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EDITED TRANSCRIPT

COO - Q3 2015 Cooper Companies Inc Earnings Call

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OVERVIEW:

COO reported 3Q15 consolidated revenues of $462m, GAAP EPS of $0.91 and non-GAAP EPS of $1.97. Expects FY15 revenues to be $1.808-1.825b and non-GAAP EPS to be $7.51-7.61. Expects 4Q15 revenues to be $467-484m and non-GAAP EPS to be $2.07-2.17.

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Cooper Companies, Inc. Q3 2015 earnings conference call. (Operator Instructions)

As a reminder, this conference is being recorded. I would now like to introduce you host for today's conference, Kim Duncan, Vice President of Investor relations. Ma'am, you may begin.

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

Good afternoon. And welcome to The Cooper Companies' third-quarter 2015 earnings conference call. I am Kim Duncan, Vice President of Investor Relations. And joining me on today's call are Bob Weiss, Chief Executive Officer; Greg Matz, Chief Financial Officer; and Al White, Chief Strategy Officer.

Before we get started I would 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 or regulatory conditions, and integration of any acquisitions or their failure to achieve anticipated benefits. Forward-looking statements depend on assumptions, data or methods that may be incorrect or imprecise and are subject to risks and uncertainties.

Events that could cause our actual results and future actions of the Company to differ materially from those described in 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.

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 the third-quarter financial results. We will keep the formal presentation to roughly 30 minutes and 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 email 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 will turn the call over to Bob for his opening remarks.

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

Thank you, Kim. Good afternoon, everyone. Welcome to third-quarter conference call. Let me start by highlighting three key points.

First, we had another strong quarter in CooperVision and gained significant market share. For calendar Q2, we grew 9% against the market at 4%. Our market share gains were across the board including single-use and non-single-use lenses and in every geography -- the Americas EMEA, and Asia-Pacific. Our momentum is very strong and we expect this to continue.

Second, the rollout of our daily silicone hydrogel family of products, comprising clariti and MyDay, continue to do well. Sales this quarter were $39 million and pro forma was 51%. clariti continues to do well as a mass market offering and MyDay is looking good as a premium offering.

The only negatives we were seeing are a lack of pipeline fill and general sluggishness in the Americas market, which only grew 1% last calendar quarter, the slowest the Americas has grown in six years. This is leading us to be more conservative about our fourth-quarter estimates so we're now forecasting daily silicone sales of $52 million to $57 million in the fourth quarter or $150 million to $155 million for the your. From a timing perspective, July was a good month and August was a good start to Q4.

Third, CooperSurgical posted another tough quarter, down 4% in constant currency. Even with challenges I still believe strongly in the global women's healthcare market and its long-term potential. As such, I have decided to increase our focus on women's healthcare by having Al White assume management of the business in addition to his current corporate responsibilities.

Without direct involvement our recent acquisition of Reprogenetics and the launch of several new products, I see a much bright FY16 for CooperSurgical. With Al's Change, Dan McBride will remain in his role running CooperVision while assuming additional responsibilities, including CooperVision's business development and more involvement in our corporate activities, including Investor Relations. I believe these changes will strengthen our organization and help us achieve our long-term objectives. I will expand on these takeaways as I walk through the quarter's performance but I want to confirm we remain very optimistic about the underlying fundamentals of our business and believe we are well positioned to deliver solid results going forward.

On a consolidated basis, Q3 revenue grew 7% year over year to $462 million and non-GAAP earnings per share of $1.97. Regarding earnings, we were hurt by currency, both within operations and below the line, but our tax rate came in better than we expected so overall for the quarter met our expectations. CooperVision posted revenues of $386 million, up 10% year over year with pro forma growth of 7%, or 8% excluding solutions.

We had a strong quarter in Asia-Pacific and EMEA but the Americas were softer than we would have liked. I agree with some who have said recently that the market is being negatively impacted by channel inventory contraction and UPP, or unilateral pricing policy. This is in spite of New Fit data which continues to be solid.

For CooperVision we did not really see any channel inventory contraction but we did not experience any expansion either, even with the success of our clariti product. Overall this feels like an anomaly and we should see the market in CooperVision return to better growth supported by a shift to daily silicone hydrogel lenses in the near future.

Looking at silicones, our silicone hydrogel family of products delivered strong growth this quarter, up 17% pro forma to $215 million. In addition to strong daily growth our monthly Biofinity family grew 12% and our two-week Avaira family grew 11%, both pro forma. We remain under-indexed against the market in both the two-week and monthly silicone space, and silicones represent roughly 77% of the market, and for us, 70%. We anticipate growing our two-week and monthly silicones nicely for many years.

Regarding one-day silicone hydrogels, sales of clariti and MyDay combined for $39 million, equating to pro forma growth of slightly over 50% for each. Growth was driven by our strong product portfolio which includes the two-tiered approach to the daily silicone market, with clariti positioned as our mass market offering and MyDay as our premium offering. Remember, the contact lens market is being driven by dailies growth, and we strongly believe we have the best product offering in the space as the only company with premium and mass market lenses, including a full portfolio of sphere, toric and multifocal lenses.

