

Question and Answer

Operator

[Operator Instructions] Your first question today comes from the line of Tristan Joll from UBS.

Tristan Joll

UBS Investment Bank, Research Division

Just a couple of questions on, I would say, composition, if I can. I know, Mike, you made the general comment that premium products were offsetting price declines. Is that also true in masks? So in the 16% second half mask performance, do we assume that pricing was sort of generally flat?

Michael Grenfell Daniell

Non-Executive Director

Yes, the overall price was flat to maybe just a fractional improvement because of mix and offsetting any price declines.

Tristan Joll

UBS Investment Bank, Research Division

Okay. And again, you talked about mid-teen constant currency revenue growth through next year. Just a bit more granularity on that, do we project -- I mean, the mask number has been trending upwards. Do we project 16% as a take or would you expect that to continue going up?

Michael Grenfell Daniell

Non-Executive Director

We would expect growth rates to continue in the mid-teens. What it actually turns out to be, of course, will depend. There's a lot of months to go in the year-on-year. But that's a pretty good indicator, and we'd like to see it improve. We really hardly started with the simplest masks at present.

Tristan Joll

UBS Investment Bank, Research Division

Okay. And just granularity on the flow gens. What sort of percentage now are you selling SleepStyle versus ICON?

Michael Grenfell Daniell

Non-Executive Director

I think it's down to SleepStyle at 20% of our flow generators.

Tristan Joll

UBS Investment Bank, Research Division

Okay. And do you expect that to sort of -- I think previously you said that will probably flesh out sort of, I guess, maybe through this fiscal year. Is that reasonable?

Michael Grenfell Daniell

Non-Executive Director

It will decline again through this year, but it will run a bit into the following year as well.

Tristan Joll

UBS Investment Bank, Research Division

Okay. And then finally, just clearly you've upped in terms of your mask frequencies or the frequency of mask launches. Can you give us sort of some -- do you have the right rate beyond the simplest or are you still aiming for 2 to 3 masks per year? Or are you kind of try and increase that run rate?

Michael Grenfell Daniell

Non-Executive Director

We have had a very big period over the last 9 months or so, of course. You can expect to see regular new mask in productions, but it will be premature to say what or when.

Operator

Your next question comes from the line of Marcus Curley from Goldman Sachs.

Marcus Curley

Goldman Sachs Group Inc., Research Division

Just a couple questions, if I can. Just first on RAC. Can you give us a little bit more color in terms of the key components of the 38% growth in new applications?

Michael Grenfell Daniell

Non-Executive Director

Well, the 2 biggest contributors there are oxygen therapy, our Optiflow system, and noninvasive ventilation. And that spans both adult care and infant and the enabled care. They're the 2 biggest contributors.

Marcus Curley

Goldman Sachs Group Inc., Research Division

And outside of that, are you seeing any material sales in the surgery side at the moment or is that still emerging?

Michael Grenfell Daniell

Non-Executive Director

It's growing quite strongly off its small base. And so it's becoming -- just becoming material. But still, there's time to go there as we steadily offer that in more markets, bearing in mind that market was more than we have. We have quite a substantial business related to surgery with our respiratory products as well because they're frequently used in the a postsurgical setting.

Marcus Curley

Goldman Sachs Group Inc., Research Division

And then just on RAC, can you just give us the proportion of consumables versus durables?

Michael Grenfell Daniell

Non-Executive Director

I don't have the number right in front of me. I'm wanting to say about 80%.

Marcus Curley

Goldman Sachs Group Inc., Research Division

I'll ask the same question for OSA as well.

Antony G. Barclay

82%, Marcus.

Marcus Curley

Goldman Sachs Group Inc., Research Division

82% for RAC. And for OSA?

Antony G. Barclay

About 71%, Marcus.

Marcus Curley

Goldman Sachs Group Inc., Research Division

Yes, secondly, when you look at your hedging outcomes in the forecast year, can you give us any color in terms of a range of hedging gains that you have baked into that FY '14 forecast?

Michael Grenfell Daniell

Non-Executive Director

Sure, Marcus. So at the higher exchange rate value would be around the \$60 million or so. And at the lower USD 80 million, that is around the \$50 million mark pretax, obviously.

Marcus Curley

Goldman Sachs Group Inc., Research Division

And that compares to the \$49-odd million that you did this year?

Michael Grenfell Daniell

Non-Executive Director

Indeed, yes.

Antony G. Barclay

A little bit more closeout value, that's part of the reason. But on average, a number of currencies in the forecast, particularly Japanese yen and the like, are higher at this point and, therefore, there'd be a bit more value coming through from the hedge book than those other areas.

Marcus Curley

Goldman Sachs Group Inc., Research Division

Okay. And then you gave us some color on '15 for the euro. I think I wrote it down at 46% at EUR 0.43. Any coverage on the U.S. dollar into '15?

Antony G. Barclay

Yes, we've got 20% cover at \$0.77, Marcus.

Marcus Curley

Goldman Sachs Group Inc., Research Division

And I suppose one of the highlights of the result, the low gross margin was obviously good control on SG&A and R&D. Can you give us any color? Obviously, you talked about the new building impacting SG&A in the second half. Is this a year where SG&A is still and R&D is still below teens constant currency growth rates?

