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EDITED TRANSCRIPT

COO - Cooper Companies Inc at Jefferies Healthcare Conference

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PRESENTATION

Anthony Charles Petrone - *Jefferies LLC, Research Division - Equity Analyst*

Thank you, everyone, for joining us on the fourth day of the Jefferies 2017 Global Healthcare Conference. I'm Anthony Petrone with Research here in New York. Next, we have Cooper Companies. We're happy to introduce Dan McBride, the company's Chief Operating Officer. And we're going to do it a little bit different here and just do a fireside chat, go through a Q&A with Dan. And we want to keep it as informative as possible, so if any questions from the audience, please either e-mail or we'll open it up to Q&A.

QUESTIONS AND ANSWERS

Anthony Charles Petrone - *Jefferies LLC, Research Division - Equity Analyst*

So Dan, I think maybe just to start off, the company, over the past several quarters, has been on a number of product cycles in both the Vision business and Surgical business. Most recently reported earnings a couple of weeks ago, the quarter showed significant growth in a number of categories. Before we get into the specifics of each business, I think maybe it would be good to start off on the Vision side and maybe just an overview, the general state of the market, a recap of total market size, growth statistics in the U.S. and Europe and anything of note within the lens business that you're seeing of lately that you would like to share with the audience.

Daniel G. McBride - *The Cooper Companies, Inc. - COO, EVP and President of CooperVision Inc*

Great, yes. So right now what we're seeing is that the market appears to be getting back to the higher end of the 4% to 6% growth range that we typically say that the industry is growing. It seems to be fairly healthy, largely, in part, our competitors seem to have stabilized a bit. Certainly, J&J has stabilized a bit. Alcon's more of a question mark. So we're starting to see them participating in the marketplace a little more, which is good for the industry as a whole.

The big dynamic remains in the marketplace, the shift to 1 Day, and 1 Day now is getting close to 50% of the contact lens space. There's a double shift going here in the U.S. market of both the shift into 1 Day from being primarily a 2-week and monthly market but also a shift into 1 Day silicone hydrogel. For Cooper, we're well positioned to participate in these market dynamics, having really the only full family of silicone hydrogel 1 Day product in clariti and then a really nice premium product in MyDay, which has a sphere, and now we're releasing the toric into the marketplace. So we're seeing those dynamics playing out.

We think that the -- we are growing 43% in the silicone hydrogel 1 Day space, and we're starting to see our competitors enter the space more meaningfully, particularly with J&J launching the Oasys 1 Day on the premium side and Alcon expanding the Dailies Total1 product range. So we think that's healthy for the market and it's healthy for us.

Anthony Charles Petrone - *Jefferies LLC, Research Division - Equity Analyst*

So you touched upon competition. I think one of the things that certainly is top of mind for a number of folks out there that are familiar with the space is the share shift dynamic. And so maybe if you can review for us where CooperVision was, say, 2 or 3 years ago in terms of total share. And then you specifically mentioned Alcon/CIBA. Can you just give us an update there? It sounds as if there's been some management turnover there. Their Total1 lens has been on the market for quite a bit but seems to be slipping and, for that matter, Bausch + Lomb. So a little bit on where Cooper was a couple of years ago in terms of share, where they are today and the dynamics with those 2 competitors specifically.

Daniel G. McBride - *The Cooper Companies, Inc. - COO, EVP and President of CooperVision Inc*

Yes. Cooper has made a really nice move within the marketplace from -- we were, a few years back, around a 20% market share. We're now at a 24% market share. We were a clear #3. Now we're right on the edge of where Alcon is for #2 globally. If you look at the European market, we're similarly positioned to be #1 in Europe, to take over that share from Alcon. And we would expect to be able to do both those things in the next year or 2. So we've made pretty good moves there. A big driver of that was the acquisition of Sauflon, when we -- really put us from being in kind of a trailing position in 1 Day silicone hydrogel to being in a leadership position in that part of the space.

