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COO - Q4 2016 Cooper Companies Inc Earnings Call

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OVERVIEW:

Co. reported 4Q16 revenues of over $500m and non-GAAP EPS of $2.28. Expects FY17 consolidated revenues to be $2.09-2.13b and non-GAAP EPS to be $9.00-9.30. Expects 1Q17 revenues to be $494-508m and non-GAAP EPS to be $1.78-1.88.

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Cooper Companies Incorporated fourth quarter 2016 earnings conference call.

(Operator Instructions)

As a reminder, this conference call is being recorded. I'd now like to introduce your host for today's conference, Miss Kim Duncan, Vice President. Ma'am, you may begin.

Kim Duncan - *Cooper Companies Inc. - VP of IR*

Good afternoon and welcome to the Cooper Companies' fourth quarter and full year 2016 earnings conference call. I'm Kim Duncan, Vice President of Investor Relations, and giving prepared remarks on today's call are Bob Weiss, Chief Executive Officer; and Al White, Chief Financial Officer and 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 or regulatory 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 [currently] available and on request from the Company's Investor Relations department.

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 Al who will then discuss the fourth-quarter and full-year financial results.

We will keep the formal presentation to roughly 30 minutes, 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 e-mail IR@cooperco.com.

This call is being webcast and a copy of the earnings release is available through the Investor Relations section of the Cooper Companies' website. With that, I'll turn the call over to Bob for his opening remarks.

Bob Weiss - *Cooper Companies Inc. - CEO*

Thank you, Kim, and good afternoon, everyone. Welcome to the fourth-quarter and full-year 2016 conference call.

Let me start by saying I'm very proud of our accomplishments this quarter, including record revenue and free cash flow. We also delivered a very strong fiscal year gaining share in the $7.2 billion contact lens industry, continuing our push into the one-day silicone hydrogel space, expanding our Biofinity franchise and posting strong growth in our CooperSurgical business.

We enter FY17 with strong momentum and remain confident we will see market share gains in both of our businesses for the foreseeable future.

Let me highlight three key points for the quarter. First, I'm pleased to report another strong quarter with revenues over $500 million. This includes CooperVision reporting revenues over $400 million and CooperSurgical reporting revenues over $100 million. This resulted in non-GAAP earnings per share of $2.28 and free cash flow of $158 million.

Second, CooperVision posted strong results in all key areas of its business, resulting in 10% as reported and 11% constant currency revenue growth. This includes one-day silicone hydrogel lenses growing 53%, and two-week and monthly silicone hydrogel lenses growing a combined 14%, both in constant currency.

Third, CooperSurgical had another strong quarter, posting revenue growth of [30%] (corrected by company after the call) or 6% pro forma. Fertility was a highlight, posting growth of 74% or 8% pro forma.

Moving into the details. CooperVision reported fourth-quarter revenues of $412 million, up 10% as reported and 11% in constant currency. This is the fastest CooperVision has grown in 11 quarters.

The Americas grew 8% in constant currency, with strength in multiple categories including Biofinity and one-day silicone hydrogel lenses. Biofinity continues to be our work horse, and we began our launch of Biofinity Energys in mid-August to strong reviews. Our enhanced clariti lens is also performing well, and MyDay had another very strong quarter.

EMEA posted a very strong quarter, up 12% in constant currency. Growth was driven by Biofinity and our one-day silicone hydrogel franchise. Asia Pacific also had a very strong quarter, up 13% in constant currency. Growth was strong throughout the region, driven by Biofinity and our 1-Day silicone hydrogel franchise. Within Japan, our MyDay sphere and toric launch is progressing well, and while it's still early, we continue to believe MyDay can be a very successful premium offering in that market.

Turning to product categories. Torics grew a healthy 14% and multi-focals grew 10%, both in constant currency. We remain the global leader in specialty lenses, and our success with Biofinity and clariti in both of these categories should continue to drive growth for many years to come.

Looking at silicone hydrogel lenses, these products grew 21% in constant currency and now represent 62% of our sales. We expect this strong growth to continue given our product portfolio, which includes Biofinity, vitality, our newly launched two-week product, and our diverse 1-Day offering.

And remember, the biggest driver in the contact lens market is the 1-Day growth. And we strongly believe we have the best product offering in the space as the only Company selling premium and mass market silicone hydrogel lenses, including a full portfolio of sphere, toric and multi-focal lenses.

We are also investing in sales and marketing to support our strong product portfolio. Forecasting new hires is always challenging, especially when you are evaluating opportunities around the world. But we believe CooperVision can add numerous sales reps and get a very nice return given our strong product platform, our capacity and our growth opportunities that we see.

