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COO - Q3 2014 Cooper Companies Inc Earnings Call

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OVERVIEW:

COO reported 3Q14 consolidated revenue of $432.5m and GAAP EPS of $1.80. Expects FY15 preliminary revenues to be $2.00-2.06b and non-GAAP EPS to be $8.20-8.60. FY14 revenues are expected to be $1.725-1.740b and non-GAAP EPS excluding amortization to be $7.34-7.44. 4Q14 revenues are expected to be $477-490m and non-GAAP EPS excluding amortization to be $2.00-2.10.

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to The Cooper Companies third-quarter earnings results conference call. My name is Philip and I will be your operator for today.

(Operator Instructions)

As a reminder, this conference is being recorded for replay purposes. I wold now like to turn the conference over to your host for today, Ms. Kim Duncan. Please proceed.

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

Good afternoon and welcome to The Cooper Companies' third-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 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 or future actions of the Company to differ materially from those described in the forward-looking statements are set forth under the caption Forward-Looking Statements in today's earnings release, and are described in our SEC filings, including the business section of Cooper's annual report on Form 10-K. These are publicly available and on request from the Company's Investor Relations Department.

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 will then discuss the third-quarter financial results. 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 requested 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. With that, I will turn the call over to Bob for his opening remarks.

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

Thank you, Kim. And welcome, everyone. We had a very busy third quarter, so we have a lot to discuss.

As I'm sure everyone is aware, we announced the acquisition of Sauflon in our fiscal third quarter, and we closed the deal on August 6, early in our fiscal fourth quarter. Since then, we've been incredibly focused on integrating the business and making it part of CooperVision.

I'm very happy to say we're making great progress and the integration is running smoothly and on time. Additionally, I'm very happy to say that we've learned a number of things post closing that make me more positive on this deal, especially with respect to the manufacturing side. I'll discuss this in the Sauflon business in more detail later.

Let me now start by providing some highlights on our fiscal third quarter. On a consolidated basis, we grew revenues 5% to $432.5 million. Revenues were also up 5% in constant currency and excluding our Aime divestiture from last October.

We posted GAAP earnings per share of $1.80 and non-GAAP earnings per share of $1.90. Free cash flow was $54 million, bringing our twelve-month trailing free cash flow to $206 million.

Before getting into too many details, let me comment on CooperVision and CooperSurgical at a high level. CooperVision grew 6% year over year to $350 million. We continued making progress in a number of different areas. And we saw strength in all our key areas including silicone hydrogel family of lenses which grew 21%. We also continued taking market share, growing roughly 1.6 times the global market in calendar second quarter.

Within CooperSurgical, we grew 1% year over year to $83 million. This met our expectations as we are implementing some minor restructuring and reducing our focus on low-margin capital equipment sales within the IVF section.

Now, let me provide some additional color on the Sauflon acquisition. As you know, we closed the acquisition on August 6. We immediately began integrating the business. And, again, I'm happy to say things are going very well.

We believe we will be able to get the vast majority of the integration done by the end of 2015, with a significant portion done in the next six months. We have a number of personnel decisions we are in the process of making, along with a number of decisions around product offerings, back-office combinations and manufacturing decisions.

Regarding details, I visited Sauflon's primary manufacturing facility in Budapest last month and I can tell you it's an extremely impressive facility. The cost and speed to get new lines operational, combined with their flexibility, is really impressive. As a matter of fact, it's better than we anticipated and I think it's going to offer us manufacturing improvements in the outer years, as we integrate our platforms.

Now, before I get into the details of last quarter, I want to touch on the soft contact lens market in calendar Q2 and our related performance. First off, I'm happy to say we once again took market share, growing roughly 1.6 times the global market. The global market grew 3% for the quarter and we continued to take market share, growing 5%.

Although the 3% market growth is low, remember, there was a large amount of pull forward in Q1 as Japan raised their sales tax effective March 31, and this resulted in a significant channel fill which resulted in global growth of 8% in the first quarter. To net everything out, we believe the best way to look at the market is on a trailing 12-month basis, where the market grew 6%, and we grew 10%. At this point, I believe the global market will continue to grow around 6%, and you should see us continuing to take share, especially with the addition of Sauflon's daily silicone hydrogel family of lenses.

For the quarter, our strength continued to be seen in Europe, where we grew 9% against the market at 3%. This is a market where we sell all our products, including MyDay, and are doing very well.

The Americas, on the other hand, is a market where our performance lags. The market grew 7%, which surprised me, and makes me believe there is something going on with channel fill.

Our new set data shows CooperVision running roughly 200 basis points above existing market share in the US, which clearly indicates we are growing share on a fit basis. We did see some inventory contraction, so perhaps others saw some inventory expansion. Regardless, I believe you'll see CooperVision return to gaining share in the near future, as we incorporate Sauflon and bring MyDay into the United States.

Now, turning to CooperVision details for the past quarter, on the sales side, we had revenues of $350 million, up 6%. Excluding currency and the impact of the divestiture of Aime, sales were up 6%.

Our silicone hydrogel family continues to drive our top line with revenues of $174 million, up 21%. The silicone hydrogel family is now very deep, with our monthly Biofinity product leading the way, posting upper teens growth this past quarter. Our two-week family of products, the Avaira line, also posted strong growth in the quarter, up slightly over 20%.

