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COO - Q1 2014 The Cooper Companies, Inc. Earnings Conference Call

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OVERVIEW:

COO reported 1Q14 consolidated GAAP operating income of $81.6m and GAAP EPS of $1.47. Expects full-year revenue to be $1.685-1.725b and GAAP EPS to be $6.75-7.00.

CORPORATE PARTICIPANTS

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Steve Willoughby *Cleveland Research Company - Analyst*

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PRESENTATION

Operator

Good day, ladies and gentlemen, and thank you all for joining The Cooper Companies first-quarter 2014 earnings conference call. My name is Ryan and I will be the operator on today's call. At this time all participants are in a listen-only mode. We will facilitate a question-and-answer session later. (Operator Instructions).

As a reminder we are recording this call for replay purposes. Now I will hand the call over to your host, Ms. Elizabeth Bremner with Investor Relations.

Elizabeth Bremner - *The Cooper Companies, Inc. - IR*

Good afternoon and welcome to The Cooper Companies first-quarter 2014 earnings call. I am Elizabeth Bremner, Investor Relations analyst and joining me on today's call are Bob Weiss, Chief Executive Officer, Greg Matz, Chief Financial Officer, and Al White, Chief Strategy Officer.

Before we get started, I would like to remind you that this conference call contains forward-looking statements as defined by the Private Securities Litigation Reform Act of 1995, including all revenue and earnings per share guidance and other statements regarding anticipated results of operations, market conditions, and integration of any acquisitions or their failure to achieve anticipated benefits.

Forward-looking statements depend on assumptions, data or methods that may be incorrect or imprecise and are subject to risks and uncertainties. Events that could cause our actual results and future actions of the Company to differ materially from those described in forward-looking statements are set forth under the caption Forward-looking Statements in today's earnings release and as described in our SEC filings including the business section of Cooper's Annual Report on Form 10-K. They 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 of the quarter followed by Greg who will then discuss the first quarter and full or financial results. We will keep the formal presentation to roughly 30 minutes and then 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 email IR@coopercos.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.

And with that, I will turn the call over to Bob for his opening remarks.

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

Thank you, Elizabeth, and good afternoon, ladies and gentlemen, and good evening in some cases. Well, a few financial highlights. A solid way to start the new year -- topline growth was 7%, 11% in constant currency excluding the divestiture of Aime. GAAP and non-GAAP earnings per share of $1.47 and non-GAAP earnings per share is up 20% versus the prior year's first quarter.

Some highlights and key events during the quarter. We continued to gain market share and grow at two times the market. Our silicone hydrogels are posting -- posted $154 million in revenue, were up 30% in constant currency in the fourth quarter -- or in the first quarter. A rollout of MyDay most notably in Europe proceeds to plan; our manufacturing ramp-up of MyDay is also proceeding to plan if not slightly ahead of plan.

The depth of our topline growth is broad-based, all regions, all modality, all types of lenses, spheres, torics and multifocals in both hydrogels and silicone hydrogels. We delivered a solid topline, a solid gross profit percent, a solid operating margin and a solid earnings per share. We took the opportunity to continue opportunistically, buying our shares, buying in another 396,000 shares for $50 million.

At $326 million, CooperVision revenues put up solid topline results in the first quarter excluding the effects of the divestiture of Aime, our CooperVision sales were up 14% in constant currency versus the prior year. Our silicone hydrogel family continued to drive our top line. With revenues of $154 million our silicone hydrogels were up 30% in constant currency. Our silicone hydrogel family is now very deep, monthly switches Biofinity, two weeks, [Vera] and now the daily disposable MyDay. All modalities performed well. Even our non-silicone hydrogel products performed well. Our Proclear family led by Daily Disposables was up 12% in constant currency and accounts for 25% of CooperVision's revenues.

By lens type, we also kept our momentum with torics accounting for 31% of CooperVision's revenues of 12% in constant currency and multifocals now 10% of CooperVision revenues up 24%. We continue to lead the market in these more specialized categories.

When it comes to the fastest growing modality, Daily Disposables or single-use lenses we put up stellar numbers with single use seers up 14% in constant currency and overall single use up 19%.

Geographically, CooperVision's foreign-exchange headwinds continued reducing our revenues down 3% in the quarter. Excluding foreign-exchange and the Aime divestiture our CooperVision revenue growth was 14% in constant currency. The biggest headwind is still the year-over-year comps on the yen which was down 21% versus the prior year. With $200 million of revenue in Japan this certainly is a drag but one that should moderate, starting in the second quarter.