Regarding clariti, we made great progress on our manufacturing buildout and are in excellent shape to meet demand to the end of the fiscal year and into next. From a launch perspective, we are in good shape in Europe and that business continues to grow nicely. In the United States we have made significant progress distributing fitting sets, and we are now aggressively selling product as opposed to dealing with the administrative task of getting fitting sets out to the doctors.

Regarding MyDay, sales are still ramping in Europe and we have begun selling lenses in the US with very positive early feedback. Similar to Europe, our US launch is on a branded and private-label basis. Regarding capacity we're continuing to sell everything we can make and we are bringing on additional lines to help meet the demand. As anticipated, MyDay is fitting perfectly into the high-end segment of the daily silicone market in Europe and the US.

Our specialty business remains strong this quarter with torics up 7% and multifocals up 12%, both on a pro forma basis. We are the global market leader in specialty lenses and we are taking market share.

Regarding Proclear, sales of this hydrogel product line were down 1% pro forma, driven by softness in our non-daily Proclear product lines. On a regional basis the Americas were up 4% pro forma, led by Biofinity and clariti. Clariti was still very small in Q3 but we anticipate our US growth will accelerate as we roll out progressives.

Europe posted a solid quarter, up 9% pro forma. I continue to be impressed by that team as they're posting strong results while completing the Sauflon integration activity. Meanwhile, Asia-Pacific was up 12% pro forma with strong growth in a number of markets.

On Sauflon integration activity we integrated several Sauflon distribution centers this past quarter and we are in good shape to finish all integration activity impacting operating expenses shortly. Regarding manufacturing activity, which includes startup costs for our new Costa Rica and UK facilities, and the right-sizing of certain manufacturing activity due to Sauflon, we anticipate finalizing remaining decisions shortly.

From an accounting perspective we expect to incur certain charges associated with this work throughout FY16 and we'll highlight these items as they occur. It is worth noting there is nothing unexpected, just work that needs to be completed as we incorporate the manufacturing benefits where we see them from the Sauflon acquisition.

Additionally on manufacturing, remember that the clariti lines cost one-third our equivalent lines, they are received in one-half the time, and they have better flexibility around shifting production from one product to another. A large reason for this is the material formulation which provides the ability to produce silicone lenses without alcohol.

We will be incorporating these advantages into our manufacturing processes over time and it will reduce CapEx while also yielding a lower cost per unit. We have also been successful in incorporating CooperVision's high volume manufacturing expertise into Sauflon's manufacturing base. I believe this will result in CooperVision's gross margins, strengthening in the back half of next year as the manufacturing positives work their way through the P&L. In particular I believe we will see clariti's gross margin be accretive to the Company's gross margins as we exit 2016.

Now let me comment on the overall contact lens market in the calendar second quarter. Overall, the market was up 4% and CooperVision was up 9%. Asia-Pacific was up 11% while CooperVision was up 16%. The Americas grew 1%, with CooperVision up 8%, and in EMEA the market grew 2% and we grew 8%.

If we look at the market on a modality basis the single-use market continued to drive growth up 13% while we grew 16%. Non-single-use lenses declined 2% while we grew 6%. As you can tell, our growth was strong and we continue taking market share in all regions of the world and in all modalities with our strong product portfolio.

In general, when I look at the market I expect it to grow 4% to 6% going forward. Having said that, the Americas has been a drag. As I mentioned earlier, there have been some commentary about channel inventory and the impact of UPP and I'm not going to disagree with that. In spite of that, CooperVision numbers have been strong but I'm sure there is some negative impact from the market softness.

Regarding UPP, as many of you are aware there is a lot of legal activity around UPP so hopefully that gets resolved shortly and we get back to business as usual. Overall the market should be fairly stable going forward with dailies continuing to be the growth driver. Needless to say, I believe we will continue taking market share for the foreseeable future, led by Biofinity and our strong daily portfolio.

Moving to CooperSurgical, this was a challenging quarter. On the fertility side we continue making progress by growing disposable products and rationalizing lower-margin capital equipment sales. Roughly two-thirds of that business is outside the US so currency clearly impacted results, with fertility down 11% but up 1% in constant currency.

Meanwhile, our office and surgical business was down 6%. As we discussed on our last earnings call, the slowdown in certain procedures and patient activity due to noise associated with mesh slings and morcellation is hurting the overall marketplace. We're not directly involved in these areas but this is impacting patient visits and surgical activity, thus impacting several of our products.

Based on this, I believe another challenging quarter in Q4 but I do believe this is a temporary matter. When you look at our current product launches, including the EndoSee hysteroscope we acquired last year, our acquisition of Reprogenetics and now Al's direct involvement, I'm optimistic 2016 will be a much better year for CooperSurgical.

Let me touch on guidance. Our expectations for the fiscal fourth quarter are for consolidated sales of $467 million to $484 million, including $385 million to $400 million for CooperVision, representing a 9% to 13% pro forma growth and an $82 million to $84 million for CooperSurgical, which includes $5 million from a recent acquisition of Reprogenetics.

We're forecasting a strengthening in gross margins to around 64%. And this supports non-GAAP earnings per share of $2.07 to $2.17. Greg we'll go through the details but let me say our full-year constant currency non-GAAP guidance is 27% to 29% growth, which is very strong.

