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COO - Q4 2013 The Cooper Companies, Inc. Earnings Conference Call

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OVERVIEW:

COO reported FY13 GAAP operating income of $305.9m and GAAP EPS of $5.96. 4Q13 consolidated GAAP operating income was $62m and 4Q13 GAAP EPS was $1.15. Expects FY14 revenues to be $1.675-1.735b and GAAP and non-GAAP EPS to be $6.70-7.00.

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Fourth Quarter 2013 The Cooper Companies Earnings Conference Call. My name is Philip, and I will be your operator for today. At this time, all participants are now in listen-only mode. Later will be conducting a question-and-answer session.

(Operator Instructions)

As a reminder, this conference is been recorded for replay purposes. I would now like to turn the conference over to your host for today, Ms. Kim Duncan, Senior Director of Investor Relations. Please proceed, ma'am.

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

Good afternoon. Welcome to The Cooper Companies' Fourth Quarter and Full-Year 2013 Earnings Conference Call. I'm Kim Duncan, Senior Director of Investor Relations, and joining me on today's call are Bob Weiss, Chief Executive Officer; Greg Matz, Chief Financial Officer; and Al White, Chief Strategy Officer.

Before we get started, I'd 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 I turn the call over to Bob, let me comment on the agenda for the call. Bob will begin by providing highlights on the quarter, followed by Greg, who will then discuss the fourth-quarter and full-year financial results. We will keep the formal presentation to roughly 30 minutes, and then open up the call to 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@cooperco.com. As a reminder, this call is being webcast, and a copy of the earnings release is available through the Investor Relations section of The Cooper Companies' website. With that, I'll turn the call over to Bob for his opening remarks.

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

Thank you Kim, and good afternoon, everyone. Welcome to our fiscal fourth quarter and our fiscal year 2013 conference call. Let me start by saying I'm very proud of the fiscal year, and our accomplishments highlighted by revenue growth of 10%, our non-GAAP earnings per share growth of 15%.

Having said that, I know many of you are looking at our fourth-quarter results versus our guidance, and I want to immediately provide some color on that. Let me start with revenue. As you will have noted on our earnings release, our consolidated revenue growth was significantly impacted by our CooperVision Americas growth of only 2%. This came in around 7% lighter than we were expecting, and it was driven by one key item, channel inventory. Using -- oh, this came in $7 million lighter than we were expecting, and it was driven by one key item, channel inventory. User demand has remained strong, and we've seen no negative signals on that front. However, the largest two US distributors merged, and their efforts to consolidate operations and reduce inventory impacted us significantly in the month of October. This flows into gross margins, as a larger portion of the lost sales would have been Biofinity, which carries gross margins over 70%. On a positive note, CooperVision Americas revenue in November was up 18%, so we are beyond the year-end reduction in channel inventory, and we're entering fiscal 2014 off to a good base.

Next, let me provide some additional color on gross margins. Cost of goods came in around $6 million higher than anticipated. The biggest reason for this was changes regarding the manufacturing of MyDay, our daily silicone hydrogel lens. We made a couple of important strategic moves at the end of our fiscal year to accelerate manufacturing and expand our parameter range. This was done to capitalize on the success we are seeing with MyDay in the market place. Unfortunately there is an accounting hit with these moves, and MyDay was produced at a negative gross margin in the fourth quarter. We've done this with many products over the years, and as volume increases, and as we bring on additional lines, we see these costs decrease. It's very important to note that our manufacturing process for MyDay and our ramp-up of MyDay production is ahead of schedule, and there's no manufacturing surprises. The fact is that demand for MyDay is very strong, and accelerating the manufacturing process hurt margins. This is absolutely the right strategic move, and we are confident it will pay off in fiscal 2015 and beyond.

Also, with respect to 2014, we are comfortable we've captured the impact of MyDay in our guidance. For competitive reasons I don't want to get into too many details, but I do believe we will have sales of MyDay of roughly $25 million in fiscal year 2014. Margins will start the year very low, if not negative, but we should finish the year with margins in the upper single digits. Combining these two items, that channel inventory reduction and the higher cost of goods, resulted in a negative impact on gross margins of approximately 175 basis points from where we were when we gave guidance in September.

Lastly, with respect to the fourth quarter, let me touch upon SG&A over the last couple of months of the quarter, which came in roughly $5 million higher than we originally forecast. Again, the largest part of this was tied to our success with MyDay. MyDay has been received extremely well, and recently won an award for the best contact lens product at the prestigious Silmo Global Optical Show in Paris in late September. Based on that, we made the decision to be more aggressive launching the product in Europe. I believe this was the right decision, and we will remain aggressive marketing this product going forward.