From a revenues perspective we have put up solid constant currency growth in all regions. Our growth drivers are in the Americas, trading up to Biofinity including the ongoing halo effect of Biofinity multifocal with the entire family doing well. Also while off of a much smaller base, Proclear one day and the Avaira Toric in Sphere family are significant contributors.

In Europe right now the euro is helping offset some of the yen, driving our 13% constant currency growth is the -- in this region -- is the entire Biofinity family 1-Days, including MyDay and Avaira. In Asia-Pacific, while foreign-exchange took its toll on revenues in constant currency our constant currency revenue was up 17% excluding Aime. The Biofinity family with strong support from both Biofinity toric and Biofinity multifocal and single use led by Proclear 1 day are key drivers.

In Asia Pac, torics and multifocals are key drivers by lens size.

Worldwide [silicone] soft contact lens market in the fourth quarter of 2013 calendar quarter was up 6% in constant currency while CooperVision was up 13%. For the calendar 2013, the soft contact lens market now $7.5 billion worldwide was up 5% in constant currency. CooperVision was up 11% on the strength of Biofinity and Proclear 1-Day and by lens type, torics and multifocals.

For the calendar fourth-quarter the markets growth was sponsored by 1-Day now 43% of the soft contact lens revenue dollars [worldwide], while industry growth is not currently available on silicone hydrogel material its trade up material is most likely the growth driver and we believe silicone hydrogel accounts for about 48% of soft contact lens revenue worldwide.

CooperVision is currently at 47% of silicone hydrogel revenue dollars. Soft contact lens market continues to be a trade up market; this includes premium products, silicone hydrogel torics and multifocal. The trade up to the 1-Day disposables and revenue per patient by 400% to 600%. Even more important the one day wear generates 300 to 500% more profit. It's also important to understand that torics and multifocals have a long way to go in terms of capturing the market opportunity especially outside the United States.

Geographically the Americas did best 8% in the calendar quarter, on the strength of the 1-Day trade up and a strong showing from silicone hydrogel torics and multifocals. Asia Pac delivered 6% growth aided by a strong showing of silicone hydrogel lenses and in Europe was up 5% for the same reason.

Looking at CooperSurgical, I wanted to talk to our franchise. It turned in a slightly positive revenue performance in the quarter. We were pleased with the continued strength of topline growth in fertility which was up 15% above prior year. Our fertility business now accounts for 35% of our CSI franchise. With our office in surgical space we continue to run into industry headwinds caused by the Affordable Care Act or Obamacare, if you will.

Having said that the negative 6% we reported is not truly reflective of that business as we had -- some orders we typically receive in the first quarter did place in the second quarter. This would have brought our office in surgical sales closer to a flat quarter.

For the year we believe we will see moderate topline growth for CooperSurgical with gross margin similar to last year and operating margin expanding to some operating expense leverage. Overall Surgical continues to be approximately 20% of our overall global business.

Looking at guidance we continue to increase our earnings per share by raising the lower end and narrowed our revenue guidance initially provided on our year-end earnings call. This guidance reflects our successes in the first quarter including a $0.04 benefit of our buying of almost 400,000 of our shares in the open market in the first quarter.

MyDay, our new 1-Day silicon hydrogel being rolled out in Europe and in Australia and New Zealand is marching to plan and we are continuing to expect around $25 million in revenue this fiscal year, limited only by capacities and strengths.

On strategy we continue to -- we are continuing with our successful strategy which I frequently have articulated in the past. We believe it is a solid one and it has delivered results. CooperSurgical is putting up solid results and is leveraging infrastructure of the franchise, was built with solid understanding of the value of critical mass in the woman's healthcare market, targeting OB/GYNs.

We follow the professional wherever they go -- office, surgery center, hospital, or [IBF] centers. Although the call points are different for each, the leverage is considerable. CooperSurgical's first-quarter gross profit percent was 63%, operating margin was 18% and due to minimal capital requirements CooperSurgical is a significant contributor to our free cash flow. We are dedicated to the strategy and will continue tuck-in and non US acquisitions to leverage this [physical] structure and products.

At CooperVision, the strategy is more complex and is much more global in nature. The $7.5 billion soft contact lens industry, because of the uniqueness of our manufacturing platform, we are the only company that anticipates with a very broad and very deep product portfolio. Just to crystallize this point, CooperVision aggressively promotes silicone hydrogel and non-silicone hydrogel which is the Proclear family.