And then we've been helped a lot by competitive dynamics. So over the last 3 or 4 years, all of our competitors have been disrupted at one time or another. J&J has gone from a 45% share down to around a 39% share, largely on the weakness of its 2-week market. If I were to look at J&J today, I think they've stabilized their business. They put Oasys 1 Day at -- where they would really like to shift the market to. But they've also added Acuvue Vita in the monthly space to give them a play so that the 2-week space has 2 places to go for J&J.

Now, of course, there's a lot of that share that's also going to the rest of us as well because the 2-week was the least compliant segment. So the fact that they're participating in it doesn't really dampen what we see as our growth prospects.

So J&J was a big share giver. I think they're probably stabilized at this point now. When I look at Alcon, Alcon 2 years ago was by far the most effective competitor we had in the marketplace, and then the wheels sort of came off that business. And for the life of me, I'm not exactly sure why, though I think it has a lot to do with the dynamics of how they had their management team shifts that they've had between Novartis, Alcon and CIBA. But they have both a problem with -- currently, their parent company obviously wants to either sell or spin them off, so they're trying to deal with that dynamic. But they also have a fairly weak product portfolio.

Dailies Total1 is a very good product, and it's done well in the premium space. Oasys 1 Day was largely, I think, put up by J&J to kind of counteract what Dailies Total1 was doing to J&J in that space. So they do have 1 good product, but it's in a small segment. The rest of their portfolio is fairly old. They relaunched Air Optix with HydraGlyde. They put a packaging solution in it, but it's basically the same product they've had out since 2004. And they haven't offered a lot of other innovation into the industry.

So they had a good first quarter. They've been very aggressive in the marketplace on pricing and advertising, and I think it's -- it makes a lot of sense, because when you're a business that's looking to either be sold or spun off, showing growth or at least stabilizing that you're not losing share is pretty important for pricing. So I think they've been aggressive in that basis because of the nature of what they're having to go through as a corporate dynamic. And I still will wait and see if there's any real -- I think they're still going to be a share donor over the next year or 2 until they really get their act fully together.

Bausch, we used to talk about the market as being 4 players. It really is more of a 3-player market now with J&J, Alcon and ourselves. Bausch is around 8, 9 share. I think they had -- it's really hard to read through their financials anymore. They're giving less and less information. They used to give their top 20 products. Now they give their top 10. So the products that we can see are all losing share. The read that we're getting in the marketplace is Ultra is not doing a whole lot right now. They're in the process of launching Ultra toric. It seems to be a small launch at this phase, and I don't know a lot about the product yet. But it's kind of a "me too" product in a -- the FRP space is pretty much flat to declining, other than the growth that we're putting into the marketplace. So it's not the right segment to be in.

So we don't see a lot of recovery out of Bausch at this time. And then they are under the same dynamic of what's ultimately going to happen with their parent company and whether they'll be part of Valeant or whether they'll be somewhere else. So it's a combination of we have a very nice product portfolio and we've had a good run in terms of focus, and it's a combination of having competitors relatively disrupted that's been really the drivers for us.

Anthony Charles Petrone - *Jefferies LLC, Research Division - Equity Analyst*

So a little bit on just the market structure in the U.S., and then we'll jump into some product-specific questions. One of the things we're trying to do is get a deeper look into the various channels. So maybe a recap of CooperVision's business as it relates to end market channels, specifically optometrists' offices and the various different types of retailers out there, online and brick-and-mortar. How is that structured? Where's the split of your business today? And do you see much variability quarter to quarter in how that's split?

Daniel G. McBride - *The Cooper Companies, Inc. - COO, EVP and President of CooperVision Inc*

Yes. There's not a lot of variability. Again, this is a relatively stable industry. Even though there's a lot of dynamics that are at play, movements are relatively slow on a quarter-to-quarter basis. When we look at the market, because we're playing in both retail and with the independents and want to have good relationships with both, we really put our touchtone as -- we try and design our product offerings and our pricing as to what is best for the fitter. And so when we look at the market and when we look at what actions we're going to take in the market, it's very fitter oriented.

