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Q3 2018 Resmed Inc Earnings Call

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PRESENTATION

Operator

Welcome to the Q3 Fiscal Year 2018 ResMed Inc. Earnings Conference Call. My name is Tim, and I'll be your operator for today's call. (Operator Instructions) Please note that this conference is being recorded.

I'll now turn the call over to David Pendarvis, Chief Administration Officer and Global General Counsel. David, you may begin.

David B. Pendarvis *ResMed Inc. - Chief Administrative Officer, Global General Counsel & Secretary*

Thank you, Tim. Good afternoon, and good morning. Thank you for attending ResMed's earnings call for the third quarter of fiscal year 2018 ending March 31.

Joining us on the call today are Mick Farrell, our CEO; and Brett Sandercock, our CFO. Rob Douglas, our President and Chief Operating Officer, will also be available during the Q&A portion of the call.

In addition to the financial information presented on today's call, we encourage investors to review our earnings presentation, our earnings press release and our Form 10-Q for the period ended March 31, 2018. These documents will be available on our Investor Relations website at investor.resmed.com. A replay and a transcript of today's call will also be made available at that location shortly after this call.

Now on today's call, we'll discuss certain non-GAAP financial measures. The descriptions and reconciliation of these non-GAAP measures are available on our earnings release and will also be in our SEC filings.

Our discussion today may also include forward-looking statements such as expectations for ResMed's future performance. We believe these statements are based on reasonable assumptions, but of course, actual results may differ materially. Important factors that could cause actual results to differ materially from those in the forward-looking statements are detailed in our SEC filings.

I'll now hand the call over to Mick Farrell.

Michael J. Farrell *ResMed Inc. - CEO and Director*

Thanks, Dave, and thank you to all of our shareholders who are joining us today as we review financial results for the third quarter of our fiscal year 2018.

For the call today, I'll review top-level financial results, business highlights and key announcements this quarter. Then I'll hand the call over to Brett Sandercock, who'll walk you through our financial results in more detail.



So first, our top-level financial results. I'm really grateful to our global team for another quarter of very strong performance. We achieved double-digit revenue growth, 15% headline growth and 10% constant currency growth led by sales in Europe and Asia. And in those combined regions, we grew at 16%, 1-6, 16% in constant currency. Revenue in the U.S., Canada and Latin America grew 7% overall, in line with market growth.

At the bottom line, we are continuing to drive operating leverage as we did in Q2. Adjusted net operating profits in Q3 grew 25% year-over-year, which is an excellent result and the outcome of our global team's hard work in operating excellence. This translated to non-GAAP diluted earnings per share of \$0.92. We are proud of this strong top line and bottom line performance from our global ResMed team.

Now some business highlights, and let's start with Brightree. Growth in our Brightree's software-as-a-service business continues to be strong at 14% year-on-year. The Brightree team has been part of the ResMed group for 2 full years and there's a stable record of success.

To show Brightree's scale, here is an interesting metric. In the last 12 months, Brightree's systems handled more than 8.2 billion digital requests. By quickly and accurately responding to these cloud-based requests, Brightree helps its users reach more patients, more efficiently, more effectively and more economically.

In terms of next steps, Brightree is beta testing with select customers an exciting new analytics platform, using data from algorithms that will generate actionable insights for customers to improve their business effectiveness and their patient care. We look forward to Brightree bringing value to customers with this new data analytics offering in the very near future.

For the longer term, we are very pleased to continue to have Raj Sodhi, the President of our software-as-a-service business, focus not only on Brightree but also on new growth opportunities in the global out-of-hospital software market. Raj and his team are working to enable an ecosystem of connected software and human services to create a frictionless network for data and information to move across the health care value chain. So that as people progress through their personal health care journey, their medical data can seamlessly follow them.

Brightree solutions were featured in the interoperability showcase at HIMSS. That stands for the Healthcare Information and Management Systems Society conference. Brightree's participation in these demonstrations at HIMSS, with over 7,000 visitors touring the interoperability showcase, is just one example of our ResMed and Brightree commitment to connecting the post-acute care industry and patients to the rest of their care settings across that digital health care ecosystem. The response from current customers, prospects and industry stakeholders at HIMSS has been very positive. We will continue to showcase the power of an interconnected out-of-hospital software platform to the rest of the industry.

Turning to our core sleep apnea and COPD businesses. We continue to pioneer new horizons in those core businesses with digital health. We passed some very significant milestones during the quarter that I think are worth noting.

Our cloud-based patient management system called AirView now supports over 5 million 100% cloud-connected medical devices across the globe. More than 7 million patients are included in the AirView system for their AirSense 10, AirCurve 10, AirMini, S9, Lumis, Stella and Astral delight -- device platforms. We are proud of the extent to which this market-leading system has been adopted around the world, but we want to be clear that we recognize that this is just mile 1 of our digital health care marathon. All these digital health nodes connecting everyday has produced an incredible resource. We now have over 2 billion nights of medical sleep and COPD therapy data in the cloud. I'll talk a little later about how we are turning this big data or big clinical data into actionable information for our customers and the ultimate customer, the patient.

Our connected health strategy received another boost this quarter when Japan announced a revised reimbursement system that allows physicians to be paid for remote telemonitoring of CPAP patients. Japanese guidelines already require that doctors meet at least once every 90 days with CPAP users. The new guidelines, effective April 1, have allowed remote telemonitoring to substitute for face-to-face meetings up to 2x per quarter. This new system will allow busy physicians and patients, as their patient pool grows, to continue to receive excellent patient care without having to meet as frequently in person.



