THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

COO - Cooper Companies Inc at JPMorgan Healthcare Conference

EVENT DATE/TIME: JANUARY 09, 2018 / 11:30PM GMT

CORPORATE PARTICIPANTS

Robert S. Weiss *The Cooper Companies, Inc. - CEO, President and Non-Independent Director*

CONFERENCE CALL PARTICIPANTS

Robert Justin Marcus *JP Morgan Chase & Co, Research Division - Analyst*

PRESENTATION

Robert Justin Marcus - *JP Morgan Chase & Co, Research Division - Analyst*

Good afternoon, everyone. I'm Robbie Marcus of the J.P. Morgan med tech team. Happy to have with us today Bob Weiss, President and CEO of The Cooper Companies. We'll be having the break on the Yorkshire room just down the hall afterwards.

Robert S. Weiss - *The Cooper Companies, Inc. - CEO, President and Non-Independent Director*

Thank you, Robbie, and good afternoon. It's almost evening, probably, to everyone. Thank you for attending.

First of all, The Cooper Companies, I'll make sure, since there's always someone watching me, that I comment on forward-looking statements or give you the opportunity to read it. I've sat in the back of the room and I was able, with my contact lenses, to read that. So I trust everyone can read it.

The Cooper Companies is a New York Stock Exchange company. We've been on the Exchange since 1983, 35 years. We're also now a S&P 500 company. We are a quality-of-life company and we have 2 businesses: CooperVision, which is 75% of our business, following the acquisition of PARAGARD in the surgical side, which makes it now a 75%-25% split.

A little bit about CooperVision. CooperVision is a soft contact lens business. It's in a, I'll call it cottage industry. There are 3 companies that essentially make up 90% of the $7.5 billion business: Johnson & Johnson, which is ACUVUE; Alcon, which is part of Novartis; and then The Cooper Companies.

When we talk about contact lenses, we're really talking about myopia and as many of you may know about the demographics, myopia is going off the chart. 23% of the world was myopic in the year 2000. Today, about 30%. And it's headed to 50% by 2050. So directionally, a lot of favorable trends relative to what's good for Cooper and contact lenses.

When we talk about contact lenses, we basically talk about it in several different ways: type of lens for -- sphere, for myopia; toric for astigmatism; and multifocal for presbyopia. We also talk about modality: 1-day lenses, 2-week and 3-week -- and 1-month lenses. And we'll talk about materials: Silicone hydrogel materials and conventional or traditional hydrogel materials.

Cooper's been doing real good. We've been growing 2x the market for most of the last 10 years and there's a lot of progress we've made that we'll get into in some of the charts later on.

CooperSurgical is our other business. It's 60% women's healthcare, following the PARAGARD acquisition. And about 40%, which is IVF and genomics. Overall, we have 11,000 employees and essentially about 10,000 of them are in CooperVision.

We're an October 31st year-end company, so we recently reported our year-end results in December. Compounded top line growth rate close to 10%, 9.9%. Reported 2 million -- $2,139,000,000 in revenue, up 7% pro forma. When we say pro forma, we mean adjusted for acquisitions, adjusted for constant currency. We reported $9.70 of earnings per share, up 15%, and we generated a lot of cash. We reported $466 million of free cash flow.

Looking at our bottom line, we're a company not only focused on the top line but the bottom line. Our compounded annual growth rate for earnings per share was 12.1%. But in 2015, we took a large hit on -- because of foreign exchange, $1.76 hit. So if we were to adjust for that, we would've been over 14% compounded annual growth rate in constant currency. We gave guidance in December, and our guidance called for more about $2.5 billion in revenue. In CooperVision, we expect growth to be 6% to 8%, midpoint 7%. In CooperSurgical, 2% to 4%, midpoint 2% -- I'm sorry, 2% to 4%, midpoint 3%, and then overall growth of 5% to 7%, midpoint 6%.