It's important to note that we are still under-indexed against the market in the non-daily silicone space. This portion of the market is now approximately 71% silicones and we're at 66%. So, we are expecting to continue growing our non-daily silicone franchise for several years.

Regarding silicone dailies, our one-day product, MyDay, had a solid quarter. We are continuing to improve production on our lines, and we remain on schedule to bring additional manufacturing lines into production in calendar Q2 and Q3 of 2015.

We remain very positive about this product. Obviously, we are spending a lot of time evaluating the market with the addition of Sauflon's daily silicone hydrogel product family. And we continue to believe there's a great opportunity to split the market with a premium daily silicone and hydrogel lines in a mass-market lens.

We also believe we have a premier portfolio in this space to become the market leader in the coming years. As a reminder, with the Sauflon acquisition, we now are the only company offering a daily silicone hydrogel product portfolio, which includes a sphere, a toric and a multifocal. The marketplace is clearly hungry for this portfolio and we are here to deliver it.

Our toric business remains strong, growing 11% and now accounts for 32% of CooperVision total revenues. Multifocals grew 16% and now represent 11% of our total revenue. We continue to lead the global market in these specialized categories and we are taking market share.

CooperSurgical, our women's health care franchise, turned in a solid performance, meeting our expectations. Revenue growth was only 1%, but we are pleased with the strength in margins. On a non-GAAP basis we increased our margins from 64% to 66%.

Our fertility business continued to grow with our reduced focus on low-margin capital equipment sales. Growth was only 3%.

We are continuing to work to find the optimal model of sales growth and margin improvement, and we are confident we are on the right track. Based on this, revenues will likely continue to be lower than we've historically seen in our IVF business over the next year, but gross margins should remain strong.

IVF now accounts for 34% of CooperSurgical's franchise. Within our office and surgical business we posted growth of 1%. We're continuing to experience the challenges a lot of medical device companies are with the changing US healthcare landscape.

Having said that, we believe we are maintaining if not taking share in our overall product portfolio. We also believe we have some products in development that should help grow in 2015 and 2016.

A few comments about strategy. We continue with our successful strategy which I've frequently articulated in the past. We believe it's a solid strategy and it has delivered results.

This includes investing in our businesses to ensure we continue to take market share. This includes direct investments, such as our new manufacturing facility in Costa Rica which we anticipate producing product in late 2015 and, our investments in emerging markets such as China.

This also includes strategic acquisitions such as Sauflon. We are also keenly focused on improving our operating margins, which we now are targeting being 26%-plus in the 2018 time period, excluding amortization.

The contact lens industry is $7.4 billion globally. Our unique manufacturing platforms and wide product offerings mean we offer the most comprehensive portfolio in the industry.

Just to crystallize this point, CooperVision aggressively promotes silicone hydrogel and non-silicone lenses. We also emphasize branded and private label products. And, note, private label does not mean lower operating margins.

We also actively promote and specialize in custom lenses. We support all modalities that eyecare professionals prescribe -- one day, two week and monthly. And we support all types of lenses -- spheres, torics and multifocals.

With a market leading position in the high-growth specialty lens categories, torics and multifocals, it is acknowledged by eyecare professionals that we are pretty good at specialty contact lenses. In my opinion, we continue to be the most focused company in the industry.

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 lenses for the 10% to 20% of those lens wearers that require other than standard sizes and/or designs.

While we already have pretty respectable gross margins and operating margins, we have considerable upside, yet to be fully developed. Upsides include elimination of our silicone hydrogel royalty with the expiration of patents, reduction of labor costs through opening new facilities such as Costa Rica, improving molding cycle times, synergies from Sauflon, and also leverage from our one day-strategy.

CooperSurgical is putting up solid results and it's 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 professionals wherever they go, be it in the office, the surgery center, the hospital or the IVF center. Although the call points are different, the leverage is considerable.

CooperSurgical maintains solid margins with gross margins in the mid 60%s and operating margins in the low 20%s, both of which have upside. And due to the minimum capital expenditure requirements, CooperSurgical is a significant contributor to our free cash flow. We are dedicated to our surgical strategy and we will continue to leverage the CooperSurgical structure and products.

Additionally, the market 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 to our local 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 continue to find opportunities to invest in other countries for decades to come, thereby, sustaining our low effective tax rate indefinitely.

Finally, we have a share repurchase plan which has roughly $212 million of remaining availability and we will use that program when we believe it makes sense.

Now, to touch a little on guidance, I'll let Greg provide the details, but I want to comment on a few things. As you can imagine, we have a significant number of moving parts as we work to integrate Sauflon.

Every acquisition requires a number of decisions to maximize revenues while realizing synergies. As such, the CooperVision team needs time to a evaluate and implement their plans, including decisions on personnel, facilities, duplicate products and so forth.

Having said that, I do want to provide some color on the numbers. For fiscal fourth quarter, we are providing guidance on consolidated sales of $477 million to $490 million, and this includes $395 million to $405 million for CooperVision and $82 million to $85 million for CooperSurgical.