In anticipation of increasing demand for telemonitoring capability, our Japanese customers have stepped up their adoption of the AirView platform and AirSense 10 devices, our 100% cloud-connected sleep apnea therapeutic devices. This was a factor in some of our very strong sales in Japan during Q3. We are confident that in the future, this will make it easier for patients who are not treated today to begin and remain on CPAP therapy, happy and healthy at home.

Today, now 3 of our largest sleep apnea therapy geographies, the U.S., France and now Japan, all have systems that incentivize the adoption of our market-leading connected health solutions. That includes AirSense 10, AirCurve 10, AirView and myAir.

During Q3, the French market continued to benefit from its own telemonitoring reimbursement incentives, where there's a differential between telemonitored and non-telemonitored sleep apnea therapeutic devices. France and Japan, combined with good execution in a number of other countries worldwide, have contributed to very strong growth of device revenue across Europe and Asia during Q3. This category grew 18% year-over-year in constant currency across those regions.

Our U.S., Canada and Latin America device business was in line with market growth this quarter, growing at 6% year-over-year. We continue to see very good adoption of our connected health care solutions in these markets by customers and patients, and we continue to improve our offerings. We just announced that our patient engagement app called myAir, and that's for all of our Air 10 devices, is now available on Android-based phones. We're happy to now offer the same high-quality in-app experience to all patients with myAir, whether they use iOS from Apple or Android from Google. They can all use in-app care now, not the web-based care.

The most important differentiator here at ResMed from our competitors is our people, our passion, our skills and our dedication to changing lives with every breath. We were thrilled this quarter to announce the appointment of Bobby Ghoshal as our new Chief Technology Officer. This appointment enhances our management bench strength as we continue to build our leadership in connected health. Bobby has over 25 years of experience as a technology engineer and a technology executive at Wipro, Motorola, Freescale and most recently at Brightree. He has both the technical expertise as well as the cultural fit with ResMed to help us take our health care informatics leadership and data analytics solutions, along with Dana Di Ferdinando and her team, to the next level.

We will continue to work with payers across the globe on a number of initiatives in this space and also regarding reimbursement and market access.

Two recent wins are worth noting. First, France announced that beginning April 1, reimbursement for mandibular repositioning devices, so the dental devices that we sell to treat sleep apnea, would increase by 35%. Our product, the Narval MRD, is a device that leads the market in France. And we will continue to drive MRD sales in France and other geographies where that category can be just as successful.

Second, South Korea will soon begin reimbursing diagnosis and therapeutic treatment for sleep apnea. This is a great opportunity for us to help the many, many millions of South Koreans who need our solutions.

On the masks and accessories side of our business, in Q3, we saw solid global constant currency growth of 9%. This was led by Europe and Asia markets, which grew 13% in constant currency in the masks category. We are seeing good traction with our AirFit F20 and our AirFit N20 products in these regions.

We're also encouraged by the success of our AirFit N20 classic. The N20 classic combines the comfort and seal of our InfinitySeal cushion used across our AirFit series with an adaptive forehead support for stability and to adjust the marked tension to movement. The N20 classic is performing well in the very specific countries we are targeting and validates our approach to find unique solutions for different geographies around the world in 100 -- over 120 countries that we do business in.

The U.S., Canada and Latin America teams achieved solid revenue growth of 8% in our masks and accessories category, which is in line with market growth. We saw continued preference for the AirFit F20 and the AirFit N20 masks by patients, physicians and our channel partners. To help catalyze even better growth as we look forward, we are excited to be launching a technology upgrade onto the F20 and



to the N20 platforms.

At MedTrade, we demonstrated the new ResMed QuietAir diffuser technology, which results in masks that are 89% quieter and that have 70% more diffused airflow. What does this mean? Well, with this technology, our full-face masks' noise levels are down to 21 DBA, which is well below ambient noise in the bedroom. With ResMed's new QuietAir technology, we are providing patients and their bed partners with the peace and quiet they deserve for better sleep.

We think patients, particularly, as well as providers and physicians will adopt to QuietAir technology very rapidly. So watch this space.

Now for some business highlights of our operating excellence initiatives across ResMed. We are pleased this quarter to be able to continue to show our delivery in operating leverage to improve our bottom line.

We grew non-GAAP income from operations by 25% in the quarter. We combined solid revenue growth and stable margins with disciplined growth in SG&A, which grew at just 3% in constant currency, and research and development, which grew at just 4% in constant currency.

I want to emphasize that our operating excellence initiatives are about the long term, and they're about working more efficiently. They're about being more focused on eliminating waste, and they're about working smarter.

Let's look at a quick case study here of our medical affairs team and their operating excellence initiatives here at ResMed. The medical affairs team, led by Dr. Carlos Núñez, our Chief Medical Officer, has adjusted its balance between traditional, randomized, placebo-controlled trials and new big data, clinical data-based trials analyzing real-world digital databases.

Carlos has assembled a global team of key opinion leaders within ResMed and beyond to ask tough clinical questions and investigate them, leveraging the 2 billion nights of medical sleep and COPD data in AirView. These efforts are starting to bear fruit. Our medical affairs team is spending less money, reducing the time to complete the studies and increasing the number of top-quality clinical studies that they are completing and pushing through to publication.

The peer review process and top medical journals have accepted that these data-driven studies are important and worthy of publication. In short, ResMed is not only a pioneer in digital health, we are now pioneers in digital health research, all with cause of better patient outcomes.