We began this initiative in our fourth quarter, and expect it to continue through FY17 and possibly into 2018. For competitive reasons, I won't get into many details. But suffice it to say, we carefully evaluate all hiring and expect to realize a solid return from this activity.

Now let me comment on the overall contact lens market. And remember, this information is on the last page of our earnings release. For calendar Q3 2016, we continued taking share, growing 6% with the market up 1%. Geographically, CooperVision grew 3% in the Americas while the market was down 3%. In EMEA, we were up 8% and the market was up 7%. In Asia-Pacific, we grew 9% with the market up 3%.

On a modality basis, single-use lenses continued driving growth, with CooperVision up 12% and the market up 8%. For non-single use lenses, we grew 3% while the market declined 4%. As you can see our growth remains diverse and strong. On a trailing 12-month basis, CooperVision grew 8% while the market grew 3%.

Although the market remains choppy and hard to read at times, we continue to believe it will strengthen and grow 4% to 6% over the next five years driven by continuing shift to dailies, geographic expansion, and an expansion of the wearer base. We expect to continue taking market share, led by our strong portfolio of market-leading products.

Moving to CooperSurgical. We reported fourth-quarter revenues of $107 million, up 30% year over year driven by organic growth and acquisitions. On a pro forma basis, we grew 6%. Fertility led the way, up 74% or 8% pro forma. Within fertility, we had growth throughout the business and continue to believe our market-leading product portfolio, which includes medical devices, genetic testing and capital equipment, is the broadest portfolio in the space and should continue to drive growth for many years to come.

Within our office and surgical category, growth was 5%. We're continuing to execute on several product launches, including our disposable hysteroscope, EndoSee, and we continue to see success in this area.

Regarding other activity, we announced on November 6, that we acquired a Wallace portfolio from Smiths Medical for approximately $168 million. This is a great strategic fit, and with our existing global IVF portfolio as it brings the gold standard of embryo transfer catheters along with several other premier products.

Finally, on CooperSurgical, we're busy integrating recent acquisitions but also executing on several initiatives which should significantly strengthen the business. These include transitioning to a geographic sales model, adding sales reps in underpenetrated areas, launching products into new markets and increasing our focus on high-growth areas such as IVF genetic testing. We have made a lot of progress in these areas over the past year, and expect to continue or to even have more progress as we go forward.

Now before I turn it over to Al, let me comment on a couple other items. We anticipate another strong year of revenue growth in fiscal 2017, including CooperVision growing 6% to 8% in constant currency and CooperSurgical growing 6% to 8% pro forma. We also remain bullish on our future and are updating our long-term objectives for operating margins of 28% and free cash flow generation of over $2 billion by 2021.

In conclusion, I want to express my appreciation to our employees for all their hard work and dedication. And now I'll turn it over to Al to cover the financial results.

Al White - *Cooper Companies Inc. - CFO & Chief Strategy Officer*

Thank you, Bob, and good afternoon, everyone. Bob did an excellent job covering revenues, so I'll focus on the rest of our Q4 financial performance along with guidance. Most of my commentary will be on a non-GAAP basis, and a full reconciliation between our GAAP and non-GAAP results is included in today's earnings release.

For the quarter, gross margins were slightly over 64%, with both CooperVision and CooperSurgical up year over year. CooperVision improved roughly 50 basis points to 64.8%, driven by factors such as currency and product mix. While CooperSurgical grew roughly 30 basis points to 62.5%, driven by cost reduction efforts.

Operating expenses grew 11.7% in the quarter, driven heavily by CooperSurgical's acquisition-related activity. Within operating expenses, sales and marketing expenses grew 14%, as both CooperVision and CooperSurgical executed on sales and marketing expansion plans to capitalize on strong product portfolios.

Outside of sales and marketing, we drove leverage through general cost controls. Operating margins were 25.1%, up nicely from 24% last year. Driven by gross margin improvements and operating expense leverage.

Moving to interest expense. We reported $5.3 million, which was lower than our guidance as we had a true-up of roughly $1.5 million. This true-up was associated with an over allocation of commitment fees in Q2 and Q3 related to the refinancing of our credit facilities completed in Q2 of this year. What should have happened is Q2 interest expense should have been lower by $600 thousand, and Q3 should have been lower by $900 thousand.

Our effective tax rate was 10.3%, and the resulting non-GAAP EPS was $2.28 with roughly 49.3 million average shares outstanding. Total debt decreased this quarter by $110 million to roughly $1.33 billion. Driven by strong free cash flow of $158 million, comprised of $193 million of operating cash flow and $35 million of CapEx.

Regarding full-year FY16 results, consolidated revenues were $1.967 billion, up 9.4% or 7.3% pro forma. CooperVision revenues were $1.577 billion, up 6% or 7.5% in constant currency, and CooperSurgical's revenues were $390 million, up 26% or 6.3% pro forma.