Given we're still working through budgets and there's significant currency volatility, we won't be providing detailed FY16 guidance until our December earnings call. The only direction we will give is that we are targeting non-GAAP earnings-per-share growth in the low to mid teens for next year. From a longer-term perspective, we are targeting operating margins over 26% in 2018.

Regarding strategy, we are continuing our successful strategy, which I've frequently articulated in the past. This includes investing in our businesses to take market share by expanding geographically, aggressively rolling out products, and investing in emerging markets. We do all this while remaining keenly focused on delivering solid earnings per share and cash flow, and we remain focused on delivering strong shareholder returns.

In summary, before I turn it over to Greg, let me say the remainder of the year should be solid and 2016 should be a really good year for us. Our profit margins are solid, our cash flow generation is strong, and I remain bullish on the future.

With that, let me express my appreciation to our employees, our number one asset. Their hard work and dedication to creating value is the backbone of our success.

And now I will turn it over to Greg to cover the financial results.

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

Thanks, Bob. And good afternoon, everyone. Bob provided an overall summary of our performance including a review of the market and our revenue picture, so let me start with gross margins.

Looking at gross margins, in Q3 the consolidated GAAP and non-GAAP gross margins were 59.1% and 62.4%, respectively, compared with 64.9% for GAAP and 65% non-GAAP in the prior year. The primary difference between GAAP and non-GAAP is related to product equipment rationalization due to the Sauflon acquisition and facility startup costs directly attributable to our two new manufacturing facilities located in Costa Rica and the UK. Both of these facilities will be initially dedicated to our expansion of the [Davis] silicone manufacturing. The year-over-year decline in non-GAAP gross margins was driven by a significant negative FX impact to revenues, slightly offset by some favorable FX impact to cost of goods sold and product mix led by Biofinity.

CooperVision on a GAAP and a non-GAAP basis reported gross margins of 57.9% and 61.8%, respectively, versus 64.8% for GAAP and non-GAAP in Q3 of last year. The difference between GAAP and non-GAAP is largely related to product and equipment rationalization from the Sauflon acquisition and the facility startup costs mentioned earlier. The year-over-year decline in non-GAAP gross margin was due primarily to FX, partially offset by product mix led by Biofinity.

CooperSurgical had a GAAP and non-GAAP gross margins of 65.2% and 65.4%, respectively, which compares to Q3 2014 of 65.3% and 65.8% GAAP and non-GAAP, respectively. The difference between GAAP and non-GAAP relates to approximately $160,000 of restructuring costs, the year-over-year decline of non-GAAP margin is mainly due to product mix.

Now looking at operating expenses, SG&A, on a GAAP basis SG&A expenses increased by 19% from the prior year to $191.8 million or approximately 42% of revenue, up from 37% in the prior year. On a non-GAAP basis SG&A increased approximately 6% to $165.7 million or 36% of revenue, in line with the prior year. The difference between GAAP and non-GAAP was comprised of a $17 million legal settlement with J&J and $9.1 million in charges largely related to integration and restructuring costs for the Sauflon acquisition.

Now looking at R&D, in Q3 R&D on a GAAP and a non-GAAP basis was $18.3 million and $16.4 million, respectively. The main difference between GAAP and non-GAAP was related to assets written off related to the Sauflon acquisition. On a non-GAAP basis R&D was 3.5% of revenue, down from 3.7% in the prior year.

Looking at depreciation and amortization, in Q3, depreciation was $41.4 million, up $15.7 million year over year, which includes $10.8 million of accelerated depreciation related to the Sauflon acquisition not included in our non-GAAP numbers. And amortization was $12.5 million, up approximately $5.7 million primarily due again to the Sauflon acquisition.

Moving to operating margins, for Q3 consolidated GAAP operating income and margin were $50.3 million and 10.9% of revenue versus $96.6 million and 22.3% of revenue in Q3 last year. This drop was primarily due to integration related costs and increased amortization from the Sauflon acquisition, manufacturing facility startup costs, the J&J legal settlement, as well as the negative impact of currency.

Non-GAAP operating income and margin were $106.1 million and 23% of revenue versus $108.5 million and 25.1% of revenue for the prior year. The reduction in operating income and margin were driven by the reduction in gross margin largely from the impact of currency on the top line.

In Q3, CooperVision had GAAP operating income and margin of $46.4 million and 12% of revenue versus the prior year Q3 of $88.4 million and 25.3% of revenue. On a non-GAAP basis operating income and margin were $97.7 million and 25.3% of revenue versus $97 million and 27.7% of revenue in the prior year.

CooperSurgical had GAAP operating income and margin of $15 million and 9.7% of revenue versus the prior year of $18.4 million and 22.3% of revenue. Non-GAAP operating income and margin were $19.5 million and 25.6% of revenue versus Q3 2014 of $22.4 million and operating income of 27.1% of revenue. The primary reason for the year-over-year decline in operating income is due to the reduction in revenue.

Looking at interest expense, the interest expense was $4.7 million for the quarter, up $3.2 million year over year primarily due to the acquisition of Sauflon and higher interest rates on our bank pricing grid. Included in Q3 2015 in the other expense category is approximately $1.8 million of FX losses. These FX losses for the quarter were associated with our inter-Company loans, some of which are in restricted currencies which are difficult and expensive to hedge.

