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COO - Q2 2014 The Cooper Companies, Inc. Earnings Conference Call

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OVERVIEW:

COO reported 2Q14 revenues of $412m and GAAP EPS of $1.62. Expects FY14 GAAP EPS to be $6.78-7.00 and non-GAAP EPS to be $6.80-7.00.

CORPORATE PARTICIPANTS

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

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

Matthew Mishan *KeyBanc Capital Markets - Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen. And welcome to the second-quarter 2014 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 a listen-only mode. Later, we will be facilitating a question-and-answer session. (Operator Instructions). As a reminder, this conference is being recorded for replay purposes.

I would now like to turn the conference over to your host for today, Ms. Kim Duncan, Senior Director of Investor Relations. Please proceed.

Kim Duncan - *The Cooper Companies, Inc. - Senior Director of IR*

Good afternoon. And welcome to the Cooper Companies' second-quarter 2014 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 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 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 second-quarter financial results. We will keep the formal presentation to roughly 30 minutes, and then I want to open up 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@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.

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, Kim, and welcome, everyone. The solid quarter was continued momentum, topline growth with 7%, with revenues of $412 million. This was 9% in constant currency and excluding Aime from prior-year results. CooperVision grew 9% in constant currency, and excluding Aime, CooperSurgical was up 9%. GAAP earnings per share of $1.62 and non-GAAP earnings per share of $1.64, excluding certain acquisition-related costs. Free cash flow was $65 million, bringing our twelve-month trailing free cash flow to $217 million.

Within CooperVision, we continued making progress with MyDay, our single-use silicone hydrogel rinse. We ramped up production and continued to grow sales. And I'm happy to say everything is progressing well. Additionally, our traditional hydrogel 1-Day business, led by Proclear, continued growing nicely, resulting in total 1-Day growth of 21% for the quarter in constant currency and excluding Aime.

Outside of 1-Days, our growth was driven primarily by Biofinity and Avaira, both -- which grew in the mid to upper-teens. Regarding CooperSurgical, our fertility business, was strong again, up 17%. This drove 9% overall growth in Surgical, which was very nice. From a gross margin perspective, we were at 65.1%, which met expectations, especially given the strength of our 1-Day portfolio, including ramp-up costs for MyDay.

From an operating margin perspective, we leveraged our operating expenses to grow our non-GAAP operating margin to a very nice 21.8%, up from 21.2%. This all lead us to solid earnings per share and to us again raising the low-end of our earnings per share guidance. Regarding guidance, I should also mention we maintained our revenue and continue to be comfortable with the drivers of our growth, 1-Day lenses, driven by MyDay and Proclear, and our Biofinity and Avaira product families.

Now before I get into the specifics on vision and surgical, I wanted briefly to touch on the soft contact lens market in calendar Q1, and our related performance. As you know, we have been taking market share for years at around two times the market. In the first quarter, the market grew 8% and we grew 9%. It's important to know there was an anomaly in the quarter, as Japan raised their sales tax effective March 31. And this resulted in a significant channel fill in Japan. I believe J&J and Alcon have mentioned this.

To net everything out, we believe the best way to look at the market is on a trailing 12-month basis, where we grew 11% and the market grew 6%. Final point on this Japan event did not impact our fiscal second-quarter, as it netted itself out within the fiscal quarter between March and April. We are under-indexed in Japan and Asia-Pacific, and we don't have any impact on our third fiscal quarter.

Now turning to CooperVision details. On the sales side, we had $331 million at CooperVision, which put our prior topline results in the second quarter. Excluding the effects of the divestiture of Aime, a rigid cast permeable business in Japan, our CooperVision sales were up 9% in constant currency versus the second quarter of 2013. Our silicone hydrogel family continued to drive our topline. With revenues of $161 million, our silicone hydrogels were up 20% in constant currency.

Our silicone hydrogel family is now very deep with monthly Biofinity; two weeks, the Avaira line; and now 1-Day, which is MyDay. And with the Proclear family, we continued to gain share in hydrogels also during the second quarter. The Proclear family was up 8% in constant currency on the strength of 1-Days. The overall family accounts for 26% of CooperVision revenues. By lens type, they're also -- we also kept our momentum, with torics accounting for 32% of CooperVision, and revenues up 8% in constant currency, and our multifocals now 11% of CooperVision revenues, up 19% above the prior year.

We continue to lead the market in these specialized categories. When it comes to the fastest-growing modality -- 1-Day disposables or single-use, if you will -- we put up stellar numbers with 1-Day spheres up 15% in constant currency, and overall 1-Day use up 21% in constant currency, ex-Aime.

