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COO - Q3 2013 The Cooper Companies, Inc. Earnings Conference Call

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OVERVIEW:

COO reported 3Q13 revenue growth of 9%, consolidated GAAP operating income of $93.6m and GAAP EPS of $1.79. Expects 4Q13 total Co. revenue to be $410-425m and GAAP EPS to be $1.76-1.81.

CORPORATE PARTICIPANTS

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PRESENTATION

Operator

Good day, ladies and gentlemen. Welcome to the third quarter 2013 The Cooper Companies Incorporated earnings conference call. My name is Cilia and I will be your operator for today. At this time, all participants are in listen-only mode. Later, we will conduct a question-and-answer session.

(Operator Instructions)

As a reminder, this conference is being recorded for replay purposes. I would now like to turn the conference over to your host for today, Miss Kim Duncan, Senior Director, Investor Relations. Please proceed.

Kim Duncan - *Cooper Companies Inc - Senior Director IR*

Good afternoon and welcome to the Cooper Companies third quarter 2013 earnings conference call. I'm Kim Duncan, Senior Director of Investor Relations and joining me today 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 conditions and integration of any acquisitions. Forward-looking statements depend on assumptions, data or methods that may be incorrect or imprecise and are subject to risks and uncertainties. Events that could cause our actual results and future actions of the Company to differ materially from those described in the forward-looking statements are set forth under the caption Forward-looking Statements in today's earnings release and are described in our SEC filings including the business section of Cooper's annual report on Form 10-K. These are publicly available and on request from the Company's Investor Relations department.

Now, before 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 open the call for questions. We expect the call to last approximately one hour. We request that anyone asking questions please limit yourself to one question. Should you have any additional questions please call our Investor Line at 925-460-3663 or e-mail ir@coopercos.com. As a reminder this call is being webcast and a copy of the earnings release is available to the Investors Relations section of the Cooper Companies' website. And with that I'll turn the call over to Bob for his opening remarks

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Bob Weiss - *Cooper Companies Inc - CEO*

Thank you, Kim. First of all, to some of you on the call, happy new year both to you and your families. Our apologies for having our release date the first date of -- first day of Rosh Hashanah. On to results. Another solid quarter; we march on. Top-line growth of 9%; GAAP earnings per-share, $1.79, up 32% versus the prior year; non GAAP earnings per share, $1.74 is up $0.29 or 20%; and free cash flow of $64.5 million means our trailing 12-month free cash flow was $245 million. Some highlights and key events. Our silicone hydrogel family of soft contact lenses continues to show strong growth with worldwide sales of 22% in constant currency, now accounting for 43% of CooperVision revenues. Additionally I'm proud to announce that just this week we have officially launched our branded daily silicone hydrogel lens, MyDay, in Europe. Demand is very strong for this lens and we are very optimistic about the future. We also continue to see a lot of success in our entire silicone hydrogel family of projects with Biofinity and Avaira. The combination of these products should continue our momentum for years to come.

For the most recent calendar quarter we grew two times the market, which grew 4%. We achieved 23% operating income and even exceeded 20% in net income as a percent of revenues. We are very pleased with our IVF or fertility growth, which was 180% and adjusting for acquisition comparability grew 20% over the prior year comparable period. Our free cash flow delivery resulted in our debt to cap now moving to single digits. We have a very strong balance sheet as well as a strong free cash flow. On revenue results, during the third quarter our silicone hydrogel family continued to drive our top line and our bottom line. Silicone hydrogel revenues were $143 million. A halo effect of Biofinity toric in Japan continues.

In Japan, Biofinity constant currently sales are up over 100% versus the prior year. The halo effect of Avaira toric is contributing to solid growth of the Avaira two-week family. As previously mentioned, we have launched MyDay, our branded single use silicone, into Europe this month. We expect this newest addition to our silicone hydrogel portfolio of soft contact lenses to help continue our silicone hydrogel revenue growth momentum for many years to come. I'm extremely happy to say that we believe we once again this calendar quarter ended June 30 gained share across the board--all regions, all modalities, all lens types, sphere, torics and multi-focal in both materials, silicone hydrogel and non-silicone hydrogel. This demonstrates the breadth of our reach and the product portfolio. Geographically, foreign exchange headwinds continue to reduce CooperVision revenues, down 4% in the quarter. Excluding foreign exchange CVI constant currency growth was 9%.

Last year was the Euro and this year it is the Yen, which is down 25% versus the third quarter of 2012. With over $200 million in revenue in Japan this not only -- is not only impacting our revenue but is also negatively impacting our gross margin as well as our operating income and on bottom line I might add. But even with this major nuisance, on the strength of our product lines we are putting up some solid numbers. From a revenue perspective, regionally we have put up solid constant currency growth in all locations. America is up 9%; EMEA or Europe, up 8%; Asia PAC, 8%; and worldwide, 9%. Our growth drivers in the Americas trading up to Biofinity including the halo effect of Biofinity multi-focal, with the entire family doing well. Also aloft a much smaller base, Proclear One Day and the Avaira Toric and family are significant contributors.