Non-GAAP EPS was $8.44, up 13%. Lastly, free cash flow was $357 million. So all in, a very strong year.

Moving to FY17 guidance. Let me start by commenting on currency which has moved significantly against us over the past month or so. For 2017, we're estimating a negative year-over-year currency impact to revenues of approximately $57 million, and negative $0.10 to EPS. Incorporating this into our outlook, we expect FY17 consolidated revenues of $2.09 billion to $2.13 billion. This is comprised of $1.62 billion to $1.65 billion at CooperVision, which equates to roughly 6% to 8% constant currency growth. And $470 million to $480 million at CooperSurgical, which equates to roughly 6% to 8% pro forma growth.

We expect gross margins to improve to around 64.5%, and operating margins to improve to 25%. Interest expense is expected to be around $28 million, which includes the additional debt from the Wallace acquisition along with an assumption of one 25 basis point rate increase.

The effective tax rate is expected to be around 10%. This may be higher than many of you were expecting, but it's based on our current forecast which include fewer discrete items and is thus more of a true run rate of our current operations.

Non-GAAP EPS for FY17 is expected to be in the range of $9 to $9.30 based on 49.4 million shares outstanding. To provide color on this, the higher year-over-year tax rate will negatively impact earnings by roughly $0.20 and FX will negatively impact earnings by $0.10.

We also anticipate to continuing to invest in sales and marketing above and beyond our normal levels, and this will likely be in excess of $10 million or $0.20 in FY17. Having said that, we do have several positives such as accretion from our CSI acquisitions, less idle equipment and inventory charges, savings from manufacturing improvements and the royalty roll off, and these will help drive earnings growth.

Regarding Q1, we anticipate revenues of $494 million to $508 million. This is comprised of $383 million to $393 million at CooperVision or roughly 7% to 10% constant currency growth, and $111 million to $115 million at CooperSurgical which equates to roughly 3% to 7% pro forma growth. For Q1 non-GAAP EPS, we expect $1.78 to $1.88, and note this assumes a 10% tax rate as compared to last year's 3.9%.

And with that I'll hand it back to the operator for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question comes from the line of Jon Block of Stifel Nicolaus.

Jon Block - *Stifel Nicolaus & Company - Analyst*

Okay, great. Thanks, guys, and good afternoon.

Maybe the first question, still working through some numbers, didn't really surprise us all too much on the FY17 guide. Al, you went through a lot of numbers. The lowest on 1Q, is that just a function of you do have the pound benefit for FY17 but again it really takes effect come January so you only have that for a slight stub of 1Q that could be causing approximately the $0.20 disconnect where you guided 1Q versus street? That's a specific number.

And then, Bob, maybe just to take a step back. Just some market commentary. The down 3% US is very surprising.

We get your number up 2% per your release. J&J I think was up 5% and change US. So how could two-thirds of the market be up a weighted 5% and we see negative 3% in the market data? Thanks, guys.

Al White - *Cooper Companies Inc. - CFO & Chief Strategy Officer*

Yes, I'll answer the first one and then let Bob get into the market data. Yes, I agree with you.

When you look at the pound move, most of that starts for us in January. So we get it for one month in the first quarter. So when you look at the incremental sales and marketing investments and you look at the higher tax rate which is somewhere around $0.13 for Q1 combined with only getting the pound benefit for really the month of January, I think that's probably where that probably comprises certainly the vast majority of the delta.

Bob Weiss - *Cooper Companies Inc. - CEO*

Yes, as far as the market, I think we've all scratched our head a little about the results being reported by us and the various market players compared to some of the data we see in industry data. And probably the best way to think about it is that a year ago, the Americas showed 11% growth and the entire market showed 8% growth worldwide, driven very heavily by the Americas. This year, that kind of slips to a negative of 3% for the Americas and only 1% for worldwide.

So you really have to look at five quarters or better yet even two rolling years, because of what happened a year ago was all of the activities by J&J as they rolled out new products. There were things going on with UPP. So channel fill, so you end up with probably a delink between the way data comes into CLI and the public company. There's variances there to and including some of the activity associated with that.

So when I think of the market I say, all right, put the two together, last years 11% this year's negative 3%, that's 8%, divide by two, it looks more like 4% to me. And in the interim, we had a fourth quarter 4%, a second quarter 4% and then a flat first quarter last year.

So last year, my way of thinking last year rippled into the first quarter. So that 11% third quarter showed up as a neutral first quarter. The long and the short of it is, it's probably best to look at it as five, the average of five quarters if you're going to make much sense out of it.

Operator

Thank you, and our next question comes from the line of Larry Biegelsen of Wells Fargo.