One very important point to understand about our product mix and the industry strategy of trading up 20% to 40% to silicone hydrogel lenses, it may appear that Cooper has caught up with the industry in trading up silicone hydrogel, CVI, our CooperVision is at 49% of its revenue in silicone hydrogels, while the market is at 50% in dollars. In fact, our mix masks how much room we still have to grow.

For 1-Days, the silicone hydrogel market is at 13% and we are at 6%. For all other modalities, the market is at 71% and we are at only 64%. Also, our 1-Day market share is still one-half our overall all other products. Geographically, CooperVision foreign exchange headwinds have moderated on the top line with zero impact worldwide, although it took a strong pound and euro to offset a year-over-year weaker yen and Canadian dollar. From a revenues perspective, we have put up solid constant currency growth in all regions.

Our growth drivers are in the Americas continued strong Biofinity performance, with the halo effect of Biofinity multifocal and the strong 1-Day lead of Proclear sphere. In Europe, our success in constant currency includes the MyDay rollout, including Biofinity, including the Biofinity multifocal halo effect, as well as Avaira. In Asia-Pacific, adjusting for the exclusion of Aime, divestiture year-end or October 31 last year, and for foreign exchange rates, Asia-Pacific was up 20% in constant currencies.

Drivers include the Proclear family led by 1-Days and the Biofinity momentum. The sales increase in Japan effective -- or the sales tax increase in Japan effective April 1st, which impacted calendar quarter-one 2014 market data, was considerably fleshed out in April, when we had a decline year-over-year.

Looking at contact lens market, the worldwide market in the calendar first-quarter was up 8% in constant currency, while CooperVision was up 9%. The soft contact lens market is now $7.4 billion. The market grew 6% on a constant currency basis the past 12 months. CooperVision was up 11% during the same period in constant currency. CooperVision's market share gains were broad-based, similar to past results -- all modalities, all regions, all materials, and all lens types.

For the calendar first-quarter, the market growth was sponsored again by the 1-Day modality, up 16%, and is now 41% of the soft contact lens market in dollars. Also sponsoring growth is the silicone hydrogel material, which grew 14% and now accounts for 50% of the soft contact lens market. For the calendar first-quarter, CooperVision 1-Day was up 23%, and silicone hydrogel was up 20% in constant currency.

The soft contact lens market remains a trade-up market, with the trade-up to 1-Days about 400% to 600%, and a trade-up to silicone hydrogels about 20% to 40%. Also, it's important to note that torics multifocals have a long way to go in capturing the market opportunity, especially outside the United States. Here, CooperVision is the number one player worldwide. Geographically, Asia-Pac has done best, up 18%, sponsored by the value-added tax or sales tax, if you will, increase that took effect on March 31st.

In calendar first-quarter, CooperVision had offsetting events, the value-added tax in calendar period being fleshed out in Asia-Pac, which did bring up the revenue on a calendar basis up 29%. Offsetting this was the impact of a January 1, 2014 select price increase in the United States, and some first-quarter retail order delays in the United States. This net out to 9% growth for the calendar quarter, with CooperVision as well as 9% for the fiscal quarter.

CooperSurgical, our women's health care franchise, turned in a solid topline performance. We were pleased with the continued strength of topline growth in infertility, which was up 17% above the prior year's second-quarter. Our fertility business now accounts for 36% of CooperVision franchise. Our office and surgical business rebounded somewhat, putting up a positive growth of 4% above last year's quarter.

A little bit about guidance. We again slightly increased our earnings per share guidance by raising the lower end of our previous guidance. This guidance reflects our successes in the second quarter in managing SG&A costs in spite of ongoing investment in the rollout of our MyDay, our new 1-Day silicone hydrogel product. Our MyDay plans remain intact, starting Europe in 2014, expand into the US in 2015, and then in Japan in 2016.

We continue making progress with the ramp-up of capacity and are on target for around $25 million in revenue this fiscal year. Our outlook for 2015 remains around $75 million, as we continue to ramp up and to expand in Europe, and expand in the developed -- developing into the United States market.

A few comments about strategy. We'll continue with our successful strategy, which I've frequently articulated in the past. We believe it is solid and it has delivered results. CooperSurgical is putting up solid results and is leveraging its infrastructure. The franchise was built with a solid understanding of the value of critical mass in the women's healthcare market, targeting the OB/GYNs. We follow the professional wherever they go -- office, surgery center, hospital or IVF center. Although the call points are different for each, the leverage is considerable.

CooperSurgical's second quarter 2014 gross margin was 65%. Operating margins were over 22%. And due to minimal capital expenditure requirements, CooperSurgical is a significant contributor to our free cash flow. We are dedicated to the strategy and will continue to do tuck-ins and non-US acquisitions to leverage the CooperSurgical structure and products.