Totalling the three items, the channel inventory reduction, the high cost of goods, and the higher SG&A cost, earnings per share was negatively impacted by roughly $0.30 at the end of the fourth quarter. Let me say I'm not concerned about the end-user demand, and we believe we are beyond the channel inventory issue. I'm also not concerned about the production of MyDay or the demand for this product. All I'll discuss later -- as I'll discuss later, MyDay will have a significant impact on our P&L in coming years, as it's a reduction of gross margins, but a driver of top- and bottom-line growth. We believe it is absolutely a positive for our business.

Now let me spend some more time on the revenue line. Our sales are a tale of two cities, an overall strong quarter of CVI and CSI, but a very weak October in CooperVision Americas. As I mentioned, the Americas weakness was due to the channel inventory matter at the distributors, and it negatively impacted revenues by $7 million. At the end of the day though, end-user demand remained strong throughout the world, with all of the CVI regions, and core products posting solid results. This is clearly seen in the market data for calendar year Q3, where we grew 10%, almost twice the market.

Additionally, in spite of US distributor issue in October, our sales of silicone hydrogel continue to drive our market-share gains. Silicon hydrogel sales were up 19% in the quarter in constant currency, and now represent 45% of CVI's revenues. The key driver continues to be Biofinity on a global basis, with strong contributions from all modalities, as well as all lens types, spheres, torics, and multi-focals. In Japan, our roll-out of Biofinity continues to go extremely well, with sales up two times the prior year -- 2X. Avaira had a decent quarter, growing 8%. As mentioned, MyDay roll-out is very strong, constrained only by our capacity issues. Also, our Proclear one-day product continues to gain share, with revenues up 19% in constant currency. Once again, I'm happy to say we believe we are gaining share across the board in all regions, all modalities, all lens types, spheres, torics, and multi-focals; and materials, be it silicone hydrogel or traditional hydrogel lenses. This demonstrates the breadth of our product portfolio.

Within CooperSurgical, I'm pleased to report sales growth of 8%, led to our -- led by our IVF franchise, which grew 24%. Stock -- geographically. Foreign-exchange headwinds continue reducing CooperVision revenue 3% in the quarter. Excluding foreign exchange, CooperVision growth was 6% in the fiscal quarter. Last year, the euro was down 7%. This year the yen was down 19% in the fiscal year, and 25% in the fourth quarter, compared to the prior year. With $200 million of revenue in Japan, this is not only impacting our revenue, but is also negatively impacting our gross margin, as well as our operating income and our bottom line. Even with the major -- this major nuisance, on the strength of the product lines we are putting up some solid numbers.

From a revenues perspective, regionally we have put up solid constant-currency growth, except for the Americas, which was impacted in October by the 16% decline in days in inventory at authorized distributors. Regionally, the Americas is up 2% in the fourth quarter in constant currency, Europe 8%, Asia-Pac 11%, and worldwide 6% in constant currency. Our growth drivers are, in the Americas trading up to Biofinity, including the halo effect of Biofinity multi-focal, with the entire family doing well. Also, while off of a smaller base, Proclear one-day, sphere, and multi-focal is a key contributor. In Europe, right now currency is helping offset some of the yen. Driving our 8% constant-currency growth in this region is the entree, the entire Biofinity family, and the one-days including MyDay. In Asia-Pac, while foreign exchange took its toll on revenues, our constant-currency revenues were up 11%, 12% excluding Aime. Drivers, the tremendous success of the Biofinity family, especially with the halo effect of Biofinity toric and the Proclear one-day.

Let's talk a little bit about the marketplace. The worldwide soft contact lens market in the third calendar quarter 2013 was up 6% in constant currency, while CooperVision was up 10%. For the trailing 12 months ended September 30, the soft contact lens market now is $7.4 billion worldwide, was up 5% in constant currency. CooperVision was up 10% on the strength of Biofinity and Proclear One Day. For the calendar quarter, the market growth was sponsored by one-day growth, which was up over 10%. While industry growth data is no longer available on silicone hydrogel material, most likely this trade-up of material remains a solid growth driver. CooperVision was up 23% in constant currency in the calendar quarter, third quarter of 2013, and at CooperVision, silicone hydrogel now represents 45% of our revenues.

The soft contact lens market continues to be at trade-up market. This includes premium products silicone hydrogel lenses, torics and multi-focals. The trade-up to one-day disposable expands patient revenue by 400% to 600%. Even more important, the one-day wearer generates 300% to 500% more profit per patient. 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, the Americas did best, up 7% in the calendar quarter, on the strength of the one-day trade-up; Asia-Pac, 6% on the strength of a 10% growth excluding Japan; and in Europe it was up 4%, also on the strength of the one-day trade up.