Now looking at the effective tax rate, in Q3 the GAAP and non-GAAP effective tax rates were a negative 1.4% and a positive 3.1%, respectively, versus Q3 2014 GAAP effective tax rate of 6.1% and non-GAAP effective tax rate of 7.3%. As we've mentioned before, the effective tax rate continues to be below the US statutory rate as the majority of our income is earned in foreign jurisdictions with lower tax rates.

The current quarter reduction in the ETR is largely due to the higher dollar amount of Q3 discrete items related to the prior years but which were reversed this quarter. With respect to Sauflon we have made significant progress incorporating them into our global trade arrangement. We anticipate being substantially complete by the end of the fiscal year.

Looking at earnings per share, our Q3 earnings per share on a GAAP and non-GAAP basis was $0.91 and $1.97, respectively, versus $1.80 and $2 for GAAP and non-GAAP in the prior year. Net currency impact on earnings per share year over year for Q3 was unfavorable by $0.54. Due to differences in rates and mix from our Q2 earnings call, Q3 was negatively impacted by an additional $0.06, of which $0.03 is on the inter-Company balance, as I mentioned earlier, which is in the other expense line.

One thing to point out is that we always highlight the euro, the yen and pounds, which may at times overshadow the FX pressure that comes from many other currencies that influence our results. As an example, when we look at the changes in rates from our June guidance to now, we see negative movements in most of our other currencies, like the Aussie dollar down 10% and the ruble down 18%.

Looking at balance sheet and liquidity, in Q3 we had cash provided by operations of $96 million less capital expenditures of $66.4 million, resulting in $29.6 million of free cash flow. Excluding integration costs of $12.9 million and litigation settlement costs of $17 million, adjusted free cash flow was $59.5 million.

Total debt decreased within the quarter by $39.8 million to $1.308 billion. Inventories increased approximately $3.5 million to $406 million from last quarter due to an increase in daily lenses. For the quarter, we're seeing months on hand at 6.5 months, 7 months on hand adjusted for inventory and equipment rationalization charges and facility startup costs, consistent with 7 months last year and down from 7.6 adjusted months on hand last quarter. Day sale outstanding is at 55 days which is down from 56 days in the prior quarter and up from 53 days last year.

We've mentioned the J&J legal settlement today so Let me provide a little context. In July, CooperVision made a one-time lump sum payment to J&J of $17 million to settle their existing patent disputes and agree on a combination of cross licenses and reciprocal covenants not to sue on current core products including all silicone hydrogel lenses. This settlement was worldwide in scope with no royalty obligation for either party. Neither party admitted any liability as part of the settlement.

Turning to guidance, in order to provide a little more color for your models I will share some additional specifics on our Q4 and FY15 non-GAAP guidance. For clariti I will start with Q4 guidance and then share what that will look like on a full-year basis. Regarding foreign exchange, the rates for our main currencies we're using are 1.12 for the euro, 121 for the yen and 1.54 for the pound. We are expecting an additional unfavorable $0.02 impact in Q4 to EPS. The negative FX impact to EPS for the year is now forecasted to be $1.76 and the impact to revenue is expected to be $154 million.

For the fourth quarter the revenue range for the Company is $467 million to $484 million, or 10% constant currency growth at the mid point. CooperVision's revenue range is $385 million to $400 million, 11% constant currency growth at the mid point. CSI's revenue range is $82 million to $84 million, 4% constant currency growth at the mid point, which includes $5 million of revenue from Reprogenetics.

We expect non-GAAP gross margin to be around 64% for the quarter. OpEx is expected to be around 39%. Operating margin is expected to be around 25%. Interest expense expected to be around $5 million.

Our Q4 effective tax rate is expected to be between 7% and 8%. Our expected share count will be around 49.2 million shares. And our non-GAAP EPS is expected to be in the range of $2.07 to $2.17, or a growth of 22% to 27% on a constant currency basis.

Looking at the full-year, the revenue range for the Company is $1.808 billion to $1.825 billion or 6% pro forma growth at the mid point. CooperVision's revenue range is $1.499 billion to $1.514 billion, 7.5% pro form a growth at the midpoint. CSI's revenue range is $309 million to $311 million, down 1% in constant currency at the mid point.

We expect non-GAAP gross margin to be around 63.5% for the year. OpEx is expected to be around 40%. Operating margin is expected to be around 23%. Interest expense is expected to be around $18 million.

Our effective tax rate is expected to be around 7.5%. Our share count is expected to be roughly 49.2 million shares for the year. And our non-GAAP EPS is now expected to be in the range of $7.51 to $7.61, or 27% to 29% constant currency growth. Finally, we expect both capital expenditures and adjusted free cash flow for the year to be north of $200 million.

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

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

Operator, we're ready to take some questions.

QUESTIONS AND ANSWERS

Operator

(Operator instructions)

Larry Keusch, Raymond James.

Larry Keusch - *Raymond James & Associates, Inc. - Analyst*

Thanks very much. Bob, I was wondering if you could, again, help us understand really what changed with the initial outlook for $175 million in single-use silicone hydrogel sales to the new range of $150 million to $155 million.