At CooperVision, the strategy is more complex and is much more global in nature. In the $7.4 billion soft contact lens industry, because of the uniqueness of our manufacturing platforms. We are the only company that participates with a very broad and very deep product portfolio. Just to crystallize this point, CooperVision aggressively promotes silica hydrogel and non-silicone hydrogel, that is the Proclear family. We emphasize branded and non-branded products. Note private label does not mean lower operating margins.

Actively, we promote and specialize in custom lenses, with a high gross margin. and I might add that our gross margin on the private label and extended range lenses is good. We support all modalities that eyecare professional prescribe -- 1-Day, two-week, and monthly. And we support all types of lenses -- spheres, torics, and multifocals. With over 30% share in the high-growth specialty lens categories, torics and multifocal, it is acknowledged by eyecare professionals that we're pretty good at specialty contact lenses.

For a few eyecare professionals, we challenge why the success of Biofinity toric for astigmatism put a great design together with a great material and great things can happen. We have seen similar success for the same reason with Biofinity multifocal, which first hit the market in the middle of calendar year 2011, almost three years ago.

On the capacity front, we are capable of delivering considerable more product where we had been previously supply-constrained. The Biofinity family, Proclear 1 day, our 1 day toric, and -- are all in good capacity shape. Our newest Endeavour is ramping up MyDay, our 1 day silicone hydrogel. On pricing, we, like the rest of the soft contact lens industry, have a trade-up strategy. Our new wearers and existing wearers are targeted for silicone hydrogels, Proclear family and the 1 day or single-use lens. Each creates more revenue per wearer. A 1-Day modality, for example, results in 4X to 6X more revenue per wearer.

While this strategy sacrifices the gross profit margin, that is the percent, it generally creates three to five times more profit per wearer. Of course, the strategy competes head-on with the lens care space, since we are shifting wearer revenue resources from lens care to contact lenses only. Competing for lens care dollars is more of a problem for some of our competitors. In my opinion, we continue to be the most focused company in the industry, lacking many of the distractions that some of our competitors have, and are now going through.

I might add, with Biofinity, Avaira, Proclear and MyDay, we have a lot to talk about with eye care professionals all over the globe. As we look down the road over the next several years, we expect to continue improving our operating margins and deliver above-average shareholder returns. We expect to continue to average double-digit earnings per share growth, while investing in geographic expansion and new product development.

In today's market we have a solid product portfolio to leverage all modalities, multiple materials, all lens types, and we retain our expertise to emphasize customizing the lenses for the 10% to 20% of those lens wearers that require other than standard 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 same applies to Avaira, where we -- where the Avaira sphere was anxiously awaiting the relaunch of the Avaira toric. This combination has now put us in much better position to exploit the US two weeks space owned by J&J, and to also exploit our private label strategy more aggressively with this family.

While we already have pretty respectable gross profit and operating margins from a cost perspective, we have considerable upside yet to be fully developed. Upsides include the elimination of our silicone hydrogel royalty with the expiration of the patents, the reduction of our manufacturing costs, 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 cost.

Also, given the considerable amount of free cash flow we generate, we will continue to look for tuck-in acquisitions and geographic expansion opportunities, like Origio, in our two businesses. The key requirement, however, is that each acquisition must exceed our minimum investment rate. Each must achieve over time hurdle rate that exceeds 10% return on invested capital.

Additionally, the markets for both women's healthcare and soft contact lenses are much less developed outside the United States. And we generate considerable amount of cash offshore, due in part our level of manufacturing outside the United States. As such, we will continue to aggressively invest in global expansion opportunities. With over 95% of the people on the planet outside the United States, we believe we will find opportunities to invest in other countries for decades to come, thereby sustaining our low effective tax rate indefinitely.

And finally, we again this year demonstrated we are opportunistically willing to buy in some of our stock to maximize total shareholder return. We will, however, keep everyone guessing as to the timing.

In summary, before I turn it over to Greg, let me say how happy I am with the quarter operating results. Operationally, we continue to outperform the market, being almost 2 times on a trailing 12-month basis, and 1.2 times an inflated calendar first-quarter. Our trailing 12-month market share gains are deep, covering all geographies, all modalities, all lens types, all lens materials, in both branded and private label. Our family of products like Biofinity, Avaira, Proclear 1-Day, MyDay, as well as fertility in women's healthcare, are very promising -- each promising continued growth not only in the United States but throughout the rest of the world.

And 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, sales force expansion in R&D the past five years. Our improving operating income ratios have been cost of goods-driven, leaving room to invest. Our balance sheet and our free cash flow are strong, which is allowing us greater flexibility in acquisition activities, and to continue select operational investing, such as the BRIC expansion and focusing on our commitment to capital expenditures to support a 1-Day expansion strategy.

