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# EDITED TRANSCRIPT

RMD - ResMed Inc at William Blair Growth Stock Conference

EVENT DATE/TIME: JUNE 14, 2016 / 3:50PM GMT



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**Margaret Kaczor** *William Blair & Company - Analyst*

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## PRESENTATION

**Margaret Kaczor** - *William Blair & Company - Analyst*

My name is Margaret Kaczor, and jointly with Ben Andrew, we are the research associates at William Blair that cover ResMed. I'm required to inform you that you can obtain a complete list of research disclosures or potential conflicts of interest at WilliamBlair.com.

But with that, very happy to introduce Mick Farrell of ResMed, as well as Agnes Lee of ResMed. Both are sitting up here. ResMed, as you guys know, is a Company that we have covered for a very long time. They primarily treat patients with sleep apnea, which is both a growth market, as well as overpenetrated, both in the US and OUS.

But the next leg of growth and maybe an additional leg of growth is this recent acquisition of Brightree, which they had announced earlier this year. It folded in a SaaS Company, and even more of an HCIT element than they already had at ResMed.

The move for us is brilliant because HCIT increases compliant rates for their products. It adds a new high-growth, high-margin recurring revenue line. Then most importantly, it really positions ResMed ahead of not only their peers in sleep apnea, but probably one of the companies that is most advanced within healthcare at trying to connect the patient at the patient's home with the manufacturer, as well as with the system, and even their own patient data, which helps them take control of their own health.

So with that, there is a lot to hear, but I will turn it over to Mick.

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**Mick Farrell** - *ResMed Inc. - CEO*

Thanks, Margaret. And yes, we'll talk about Brightree and a couple of other acquisitions that we made a little bit further into the presentation.

So here's the Safe Harbor statement. I am told by my General Counsel to say here's the Safe Harbor statement, so here's the Safe Harbor statement. You can read that on our website.

So who is ResMed? I think -- I am seeing some familiar faces in the room, maybe some new faces. ResMed is the global leader in respiratory medicine. We literally focus solely on helping people breathe, and we helped 9 million people breathe in the last 12 months. And when we help them breathe, we provide a product, either a flow generator or a mask, that literally gives the gift of breath.

And our goal, our aspirational goal, is to grow significantly in double-digit revenue and double-digit volume terms over a period of time, so that by 2020 we can impact 20 million lives in the year 2020 by providing the gift of breath. We've been doing that for couple of decades and we are global. We're in 100 countries. And we look to expand that as well.

So this is our strategy on the page. We call it the three horizons growth strategy. You can think of it as time to materiality on the short, medium, and long term of the value plays that we have in the marketplace. And I am going to walk through each of these three horizons as the format for the presentation here today.



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So the first horizon is really around end-to-end solutions for our core market, which, as Margaret says, is obstructive sleep apnea, central sleep apnea.

Our second horizon of growth is focused on the number three killer in the United States and the number two cause of rehospitalization, which is chronic obstructive pulmonary disease, so lung disease. And we will talk about that in the US, France, Germany, Japan, but we'll also talk about that in India and China and some of the markets where, sadly, COPD is catching up into the top three killers in the developing markets as well.

And then our third horizon of growth, I will spend a little bit of time on that at the end, is really looking at other chronic diseases where we have the ability by measuring breath rate and heart rate to potentially keep patients out of hospital, and particularly around heart failure in COPD, and some new technologies we have for sleep and consumer wellness, engaging consumers in the importance of the 33% of their lives they spend asleep and why that is important, engaging patients with other chronic diseases like AFib and heart failure and looking at them holistically. So I will spend a bit of time on that as well.

So, first, I will spend some time on Horizon 1. Before I do that, across the bottom of this slide, this strategy on a page, you also have sort of three foundations that are really critically important to ResMed. One of them is operating excellence, and I'll spend a little bit of time on what we do, manufacturing supply chain and R&D and SG&A leverage.

The second foundation there is our global leadership in digital health and connected care. We've made a very significant investment in healthcare informatics, not just in the Brightree acquisition, but also organic growth in taking data to the cloud, liberating data for patients and providers, and I will talk about healthcare informatics as an important foundation.

And then, the other foundation is our investment in some of those high-growth geographies, so I will talk about each of those as well.

So drilling down on Horizon 1, ResMed really pioneered the field of 100% cloud-connected medical devices, certainly in respiratory medicine, but really across the field of med tech. And there was a recent report from a Swedish group called Berg Insight and they were looking at the number of medical devices that are 100% cloud connected in all industries -- diabetes, cardiovascular disease, and sleep apnea and beyond, all chronic disease. And they ranked ResMed as the number one across all medtech in terms of cloud-connected medical devices, and they gave us a number which is slightly north of 1 million. They're a little south of where we are, but they were pretty close.

