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RMD - Resmed Inc at Jefferies Healthcare Conference

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## CORPORATE PARTICIPANTS

**Robert A. Douglas** *ResMed Inc. - President and COO*

## CONFERENCE CALL PARTICIPANTS

**Anthony Charles Petrone** *Jefferies LLC, Research Division - Equity Analyst*

## PRESENTATION

**Anthony Charles Petrone** - *Jefferies LLC, Research Division - Equity Analyst*

The COO, Rob Douglas. We also have with us the Head of IR, Agnes Lee. So we appreciate both of you being here with us this year. I think what we're going to do here since we do not have a formal breakout is Rob will give a brief update on the latest strategy of the company for the next couple of minutes and then we'll go straight into Q&A. And we encourage questions from everyone here in the crowd.

So with that, I'll hand it off to Rob.

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**Robert A. Douglas** - *ResMed Inc. - President and COO*

Great. Thanks, Anthony. And thank you, everyone, for being here. I just thought I'd start with a quick recap of ResMed's Three Horizon strategy and give you a little bit of some of the latest news of what we've got going on there.

We think of our business in Three Horizons. And the horizons are time to materiality. And the first horizon and our largest business is treating sleep apnea or sleep suffocation, if you like. This is where people basically strangle when they're sleeping. And a very effective treatment is our CPAP systems and masks for that. And those systems are also all cloud-connected. And we capture the data of how people are sleeping and package that up and provide it back to providers and patients to help them manage their condition. We had some exciting new product launches in that, which I'll come back to in a few minutes.

In our second horizon, we think about treating respiratory insufficiency, mostly COPD patients. And we believe that oxygen and the ventilation is a very good part of the overall spectrum of treatment that COPD patients will have on their journey. We've got excellent oxygen concentrator, an excellent ventilator business in that.

Our third horizon really is options for the future. And in that, we think about things like chronic care management. We think about consumer wellness. And sleep is an incredibly important part of that. And we think about the comorbidities of sleep-disordered breathing, which really have many cardiovascular complications and metabolic issues related to that. And many of those conditions can be improved if you can control the breathing of people while they're sleeping. And they all represent a lot of future opportunities for us.

Underpinning those Three Horizons, we're really focusing a lot on operating leverage. And we've got very strong operating excellence program. They're pushing really the efficiency of the overall company and ensuring that we're in a position to grow our bottom line at a faster rate than our top line.

## QUESTIONS AND ANSWERS

**Anthony Charles Petrone** - *Jefferies LLC, Research Division - Equity Analyst*

That's great. With just a brief overview kind of, of the horizons, but within there, certainly, there are a number of markets that ResMed competes. And the largest, of course, being the sleep market and certainly an emerging presence within respiratory and then another horizon thereafter being cardiovascular disease treatment. So maybe beginning with the overall sleep market, I think one thing that folks struggle with is exactly how

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large the opportunity is. So maybe a review of the funnel in sleep-disordered breathing in terms of U.S. total prevalence, global prevalence as well and then how that funnel actually distills down to the more addressable market for ResMed.