Today's 1-Day market is over $3 billion and growing more than five times that of the rest of the soft contact lens market. Not everyone will play. We have the products, the manufacturing platforms, and the financial strength to move this needle. And given the four times to six times trading-up of the more compliant 1-Day wearer, we are more than willing to trade off our gross profit percent for the added profits from a 1-Day wearer.

And we remain committed to our 2018 objective of a 25% operating income target 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 return.

While we did not purchase more shares of stock this past quarter, leveraging our financial strength, this remains a viable use of free cash flow generation that we will continue to selectively use in the future. With that, as always, a reminder that, at Cooper, our number one asset is our employees. To them, I express my appreciation for their dedication to creating value and delivering results.

And now I'll turn it over to Greg to cover some of our solid financial results.

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

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 margin.

Looking at gross margins, in Q2, consolidated GAAP and non-GAAP gross margins met our expectations of 65.1% compared with 66.2% for GAAP and non-GAAP in Q2 last year. The vast majority of this difference was due to the mix impact of start-up costs associated with MyDay. As we have discussed in the past, these costs are expected during a startup phase where you are building capacity. We still expect this product to exit the year in the high-single digit margin range.

Now looking at FX, the impact of FX on gross margins was negligible this quarter. In addition also for this year, we still expect gross margins in the range of 65%. CooperVision on a GAAP and a non-GAAP basis reported gross margin of 65.2% versus 66.6% for GAAP and non-GAAP in Q2 last year. As I just mentioned, this was mainly due to the costs associated with MyDay. CooperSurgical had a GAAP to non-GAAP gross margin of 64.7%, which compares to 64.5% in Q2 2013.

We saw some positive impact as the higher margin base business grew. 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.

Now looking at operating expenses. SG&A in the quarter on a GAAP and non-GAAP basis, SG&A expenses increased by approximately 3% from Q2 last year to $155.8 million for GAAP and $154.8 million for non-GAAP, and both were 38% of revenue down from 39% in the prior year. The difference between GAAP and non-GAAP was about $1 million in acquisition-related costs, which were included in our GAAP numbers. SG&A on a non-GAAP basis declined 2% sequentially.

Now looking at R&D, in Q2, R&D increased by approximately 12% year-over-year to $16.3 million or up $1.8 million. R&D was 4% of revenue, up from 3.8% in Q2 2013 and 3.9% sequentially. We continue to expect R&D to grow faster than sales in fiscal 2014.

Now looking at depreciation and amortization. In Q2, depreciation was $24.3 million, up $854,000 or 4% year-over-year. And amortization was $7.5 million, down slightly or negative 1% year-over-year for a total of $31.8 million.

Moving to operating margins. For Q2, consolidated GAAP operating income and margin were $88.9 million and 21.6% of revenue versus $81.5 million and 21.2% of revenue for GAAP in Q2 last year. Non-GAAP operating income and margin were $89.9 million and 21.8% of revenue, versus $81.5 million and 21.2% of revenue for the prior year. This represents a 9% increase in operating income over the prior-year GAAP numbers.

In Q2, CooperVision had GAAP operating income and margin of $82.6 million and 25% of revenue versus $79.3 million and 25.6% of revenue for GAAP and non-GAAP in Q2 of the prior year. Q2 2014 non-GAAP operating income and margin were $82.8 million and 25% of revenue. This year-over-year slight reduction in margin comes from a reduction in gross margins partially offset by leverage and SG&A.

CooperSurgical had GAAP operating income and margin of $18.1 million, and 22.3% of revenue, versus $12.4 million and 16.6% of revenue for GAAP and non-GAAP in the second quarter last year. Q2 2014 non-GAAP operating income and margin were $18.2 million and 22.5% of revenue. And operating income grew approximately 46% year-over-year on a GAAP basis. This improvement is largely due to an increase in gross profit improved SG&A leverage. Interest expense at the quarter was $1.6 million, down 36% year-over-year.

Looking at the effective tax rate, in Q2, the GAAP and non-GAAP effective tax rate was 9.3% versus Q2 2013 GAAP effective tax rate of 4.4% and non-GAAP effective tax rate of 5.5%. As we've mentioned before, the effective tax rate continues to be below the US statutory rate, as the majority of our income is earned in foreign jurisdictions with lower tax rates. As a reminder, in Q2 2013, we saw the favorable settlement of a multiyear foreign tax authority audit, which reduced our quarterly effective tax rate by about 400 basis points.

Now moving on to EPS. Our Q2 earnings per share on a GAAP and non-GAAP basis was $1.62 and $1.64, respectively, versus $1.52 and $1.50 on a GAAP and non-GAAP basis in Q2 2013, respectively. Current-quarter GAAP EPS does include the impact of acquisition-related costs for approximately $1 million or $0.02 per share. There were no share repurchases in Q2. The impact on EPS for Q2, due to our Q1 share repurchases, was approximately $0.02 per share. And the impact for the year will be approximate $0.04.