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

Hey, guys, thanks for taking the questions. Bob, I'm sure it's going to get asked on this call so I may as well ask about it. Just any thoughts on corporate tax reform and Cooper's view on this and how you think it could impact you guys?

And then one other question. Just on the quarter itself, the 11%, obviously quite strong. Was there anything one-time in the quarter selling days, stocking, et cetera that helped you this quarter? Thanks for taking the questions, guys.

Bob Weiss - *Cooper Companies Inc. - CEO*

I'll do the second one first, which is there's nothing unusual about the 11%. We're obviously rolling out some new products. We had a slightly easier comp from a year ago, particularly relative to the Europe theatre which was going through the consolidation last year with the Sauflon. But by and large, a solid quarter.

As far as tax reform, well tax reform has been talked about forever. And I can give you two theories on if I just lock in on one thing that's being thrown around out there is the 35% going to 15%. Suffice it to say, that wouldn't be bad for most anyone and will serve as a neutralizer to a degree on however it shakes out the rest of the world.

There are too many different debates going on out there. There's the fact that any meaningful change would require a vote of 60% of the Senate to go along with it, and that could be tough or only come with a lot of compromise. So I think it would be way premature to know if it's a net plus or a net minus, but most people wouldn't complain about a huge reduction in the corporate tax rate.

Operator

Thank you, and our next question comes from the line of Matt Mishan of KeyBanc.

Matt Mishan - *KeyBanc Capital Markets - Analyst*

Good afternoon, and thank you for taking the questions. Could you go a little bit further into the investment you guys are making in SG&A and really around the cadence, and maybe break out what the difference is between the growth in SG&A from the investment and the growth in SG&A from the acquisitions that you're making? Just so we can get a better sense for how to model this?

Bob Weiss - *Cooper Companies Inc. - CEO*

So the investment we're making in SG&A is sales and marketing. We're leveraging the rest of the infrastructure. And in the area of sales and marketing, that is both on the Vision side, heavily feet on the street where we're under indexed compared to our competitors and as I indicated I'm not going to start quoting numbers of adds in terms of number of salesforce we're adding.

But suffice it to say, we also are rolling out many new products. Some of them are conceptually new, like Energists, so there will be a fair amount of energy also supporting those new products. And putting the two together, we will while we are giving you guidance at 6% to 8% top line growth for both Surgical and Vision, we will be, suffice it to say, growing our sales and marketing at a rate faster, primarily in the area of both feet on the street and to a lesser extent the marketing support behind that.

Beyond that, like I said, we aren't going to get into how under indexed we are compared to our competitors. And I would say it's in many cases it will be not across the board, it's if you have a vacancy or you're under indexed in a geographic area, and I've always used an example of a city like Las Vegas and said, if you didn't have a sales person in Las Vegas it's a pretty big town. Maybe you ought to have a sales person there if you have a lot of products to talk about.

So in some in some cases it's adding junior people to support senior people. In other places, it will be having feet on the street where you're currently making telephone calls and piggybacking on that.

Al White - *Cooper Companies Inc. - CFO & Chief Strategy Officer*

And one quick-add comment. When you look at the breakdown between Vision and Surgical, it's probably easiest to think about it from a sales and marketing perspective as if sales and marketing in each business is going to grow somewhat similar to what their revenues are. Their as-reported revenues, so if you look at that on a CooperSurgical basis obviously it's quite a bit higher on a percentage growth basis than Vision due to the acquisitions.

Operator

Thank you, and our next question comes from the line of Matthew O'Brien of Piper Jaffrey.

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

Good afternoon. Thanks for taking the question.

Just on the daily side, the performance in the quarter was a slight acceleration over what we saw last quarter. Could you talk a little bit about where that came from be it MyDay, be it clariti, maybe MyDay in Japan?

And then on top of that, just the two-year stacked on the non-daily side appears to have decelerated. Can you just talk a little bit about what's going on there, are you're seeing some VA impact? Thank you.

Bob Weiss - *Cooper Companies Inc. - CEO*

Yes, on the daily side, there was some acceleration. Having said that, we targeted for basically something approaching 50% for the year, a slight acceleration from the prior year is the way we thought about it coming into this year. So it's moving along those lines, and the way it's moving is obviously the more mature market is EMEA whereas these products started out both MyDay and clariti, the least mature is Japan and the Americas.

So we're very early in the cycle in those two areas, and rapidly expanding the offering even in Europe. So it's geographically across all theatres, and very much we've now did the redo of the first clariti that was out there and that's performing real well so we're now expanding our attention into

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more than our own accounts. Initially, we had to take care of our accounts that we had given the first generation, if you will, product, so a long way to go and we're very early in the cycle and obviously moving off of a larger base as we go forward.