**Robert A. Douglas** - ResMed Inc. - President and COO

Yes, thanks, Anthony. So when ResMed was started, people thought sleep-disordered breathing or obstructive sleep apnea was a rare disease that physicians did rarely see in their life. And then a cohort study in Wisconsin run by Terry Young started up and it's progressively published following the same cohort. And their last publication had mild to moderate, to severe sleep apnea affecting 26% of the adult population. That's just a huge, huge number. Now to the extent that there's controversy in that, it's all what level should that be treated? And so we think that really suffocating in your sleep every 5 minutes isn't a good thing. And that should be treated, right? And so we really, really think that many of the health systems around the world undertreat and underrecognize. And our mission really is to create the awareness, not only the public awareness of that, which is very strong, and you'll rarely meet people today who are not aware of sleep apnea and the condition, but also the consequences of it and not treating it. And we don't think that the medical system and also consumers are aware that untreated sleep apnea is very bad for you. It puts your blood pressure up. It's bad for your metabolic system, apart from the risk of accidents and inattention and just lack of sleep and the mental problems that come with that. There's nothing good about it. The condition really should be -- being treated. The U.S. is our most penetrated market and has the most significant patient inflows. But in all of our markets, we continue to see strong inflows of patients into the treatment. Pretty well in many markets, we don't see reimbursements increasing for this, and we have had pricing pressure as a result of that. But that's always really been in response to the very strong patient inflows. And we're still very confident in the future of this market. Recent product launches that we've done over the last few years where we've connected the CPAP machines have seen us in our own trials that we've done with HMEs and other providers, we'd see typical compliance rates go from sort of in the low 60s to well into the 80s in terms of compliance rate. And that as compliance for use for chronic optional treatment is actually really astounding. And really, what we're doing is we're greatly improving the accountability of the treatment and we really think that health systems need accountable treatments. You can track what's happening and you can follow the results. We also still see a lot of opportunity in terms of products. We hear a lot of news about patients who are successfully on treatment and would like to travel. And just in the last few weeks, we started shipping AirMini, the new CPAP product. This is the smallest CPAP in the world. And it's targeted for people who really are successfully on treatment, but when they travel, they find it inconvenient to carry their bedside CPAP system with them. And this unit comes with humidification and really no compromises on the quality of ResMed treatment. Very early days for it, and it's in a sense, a new segment, probably won't be reimbursed in most markets. But for people who need better access to their treatment over time, really, it's going to be a very useful product.

**Anthony Charles Petrone** - Jefferies LLC, Research Division - Equity Analyst

And so when we sort of dig into that a little bit more, you have a certain amount of patients coming in consistently quarter in and quarter out. Diagnostics have improved. There's home sleep diagnostics. Polysomnography is still ongoing. There's also an attrition rate in there. But you're mentioning your compliance rates are now up to 80%. So maybe just a little bit more on the route of new patients coming in. Is it more still sleep centers or home sleep testing? And then on the specific attrition rate, what is that these days? You mentioned compliance is 80%. Is that over the first 3 months? Is that over the first year?

**Robert A. Douglas** - ResMed Inc. - President and COO

Yes. So that 80% compliance is actually to sort of formal definition like the Medicare definition of compliance, which says that in the first 90 days, you're going to use it a certain number of nights in sequence for at least 4 hours a night. That's a very specific definition. But the typical patient in sleep apnea thinks they have a problem or someone else, maybe a bed partner, identifies that they have a problem. They might go to their primary care physician. They get referred to a sleep specialist who would refer them for a sleep test. And then after reviewing that sleep test, refer them to an HME provider who would set them up. And then through all of those points, there are leakages. Some people are intimidated by the thought of a night in hospital wired up on a polysomnography machine. But for those, there are options of home sleep testing. And we're seeing a lot of businesses around that are running home sleep testing for some patients. But for other patients who might be more complex, have comorbidities or have an unclear answer from home sleep testing, then they would be referred on -- the in-lab test would do and give the sort of the gold standard diagnosis for them. So there's more options now for people.



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**Anthony Charles Petrone** - Jefferies LLC, Research Division - Equity Analyst

So the company has recently launched a couple of new products here, just coming out of the SLEEP conference as well up in Boston so. And before we get into the specifics of some of those launches, both on the mask side and you mentioned, AirMini, maybe it will be helpful just to review at a high level current overall share figures in both flow gens and masks between ResMed and the #1 competitor, Respiroics, and then maybe the rest of the market. And then maybe we can jump into some of the product-specific questions.

**Robert A. Douglas** - ResMed Inc. - President and COO

Yes, we don't get too granular on market shares. And particularly, one of the competitors being a division of a larger company that doesn't report out, there's not much clarity there. We have our own view in triangulating the market shares, but we don't really quote them. But ResMed and Philips, we would say, have sort of the bulk of the market share. And we believe ResMed is the market leader in most of the segments. There's another player in the mask area really focusing on mask in most of the markets that we're in. And then there are local competitors in other markets that really don't register much in terms of the global share position.