Regarding CooperVision, I'm not going to break out a Sauflon number, as we have overlapping products, specifically daily hydrogels, and we need to determine the best products to focus on. This may result in eliminating certain CooperVision or Sauflon products. We're working to make these decisions as quickly as possible and will communicate those details once available.

Regarding earnings, we anticipate non-GAAP earnings of $2 to $2.10. Note this range excludes all amortization. Also note, this guidance reflects updated currency rates which have moved against us recently with the euro dropping to below 130s -- actually, today, down to the sub 130 level -- and the yen to roughly 105.

Regarding FY15, due to the Sauflon acquisition, I've decided to change our historical practice of waiting until December to provide any details. Obviously, it's too early to provide any granularity. Let me say I believe we will see consolidated pro forma revenue growth in the upper single-digit range on a constant currency basis, which should mean $2 billion to $2.060 billion in revenue in 2015.

We believe this should result in a non-GAAP earnings per share in the range of $8.20 to $8.60. As you can imagine, there are a lot of moving parts with the Sauflon integration. So, we will wait to provide more details on the December call.

In the meantime, we have an analyst day next week in New York City on September 11, and we'll provide additional color on the integration details at that time. Speaking of our analyst day, the format will be similar to our last one, which the majority of the presentations will be from our operational management. Al and I will only make a few brief comments, which will provide plenty of time for our Chief Operating Officer, Dan McBride, and his teams to discuss CooperVision and CooperSurgical.

This will include Dennis Murphy presenting on CooperVision's commercial operations and Fernando Torre presenting on the manufacturing and distribution parts of the business. Paul Remmell will present details on CooperSurgical and Greg will cover our financials. This should be a very informative morning so I hope you can all join us.

In summary, before I turn it over to Greg, let me say how happy I am with our businesses. Operationally, we continue to outperform the market, growing 1.6 times the market last quarter and on a trailing 12-month basis.

Our family of CooperVision products, led by our silicone hydrogel families and our fertility line within women's healthcare, are all very promising, each offering growth opportunities throughout the world. We also closed the acquisition of Sauflon. And I truly believe our new market-leading product offering in the daily silicone space is going to provide strong growth for many years to come.

We believe our optimism is with good reason. Because of our solid profit margins and free cash flow generation, we have been able to continue investing in our businesses, including maintaining our commitment to capital expenditures to support a one-day expansion strategy.

Today's one-day market is over $3 billion and growing much faster than 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 the needle. 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.

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 delivering results.

And, now, I'll turn it over to Greg to cover our financial results.

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

Thanks, Bob. Good afternoon, everyone. Bob shared with you a pretty thorough review of the market and our revenue picture. Now let me start with gross margins.

In Q3, consolidated GAAP and non-GAAP gross margins were 64.9% and 65%, respectively, compared with 65.1% for GAAP and non-GAAP in the prior year. Gross margins came in at expectations. When looking at FX we had a slight negative impact due to pound-based inventory flushing through the system, as we've discussed on the last couple of earnings calls, which was partially offset by favorable currency impact on revenue over the prior year.

We saw a similar offset due to mix, as favorable Biofinity products were largely offset by other products, including MyDay. On MyDay, specifically, we still expect this product to exit the year in the high single-digit gross margin range.

CooperVision, on a GAAP and non-GAAP basis, reported a gross margin of 64.8% versus 65.4% for GAAP and non-GAAP in Q3 last year. As I just mentioned, this reduction of gross margin was mainly due to a slight negative currency impact related to pound-based inventory flushing through the system and product mix.

CooperSurgical had a GAAP and a non-GAAP gross margin of 65.3% and 65.8%, respectively, which compares to Q3 2013 of 64.1%. We saw positive impact from reducing our low-margin capital equipment sales within IVF and with growth from certain higher-margin products in the base business.

It's worth remembering that our fertility business has lower margins than the rest of our business, but we are seeing improvement there as we focus on selling higher-margin products. The difference between GAAP and non-GAAP relates to approximately $427,000 of severance costs.

Looking at operating expenses, in the quarter on a GAAP basis SG&A expenses increased by approximately 6% from Q3 last year to $161.2 million, and were 37% of revenue, similar to the prior year. On a non-GAAP basis, SG&A increased approximately 3% to $156.5 million. The difference between GAAP and non-GAAP was about $4.7 million in acquisition-related costs which were included in our GAAP numbers. SG&A on a non-GAAP basis increased 1% sequentially.

Now looking at R&D, in Q3 R&D increased by approximately 8% year over year to $16.1 million or up $1.2 million. R&D was 3.7% of revenue, up from 3.6% of revenue in Q3 2013 and down from 4% sequentially.

In looking at depreciation and amortization in Q3, depreciation was $25.7 million, up $2.3 million or 10% year over year. Amortization was $6.8 million, down approximately $900,000 or 12% year over year, for a total of $32.5 million.

Moving to operating margins, for Q3, consolidated GAAP operating income and margin were $96.6 million and 22.3% of revenue, versus $93.6 million and 22.7% of revenue for GAAP in Q3 last year. Non-GAAP operating income and margin were $101.7 million, and 23.5% of revenue versus $93.6 million and 22.7% of revenue for the prior year. This represents a 3% increase in operating income over the prior year GAAP numbers and a 9% increase for non-GAAP. The difference between GAAP and non-GAAP is due to approximately $5.1 million with acquisition and severance costs.

