FINAL TRANSCRIPT

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COO - The Cooper Companies Inc at Robert W. Baird & Co Health Care Conference

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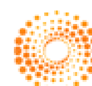

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CORPORATE PARTICIPANTS

Bob Weiss
Cooper Companies, Inc. - President & CEO

CONFERENCE CALL PARTICIPANTS

Jeff Johnson
Robert W. Baird - Analyst

PRESENTATION

Jeff Johnson - *Robert W. Baird - Analyst*

My name is Jeff Johnson. I'm the Senior Medical Technology Analyst at Baird, and our next presentation this afternoon is with Cooper Companies, a specialty medical device manufacturer servicing the ophthalmic market through their CooperVision contact lens division, and the womens healthcare market through their CooperSurgical division.

With us today from Cooper -- we're very pleased to have President and Chief Executive Officer, Bob Weiss, and Director of Investor Relations, Kim Duncan. Bob, I'll turn it over to you for a few minutes, here, of prepared remarks, then we'll go straight into Q&A.

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

I'm not going to read to you forward-looking statements. Briefly, Cooper is a New York Stock Exchange Company. We have revenue that runs around $1.3 billion a year. It's -- has two businesses, contact lenses is 85% of our business. CooperVision, our subsidiary in contact lenses, is in a $6.7 billion industry, growing, even in weak economies, in the range of 4% to 6%. 5% -- our lowest growth as an industry was back in '09, when we got down to 3%. Typically does not go negative. Very recession resistant.

It is a global company with the majority of our sales outside the US. Ballpark, around 33% of lenses sold around the world are in the United States. 67%, two-thirds, outside the US.

There are really only four competitors that make up 95% of the market. Vistakon, which is J&J, is 44% of the market. Ciba Vision, which is Novartis, is 22%. Cooper's number three, at 17%. Bausch and Lomb is number four, at 13%, and then there's about 4% outside of that. So, it's pretty much a boutique industry.

It's done very well with very solid growth over the last 20 or 30 years. A lot of the strategy has to do with trading up the wearer base to more expensive products, specialty lenses, Torics for astigmatism, multi-focals for presbyopia, silicone hydrogel lenses, a chemistry with high oxygen permeability and modality, which is a one-day modality where you throw the lens away every day.

If I convince someone to wear a one-day lens compared to the average lens-wearer, by and large, that's a trade-up of four times on revenue. So, if an average patient creates $100 of revenue, then -- and I convert them to one-day, it's $400 of revenue. If I look to the bottom line, the operating income line, that trade-up, typically, is about four times also, so I make four times more profit if we can move the modality from a monthly to a one-day wearer. So, a lot of what the industry does, collectively, is try to push more and more planned replacement that's been going on, really, since the late '80s.

As far as manufacturing, our locations for manufacturing product is primarily the UK, and, in Puerto Rico, we make 1.2 billion lenses. Only 10 million of our 1.2 billion is made in the United States in Rochester, but we make 600 million lenses in Puerto Rico and more than 500 million lenses in the UK.

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Many lenses that have emanated through Cooper have come out of the UK for one reason or another. Proclear is our one-day product, Biofinity and Avaira. Avaira's our two-week product. We talk about modalities, one-day, two-week, monthly. [Affinity] have emanated out of the UK, and a lot of the growth, as a result, has come from that route.

We also have a womens healthcare business. That womens healthcare business is called CooperSurgical. It's north of here, in Trumbull, Connecticut, in a campus setting. It is the amalgamation of about 30 acquisitions over the last -- close to 20 years. Obviously, its total revenue is $200 million, so the average acquisition has not, basically, brought in that much revenue.

They're small acquisitions. Not the type of acquisitions you're going to see some of our competitors in the space -- like, J&J is not going to go around buying companies that have $10 million and $15 million in revenue.

We, as a matter of -- as a acquisition company, look at acquisitions that range from what we'll call small, less than $30 million purchase price. Medium, $30 million to $100 million. Large, above $100 million. Just like we acquired 30 acquisitions the last 15 years, we're still looking, at one point in time, to have 20 to 30 different targets at a given them. So, a lot of opportunity.