**Anthony Charles Petrone** - Jefferies LLC, Research Division - Equity Analyst

So maybe on the 2 product introductions, we'll start on the mask side. So the AirFit mini launch, which was introduced, I believe, last quarter on the conference call or early this year. Maybe just go through -- and I'm actually reading here, AirTouch F20 full-face mask launch. So maybe a little bit about that product, how it's perhaps different from your existing portfolio and sort of your initial view on what that can mean for the mask category this year and next year.

**Robert A. Douglas** - ResMed Inc. - President and COO

Sure. So we've actually launched quite a lot of products in the last 6 months. Last October, November, December, we launched the AirFit F20 and the AirFit N20. And these are 2 masks in the full-face segment, where the full-face is where the mask covers your mouth. And they're for people who might breathe out of their mouth. And the N20 with the nasal segment, where the mask just covers the nose. They -- those 2 masks had a whole new approach to the way the seal works from the silicone seal on the skin. And we had what we called an InfinitySeal, which is really a loop inside the unit that really stabilizes the mask. Our testing showed that we were getting really 98% seal rates, which were much better than what we've seen on any previous products, either competitors or our own. And since we've launched those products, that experience has borne out strongly and these masks really seal well. They're really comfortable and they're really easy to use. So they're going well. But remember, the bulk of masks go to existing patients today and share changes really change in the new patient category. And so what mask is being given to new patients. Then typically, patients will tend to stay on those same masks for a longer period of time. And we're seeing good growth and strong share take-up in those new patient segments from both those products. It's really exciting. Just a few weeks ago, we launched what we call the AirTouch F20, which is also a full-face mask. And you may well be able to see this on the screen. This is the cushion. We're actually changing the seal technology from a silicone rubber to a open cell foam. This foam is really soft. It's really comfortable to wear. And we expect to see strong take-up with this as maybe a particular segment of people who want this extra comfort in the foam. We've only been shipping this for a few weeks now. So it's very early days in that.

**Anthony Charles Petrone** - Jefferies LLC, Research Division - Equity Analyst

So is there any stocking component for these new mask products and just how does it stack up from a price standpoint to the existing portfolio broadly when you consider nasal cushion, nasal mask and full-face mask?



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**Robert A. Douglas** - ResMed Inc. - President and COO

Yes. We tend not to see stocking behavior on new products. What you do see with new products is trialing behavior, where people will trial. And so your early experience, people will try it, but then it's the reorder cycles that are really important. And those reorder cycles sort of come in the first few months. Sometimes it's a bit longer. So it's early days up to this on the reorder cycle. On the AirFit F20 and AirFit N20, the ones we launched last October, they're going very strongly.

**Anthony Charles Petrone** - Jefferies LLC, Research Division - Equity Analyst

And then before we can get in the financials of masks and flow gens a bit after. But let's jump on AirMini a bit. Again, this is the smallest now flow gen on the marketplace. I know that Respironics was out there last year at some point with a launch. This is smaller than that launch. So what is the actual approach for this product. You mentioned it's a cash pay product. So is there going to be direct-to-consumer advertising on this product? How do you think the DMEs will view this product? And then ultimately, how substantial do you view this launch?

**Robert A. Douglas** - ResMed Inc. - President and COO

Yes, we're really excited about this product. We've been working on the technology for a long time. And it's not easy to get a full functional CPAP into that size. I can't turn it on now. But if I turned it on, you wouldn't be able to hear it even if I held it up to the microphone. It's incredibly quiet product. It comes really well with the integrated humidification in it. And we've changed the humidification strategy using HumidX, which is a heat moisture exchanger, which basically it self-humidifies by capturing the moisture that you breathe out. Then that works really well, but you do need a ResMed mask with it for it to be able to function that way, very important to it. We -- as I said earlier, we did preannounce it, which we usually don't do. And the reason is, is that this is a new segment for us to be playing in. It's a segment that has had other products in it, but we think there's been compromises in those products. And now we've really got a high-performing product in that segment. It will take some time to develop and we'll see how it goes. But we've had a lot of patient interest. And our advice to our patients is, go and ask your HME provider to supply you one. And so our go-to-market strategy really is through our existing customers. And we see them as very important in terms of being able to set the patient up properly and provide good service to them. But this is also providing them with options as to how they run their business and ways to run their business profitably in the face of some of the other events that are going on in that market for them.