We reported guidance for earnings per share of $11.50, and let me give you a little roll forward from 2017. 2017, $9.70. About 8% improvement in our earnings per share for PARAGARD, which is $0.70 to $0.75 accretive. About a 4% improvement for $0.38 of foreign exchange tailwinds. Also, a tax headwind of about 8% and then a 14 -- 15% other operational matters. Whether or not you give the credit to PARAGARD or you give the credit to operations, basically, we are funding about a 8% headwind on our tax challenges. Our challenge is to move from a 7% tax rate to about a sub-15% tax rate.

A little bit about our long-term objectives for 2017 through 2021. We expect to continue to gain share, grow faster than the market in both contact lenses whereas I indicated, we're growing. Historically, we grew close to 2x. We're not saying we're going to grow 2x. We're saying we're going to continue to gain market share. And then we expect to gain share in our CooperSurgical business, particularly in PARAGARD and EndoSee and some of our IVF product line. We expect to grow an earnings per share going forward faster than revenue. And I'd like to point out that we had a -- set a target for 2021 of 28% operating income and we achieved it, basically, we're targeting to achieve in 2018; 3 years. Early. Over the, basically, the last 10 years, we have improved our gross margin from 55% to 68%, an improvement of 13%. And we have improved our operating margin the same 13%, from 15% to 28%. Basically, our operating expenses have stayed around 40%. We've been investing in geographic expansion. We've been investing in sales force expansion. We've been investing in distribution to support our -- the complexity of our product line, a lot of investment dollars going forward. We have not given new guidance. Now that we are targeting for 28% next year following PARAGARD, but down the road this year, we will give kind of an update on what we expect, and that will include some leverage of the operating infrastructure looking forward in the next 5 years.

I mentioned, we generated a lot of cash flow, $466 million of cash flow. If you just extrapolate that, that would be $2.3 billion over the next 5 years, enough to pay off the debt we incurred over the last several years. Our priorities for cash remain the same: To continue to invest in our business; to continue to acquire; to occasionally buy back stock; and to pay down debt, all else. We will continue to expand geographically, put a lot of energy into the BRIC countries the last 5 years. We will continue to acquire, and we did about more than 10 acquisitions the last 3 years, half of them in Surgical, half of them in Vision.

Looking at improvement in operating income. I mentioned we're targeting 28% next year. There -- and that we will be in fact updating our target for down the road to 2021.

Let's look at the contact lens business. We're targeting for close to 6% growth over the next 5 years. Today, torics are 22% of the worldwide business at $7.2 million. This is 2016 numbers they'll be updated over the next couple of months. The overall business today is more like $7.5 billion, so I'll occasionally say $7.5 billion and occasionally say $7.2 billion, which is the 2016 number. Multifocal, 7% of that. These 2 areas -- torics, multifocals, Cooper is #1 in specialty lenses as they've been called in the past, where we have basically 31% of our businesses in torics, which is about 34% market share; and then multifocal, we're about 29% market share. Why is that important? It's important because torics and multifocals are under-indexed around the world. A lot more maturity in the U.S. than the rest of the world, so we get to ride that wave with our product portfolio, which is very heavily talented, if you will, in the toric area and the multifocal area.

Looking at it geographically, each region is expected to grow close to 6% for different reasons. In the Americas, the bottom one, we expect a continuing tradeout of the 2-week modality into the 1-day modality, which is a 400% to 800% tradeup to continue. In Asia, while Japan is a more mature business, China is becoming of age. It's now a $500 million business, growing around 16% a year. So a lot of support and growth coming out of China and other regions to support the maturity of the Japanese market.

In EMEA, they liked 1-day modality. They continue to trade up to the 1-day modality and they're under-indexed in torics and multifocal. So that will be -- help sustain growth.

The real driver of the contact lens business the last 5 years has been the shift in modality from planned replacement to 1-day modality. It says 47% here in 2016. It's now over 50% 1-day. So that market has continued to be essentially 100% of the growth of the contact lens business as everyone has been trading up into the 1-day modality. It's convenient. It's the healthiest modality. You throw the lenses away at the end of the day. When you think about the 50% of the market being in the 1-day, that's dollars, it is not wearers. Wearers, it's something less than 30% of the wearer base generating 50% of the revenue dollars.