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

Yes, Larry. I think the biggest change is clearly the US ramp-up and the fact that when we look at the growth, how we're doing with clariti and with MyDay, this last quarter, that is up over 50%. So, we're putting up robust numbers. Since so much of the ramp-up relied on a more robust US market, the US market is clearly the soft spot. More so in what is going out the door from manufacturer to the supply line than it is on eye.

When we look at the on-eye data, there is a good market, a healthy market. When we look at the pipeline -- in this case it is the efficiency of the authorized distributors -- that is actually flat in a market that is, for us, growing quite robustly.

That disconnect of the fact that we are not, and we had anticipated building up a pipeline, as you mentioned. As you may recall, in the last call I mentioned that we expected a pretty robust expansion of the pipeline for Cooper given our new product rollouts. We don't see that right now so

I will emphasize it is heavily the US and heavily the pipeline. And, quite frankly, we are happy with the growth of this product portfolio. It is performing well.

Operator

Thank you. Matt O'Brien, Piper Jaffray.

Unidentified Participant - - *Analyst*

Good afternoon, everyone. This is actually JP in for Matt. Thanks for taking the questions. I want to touch on -- you gave a little color on 2016 EPS guidance. And just given the demand profile you gave for Q4 this year, can you talk about what gives you the confidence that maybe the demand in the US will come back to meet those numbers?

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

We are anticipating that 2016 will be a more robust US market manufacturer out the door. I think we're all keenly aware of the numbers that Alcon put up and J&J put up as far as their public reporting. But the deal link, as I mentioned, is not so much is the market good on eye, not so much is the market great in terms of the conversion from a two-week modality to a one-day modality. That's all going very nicely.

There's only so much more efficiency authorized distributors the middlemen can get. There's no logical reason, given the fact that we had a very shrunken pipeline a year ago for Cooper in October a year ago, it contracted down to a very efficient level. With new product rollouts you expect that to grow. And, so, we are confident that there will be, to some degree, a bounce as we roll out new products, getting product into the distributor to see the demand in the marketplace.

So, we're not at all toning down our expectation for the market pull through growth. If anything, some of the moves by one of our competitors that are moving from a two-week into a one-day silicone hydrogel modality with another product will only add to that shift from the two-week modality, which doesn't pay a lot of money.

If we think about the market is $2.6 billion at the manufacturers level in the US, you've got, let's say, 35 million soft contact lens wearers, carving out the hard, that's not generating a lot of revenue. So, they're only generating on average $75 a patient. That shift to the one-day modality as it continues to accelerate is still a 400% to 600% shift. And the two-week wearer still is the bulk of the wearers in terms of numbers. They just don't generate a real lot of revenue.

So, we are enthusiastic that all the manufacturing momentum is pushing the market that way, the underlying dynamics are pushing the market that way, and feeling good about it.

Operator

Thank you. Matt Mishan, KeyBanc.

Matt Mishan - *KeyBanc Capital Markets - Analyst*

Thank you very much for taking my questions. Given some of the slowdown in the ramp of your expectations, do you think that going into next year that SG&A marketing expenses are going to be maybe a little bit higher than you would have thought with the full MyDay and clariti rollout next year?

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

No, I really don't expect any real change on that. It's really the push-pull with the distributors in the middle that will bring about some growth and expansion. But the on-eye activity, we've shifted our energy already from getting the fitting sets out there, which consumed a lot of energy in the first half of this year, to now sell-through, meaning really converting the market into the silicone hydrogel one-day modality.

We don't need any special emphasis on that point. We have the product availability because the ramp-up on the manufacturing side has been extremely robust. So, we're good on that front and it's now really execution in the field and we do think the market is crying for it.

Operator

Thank you. Chris Pasquale, JPMorgan.

Chris Pasquale - *JPMorgan - Analyst*

Thanks. Just two questions. I want to try and understand the market issues and the guidance a little better. First, UPP has been out for more than a year, and (inaudible) by the fact that distributor inventory levels have been trending down for some time and were already at what we thought were pretty low levels. What is causing the negative inflection and what gives you confidence that that (inaudible) that you have visibility to be able to tell if it's going to recover?

And then specifically on the daily silicone hydrogel guidance, you're bringing it down by about 14% for the year. It seems like a pretty large revision. Can you just talk about what you thought you were going to be seeing in the fourth quarter, given this back end outlook for the year? What do you think (inaudible) but now you're saying it's not and you've had a delay into next year, or do you think it does not materialize at all? Thank you.

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

Yes. I think I got most of that. You were cutting out. You're correct, UPP will anniversary moving into the third calendar quarter. So, it's a year ago now that the robust rollout of UPP occurred, for the most part, and most notably the market share leader going very deep with UPP, all the other manufacturers going with new products only, following the concept. UPP is about promoting new products to the practitioner where they have to invest a lot of time in the conversion and that.

On the one front, from a market perspective, that step down that occurred with UPP is going to anniversary and therefore will have better year-over-year comps as the market goes. Relative to the middleman, the authorized distributors, we know there was consolidation leading to efficiency and we know that the manufacturers are doing a better job coordinating with the authorized distributors in terms of creating efficiency. An example of that would be more direct shipments from the manufacturers to the eye care professionals when it comes to torics, which are hard to inventory because of the large number of SKUs.