CooperVision emphasizes branded and nonbranded products. Note private label does not mean lower operating margins. Already we actively promote and specialize in custom lenses with a high gross profit percent, I might add. We support all modalities; the eyecare professional prescribes one day to week and monthly lenses and we support all types of lenses. Spheres, torics, multifocals with approximately 30% of our share in the high growth areas of specialty lenses, categories torics and multifocals. It is acknowledged by eyecare professionals we are pretty good at specialty contact lenses.

Few eyecare professionals would challenge why this success of Biofinity toric for stigmatism. Put a great design together with a great material and great things can happen.

We have seen similar successes for that same reason with Biofinity multifocal, which first hit the market in the middle of calendar year 2011, almost 2 years ago. On the capacity front, we are capable of delivering considerable more product where we had been previously supply-constrained.

Biofinity family Proclear 1-Day and our 1-Day toric and all our -- are all in good capacity shape. Our newest endeavor is now ramping up MyDay or 1-Day silicone hydrogel. On pricing we like the rest of the soft contact lens industry have a trade-up strategy. Our new wears and existing wears are targeted for silicone hydrogel and Proclear family and 1-Day or single use lenses. Each creates more revenue per patient. A 1-Day modality for example results in a 4 to 6 times more in revenue per wear. While this strategy sets prices to gross profit margin and its percent it generally creates 3 to 5 times more profit per wear.

Of course the strategy competes head-on with the lens care space since we are shifting where resources from lenscare to contact lenses only, competing for lens care dollars is more a problem with some of our competitors. In my opinion we continue to be the most selfless company in the industry lacking many of the distractions that some of the -- of our competitors are now going through.

I might add with Biofinity, Avaira, Proclear and MyDay we have a lot to talk about with eyecare professionals around the globe.

As we look down the road over the next several years, we expect to continue improving our operating margins and 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 markets we have solid product portfolio to leverage in all modalities multiple materials, all lens types and we retain our expertise to emphasize customized lenses for 10% to 20% of those wares 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 multifocals around the globe.

The single (inaudible) to Avaira where the Avaira sphere was anxiously awaiting the launch of Avaira Toric. This combination has now put us in a much better position to exploit the US two weeks space owned by Johnson & Johnson and to exploit our private label strategy more aggressively with this family.

While we already have a pretty respectable gross profit and operating margins from a cost perspective, we have considerable upside yet to be fully developed. Upside includes the elimination of silicone hydrogel royalty with the expiration of the patents, reduction of our manufacturing costs by, among other things, improving molding cycle times, increasing capacity utilization and improving yields in general. Each of these are key goals for us, and as previously mentioned our expansion plans include a lower cost labor location in Costa Rica that is now being built. This is a multiyear project that will further help us manage down 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 [Oreshio] in our two businesses. The key requirements however is that each of the acquisitions 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 the US. And we generate a considerable amount of cash offshore due in part to our level of manufacturing outside the US. As such, we will continue to aggressively invest in global expansion opportunities. With over 95% of the people on the planet outside the US we believe we will find opportunities to invest in other countries for decades to come, thereby sustaining a low effective tax rate definitely.

And finally, we again this year demonstrated we are opportunistically willing to buy in our stock to maximize total shareholder returns.

In summary, before I turn it over to Greg, let me say how pleased I am with our progress. We continue to outperform the market, placed more than two times market growth 2012 and 2013 and almost two times over the last five years.

Our market share gains are deep covering all geographies, modalities, lens types, lens materials in our both branded and private labels. Our family of products like Biofinity, and Proclear 1-Day and MyDay as well as fertility and women's healthcare a very promising continuing growth potential in the United States and throughout the rest of the world. We believe our optimism is with good reason.

Because of our solid gross profit percent performance, we have been able to continue investing in geographic expansion, salesforce expansion and R&D for the past five years. Our improving operating income margins have been cost (inaudible) driven leaving room for -- to invest. Our balance sheet and our free cash flow are strong and we will continue to fund each of these areas as well as capital expansion north of $200 million. Being a player in the 1-Day soft contact lens market requires commitment to capital. Not everyone will play. Today, this market is over $3 billion and growing double-digit.

Given the four to six time trade-up, the 1-Day conversion we are more than willing to trade off our gross profit percent for the added profit per patient -- profit per patient of a 1-Day wear, but we remain committed to our 2018 objective of 25% operating income and related earnings-per-share growth impact. 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 cumulatively 2.8 million shares of our stock the past three years at an average cost of $103. We have done this opportunistically with our strong balance sheet and free cash flow. So our focus is on delivering bottom-line total shareholder returns.

Lastly as a reminder that at Cooper, our number one asset is our employees. To them I express my appreciation for the dedication to creating value and delivering results. And now I'll turn it over to Greg to cover some of the financial results.