So as a result, we have less interest in the Internet in terms of seeing them as true market drivers. They're an important player, but we don't see them as really driving people into stores and driving people into contact lenses as much as we see fitters as being the primary driver. And I say that largely as a U.S.-Europe phenomenon. When you go into Asia, obviously consumer dynamics are different, and the development of ECPs and the size of that field is different there, too.

So when we look at what we're trying to do, is we're trying to be effective in both segments, not just independents, but also effective in retail. Part of the way that we're able to do that is in having a very diverse product portfolio so that you can kind of tailor products that are maybe more suited for independents or more suited for retail. And also, we do that through our private label strategy as being able to give products that have some unique feature that allows them to be sort of differentiated in terms of how the end user -- or the ECP goes to the end user.

Anthony Charles Petrone - *Jefferies LLC, Research Division - Equity Analyst*

So a couple product-specific questions. And we'll touch on CSI and financials, but let's dig into the portfolio in a little bit more detail. clariti-MyDay, that combination within silicone hydrogel dailies has been a significant driver. Can you recap where silicone hydrogel dailies as a market is today? Where do you think it can go in 5 years? And what percentage of that market can the combination of clariti-MyDay capture over time?

Daniel G. McBride - *The Cooper Companies, Inc. - COO, EVP and President of CooperVision Inc*

Right. So if we look at silicone hydrogel, it's been the main driver of growth for the industry up until the last couple of years, when 1 Day sort of took over as the main driver for growth. And silicone hydrogel offers a true benefit to consumers in terms of oxygen to the eye for healthier eyes, whiter eyes. When we look at FRP, which is what is our weekly/monthly space, it is now 80% silicone hydrogel, 20% hydrogel. And the whole industry has shifted that way. So we know that the fitters have bought into the story and the belief that silicone hydrogel is the better, healthier material to put consumers into.

When we look at 1 Days, 1 Days currently are at 24% silicone hydrogel and the remainder is still in hydrogel. The dynamics are different in terms of the shift, and that's largely because silicone hydrogel is more expensive to make, and so it sits in a premium segment with Alcon and with J&J, and then we obviously have a premium offering with MyDay. But J&J and Alcon, which are the dominant 1 Day fitters in the marketplace, with Dailies AquaComfort Plus as Alcon's product and Moist as being J&J's product, they don't have a product to shift those consumers into. clariti represents the only product that really is priced at the level of the mass market, and that, of course, is our product.

So when we look at the way the market shifted from hydrogel into silicone hydrogel in the FRP space, we see a slower migration occurring in the 1 Day space because not everybody can participate in the upside of that. Right now, it's largely ourselves. So when I look out over time, rather than projecting that it will be the 80-20 split that we see in the monthly space, in a 5-year time span we think it's going to be more like 60-40, because we think that there's going to be more resistance to the change until we start seeing competitors come up with products.

If you look at our position in silicone hydrogel versus our share of single use, we're way overindexed to the market because we have a great portfolio of products in silicone hydrogel. We could see ourselves in 1/3 of that 60%, which is -- you're talking about potentially, depending on where you see market growth overall for silicone hydrogels, an $800 million to $1 billion product family in 5-plus years.

So that's the potential for it. It obviously depends on how the market actually develops. But there's absolutely no difference in the customers being fit, their wearing habits, the needs of the eye between an FRP, meaning a weekly/monthly wearer, and a 1 Day wearer. And given the fact that silicone hydrogel material is a high-oxygen material, it is healthier for the eye, there's absolutely no reason that, over time, those 2 markets shouldn't look the same. And so we're pretty bullish that there's a huge opportunity there.