The distribution channel is more efficient. I would conjecture it cannot get much more efficient than it is now so I think that will have a flushed out. And that's been leading to some suppression of the growth from a manufacturer point of view out the door the last two years ever since the big consolidation took place, if you will. So, I'm pretty bullish about that.

Relative to visibility, we always said there would be in that $175 million objective for silicone hydrogel a good chunk of pipeline fill in the fourth quarter. We are just not assuming that it is going to occur anywhere close to where we thought. So, it wasn't so much an on-eye demand as it was if you're creating a lot of demand in the marketplace you're going to want to backfill that so that your authorized distributors are not going on back order on a product you're just creating demand on.

I think that is a pretty efficient system now and part of it really is the efficiency of the torics because we are the one company that has a multifocal toric and a sphere in the silicone hydrogel modality. We basically have cut back assumptions on how massive a pipeline fill you need for that part.

Relative to next year's outlook we are feeling good about the supply chain of product available and the reception of on-eye in the market, and therefore still quite bullish about top-line growth into 2016 and beyond.

Operator

Thank you. Joanne Wuensch, BMO Capital Markets.

Joanne Wuensch - *BMO Capital Markets - Analyst*

Good afternoon. If I heard you correctly you gave some commentary for EPS next year but no commentary for revenue. It seems like most of the questions this evening are related towards revenue. How do we get from the current growth rate towards a higher one over the next couple of quarters? And what do you think a proper range would be for next year?

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

For a number of regions, one of which is the volatility of currency, we are not going to get into clariti until we get through our budgeting process, which we are in the middle of. We will shed light on that in December but we are not going to at this juncture. Suffice to say we still believe we will continue to gain market share. And you can see the numbers we've put up against the marketplace. We're feeling good about solid top line. We're just not ready to give a range of what to expect on the top line next year.

Operator

Thank you. Brian Weinstein, William Blair.

Brian Weinstein - *William Blair & Company - Analyst*

Thanks for taking the question. Last quarter you guys took down total revenue guidance by, I think it was $40 million or 44 million. Part of it was a little bit of a miss in Q2 but then also you had cited issues with the solutions business being down a little bit more than expected and a little bit faster slowdown in some of your legacy products. I didn't hear you really mention those types of things on this call. So, is the takedown in guidance exclusively related to the US issues that you have been talking about or are we still seeing some of those older legacy products decline faster than expected? And what's going on with the solutions business? Thanks.

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

The solutions business was surprisingly benign for the quarter, meaning down slightly but not much less than the marketplace. So, our further guidance down has nothing to do with legacy and solutions. It really is going from the $175 million down to the $150 million to $157 million range.

Operator

Thank you. Larry Biegelsen, Wells Fargo.

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

Good afternoon. Thanks for taking the question. Bob, we've gotten very positive feedback on MyDay but we've gotten mixed feedback on clariti's comfort. Is that something that could be improved? And then on the manufacturing changes in 2016, maybe it wasn't clear to me but will those costs be taken out of non-GAAP earnings? And, if not, how should we think about gross margins in 2016? Thanks.

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

On the positive feedback on MyDay and the mixed clariti feedback question, MyDay is very early in the game in the US and certainly it has performed well as a premium product outside of the US. It is clearly in a league that is targeting TruEye and TOTAL1 and that is a different league. It is a great product. I would say a lot of the people probably going into MyDay are getting there from TruEye and therefore it is silicone hydrogel to silicone hydrogel.

The history of conversion to silicone hydrogel lenses has not been a rocket ship. It's been kind of stairstep. Some of you may recall when Oasys and Acuvue Advance came out in the about 2007-2008 time frame, there was an attempt to totally shift the patient from the Acuvue 2 lens to a silicone hydrogel and a lot of patients reacted negatively. They basically said -- I can still feel the rigidity of a silicone hydrogel lens, put me back in my hydrogel lenses.

That's actually one of the reasons even today in the FRP and the plan replacement modality it is only 77% silicone hydrogel, which translates probably like 70% wearers and 30% of the -- because there is a premium you pay for that. So, toning and effecting for that premium, about 30% of the people are still staying in their hydrogel lenses because they're not as rigid.

The same thing is going on with clariti, to some degree. We're going after Moist. Moist is not a silicone hydrogel and therefore you're going to have some patients that are going to go from Moist to clariti or any other silicone hydrogel and say -- I can feel it, it is more rigid than what I'm used to. Some people are not going to give it the chance and some people will adapt to it. Every eye is different, every patient is going to be a different battle on that conversion front, if you will.

On manufacturing startup costs the intent is, there are a number of moving parts in manufacturing going on right now and into next year. We have two new plant startups that will be ramping up in Costa Rica and in Speedwell in the UK. There will be some call out of those startup costs that will be specifically called out as part of restructuring of manufacturing activity.

On the negative front relative to what's in the ongoing reported cost of goods, when we transition from a one plant only model, let's say in Hungary or in Budapest, to a new startup in Costa Rica, even though labor costs will be lower in Costa Rica, and certainly much lower than our other plants in Puerto Rico and UK and Rochester, ultimately that will be a huge advantage, short term it's negative because you are ramping up without having the full critical mass. And there will be some drag on cost of goods and gross margins in 2015, 2017, and probably all the way into 2018 until you have a robust plant in Costa Rica.

