugs in Women's Healthcare, but we'll leave that alone for a second.

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

I mean, no change for us. I mean, we generate a lot of cash, we're forecasting a lot of cash. We put that cash back into the business, first and foremost, into the businesses that we have. We do look at acquisitions, we've done a number in Vision, a number in Surgical, we want and we look for strategic acquisitions, deals that make logical sense like what you've seen from us over the years, and deals that offer a good return. And then we also look at share buybacks. So periodically, we'll reach in and buy shares back, and I would envision we'll continue to do all those things moving forward.

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

And generic pharma risk is bad for multiple?

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

I'm not going to comment on any of that.

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

Fair enough. All right, I think that's all the time that we have. So please thank, or join me in thanking AI for a wonderful overview here of Cooper Companies. And as a reminder, the next up presentation is set to begin at 12:50 p.m., include MEDNAX in this room, (inaudible) sciences in Empire Ballroom A, R1 RCM in Empire Ballroom B, and PerfectServe in Morgan Suite. Thank you.



SEPTEMBER 06, 2017 / 4:15PM, COO - Cooper Companies Inc at Robert W Baird Gobar Healthcare Conference

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