And the next was Medtronic with its diabetes particularly, but also its cardiovascular business, at about 800,000 cloud-connected medical devices. And it went -- it was a steep curve down from that, and really why we did that and why we think it's important is that we think patients should have access to their data. We think doctors should have access to their data in their own systems and that there is huge value that can be extracted for our broken health care systems in doing so.

So, we changed the basis of competition in respiratory medicine from just smaller, quieter, more comfortable to smaller, quieter, more comfortable, and more connected, and now, I would argue, better connected is really where it's going.

We did that to liberate data. We did that to prove that we could improve outcomes and improve it in your Epic or Cerner system, prove it in your EMR/EHR system, prove it with your data and unlock value for the whole value chain. So I will talk a little bit about how that can happen.

We all know here in the United States one in every five of our GDP dollars is spent on healthcare. So that's 20% of our GDP is spent on healthcare, and about 75% of that is spent on chronic diseases. It's really a sick care system where you are a frequent flyer at the ER, the ICU, and the CCU.

That is not sustainable, right? And so, we need to have fewer caregivers managing more patients at a lower total cost, and we believe that connected care is going to be a big catalyst for that -- in fact, the catalyst for that.

And patients themselves, they want access to their own data. You see these trends in consumer where patients are out there buying FitBits or using their Apple Watches and all these mechanisms to check their exercise. We believe that the triumvirate of health, which includes both exercise,



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good nutrition, but also good sleep, so William Dement from Stanford created the triumvirate of health, and sleep is really the underrecognized component of that.

We have an app called myAir, which we make available for any patient who is using one of our devices. We have more than 900 patients a day signing up to get their own data. We think this is a big trend in healthcare. They want to track their own data, they want to track their own quality of life, and they want to have the quantified self, and they want it in their own Apple healthcare or whatever other repository they want. But they want access to it.

So we think both of those trends are really important, the physician driven, the payer driven, but also the patient driven.

So this is sort of a graphical illustration of what we are calling the end-to-end solutions for particularly sleep apnea that you have on this front, all the way from diagnosis with a product called ApneaLink Air, which is a diagnostic tool that sends data to the cloud the next morning after the patient has been diagnosed, all the way through to ongoing management, ongoing interface with either the insurance company or the patient through GoScripts or through one of our resupply programs or one of our patient engagement programs, technologies, called U-Sleep. And I would talk a little bit about that circle U-Sleep and about the value that that is providing, quantified value that has just recently been published by Kaiser Permanente in a study that we released yesterday in a press release.

And then, I will talk a little bit about myAir, which is a patient engagement app, up there in the top right. And then, I will talk in the bottom right-hand corner about our \$800 million investment in Brightree and what leverage we can get on that front.

But this is a really good graphical illustration of the flow of patients through their lifecycle in sleep apnea and the value that we can provide in connected care across that.

So I talked about the 900 patients a day signing up to myAir. I think it's really important that this -- and I talked about the well north of 1 million cloud-connected -- 100% cloud-connected medical devices that we have out there on people's bedside tables. But we have more than 2.5 million patient lives within AirView that are being monitored by doctors and payors.

The number of calls made, eight calls per second, the beauty of that is it's not a customer service rep in Omaha paid X dollars per hour making those calls. These are automated, scalable, digital and it's generational. My son likes to get texts. I like to get emails. My father likes to be called. So we do the demographics. We find out what you want, how you want to be contacted, and you opt in for how you want to be contacted and if you want to be contacted and how frequently. So these engagements are automated, scalable, but also customized by the patient, by the consumer and the caregiver.

So everyone talks about Big Data, and I actually really hate the term Big Data. What I prefer is actionable information. Quantify it. Show me how those ones and zeros can be useful for me. And so, we've got a couple of studies that we've published that have shown the value that you can get from these Big Data applications and turning them into actionable information.

One worth calling out from this slide is the technology called U-Sleep. So it's a cloud-based algorithm. It came from an acquisition that we made in 2013 of a Company called Umbian in Halifax, Nova Scotia, so up there with the BlackBerry engineers where there is a lot of buildings and engineers available now as BlackBerry has lost share to Apple and Samsung. They are amazing cloud software engineers and some amazing technologies that we've been able to get very efficient R&D rates as well.