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

Thanks, Bob, and good afternoon, everyone. Bob shared with you a pretty thorough review of the market and our revenue picture.

Now let me start with gross margins. Looking at gross margin, in Q1 the consolidated GAAP and non-GAAP gross margins were 64.9% compared with 63.3% for GAAP and non-GAAP in Q1 last year. We continued 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 an 80 basis point impact year over year.

We are continuing to see an impact to margins of approximately 95 basis points due to MyDay somewhat equally split between mix impact and start-up costs. As we discussed in the past this product will have low to no margins earlier in the year but will exit the year in the high single-digit margin range which is normal in a start-up phase where you are building capacity.

Helping to offset the headwinds has been favorable product mix led by the Biofinity family and the CIBA royalty savings which started in January 2013. CooperVision on a GAAP and a non-GAAP basis reported a gross margin of 65.4% versus 63.1% for GAAP and non-GAAP in Q1 last year. Factors impacting gross margin in the quarter as I just mentioned are the currency headwinds of MyDay, other favorable product mix and the CIBA royalty savings.

CooperSurgical had a GAAP and non-GAAP gross margin of 63.1% which compares to Q1 2013 of 64.1%. Fertility with lower margins will continue to put pressure on our gross margin as that part of the business continues to become a larger part of their mix, but we still expect CooperSurgical's margins to be around 64% for the year.

Now looking at operating expenses, SG&A in the quarter on a GAAP and non-GAAP basis as G&A expenses increased by approximately 5% from Q1 last year to $158.1 million and [more than] 39% of revenue down from 40% in the prior year. SG&A was up less than 1% sequentially.

Now looking at R&D. In Q1 R&D increased by approximately 15% year over year to $15.7 million or up $2.1 million. R&D was 3.9% of revenue up from 3.6% of revenue in Q1 2013 and 3.8% sequentially. We continue to expect R&D to grow faster than sales in fiscal 2014.

Depreciation and amortization. In Q1 depreciation was $23.9 million down $265,000 or 1% year over year. And amortization was $7.5 million up $136,000 or 2% year over year for a total of $31.4 million.

Moving to operating margins, for Q1 consolidated GAAP and non-GAAP operating income and margin were $81.6 million and 20.2% of revenue versus $68.8 million and 18.1% of revenue for GAAP and $69.4 million and 18.3% of revenue for non-GAAP in the first quarter last year. This represents almost a 19% increase in operating income over the prior year GAAP numbers.

In Q1, CooperVision had GAAP and non-GAAP operating income in margin of $84.1 million and 25.8% of revenue compared with a GAAP and non-GAAP operating margin in Q1 2013 of 22.3%. This year-over-year improvement comes from a combination of improvement in gross margins and leverage in SG&A.

Operating income grew 25.5%. CSI's -- CooperSurgical's GAAP and non-GAAP operating income and margin were $14.2 million and 18% of revenue compared to margins of 17.9% for GAAP and 18.7% for non-GAAP in the prior year. Operating income grew approximately 1% year over year on a GAAP basis but was down approximately 3.5% on a non-GAAP basis.

Interest expense was $1.7 million for the quarter, down 36% year over year. As a reminder included in our Q1 2013 GAAP numbers under gain on insurance proceeds is $14.1 million of insurance proceeds for business interruption related to an October 28, 2011, incident in our UK facility. In other expenses included in the other income loss category approximately $900,000 of FX losses versus roughly $600,000 gain last year.

Over the quarter we experienced relatively sizable currency moves that resulted in some FX losses associated with our intercompany loan, some of which are in restricted currencies which are difficult and expensive to hedge. We do our best to minimize these types of losses or gains through our balance sheet hedging program, but we do experience fluctuations every quarter so we will always see some gains or losses.

And looking at the effective tax rates, in Q1 the GAAP and non-GAAP effective tax rate was 9.1% versus Q1 2013 GAAP effective tax rate of 7.5% and non-GAAP effective tax rate of 9.2%. As we have mentioned 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 taxes.

We continue to expect the full year GAAP and non-GAAP effective tax rate to be in the 8.5% to 10.5% range.

While looking at earnings per share our Q1 earnings per share on a GAAP and non-GAAP basis was $1.47 versus $1.50 and $1.23 on a GAAP and a non-GAAP basis in Q1 2013 respectively. GAAP EPS was down $0.03 over the prior year, largely due to the $0.28 favorable impact due to the business interruption insurance proceeds which were shown in 2013 GAAP earnings but excluded from non-GAAP earnings. On a non-GAAP basis, EPS is up $0.24 versus the prior year.