CooperSurgical, our women's health care franchise, turned in a solid $84.8 million in revenue, up 8% with the prior-year fourth quarter, on the strength of a $29-million contribution from fertility, which accounts for 34% of CooperSurgical, and was up 24% above the prior year.

I'll talk briefly about guidance. We have now provided more color on what we think fiscal year 2014 will bring. We remain bullish about top-line growth and gaining market share. We expect upper-single-digit top-line growth, with CooperVision growing close to double digit in constant currency, and continuing to out-pace the market. Our assumption is that the soft contact lens market will continue to grow in that 4% to 6% range. Between Biofinity, Proclear one-day, and now MyDay, we have the products to address the growth areas of the global soft contact lens market.

On the profit side, we will have a few ongoing challenges. Clearly, the yen will stay a headwind, at least through the first six months of the fiscal year, with the prior-year comps for the yen being 85 in the first quarter last year, and 95 in the second quarter. The other muddying factors will be the ongoing expense of the MyDay roll-out, and the numerous capital expansion programs we are in the middle of. Also, geographic expansion will continue on several fronts. Even so, we remain optimistic Biofinity will continue to deliver a good top line, gross margin percent, and operating profit to fund many of our ventures. The net result is we expect to deliver very respectable growth in non-GAAP earnings per share, in the 13% to 18% range, or the $6.70 to $7 in our guidance in the fiscal year 2014. 2014 will be another year of heavy commercial, heavy commitments to capital expenditures. We expect capital expenditures will exceed $200 million. Even so, we again expect to deliver in excess of $200 million of free cash flow.

One more point before I leave guidance. I, for several years, have been very clear and very deliberate about saying we will forgo our greatly improved gross profit percent for the trading up to the one-day modality that is expected to deliver 400% to 600% more in top-line revenue per patient, and longer term, 300% to 500% more profit per patient. This will come at the expense of the lens care industry. We remain committed to the strategy, to this strategy, and to our 2018 objective of a 25% operating income margin. Other contributions in the 2014 to 2018 period include the roll-off of the CIBA royalty, the elimination of the ten-year amortization period on the Ocular Sciences acquisition in January 2005. It rolls off in 2015. The beginning of the expiration of depreciation on many of the Gen 2 lines that came with the Ocular acquisition; and additionally, the expiration -- we will begin -- additionally, the expectation that we will begin leveraging some of the investment we've been making in global sales and marketing and R&D the past six years. All in all, we believe a 25% operating income target for 2018 is achievable.

One thing I have historically put much -- not put much color on is how we have done the first month following the quarter. Breaking with tradition given my earlier comments about the 16% shrinkage in the US authorized distributor pipeline, I thought I would add some color. In November, CooperVision's revenues were up 5% as reported, but up 12% in constant currency, excluding Aime. The Americas were up 18%. These November results have been factored into our fiscal year 2014 guidance. Enough on guidance and outlook. Today I'm going to skip some of the traditional comments on strategy to allow a bit more time to have Greg review the financials, and for questions and answers.

In summary, before I turn it over to Greg, let me say how pleased I remain with our results. We continue to out-perform the marketplace, most recently growing in the neighborhood of two times the market for soft contact lenses. Our family of products: Biofinity, Avaira, Proclear one-day, and MyDay; and in the women's health care fertility, all have promising growth potential in the global marketplace. We have continued to invest in global expansion, and are making good progress in many of these markets.

Our balance sheet and our free cash flow are strong, and will fund our global expansion plans as we aggressively move into the one-day market, which accounts for over 40%, or $3 billion of the $7.4-billion soft contact lens market worldwide. While we are more than willing to trade off our gross profit for one-day top line, we will do this in a manner that increases our operating income margins and earnings per share. We remain keenly focused on delivering improving results, mindful of our desire to invest and leverage prudently, thereby delivering optimized long-term total shareholder returns. I might add we purchased almost 1 million shares of our stock in the fiscal fourth quarter, and will continue to do this if we believe it makes sense.

Lastly, as always, a reminder that at Cooper, our number one asset is our employees. To them, I wish to continue to express my appreciation for their dedication to creating great results. Now, I'll turn it over to Greg to cover more of the financial highlights.

Greg Matz - *Cooper Companies Inc - VP, CFO*

Thanks Bob, and good afternoon, everyone. Bob shared with you a pretty thorough review of the market and our revenue picture. Bob also gave you highlights of our Q4 gross margin and earnings per share versus our expectations we'd shared in guidance on September 5.