In one example in this space, in the last 12 months, our team prepared a study looking at over 128,000 patient records. The analytical process took a few months and produced positive results and was accepted into a top-tier industry journal, the Journal of Sleep Medicine. And the results were impressive, showing how our patient engagement tools drive adherence to our CPAP therapy significantly higher than typical adherence to a pharmaceutical pill.

We continue to do other big data studies, and we are excited that several abstracts have been accepted for presentation just next month, a couple of weeks actually, at the upcoming annual meeting of the American Thoracic Society right here in San Diego, California. You'll hear more about these studies when they are presented, so watch this space.

Finally, some business highlights from our product development teams. Our amazing product development teams continue to deliver meaningful product innovation. As I mentioned earlier, we are launching brand-new QuietAir technology to our AirFit range, starting with the F20 full-face mask, and our mask pipeline after that is full.

As we speak, we are in the process of commencing a controlled product launch of Mobi, our first ResMed-branded portable oxygen concentrator. Mobi helps people with chronic obstructive pulmonary disease, or COPD, and others who require oxygen therapy to live life with fewer restrictions. Mobi's great balance of battery life, weight and oxygen delivery provides patients with the freedom to continue therapy while being mobile and active, which is what their doctors want, whether it's just around the neighborhood or across the country or across the globe. This controlled product launch is the start of our ResMed-branded journey in the portable oxygen concentrator

market.

In the U.S., only around 8% of those people who are eligible to receive a portable oxygen concentrator have such a device. We think that's wrong, and it's an unmet need, and ResMed can help fulfill it. It's also part of our long-term vision to change lives in COPD. There are hundreds of millions of people around the world with this debilitating disease. Our goal is to give them better quality of life, to reduce the cost of care and to help them keep happy and well at home and on the go.

Finally, we are in the process of launching a new smartphone app-based sleep apnea screening technology in China. We call this technology Sleep Q. Sleep Q uses a very inexpensive, lightweight tube combined with smartphone software technology to detect sleep disturbances that suggest a person may be at risk for sleep apnea. This very affordable and very-easy-to-use solution will give our China team another tool to reach the many, many tens of, maybe hundreds, of millions of undiagnosed sleep apnea sufferers in China. We will continue to keep you updated as this technology is launched by our ResMed and curative teams across greater China.

Three quarters now through our fiscal year, we have achieved solid revenue growth and stronger operating profit growth. Our connected health strategy continues to play out across multiple markets with our digital health ecosystem now including over 2 billion nights of medical sleep apnea and COPD data. We have seen success with new and upgraded masks and devices and software solutions, including the N20, the F20, AirTouch, the AirMini and upgraded myAir. We look forward to early results from our first ResMed-branded portable oxygen concentrator, the Mobi, as we move forward in the coming quarters and fiscal years.

We have a robust pipeline of innovation for the future as well. Most importantly, we have a talented and motivated ResMed team, serving patients in over 120 countries.

We are positioning the company for long-term top and bottom line growth for 2020 and beyond as we execute our strategy and lead the med tech field to create value with digital health solutions. We continue to be laser focused on our goals of slowing chronic disease progression, reducing overall health care system costs and, most importantly, improving outcomes and quality of life for our ultimate customers: patients.

With that, I will turn the call over to Brett for his remarks, and then we'll go over to Q&A. Brett?

Brett A. Sandercock ResMed Inc. - CFO

Great. Thanks, Mick.

In my remarks today, I will provide an overview of our results for the third quarter of fiscal year 2018. As Mick noted, we had strong quarter. Group revenue for the March quarter was \$591.6 million, an increase of 15% over the prior year quarter. Though, in constant currency terms, revenue increased by 10%.

Taking a closer look at our geographic distribution, and excluding revenue from our Brightree software-as-a-service business, our sales in U.S., Canada and Latin American countries were \$317.5 million, an increase of 7% over the prior year quarter. Sales in Europe, Asia and other markets totaled \$234.2 million, an increase of 29% over the prior year quarter. In constant currency terms, sales in combined Europe, Asia and other markets increased by 16% over the prior year quarter.

Breaking out revenue between product segments. U.S., Canada and Latin America device sales were \$168.1 million, an increase of 6% over the prior year quarter. Masks and other sales were \$149.4 million, an increase of 8% over the prior quarter.

For revenue in Europe, Asia and other markets, device sales were \$160.1 million, an increase of 31% over the prior year quarter or in constant currency terms, an increase of 18%. Masks and other sales were \$74.1 million, an increase of 25% over the prior year quarter or in constant currency terms, a 13% increase.

Globally, in constant currency terms, device sales increased by 11% while masks and other increased by 9% over the prior year quarter.

Brightree revenue for the third quarter was \$39.9 million, an increase of 14% over the prior quarter.

During the rest of my commentary today, I will be referring to non-GAAP numbers. The non-GAAP measures adjust for the impact of amortization of acquired intangibles, restructuring expenses and tax-related charges associated with the recently enacted U.S. tax reforms.

In the prior year comparable, they exclude amortization of acquired intangibles and restructuring expenses. We have provided a full reconciliation of the non-GAAP to GAAP numbers in our third quarter earnings press release.

Our gross margin for the March quarter was 58.2% compared with 58.3% during the same quarter in the prior year. Our margin was essentially consistent with the prior year and reflects typical declines in average selling prices, largely offset by manufacturing and procurement efficiencies. Assuming current exchange rates and likely trends in product and geographic mix, we expect gross margins at Q4 to be broadly consistent with our Q3 FY '18 gross margin.