Here are the drivers of the industry. In the wearer base expansion, children entering contacts earlier, presbyopia, people staying in contact lenses longer, better comfort. There's been a lot of dropouts in the past. Increasing incidents of myopia. I mentioned the 23%, 2000, headed to 50% of the planet. Basically, in today's version, 3.5 billion people out will be myopic by 2050 if the population of the planet does not grow.

Trading up. We talk about pricing and modality in trading up. When we say -- trading up, we say trade into a 1-day that's 4 to 8x or 400% to 800%. When we say trade into silicone hydrogel material, usually 20% to 40%. Trade into a toric, 50%. Trade in to a multifocal, 100% markup compared to a conventional sphere. So trading up, trading up has been a large driver of the industry.

BRIC expansion. I mentioned China, Eastern Europe and Asia as opportunities. It's not one-size-fits-all. When we look at this chart, we see that AsiaPac, it's 65% 1-day. It's because the Japanese and Taiwan didn't like chemical disinfection. They pushed everything into a 1-day disposable, "throw it away at the end of the day" modality, and that continues to inch up.

The U.S. or the Americas on the other hand, if we looked at it 5 years ago, 68% of the market was the 2-week modality. Now, it's down to 25%. There's a massive shift, sponsored not only by just the general dynamics, but by J&J, trading up OASYS 2-week, which is frequently noncompliant, to OASYS 1-day. That's the 800% trade up. Overall, the world, 50% 1-day, 20% 2-week and 30% monthly.

Looking at the competition. Bausch + Lomb, around 9%. J&J at 39% is doing a pretty good job of understanding their model, moving from the 2-week into the 1-day, so they're holding their own. Alcon has struggled of late. Obviously, they're getting ready to go public. They're getting a little bit more aggressive in the marketplace advertising, but their challenge is they have a tired line in the -- they don't participate in the 2-week space, they have a tired line in the monthly space. And while TOTAL1 is a great product and the most expensive product on the planet, if you will, it's the top of the premium chart. It's got a bull's eye on it, and everyone's shooting at that bull's eye or how the trade up to that level of pricing. So that's called the premium product. And they're struggling, trying to hold their own with a lot of competition coming in, including Cooper with its MyDay product and, now, MyDay toric, which Cooper is rolling out.

Cooper, 23% market share. If we look at it 10 years ago, it was 15%. So we've gone from 15% market share to 23% market share.

Our track record is pretty consistent. So year after year, we put up pretty good market share gains, trailing 12 months where we are now, market growing 5%, us growing 8%. If you kind of extrapolate that out the market, we will have grown 8.8x the market the last 5 years, or 8.8% the last 5 years in the market, 4.4%, 2x the market exactly.

Here are some of the drivers. Why are we doing so well? Well, we have 2 plays in the single-use market. And remember, I said the single-use market is what's driving the entire market. So 2 plays in the silicone hydrogel single-use market. These 2 product lines grew 37% last quarter, 44% last year. So they're big drivers. One is in the premium market going straight after TOTAL1, going after OASYS. That's the one where we're rolling out the MyDay toric now around the world. And it started in Japan. Last year, we rolled it into Europe, and we started launching MyDay toric in the U.S. this month.

The other one in is clariti. clariti is in the mass market of the 1-day space. Think of that 1-day space, 3.7 million -- $3,750,000,000. Half of it is -- excuse me, $750 million of it is in the premium category where TOTAL1 is where OASYS is and where MyDay is. The mass market is $3 billion and that's where clariti is the only silicone hydrogel in that $3 billion space. A lot of work to do. Your big billion-dollar products are there. MOIST, ACUVUE MOIST and daily AquaComfort Plus; MOIST being J&J, daily AquaComfort Plus being Alcon. So we're making a lot of headway there. Obviously, the numbers speak for themselves.