Let me start with gross margins, looking at the full fiscal Q4 2013 versus Q4 2012. In Q4, the consolidated GAAP and non-GAAP gross margins were 64.1%, compared with 63.8% for GAAP and non-GAAP in Q4 last year. We continue to see strong headwinds year over year due to the impact of foreign exchange, predominantly the yen, on our revenue and the related direct impact on gross margins, which had approximately a 95-basis-point impact year over year. We are seeing a large impact to margins of approximately 70 basis points due to MyDay, and a combination of mix and start-up costs. As we discussed in the past, we've been fluctuating between low and no margins on this product, which is normal in the start-up phase where you are building capacity. Helping to offset the headwinds has been favorable product mix, excluding the impact of MyDay, and the CIBA royalty savings. On a full-fiscal-year basis, we finished at 64.7%, up 80 basis points from the prior year.

CooperVision, on a GAAP and non-GAAP basis, reported a gross margin of 64%, versus 63.7% for GAAP and non-GAAP in Q4 last year. Factors impacting gross margin in the quarter, as I mentioned, are the currency headwinds, MyDay, and the CIBA royalty savings. For the full year, gross margins went from 63.4% in 2012 to 64.8% in 2013.

CooperSurgical had a GAAP and a non-GAAP gross margin of 64.3%, which compares to Q4 2012 of 64.1%. Fertility, with lower margins, will continue to put pressure on our gross margin. But we still expect CooperSurgical's margin to be modestly higher in fiscal 2014. For the full year, CooperSurgical's margin went from 66.4% in 2012 to 64.2% in 2013. The reduction was largely due to the purchase of Origio in July 2012, which expanded our presence in the IVF space.

Now looking at operating expenses, SG&A in the quarter on a GAAP basis. SG&A expenses increased by 3% from Q4 last year to $157.2 million, and were 38% of revenue, same as the prior year. On a non-GAAP basis, SG&A grew 4% year over year. The difference is that GAAP SG&A for Q4 2012 included $800,000 of a Origio integration costs. As Bob previously mentioned, during this past quarter we did experience higher selling and marketing expenses than planned, as we ramp some of our product launch efforts for MyDay in Europe. On a sequential basis, SG&A was up 3%. As we discussed in the past, CooperSurgical is impacted by the medical device excise tax. We had $736,000 of medical device excise tax in the quarter hit SG&A. We had a total of about $2.4 million hit in 2013. We would expect to see around $3 million for this tax in 2014.

Now looking at R&D. In Q4, R&D increased by approximate 12% year over year to $15.8 million, or up $1.7 million. R&D was 3.8% of revenue, up from 3.6% in Q4 2012. We expect R&D will continue to grow faster than sales in fiscal 2014.

Depreciation and amortization -- in Q4, our depreciation was $24.1 million, up $560,000, or 2% year over year; and amortization was $7.7 million, up approximately $400,000, or 5% year over year, for a total of $31.8 million. For the year, depreciation and amortization were $95.1 million and $30.2 million, respectively, for a total of $125.3 million.

On October 31 this year, we completed a transaction to sell Aime, our rigid, gas-permeable contact lens and solution business in Japan to Nippon Contact Lens, Inc. The business was originally obtained as part of the December 2010 acquisition which included obtaining the rights to market Biofinity in Japan. The divestiture is consistent with CooperVision's strategy to focus on its core soft contact lens business. The Company recognized a fourth-quarter GAAP charge to earnings, under the line of loss on divestiture of Aime, in the amount of $21.1 million. This will have a GAAP EPS impact of $0.28 for the quarter, and $0.26 for 2013. Going forward, this is expected to be neutral to earnings per share.

Moving to operating margins, for Q4, consolidated GAAP operating income and margin were $62 million and 15.1% of revenue, versus $79 million and 19.9% of revenue in Q4 2012. On a non-GAAP basis, operating income and margin were $83.1 million and 20.2% of revenue, versus $79.8 million and 20.1% for non-GAAP in Q4 2012. This represents a 4% increase in operating income over Q4 2012 non-GAAP numbers. The difference in the current year between GAAP and non-GAAP operating income is the $21.1-million Aime charge. For the full year, GAAP operating income and margin were $305.9 million, and 19.3% of revenue, up 8% in operating income, down 30 basis points on the margin. On a non-GAAP basis for the full year, operating income and margin were $327.6 million, or 20.6 % of revenue, up 13.7%, and up 70 basis points on the margin, respectively.