**Anthony Charles Petrone** - Jefferies LLC, Research Division - Equity Analyst

That's a good segue into sort of just end market dynamics here. And certainly, there's a clear distinction between the U.S. market and various o U.S. markets in the sense that in the U.S. market, we have durable medical equipment providers, essentially pharmacies for medical equipment providers. Maybe just review the state of the market. You and I had a meeting this morning. I was quite surprised to hear the company's view on how many DMEs are still left out there. So maybe where -- what are the number of DMEs prior to competitive bidding a few years ago? Where is it today? And ultimately, where do you think it sort of normalizes? And I think if I recall correctly, the company feels that it already has normalized. So a little bit of details on the U.S. market dynamics in terms of end customers.

**Robert A. Douglas** - ResMed Inc. - President and COO

Yes, so the U.S. is a bit more than half of our patients. And just for people's information, obstructive sleep apnea is not an old person's disease. Particularly, it can affect young people. And the average age of onset is probably in the 40s. So we think that Medicare patients are maybe 25% of them. There's been a lot of reform in terms of the Medicare payment to the home medical equipment industry over the past years. And it's been a tough time for the industry. And they've really had to focus on profitability and service provision and access. And our actual strategy toward supporting that has been to put these products online, provide cloud-based software that you automate the management of patients as well as increase the number of patients that end up actually long term on treatment, which is what triggers how their business runs. And we're very focused on supporting that. Our view of the mask. Is it a mask that a patient likes and will use? It's a lot less work and more profitable for people to use in the industry. And we've stuck really with that. To your question, how many the size and scale of the industry, just rough guessing numbers, we would have said there were more than 8,000 DME providers probably 6 or 7 years ago. And we saw some data the other day that said there's still



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nearly 6,000 of them. And so there's quite a dynamic of businesses growing, being acquired, become part of very strong, competent, large organizations. But also, new smaller ones, still starting, coming in. So there are a few startups or a few people moving laterally into the industry. And it's very much a service-sided industry. And so there's a lot of benefit in having really good service and knowing your local market in the industry.

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**Anthony Charles Petrone** - *Jefferies LLC, Research Division - Equity Analyst*

So one of the things that ResMed has done effectively in this environment and competitive bidding has been going on for a couple of years is the introduction of software. You mentioned that. And so that's really, I guess, how I'm viewing it, the AirSense 10 ecosystem. And so there's a lot in there. There's software for resupply, compliance monitoring, which I think is U-Sleep. You have ResScan. You have other solutions. What has been the most influential software solution within there? I failed to mention Brightree, revenue cycle management. And how sticky has that sort of made the AirSense 10 solution to end customers?

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**Robert A. Douglas** - *ResMed Inc. - President and COO*

Yes, when we launched the AirSense 10 and we packaged it with what we called Air Solutions, which really was automated compliance monitoring, but also simple things like answering questions about product performance in the field. You could actually look up online and see what the product had been doing. It just made the whole management of products easier. We also had another product called Umbian that was an acquisition that's now integrated into the core system that looked at the early compliance data and was able to predict the likely outcomes and actually provide advice to the HMEs about how to intervene in patients. And in some cases, it could automatically intervene with text messages to say, looks like there's a few problems here, perhaps your mask leak needs adjustment. Would you like someone to call you and see if we can help you with that? And we were surprised that the extent to which our customers in the U.S. understood and saw that value proposition and took it up. Actually, outside the U.S., it's been a longer road to get that value proposition understood. But it's actually starting now that we're seeing good take-up of utilization of those services outside as well.