Anthony Charles Petrone - *Jefferies LLC, Research Division - Equity Analyst*

So in addition to just being a significant top line driver, it's certainly a margin and earnings power driver for the company. And so maybe can you review the dynamics of shifting a patient from a longer-dated modality to a daily, what the operating margin uptake is on that transition and maybe just a recap on where the operating margin profile is today for both clariti and MyDay?

Daniel G. McBride - *The Cooper Companies, Inc. - COO, EVP and President of CooperVision Inc*

Yes. So in terms of operating margin, you get about a 300% to 400% uplift if you're going from like a 2-week wearer into a 1 Day silicone hydrogel wearer. So there's a huge amount of operating margin and, similarly, I think, the similar amount of revenue uplift between the 2 product lines. So where you take a bit of a hit is on gross margin, because typically 1 Day products are closer to 50% gross margin products, whereas your FRP products are going to be your 60%-north products.

The nice thing about clariti is that it is a product that actually kind of breaks the model there in that it is not dilutive to our gross margin profile. So it's well above -- it's in the 60s, it's not in the 50s as a gross margin product. But then MyDay we see as being more typical in terms of where single-use products or daily products sit.

When we look at their contribution down to operating margin, those aren't -- that isn't data we put out into the marketplace at this stage, but clearly it's a big driver in what we have talked about, which is that we're looking to move the profile of the organization by 2021 to 28%-plus on operating margin. And currently, right now, this year we -- or this quarter we hit 25.5%. So we're seeing good growth in operating margin, and 1 Day is a big driver of that.

Anthony Charles Petrone - *Jefferies LLC, Research Division - Equity Analyst*

And maybe a final product question and we'll jump into CSI in a moment. But Biofinity Energys and the Biofinity Toric XR seems to be even -- making that Biofinity family of products even more durable. And so maybe just a moment on Energys and the Toric XR. It seems those products are doing well. And what is the outlook for the next year, 2 years for those 2 products?

Daniel G. McBride - *The Cooper Companies, Inc. - COO, EVP and President of CooperVision Inc*

Yes. On both of those products, again, when you look at the FRP space, it's really a flat to low-growing -- flat to really low-growth space, and yet all the growth in the space is really coming from Cooper. We grew, I think it was 12% between Biofinity and Avaira in the quarter, and a lot of that has to do with the fact that there's renewed life in the Biofinity with both Energys and XR toric.

What they both offer -- so Biofinity Energys is really a recognition that people use their eyes differently today than they used their eyes 10 years ago. There's a lot more use of devices. There's a lot more close-in work. Everybody's on PDAs, on your cell phone, on your iPad or whatever else. There's no reason that your eyewear shouldn't be supporting that type of usage of your eye. And so Biofinity Energys is just a better sphere than the traditional sphere on the marketplace. We see it as it should be just the base sphere that you're using. You should be -- unless you have an odd consumer that isn't spending their life on the digital world, that's what they should be going into. And that has an uplift in price over the regular Biofinity Sphere, so it's a nice uptick for us.

Biofinity XR toric basically just extends the range of that toric. It makes -- gives practitioners the ability to service pretty much anybody that comes in the door with Biofinity toric as a design. That adds a lot of life to it, not only because it adds new consumers that can be fit with Biofinity toric, but it makes Biofinity toric, which is already accepted as the best toric on the market, all that more relevant to why it should be your go-to toric, because you can use it for everything.

So the combination of that has taken what would have been a product family that you would sort of naturally assume would be slowing down in growth and really renewed all the growth into it.

Anthony Charles Petrone - *Jefferies LLC, Research Division - Equity Analyst*

So quickly on Cooper, the women's health business, CSI, it's been a growth-through-acquisition story for quite some time. Origio I think was one of the key acquisitions positioning the company in the IVF arena. Now can you just review for us the strategy in CooperSurgical and what the M&A wallet is today for future acquisitions?