So Umbian was an acquisition from Halifax and they have a product called U-Sleep that is now obviously a ResMed offering called U-Sleep. This offering is able to, through these cloud-based email, texts, and IVR, and knowing how, when, and to what context to contact patients, is able to drive adherence rates for positive airway pressure for sleep apnea from 60%, which is the baseline -- 60% is the equivalent of a heart attack medicine compliance rate, 50%, 60% from the peer-reviewed literature on that -- to 87%. And pharmaceutical companies would do anything to know if you took the pill and how the pill interacted with you.



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So we have the most expensive real estate in the world and it's not that building in Halifax or San Diego. It's your bedside table. And we are there with 100% plugged-in AC/DC power. So we know not only that you took the pill there, we know what time you started taking the pill, 10 PM. We know what time you stopped taking it, 6 AM. We know the dose you got because we know masks leak. Oxygen is 21% of air. We know the active ingredient and how much got into your lungs by the total volume.

So we've got all this information, so we are able to engage with the doctor and do exception management. We are able to also engage with the distributor and reduce their labor costs. So this study on U-Sleep showed a 59% reduction in the labor costs for the DME who were doing the setup and management of the patients. So, improving outcomes and lowering costs and quantifying it. And that was published in the American Thoracic Society.

We also just released this morning, Agnes, our press release -- or yesterday, a press release from a study that we do with Kaiser Permanente. So Dennis Hwang is the medical doctor from Kaiser who ran this study for us. And they were going to publish the data whether it was positive or not. Kaiser did their own approach on this.

What we saw in this same technology, this U-Sleep cloud-based algorithm, was a 21% relative increase in CPAP adherence. That's huge. When you are a payer provider like Kaiser, all the costs -- or all the benefits flow to you if you get adherence right. They know it saves them money, and so therefore that adherence is really about keeping that patient out of the hospital, in the home, and better taken care of.

So these data just literally hot off the press, and it was a randomized, controlled trial, prospective, and you can read all about that as that gets published, I think they are presenting it at the sleep conference, which is going on in parallel with this. Our team's over there in Denver looking at the clinical data on that.

So I have talked a lot about that sort of patient engagement part and that cloud informatics on the front end, which is patient engagement, and making sure patients certifiable and will have their data and the doctors have their data and Kaiser has the data of their patients.

Margaret talked about our \$800 million investment in Brightree. It's about 10% of our market cap, so this was a major investment, the largest investment ResMed has ever made in an acquisition. And what this was really about was if we take in all the data to the cloud on the front end around patient engagement, yet our distributors a lot of the times are still doing faxes and paper management, and paper management of inventory and all the aspects of healthcare.

Healthcare is one of the most inefficient delivery mechanisms in the world. I used to work in the steel and chemicals industries, and we had margins of decimals of percentage points where everything had to be incredibly operationally efficient. Healthcare is not operationally efficient. It is the exact opposite of that.

And so you look at these distributors and these faxes and loads of paper and inventory management done on spreadsheets, and you say, this could be a lot more efficient. And Brightree saw that opportunity and created a software-as-a-service system to automate the back end of DME, so to do all that -- to do the faxing, to do the calling, the revenue cycle management calling payers, to do inventory management, to do prescription management or checking that every box was ticked from their doctor, but to do it electronically and to do it in the cloud.

And so, they had a very strong business, about \$113 million in revenues, \$43 million in EBITDA on a 12-month basis, and it was growing at double digits. So they had good revenue, high-quality revenue, good quality profit that is accretive to ResMed on gross margin, EBITDA margin, EPS margin immediately after the acquisition. But in addition to that, they are making our customers more efficient in an environment where price is going down. And, also, helping the small to medium-sized guys have some of the scale that some of the larger customers have. So Brightree were doing a really good job of getting out there and helping the DMEs be more efficient.

And we thought rather than be owned by private equity, it might be good to be owned by a long-term public Company that is investing in this space, that really cares about this space for the long term. And so, we made the acquisition.



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And if you include the \$300 million, because it was an LLC, the \$300 million in tax loss carryforward, it was about -- net present value of around \$225 million of tax synergies that we garnered as part of this acquisition that we will get over the coming number of years. So including that, the multiple on this, on EBITDA, was around 13, 13-1/2, and we think that's pretty good for a SaaS based system.

And we think it's even better for what we can do for our customers and help them with efficiency and our channel can help grow that. We have a larger sales team than Brightree did, so we are really excited about that.