In many cases, our products that we're selling -- there are 600 different products. 19 different product groups all have a 50% or higher market share in that little niche market, so the barrier of entry is literally impossible to replicate. You couldn't find those 30 companies that would mirror image what it's about.

The good thing about Surgical -- highly profitable. 65% gross margin, 25% operating income and no CapEx. So, it generates a ton of cash. It represents primarily our US model, so it's essentially a US business, 85% US, whereas our contact lens business, as I mentioned, is -- two-thirds of the action is outside of the US.

Cooper has come out with strong results over the last four years. We recently came out with third quarter results. We're an October 31 fiscal year-end company. Reported revenue up 19%, and 12% in constant currency, and our CooperVision business was up 20%, 11% constant currency. So, solid top line growth.

Earnings per share, non-GAAP, which excluded our recall and excluded an accounting acquisition entry, was $1.15, up 26%. Importantly, one of the things Cooper was being questioned on -- its ability to generate cash. About two and-a-half years ago, we had over $900 million in debt. In the last two and-a-half years, we paid down, essentially, half that debt. We generate about $200 million in free cash flow a year, so not only do we make a lot of profit, we make a lot of cash.

We've given guidance, then, for the, I guess, third time this year. We upped the guidance both at the top line and the bottom line. Our most recent guidance has increased $40 million at the bottom end of the range on revenue. Our non-GAAP guidance, I think, started the year at around $350 million to $360 million, so we're up (inaudible) on the bottom end, and free cash flow, likewise, has been taken up.

Importantly, our strategy at Cooper is to grow revenue faster than the market. We expect to gain market share in contact lenses over the next five-year period. A lot of that has to do with the freshness of our products that we now have in the market. We're not prejudiced to -- is it a one-day modality? A two-week modality? A monthly modality? We're not prejudiced as a Sphere, a Toric or a Sphere, the types of lenses -- or a multi-focal, the types of lenses.

The products that we have in each space are fresh, meaning they've really been rolled out over the last three to four years. In some cases, we just had [some atrial] launches in the third quarter. We launched our Biofinity silicone hydrogels into Japan in June. That's a $400 million silicone hydrogel market that we did not participate in, meaning zero share.

We launched our Biofinity multi-focal into the multi-focal silicone hydrogel market. That's a $150 million market we don't have any share in, likewise. In both cases, Biofinity has a good name in the marketplace. It's captured, ballpark, 13% of the silicon hydrogel market, where it participates. So, it's a good product, and we're pretty optimistic about its potential in Japan and in the multi-focal market.

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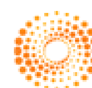

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Importantly, we'll continue to leverage the Company, expect to grow our bottom line faster than the top line and prove operating margins. Today, our operating margin's around 18% to 19%. We expect, over the next seven to eight years, that it will move up about 100 basis points per year to about the mid-20s. Part of that is royalty-driven, part of that is just leveraging cost. We expect to grow our bottom line faster than top line, partly through leveraging operating costs, partly through improving gross margins and also as a result of large cash flow generation.

Overall, we expect to generate $1 billion of free cash flow over the next five years. We will continue to invest in acquisitions. As I mentioned, we think of them in three tiers, small, medium, large, sub-$30 million to $100 million, $100 million in larger, and we will look at companies in both contact lenses and womens healthcare that fits that profile on both sides of the aisle, meaning both segments.

With that, I think I'll wrap up and let Jeff have his questions, and we'll take any other questions.

QUESTIONS AND ANSWERS

Jeff Johnson - *Robert W. Baird - Analyst*

We'd be happy to take any questions from the floor, but let me just start, I guess, with one bigger-picture question, Bob. And you addressed it there a second ago, with the potential ramp in mid-20% margins.