In Europe right now currency is helping offset some of the Yen. Driving [RE percentase] in currency growth in this region is the entire Biofinity family and one day including single use silicone hydrogel. In Asia PAC, while foreign exchange took its toll on revenue, our constant currency revenue is up 8%. Drivers include tremendous success of the Biofinity family especially with the halo effect of Biofinity toric and Proclear one day. The worldwide soft contact lens market ended the second quarter -- calendar quarter was up 4% in constant currency while CooperVision was up 10%. For the trailing 12 months ended June 30, the soft contact lens market, now $7.2 billion worldwide, was up 4% in constant currency. CooperVision was up 11% on the strength of Biofinity, Proclear one day and Avaira.

For the calendar quarter, the market was up -- growth was sponsored by one day. While industry data is no longer available for silicone hydrogel material, most likely this trade-up material remains solid growth material. CooperVision was up 22% in constant currency in fiscal third quarter of 2013 and add CooperVision, silicone hydrogel now is 43% of our revenues. Soft contact lens market continues to be a trade-up market. This includes the premium products, silicone hydrogel lenses, torics and multi-focals, a trade up of a one day disposable expense patient revenues by 400% to 600%. Even more important, the one day wearer generates 300% to 500% more profit. Also it is important to understand that torics and multi-focals have a long way to go in capturing the market opportunity, especially outside the United States.

Geographically, growth is reasonably balanced, with the Americas and Europe up 4% and Asia PAC up 5% in the calendar quarter, second quarter. Drivers continue as one days and silicone hydrogel trade up. Also we believe torics and multi-focals continue to expand faster off of a lower base outside of the United States. CooperSurgical, our women's healthcare franchise, turned in $81.5 million of revenue, up 27% versus the prior-year third quarter on the strength of a $27 million contribution from our IVF business or fertility business, which now accounts for one third of CooperSurgical revenues. Revenue growth of our fertility business was up 180% and adjusting for acquisition comparability, the IVF product growth was 20% over the prior year's comparable period. We were pleased to see our Office and Surgical Procedures product lines achieve a breakeven following last quarter's declines. This reflects some returning momentum in the surgical procedure area in spite of continued softness with our closure device.

You'll remember we are in a transition mode with this product, the Carter Thompson closure device, as we rollout an upgrade of the product. This in essence results in lost revenues during a trial period -- trialing period. We continue working through this rollout and remain optimistic we'll see improvements over time. Adjusting for acquisition comparability, including the 20% for fertility, CooperSurgical growth was 6% above the prior year. In terms of guidance, we have taken our non-GAAP earnings per share range and have again taken up our bottom line end of our guidance range for revenue for fiscal year 2013. This results from the strength of our third quarter results, the bottom line brought about by solid top line moderating foreign-exchange movement, a 23% operating margin in the third quarter and favorable tax movement. The favorable tax movement includes the effects of geographic mix, tax rate reduction, specifically in the UK, and the effects of some positive discrete tax items.

The Yen took its toll, with about a $13 million hit on revenue due to a 25% decline in the Yen versus the prior year. In spite of this, we overcame it -- its effects with our positive top-line performance and the strength of our gross profit percent in prior years' comparable -- versus prior years' comparable periods. Our new guidance for non-GAAP earnings per share for this fiscal year is $6.23 to $6.28 versus our prior guidance of $6.15 to $6.25. This reflects the ongoing strength of our product portfolio including Affinity and the Proclear one day as well as the lower effective tax rate for this fiscal year. Importantly, in spite of increasing our guidance we continue to invest in geographic expansion and R&D with emphasis on D or product development. This D is what has accelerated our rollout of new products like MyDay, our new branded one day silicone hydrogel. This branded product is now launching in Europe this month.

Regarding free cash flow guidance, we're increasing our free cash flow range to $180 million to $210 while reducing our CapEx to $180 million to $210 million. This mainly reflects the timing of CapEx, our capital expenditure payments, as we continue to aggressively manage our free cash flow. As Jim will comment on capital expenditures, our production plans remain on schedule. I am pleased to say our manufacturing for MyDay and other products is meeting or beating our internal expectations. I might add one other thing. We are pleased with our -- how we are progressing with fiscal year 2013 and how it's shaping up and are anticipating low double digit earnings per share growth again next fiscal year. On strategy, we are continuing with our successful strategy, which I have frequently articulate in the past. We believe it is solid and it has delivered results. CooperSurgical is putting up solid results and is leveraging its infrastructure. This franchise was built with a solid understanding of the value critical mass in the women's healthcare market targeting the OB/GYNs.

We follow the professional wherever they go, be it the office, the surgery center, hospital or IVF centers. Although the call points are different for each, the leverage is considerable. CooperSurgical's third-quarter gross profit percent was 64%, its operating margin was 20% and due to minimal capital requirements CooperSurgical is a significant contributor to our free cash flow. We are dedicated to the strategy and we'll continue tuck in acquisitions to leverage the CooperSurgical structure and products. At CooperVision the strategy is more complex and it is much more global in nature. In the $7.2 billion soft contact lens industry, because of the uniqueness of our manufacturing platforms and product portfolio, we are the only participant that aggressively promotes silicone hydrogel and non silicone hydrogel, that is the Proclear family. We emphasize branded and non-branded products. Note private label does not mean lower operating margins. We actively promote and specialize in custom lenses with a high gross profit, I might add.