In Q3, CooperVision had GAAP operating income and margin of $88.4 million and 25.3% of revenue, versus the prior year Q3 of $88 million and 26.6% of revenue for GAAP and non-GAAP. In Q3 2014, on a non-GAAP basis, operating income and margin were $93.4 million and 26.7% of revenue. The difference here between GAAP and non-GAAP is due to approximately $5 million of acquisition costs for Sauflon.

CSI, CooperSurgical, had GAAP operating income and margin of $18.4 million and 22.3% of revenue versus the prior year Q3 of $16.4 million and 20.2% of revenue for GAAP and non-GAAP. Q3 2014 non-GAAP operating income and margin were $19.2 million and 23.2% of revenue. This difference between GAAP and non-GAAP is related to approximately $800,000 of acquisition and severance costs.

Moving on to interest expenses, interest expense was $1.5 million for the quarter, down 34% year over year. Looking at the effective tax rate, in Q3, the GAAP and non-GAAP effective tax rate was 6.1% versus Q3 2013 GAAP effective tax rate of 2.3% and non-GAAP effective tax rate of 5%. As a reminder, the effective tax rate was abnormally low in last year's third quarter due to a drop in the UK statutory rate from 23% to 20%, which was enacted during that quarter.

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.

Looking at earnings per share, our Q3 earnings per share on a GAAP and non-GAAP basis was $1.80 and $1.90, respectively, versus $1.79 and $1.74 on a GAAP and non-GAAP basis in Q3 2013, respectively. GAAP EPS includes the impact of acquisition and severance-related charges of approximately $5.1 million or $0.10 per share.

Ahead of recasting our non-GAAP reporting to include Sauflon, which we will do in Q4, we are today updating our non-GAAP reporting to exclude amortization. We believe this change reflects how our industry is treating amortization, and believe this will aid in transparency and the ability to compare results across companies.

Regarding the financial impact of amortization, if you exclude it from non-GAAP results this year, the impact on non-GAAP EPS would be as follows. For Q1 2014, with $7.5 million of amortization reported, the earnings per share impact would be $0.12. In Q2 2014, with $7.5 million of amortization, earnings per share is also $0.12. In Q3, with $6.8 million in amortization, we saw a $0.10 impact on EPS. And for Q4, excluding Sauflon, we expect $6.8 million of amortization and an impact of $0.10 on EPS.

For comparability, FY13 amortization impact on earnings per share was, in Q1, $0.11; Q2, $0.11; Q3, $0.12; and Q4 was also $0.12. For FY15, excluding Sauflon, the full-year amortization would be approximately $22 million with an estimated EPS impact of $0.32.

It's important to note that there is a tax impact on the amortization, depending upon where, geographically, the intangibles reside. We have intangibles relating to deals in several countries including the US and UK, so the tax effect on amortization expense I just quoted is higher than our average effective tax rate.

Moving on to share repurchases, there were no share repurchases in Q3. Looking at foreign exchange, the net impact year over year for Q3 was slightly favorable by $0.02. At the current FX rates, we will see a headwind on our fiscal Q4 guidance.

For Q4 we're expecting a negative year-over-year impact of $0.17 which is $0.06 more than we guided to in our last earnings call. This EPS deterioration for Q4 is generally related to the weakening of the euro and European currencies which track the euro, like the kroner as well as the yen.

Note, at the current FX rates we now expected a $0.31 negative FX impact on our earnings per share in 2014. For today's guidance, we use the rate of $1.31 for the euro, JPY105 for the yen and $1.65 for the pound. If any of you have been following it during the day, you realize it has gotten a little weaker from this morning.

Balance sheet and liquidity in Q3, we had cash provided by operations of $107.9 million, capital expenditures of $55.8 million, and excluding acquisition-related costs of $1.7 million resulting of $53.8 million of free cash flow. Total debt increased within the quarter by $12.5 million to $347.9 million.

Subsequent to quarter end, on August 6, we announced the Company entered into a $700 million three-year senior unsecured term loan which matures August 4, 2017. The facility was used to contribute to the funding of the Sauflon acquisition as well as to provide future working capital and be available for other general corporate purposes. This loan combined with previous facilities gives us combined debt capacity of over $2 billion.

Inventories increased approximately $7.6 million to $353.4 million from last quarter. For the quarter, we are seeing months on hand at seven months, down from months on hand of 7.1 months last year, and down from 7.2 months on hand last quarter. The DSO is at 53 days, up from 51 days in the prior quarter and same as last year.

Touching on a couple of important topics -- first off, we closed the Sauflon acquisition for $1.2 billion on August 6, using offshore cash and debt facilities. We will be including their results in our Q4 reporting. With this acquisition, we now expect to see interest expense of roughly $3 million in Q4. It's a little early to forecast interest expense in FY15, but at current rates is likely to be in the range of $18 million.

Integration activities are proceeding on schedule, but we've not had a financial close with Sauflon yet, so we are working through a number of financial and operational details, and will continue to share information with you as we gain better insight into those details.