Interest expense was $1.9 million for the quarter, down 30% year over year. Looking at the effective tax rate, in Q4 the GAAP and non-GAAP effective tax rates were 6.2% and 10.3%, respectively, versus Q4 2012 GAAP and non-GAAP effective tax rates of 12.7% and 13%, respectively. As we've discussed before, the effective tax rate continues to be below the US statutory rate, as a majority of our income is earned in foreign jurisdictions with lower tax rates. The full-year GAAP and non-GAAP effective tax rates were 4.9% and 7.4%, respectively, versus 2012 rates of 9.7% for both GAAP and non-GAAP.

Looking at earnings per share, our Q4 earnings per share on a GAAP and non-GAAP basis was $1.15 and $1.48, respectively, versus $1.46 and $1.47 on a GAAP and a non-GAAP basis in Q4 2012. Earnings per share is down 21% on a GAAP basis, largely due to the $0.28 charge for Aime in the current quarter, and the $0.10 benefit in Q4 2012 from insurance proceeds. On a non-GAAP basis, EPS is up 1%, or $0.01 versus the prior year. In Q4 2012, the non-GAAP earnings also benefited from the $0.10 favorable impact of insurance proceeds. As Bob discussed, Q4 earnings per share was impacted negatively by US distributor inventory reductions, and certain items in cost of goods sold, and operating expenses, led by decisions to support our MyDay product. For the full year, our earnings per share on a GAAP and a non-GAAP basis was $5.96 and $5.95, respectively, which is a growth of 18% and 15.3%, GAAP and non-GAAP, respectively.

During Q4, we repurchased approximately 960,000 shares, with an average share value of $128 per share, for a total cost of $123 million. This makes the total shares repurchased during 2013 approximately 1,421,000 shares, at a total cost of $167.3 million, or $117.78 per share. This leaves a remaining $61.6 million available for future share repurchases under the current approved program. The earnings-per-share impact of our 2013 share repurchases is $0.01 in Q4 and $0.05 for the full year.

Regarding foreign exchange, currency continues to have a big impact on our business. From a year-over-year perspective, currency negatively impacted us by $0.12. This was mainly driven by the yen, which is down 25% year over year. For the full year, we saw a $0.50 EPS impact due to currency. At the current FX rates, we would expect an approximate $0.21 negative FX impact on EPS next year, which is baked into our guidance. For our 2014 guidance, we used today's rates of roughly $1.36 for the euro, 102 for the yen, and $1.64 for the pound.

Looking at the balance sheet and liquidity items real quickly, in Q4 we had cash provided by operations of $150.3 million, capital expenditures of $72 million, resulting in $78.3 million of free cash flow. For the year, our free cash flow was $239.4 million. CapEx for the year was $178.1 million.

On September 16, we announced the Company closed a $300-million, five-year, senior unsecured term loan, which matures September 12, 2018. We used the facility to pay down borrowings under our $1-billion, senior unsecured, revolving line of credit, which matures May 31, 2017. This term loan provides additional financial flexibility through an improved maturity structure, additional capacity, and lower interest rates. Total debt increased within the quarter by $101 million to $344.7 million, due to $123 million of share repurchases. This leaves us with approximately $1 billion of total credit available at October 31.

Inventories were basically flat, at $339 million from last quarter. For the quarter, we are seeing months on hand at 6.9 months, up from a months on hand of 6.7 months last year, and down from 7.1 months last quarter. Accounts receivable continues to be well managed, with DSOs at 53 days, down slightly from 54 days last year, and the same as the end of last quarter.

Now turning to guidance. In order to provide a little bit more color for your models, let me share some additional specifics on our guidance. Revenue range for the Company is $1.675 billion to $1.735 billion. CooperVision's revenue range is $1.355 billion to $1.395 billion. Finally, CooperSurgical's revenue range is $320 million to $340 million. We expect non-GAAP gross margin to be around 65% for the year, and slightly less in the first half, as we make progress on the MyDay ramp-up, specifically around re-engineering current equipment from MyDay. We continue to expect efficiencies in the manufacturing process, positive impact due to Biofinity, offset by MyDay in currency, especially the pound impact on manufacturing, as we look at rates up into the 1.64 range. As we stated in the past, just under 50% of our production value is produced in the UK.

OpEx we are expecting around 43%. Amortization at $28 million for the year, with around $7.4 million in Q1 and Q2, and Q3 and Q4 would each be about $6.7 million. R&D's expected to grow slightly faster than revenues. Operating margin expected to be around 22%, interest expense to be around $8 million. Our effective tax rate is expected to be in the range of 8.5% to 10.5%. Our earnings per share, as Bob mentioned per GAAP and non-GAAP, is expected to be in the range of $6.70 to $7. Finally, we expect capital expenditures and free cash flow for the year to be above $200 million. With that, let me turn it back to Kim for the Q&A session.