As far as the deceleration in the planned replacement area, the non-one day, really that market if we look at it, from a 2.5-year, 3-year perspective is in around breakeven with the growth all being driven by the one-day. That's been pretty consistent over the last four years, and we don't see that changing as she's been consistent a lot -- a driver longer than four years, but more so outside of the US than more recently inside the US. So don't see any changes there.

There is activity in the planned replacement market. Things like Biofinity obviously are still putting up terrific numbers, so there's room to grow. And particularly as we think about the geographic expansion, some of what goes into China and into some of those theatres maybe a little less weighted initially in the one-day modality.

Although that -- you can't make that statement about every country. So a lot of opportunity, even in the planned replacement arena and we're obviously continuing to grow that while the market may be not growing it if you will.

Operator

Thank you, and our next question comes from the line of Joanne Wuensch of BMO Capital Markets.

Joanne Wuensch - *BMO Capital Markets - Analyst*

Hello, good evening. Can you hear me okay?

Bob Weiss - *Cooper Companies Inc. - CEO*

I can hear you fine.

Joanne Wuensch - *BMO Capital Markets - Analyst*

Wonderful, two questions. The first one, is the new SG&A rate for 2017 do we think of that as the go-forward rate or do we think of that as a period of investment and then it should ease off?

And then in the second question to circle back to the tax issue. We're getting questions from investors regarding their buy in plan and what it means -- may or may not mean for Cooper which manufactures a fair bit outside of the United States, generates a fair bit of its revenue outside the United States and I was curious if you'd looked into that yet. Thank you.

Bob Weiss - *Cooper Companies Inc. - CEO*

So on the SG&A, is it short term or long term, the sales and marketing. We plan on continuing to invest throughout 2017, and as I indicated in my commentary to the extent it rolls into 2018 where we are getting the top line growth we want, we will continue that modality. What the driver there is if you have a lot of products to talk about and you have the capacity, then you should try selling the products and leverage the capacity.

We know we have excess capacity, and why not use it. So to the extent we're getting our payback which will include diminishing the idle charges that we're incurring on cost of goods as a by-product, we're going to do it. And we obviously have an agenda of gaining market share and we certainly have done a good job of that the last seven years, and if I look at it over the last 12 months its been greater than 2% that we've grown the market.

You can't make much out of this quarter's number because we grew 6% and the market grew 1%. I'm not going to say we're growing six times the market, but obviously we are growing in around that 2x.

Relative to the rest of operating costs, distribution, G&A and even to a lesser extent R&D, we expect to get leverage out of those around the world. So it isn't to say that operating costs in total will keep going up as a percentage of revenue.

As far as the Ryan plan, I'm not going to get too detailed into it because there are too many soft spots and too many assumptions you'd have to make. But I guess I'd point one thing out which I think is very important.

When we look at -- people think we're very oriented towards outside the US the way we think. But the fact of the matter is our headcount around the world is pretty balanced US and the rest of the world, both as to revenue and as to headcount. And that is after you count Puerto Rico where we make a billion lenses in Puerto Rico, that is a possession of the United States and it's part of the US.

So when we think about this, we, they that we're hearing about, we, the US, against rest of the world, we, the US, 5% compared to 95% of those outside the US, it is not as in balance in Cooper's model as some may think it is. Long and the short of it is, I'm not going to over react to any theory that gets thrown around out there and I'll react to legislation.

There hasn't been meaningful legislation since I think 1986. There's been a few things along the way that have come and gone, but it would be very premature to over analyze it.

Operator

Thank you, and our next question comes from the line of Steve Willoughby of Cleveland Research.

Steve Willoughby - *Cleveland Research Company - Analyst*

Hello, good afternoon and thanks for taking my questions. I guess first, Al, if we look back a month ago as it relates to FX, what would you be thinking in terms of the impact from FX to the total Company for 2017 at that point versus the $0.10 headwind you're expecting now?

Al White - *Cooper Companies Inc. - CFO & Chief Strategy Officer*

Yes, well, Steve, tough to say because it depends what day you chose when Trump was elected, so to speak. That's when currency rates really started moving. So if you go back to that data prior to that date, we had one point in time would have been $0.30, $0.40 positive.

We would have had the wind at our back. We'd probably ended up with I don't know what the exact number are, but it wouldn't surprise me as $0.50 swing from what it was to what it is today. Maybe even a little bit more than that.

Steve Willoughby - *Cleveland Research Company - Analyst*

Okay, and then just a follow-up. With the roughly 50% one-day silicone hydrogel growth this year, do you have any expectations for what that looks like next year?

Bob Weiss - *Cooper Companies Inc. - CEO*

Well as I indicated, it's off of a larger base. So I wouldn't expect the 50% to be sustainable, but I think in terms of whole dollars that certainly should be something we would expect. We have so much opportunity and we have the capacity that all I'll say is we'll put up solid numbers throughout 2017, but I'm not going to say that it's any one particular percentage, let's put it that way.