Speedwell in the UK is less problematic because that is a one-product, smaller model, if you will, that comes into play. Some of it will be called out as the new plant startup. Some of it will not. It will be in the cost of good blended gross margin.

Operator

Thank you. Steve Willloughby, Cleveland Research.

Steve Willoughby - *Cleveland Research Company - Analyst*

Thanks for taking my question, guys. I have a three-part question and then a separate question so I will just ask them all at once, if you don't mind. The three that are related, Bob, you talked about the inventory reductions in the channel and things, and I think this might be like the fourth year in a row we've talked about inventories coming down. I think even at one point you talked about how they could not contractually go any lower.

So, the first part of it is, have inventories in the channel gone even lower? And then the second part of that is, you talked about distributors and retailers not really taking on inventory here in the third quarter. I would say you're guiding down a bit for the fourth quarter. So, are you not expecting distributors and retailers to take on inventory? And if that is the case, why are you now not expecting them to take on inventory?

And then my separate question is just, what are your thoughts on the new daily product from J&J coming into the market here soon? Thank you.

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

All right. The first one on the inventory reduction, you are quite right that we talked about for the third year in a row in October of last year inventory reduction with the authorized distributor relative to Cooper. The inventory reductions we're talking about now is there have been some of our competitors that have talked about their pipeline inventory reductions. With Cooper we're not saying they reduced inventory, it's already at a very efficient level. We're saying we were guiding to an expansion of the inventory held by authorized distributors for new product rollouts like clariti and like MyDay. And that is just not happening.

And given the efficiency of the authorized distributors, we are not expecting it to happen anywhere to the same degree that we once anticipated. Part of that is the efficiency, as I pointed out, of getting toric lenses to the patients or to the eyecare professional where much of it is going around the authorized distributors. They like carrying spheres. It's very easy, limited SKUs. Multifocals, limited SKUs. Toric is a pain in the neck. We have come up with a workaround to make the system as efficient as it possibly could be.

On the authorized distributors/retailers, in the fourth quarter we're basically saying we've toned down the pipeline for the new product rollout, part of it for efficiency and part of it is just how tight authorized distributors are managing it.

As far as the new J&J product that is coming out in the one-day modality, which is Oasys one day, if I were J&J I would do exactly the same thing. They're basically trying to trade out TruEye or -- this is conjecture because I'm not sure they've formally announced -- but the conjecture out there is it will come out, go into the premium modality with a sphere and basically trade out the TruEye product, which has not done well in the US market, with several missteps. If I were them I would do that.

The negative of it is it is clearly that it could accelerate two things. One is people leaving the non-silicone hydrogel bucket and then going in play. But, more importantly, people transitioning from the two-week modality owned pretty much by J&J. They have well north of 70% or almost 80% of share of that two-week wearer base, and they'll be putting those in play, and we'll take our chances on that. So, I love that.

Operator

Thank you.

(Operator instructions)

Jon Block, Stifel.

Jon Block - *Stifel Nicolaus & Company - Analyst*

Great. Thanks. And I will see if I can also just try to maybe ask a question and a half. The first one, Bob, you tried to isolate the on-eye data in the US -- again, on-eye. What do you think the trend line of your market share gains are there? I'm just trying to tease out, do you think J&J's aggressive pursuit of UPP and B&L are gaining back of some of the share in the US -- again, on-eye?

And, second question, just shifting gears, can you just talk to the additional manufacturing capacity that you expect to come online from MyDay in FY20 relative to FY15? And is MyDay still teed up for Japan approval next year? Thanks, guys.

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

All right, I think I got that all. The on-eye data for Cooper, we have to look at it in two pieces, the independents where there is kind of a battleground -- J&J has basically invited themselves into, very vocally, with their UPP policy -- and then the all others, the retailer half. There is a very clear divide. Retailers do not like UPP and independents love UPP. It's as black and white as a republican and a Democrat, I guess. Maybe that is a poor example because maybe it is not black and white. But they are on one line or the other clearly in the way they view the world.

It's hard to walk the tightrope. Cooper -- our loyalty is pretty black and white, also. We are loyal to the eyecare professional who writes a prescription and we are not at all loyal to those that do not write prescriptions. That's where we draw the line. And we think there are better ways than UPP to show your loyalty to the eyecare professional, the independent, or be it working in a retail setting.

When it comes to where is J&J doing well, they are doing better with independents, no doubt. One would say they are probably doing horrendous in some areas with certain retailers. Their overall numbers don't look very good and we'll see what happens as they annualize the UPP decision that they made on their full product line a year ago.

Relative to the ramp-up of MyDay, it's going to be pretty robust on two fronts, both our continued expansion in Puerto Rico and our new facility called Speedwell in the UK, which is dedicated to MyDay. Throughout 2016, really much more the back half, we will be coming online with a pretty robust amount of a ramp-up. Will we catch up with demand in 2016? -- probably not.

The third piece you asked about is Japan and so far so good in terms of our expectation for MyDay into Japan by the end of 2016.

Operator

Thank you. Jeff Johnson, Robert W. Baird.