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

Operator, we are now ready to take some questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Your first question comes from line of Jeff Johnson from Robert Baird.

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

Bob, I just want to go back to your comments on the 25% operating margin in fiscal 2018. Greg, you laid out a plan here of maybe 130, 140 basis points of margin expansion in fiscal 2014. So from fiscal 2014 to fiscal 2018, Bob, obviously you're going to have a lot of moving parts as MyDay becomes an even bigger part of the mix. You obviously have some things coming off on the IP side, and also on the amortization side.

But wondering as you paint the picture going from 20%, 20.5% this past year to 25%, is it a pretty consistent 100, 150 basis points a year each of the next five years, or when we get beyond fiscal 2014, is there risk that we may be flattened out at the margin line for a year or two as MyDay has a bigger impact, before then seeing a nice pick up from there?

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

Jeff, I think it is going to be -- I don't want to say smooth, but 2015 should be an okay year relative to 2014, and when you move into 2016 likewise you have some favorable events. As I see it, it may be not a straight line going up from 20% to 25%, but it shouldn't be a hockey stick, meaning we hang out at 21.5% to 22% until the last two years. That's not the way I see it. I see it improving somewhat every year.

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

All right, that's helpful. Thank you.

Operator

Your next question comes from the line of Jon Block from Stifel. Please proceed.

Jon Block - *Stifel Nicolaus - Analyst*

Great guys. Thanks and good afternoon. I guess maybe I will try to wrap this up in one question. Can you speak a little bit Bob to MyDay? It's been out there in Europe, the pricing. You talked a little bit about manufacturing, and it seems like hitting the gas there, you now have approval in hand with the US, but you are seeing strong demand in Europe. Can you talk to is Europe pushing out the US because you want to make sure that you are feeding those mouths, or are you trying to hit the gas to even come to the US sooner? Thanks.

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

John, we are obviously very pleased with the progress we're making in Europe, and following good military guidelines, you don't over-extend yourself and then tick off everyone. Europe is obviously in the queue first up, and suffice it to say that means depending on how Europe is going, will influence the timing in the US.

Having said that, on the other front, the supply end we are doing everything we can do to accelerate within reason the production side. It obviously, because of the long lead times, somewhat problematic to just kind of wish it all here tomorrow, because that's just not going to happen.

Europe is doing very well. The gold award at the Silmo conference, best product there, only gave it a better shot in the arm. One of the things we did do is deliberately round out the product portfolio, which means build out the plus powers, as well as the minus powers.

That obviously was done with the intent of giving the customer a better product line to pick from, and it did cost the short term in terms of yields. It cost the short term in terms of cost of goods. We just think there is a right kind of decisions to make.

But to answer your question about the timing into the US, it will probably get her some time next year, but number one it won't be robust. Number two, it is somewhat influenced by Europe.

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

Next question?

Operator

Your next question comes from the line of a Steve Willoughby from Cleveland Research. Please proceed.

Steve Willoughby - *Cleveland Research Company - Analyst*

Hi, guys. Just a question on the MyDay and what that product looks like going forward. For gross margins to get into -- maybe let's say 40% to 50% range, where other one-day lenses are -- can you maybe walk through what needs to happen there?

Is it just a matter of increasing your capacity in volume for that product, or do we need some sort of breakthrough in the manufacturing process in order to get the margins up on that product? Thanks.

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

Steve, I guess I would describe it this way. There are some easy fixes and easy improvements getting the first, getting to the red zone, so to speak. We have a pretty good map of where we are going the next three or four years by way of improvements in the equipment where manufacturing improvements in the yields on the existing lines.

When you then get down to the point where maybe you are approaching 40% margins, moving the next 10 gets a bit more challenging, and you have to find those ideas sooner rather than later, if you're going to alter some of the equipment or modify the equipment. It is very much like the description of 20% OI going to 25%. It is going to happen in steps along the way, but directionally it will -- we'll get a good way down the path.

Operator

Your next question comes from the line of Kim Gailun from JPMorgan. Please proceed.

Kim Gailun - *JPMorgan - Analyst*

Great. Hi everybody, thanks for taking the question. Question on MyDay. At what revenue level do you think that MyDay becomes operating-margin neutral? You talked about some of the gross margin ramp that you are expecting in 2014, but I also imagine you're going to be spending on sales and marketing behind the MyDay roll-out. At what level should we think about that becoming a product that's closer to operating-margin neutral relative to the corporate average?