Moving on to operating expenses. Our SG&A expenses for the quarter were \$147.9 million, an increase of 7% over the prior year quarter or in constant currency terms, SG&A expenses increased by 3%. SG&A expenses as a percentage of revenue improved to 25% compared to the 26.8% we reported in Q3 last year. Looking forward and subject to currency movements, we expect SG&A as a percentage of revenue to be in the vicinity of 25% for Q4.

R&D expenses for the quarter were \$37.4 million, an increase of 7% over the prior year quarter or on a constant currency basis, an increase of 4%. This increase reflects incremental investments across our R&D portfolio. R&D expenses as a percentage of revenue was 6.3% compared with 6.8% in the prior year. Looking forward and subject to currency movements, we expect R&D expenses as a percentage of revenue to be in the range of 6% to 7% for Q4.

Amortization of acquired intangibles was \$11.7 million for the quarter, an increase of 3% over the prior year quarter. Stock-based compensation expense for the quarter was \$12 million.

Non-GAAP operating profit for the quarter was \$159 million, an increase of 25% over the prior year quarter while non-GAAP net income for the quarter was \$132.5 million, an increase of 32% over the prior year quarter.

Non-GAAP diluted earnings per share for the quarter were \$0.92, an increase of 30% over the prior year quarter while GAAP diluted earnings per share for the quarter was \$0.76. Foreign exchange movements positively impacted third quarter earnings by approximately \$0.04 per share, reflecting the favorable impact from the stronger euro relative to the U.S. dollar, which were partially offset by the stronger Australian dollar.

During the quarter, we recognized restructuring expenses of \$10.9 million associated with a strategic global workforce planning review. Associated with this review, we also expect to record an additional restructuring charge of approximately \$7 million during Q4 FY '18.

On a GAAP basis, our effective tax rate for the March quarter was 15.4%. As discussed during the previous quarter, we had recorded additional income tax expense of \$126.6 million relating to the newly enacted U.S. tax laws. As permitted under the SEC guidance, this calculation is provisional until December 22, 2018, a year after the enactment of the law. Based on recent IRS guidance on the new law, we continue to refine our calculations, which resulted in additional income tax expense of \$5.6 million being recorded in our third quarter results.

On a non-GAAP basis, which excludes the onetime charges I have just discussed, our effective tax rate for the quarter was 13.2%. We estimate that our non-GAAP effective tax rate for fiscal year 2018 will be in the range of 13% to 15%.

Turning to fiscal year 2019. We continue to estimate that our fiscal year 2019 effective tax rate will be in the range of 21% to 23%. As we discussed last quarter, this rate reflects both the anticipated unfavorable impact of prospective Australian tax legislation and the favorable impact of the recent U.S. tax law changes.



Now I would like to update you on the Australian Taxation Office audit that is described in our Q3 press release and our previous SEC filings. At the end of the quarter, we received notices of amended assessments from the Australian Taxation Office for the years 2009 to 2013. Based on these assessments, the ATO is asserting that ResMed owes a total of \$151.7 million in additional income tax and \$38.4 million in accrued interest. Essentially, this is a transfer pricing dispute around the jurisdictional split of certain activities and the tax on related income. We do not agree with the ATO's position on the issues raised in the audit. We intend to pursue administrative and legal steps to defend our position, and we continue to believe we will be successful in defending our position.

As is normal convention, we have agreed with the ATO to pay 50% of the amended tax assessments pending resolution of the dispute. We have recorded this as a liability in the current quarter. However, we have also recognized an offsetting asset related to these amounts and have not recognized any additional tax expense in relation to these assessments. It is important to note that irrespective of the outcome of the tax dispute, we do not expect it to materially change our underlying effective tax rate guidance for fiscal year 2019 and beyond. Ultimately, if we do not prevail in this dispute, there would be significant one-time tax expense and interest charge recorded at that time.

Finally, on tax-related matters, I am pleased to advise that early this month, we agreed with the Singapore Economic Development Board to extend our investment and tax incentive programs through to the year 2030. While actual incentives are confidential, they're broadly consistent with our original agreement which was due to expire in 2020.

Moving on from tax-related matters. Cash flow from operations during the third quarter was \$149.1 million, reflecting strong underlying earnings and improved working capital management. Capital expenditure for the quarter was \$13 million. Depreciation and amortization for the March quarter totaled \$29.3 million.

During the quarter, we paid dividends of \$50 million. Our Board of Directors today declared a quarterly dividend of \$0.35 per share. We also continued our share buyback during the quarter and repurchased 200,000 shares for consideration of \$19.4 million.

Subsequent to quarter end, we entered into a new syndicated debt facility that provides for an \$800 million, 5-year revolving facility with an uncommitted option to increase the facility by an additional \$300 million. Furthermore, we also entered into a \$200 million, 5-year term loan. The term loan funds were used to pay a portion of the outstanding balance of the credit facility.

We continue to progressively repatriate cash back to the U.S. in order for us to more effectively utilize our strong global cash flows. At March 31, we had \$800 million in gross debt and \$116 million in net debt. Our balance sheet remains strong with relatively modest debt levels.

At March 31, total assets were \$3.5 billion, and net equity was \$2.1 billion.

And with that, I'll hand the call back to David.

David B. Pendarvis *ResMed Inc. - Chief Administrative Officer, Global General Counsel & Secretary*

Thanks, Brett. We'll now turn to Q&A. (Operator Instructions)

Tim, we're now ready for the Q&A portion of the call.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Joanne Wuensch with BMO Capital Markets is on the line with a question.