During Q1 as Bob mentioned, we repurchased approximately 396,000 shares with an average share value of $126.21 per share for a total cost of $50 million. This leaves a remaining $211.5 million available for future share purchases under the current approved plan. There was no impact on EPS for Q1 due to our Q1 share repurchases, but we expect a $0.04 impact for the year.

Looking at FX, regarding the foreign exchange, currency continues to have an impact on our business. From a year-over-year perspective for Q1, currency negatively impacted us by $0.14 and this is mainly driven by the yen which was down 21% year over year. At the current FX rate we now expect an approximate $0.22 negative FX impact on EPS in 2014 with the majority of the remaining impact actually hitting in fiscal Q4. This is reflecting the impact of the strengthening of the pound on our UK production cost and the impact to our P&L based on our inventory turns as we have discussed in the past. Net net though, the thing to keep in mind is currency impact is pretty similar to what we had when we gave our initial annual guidance in December. For today's guidance we used rates of $1.38 for the euro, $1.03 for the yen and $1.67 for the pound.

Looking at balance sheet liquidity, in Q1 we had cash provided by operations of $68.6 million, capital expenditures of $61 million and insurance proceeds of $1.4 million, resulting in $9 million of free cash flow. Total debt increases in the quarter by $1.1 million to $345.7 million. We now have approximately $1 billion of total credit available as of January 31.

Inventories were basically flat at $339 million from the last quarter. For the quarter we are seeing months on hand at 7.2 months up from months on hand of seven months last year and 6.9 months last quarter. Accounts Receivable continues to be well-managed with DSOs at 53 days same as the prior quarter and down from 58 days last year. Looking at guidance for the remainder of the year, Bob mentioned we raised the bottom of the revenue range by $10 million and dropped the top of the range by similar amounts. The full-year revenue range for the Company is now $1.685 billion to $1.725 billion. CooperVision's revenue range is $1.365 billion to $1.395 billion. Finally CSI's revenue range is $320 million to $330 million. Regarding earnings per share guidance, we raised the bottom of our earnings slightly and both GAAP and non-GAAP is now $6.75 to $7.00.

Quickly covering our annual guidance, there are no changes from December, gross margin percent still expected to be around 65%, OPEX, we are still expecting around 43%. Operating margin around 22% and the effective tax rate in the range of 8.5% to 10.5%. We are expecting the share count to be around 49.5 million shares. In addition, free cash flow and Capex are still expected to be greater than 200 [million].

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

Elizabeth Bremner - *The Cooper Companies, Inc. - IR*

Operator, we will now take questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Jeff Johnson, Robert W Baird. Jeff, is your phone muted by chance?

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

Sorry about that. Two quick questions here, one on competition. Lot of noise out there over the last couple of months on competition. Some of us think it maybe is somewhat normal maybe a little bit higher than normal here but nothing too egregious. Others may be thinking it's a bigger year on the competitive front. Like you take just -- not necessarily asking which competitors or anything specific like that but just how you view the competitive environment going into 2014?

And then also on the daily business on your daily disposable business, if I back out an assumption on MyDay of a few $3 million to $5 million or so it looks like the rest of the daily business may be growing amid slightly above mid-single digits. So is that a sign that MyDay is cannibalizing your daily's business or just how should we think about MyDay being incremental versus capitalizing some of your current daily business? Thanks.

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

As far as competition is concerned, I would say it's in 2014 looks to be as active as I would say noticeably more or less, a lot of good products have come out from some of our competitors over the last five or six years. And I would speculate the only thing that shifts who's making the most noise in a given year and, clearly, we have kind of a new entrance if you will in the US, but one that has been around for 20 years in Europe.

And there's a couple of new products from companies that have been less active in the last 10 years. When you put it all together, I don't know that it noticeably changes much other than maybe the market upticks a little bit more because I think we're all getting a little better at the trade-up strategy to one day and now silicone hydrogel 1-Days which is ticker trade up.

As far as cannibalization with MyDay. We kind of looked at that, thought about it we know where the majority of -- by far the majority of the revenue is coming from new fits and competitive products so very little by way of cannibalization occurring.

Next question.

Operator

[John Block], Stifel.

John Block - *Stifel Nicolaus - Analyst*

Good afternoon. It is a little bit of a similar but different question if there is such a thing on dailies. I was going to ask in the US, Bob, if you feel like the Proclear 1-Days may face -- maybe walk us through -- they may face some modest headwinds over the next several quarters until MyDay is out there. In other words are you seeing some of the Proclear 1-Days move to a competitive US [si-islands] only because you guys don't have MyDay in the market yet? And then I have a quick follow-up if you would.