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

Kim, many products that we roll out like this, be it Proclear one day, be it Biofinity, quite frankly, for several years didn't make operating profit. For sure today it makes operating profit. We are going to look at how much muscle at any point in time we have by way of capacity, and how many markets we have available to dictate that.

My expectation is that it is unlikely we will be making profits on MyDay the next several years, with the intent of continuing to develop that franchise, continuing to drive down cost of goods, but we'll be putting a fair amount of muscle as the capacity increases behind the product once we come to the US, and then once we go into other markets around the world.

So it isn't as -- if we wanted to make money, clearly we can kind of map out the European model, invest one year and start reaping profits as early as two years from now, but I don't think that's the right model. I truly hope the product has more legs so that we have investment opportunities even post the two-year period.

I don't want to assign anyone a dollar amount and say gee, if we get to $100 million, we arrive at profitability. Costs will be coming down, no doubt, as you ramp up and it's a $100-million product line instead of a $25-million product line. But there are other variables that we will consider in drawing that line.

Kim Gailun - *JPMorgan - Analyst*

Okay, thank you.

Operator

Your next question comes from the line of Matt O'Brien from William Blair. Please proceed.

Unidentified Participant

Hi, guys. It's Kayla in for Matt. First off, I just wanted to get a little bit more color on the channel inventory issues that occurred this quarter, and if you could just help us understand what gives you the confidence that those issues won't linger into 2014?

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

Kayla, good question. The confidence we really have is a year ago some of you may remember we had a reduction in channel inventory, and that reduction was around 20% in the authorized distributors here in the United States. I'm talking principally about the US now.

We assumed that that probably would be where it would settle out. Then during the course of this year the merger came along of the two largest distributors. They're certainly our two largest distributors in the United States. We kind of knew maybe something would happen that would -- they had different models, and we weren't sure which model would pre-empt which and in what time frame, and what the implication would be.

It turns out we found out at the end of the fourth quarter that those levels were going to come down to a pretty tight level. It's our best view that's where it's going to settle out. That means that in 2013 we really lost arguably one to two weeks of sales to distributors in the year. Therefore, we quite frankly have a slightly easier comp in 2014 than we do in 2013, as a result of that phenomenon.

But we think based on what we saw in November and month to date in December that we have a handle on the fact that they got it down to the level they wanted and it is business as usual going forward.

Unidentified Participant

Okay, that's helpful. On MyDay, you have mentioned that $25 million estimate in 2014, does that assume any further contributions in the US next year?

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

No. Nominal.

Unidentified Participant

Thank you.

Kim Gailun - *JPMorgan - Analyst*

Next question.

Operator

Next question comes from the line of Larry Biegelsen from Wells Fargo. Please proceed.

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

Good afternoon, guys. Thanks for taking the question. I'm trying to understand the items in the fourth quarter that hurt you by $0.30 on EPS line. We should see them as one time or not?

If they are one time then your EPS would've been about $6.26 for the year and the guidance for 2014, then the implied guidance would be 7% to 12% growth, not the low double digits that you said on the third-quarter call. If you can help me understand that, that would be helpful.

Bob, on the gross margin, I heard the 65% for 2014 in the guidance, and I heard obviously your commentary earlier. Can you talk about how the gross margin progression looks over the next few years, given some of the head winds and tail winds, even directionally. Do you think the gross margin can go up, or should we kind of model it flat for the next few years beyond 2014? Thanks.

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

(no audio - technical difficulty) As far as how much is re-occurring and how much is non-re-occurring, clearly things like the authorized distributor shrinkage in 2013 should not repeat, and should be viewed as non-recurring. That's kind of a step-up of be it $0.10, plus or minus. That gets you, if you will, from $5.95 to $6.05.

When it comes to those things surrounding MyDay, that is not black and white. Some of it was one time within that pot, such as taking a machine down and retooling it for the MyDay operation. Some of that will, if you will, once you get into production, go away. Having said that, some of that activity continues into 2014, so there will be some repeating of some of the events in the fourth quarter into 2014, which is built into our full-year guidance.

I think the comp is not at either extreme, not at the $5.95 compared to let's say the mid-point of $6.85, just to pick a number within that range; nor is it at the -- I add $0.30 to the $5.95 and then do the comp. It's someplace in the middle of the $0.30 and the zero.

On the second question of gross margins, where do they go from here? There are a number of moving parts. There's no doubt the royalty, there's no doubt things like depreciation, there's no doubt MyDay. There's no doubt the remnants of foreign exchange, which have played havoc on us in the last two years.