Joanne Karen Wuensch BMO Capital Markets Equity Research - MD & Research Analyst

When I take a look at your devices and your masks and accessories, your international growth is particularly strong. Is there anything that you can comment on as it relates to that?

Michael J. Farrell ResMed Inc. - CEO and Director

Yes, Joanne. As I mentioned in the prepared remarks, we did have some items that were extraordinary. The change in reimbursement in Japan of giving physicians the opportunity to get reimbursed for telemonitoring visits, which they, frankly, need as they're getting overloaded with in-person visits every 90 days with larger and larger growing sleep apnea patient populations meant that there was physician demand for telemonitoring capabilities, which meant that our customers, the large home care companies in Japan have certainly in the last quarter and will continue to, upgraded their fleets to be even more cloud connected. And so that meant if they were using S9s in their pool, they needed to move to AirSense 10, 100% cloud-connected medical devices. So there's extraordinary growth there in Japan. And as we also said last quarter, and it continued this quarter, the reimbursement changes in France where there's a significant differential between the cloud-connected sleep apnea therapeutic device and a non-cloud-connected sleep apnea therapeutic device in terms of reimbursement because the French government has seen that they get higher adherence through the coaching and techniques like AirView on the cloud-connected devices, they have a differential reimbursement. So I think those impacts in France and Japan are, together, moving beyond. And as you've been watching us the last 2, 3 fiscal years since we launched our AirView solution in the United States, we've seen some significant growth of that over the last 2, 3 years and now are in-line growth in U.S. So I think those are some of the factors that contributed to that, Joanne.

Joanne Karen Wuensch BMO Capital Markets Equity Research - MD & Research Analyst

That's very helpful. One of the things that Brightree brought to you was a very good platform in the United States, but my memory is that it was not as strong internationally. Can you discuss where that might be going and what your plans are there?

Michael J. Farrell ResMed Inc. - CEO and Director

Yes. So certainly, Brightree is -- although globally resourced, we have software teams in various countries around the world that support Brightree, that it's focused on a customer base which is home medical equipment, HME companies in the United States. And that's still the core focus of Brightree. However, Raj Sodhi, who's the President of that global software-as-a-service business team, is looking and growing both organically, potentially inorganically that business over the period between now and 2020, the period between now and 2025 as we look forward in our strategy. So if you look back at a trailing 12 months, you've got 6%, 7% or so of our global revenues coming from software-as-a-service. The vast majority of that is Brightree, but we do have some other mask replenishment and other software-as-a-service revenue in there as well. That will continue to grow and I think ahead of the ResMed group within that software-as-a-service part into other geographies over time.

Operator

David Low is on the line with JPMorgan.

David A. Low JP Morgan Chase & Co, Research Division - Research Analyst

If we could just start with the restructuring charges. I was wondering if you could give a little bit more insight into what those charges relate to and what the expected benefit will be, and I presume that we won't be seeing any more of that going into the new financial year?

Michael J. Farrell ResMed Inc. - CEO and Director

Yes, look, I'll give you the high-level sort of strategic rationale, then hand to Brett for some of the details there, David. The strategic rationale was we're changing to a more and more -- as I just related to Joanne's question, a more and more software-driven medical device company, and I'd say with 5 million 100% cloud-connected medical devices, the world's leading cloud-connected and remote monitoring med tech company. And so we're changing our go-to-market model to be more software driven, more software sales and changing our approach to that. And so there's some structural changes and others associated with that. It's really around Q3 and Q4, as Brett talked to. But Brett, why don't I hand to you for any further detail on that?

Brett A. Sandercock ResMed Inc. - CFO

Sure. Thanks, Mick. Yes, I mean, it very much was a strategic view and just looking at where we needed to invest in terms of our talent and growth areas. So we looked long and hard at that. And the restructure, it's probably, look, between 200 and 250 employees impacted through that restructure or reorganization. We've got -- we took some charge in Q3 and we do -- on the U.S. GAAP, we'll take the kind of balance of that through to Q4, but our expectation is that we wouldn't see any sort of -- seeing a bit of restructure into FY '19.

David A. Low JP Morgan Chase & Co, Research Division - Research Analyst

Okay, great. No, that's helpful. Look, the other question I had is the operating leverage has been phenomenal. The SG&A growth, R&D, to a lesser degree, growing much more slowly than the top line. Is that sustainable? I mean, should we be assuming that SG&A, in particular, will grow in the low single digits and through that, the operating leverage will continue on out into FY '19 and beyond?

Michael J. Farrell ResMed Inc. - CEO and Director

Yes, David, I'd parse that out into 2 categories. I think on the SG&A side, we like to see that grow well less than half our revenue growth. You saw 10% constant currency revenue growth for the quarter. We want to keep our SG&A growth below that, well below that. On the R&D front, there's different investments that we make in different parts of the business, the software side and in the device side. And I would probably say that we're going to look to keep our R&D as a percentage of revenue in the vicinity of that sort of 6% to 7% range. And so therefore, it might grow closer to -- if we're keeping it at 7%, let's say, of our revenues, then it's going to grow closer to our revenue line. So operating leverage, I think, in SG&A and keeping that growth under control and actually, just working smarter, as I said in the prep remarks, and finding systems and capabilities to solve problems and thinking more digitally and scalably about how our team approaches problems rather than just. Looking to hire more people, we can look to hire smarter systems, engage smarter system, so that our team can be more engaged on more strategic issues. That's sort of how we're looking at it, David.