When you put all that together, this is sort of the ecosystem of what we've now got with Brightree, plus Air Solutions, which is an end-to-end postacute care system for not only HME, but also two new channels -- home health, also known as home nursing, and hospice, where again there are a lot of sleep apnea and COPD patients and many of them still undiagnosed within that group.

So a big part of ResMed's value proposition is, as I said, taking patients who are in the hospital, frequent flyers in the hospital, and getting them out of the hospital. And if you look at the key chronic diseases in the United States, let's just take these two to start, asthma and obesity, \$60 billion to the healthcare system in the United States, \$150 billion from obesity that is impacting our costs on an annualized basis. Diabetes, \$245 billion per year spent on diabetes; \$405 billion per year spent on cardiovascular diseases, including stroke, cerebrovascular disease.

If you were to ask a primary care doctor where they thought sleep disordered breathing or sleep apnea would fit on this chart, it's pretty obvious the gap I've left here for you guys. But if you were to ask them, they'd probably say it's about on the order of asthma, around \$50 billion, \$60 billion a year. Data from -- this is McKinsey and Harvard Medical School, they showed \$165 billion is the cost just of obstructive sleep apnea, one of the respiratory medical diseases that we treat.

And so, we believe ResMed can have a huge impact on reducing that total cost because a lot of those costs are rehospitalization costs and avoidable acute care costs that can be saved by treating those patients appropriately in the home.

So apart from the health economics, there is also a geographic opportunity. And if you look at the 100 countries we do business in and look at the sort of penetration rates of diagnosis for our core disease of sleep apnea, we are probably somewhere around 15% penetrated into the disease population in the United States and the developed countries. In western Europe, it's probably around 10% penetrated, and as we look and have invested recently in China, I've been making a lot more trips to our team now in Shanghai and Beijing, the penetration rates are just sub decimals of one percentage point in that area.

And so, I look on those high-growth geographies. And I know there's obviously cyclical around emerging-market economies right now, but we are looking at this on a 10-, 15-year time horizon. And these are areas that there is an epidemic of obstructive sleep apnea and, even worse, there is an epidemic of COPD in China and particularly India that is going to need to be treated by the government either in the home with oxygen and ventilators or in the hospital at 10 times the cost. And we are going to help them hopefully do the former.

So we are the global leader in sleep apnea. I am not going to go through our masks and devices. I am just going to spend a little bit of time drilling into how they impact. But we are the global leader in this space. We are not only the leader in market share, but the leader in innovation. I think driving the informatics revolution into respiratory medicine has forced our competitors to follow us there. We think it's really good because that's the only way that we are all going to provide value for our ultimate customers, the patients, and also the physicians and providers as part of that.

Okay, let me drill down now a little bit into Horizon 2 on COPD. So recent data from the American Thoracic Society put the prevalence globally around 200 million people with COPD, probably 65 million with moderate to severe, but half that 200 million is in these high-growth markets -- China, India, Brazil. The cost to the healthcare systems -- these might be underestimates. US, it has got \$50 billion a year; Europe, EUR48 billion per year.

More than 3 million people die each year due to COPD. While I have been talking, two people have died so far in this talk from COPD. This is a major impact on mortality and morbidity.



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So I talked about India and China having an epidemic of COPD. The red bars here at the top right of your chart are the air pollution rates in 20 cities in India -- 15 cities in India. And the bottom in the blue are four cities in China. The black line is where the global governments, the UN, say that we should have air pollution models. So you can see just the insane levels of mostly particulate, but also volatile organic compound, pollution levels in these high-growth markets. These are all going to the lungs and they are killing the lungs.

And if you think about it, you've got a football field of surface area within your chest, which is how you breathe. One-third to half the football field is dead when you have COPD, dead grass, and it hurts when you get tackled on it. There is no oxygen interchange. This is going to happen in China and India at a significant level based on these air pollution levels.

What can we do about it? Well, noninvasive ventilation can reduce the mortality curve. If you look at the top line here, that's the mortality rate for COPD patients. And then, the bottom curve is the mortality rate for COPD patients on noninvasive ventilation, like ResMed's AirCurve systems. We can turn a 33% mortality into a 12% mortality. That is pretty significant. That is a 60% relative reduction in mortality rates just by introduction of one therapy in these severe hypercapnic COPD patients, which is noninvasive ventilation.

We also recently made an acquisition of a Company called Inova Labs, which is a portable oxygen concentrator company. And so oxygen, even before you get to noninvasive ventilation, is a great therapy for COPD patients. But the value that we are going to bring to that space is not only having a POC with the longest battery life, which is Inova, but we are going to add technology to it. So we're going to put a chip on every POC the same way we put a chip on every CPAP and [bio level] and ventilator so that you can know that that patient is getting the oxygen, how much oxygen they've got, how much exercise they're getting because it will have a GPS on it, and really doing that quantified work on POCs the same way we did on the ventilators and the CPAPs to get that value back to the patient, that value back to the physician, value back to the provider.