Regarding foreign exchange. The currency continues to have an impact on our business, but the net impact year-over-year, especially on revenues much less in Q2. From a year-over-year perspective for Q2, currency negatively impacted us by $0.02. And this was mainly driven by the yen, which was down 7.5% year-over-year. At the current FX rates, we now expect an approximate $0.25 negative FX impact on earnings per share in 2014, with the majority of the remaining impact actually hitting in fiscal Q4. This is reflected in the impact of the strengthening of the pound in our UK production costs, and the impact to our P&L based on our inventory turns, which we've discussed in the past.

We expect a smaller production impact in Q3, but this should be offset with a favorable FX revenue impact. Net-net, this currency impact is close to the $0.21 impact we mentioned when we gave our initial annual guidance in December. For today's guidance, we use today's rates of $1.00 -- or 1.36 for the euro, 103 for the yen, and 1.67 for the pound.

Moving on to balance sheet liquidity. In Q2, we had cash provided by operations of $126.3 million, capital expenditures of $61.2 million, resulting in $65.1 million of free cash flow. Total debt decreased within the quarter by $10.3 million to $335.4 million. We now have approximately $1 billion of total credit available as of April 30.

Inventories increased approximately $6 million to $345.8 million from last quarter. For the quarter, we are seeing months on-hand at 7.2 months, down from months on-hand to 7.8 months last year, and flat to last quarter. Cash receivable continues to be well-managed, with DSOs 51 days, down from 53 days the prior quarter, and down from 54 days last year. For guidance, as Bob mentioned, we moved the bottom of the GAAP EPS range up to $6.78, and left the top of the range at $7.00. On a non-GAAP basis, we have increased the bottom of the range to $6.80, and have left the top of the range at $7.00.

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

Kim Duncan - *The Cooper Companies, Inc. - Senior Director of IR*

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Larry Biegelsen, Wells Fargo.

Larry Biegelsen - *Wells Fargo Securities - Analyst*

Thanks for taking the questions. Just two for me. One, first a clarification. Bob, I don't understand the 8% to 9% -- 8%, when you look at the calendar first-quarter of 2014, the 8% for the market and 9% for CooperVision, why that isn't a fair comparison? Because your Asia-Pacific business was up 29% and did benefit from the buy-in from Japan.

And second, can you talk about -- it wasn't clear to me why the Americas was flat in calendar Q1. I know I think you were up 5% for fiscal Q2, but could you talk about what you saw in April and May? Thanks.

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

Okay. The 9% versus the 8%, 9% for us and 8% for the market, of course, the market is inflated, and keep in mind that Japan is a big part of the market. So that inflation that occurred in March, the end of the calendar quarter, is reflected in that. And your large players, if you will, in the Japanese market, by far the largest player is J&J. So it had a profound impact on J&J. It had a profound impact on the market.

Relative to Cooper, while that percent is big, 29%, we are hugely under-indexed. Our market share is about -- just a little above half the market share in Asia-Pac as it is in the rest of the world. So, the percentages don't always add up with equal weighting, if you will.

Secondarily -- and that's where Asia-Pac for the entire market, which is around 30% of the world, matters a lot. When it's only half that for us, it matters a lot less. Relative to the Americas, the Americas is coming off of a calendar quarter that was 15% for Cooper, and it dropped from 15% to 0% in the second -- in the next calendar quarter.

We had a price increase, full price increase effective January 1, which had the impact of bringing revenue from January into December. And therefore, the calendar fourth-quarter is inflated. That fleshes out considerably in January; therefore, it doesn't show up in the fiscal period like it does in the calendar period.

So we were artificially high on a calendar basis in that fourth quarter. And this is somewhat neutralizing that. Relative to the flesh out in April and May, most of the flesh-out occurs in April, which is people buying forward into March in Japan. And it had a minimal effect on our May results. And that has been factored into the guidance we're giving going forward.

Larry Biegelsen - *Wells Fargo Securities - Analyst*

Thanks for taking the question.

Operator

Larry Keusch, Raymond James.

Larry Keusch - *Raymond James & Associates - Analyst*

I know, Bob, you'd talked a little bit about MyDay being on plan, and gave some sense of where you expect the margins to be. But could you dig in a little bit and then perhaps talk a little bit about the experience with the yields? And I was under the impression that there was an opportunity to actually exit fiscal 2014 at an operating margin that was north of single digits. And so if you could talk about that.

And then I didn't see any update for free cash flow and CapEx for the year in terms of guidance. Also, that would be a question for Greg.

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

The operating outlook for MyDay -- I think we've been pretty clear on operating margin. We're not expecting operating margin in 2014 into 2015, and we may be investing into 2016 as we go from Europe to the US to Asia-Pac. Relative to gross margin, we indicated that we had a negative gross margin in the first quarter. It would move into a, I think, upper-single digit mode the second half of this year, and then move into teens in 2015.