And importantly, when I say clariti, silicone hydrogel, we're talking about a complete family where you have a sphere, a toric and a multifocal, which then has a halo effect as you expand. In the planned replacement market, which is flat, Cooper is essentially 100% of the growth, so we're growing with Biofinity, a lot of that had to do with creativity of the product line. We introduced a product called Energys, and Energys is, for those people, and there's probably a couple in the room, that use digital devices. So it's very geared towards the digital age. Then we brought out this last year, Biofinity, extended toric, extended range. The extended range means the more difficult to fit torics or astigmatics. Those 2 have enhanced the livelihood of the Biofinity franchise, and Biofinity is the biggest product we have by far at this juncture. Then we have Avaira Vitality. Avaira Vitality is the only product competing in the U.S. market really against J&J, OASYS and the 2-week market. We're going through a transition from Avaira to Avaira Vitality, and that's all about gross profit improvement. It's a $70 million product. We want to improve the gross margin 40 percent. And to do that, we had to change the manufacturing platform from where it was to a new platform.

Looking at our historic CooperVision sales, they've grown 7% and they're targeting $1.8 billion in 2018. The drivers, once again, are the 1-day silicone hydrogels and the Biofinity franchise. We're in transition with the Vitality one. Once we get done with the transition to Vitality from Avaira, we can be more aggressive at going for market share, although that's a shrinking -- clearly, a shrinking space.

The overall pie is we have about 39% of our business in the Americas, which gives us 20% market share. We have 40% of our business in EMEA, which gives us 34%, which is we're basically neck and neck with Alcon for #1 in Europe. And then we're under-indexed in Asia Pacific with about 17% share of that market. Torics, I mentioned, that we already have 31% of our business is in torics, which gives us essentially 33% share. Multifocal, 10% of our business is in multifocals, which gives us 29% share. So those 2 areas, we're #1. And then we're under-indexed on spherical or the easier-to-fit contact lenses.

CooperSurgical. In CooperSurgical, we have top line growth compounding at 19% that reflects PARAGARD. PARAGARD brought with it about $170 million in revenue, high gross margin. We finished the year pretty strong with 7% pro forma growth, which was pretty PARAGARD. Our fertility business did well, up 12%, and our office and surgical product line was up 2% pro forma, and that's kind of where the fit there is with the PARAGARD.

We've been very active. People ask, why do you have CooperVision and CooperSurgical side-by-side? How do they fit together? Well the answer is it's mainly a financial play. Use of cash. There are things to buy, and there are things to buy in both sides of the ledger. We spent $1.2 billion for Sauflon and we spent $1.1 billion for PARAGARD. We clearly lucked out with PARAGARD. We closed November 1. It's a nonhormonal IUD. You may have heard some news about hormones and contraceptives recently that came out in the New England Journal of Medicine. We clearly are in a -- and that happened after we closed the deal. We're continuing to assess how best to commercialize that or leverage that by using the professionals, the gynecologists, certainly. But clearly, the opportunity, given the drag on hormones is higher risk of cancer, higher risk in a younger person of depression, if you will. Other products we put together that are pretty exciting, the Wallace catheter, patent-protected, and of course, EndoSee, which is a product we're rolling out for diagnostic hysteroscope, which gives the doctor in the office a convenient way to examine and visualize the uterus as opposed to doing a colposcopy.

Turning to the 5 takeaways. We have 2 great markets, high barriers of entry in both. Both are growing faster than the market. We have spent a lot of time over the last 10 years building out the infrastructure geographically around the world, in the BRIC countries, in China. We have -- we're in great position to achieve our long-term objectives and we have a great track record. And by a great track record, I mean our TSR for the last 10 years has been 19%; for the last 5 years, 19%; and for the last year, 25%. So we think the bottom line matters and that we're looking forward to the next 5 years from here on out.

And with that, I'll thank you.