We support all modalities that the eye care professional prescribes for one day, two week as well as monthly lenses. And we support all types of lenses--spheres, torics and multi-focals, with approximately 30% share in the high-growth specialty lens categories, torics and multi-focals. It is acknowledged by eye care professionals that we are pretty good at specialty contact lenses. Few eye care professionals would challenge why the success of Biofinity toric for astigmatism; put a great design together with a great material and great things can happen. We happened -- we have seen similar successes for this same reason with Biofinity multi-focal, which hit the market in the middle of calendar year 2011. On the capacity front, with the possible exception of Avaira toric we are ahead of plan to deliver considerably more product where we had previously been supply constrained. The Biofinity family, Proclear one day are all in good-capacity shape.

Our newest challenge will be to ramp up one day silicone hydrogel as we -- as it is yet a niche market. On pricing, like the rest of the soft contact lens industry, we have a trade-up strategy. Our new wearers and existing wares are targeted for silicone hydrogel lenses, the Proclear family and the one day or single use lenses. Each creates more revenue per patient. A one day modality, for example, results in 4x to 6x more revenue per patient. While this strategy sacrifices the gross profit margin, it generally creates three to five times more profit per wearer. Of course this strategy competes head on with the lens care space since we are shifting the wearers' resources from lens care to contact lenses only. Competing for lens care dollars is more of a problem for some of our competitors.

In my opinion we continue to be one of the most focused company in the industry lacking many of the distractions that some of our competitors are going through. I might add with Biofinity, Avaira and Proclear we have a lot to talk about with eye care professionals around the globe. As we look down the road, over the next several years we expect to continue improving operating margins and deleveraging -- or delivering above average shareholder returns. We expect to continue to average double digit earnings per share growth while investing in geographic expansion and new product development. In today's market we have a solid product portfolio to leverage in all modalities, multiple materials, all lens types and we retain our expertise to emphasize customizing lenses for the 10% to 20% of those lens wearers requiring other than standard lens sizes and/or designs. We have a lot of work to do before we come anywhere close to having exploited our number one contact lens family, Biofinity. This is particularly true when it comes to geographic expansion and fully developing the Biofinity family of torics and multi-focals around the world.

The same applies to Avaira, where the Avaira sphere was anxiously awaiting the relaunch of Avaira toric. This combination has now put us in a much better position to exploit the US two week space owned by Johnson & Johnson and to also exploit our private label strategy more aggressively with this family. While we already have pretty respectable gross profit and operating margins, from a cost perspective we have considerable upside yet to be fully developed. Upsides include the complete elimination of silicone hydrogel royalty with the expiration of patents in September 2014 in the United States and in March 2016 in the rest of the world. The reduction of our manufacturing cost by, among other things, improving loading cycle times, increasing capacity utilization and improving yields in general. Each of these are key goals for us. As previously mentioned our expansion plans include a low-cost labor location in Costa Rica that is now being built. This is a multi-year project that will further help us minimize costs or manage our costs.

Also, given the considerable amount of free cash flow we generate, we will continue to look for tuck-in acquisitions and geographic expansion opportunities like Origio in our two businesses. The key requirement, however, is that each acquisition must exceed our minimum investment hurdle rates. Each must achieve over time a hurdle rate that exceeds 10%. Additionally the markets for both women's healthcare and soft contact lenses are much less developed outside of the United States and we generated a considerable amount of cash offshore due in part to our level of manufacturing outside the United States. As such, we will continue to be -- to aggressively invest in global expansion opportunities. With over 95% of the people on the planet outside the United States we believe we will find opportunities to invest in other countries for decades to come, thereby sustaining our low effective tax rate indefinitely.

And finally, we again this year demonstrated we are opportunistic when it comes to buying back our stock in order to enhance total shareholder return. In summary, before I turn it over to Greg, let me say how pleased I remain with our ongoing progress on many fronts. We continue to outperform the marketplace, most recently growing two to three times the market rate of growth. Our top-line growth in a so-so economy, a low inflationary economy, remains solid and I am very pleased at our upper single digit organic constant currency growth at CooperVision during the quarter. Our family of products, Biofinity, Avaira, Proclear one day and now one day silicone hydrogel MyDay as well as our women's healthcare, our global fertility products, are all promising growth going forward. We continue to execute well and invest in geographic expansion in a new product pipeline.

While we are still very early in our expansion programs in each of the BRIC countries and there are challenges in each, I am very pleased with our progress to date. Our women's healthcare franchise has now become more global with the Origio acquisition made one year ago. Our balance sheet is very strong, our debt to cap which was near 40% only a few years ago is now single digit at 9%. We remain keenly focused on delivering consistently improving results mindful of our desire to invest and leverage prudently, thereby delivering a respectable total shareholder return.

Lastly as always, a reminder that at Cooper our number one asset is our employees. To them a big thank you for consistently delivering great results. And now, I turn it to -- over to Greg to cover more financial highlights.