Operator

Thank you, and our next question comes from the line of Larry Keusch of Raymond James.

Larry Keusch - *Raymond James & Associates, Inc. - Analyst*

Thanks, good afternoon, guys. Couple questions here. Just, Al, I'm wondering if you could talk a little bit about the FX assumptions that you are using for 2017 on the major currencies?

Al White - *Cooper Companies Inc. - CFO & Chief Strategy Officer*

Sure, pretty much today's rates. They are obviously bouncing around a lot, but the euro at about $1.06 and the yen at $1.14, pound at $1.26 and that's similar to where they are today. And then other currencies around the world would be pretty similar to that.

Larry Keusch - *Raymond James & Associates, Inc. - Analyst*

Okay, perfect. And then two other ones quickly here. I know you mentioned the outlook for free cash flow generation in totality through 2021, but how are you thinking about free cash flow generation this year and maybe wrap into that CapEx?

And then I guess the last thing is, just struggling a little bit with the first quarter and why it's so low. I understand the tax rate, obviously there's a tough comparison. But can you talk a little bit about perhaps the gating for the spending of this incremental for sales and marketing, and is it weighted towards the first quarter or is it more ratable through the year?

Al White - *Cooper Companies Inc. - CFO & Chief Strategy Officer*

Yes, I'll hit cash flow and I'll let Bob go through on the marketing side. For this year, we're probably going to be $400 million -- should be north of $400 million of free cash. Currency is hurting us a little bit right now, but it should be somewhere in that $400 million range.

CapEx, we'll see how that plays out. It looks like it's going to be somewhere around $150 million for the year. So if you work off those numbers, $400 million and $150 million, that's probably not a bad way to look at this year at this point in time.

Bob Weiss - *Cooper Companies Inc. - CEO*

I think as far as the gating of the investment spend and is it a drag on the first quarter yet. It is a drag partly because of the fact that our first quarter is always the lightest on a revenue basis -- from a revenue point of view, which has always been the case. And we started a lot of our investment started ramping in the fourth quarter, so it's rolling into the first quarter.

Obviously it's part of the infrastructure already and will be somewhat of a drag. Some of our investments, if you will, that started in the fourth quarter and worked their way through the first quarter will start yielding, if you will, as the year progresses and we start expecting a return from some of that towards the back half of the year.

Operator

Thank you, and our next question comes from the line of Andrew Hanover of JPMorgan.

Andrew Hanover - *JPMorgan - Analyst*

Thanks for taking the question. Al, I just wanted to go back just through 2017 guidance, and just it looks like it's extremely conservative at least from what I can tell right this second.

I think this is the first time you've embedded an interest rate increase in the numbers, and it's 125 bips. So I was just wondering, is that around -- is that an impact of around $0.18? And then I'm just trying to get a better feel for FX, SG&A and the higher tax rate, and what's driving the higher tax rate for the year?

Al White - *Cooper Companies Inc. - CFO & Chief Strategy Officer*

Yes, a couple comments. If you look at our debt levels, $1.3 billion, we acquired Wallace obviously. So another $150 million plus on that, and it's pretty straightforward to do the math on the increase. We assumed a 25 basis point rate increase happening with the Fed moving here in the month of December, so fully baking that in for the year, if you will.

We're probably a little conservative on interest expense where we're at based on the amount of cash flow we're generating and so forth and where we'll come out on the pricing grid, but we'll see how that plays out. When you look at the tax rate itself, we've been running on a look-through basis, if you will, somewhere around that 10%. We've had a number of discrete items that have come through, we've had acquisition-related activity and so forth that have allowed some write-offs and so forth that have pushed the tax rate down.

Could it come in lower than 10%, it could. But I would tell you right now based on what we have today, we're looking at somewhere around that 10%. With Q1, Q2, Q4 probably being somewhat similar and as usual Q3 being a little bit lighter, but not as dramatic as what you've seen in prior years where you'd see a quarter that's 3% or a 4% quarter as an example.

Bob Weiss - *Cooper Companies Inc. - CEO*

And I think one way of looking at that is our fourth quarter effective tax rate is 10.3%. That is excluding any discrete items. So that's what the business runs ex the discrete items we've had year after year, but do not anticipate going forward.

Operator

Thank you, and our next question comes from the line of Jeff Johnson of Robert Baird.

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

Thank you, good afternoon, guys. Bob, I wanted to start with you just on the salesforce. So if I think about your salesforce, I think it's about half to maybe 55% the size of your two larger competitors and your market share is in that same range.