So another recent acquisition we made was a company called Curative. I was referring to it earlier. It is based in Suzhou, just outside Shanghai, sort of the Silicon Valley area for medtech outside Shanghai, and really top-quality technology made in China, developed in China, made in China, sold in China. It gives us access to hospitals that foreign-made products could never go into, so it's a whole other channel access opportunity. But it's also great technology.

And the CEO of that Company, Jason Sun, is working with us and really, being the Chairman of ResMed China, going out to conferences in Beijing and Shanghai and driving the value and showing the epidemic of COPD that's coming, and showing how Curative technology, ResMed technology can help save the government billions, hundreds of billions, of dollars of healthcare costs over the next 10, 20 years. So, watch this space. It's a really interesting area of investment for us.

So within that whole spectrum of respiratory care, we service all the way now from POCs to life support ventilators. We just last quarter added a ResMed communication module, this RCM, to our life-support ventilator, Astral. So the data are now going to the cloud from the life-support ventilator. That top right-hand corner, that is literally keeping Stephen Hawking breathing, so patients with ALS, Lou Gehrig's disease, neuromuscular disease, breathing, all the way down to basic COPD, hypercapnic COPD, and complex sleep apnea in the bottom left-hand corner.

So we think that in the COPD space, given the fact that is the number two cause for rehospitalization, this will be one of the most exciting areas. Even though we started in sleep apnea and connected care for sleep apnea, that connected care for COPD is probably in the area of 10X the value that we can get as we start to get the connectivity around these hospital vents and these life-support vents in the home.

And that will be tied into disease management protocols that go well beyond just the breathing, also to lifestyle. It will be part of a bigger ecosystem. We don't believe we are going to own the whole ecosystem, but we do believe we are going to own the pipeline that provides the respiratory medical data into that.

So we talked about the US healthcare costs and the impacts there. Clearly, there's a lot of opportunity for improving our expenditure on healthcare in this country to get closer to western European costs, and we think hospital to home, taking patients out of the hospital, keeping them in the home, is a huge part of that. We think ResMed is really well positioned to play a part of that.

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We have a really strong position in western Europe. Probably 80% share in a lot of the countries in northern Europe is respiratory medical devices from ResMed, where we have proven to governments -- Kaiser Permanente is a payer provider, but the government has you for life when you have got socialized medicine. And they really care about keeping you out of hospital. And we have done some great work in northern Europe on that front.

So we call it the holy grail of healthcare. It's this triple aim, if you like, of improving quality of life of patients; preventing the core chronic disease progression, so impacting that core cardiovascular diabetes or hypertension; but also reducing the costs and managing those costs well.

So I've only got five minutes. I want to go through Horizon 3 pretty quickly here, talk a little bit about each of these spaces. Look, sleep apnea impacts the cardiovascular system and the cerebrovascular system. I am not going to go into all the prevalence numbers. We've got some really interesting data from a meta-analysis on atrial fibrillation, where we are able to show that we can reduce AFib recurrence in patients with AFib.

And these data were literally just released in this last month that show that when you treat patients with heart failure with preserved ejection fraction with a technology of ours called Adaptive Servo-ventilation, we can improve a combined outcome of mortality, morbidity, and functional outcomes. So we can save lives and save hospitalization costs in heart failure with preserved ejection fraction.

It's pretty small studies, only 156 patients, but we are going to do further analysis on this and you can see over the next three, five plus years, a lot of work from us in this heart failure with preserved ejection fraction [occurrence]. I won't talk about sleep and consumer wellness. I've been told about one minute. Very strong (multiple speakers)

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**Ben Andrew** - *William Blair & Company - Analyst*

Yes, the timer went a little crazy on you. Sorry about that, Mick.

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**Mick Farrell** - *ResMed Inc. - CEO*

Not at all. And so, we will do -- in Q&A, we will cover all the financials. Thank you very much.

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**Ben Andrew** - *William Blair & Company - Analyst*

That's a quick wrap. All right, well, thank you. We will take Q&A in the Oak room. I appreciate the presentation and the commentary. It's certainly an exciting opportunity for the Company with the three Horizons developing. So, thank you.

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**Mick Farrell** - *ResMed Inc. - CEO*

Thanks, Ben.

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