Greg Matz - *Cooper Companies Inc - CFO*

Thanks, Bob, and good afternoon, everyone. As Bob shared with you a pretty thorough review of the market and our revenue picture, let me start with gross margins. Looking at gross margins in Q3 the consolidated GAAP to non-GAAP gross margins were 65.1% compared with 63.5% for GAAP and non-GAAP in Q3 last year. We continue to see strong headwinds due to the impact of foreign exchange, predominately the Yen, on our revenue and the related direct impact on gross margins, which had approximately a 90 basis point impact year over year. In addition we continue to experience a negative mix impact due to Origio, which we purchased in July 2012. Despite these headwinds we continue to run favorable margins due to a reduced CIBA royalty, strong product mix led by Biofinity and increased manufacturing efficiencies.

Looking sequentially, we saw gross margin drop from a high of 66.2% to 65.1%. This is primarily attributable to our normal seasonality of manufacturing variances including the impact of the December plant shutdowns, that inventory turns, as well as FX. We saw the continued degradation of the Yen, which had a 30 basis point impact. For Q4 we are looking for gross margins to be in the range of 65.5% to 66%. CooperVision on a GAAP and a non-GAAP basis reported a gross margin of 65.4% versus 62.8% for GAAP and non-GAAP in Q3 last year. Factors driving the year-over-year gross margin improvement were the reduction of our royalty expense, product mix and manufacturing efficiencies. The major headwind on gross margin was FX, largely the weakening of the Yen. CooperSurgical had a GAAP and a non-GAAP gross margin of 64.1%, which compares to Q3 2012 of 67.1%. As previously discussed, the lower margin is primarily attributable to our acquisition of Origio in July of 2012.

Now looking at operating expenses. In the quarter on a GAAP basis SG&A expenses increased by 6% from Q3 last year to $152.1 million and were 37% of revenue versus 38% of revenue in the prior year. Part of this increase reflects CooperVision's continued investments in geographic expansion. Also remember that we acquired Origio in July 2012 and our current quarter has three months of expenses versus the one month in the prior year. On a non-GAAP basis, SG&A grew 9% year over year. The difference is GAAP SG&A for Q3 2012 included $4 million of Origio deal costs, which was excluded to get to non-GAAP last year. SG&A was up 1% sequentially. As we discussed in the past CooperSurgical is impacted by the medical device excise tax. We had about $700,000 of medical device excise tax in the quarter that hit SG&A. We expect about $2.4 million in 2013.

R&D expenses. As we look at R&D, in Q3 R&D increased by approximately 13% year over year to $14.9 million or up about $1.7 million. R&D was 3.6% of revenue, up from 3.5% in Q3 2012 and down from 3.8% sequentially. As we discussed in the prior quarter, we would expect that R&D will continue to grow slightly faster than sales in fiscal 2013. Depreciation and amortization. In Q3 depreciation was $23.4 million, up $1.5 million or 7% year over year; and amortization was $7.7 million, up $1.8 million or 31% year over year, for a total of $31.1 million. Origio amortization for the quarter was approximately $2.1 million. Moving to operating margins, for Q3 consolidated GAAP and non-GAAP operating income and margin were $93.6 million or 22.7% of revenue versus $77.3 million and 20.4% of revenue for GAAP and $81.3 million and 21.5% for non-GAAP in Q3 2012. This represents a 21% increase in operating income over Q3 2012 GAAP numbers and a 15% increase over non-GAAP. The increase in GAAP operating margins is due to a combination of improved gross margin and the elimination of the 2012 Origio deal costs and GAAP operating expenses.

Interest expense was $2.3 million for the quarter, down 2% year over year. Looking at the effective tax rate, in Q3 the GAAP and the non-GAAP effective tax rate was 2.3% and 5%, respectively, versus Q2 -- I'm sorry, Q3 2012 GAAP and non-GAAP effective tax rate of 6.2% and 6.1%, respectively. As we discussed before and as Bob mentioned, 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. In Q3 the single biggest factor impacting our effective tax rate was the drop in the UK statutory rate from 23% to 20%, which was enacted in July. This had a favorable quarterly impact of about 230 basis points. So our 5% non-GAAP rate would have been 7.3% without this. We now expect the full-year GAAP effective tax rate to be in the range of 5.5% to 7% and the non-GAAP effective tax range to be in the range of 7% to 8%. This will result in an estimated Q4 non-GAAP rate of 9.5% to 10.5%.

When thinking about these ranges and our future effective tax rate, remember, there were some nonrecurring items so far this year, including the UK statutory rate reduction impact on our deferred tax liabilities I just mentioned, the favorable settlement of a foreign tax authority audit we mentioned in Q2, and the multiple years of R&D tax credit which was renewed in Q1. These will amount to roughly 200 basis point reduction in the effective tax rate this year. Another driver in the lower effective tax rate is the reduction of the CIBA royalty, which increased offshore profits and which we will continue to see going forward. Earnings per share. Our Q3 earnings per share on a GAAP and non-GAAP basis was $1.79 and

$1.74, respectively, versus $1.36 and $1.45 on a GAAP and non-GAAP basis in Q3 2012. Our earnings per share is up 32% to 20% on a GAAP and a non-GAAP basis, respectively, versus the prior year. Touching on share repurchase, there was no share repurchase activity in Q3. There still remains $184.5 million available under this program.