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

Yes. I think the niche -- it's still a niche market in the US with TruEye and Total 1 and they are at the high end. Not where one would expect to find Moist and Proclear 1-Day. Proclear 1-Day, I would say, is more at the top end or the spot on location of Moist and then MyDay would be, which is not relative to the US market, would be more nipping at the top end of the Moist.

We kind of divided that pie in half, top end, top half of the pie. So no, I don't think there's much of an impact at this juncture with 1-Day silicone hydrogels in that US market on Proclear 1-Day.

John Block - *Stifel Nicolaus - Analyst*

Okay, and then as a quick follow-up you mentioned MyDay and feeling good or maybe a little better on the manufacturing side and can you maybe give us a little bit more detail there? In other words is that specific to your ability to ramp manufacturing capacity or is it the thought that maybe you are doing something better on the cost side of things in that high single-digit gross margin exiting 2014 might inch up? Any detail you can give on MyDay manufacturing would be great. Thanks.

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

The [wad] of MyDay in 2014, 2015 is totally capacity-driven and that is what capped us off at $25 million in terms of expectation in 2014 and we are still feeling very good about that number. Mainly because it looks like we will be able to deliver on supply-side enough to deliver that revenue number and maybe a small bit more, but not enough to take to the bank.

So all is going well on the capacity role outside on the yield curve. We talked about entering the year, the first half being in the low single and the second half being the upper singles and then moving into the teens next year. That all is looking very promising, timelines getting equipment in, getting it production quality as we -- say [PQ] is going on schedule and the yield learning curve is on schedule and maybe slightly better.

So therein my little comment about being maybe a little ahead even on the manufacturing side which would be good news. Next question.

Operator

Larry Biegelsen, Wells Fargo.

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

Good afternoon. Congratulations on a nice quarter.

Two for me. On MyDay, can you give us any sense of what you think 2015 will look like beyond the $25 million in 2014? I am just trying to understand if you think you will have significant additional capacity by fiscal 2015 if we should assume a ramp. And secondly we had heard that the weather did have an impact in January/February on the US contact lens market. Can you give us any color around what you are seeing in January/February?

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

I will first comment on question on MyDay ramp-up rollout in 2015. We expect to be able to triple our 2014 number meaning our 25 going up to around 75 once again capacity limited, but that is a function of a number of [lines] coming on board and with that we would then, of course, enter the US market beyond just in 2014 if you see product in the US that would be mainly key opinion leaders, just a handful of them, not much more than that. So it is still restricted to mainly Europe and to a lesser extent New Zealand and Australia.

As far as the weather, the weather we kind of monitored that. I'm sure you we certainly have heard some limitations caused by the weather and we certainly know watching the news that while the shops weren't open in the Southeast when Atlanta got shut down a few days and then it got it again.

So there's no doubt that that took a modest impact on the contact lens space as well as our revenue. Having said that, our numbers were robust enough I don't think we really saw the impact of those impact our P&L. So therein we didn't make much of a statement about it if you will.

Operator

Larry Keusch, Raymond James.

Larry Keusch - *Raymond James & Associates - Analyst*

Good afternoon. I guess two here. First one, Bob, again, coming back to MyDay. When you went to the change in the manufacturing to go to the higher powers as you did in the fourth quarter you sort of went negative margins. I just wanted to confirm that you are back positive margins on the production here and then, secondly, you showed really nice leverage on the SG&A line, certainly growing substantially less than the top line. And just wanted to get a sense of what is driving that and how sustainable that is through the year.

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

On the -- first comment on the growth margin of MyDay is has moved into that low single digits or single-digit arena aside from the fact that when we did take lines down and ramp them back up the second line for example as we call it the [Galactic] line. There was idle equipment during that period of time. So there is a charge in the P&L. In addition let's say if you were to overlay that into MyDay, MyDay would have a net loss on the first margin line when considering idle equipment and start-up costs on the second line. When we look to the line making product and selling product we are in that single-digit arena.

On the SG&A commentary, yes. We are getting some leverage albeit modestly, so, in terms of ramping up, Greg, I will defer if you want to add anything to that.

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

I think the only thing I would add is that we are aware that, as our gross margin improvement has slowed, that we have been talking for the last year that we need to get that in SG&A. And there are focused efforts to look and be mindful of SG&A so I think we are seeing some of that work.

Larry Keusch - *Raymond James & Associates - Analyst*

Okay, terrific. Thank you.

Operator

Anthony Petrone, Jefferies Group.