A couple points to note on this. We are in the process of doing our financial and tax valuation work, including completing pro forma financial statements. This will be completed in stages and we will have quarterly pro forma financial statements completed by our Q4 earnings call, and we will distribute those as soon as possible. I appreciate that this is a key item for your FY15 model, so we are working diligently to get this work completed.

Regarding taxes, we believe that Q4 non-GAAP effective tax rate will be approximately 11.5%, which is higher than our run rate, but reflects the impact of excluding amortization as well as the addition of the Sauflon acquisition. We are very much in the early stages and this number will change depending on various integration decisions, but this is the best number we have at the moment.

Regarding Sauflon's tax structure, we are actively working on integrating their business into our global tax structure. This is in the early stages and dependent on a number of items including the valuation work. But we hope to get this finished prior to calendar year end. More to follow on this.

Looking at guidance, Bob gave you a little bit of guidance. As Bob mentioned, we are guiding to fiscal Q4 2014 revenues of $477 million to $490 million, with CooperVision at $395 million to $405 million and CSI at $82 million to $85 million.

Bob covered the details around revenue, but let me provide some more detail on EPS. It is difficult to provide too much granularity on a GAAP EPS basis, as this number could change significantly based on Sauflon integration-related decisions and the final valuation model. But on a non-GAAP basis we are anticipating Q4 2014 gross margins of roughly 64%, operating margins roughly 24.5%, which combined with the interest and the tax rate I mentioned earlier, $3 million and 11.5%, respectively, results in a non-GAAP EPS range for the quarter of $2 to $2.10, and this excludes amortization.

Regarding FY14 annual guidance, all of this results in revenues of $1.725 billion to $1.74 billion, with CooperVision at $1.4 billion to $1.412 billion, and CooperSurgical at $325 million to $328 million. Non-GAAP EPS guidance excluding amortization is $7.34 to $7.44. As I mentioned earlier, because of the large number of integration activities and the wide range of potential costs, it does not make sense to provide GAAP EPS at this time.

Looking at the preliminary guidance for 2015, Bob mentioned revenue at $2 billion to $2.06 billion and non-GAAP EPS in the range of $8.20 to $8.60. Taking into consideration that there are a lot of moving parts and that things will change, let me give you some of the assumptions we've used for our non-GAAP EPS at this point. Gross margins in the 63% to 64% range, operating margin 23% to 24% range, ETR 9% to 11%, share count just under 50 million shares.

Again, a lot of work has to be done and these are some preliminary ranges. But because we know you're trying to set up your models, we will do what we can. We will try to provide more insight during our Q4 earnings call in December.

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

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

Operator, we are ready to take some questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Jeff Johnson with Baird.

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

Bob, I'll ask first on the FY15 guidance, if I can, on the $8.20 to $8.60 range. Pretty big range. Obviously, you've got a lot of moving parts. I think we all get that. I'm wondering if you can just maybe take us through risks and opportunities, if there's any bias to that guidance to the upper end, lower end. And what would happen to take it to the low end and what would then maybe have to happen to get it to the higher end. Thank you.

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

Jeff, you were a little muffled but I think I got the gist of it. The $8.20 to $8.60 guidance, let's call that middle of the road. It's broader than we normally would like. Obviously, we're going out a lot further than we normally would, with a lot of moving parts that Greg alluded to.

Obviously, some of the moving parts have to do with each of the key assumptions. One is on product rationalization. I alluded to the fact that we're going to be making some decisions on product rationalization, which could certainly impact top line, what happens and how we use the plants.

In some cases, a factor might enter into -- you have MyDay and you have clariti, both in the one-day space -- how we position that, and whether or not we put more emphasis on go-to-market or, basically, on which do we go to market with. Those decisions are being debated extensively, as we speak. Various meetings going on throughout the world. And they certainly could have implications, do you go faster or slower, or do you build and rollout more fitting sets of one product 1 compared to product 2.

The finalization of the rationalization of the split between the mass market and the premium market and the related pricing that goes into that, particularly as we enter the US, all of those things are up in the air. Suffice to say, one of the other things up in the air is foreign exchange, which is moving, as we speak, and, unfortunately, the wrong direction.

We've given guidance coming into today with euro, which is a very key catalyst for our business, if you will, top line and bottom line at 1.31, I think it was. We're already down to sub 1.30. So, clearly things like that would weight us towards the bottom end of the range if that were to keep up.

The timing of our transition into the global tax arrangements of Sauflon, and is it all of the products or only some of the products, would weight on our effective tax rate. So, I would say, suffice it to say there is softness from the top to the bottom in terms of some of the assumptions, therein why we have 63% to 64%, or a 1% spread on gross margin, for example.

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

Understood. And then just as a follow-up, you mentioned in your prepared comments some better than expected things you are seeing on the manufacturing side on Sauflon. Any specifics you can provide? I know you can't make MyDay on the Sauflon lines. I know it's not as simple as that. But maybe give us some ideas of how you could apply some of that manufacturing to some of your technology over time

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

Yes, I will give you two insights on it. One is the ease of change -- how easy it is for them to convert from making one product to another in the downtime. Compared to much more expensive equipment that's more rigid but high volume, they get a lot more versatility in their platform. It's like our platform in Rochester, which gives us the ability to make made-to-order product, make changes a lot more rapidly compared to our high-volume gen-2 type lines. So, that's one thing.