Regarding foreign exchange, currency continues to have a big impact on our business from a year-over-year perspective and even some continued negativities since we gave guidance on our Q2 earnings call. From a year-over-year perspective, currency negatively impacted us by $0.17 and this was mainly driven by the Yen, which is down 25% year over year. From our Q2 earnings call when we last give guidance, currently negatively impacted Q3 EPS by $0.02 and is projected to negatively impact Q4 by an additional $0.02. As we look at the fourth quarter we continue to see a significant negative impact on a year-over-year basis of around $0.16. This does include some favorable impact of seeing some of our lower cost pound inventory flow through the P&L in Q4. Regarding our Q4 guidance, we used roughly today's rates of Euro being $1.32 and the Yen at 100. Looking at the balance sheet and liquidity, in Q3 we had cash provided by operations of $103.1 million, capital expenditures of $38.6 million, resulting in $64.5 million of free cash flow.

Inventories were basically flat a $340 million from last quarter. For the quarter we are seeing months on hand at 7.1 months, up from months on hand with 6.6 months last year and down from 7.8 months last quarter. AR continues to be well managed, with DSOs at 53 days, up slightly from 52 days last year but down from 54 days at the end of last quarter. Before I turn it back to Kim I want to touch on guidance for Q4. And Bob mentioned some of this but just to reiterate it, total Company revenue for Q4 is expected in the range of $410 million to $425 million for a year-over-year growth rate of 4% to 8%. We expect CooperVision's Q4 revenue to be in the range of $330 million to $340 million or a year-over-year growth rate of 4% to 7%. This equates to a constant currency growth rate for CooperVision of 8% to 11%. We expect CooperSurgical's revenue in the range of $80 million to $85 million, with a year-over-year growth rate of 3% to 9%.

We expect non-GAAP gross margin in Q4 to be in the range of 65.5% to 66%, non-GAAP OpEx to be around 41.5%, non-GAAP operating margin to be in the range of 24% to 24.5%. As I mentioned earlier we expect the Q4 non-GAAP effective tax rate to be 9.5% to 10.5%. Our Q4 GAAP earnings per share is estimated in the range of $1.76 to $1.81 and excludes the impact of the potential [IME] transaction. Our Q4 non-GAAP earnings per share is also estimated in the range of $1.76 to $1.81, this being based on a diluted share count of 49.9 million shares. Finally, we expect capital expenditures for the year of $180 million to $210 million and free cash flow of $180 million to $210 million. With that, let me turn it back to Kim for the Q&A session

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Kim Duncan - *Cooper Companies Inc - Senior Director IR*

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

QUESTIONS AND ANSWERS

Operator

Thank you.

(Operator Instructions)

Kim Gailun, JPMorgan.

Kim Gailun - *JPMorgan - Analyst*

Just two quick ones. The first is on gross margin. And as we look at it sequentially, in the quarter you were down just over 100 basis points and gave a lot of detail on the call, so thanks for that. And I think essentially what you were saying was FX sequentially was about 30 bps worse and most of the rest of that was manufacturing variances. Just hoping you could clarify that. Was there any mix impact sequentially? And then the follow-up is just with the lower tax that we're seeing this year and how we should be thinking about earnings growth for next year. You had a bunch of different moving parts in the tax rate this year and how we should think about that number as we get into 2014 ?

Greg Matz - *Cooper Companies Inc - CFO*

Great. Yes. Thanks. On the gross margin I think you nailed it. We basically had the Yen go against us a little bit from our last guidance so from a sequential standpoint we did see about a 30 basis point impact. And we do have -- if you do look back and I just have data for the last five or six years in front of me, and you can see that Q3 is always our lowest gross margin quarter. We see that dip, it's normal, we have a number of manufacturing variances that come through including we have traditionally shut down our plants in December in order to do some maintenance and get it prepared for the year and that flows through naturally in the Q3 timeframe. On the tax side we have had a lot of one-time items pop up this year. We're not in a position where we want to give guidance for next year. I did want to highlight that there are some things that are one time in nature and that's why I brought that out. On the other side that I didn't mention but you have a certain number of discrete items that reverse occasionally each year and the size of those items are really we don't know those in advance. So that has an impact that can actually raise the rate. So at this point we're not going to go through and give yearly guidance for 2014 on the tax rate.

Operator

Larry Biegelsen, Wells Fargo.

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

-- taking the question and good evening. I wanted to focus on MyDay if I could. So obviously you just launched the product. Bob, you mentioned that demand is strong. Could you give us an update on pricing relative to Dailies Total 1 and True Eye. Will you be able to meet capacity -- meet demand. Do you have enough capacity to meet demand going forward in fiscal 2014 and any more color on the US approval timing and the production plan. And just lastly, Bob, on MyDay, could you just give us some reassurance that as you ramp up we won't have production issues that we did with Biofinity? Thanks.