But, if I look back over the last decade at your company, you guys did peak out at margins in the 24%, 25% range, so it's been done in the past. The stock has reacted very favorably to -- over the last two years, two and-a-half years, to kind of bouncing off that trough, 14%, 15% margin, back up to 19%, but it seems to me there's nothing, structurally, that's really changed in your business over the last decade that would prevent you from having that nice ramp from where we've been 19%, on a trailing 12-month basis, back to the 24%, 25%.

And I know you're alluding to that, but I get a number of investor questions about how can you keep the margin expansion up when it's been so strong over the last few years, and that. But, structurally, you see anything different between now and six, seven, eight years ago that would prevent you from getting to that mid-20s?

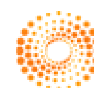
Bob Weiss - *Cooper Companies, Inc. - President & CEO*

The answer is no. That -- the industry's a great industry. It does afford good profitability. The product line that we have is refreshed. We have not been cheap on investing in operating costs, so we're generating margins of 18% to 19%, and that's basically in an investment mode.

We have yet to leverage a lot of areas. A lot of things we can do to reduce our cost of goods. Some of those will translate to improving gross margins. Mix will play into that, but there is nothing -- importantly, there's nothing in mix that necessarily hampers the operating income line.

So, when I talk about a mix, I am talking a mix shift from a monthly modality to a one-day modality, which happens to be the fastest modality growth in the United States. We've gone from 10% one day to 18% one day, which is a lower gross margin but not a lower operating margin. That's good for top line growth. If I can get four times revenue out of a patient, and I did that for the entire industry, the industry would be a $20 billion not a $6.7 billion industry.

Importantly, that trade-up, while it distorts gross margin, meaning the 65% gross margin that the industry would normally get without one-day lens, could diminish sub-30 -- sub-60 -- excuse me, sub-60, that does not translate to operating margin going



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below the 25% objective. I think that's an important thing, and it could radically impact the mix between cost of goods and operating cost in the equation.

But, where we are today, a lot of leverage potential. There is nothing I see structurally that would preclude us from getting back to the 25% range. Importantly, we also have a royalty we pay to one of our competitors, and that royalty is 8% on our silicone hydrogel gel lenses. Today, they represent 31% of our business. Down the road, that will probably grow to north of 40% of our business, so 8% times 40% would be north 3% impact on our gross margin.

That royalty will go away in the United States in 2014 -- the latter part of 2014, and outside the United States in 2016 -- September of 2016. So, with that going away is one of the last components to get to that mid-20s.

Jeff Johnson - *Robert W. Baird - Analyst*

I've asked you that softball question before on the mid-20s, and I ask it each time just to make sure your answer's the same. And it is. It's always consistent.

But, after last night's dinner, let me push you a little bit on one thing. You talked about potentially getting alcohol out of some of the lenses that could bring another couple points to the silicone hydrogel gross margins or a couple points to -- company-wide, when you do the math on percentage of sales and what have you.

And with the royalty going away and with this mix shift to dailies, we have seen dailies pick up, surprisingly, in the US. Not just their 100 to 200 basis points they've been picking up, but, over the last six months or so, it seems like you've picked up another few hundred basis points, as an industry-wide comment, on the daily market. Your comment about dailies have higher operating margin or, at least inline, if not potentially higher, flowthrough to -- at the operating line.

In 2000/2001, when you guys were cranking along on your standard hydrogel product lines, you were, far and away -- and still are, but far and away the Toric lens leader, the multi-focal lens leader, your operating margins were actually in the 28%, 29% range. So, what, structurally, is maybe different today versus the early 2000s, on getting to that 28%, 29% range?

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

Well, that's a good question. I would say that one has to remember that premium lenses, specialty lenses -- Torics and multi-focals, are higher margin. So, there are two ways to look at margins and profitability. One is by modality. Clearly, one-day is a lower modality, more like 50% gross margin. The monthly is a high gross margin, north of 70%.

The second way is specialty lenses versus non-specialty. There is no doubt that Spheres, which is a more commodity product, meaning 160 SKUs, you can respond to most people's corrective vision needs, whereas, when you get into Torics -- well, we carry one million SKUs in our inventory, because we carry a very broad amount of Torics, and we'll even custom-make a Toric. That part of the business, no doubt -- if we were only the business to be a specialty lens company, we would command higher gross margins and operating margins.