How you look forward the 65% going down the road to 2018, some of that will be the more successful we are with MyDay, the more pressure we obviously put on that gross margin going forward. I think I've indicated several times I really don't care if it turns out to be one day is 50% of our portfolio, our gross margin undoubtedly will be lower than 65%. I kind of hope that happens, because it obviously is good for our operating income line -- and not only the top-line growth, but the operating income growth.

I would assume that the 65% going forward has some potential pressure on it if we are extremely successful with MyDay. Beyond that, if it is kind of middle of the road, we have a fair amount of good things going that may minimize some of the mix issues by MyDay. Whether or not that leads to 65% or something modestly lower, I don't know, quite frankly.

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

Thank you.

Operator

Your next question comes from the line of Joanne Wuensch from BMO Capital Markets. Please proceed.

Joanne Wuensch - *BMO Capital Markets - Analyst*

Thank you very much for taking my question. The channel inventory situation, which segment of CVI did that impact the most? Do we assume that the entire roll-off that happened in the fourth quarter comes completely back on? My second question is, the operating margins for CSI don't really seem to be recovering from the Origio acquisition. Can you talk about plans to help that move forward, too? Thank you.

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

First of all, on the channel inventory, which comes from CVI US, and I think we indicated that a fair amount of what that distributor gets, which is the US profile, if you will, of products, excluding the limited-volume SKUs for torics, for example, which we ship direct, and they don't go through the distributor. By and large, the distributor takes the entire breadth of the US product line of CooperVision, ex the -- stop keeping units that don't make sense to carry at that level.

As far as the impact, the impact was on the fourth quarter. We are expecting that level, that new level of inventory on hand, will stay quarter by quarter hereafter -- which is to say no new collapse, no new comeback. It's not going to step up, and it's not going to step down, it is going to stay steady state. That's our underlying assumption. There is some modest tweaking that goes on within the quarterly cycles for cyclical reasons, but it is fairly modest. It is nothing like what we are talking about at year end.

As far as the operating margins of CooperSurgical, will they rebound to where they were pre-Origio, Origio number one is a very global acquisition. As you go global building out that structure, it's going to operate a little less efficiently by nature than having a US-centric business where I make it in the US, ship it in the US, that's all there is. That's one downward pressure.

Second thing is we continue to invest in Origio as it builds itself out globally. It grew 24% this last quarter, and as long as it's putting up good growth numbers, we will continue to invest and not try to reap the profits on that.

The one thing we do have in mind, however, is ultimately fine-tuning its production process, I guess in the sense of product mix and profitability on the gross margin line. I would hope that as we look forward over the next several years we improve somewhat on its gross margin.

Joanne Wuensch - *BMO Capital Markets - Analyst*

Thank you.

Operator

Your next question comes from the line of Amit Bhalla from Citigroup. Please proceed.

Amit Bhalla - *Citigroup - Analyst*

Two quick ones for Greg. Greg, number one, share-count guidance for 2014. Second on Aime. I just want to reconcile on a non-GAAP basis the charge and the impact on revenues and earnings to the fourth quarter, based on Aime.

Greg Matz - *Cooper Companies Inc - VP, CFO*

Okay, Amit. The first thing, the share count is 49.5.

Amit Bhalla - *Citigroup - Analyst*

Okay.

Greg Matz - *Cooper Companies Inc - VP, CFO*

For Aime, if you look at Aime there are a couple pieces. One the charge was the $21.1 million we mentioned. It had for the fourth quarter a $0.28 impact. For the year it's $0.26. That difference is really around taxes. There was a tax true-up in there. You actually had some additional $0.05 of tax true-up in the quarter.

If you look at the difference between GAAP and non-GAAP you see $0.33. That really is an additional $0.05 on top of the $0.28 Aime. For it's a typical tax true-up at the end of year. You estimate your rate throughout the year. Once you hit year end, finish your provision, you're able to go back in and exact-like hit what your tax rate will be. So nothing unusual.

Operator

Ladies and gentlemen, this will conclude the question-and-answer portion of today's call. I'll now turn the call back over to Bob Weiss for closing remarks.

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

Well, thank you, everyone, for participating in today's call. We are obviously very excited as we look down the road to 2014. I think you can tell that from our guidance. We are feeling pretty bullish about what is going through the pipeline.

We're very bullish about MyDay, and look forward to talking to you a lot more on our first-quarter conference call about our progress in some of these areas as we go forward. With that, I think our next conference call is on March 6, if I have it right, of 2014, which is a Thursday. We look forward to updating you at that point in time.

Operator

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