Daniel G. McBride - *The Cooper Companies, Inc. - COO, EVP and President of CooperVision Inc*

Yes. So Origio really brought us into the fertility space. We had a fertility -- a portion of the original CooperSurgical business was in fertility, so it wasn't a complete stretch into a new space. But Origio really gave us a fuller family of products.

The nice thing about the fertility space is it has an organic growth story to it, and it's a business that's capable of your sort of mid-single or even, in good cases, upper single digit kind of growth. Over the past 1.5 years or so we've added in a genomics piece, which really rounds out to making ourselves much more relevant to the fertility center in terms of the growth of the embryo and the selection of the embryo. And a lot of the equipment that was associated with the Origio business was associated with selection of embryo. So the genetic space really complemented that and actually provides some superior ways for making those selection decisions.

So that's how we see the pieces fitting together. And what really that fertility side does is it provides us a real strong organic growth business to tie to the traditional CooperSurgical business, which is, as you say, one that really is growth through acquisition and will remain so. But even that business, because this is all ultimately coming into fertility and childbirth and there's an interplay between that and the OB-GYN fertility centers, and it's kind of a nice platform. So the businesses are distinct, but they are very complementary. And there's some -- there's definite synergies that can be driven between the various businesses.

When we look at the M&A wallet, if you look at Surgical as it is today, it has all the pieces it needs to be a very successful business. But it still is in a growing space, and there are opportunities. And so we'll continue to look for surgical opportunities to either tuck into the base business, to continue leveraging that sales force and that presence they have in the marketplace or to continue to add in on the fertility side to make it even stronger in terms of its relevance to the fertility center.

So basically, the same strategy that we've had in place all along, which is, if we think it's accretive and adds to shareholder value and meets the internal metrics we have for M&A, then we're still interested in being active and building Surgical. And similarly on Vision. The opportunities tend to be bigger and more spread out, but we're looking to continue to build both businesses.

And so when we look at uses of cash, accretive M&A that adds to shareholder value sits at the top of the list. Share buybacks probably are next, and we do that sort of opportunistically when we see there's a disconnect in the marketplace and we think that our stock should be valued higher. And so if we think it's an opportunity to deliver shareholder value through share buyback we'll do that. And then, of course, we always have debt, both onshore and offshore, to pay back if we ran out of opportunities.

Anthony Charles Petrone - *Jefferies LLC, Research Division - Equity Analyst*

So we have time for one last question. It's just a financial question. So overnight, of course, we had some activity over in London, and currency markets were quite active. And so I think the pound was down about 2% overnight, and clearly that's a benefit for Cooper. There's a bit of a staggered impact. But how should we actually view this most recent move in the pound and potentially when you can see that benefit Cooper P&L?

Daniel G. McBride - *The Cooper Companies, Inc. - COO, EVP and President of CooperVision Inc*

Yes. So whenever the pound moves, the thing to understand is that, in the first 6 months it's a hit because we have a fairly substantial business in the U.K. that's in pounds. So we take the revenue hit immediately. We get the benefit to cost of goods about 6 months later as it rolls through. I would say with the move in the pound, even though one would think it's substantial, but given the moves that the pound has made since Brexit, we kind of view it as sort of a minor move in that regard.

Where I would say the benefit is, is that what we were seeing was strengthening the pound, which was going to help us a lot in 2017 off of what we were bringing in, in terms of manufacturing -- the cost -- the pound in manufacturing in '17. So that, what it really does is it moves the benefit out of '17 and into '18, in my mind, more than anything because we're going to get the cost of goods benefits over there.

But net-net-net, I don't see it changing at all, what we expect to do in 2017. It's not big enough to make that kind of a change. And what it does say is that we should be able to continue to see some really favorable cost structure into 2018, because it looks like it may stick for a while.

Anthony Charles Petrone - *Jefferies LLC, Research Division - Equity Analyst*

And with that, we're just about out of time. Thank you, Dan, for joining us.

Daniel G. McBride - *The Cooper Companies, Inc. - COO, EVP and President of CooperVision Inc*

Thank you.