So on the face of it, it seems like your salesforce isn't overly undersized I guess. And then I think about your private-label business, it's somewhere around 25% or 30% of revenue, and I'd assume that's a lower touch business. So just wanting to understand why is the big focus on salesforce additions at this point, and what's really driving that?

And then maybe, Al, for you a follow-up question. I think I agree, your EPS guidance looks maybe like there's some levers of conservatism in there, but 6% to 8% CVI growth in a fairly choppy market and maybe in a med tech market that's a little uncertain right now doesn't feel overly conservative to me. So maybe if you can address your thoughts on the 6% to 8% CVI growth for 2017, that would be helpful as well. Thanks.

Bob Weiss - *Cooper Companies Inc. - CEO*

Yes, Jeff, on the size of our salesforce compared to our competitors, I think if we compare our 23% market share to Alcons which is just a tad above ours, suffice it to say, the size of their salesforce compared to ours is nowhere comparable. And J&J, if we were going to do allocations against market share with their 40% market share or there and or about to our 23%, that would barely line up.

I think more importantly is it really is about if you have the products, and we have the broadest product portfolio. And you have the capacity, something we have not had in the past, at least relative to clariti, MyDay, and to a lesser extent even Biofinity. So if you have the capacity you want, why wouldn't you test the water and see how good your products are, why wouldn't you go after your competitor's accounts more aggressively.

And we can't do it if we're under indexed on feet on the street. So it's one thing if you're growing methodically and you're confined with how much you can grow, it's another thing if you don't have those limitations which I'll call capacity.

Al White - *Cooper Companies Inc. - CFO & Chief Strategy Officer*

Yes and I'll comment a little bit on the growth rate assumption. If you look at CooperVision last year, they grew 7.5% in constant currency, 11% in Q4. So obviously a lot of momentum there.

You look at the Q1 guidance of 7% to 10% and expecting that momentum to continue, and, Jeff, I think where you going with this to your point is if you look at 6% to 8% for the year and you roll that Q1 in, you'd be talking about implied guidance, if you will, of Q2 to Q4 for CooperVision in the upper 6%s which would be decelerating in the face of some decent investments. So I think that's a very fair question.

I would tell you that I think that giving a 6% to 8% range in today's world is prudent, and a good way to look at the business. But I don't think anybody would be very happy, let me put it to you that way, if we were growing in the 6% to 7% range.

Operator

Thank you, and our next question comes from the line of Anthony Petrone of Jefferies.

Anthony Petrone - *Jefferies & Co. - Analyst*

Maybe just one question on the sales investments, and then one just on the competitive landscape to follow up there. Just in terms of feet on the street, I'm just wondering how much of the investment is focused on optometrists, that channel, as opposed to other retail channels? And I guess the core of that is that we're under the impression that still the majority of sales for Cooper comes from optometrists.

So just wondering if you're doubling down in that channel or expanding in other retail channels? And in terms of the competitive landscape, it would just be great to get an update. Where Alcon sits at this point, it looks like they are still in a position of giving up some share and similarly, Bausch & Lomb and J&J. Thanks.

Bob Weiss - *Cooper Companies Inc. - CEO*

Sure, our focus in terms of feet on the street and whether it's independent ODs or ODs that are at the retail level is the OD wherever they are. And a lot of our Cooper is very open as part of its strategy being it could be branded affinity or it could be private label. So we're indifferent to what it's called.

But what we have learned in the past is just because you send a bunch of your product, whether it's private label or branded, to a large retailer, if you don't work it, it's not going to work itself. You have to go to the OD whether they are under an umbrella of a retailer or not, so that has contrasted to maybe an online or some other mechanism. We don't waste our time with that. If you don't write the prescription, you don't have our attention and that will continue.

Relative to the competitive landscape, yes, our competitors continue to be in various stages of disarray. Alcon, we know what the CEO and Chairman of Novartis basically said. They are restructuring that organization, there is disruption there, they have a tired product line.

B&L likewise is in a very disruptive environment to say the least. And J&J has done a pretty good job of marketing one product, Oasis by any other name is Oasis. So it's all over, one day, one week, two week, one month, called Vita.

So of the three competitors I would say J&J has in fact together better than the other two. But having said that, they are obviously presenting some opportunities in their approach. Are they in UPP one day and then they are out of UPP the next day?

UPP wholesale across all other products, and then they vacate the entire thing and come up with a different plan. So we have been pretty steady state in the way we're approaching the market. We have the product portfolio, and we feel good about our competitors.

Operator

Thank you, and our next question comes from the line of Brian Weinstein of William Blair.

Brian Weinstein - *William Blair & Company - Analyst*

Hey, guys, thanks for taking the question. First one on margins, you guys had targeted some improvement in MyDay by the end of the year and talked about clariti getting north of corporate margins. Can you just comment where the margins are on those products?