Anthony Petrone - *Jefferies & Company - Analyst*

Going back to MyDay as well and maybe just to revisit margins there for a bit understanding that margins on the product are in that low single-digit range but sort of as you look out and we look into the next two, three years can you just give maybe a feel of where margins can go on that product over time and when do you see that product eventually becoming margin-accretive to the business?

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

My expectation is that this is a three-year rollout of investing first year in Europe, 2014; second year in the US, 2015; and the third year in Japan and Asia, 2016. During that period of time, margins will move from single digit this year into the teens, upper teens next year and normalize margins I would expect post-year 3 and then you are getting get into the 40s and hopefully we should get in around a 50% neighborhood on gross margin.

Operating margins get into year four by then you start getting a normal, a more normalized operative margin contribution from the 1-Day modality we should be someplace in the 20s. (multiple speakers) Long-term objective if we look at a model [to 18] we have 25% operating margin, the success of the 1-Day strategy should not result in any undue push on the operating margin of 25%. However it will certainly influence the gross profit percent and its related mix.

Anthony Petrone - *Jefferies & Company - Analyst*

Quick follow up there. Does the CIBA royalty, I mean -- how much does the CIBA royalty run off by the end by 2016 entitled to the business sort of play into those figures?

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

What we've said on the CIBA royalty runoff is that it is going to certainly be part of the equation going from 21% last year to 25% in 2018. We are going to take some of that and spend it on certain areas R&D and geographic expansion, but that we -- between leveraging the P&L favorable shift of the continuing growth of Biofinity, which is a very high gross margin, and will help keep our gross margins reasonable in this five-year period that we have enough strings to pull in terms of operating expense levers to get to the 25%.

The other variable, we have the royalty is one, we have the runoff of the 10-year anniversary of the outdoor acquisition where amortization drops off as a favorable tailwind; and then you also have some depreciation on the initial [equipment] we got with the [Ocular] acquisition which is now going to anniversary at 10 years also, so not only amortization but also depreciation on the source line of equipment.

Having said that, we are spending a lot of money on capital equipment so don't expect to see depreciation in total go down. It will go up as we shift into that 1-Day modality. Net net net, we are the royalty is a contributor to that 25% [objective].

Operator

(Operator Instructions) Steve Willoughby, Cleveland Research.

Steve Willoughby - *Cleveland Research Company - Analyst*

Actually two quick ones for you. I know last quarter there was some destocking that was a bit of a head wind. Just wondering if there was any restocking this quarter. And secondly I saw in the press release when you guys were talking about cash flow there was about a $1.4 million insurance recovery, and I was just wondering if that impacted the income statement as well anywhere, and if so, where.

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

I will let Greg answer the second one, but on the first one the discussion on the distributors at the end of the fourth quarter I know there was not a rebuild of inventory so they have the same level in terms of stocking levels essentially that they had at the end of the fiscal year. There was no build during the quarter.

On the insurance, $4 million.

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

It was like $1.4 million. That is -- no P&L impact that is all balance sheet. That is all balance sheet. It was reimbursement for damaged equipment in that October 2011 UK issue where the fire suppression system malfunctioned.

Steve Willoughby - *Cleveland Research Company - Analyst*

So you already got that back? Because I thought maybe a year ago you got some of that back and it positively impacted the GAAP number.

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

Yes, the difference was the business interruption insurance. The business interruption insurance hit the P&L on a GAAP basis and you saw that last year. In fact in Q1 it was $14.1 million. The reimbursement for equipment that was damaged, that always went through the balance sheet and there was no P&L impact.

Steve Willoughby - *Cleveland Research Company - Analyst*

Okay. Thanks so much.

Operator

Matt O'Brien, William Blair.

Unidentified Participant

This is Kayla in for Matt. You talked a lot about Biofinity as a growth driver and we wanted to get a better sense and update on the opportunity there as you see it and, particularly in the US, with a new competitive launch and the monthly [phase]. I know you have touched on the competitive dynamic a bit, but how are you anticipating that will impact your presence here? Thanks.

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

Well, Biofinity has been doing well in the US and throughout the rest of the world. And in this last quarter, it had growth I want to say in around 28% to 24%, it was right up there if you will. 28% constant currency worldwide.

Relative to the launch of a monthly fear in the US market I don't anticipate that we will see much of a volume if you will of that product in 2014, partly as undoubtedly supply limitations are on just very much like we have on MyDay where of you only have one line running it is going to be hard to make a lot of product and your limitations are there.

I think the second issue there is, I think there will be a lot of cannibalization of that product with their franchise product in the same space and that will evolve.