We are, I would say, on track or ahead of schedule a little in those areas. So we are pleased with the progress we are making moving the needle on profitability there. It would still be our intent, however, to invest in the rollout and not expect to make operating profit, even in 2015 on MyDay.

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

Yes, Larry, on the guidance, the guidance hasn't changed. We still see free cash flow and CapEx above $200 million.

Larry Keusch - *Raymond James & Associates - Analyst*

Okay. And just on that CapEx, sort of just help us all, how much above $200 million are we thinking? Is it really closer to $250 million?

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

We're at a modal where -- we just came off $61 million quarter. Year-to-date, I want to say we are approaching $120 million. So we are running at a $240 million -- I would not be surprised if it's north of $220 million by the end of the year, but we'll kind of leave it in that -- [plus] the $200 million to as high as $240 million range.

Larry Keusch - *Raymond James & Associates - Analyst*

Okay. Perfect. Thank you.

Operator

Joanne Wuensch, BMO Capital Markets.

Joanne Wuensch - *BMO Capital Markets - Analyst*

Thank you so much for taking my questions. Can we spend a little bit of time on SG&A? That seems to be particularly well-managed. And I'm curious how we should think about that as a go-forward metric?

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

Yes. As far as the SG&A is concerned, we are in the mode of moving into more leverage. We have been investing heavy over the last four or five years in the BRIC expansion as well as sales force expansion in R&D. And we would expect to, over the next several years, start really getting some meaningful leverage out of those areas. Particularly, where we have invested several years in certain countries, we have been in the BRIC area, if you will, losing a fair amount of operating income in the startup mode.

That's been kind of masking the total P&L that you see worldwide. And now it's time with revenue generation to get some leverage out of that. So -- and that will continue over the next -- the period where we say we are going from 22% OI to 25% OI, that is more about SG&A leverage than it is about change in the gross profit margin.

One thing noteworthy, and to put your thoughts office, however, is during the next three years, we will continue to reduce cost of goods in terms of manufacturing. That will not necessarily show up in gross margin and reduction of cost of goods. It will be masked by product mix as we shift into the 1-Day modality. The 1-Day modality will have basically a lower gross margin, but also lower operating expense ratio. So there will be some -- there should be, through mix, some improvement in operating cost over that timeframe also.

Joanne Wuensch - *BMO Capital Markets - Analyst*

Okay. As a follow-up question, while you have us all here together, could you comment on the FDA warning letter that hit the website about three weeks ago? Thank you.

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

Yes. I'm not going to say too much about it, other than like any warning letter or 483, which preceded it, we take FDA observations seriously. And rest assured it's getting our full attention. We -- it was in Puerto Rico. I think some people had asked whether or not it was connected to anything that happened in the past, the recall of Avaira toric, the answer to that is no. It is not connected with any previous activity.

It was more a result of an inspection done that led to a 483 that happened in December and January timeframe. And a lot of it had to do with capa's and in documentation, which we were, as I indicated, taking seriously. At some point in time, the FDA, we would expect by the end of calendar year, to come in and confirm the actions that we have taken. Don't have any more color on it than that at this junction.

Joanne Wuensch - *BMO Capital Markets - Analyst*

Thank you.

Operator

Matthew O'Brien, William Blair.

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

Thanks for taking the question. Bob, I was hoping for us just to start with a clarification point, and then get into my actual question after that, if that's okay. But on the clarification side, I think what you're saying is with what went on in Asia-Pac, and especially Japan, given your underindexing there, plus the strong comp you had in the Americas this time last year, that the market growth rate is probably something around 5%, you guys did 9%. But on a rolling average basis, you were probably a little bit higher than that.

So, you're still taking share roughly at about double the market rate, and you anticipate that type of trend will continue going forward. Is that the way that we should characterize this -- the quarterly result?

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

That's a pretty good summary. I would say we've never cut a -- said we think we can keep taking double, 2X, indefinitely. So, it's nice that the last three years, we have done 2. And if we look at it over a five-year perspective, I think we average maybe about 1.8. So, anything in the range, you're talking about the 9% to 10%, we are happy with that. Obviously, we want to beat it. And the market I do think has moved from the 4% to 5%, now to the 5% to 6%. But you are correct, the 8% is probably more like 5% to 6% than it is much above that.

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

Okay. And then for my actual question, we are getting closer to the rolloff of the US component of the royalty to CIBA. And you've got a pretty big headwind right now with MyDay on the gross margins side of things. As we start to think about fiscal 2015, is it fair to think -- I know you don't want to give too much in terms of numbers here -- but is it fair to think we can get maybe 25% to even up to -- probably not quite this high, but maybe 50% of the headwind from the MyDay product on the gross margins side, offset by the royalty rolling off?