The fact that we're in Spheres, which, today, is 70 -- about 74% -- or 76% of the market is Spheres, 26% -- 24% is specialty lenses, of which 19% is Torics, 5% is multi-focals, if we want to play in the 76%, then we're going to forego some operating margin.

Jeff Johnson - *Robert W. Baird - Analyst*

Strategically, let me ask you a question just about another -- I guess, on the margin side, but you have been investing. You've taken your investments up on the salesforce side, on the R&D side here. One question we get from investors is how much of

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that is just trying to manage your earnings versus how much of that is -- really has a high return potential to drive incremental sales and accelerating sales as you get into 2012 and beyond?

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

The Company has been investing in sales effort and R&D effort. In the case of the sales effort, one thing we did not want to do -- we wanted to expand our footprint. We are under-indexed on the street in terms of our competitors, but we didn't want to get ahead of ourself by hiring a bunch of people in the salesforce only to create demand that we couldn't match and we could sell the capacity.

We were capacity constraint in Biofinity. We entered this year at $200 million, the capability to support a $200 million product portfolio, and we said we were going to target getting to $400 million. We're already at the $400 million, so we're now unconstrained from the point of view of product of Biofinity. We did the same thing with our Proclear material, one-day material. We did the same thing with our Avaira Spheres as well as Avaira Proclear -- one-day Toric.

Now that we're no longer capacity constrained, we are in the mode where it makes sense to hire and see how good those products are. A lot of the hiring is reflected to the fact we think we have a pretty good product portfolio. We think we can continue to gain share, and now we're going to prove it. We can make the -- we have the products, we can make the products. Now, let's go sell them. We're going to see how much mileage we can get out of that.

Very purposely, we're saying we're going to test the limits of these products. Some of that is US expansion. A lot of is geographic expansion. We have yet to overlay where we want to go in China. China -- this year, we're taking our time to analyze it. Next year, we're going to decide how much money are we going to invest in China? The idea that it may be as little as zero, meaning I private label a product, we go through a large retailer. It could be as much as $10 million, depending on what the payback is. If the payback is there, we might go that far.

Were we to invest $10 million in China, we will have a minimizing factor next year, in terms of our operating leverage, in terms of improving our operating margin 100 basis points. So, when I hedge a little on -- we could grow next year's operating margin 100 basis points, but it could be as low as 50. There's 50 basis points in there for expansion, but heavily driven by China.

Jeff Johnson - *Robert W. Baird - Analyst*

Let me push on that point for a second. You -- at this point, you have a few revenue catalysts ahead of you, for sure, over the next few quarter. It's -- the Biofinity capacity constraint's coming off. You just launched Biofinity Sphere and Toric in Japan, Biofinity multi-focal in the US and Europe. You've hired these new sales reps in the US and Europe.

So, you've got a lot that could drive the top line over the next 12 to, probably, 18, 24 months. At the same time, you've got a big company in J&J, Vistakon, that really could go in and trailblaze. Instead of investing $10 million, they could go in and invest $50 million, $100 million into the China market, develop it for you, and you could be a fast follower.

So, how do you think about your, I guess, need to be one of the first into a market as a 17% worldwide share player versus a fast follower, letting some of -- the biggest name out there really develop that market for you?

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

I would say that there's so much in China to go around that, obviously, it's a win-win for all of us if we can move the needle. Very open to joint efforts. In other words, it doesn't have to be competitive. Little Cooper going into China with 17% of the world market, J&J with 44%, we're not going to be the only one that's pushing. B&L has been there for a lot of years. They've

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got an established name in China. They probably got there 20 years too early, to their detriment, but I do think that China, over the last 30 years, is not the China of the next 10 years.

I'd be very happy if the competitors want to get together, or another type of company aligned with eye care -- lens care company, for example, set up educational programs that are really training the eye care professional, the number one reason holding back China.