Operator

Margaret Kaczor with William Blair is on the line with a question.

Malgorzata Maria Kaczor William Blair & Company L.L.C., Research Division - Research Analyst

First one for me is just a little bit more clarity on France and Japan in terms of penetration of cloud-connected devices and really a sense of can this be a multiyear benefit certainly in these 2 countries, and then beyond that, where you guys can continue to grow at this double-digit range above the market internationally.

Michael J. Farrell ResMed Inc. - CEO and Director

Yes, look, I think I'll have a first go at that and then hand over to Rob to look at it. But look, these are big changes, Margaret, that have happened, and they didn't happen overnight. Our market access team has been working in France with the French Ministry for Health for the last 5, 10 years to talk about telemonitoring and certainly showing the benefits that we've seen in the U.S. And with our Japanese team, similarly, market access teams working with the customers and the Japanese Ministry for Health to show these benefits. So these have been multiyear campaigns of working on market access to demonstrate that cloud-connected devices have better adherence, they're better for the health care system, they save costs for hospital organizations. So there will be multiyear benefits. But Rob, do you want to provide some more detail as to sort of that S curve, if you like, of penetration of the actual devices that Margaret's sort of asking about?

Robert A. Douglas ResMed Inc. - President & COO

Sure. Thanks, Mick. We were very impressed with the rate at which our U.S. customers understood the value proposition of connected care. But as Mick said, we've had multiyear campaigns to make those value propositions in other markets. We believe that the value proposition actually is there in every market that we're in, no matter what the reimbursement structure is and how that works, but it does take time to run these programs and develop it. The French one, as Mick said, was being -- the result of many, many years of work and really changing the trajectory of connected care and how it works. Now the value of the connected care is, as our data has shown, is that more people stay on treatment. And so long term, there's a greater pool of patients in the environment that need to stay cared for, they need to stay on masks, and that really has a building-on benefit that lasts long term in these markets. And we have seen that in the U.S. as well, and we'd expect to see that benefit of making this treatment for sleep apnea in the home a much more accountable and transparent treatment with everyone involved in the system, keep all patients on treatment, and we'll keep growing it. We've got a long

list of other markets that we're focusing on, and we look forward to reporting changes in reimbursement programs or major progress as it happens in the future.

Malgorzata Maria Kaczor *William Blair & Company L.L.C., Research Division - Research Analyst*

Got it. Very helpful. And then as a follow-up to top line growth, you guys really mentioned multiple new product initiatives and a very full product pipeline, whether that's on the masks side, Brightree, otherwise. Is there a cadence of product launches that you guys look at per year? Is it a couple? Is it more than that? And what kind of makes you guys pull the trigger on one product versus another?

Michael J. Farrell *ResMed Inc. - CEO and Director*

Yes, Margaret, that's a great question. Yes, we have a very full pipeline. And our goal is to bring a cadence of very innovative products at appropriate timing. The customers want them not faster than patients need, the next generation, and not slower than customers need them. And I don't know. If you talk to any sleep apnea patient worldwide and say, "Would you like your product smaller, quieter, more comfortable, more connected?" They always say yes. So we know there's demand there. And we really are trying to make sure that, that cadence is regular and strong and not too fast because patients aren't ready necessarily to switch masks or to switch software technologies too fast, but it's fast enough to make sure that the innovation is there and can have -- to the company, good, sustainable, long-term growth, but for the patients ensure that we're making it smaller, quieter and more comfortable and more connected every time. A good example is the N2O classic for this quarter, a product that's not quite as sexy maybe as MyAir, but a needed product for some of those markets in Europe and Asia. And we brought that product to market for that -- for those categories in that basic nasal category mask, and it's been very successful. On the other end of the spectrum, we got our first ResMed-branded portable oxygen concentrator out on a controlled product launch here in the U.S. and we're really excited to see how those business models go as we partner with home medical equipment companies to reach the 92% of people who should have an oxygen concentrator in this country and don't. And then when we get it right, we'll scale that to the other 119 countries we do business in.

Operator

Sean Laaman with Morgan Stanley is the line with a question.

Sean M. Laaman *Morgan Stanley, Research Division - Australian Healthcare Analyst*

I have a couple of questions on Brightree; t's another good number. I don't know if you could help us frame perhaps the contribution from subscription pricing and maybe throw some comments on adoption rates for Brightree?

Michael J. Farrell *ResMed Inc. - CEO and Director*

Yes, look, Brightree has been part of our group for 2 years and has grown pretty well in the double-digit range during that time. And there are many, many HMEs across the country who use Brightree, and there are many who don't yet use Brightree and that we need to get on the Brightree platform. It provides such efficiency in prescription management, in inventory management, in delivery of product and monitoring of patients and resupply of patients that we think -- the value proposition is there for the large chunk of the market that doesn't yet have Brightree. We do have the lead in software-as-a-service in the home medical equipment side, and we plan to continue that. But so as I said, there's a lot of road ahead, but some steady growth. I mean, look, there is consolidation in the home medical equipment space. If you go back prior to competitive bidding, there were maybe 6,000, 7,000 home medical equipment companies. Maybe now, there are 3,500 or 3,000 or so. But Brightree works on a per-user, per-month approach, and we think that it has some good growth ahead. And we will continue to invest to make sure that our software-as-a-service value proposition not only meets and beats the competition but looks around corners to see where those customers will need their next innovation from. And in addition to that, we're looking to add on capabilities, as I said, in other geographies around the world where out-of-hospital software is not limited to the U.S. geography.