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

I'm not going to put enough color on that. We have gone out of our way not to put too much color on how it weights, other than to make one point, which is, some of the royalty savings we will invest. And it is factored into our model, which is basically saying we're going to go from -- well, at one point in time, was 20% to 25%; we now are more like 21% to 22%, going to the 25% operating income between now and 2018.

So, as for our objective in the royalties of past in there, and the MyDay is a weighting factor in that model over the next several years. And relative to gross margin, in concept, you are right that 1-Day -- MyDay is taking it one way, and the royalty will help minimize that. But I'm not going to put more color on it than that.

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

Fair enough. Thank you.

Operator

Steve Willoughby, Cleveland Research.

Steve Willoughby - *Cleveland Research Company - Analyst*

Thanks for taking my question. I had a question and a follow-up to something somebody else already asked. I guess first on the follow-up question, I'm just wondering -- you mentioned the January might have been impacted by the price increases you put into effect January 1st. I'm just wondering -- do your competitors not also put in price increases at the beginning of the year? And just wondering why they may not have seen the same buy-ahead impact.

And then my second question, Bob, in your prepared remarks, if I understood you correctly, backing into it, it sounds like MyDay generated maybe a little over $4 million of revenue. So I was wondering if you could confirm that, and also maybe provide any commentary on how Biofinity growth was in the quarter?

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

Right. Several things. The competitors still have price increases while we do, and they are not across the board. Some products get more and some products get none. Relative to did the market show up -- the market in the Americas, in the fourth calendar quarter, was 8%. So that was fairly robust compared to a trailing 12-month of 6%. So it was a strong quarter for the marketplace in the Americas. So that could be a factor. It certainly was a factor for Cooper.

Relative to the question on MyDay, you are not too far off with the 4% to 5% relative to where it is. We are at a $5 million; so let's say a $20 million run rate now, your math would not be too far off. Biofinity and Avaira, I think I indicated were mid to upper-teens. Both family of products were mid to upper-teens. So, that was a comment from my -- I made that in my remarks.

Steve Willoughby - *Cleveland Research Company - Analyst*

Okay. Thanks so much.

Operator

Jon Block, Stifel.

Jon Block - *Stifel Nicolaus - Analyst*

Hoping you can hear me okay. I think -- two questions. Bob, just on the first one, I know there's a lot of moving parts with the market data due to the value-added tax, but I'm guessing Europe should be pretty clean. The market was up 3% [in one], you guys were up 12 or sort of 4X -- it's a big number. And can you speak to what led to sort of 4X the market in Europe? And to what extent MyDay played a role there? And then I'll go ahead (multiple speakers) and ask a follow-up.

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

So, you're right -- totally right that we did very well in Europe, 4X the market. And MyDay is certainly contributor there. And we continue to do well with Biofinity and Avaira in Europe as well as, really, the migration of torics and multifocals. So both as to modality, it's a factor. Lens type is a factor, and product rollout is a factor. And all three kind of play well.

Jon Block - *Stifel Nicolaus - Analyst*

Okay. Great. And then maybe -- my second one has two parts, if possible. The first one is just channel cost of different markets -- again, you mentioned a lot of moving parts. Are we normalized in the channel? You mentioned APAC did, but is that the case in the US? And actually I'll save the rest of my questions for off-line. Thanks, guys.

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

Relative to normalized to the channel, certainly, we are normalized in the channel now as we've kind of gone through April/May. Relative to the channel, when we look at calendar quarters, there is no doubt that the second calendar quarter is going to be weak relative to the first calendar quarter, because of the size of that value-added tax, the sales tax, if you will, in Japan. So, that will no doubt influence the total market.

What came in through the first quarter will come out of the second quarter, and then it will be normalized on that front. I think the US is -- by the end of the first-quarter, calendar quarter, is pretty normalized for many implications of price increases. And so I think most everything else is normalized.

Jon Block - *Stifel Nicolaus - Analyst*

Okay, perfect. Thanks for your time.

Operator

Jeff Johnson, Robert W. Baird.

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

Bob, wondered if I could maybe ask one follow-up and then my real question, I guess, from there? But on the MyDay revenues of around $5 million or so, I mean, can you talk maybe sequentially how that is trending? And just maybe qualitatively how the rollout is going? I know you said well, but maybe any color about what you are seeing in some of your European markets where you've now launched the product? And some background maybe on how those plus powers are maybe or maybe not helping the uptake of that product?

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

Well, the product is going as fast as we can make it. So it's only -- looking to the market, other than to say the market likes what they see in Europe, that's very plus. Very good. Relative to our ability to continue to ramp up, we basically planned on more than doubling capacity during a short window, primarily in the second quarter. We were successful in that, so when we say our rollout is proceeding to plan, it starts with the capacity and the capacity is doing quite well.