The best way to think of China is, today, it's a $200 million market. Japan is a $1.4 billion market. So, Japan is basically seven times bigger than all of China is. That's pretty remarkable, as far as the opportunity. It isn't that there's aren't high incidents of myopia in China. There clearly is a higher incidence of myopia in China than there is the Caucasian eye in Europe and in the Americas, so the opportunity is huge.

How we approach it and how much we're willing to invest is questionable. Is $10 million a lot? In the scheme of trying to create a Japanese -- or a Chinese market that should be more well north of $1 billion, it's obviously just a drop in the bucket. But, I don't look to do it alone. I'd love to have the [competitors] with us.

Jeff Johnson - *Robert W. Baird - Analyst*

Let me ask one on capital structure. You're now below 20% debt-to-cap. That's some 30 points, I think, lower than where you were just three years ago or so. How are you thinking about uses of cash, besides debt pay-down going forward? It seems as if your CapEx is probably going to stay around $100 million a year, free cash flow probably north of $250 million a year. So, how do you think about uses of that excess cash at this point, from a share repurchase acquisition on the CSI side, potentially, acquisitions on the CVI side?

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

Ranking clearly is -- its first preference is accretive acquisitions that are accretive maybe not in the first 12 months but by the end of 12 months, both in womens healthcare and in contact lenses. We typically have 20 to 30 on our radar screen in different levels of our watch list.

Following that, debt pay-down, following -- and the continuation of investment that we've been doing in operating areas, geographic expansion. So, geographic expansion's a China discussion. Ultimately India, ultimately Russia will come into play. We've been doing a lot in Eastern Europe already, and, to a lesser degree, in South America and Brazil and, now, recently, Mexico.

But, beyond that, buybacks and increasing dividend in the next five years -- I don't see that as a high priority. The last thing I want to do is leverage up to do a buyback only to then have the acquisition I want come along. There are several that I would describe as north of $100 million that on our close watch list.

Jeff Johnson - *Robert W. Baird - Analyst*

Those north of $100 million, I'm assuming, are CSI?

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

Both CSI and contact lenses.

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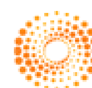

Jeff Johnson - *Robert W. Baird - Analyst*

Okay. We'll talk, maybe, about that in a little bit. But, last question, I guess, on the CSI side. We are out of time here, but CSI -- how do you balance what seems to be a great CSI division for you? A great womens healthcare business that cash flows well, takes little senior management overview or oversight? It's performed very well?

You seem to always be a bull on wanting to add more to that business, whereas, investors, on the opposite side -- a lot of investors see that as the smaller 15% division that kind of mucks up the simplicity of the contact lens story. Would make it harder, if you were to ever sell the Company, to split up a bigger CSI division, things like that. How do you balance what investors seem to have in mind versus how you think about the acquisition pipeline there?

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

Well, I would love our womens healthcare business to be larger than 15%, but I'm happy that both are growing very robustly.

Our CooperSurgical, our womens healthcare business, is very integral to our tax structure. We're -- we have a pretty creative, if you will, and thought-out tax structure. They're our US source of profit, so it's important, from not only a -- just an operating performance point of view, but from a tax planning perspective. It gives us a lot of latitude. It also gives us a lot of latitude on where future uses of cash will be targeting high return on invested capital.

The fact that we're in two business segments -- I don't think we're unique on that. The businesses are kept separate and distinct and clean enough that were anything to happen, by way of a transforming event, you can easily split and bifurcate the two.

If we were to spin it off today, it would be devastating, from a tax point of view. You'd go from a zero taxpayer, in the U.S., to a 40% taxpayer state and federal. You'd be, literally, partnering with the government and giving them a lot of the profit, so I don't think that's a good strategy.

Jeff Johnson - *Robert W. Baird - Analyst*

So, you're right to pay as little tax as possible, right?

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

[Right].

Jeff Johnson - *Robert W. Baird - Analyst*

All right. Well, that is it. We have used up all our time, so please join me in thanking Bob for a great overview, here, of Cooper Company.

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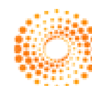

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