Sean M. Laaman *Morgan Stanley, Research Division - Australian Healthcare Analyst*

Sure, sure. And the other thing we're trying to understand about Brightree, it's not just about CPAP. But I wonder if this is going to help, Brightree will assist the rollout of the Mobi, for example. I don't know if you could give us your thoughts on that.

Michael J. Farrell ResMed Inc. - CEO and Director

Well, the rollout of the Mobi is going to be dependent upon the go-to-market strategy and the value proposition of that product within the space. So look, as I said in the prep remarks, it's got a really good balance of that oxygen output, the battery life and the weight of the device versus the competition. So I think on the product side, it's going to do really well. And in the go-to-market models, we're looking at partnering with our channel to make sure we can reach those patients who need it and drive it forward. So I would say it's more our relationships with our home medical equipment companies across the spectrum, both the products we sell in CPAP, APAP, all the masks, bilevels and ventilators as much as our software platform. So it will add to our knowledge and capability in partnership with our channel, but I'd say, it's more our partnership in the other portfolio of products that's going to help us with Mobi.

Operator

Craig Wong-Pan is on the line with Deutsche Bank has a question.

Craig Wong-Pan Deutsche Bank AG, Research Division - Research Analyst

Just wanted to touch on the U.S. market. I mean, fairly good growth there. You said in line with market, but I didn't know that it has slowed from the second quarter. So down from 12% to around 6% to 8% now. Would you just talk to the growth in there?

Michael J. Farrell ResMed Inc. - CEO and Director

Yes, sure. The U.S. market -- well, the global market we say is growing in that sort of mid- to high single digits. So we definitely held share. And in some categories, we took some share, and in some others, we held or maybe lost a little in some of the masks. But basically in line sales. I mean, if you think about our U.S. geography, for the last 12 quarters, we've been ahead of market growth. And you don't stay ahead of market growth forever, and there are product cycles. But I think that we did very well in the U.S. market with the comparables and how we performed in the last 12 quarters to grow at 7% in the U.S., Canada, Latin America geographies. And I've got to tell you, we think it's a sustainable growth. And as you add on technologies like QuietAir, which makes those masks 89% quieter and the customers don't have to add anymore SKUs. It'll roll into the same F20 and N20 SKUs they have. And so the administration, the channels are all up and running with N20 and F20 with this huge patient benefit improvement, and therefore, lower return rates, higher adherence, better for the payer, better for the patient, better for the home care provider. I think that you're going to see some very sustainable and increased growth in the U.S. geography. But look, we've got a 29-year track record of doing pretty well in the U.S. geography, and I think we will continue to do that as I look forward through, not just Q4, but all of FY '19.

Craig Wong-Pan Deutsche Bank AG, Research Division - Research Analyst

Okay. And then just for my follow-up question on QuietAir. I missed whether you talked about a timing release for that. And then is that the main reason for sort of your expectation of '19 being higher than the market growth?

Michael J. Farrell ResMed Inc. - CEO and Director

Yes. So we launched QuietAir technology at MedTrade, so that was during this last quarter in Q3 at the tradeshow. But look, yes, as you said, it's an S curve, the penetration, as that technology rolls out in Q4 throughout the fiscal year. And so we will see that start to roll through the customers in this quarter, and I think when those demonstrations start to happen with the RTs, with the respiratory therapists, and the people who do these set-ups, and they get the demo where this thing is lower than 21 DBA, I mean, that's quieter than the air-conditioning in your office right now. It's quieter than however quiet you get your home. It's quieter than that, that ambient noise. And so it's basically getting down to stretching the envelope of near silence. So we're really excited about the technology, and I think we will watch and see how it goes. Certainly, the initial patient trials of the control product releases with this have been successful in the trials, and let's see how it goes in the real world. We're very confident that this will be a successful technology for the channel, for patients and for physicians wanting to prescribe it.

Operator

Andrew Goodsall with MST is on the line with a question.

Andrew Goodsall UBS Investment Bank, Research Division - MD and Senior Healthcare Analyst

Perhaps if I could just ask you the pricing environment in the U.S. and, I guess, just thinking ahead to the next round of competitive bidding and the positive performance there. Just your expectations where pricing will even out to.



Michael J. Farrell ResMed Inc. - CEO and Director

Yes, Andrew, look, pricing environment's very stable in the U.S. We don't go into details of what that is, but it's stable. There's no big step changes within the U.S. pricing market right at the moment. As far as details with regard to competitive bidding and where we're at and that sort of 7-year process with the U.S. government and CMS. Dave, you want to provide some color for Andrew on that?

David B. Pendarvis ResMed Inc. - Chief Administrative Officer, Global General Counsel & Secretary

Sure. Thanks, Mick. Andrew, it's hard to say. The next round of competitive bidding is scheduled for January 1, 2019. We've got no guidance from CMS as to how that process is going to be conducted, and time's getting a little short. So it's not clear what the timing is going to be. However, there have been 2 significant changes to the process that came in legislatively. One is that bids have to be binding this time and -- which means that you should eliminate the sort of lowball bidders who were maybe bidding low on one category to get another or, otherwise, you're taking a flyer. And the second change is that there will be no limit on the bid ceiling, so you can bid higher if you'd like. So just those 2 factors alone, we think, will lead to more rational bidding. We've gotten some good signals from CMS that there should be some other reform coming. We'll wait to see when those signals actually turn into reality. But there's some good, strong indications that you could see a better bidding process this time that certainly what we would support, and we've been working with our partners and with CMS to try to make that happen. So time will tell, but we're encouraged.