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**Anthony Charles Petrone** - *Jefferies LLC, Research Division - Equity Analyst*

We have a few minutes. So I want to touch on the second growth horizon, COPD and then maybe we'll jump into a few financial questions. But high level, in terms of COPD, respiratory as a category. How large do you view the COPD market opportunity in terms of really -- maybe perhaps more severe COPD patients, the number is certainly very large, but how many within the broader COPD patient population are candidates for either home ventilation or non-invasive -- noninvasive ventilation therapies that the company offers?

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**Robert A. Douglas** - *ResMed Inc. - President and COO*

Yes, it's quite a tough one to triangulate that. There's a lot of data around. Some studies say there's 80 million patients. But our guys in China say, there's more than that in China. And so would probably say it's over 200 million COPD patients around. It's a chronic disease that starts off mild and progressively gets worse. And intervention is to try to improve people's standard of living and also the rate at which their lung function declines. There's a lot of pharmacological interventions. But sort of later in life and towards the end of it, adding in oxygen is a really good treatment. And we think adding portable oxygen where people can be on oxygen and active is really helpful for patients. We've published and in fact, just a few weeks ago, was published at ATS and published in journals a study called HOT-HMV that showed that by adding noninvasive ventilation, which is really helping people to clear their excess carbon dioxide into additional of oxygen therapy, you achieve really great outcomes and you virtually sort of double or halve their rate of hospitalization and greatly extend short-term survival. So both of which are good for patients and reducing the cost of keeping them in good health. The challenges are that these standards of care are not set around the world as to how the ventilation should be applied and when. And really, that's our job to try and develop those standards and make them efficient, make it easier to accurately predict which patients are going to benefit from the ventilation. And then have them -- have the ventilation applied in a chronic way and well-managed. It does need to be well-managed. It's not just something you dispense and forget.



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**Anthony Charles Petrone** - *Jefferies LLC, Research Division - Equity Analyst*

So a couple financial questions while we have a couple of minutes left here. In terms of maybe just to reset the company's expectations, overall top line growth profile when you consider the ongoing sleep market dynamics, but also the second and third growth horizons. And so if we look out the next couple of years, where would you peg underlying organic top line growth for the company? And then when you consider the current leverage profile of the business and initiatives to expand margins, how does that translate into earnings growth? And then perhaps we can just round out the discussion on capital allocation, the most recent update from the company.

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**Robert A. Douglas** - *ResMed Inc. - President and COO*

Sure, sure. So there are 3 questions there. But we actually don't give guidance on top or bottom line. We do give a little bit of indication on a few of the items inside the P&L. But in terms of the top line, we talk about the market globally growing mid to high single digits. And we talk that actually driven by patient growth across most of our businesses being quite a bit higher than that then offset by pricing, which really is partly a side effect of the volume growth and the patient growth coming into it. We believe with our product range and our ability to innovate the products to create new treatment modes and to really make the treatment more efficient and accountable, we can grow better than that market rate on the way through. In terms of translating that through, we've got a really good operating excellence program. We've got a good program driving cost out of the products. And we get -- gaining traction on our -- improving our SG&A and getting leverage there. And it's our aspiration to really provide bottom line leverage and grow the bottom line faster than that top line growth rate. You mentioned, in terms of capital allocation, we continue to believe we should be returning to the shareholders where we can. Long term, we've run dividends and the buyback. When we see an appropriate acquisition that are really supportive of our Three Horizon strategy that I was talking about earlier, we're in very good shape and plenty of firepower there to make those acquisitions. Over the last 18 months or so, we've had a higher rate of acquisitions than we've had in the past. We did suspend our buyback for a while. While we sort of got very strong cash flows, won't take long to sort of pay down that debt. And we'd look to see, absent some other acquisition that makes strategic sense for us, we'd look to see that buyback restart again in financial year '18.

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**Anthony Charles Petrone** - *Jefferies LLC, Research Division - Equity Analyst*

At this point, is it back in the buyback? Or at some point in the future?

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**Robert A. Douglas** - *ResMed Inc. - President and COO*

Well, we haven't restarted it yet, yes.

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**Anthony Charles Petrone** - *Jefferies LLC, Research Division - Equity Analyst*

Okay. With that, we're just about out of time.

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