The other thing, clearly, is the ability to make a product without alcohol. So, their product and their production is easier. We've never, basically, had a love affair with alcohol. I think, as many of those on the phone call know, now we have a platform that allows for that, and, importantly, a material that allows for that. So, those two things will weight heavily on where we might go with different products in the future.

Operator

Larry Keusch from Raymond James.

Larry Keusch - *Raymond James & Associates - Analyst*

Bob, just going back to your prepared comments, certainly relative to our model, the single-use spheres were the ones that had the biggest variance. And what I'm trying to really understand is, you grew 15%, I believe, if my numbers are right, last quarter, Q2. You grew 4% this quarter. And if I exclude MyDay, it feels like this quarter the base business was probably actually down year over year. So, could you again run us through what you believe actually happened in that product category?

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

Yes. Single-use spheres, the biggest market in the world is Japan. So, Japan would be the most profoundly impacted by some of the activities with the VAT or the sales and use tax that occurred in Q1 versus Q2. So, you do have to normalize that, for one thing.

The other thing is the second biggest market in the world now is the US. And it's clear we have a void where we are today. We have Proclear 1-Day doing a very credible job, but it can't carry all the weight in the US market. It does need a silicone hydrogel, a clariti and a MyDay. So, the absence of any of that activity yet into the US numbers means that we have a temporary void that we all know will be filled up very shortly.

Larry Keusch - *Raymond James & Associates - Analyst*

Okay. And, then, you mentioned what you felt like you saw some contraction in inventories and perhaps some expansion implied for other companies out there. Again, can you provide some further comments on geographically where that happened and in what product categories that may have happened, as well?

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

Basically, we had some further contraction in our distribution network, distributor network here in the United States. and when we look at that contraction compared to when we look at iData, which is survey data that we get, we know that we did not lose share in those spaces. We were gaining share modestly. And we still, as I indicated, have much greater new fit share than we do total fit share -- meaning, directionally we are headed the right way.

Conversely, when I look at the total market for the US and some of the survey data we have, we can see a pretty big expansion. And I'm capable of, if you will, assessing certain products of our competitors. I won't get into the details on that, but know how some of them lined up on eye compared to how to the total market moved.

It's more speculative, but I have a pretty strong hunch that there were some areas where there was pipeline expansion. Some of it could have been new product related. That leads to some expansion. We didn't have that going on in the US. So, the US -- or the Americas -- were a big part of it.

Operator

Chris Pasquale, JPMorgan.

Chris Pasquale - *JPMorgan - Analyst*

I think I heard you say that the 4Q cash EPS guidance does not include the adjustment for the additional amortization created by the Sauflon acquisition. Is that correct? And is that the case, also, for the FY15 EPS guidance, and therefore should we be expecting that range to go up once you've finalized the accounting for the deal itself?

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

We are basically excluding amortization of intangibles. So, that will never enter our non-GAAP numbers, no matter what. Ultimately, when those appraisals are done down the road, leading to GAAP amortization, if you will, it would go into GAAP and then be pulled out. It would be a bigger number, wherever that number lands. Greg, I don't know if you want to add anything.

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

The only thing in Q4, until we move the IP and have the similar tax structure that we currently have with CooperVision, you could have some tax effect. That's the only reason why we mentioned it. We're fine. Our guidance range for 2015 is fine.

Chris Pasquale - *JPMorgan - Analyst*

Okay. So, the guidance you've given for 4Q, and then preliminary outlook for next year is as close to complete as you can get. There may be some moving parts, but we shouldn't expect some other big adjustment as Sauflon is finalized?

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

Right.

Chris Pasquale - *JPMorgan - Analyst*

Okay. Then, I just want to clarify the answer to Jeff's question, the comment about product rationalization. Is it still an open question whether MyDay and clariti will both be supported? Or is the debate more about positioning in different markets?

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

Both will be supported. The debate is about positioning. Obviously, one dilemma is, do you try to introduce -- and I will be a little kind on the words -- two blockbuster products at once in the US or does one get to lead and one not get to lead. When you have limited supply, you have to make some decisions -- am I better off doing X and Y if I have two products and then sequencing it? That's one thing that matters.

The second thing, on rationalization, there are some overlapping products that are less glamorous, let's say, than clariti, 1-Day or MyDay. It would come into should we rationalize out some of those products.

Operator

Larry Biegelsen from Wells Fargo.

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

I just wanted to ask, Greg, could you tell us what the pro forma growth for CooperVision is implied in your Q4 guidance? And could you also talk about the capacity for clariti 1-Day? MyDay you said you could do $25 million in FY14, $75 million in FY15. For clariti, originally said they would do about $85 million in FY14, but you haven't given us much color on their capacity for FY15. Thanks.

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

I'll jump in on the growth rate. Fourth quarter for total CooperVision -- because we are not breaking out CooperVision and Sauflon -- but for total CooperVision, you are looking at 11% to 14% range in constant currency excluding Aime.

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

Is that pro forma, Greg?

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

Yes, it is.

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

And the other question?

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

As far as capacity for clariti expansion, two things. One is, their total capacity is expanding rapidly, meaning Sauflon. When I talked about versatility, there our two cuts on that. The versatility of whatever product you put on those lines, whether it's clariti, single-use or other products, could influence your capacity considerably. If we were to take off some products off the lines, that would directly influence the capacity.