And then thirdly, complete lines having a toric and a multifocal as well as a Sphere is an important factor in the monthly modality. Let's just fill in the 1-Day modality since you're kind of cherry picking if you will but in the monthly space it's very important to have the halo effect and there is -- they still don't have that product finalized let alone in production.

So for 2014 maybe into most of 2015 I don't think it's a big deal. I am not convinced from things I've heard from the competitor that -- spend all the money they need to on capital let alone they are going to do it on a two-pronged approach in the monthly as well as on the daily product (inaudible). So I'm not too losing too much sleep about it.

Unidentified Participant

That makes sense. We also wanted to focus in on the toric results. I know that over the last several quarters growth in that business has been in the single digits and it looks to have accelerated this quarter although a more difficult comparison. We are curious if there is anything in particular that is driving that uptick just beyond continued strength in the market.

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

No. Torics are doing good particular outside the US and particularly some of our 1-Day torics have done very well and our Biofinity in Japan as we roll out toric into our Biofinity and toric in to new areas. So the rest of the world is playing catch-up and I would expect that the toric modality and the multifocal modality as a market is doing very well and we continue to gain share in both of those markets.

As far as the one impact in the fourth quarter, we of course had a fair amount of Biofinity that went into that authorized distributor and so that had some impact on the Biofinity family, which would include to a lesser extent some torics in that equation. But that would be -- I don't think there's mutual year over year in terms of our comps on that.

Unidentified Participant

Great. Thank you.

Operator

Joanne Wuensch, BMO Capital Markets.

Joanne Wuensch - *BMO Capital Markets - Analyst*

Can we spend a minute on CSI, please? This business used to be sort of a mid-single-digit revenue grower with much higher margins. What brings it back?

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

One more time. What's your question?

Joanne Wuensch - *BMO Capital Markets - Analyst*

Question is about the CSI business. It has to do with the slowdown in the revenue growth rate as well as the compression and the margins. You touched upon it a little bit in the introduction, but I am trying to understand what, if anything, can bring this back.

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

Okay. I think what can bring it back is you have a settling in with the cloud of the Affordable Care Act and Obamacare and so there's a lot of two dynamics going on. One is that act, one is consolidation within the profession of the OB/GYN. Meaning more women coming into the profession, more men leaving it. The older demographic was men that are retiring. A newer demographic, women coming into the profession. They are more inclined to go into group practices.

Therefore if you needed one of a product for each office you need, there are less office fronts, if you will. I think most of that will have leveled out. I think the Affordable Care Act is going to translate to more companies that have one product and do not have critical mass and cannot deal with buying groups leaving the marketplace and being gobbled up.

So I wouldn't anticipate a new round of buying opportunities over the next 10 years caused by the Affordable Care Act and the related effects of it. We are in prime position to be in front of buying group and large hospitals making decisions for the main hospital as well as the main campus as well as all of the satellite locations. So I do think that will bring it back.

One of the important things for Cooper and part of that model is refreshing and, quite frankly, we have had some misses on the checkbox on refreshing the portfolio with some new acquisitions over the last two years. It is not because we haven't been kicking tires. We just didn't land the right one yet.

But we are certainly active in the area of looking and seeing what opportunities come out of the Obamacare environment, if you will, and I would suggest there will be some so I do think that will bring it back. We are very leverageable in that model as it stands.

Joanne Wuensch - *BMO Capital Markets - Analyst*

Okay. As a follow-up -- do I have a follow-up?

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

Sure.

Joanne Wuensch - *BMO Capital Markets - Analyst*

Thank you so much. Gross margins came in almost at 65% in the first quarter. Your guidance is still 65% for the year. Improving MyDay margins should dictate that you have leveraged throughout the year. Is this just a touch of conservativism as you discuss that?

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

I will refer that one to Greg, but I think the pound was a good factor in it.

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

Yes. One of the things that we are going to see especially in the third and fourth quarter is we will start to see the impact of the pound and the fact that it has been strengthening and 40% of our production happens in the UK as we have mentioned in the past. And so that will have -- that will put some headwinds on our gross margins second half.

Joanne Wuensch - *BMO Capital Markets - Analyst*

Okay. Thank you very much.

Operator

And we have no other questions in the queue so I will add it back to Bob for any closing remarks.

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

Well, I want to thank you all for joining us on our first call for the new fiscal year. Look forward to updating you on MyDay and other developments for the second quarter on our call that I think is going to be the fifth of June. If my calendar is correct, on a Thursday. So we look forward to updating you at that point in time. And with that I will conclude.

Operator

Thanks, everyone, for your time and your participation. You may disconnect and enjoy the rest of your week.