And then, Bob, for you, you'd talked previously about 50% of the $10 billion market to be in the one-day modality and of that about somewhere between 20% and 77% to be in silicone hydrogel and thought maybe the middle of that made sense. With more experience now of how these products are rolling out, do you have more confidence that over the next few years that you're going to be trending more above that 50% of the market towards that 77%. Where do you think that that could be now by 2020? Thanks.

Bob Weiss - *Cooper Companies Inc. - CEO*

Yes, I think we're rapidly approaching the 50% mark for one-days, and within one-day silicone hydrogel is continuing to make solid progress, growing 20% ish in that market. And therefore, it's now I think over 20% of the or close to 25% of the one-day market.

So I do believe the one-days will be more than 50% of the let's say that target $10 billion down the road, 2020, 2021, and who knows, foreign exchange keeps coming along putting a dent in some of that. So assuming the dollar stabilizes, that -- we're directionally headed towards that $10 billion.

One-day will be greater than 50%, and there's no doubt that silicone hydrogel one-day will be much greater than 20% of that one-day market. And will it be similar to the planned replacement where it's close to 80%, 79%, 80%, or a lot less. I think there are some reasons that it won't get well beyond the 50% barrier short term because there's so much activity in the non-silicone hydrogel mass market space that that will be somewhat barrier.

To answer your question about our costs coming down, MyDay is making good progress. We believe it's in the 30%s now, and we would expect that by 2018 sometime we'll be honing in on that 50% target for a one-day gross margin, and clariti because of its novel approach to manufacturing and cost will not be a drag and is not a drag today on our gross margin. So the mix you see, it's holding its own within that mix and is not a headwind on gross margin percentages.

Operator

Thank you, and our next question comes from the line of Steven Lichtman of Oppenheimer.

Steven Lichtman - *Oppenheimer & Co. - Analyst*

Thank you, hello, guys. Just a couple of P&L follow-ups. First in terms of the investment in sales and marketing, should we be thinking about that as solely salesforce higher investments, or is there any discrete marketing investments that are embedded in there? And then secondly, Al, on the idle equipment charges the enhanced charges we've seen owing to the efficiencies, how should we be thinking about those rolling off in 2017?

Bob Weiss - *Cooper Companies Inc. - CEO*

So on the sales and marketing, it's more than just feet on the street, albeit the concentration and the focus is more so feet on the street. But with the new products, with Energists, with the conversion from Avera to Vitality, with a new MyDay, toric, all that activity, there certainly is, and particularly up front as you come out with the new products, some energy on the marketing side.

Some of that will tail off and some of it will continue as you roll it out around the world. So nothing I would say nothing imminent where it's suddenly in a non-investment mode over the next one to two years.

The roll off of idle equipment is somewhat a function of the success of the growth of our various areas, whether it's Vitality, whether it's MyDay, whether it's clariti, the growth in those products will form the basis of consuming some of that idle equipment over the next one to two years. We indicated partly because of the continuing successes in cutting costs and getting better yields and getting better throughput, we are now talking about lines with north of 80 million unit production that two years ago we didn't even have on the drawing board by way of a thought.

So those profound changes means we'll be able to continue to ramp up and continue to be ahead of the curve in terms of the demand side for quite a while in some of those areas, clariti and MyDay. Al, I don't know what other call you want to -- ?

Al White - *Cooper Companies Inc. - CFO & Chief Strategy Officer*

Maybe just quickly, Bob is exactly right. Quantify that just a little bit, we had talked last year about $0.10 a quarter above and beyond for idle equipment and some inventory charges, and we had that in Q2, Q3, Q4. I would say that we're continuing to have that right now.

Those idle charges are mostly linked to the daily side. So the growth that you're seeing is just absolutely fantastic for us. Continuing growth like that puts those lines to use and the idle equipment goes down,

So the expansion and the focus on sales and marketing to drive top line growth and driving single use, one of the nice benefits of that is it's going to put equipment to work. We obviously don't need to buy new equipment, which helps free cash flow, and we remove idle equipment charges and put that into production.

So I would say that we're still looking at that $0.10 a quarter here to start the year. But then depending upon our success, that will move down and hopefully move to zero by the end of this year. But more likely, we'll see those charges even move into 2018 a little bit.

Operator

Thank you, and I'm showing no further questions at this time. I'd now like to turn the call over to Mr. Bob Weiss for closing remarks.

Bob Weiss - *Cooper Companies Inc. - CEO*

Well I want to thank you for joining our call today, and wish everyone the happiest of holidays coming up. And we look forward to updating you on the progress we're making and on our new product rollouts on our call in March, which I believe is going to be March 2, 2017. I'll look forward to talking to you then.

Thank you. That's it, Operator.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This concludes today's program. You may all disconnect. Everyone have a great day.