Those decisions have yet to be determined -- how much beyond their normal expansion of capacity that they were planning on in their ramp-up, which was sustaining a company growing 20% a year, if you will, and where we go with the product line. If we can already make it on a Cooper product line on Cooper equipment we may elect to take even higher ARP products off of their lines and convert them to clariti single-use, if that makes sense.

The long and the short of it is, expect good growth from 1-Day silicone hydrogel lenses next year. And it should certainly be well north of a run rate of $110 million that we're looking at this year in terms of our rollout next year.

Operator

Joanne Wuensch from BMO Capital Markets.

Joanne Wuensch - *BMO Capital Markets - Analyst*

Can we talk about capital expenditures, please? We estimate that you're probably going to spend a little over $200 million in 2014. Can you comment if that is the right range? And, then, how should we think about that next year as you ramp MyDay, integrate Sauflon and do the rationalization of products that you are thinking about?

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

Joanne, you are correct. We were targeted to spend well north of $200 million this year, prior to picking up one quarter of Sauflon. So, suffice it to say it's going to be well north of $200 million, if you will.

The good news about Sauflon, in terms of its impact on our capital requirements, their capital is less expensive by a lot. I mentioned the fact that they don't use alcohol. So, among other things, that makes it less expensive by a lot.

So, while we would normally, in the context of all the activity we have going on with our plant expansions -- for those of you attending the analyst meeting next week, you'll get a lot of insights in terms of what's going on and how many locations and how robust that expansion has been. There is no doubt that having Sauflon in the fold allows us to rethink certain capital projects going forward and migrate, to some degree, from a premium expensive equipment to less expensive equipment, which is positive.

Having said that, I think in 2015, there will be some modest favorable impact beyond 2015, a lot more favorable impact of that. Longer-term, the aggregate of having Sauflon included in our numbers, I would almost guess that the total capital program doesn't go up at all post 2015. It could be consumed in the improved capital model, if you will.

Joanne Wuensch - *BMO Capital Markets - Analyst*

If I can follow-up, please. On the tax rate, it sounds like you are doing a fair bit to manage that. Is that a project which lasts 12 months to 18 months, or is that a multi-year project as you think about resuming that lowered tax rate? Thank you.

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

No, Joanne, it's a fairly quick project and we are hoping to have done what we need to do by the end of the calendar year. We've done this before. It's fairly straightforward, it's just a lot of work that goes into doing it. Obviously there's a tremendous amount of work and forms and calculations that need to be done.

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

Just to add a little bit of color on that, there are some pieces of that process that are business related -- meaning, what are your businesses decisions that can come into play that may alter where we land. And some of that may take a little longer. So, that's maybe a piece of it. Most of it we know exactly where we're going and how we want to get there.

Operator

Matthew Mishan from KeyBanc.

Matthew Mishan - *KeyBanc Capital Markets - Analyst*

I think the first thing I wanted to touch on is, for the past couple quarters, two quarters ago, you had two of your largest distributors merge, and then the previous quarter you had a price hike, so, that pulled forward some demand. And I think this quarter you saw some kind of inventory contraction. Where are you at with your largest distributors and distributor base? Are we likely to see this kind of volatility continue?

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

I would say we're lower than I would have guessed, as we end the third quarter. I think they've rationalized their locations and that consolidation, and that we are near the floor.

Matthew Mishan - *KeyBanc Capital Markets - Analyst*

Okay. How much, if possible, could you quantify how much Sauflon did in the US in the second quarter, the calendar year second quarter?

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

For a number of reasons we are not going to get into that initial rollout. We're not.

Matthew Mishan - *KeyBanc Capital Markets - Analyst*

Just last question, trying to maybe back into what Sauflon was in your fourth-quarter guidance, I think you guided to about $210 million or so for that business for the full year this year. Is there seasonality in the Sauflon business that would make the final quarter more or less robust? Should we pretty much be thinking about that almost as a full quarter of Sauflon minus seven days?

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

The way to think about it is, it's mainly a ramp-up and rollout that they're going through. They were on a trajectory and that was building. Having said that, one of the key assumptions that would come into play would be the initial rollout into the US.

That initial rollout into the US, which started last quarter for them, is obviously one of the areas we need to think most about. That could mean going slow in certain parts of the US as a result of that. It gets back into you have two products -- MyDay, Sauflon -- both entering the US. Sauflon clariti is in front of MyDay getting here quicker.

But you have an integrated operation in the US that is what I'll call much more integrated in some parts of the world and much quicker. That comes into play, and then product strategy. We want to get it right from the get-go and we don't want to have to fix it further down the road. So, that can all translate to less than what I will call a dynamic sales strategy in the US in this next couple months.

Operator

Steve Willoughby from Cleveland Research.

Steve Willoughby - *Cleveland Research Company - Analyst*

You answered my first question there, just regarding the guidance only going up by roughly $17 million in the high end despite you said Sauflon generating roughly $50 million a quarter. Following up on that, for EPS for the year, I see that you've taken the high end up by $0.44. That basically accounts for the amortization that you are no longer including. So I'm just wondering where or when you expect Sauflon to start to be accretive, as I know when you announced the deal you said it would be accretive? Obviously, there's expectations by investors of how accretive it could be and it doesn't look like that accretion is going to start showing up in the first quarter. That's my first question.