Bob Weiss - *Cooper Companies Inc - CEO*

All right. As far as the pricing of MyDay, not going to get into all the details other than to say we are obviously not going to price at the high point that both True Eye and Total 1 are, which is the reason that the market remains a niche market. So expect our pricing is not just going to clearly be below that sphere and that tier of pricing. As far as demand, demand is going to be certainly exceeding our capacity throughout 2013 and throughout 2014. And once again that is purely a function of our ability to ramp up and long lead times on equipment that are 12 to 18 months, which really will push us out to 2015 and beyond. As far as the timing of US and what we expect in the US, the approval to sell in the US we expect within the next 12 months. Whether or not we immediately go to market once we get that approval will be a function of not overextending our reach.

So if the demand is robust in Europe and we've committed to customers we are going to honor those commitments first in Europe and then we'll take it from there as we ramp up. As far as the risk of not being able to ramp up, it's more about getting the equipment, plugging it in, validating it. It is not novel equipment. It is equipment we have been using in the production of both Avaira as well as the production of MyDay. So I think it's more execution unlike Biofinity when that really got started way back when in 2006, 2007 and 2008, it was a material that was challenging to us and a huge learning curve, not only the equipment, the production equipment that came into play but also the material came into play. So I think we're beyond that. Next question?

Operator

Matthew O'Brien, William Blair.

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

Thanks for taking the question. Can you guys hear me okay?

Bob Weiss - *Cooper Companies Inc - CEO*

Yes.

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

Okay. To follow-up a little bit on Larry's question about MyDay, as I recall the big market right now that's the big chunk of daily overall silicone hydrogel revenue is Japan. And I'm just curious, I think I get the strategy as far as going to Europe first but you've talked about some pretty big demand there and I think that's a relatively small market. So if it fair to characterize that potential revenue opportunity is something along the lines of a few million dollars maybe $10 million at the high end over the next 12 months or so? And then within there, as MyDay gets to be a bigger and bigger piece of the overall business certainly it is going to weigh on gross margins but the absolute contribution on the revenue side is going to be much higher. So should we expect a higher level of share repurchases or a higher dividend rate to offset what may be going on throughout the P&L?

Bob Weiss - *Cooper Companies Inc - CEO*

You kind of lost me someplace along there but let me comment on Japan. You're correct Japan is the biggest one day silicone hydrogel market. The gating of the one day silicone hydrogel market and the rate limiter have much more to do with price points than it does whether or not demand is there for silicone hydrogel. So the reason we are not going straight to Japan has a lot to do with the registra -- the approval process, so we are embarking on going down that path and we'll get to Japan at some point in time. As far as is the product limited by way of revenue potential, I think not -- in the next couple years we're not worrying about can we sell the product. It's kind of weird that we sell it in one order and how do we control the process so we don't offend people that can't get the product. So that's really the rate limiter, but in the perfect world if Japan were available, who knows? We might have that -- meaning that we had the approval process we might very well go there first. But that's theoretical. As far as I think some of those other questions you asked, you're going to have to maybe repeat them?

Greg Matz - *Cooper Companies Inc - CFO*

I think, Matt, when you mentioned buyback, we just don't -- we don't really comment on that.

Bob Weiss - *Cooper Companies Inc - CEO*

And other words, any buyback done by us, we have the approval to go into the market and we go into the market opportunistically. But we clearly do not define what that means or the parameters of that. I would view that as not linked with anything else we're doing. Maybe the only limiter would be use of cash in terms of investment opportunities and other things on our plate.

Operator

Jeff Johnson, Robert Baird.

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

Hey guys, good evening. Thanks for taking the call. Let me ask Bob one question and then I do have a follow-up after that but it might be picky and you guys have good fourth quarter revenue guidance our there for CVI but if I look at your fiscal third quarter growth of 9% constant currency for CVI and then your new calendar 2Q was 10%, does that -- is it over-reading to say July slowed down? Can you give us any kind of July or maybe what you're seeing so far to start this quarter off update on the CVI side?

Bob Weiss - *Cooper Companies Inc - CEO*

I think it is over -- number one July of course is in the reported period and I think you're doing a bifurcation of maybe the calendar data and the [CLI] data --

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

Exactly.

Bob Weiss - *Cooper Companies Inc - CEO*

But relative to the guidance we're giving, I think it's pretty in sync with the run rate we had both in the quarter ended June 30, which was the 10%, and the three months ended in July, which is the fiscal period. which was 9% but quite frankly that got weighted somewhat by a non-soft contact lens piece, the [IME] product business if you will. So I don't think you can read any slowing in the bifurcation or in our guidance

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

Okay, that's helpful. And then just another couple questions here on MyDay. First, I just want to confirm it doesn't sound like there was really any revenue or margin implications for MyDay in the quarter. And then, Bob, I'd like to hear -- in the quarter you just reported, sorry -- and then, Bob, I'd like to hear your bigger picture thought on MyDay. It sounds like you guys are probably going to come out at a $500, $550 price point, somewhere in there for MyDay, but long term do you think we have to get that price point down into the $400, $450 range. Where do you think daily [si high] pricing has to settle out if we look at traditionally a 20% or 25% trade-up cost is what takes these lenses out of niche territory into more of a reasonable trade-up range? Where do you think long term that pricing on daily silicone in general needs to go for users to really start taking it up faster?