So that's not an inhibitor as we continue to roll out. At some point in time, we'll be, before we know, we'll be gearing towards the best market. But there is no real expectation that we will have any meaningful going forward from 2015 into 2014, relative to the Americas or the US market. So things are going to plan. And we are -- I mentioned a $25 million that we are targeting this year; we are now at a $20 million run rate. And we would expect to have a decent shot at approaching that $75 million objective for next year.

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

All right. That's helpful. And then just on my other question, as I think through the next couple of quarters, obviously, you've got some of the pound headwinds on the gross margin. I think the market is somewhat worried about competition and just general gross margin impacts from MyDay. Your operating margin in the second half of last year was actually about 100, 150 basis points higher than in your first half of the margin comp. If you think about it that way, it gets a little tougher.

And I put all that together, and yet you're guiding to kind of an acceleration in EPS growth, the 15% to 21%, if I take kind of the range that's out there now for the second half in your guidance. So what gives you the confidence that I guess EPS accelerates from here? It was 13%, 14% in the first half, and now you're talking about kind of mid to upper-teens, if not 20% in the second half. How do you grow that fast EPS in with all the other kind of issues there I just mentioned?

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

Well, obviously, one of the factors we mentioned that we are -- we've been investing heavy in MyDay in the fourth quarter last year; invested heavy in MyDay in the first half of this year. While -- and that's even at the gross margin line. So, as we move into a positive territory on gross margin, that's a big shift, and we'll start minimizing the size of the losses. So that's one thing, is leverage.

Our comp in the fourth quarter will be easier brought about by a couple of events that took place last year. And certainly one of those was just the fact that we were accelerating MyDay forward with fitting set costs as well as conversion of equipment, which cost us a fair amount of money. So the comp is somewhat easier than the fourth quarter. And I think when you factor that -- those two things together, you will see that there's some logic to acceleration.

We also had, I think, some degree of a -- well, we had foreign exchange headwinds in the first quarter, but I think we are also anticipating more in the fourth quarter. Fourth quarter is more cost of goods-related, the lag of the strengthening of the pound, getting to the P&L. That, of course, puts a little pressure on the gross profit line in that quarter. So that will serve somewhat as a headwind against the positive trends on MyDay, in terms of cost of goods, if you will.

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

Yes, Jeff, if you look at the model, I think you'll see the second half, obviously, you have a revenue increase; second half over first half, you've got good control of gross margins, as Bob mentioned some of the opportunities. Also good control over OpEx, Joanne talked about the SG&A leverage. So, you put all that together, I think we're trying to manage this very, very tightly. And that execution, I think, will deliver the results that we've guided to.

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

Fair enough. Thanks, guys.

Operator

(Operator Instructions). Matthew Mishan, KeyBanc.

Matthew Mishan - *KeyBanc Capital Markets - Analyst*

Guys, good afternoon and thank you for taking my question. (multiple speakers) Can you talk a little bit about CooperSurgical, what you're seeing in the market place? I think last quarter, you said that some orders got pushed out of 1Q into 2Q. Are you seeing improvement here? Or is this just timing or --?

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

I would say modest improvement, but I certainly -- 4%, we were pleased with in the context of the market and some of the shifting going on there. I would say the surgical outpatient side is still tough, so we don't want to minimize that. IVF fertility has been doing a good job. We are very pleased with that, those results. And some of the products that we worked on last year in terms of second-generation product, we're starting to see some modest benefits of that.

So ,those three variables still leave us feeling pretty good about the range we gave for guidance, which is still, quite frankly -- if you were to strip out IVF, it's still a pretty anemic expectation on the surgical and the -- in office space in the US.

Matthew Mishan - *KeyBanc Capital Markets - Analyst*

Okay. And it's been two years since Origio. How would you describe the pipeline?

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

Well, Origio is a lot more about geographic expansion, and certainly taking their product portfolio much more into the outside the US world. The US world is a little bit more mature right now. The pipeline, there is -- been some plus factors in the pipeline within Origio in the marketplace. And the other thing we're trying to do over time is shift the mindset a little from -- away from less equipment, more disposable, which will lead to improving gross margins within that space. That space is a little -- still somewhat a gross profit drag within the surgical mix, but improving, if you will.

Operator

All right, ladies and gentlemen. That concludes the question-and-answer session of today's call, due to running out of time. And I will now turn the call back over to Bob Weiss for closing remarks.

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

So, I want to thank everyone for joining us today. We look forward to updating you again in September on our quarterly progress, and particularly on MyDay and the continued ramp -- ramp-up and rollout. And with that, I want to thank everyone for participating.

Operator

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