Andrew Goodsall UBS Investment Bank, Research Division - MD and Senior Healthcare Analyst

And just my follow-up. You've called out Korea, France, Japan as positive jurisdictions, I guess. Is there any other countries that we should be sort of focusing on where you think there's also a bit of positive momentum?

Michael J. Farrell ResMed Inc. - CEO and Director

Yes. Look, Andrew, I mean, France and Japan have that big change with telemonitoring. So I think there's a long runway of future growth there. I mean, you don't have to go far around the OECD countries to see where other telemonitoring capabilities in connected care, connected health capabilities might be growing. South Korea's kind of unique where it's gone from no reimbursement to reimbursement. So that's a really sort of positive sign for a really long-term play of growth and access to -- many, many millions of South Koreans can now get access to reimbursed care not just the people who could afford to pay out of pocket. So I think that's a really good development there. Other geographies to watch, well, we talked about the Sleep Q, this very low-cost screening technology that just runs off a smartphone. That's going to launch in a 1.3 billion person market there in China. We're incredibly excited about the potential of that. But look, I don't want to get ahead of ourselves. We're just launching the technology. Let's -- there's a lot of technologies that go into a country like China. And such adoption of smartphone-based buying and selling of everything over in our office in Suzhou, and you can't buy a cup of coffee without using a smart pay from your smartphone system. Note that you couldn't use cash or credit card, only a smart pay system. So the technology adoption China is just incredibly quick. And so who knows if we can get above that technology noise and make it go, but I think that's another geography to watch there, Andrew.

Operator

David Stanton with CLSA is online with a question.

David Andrew Stanton CLSA Limited, Research Division - Research Analyst

First one, just a follow-up perhaps on Andrew's previous question. What are we hearing from the government around bundling and bundling trials? Any updates on that, please?

Michael J. Farrell ResMed Inc. - CEO and Director

Dave, why don't you take that?

David B. Pendarvis ResMed Inc. - Chief Administrative Officer, Global General Counsel & Secretary

David, there's been no word on bundling as part of the CMS competitive bidding process. When that came out sometime ago, it was going to be a trial that will start in 2019. As I indicated, time's getting very short to even put out the basic rules for competitive bidding, much less some trial in non-bid markets. But the bottom line is we've heard nothing about it. We continue to have supporters that we talk to, both in the customers and in the legislature and CMS who've made it clear that we think that's a bad idea. We're hopeful it won't go forward, but we've heard nothing.



David Andrew Stanton CLSA Limited, Research Division - Research Analyst

Great. And my follow-up is can you explain a little bit more, give us some more color around how Brightree helps you with your replenishment of mask growth?

Michael J. Farrell ResMed Inc. - CEO and Director

Yes. Thanks, David. So we have 2 offerings for our U.S. customers with regard to replenishment of mask offerings for patients who want them. We have a technology solution called ResMed ReSupply, which we offer to customers that run on any digital back-end system for their home care company. And so it's available to all customers across the U.S. And then we also have a technology called Brightree Connect, which is specifically for resupply of masks and accessories for customers, not just ResMed, but for any masks and accessories they provide. And so we have 2 technologies that we have out there in the market, and they have got different capabilities and appeal to different sort of segments, if you like, of the market there, David.

Operator

And our last question for today will be from Gretel Janu of Credit Suisse is on the line.

Gretel Janu Cr dit Suisse AG, Research Division - Research Analyst

So I just wanted to go back to international and really work out some of the trends seen in the other rest of world markets, particularly, Germany, because you haven't really called out Germany at all this time.

Michael J. Farrell ResMed Inc. - CEO and Director

Yes, Gretel. Look, our German health care team, which is led by our CEO there, Katrin Pucknat, and I just had a conversation with her this morning. We've seen some really good growth of our German health care business over the last couple of fiscal years, and Katrin is really changing the approach and the service mentality of our go-to-market team there in Germany. There was no brand-new news in the last 90 days, so I wasn't neglecting one of our top 5 countries. Also didn't talk about ANZ, which had another strong growth there. We had really good growth in AirMini sales in that sort of consumer pay segment in Australia and New Zealand. And Catherine Delamare, who leads that business, is doing a great job. But look, within Germany, it's a "steady as she goes" growth there. And I think that as we look -- all the technologies that I talked about that we provide to our customers globally, we are providing to ourselves there, too, within our Germany health care business. And so I see strong, steady growth within Germany. But no changes yet to telemonitoring versus non-telemonitoring from reimbursement providers like in France. But if I was at the German Ministry for Health and looking at the success of France in driving increased adherence, lower hospitalization costs and better outcomes for their patients and for the Social Security health care system within France, if I was next door in Germany, I'd be looking at that and saying why don't we keep up with the times and try to get ahead of them in digital health.

Operator

We are now at the 1-hour mark, so I will turn the call back over to Mick Farrell.

Michael J. Farrell ResMed Inc. - CEO and Director

Well, thanks, everybody.

And in closing, I want to thank the 6,000-strong ResMed team for their dedication, focus and commitment to our operating excellence initiatives. This quarter, they have helped us deliver strong revenue growth and increasing operating leverage. Our team remains focused on our future pipeline of products and software solutions that change patients' lives and benefit all of our customers: patients, physicians, payers and providers.

Thank you for your time, and we will talk to you again after the end of our fiscal year in about 90 days, plus or minus. Back to you, Tim.

Operator

This concludes ResMed's third quarter of fiscal year 2018 earnings live webcast. You may now disconnect.



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