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

I would tell you the numbers that we guided to for the fourth quarter don't demonstrate any dilution from Sauflon. If anything, there is some accretion starting in the fourth quarter. Which then rolls into the period beyond. In other words, we are not assuming it's dilutive activity next year.

Steve Willoughby - *Cleveland Research Company - Analyst*

Okay. And then just two other quick questions.

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

Steve, just one other thing. You are seeing some of the FX impact. Again, if you look at -- just for the year, we are looking at $0.31. But even in the fourth quarter, you are looking at $0.17, which is about $0.06 above the guidance we gave last time.

Steve Willoughby - *Cleveland Research Company - Analyst*

Okay. Got it. And then two other quick ones for you. Just so I'm clear, are you not going to be breaking out how much in revenue Sauflon does either in the fourth quarter or in 2015?

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

It's going to be fully integrated with product rationalization. So, the number, in and of itself, will be somewhat meaningless. If we discontinue some of its products, obviously it's going to minimize its growth in certain areas.

Steve Willoughby - *Cleveland Research Company - Analyst*

Okay. And then just the final thing for you, MyDay, can you comment about how much in revenue MyDay generated in the quarter? and can MyDay still do $75 million in revenue next year?

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

I would put that MyDay decision hand-in-hand with clariti -- meaning, there are decisions we can make that will slow up the on-eye or revenue activity next year of either one of those products. And the example would be where you turn a product more into fitting sets, you take more of your production into Fitting sets than into revenue producers. So, those decisions, rather than start quoting numbers, if we were to take a whole bunch of lenses out of revenue, we're better off looking at a package of products, which we will start putting color on, probably in December. We're just not going to be there, clearly, next we. The activity we are going through right now will shed light on that, but not until then.

Just one more point on that. In December, we will probably be talking to the total of how we are doing with silicone hydrogel in the 1-Day space more so than one or the other of those two products.

Operator

Matthew O'Brien from William Blair.

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

Bob, I think you mentioned in your prepared comments that you now think you can get your operating margin up to about 26% in FY18. I think that's 100 basis points higher than you've mentioned in the past. First of all, is that right? And then, secondly, if that's true, can you just give us a sense for the drivers of that improved optimism? Thank you.

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

You are correct. You heard that right, the 26%-plus. But, the driving factor of that change was the removal of the amortization. So, ex the amortization, it's the 25%, although we probably said 25%-plus.

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

Thank you.

Operator

Jon Block from Stifel.

Jon Block - *Stifel Nicolaus & Company - Analyst*

The first one, Bob, relative to our expectations, APAC was light. It was up 7% year over year. It was mid to high teens ex Aime in the first two quarters of the year. And I know we had some noise with VAT tax. But I thought you said the channel was normalized. You got it in March, you gave it back in April. Can you talk to that? Was there still more inventory in the channel than you had thought? Or, if not, what led to that slowdown over in APAC?

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

If we look at it on a fiscal quarter basis, we're up 7%, and we were up a lot more in the prior quarter. On a calendar basis, where you don't have that flushout period -- obviously, it was pretty dramatic - and, there, we had -- let me see if I can get my numbers in front of me -- for the quarter a negative 3% for the industry, us coming with a positive 1%. There, I think if you look to the full fiscal year, it's more meaningful, which is 7% for the market, us at 14%. So, we are still there doing very good. I think the most meaningful gauge is the trailing 12 months when it comes to AsiaPac.

Jon Block - *Stifel Nicolaus & Company - Analyst*

Okay. And then next one, there's a lot of moving parts. If you isolate EMEA, where I'd say it's the only market where you are fighting the fight on equal footing with SiHi daily, as you grew 4X the market last quarter, you grew 3X the market this quarter. Can you just talk -- is that where the bullishness is coming from long term, just going forward with the addition of Sauflon you feel you're, for the most part, on equal footing, and when that's the case we should start thinking of market share gains that are still some multiple of the market, if you would?

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

Yes, when we look at AsiaPac, we are doing pretty good right now with Biofinity and the Proclear 1-Day material. When we look at Europe, we're basically saying it was good even before we add Sauflon's family or clariti. It was already good so it should stay and continue very good.

And, you are right. MyDay was an important catalyst, as was Biofinity and even Avaira. All products are humming in Europe against a market that's doing fair.

When it comes to the Americas, we know we have the void. It's a big void. The market is shifting rapidly from two week into one day and, to a lesser extent, into monthly. Selling in that void is really going with a dynamic growth of the one-day, which is both MyDay and clarity. So, we think we have the right answer and, therefore, have every reason to think we feel good about gaining market share in all three geographic areas.

Operator

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

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

I want to thank everyone for joining us today. For those of you that are attending next week's analyst meeting in New York, we hope to see a lot of you there. We look forward to presentation. As I indicated, Al and I are going to speak less and you are really going to hear a lot more from the managers that make it happen. So, we are excited about that.

For those of you not joining us in New York next week, we look forward to updating you in December when we report our year-end results. With that, thank you, operator.

Operator

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

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