Bob Weiss - *Cooper Companies Inc - CEO*

I think if we look way down the road you're going to end up with products in different categories as that cost -- as cost comes down over time. It will start taking on a profile a lot more traditional, albeit the strategy of the industry has always been trade up and hold the premium, some premium. My only problem with Total 1 and True Eye is that there is a limit and what you are trying to hone in on is where is that limit. There's no doubt that Moist establishes a good guideline of what is affordable. It's the biggest product in the category. And so you know price point can be at least Moist, you know the price point, since Moist is not a siliconized gel, can be higher than Moist. So I think that's one parameter that we know works in the marketplace or is -- the market is willing to pay a premium for silicone hydrogel above hydrogel. So it's someplace above Moist but clearly there is a point where it cuts off and that is where the sharpening of the pencil comes into play, which is we're not going to get too far into the details on that.

Greg Matz - *Cooper Companies Inc - CFO*

And, Jeff, to your other question on the margin, obviously MyDay has a margin well below our standard margin but it's in the rounding based on the volume of the product at this point for the quarter.

Bob Weiss - *Cooper Companies Inc - CEO*

Yes, so it's -- to your point we did not -- it was not a contributor to the quarter in that the rollout of the MyDay itself is a fourth quarter event as we speak now in Europe.

Operator

Steve Wiloughby, Cleveland Research.

Steve Willoughby - *Cleveland Research Company - Analyst*

Hi, everyone. Thanks for taking my question. Just one follow-up question on a comment that was just made on MyDay first and then I have a follow-up too. Could you just give us an update on your progression in improving the yield and margins on MyDay and where you stand now. I think in the past you've talked about maybe a 10% gross margin on that product. Just wondering where that is now?

Bob Weiss - *Cooper Companies Inc - CEO*

Let's say we're still early in the startup cycle on the production and there are things on the new equipment as it comes in that will be more accommodating to the product. And you're right; it's a learning curve. We'll continue to improve. We're well into the black, meaning when we initially started the product and when we initially rolled it out as a private label, the private label product for the most part was negative gross margin. The costs have come down so we're in positive territory but we have a long way to go relative to where we expect to take it.

Steve Willoughby - *Cleveland Research Company - Analyst*

Okay, great. And then my next question is just on the competitive environment now that Total 1 is both in the US and in Europe. I was just wondering it looks like you guys are still obviously continuing to outgrow the market in overall and in dailies. I was just wondering about what your thoughts are maybe longer term on as some of your competitors start to launch new lenses, Sauflon gets FDA approval, things like that?

Bob Weiss - *Cooper Companies Inc - CEO*

Well, I think as long as the price point is where it is on Total 1 and True Eye, this is the market that today is, let's say, something around or a little less than 5% of the global market or around that number, predicated mainly or targeted mainly at Japan. So it's -- I would say not all that much is happening in Europe and the US in the extreme premium part of this market. As far as Sauflon is concerned and clarity, it's my understanding they do have approval in the US but having said that I think they now have an order for equipment so I think like the other people in this space everyone is in the process of ordering equipment whether you're J&J or Alcon or Cooper or Sauflon, you're -- there is lead time on equipment and ramping up.

Operator

Joanne Wuensch, BMO Capital Markets.

Joanne Wuensch - *BMO Capital Markets - Analyst*

Thank you very much. Can we turn for a second to CSI? What was the Origio contribution in the quarter?

Bob Weiss - *Cooper Companies Inc - CEO*

The Origio -- we had -- Greg, do you want -- do you have that number?

Greg Matz - *Cooper Companies Inc - CFO*

Origio was accretive. We have incorporated that into our business model so we don't break that out separately

Joanne Wuensch - *BMO Capital Markets - Analyst*

Okay. And it looks as if in your guidance you tightened the guidance range. It looks like the CSI came down a little bit on the top end. Any particular reason for that?

Bob Weiss - *Cooper Companies Inc - CEO*

I just think that's in sync with the run rate off the quarter. I think we brought it down $5 million at the top end. And that's a reflection that they're more towards the middle of the range than towards the top of the range at the time. I think the closure -- as the year progressed the closure device and our conversion there, which started a little in the third quarter in terms of the numbers we put up in the third quarter, kind of ripple into the fourth quarter and it's more whether or not you rounded in -- rounded down in the third quarter.

Operator

Chris Cooley, Stephens.

Chris Cooley - *Stephens Inc. - Analyst*

Good evening. Thanks for taking the questions. Just two quick ones. One, when I think about silicone hydrogel sales as a percentage of total CVI, just looking back over the last roughly eight quarters, flat sequentially here in the 3Q. Should I think about that as greater growth obviously with ClearSight and Proclear in the dailies category or is there anything structural that we should be thinking about just in terms of your portfolio products in terms of what the ceiling may or may not be for silicone hydrogel as a percentage of total CVI revenue. And then just as a quick second one, any update on the transaction there in terms of estimated time of closure, because I'm assuming you're going to have to change that or make adjustments for that for the full year once that closes? Thanks a bunch

Greg Matz - *Cooper Companies Inc - CFO*

So, Chris on the IME transaction we are still working through that. Once we determine that it is definite and that we definitely have a deal, at that point we will book that and you will see that flow through our earnings. We were hoping that's in Q4 but again we have a couple of milestones that we're still working through at this point.