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

Thank you. Good evening, guys. I had a couple questions here. Let me just ask them all and we will go from there. Bob, I know you're not giving guidance for next year on the top line but with Oasys coming out with the market a little punky here, Bausch maybe getting a little bit healthier under Valeant, although that's a question that isn't fully answered, where do you think CVI versus the market, or CooperVision versus the market, could go over the next 12 or 18 months? That's question number one.

And then, Greg, two clarifying questions. You mentioned in the gross margin for CVI FX and mix, the offsetting impact of those two. But what was the impact of the timing of when you closed down those December facilities? If memory serves, that usually weighs down gross margin this quarter a bit, as well.

And then did I hear you correctly that gross margin on clariti, exiting 2016, could be accretive to CVI or to Company-wide, whichever you said? That would imply north of 63%. I think when you acquired that line it was in the low to mid 50%s. I just want to make sure I heard that correctly. Thank you.

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

Okay. I will do these and then Greg can fill out what I don't cover in gross profit. In terms of top line and how we feel about it relative to the new products coming out, be it the Oasys daily or the various other products being talked about in the activity of B&L and others, we are feeling a lot of that we like the move. We like the emphasis of stirring up the pot in the two-week modality and seeing where they end up. Some will go to monthly and many will go to one day. The shift to one day looks as exciting as ever and we like our product portfolio as much as ever. So, we love the direction of that.

I would expect a more robust market in the US in 2016 than 2015. 2015 I would describe as pretty anemic for the two reasons we talked about -- the authorized distributors and the UPP effect. But that does annualize and who knows how long UPP will be around to throw stones at.

As far as the gross margin, you did hear me correct about clariti, that clariti will be a contributor to our gross margin story, meaning a net plus to the mid point in the back half of next year. So, all has done very well with the ramp up. I did hedge a little by saying as we ramp up Costa Rica, that puts a short-term drag in the fact that you do not have critical mass in that ramp-up mode for a couple years. But the rest of the mass production is doing so well we're pretty bullish on the composite pop.

Relative to the timing and implications of the shutdown, you're right, the shutdown that we do for plant maintenance is the end of December, early January. That has a ripple effect. Although we flatten it a little, it still ripples into the third quarter historically.

And foreign exchange impact on our gross margin is a whopping number. It's like 200 basis points. Were it not for foreign exchange, we would be doing cartwheels on our gross margin story. And that would be accolades to our production guys on just how well they have improved cost and efficiency in spite of a shift in the one-day mix. So, they are basically hurdling that, which is a pretty extraordinary story, all lost in the world of foreign exchange, unfortunately. Greg, anything you want to add?

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

No, I think, Bob, you covered it. I think the mix aspect of the manufacturing variances I'd combined in that mix. So, so what you saw, definitely the strong part of it was FX, as Bob mentioned. You had a little bit of offset because the cost of goods sold FX was positive, and then you had the manufacturing variances in Biofinity leading from a product mix standpoint helping to offset that FX. FX was huge for the quarter.

Operator

Thank you. Steve Lichtman, Oppenheimer.

Steve Lichtman - *Oppenheimer & Co. - Analyst*

Thank you. Hi, guys. I just want to ask on the CSI side, the slightly slower growth you saw in office and surgical this quarter versus last, do you sense it is more of a negativity around the broader market maybe getting worse or is it more Company-specific? And if it's the latter, Bob, what are some of the general changes you would like to see looking ahead?

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

Clearly I'm a firm believer that we are actually doing well with the broader market. The broader market is bumping right now and it's so surrounded by a lot of litigation dealing with all those issues of mesh and slings and morcellators. You can't pick up a paper today without seeing some legal advertisement in that arena. It slowed up the market. You had a lot of gun shy gynecologists out there and that ripples into some of our products that are used tangentially with some of those procedures.

I think our product portfolio is good for the mainstay of things like doing hysterectomies and minimal invasive surgery, in general. We have a concerted effort of refreshing the product portfolio, which is, for the most part, very mature.

So, products like an EndoSee, a handheld hysteroscope, and now Reprogenetics, not so much on the part you are, this is more on the IVF part, but we are making a concerted effort within all CooperSurgical to add some muscle to it in terms of organic growth potential. And Al's role clearly is going to be a catalyst in that area where our intention is -- we've been a little slow at M&A activity, perhaps, on average, over the last two or three years -- to move that process along. We think there are opportunities out there that we're at least going to kick the tires pretty heavily on.

Operator

Thank you. I am showing no further questions. I would like to turn the call back over to Bob Weiss for closing remarks.

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

I want to thank you for joining us on this call. As you can tell, we are excited about the rollout of our products and opportunist, and very excited about the outlook for 2016. Perhaps I did not say it clear enough but targeting growth low teens to mid teens next year, coming off a 27% to 29% growth, is pretty stellar. We're proud about that.

We are really down about the fact that it still got masked by foreign exchange but we also know we're not the only company on the planet that's being hammered by that -- or the only company in the United States being hammered by that. I know there are some companies in Europe probably looking stellar over the same thing.

But, at any rate, we'll look forward to updating you on the story as we get into our year-end numbers in December. I think our next session will be on December 3, so we'll look forward to updating you at that time. Thank you for participation.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude today's program. You may all disconnect. Everyone, have a great day.