Bob Weiss - *Cooper Companies Inc - CEO*

Chris, on the other -- second comment on silicone hydrogel, as far as it being I think 43% in the second and third quarter, I think that's just shear when does it round up the next level. Obviously we're happy with the 22% growth on a much larger base and so the constant currency contribution in growth is much higher than the total. And clearly it continues to gain the size of our pot, if you will, as well as the market at a very respectable rate. So, no, I don't read anything into the 43% and the 43%.

Operator

John Block, Stifel.

John Block - *Stifel Nicolaus - Analyst*

Great. Thanks and good evening. The EPS growth is certainly very solid this year and I guess you can make the argument adjusted for some of the FX headwinds it looks like it could even be mid-20% growth year over year or higher. I know you quickly mentioned, Bob, low double digits, excuse me, next year and I'm not asking for detailed guidance but just wondering at a high level if you can talk to some of the variables that may lead to the deceleration. I'm guessing one is a potentially higher tax rate but just any other stuff to point to? Is it investments getting ready for greater ramp in MyDay? Anything there would be helpful.

Bob Weiss - *Cooper Companies Inc - CEO*

I guess I would just say we continue to invest money in the Company, both on geographic expansion as well as R&D. That is expanded more rapidly than the top line, meaning the emphasis to D not the R So it's only a matter of having time to digest that and also keep in mind that as the Yen has declined throughout the year, we still already have a hurdle to overcome first quarter next year as that will still take its toll. And those numbers have been pretty big. I think Greg pointed out the $0.17 for this quarter, $0.16 forecast for next quarter, which I think adds up to $0.54 for the year. So that's been a big hurdle and, granted, we've had some good things though that have minimized that this year from the point of view of the royalty and other factors in our cost of goods areas. When you put it all together it is clearly too early to go beyond the guidance we're giving in our -- in my comment, if you will, that it's going to be low double digits

Operator

Amit Bhalla, Citi.

Amit Bhalla - *Citigroup - Analyst*

Question for Greg. If you look to the fourth quarter for the gross margin guidance you're expecting a sequential ramp up. Please correct me if I'm wrong but I think that would assume that one day degradation on gross margin, which is really not going to happen. And so as you look to 2014 can you talk about the gross margin impact from the one day rollout? And secondly, as you think about 2014, Bob, maybe you could talk a little bit about your expectations for market growth and maybe any comments on top line for the Company? Thanks.

Greg Matz - *Cooper Companies Inc - CFO*

Amit, on the gross margin I think if you look back at the last few years, and again I mentioned I have five years in front of me, that Q3 has always been the lowest gross margin of the year. And you will see it go back up in Q4. So you've got a natural process and a lot of these around manufacturing variances, you had a little bit more revenue in the quarter, all of that stuff contributes to a higher margin in Q4. And so from that perspective we feel very comfortable with the guidance that we've given. Again, we're not going to give guidance in the next year. MyDay is still -- it's still a small product compared to our other product portfolios. So even though it has a lower than average gross margin it's -- again, it's not going to drive our gross margins in the coming year just based on the volume.

Bob Weiss - *Cooper Companies Inc - CEO*

Just a couple comments on your questions. Piggybacking on what Greg just -- the comment he just made that MyDay is not going to be a major influence next year. That is still predicated on timing of equipment. The equipment lead times are 12 to 18 months. You're only as fast as the longest piece of equipment it takes to get. So it is unlikely, quite frankly impossible to get the equipment in, get it plugged in, get it assembled, get it validated, make product and have the product make it out the door to any significance next year relative to any equipment we now have on order. That is clearly -- capacity is the governor in 2014.

Therefore MyDay is just not going to be a big factor in that process. Relative to market outlook I would say that we're -- there's no indicator I've seen that says the market should be outside of that range we've given in the past of 4% to 6% in a post deep recession economy that we had. So we're now, in my opinion, in the 4% to 6% range and we've been running most recently towards the bottom end of that range at 4% but I do think we'll start to accelerated a bit. As far as our guidance, our guidance would be limited at this point in time to say and we continue to expect to gain share. We're not saying we're going to match what we've done the last one to two years at 2x to 3x the market. We're going to gain share by how much that is one we're not going to attempt to put a lot of color on right now.

Operator

With no further questions we'll turn the call over to Mr. Bob Weiss for closing remarks. Please proceed, sir

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Bob Weiss - *Cooper Companies Inc - CEO*

Well, I want to thank everyone for calling in today and once again for those of you that have new year's activities, our apologies for the overlap and have a great, happy new year. For everyone, I look forward to updating you on our year-end results in December, I think it is December 5, very much like today, the fifth, so we look forward to giving you an update on just how well 2013 went at that point in time. Thank you.

Operator

Ladies and gentlemen, that concludes today's conference. Thank you your participation. You may now disconnect. Have a great day.