Michael Grenfell Daniell

Non-Executive Director

On an ongoing basis, yes, particularly SG&A. But as you mentioned, we do have this onetime step-up from the new building. So that will bring total expenses closer to revenue growth. But if we backed out the new building cost, we're looking to maintain a couple of percentage points leverage on SG&A and maybe just a fraction on R&D.

Marcus Curley

Goldman Sachs Group Inc., Research Division

And the new building cost just on a full year basis would be in FY '14?

Michael Grenfell Daniell

Non-Executive Director

You're talking about \$5 million and \$6 million in total, so they're at a \$4 million delta from the year just finished.

Marcus Curley

Goldman Sachs Group Inc., Research Division

And then finally, when we look at our gross margin, Mexico benefits, can you just give a bit more color on what was achieved in the year? And I know you mentioned 100 to 150 basis points. But on dollar sense, what you think the benefits will be in '14?

Michael Grenfell Daniell

Non-Executive Director

We're looking for another 100 basis points from Mexico. So I mean, that's 1% of the revenue number.

Marcus Curley

Goldman Sachs Group Inc., Research Division

And what was that in '13?

Michael Grenfell Daniell

Non-Executive Director

About the same, maybe a fraction under.

Operator

Your next question comes from the line of Brett Cole from Business Spectator.

Brett Cole

Could you just describe how you view consumer confidence or the demand by consumers for your products in Australia, sir?

Michael Grenfell Daniell

Non-Executive Director

In Australia? Well, demand has been very good in Australia. We're noticing that for new products, in particular, we introduced those first generally into New Zealand and then Australia, Australia being a much bigger market than New Zealand, of course. So we have had very, very strong demand in Australia over the last year. We've had -- all of those new products have been in the Australia for longer than elsewhere, and they've been very well accepted.

Brett Cole

Right. Then what's your view of the Australian consumer going forward? So there's a perception that the retail market is very soft in Australia because people don't have much confidence where the economy is going?

Antony G. Barclay

We don't really participate in what you would consider a true consumer market. Half of our business is in -- or more than half is into the hospital setting, and this is really our link to consumers. And even our products that go into the home setting, again, medical, and they're not really linked to consumer season very much. And it's more about do our devices do a better job, can they help provide more efficient care, more effective care. So the economy really doesn't have much of an impact.

Operator

Your next question comes from the line of Sarndra Ulrich from First New Zealand Capital.

Sarndra Ulrich

Jarden Limited, Research Division

Just a couple of questions. Can you -- firstly, Tony, can you just repeat the question Mark has asked about the hedging gains, \$50 million to \$60 million, criteria around that? I missed it, sorry.

Antony G. Barclay

Sure. In terms of the thinking about guidance on the hedge result at \$0.80, around \$50 million of hedge gain; at \$0.85, around \$60 million.

Sarndra Urlich

Jarden Limited, Research Division

Okay. Just the -- I guess, a question now is if once the closeout bus is removed in FY '15 and the hedging gains potentially, can you just talk about -- I mean, we know a large component of '14 is comprised of it. But how -- and many things are beyond your control in FY '15. But how -- what things could you say that could actually boost FY '15 earnings beyond, let's just say, considerably \$85 million and things that you are putting in place and in terms of potentially a bit more about Mexico, but just adding to Mexico as well in terms of things that you are putting in place now, in terms of operational efficiencies, cost out and product mix?

Michael Grenfell Daniell

Non-Executive Director

Sure, Sarndra. Well, It's Mike here. Of course, the biggest thing is growth. And so we're looking for mid-teens growth out into the future, maybe better. But just think mid-teens, so that's the biggest thing. And so project that off current projections that we've given for the current year and then helping in terms of margin expansion, I guess, Mexico and we've already talked about 100 basis point improvement from that. I think it's fair to say all of the new products that were introduced over the last 18 months do a better job. And in return for that, we are getting better margins. So that mix shift will be helping -- will help with margins. We do expect consumables in OSA, the masks to grow faster than the hardware items there. That's positive to margin as well. So if you go back in time, you then got just ongoing efficiencies. We're running a very effective lean program in our manufacturing operations. And as Tony mentioned earlier, we're improving our logistics and taking cost out there. And then finally, we do have the leverage on the overhead expenses of SG&A into late '16 R&D as well, again, just backing up that onetime hit on the building. So when you combine all those together, we think we're in a pretty good position to cope with the roll-off of the hedging over those 2 years, '15 and '16.

Sarndra Urlich

Jarden Limited, Research Division

Okay. So realistically, let's just assume that the currency, I don't know, let's at least just assume \$ 80 million -- just assuming the currency for FY '15 -- I know that you've done this in your budgets. Assuming the currency was \$80 million in FY '15 on average, do you think that you could beat \$90 million in FY '15? Or do you think it would be a more reasonable assumption to think that you could be around the \$90 million mark?

Michael Grenfell Daniell

Non-Executive Director

That's a great target to beat that, and it will depend primarily on growth. We have control over those leverage levers, if you like, costs, and it will be primarily growth. But assuming growth runs the expectation, that's certainly a possibility. But too early to be providing same guidance on that assumption. But certainly, that's what we're shooting for.

Sarndra Urlich

Jarden Limited, Research Division

Okay. And just -- excuse me, if I haven't understood it correctly, in terms of RAC growth, the first half consumables growth was 20%, is that correct? And now it's 38%, is that right in terms of...

Michael Grenfell Daniell

Non-Executive Director

Yes, you're talking about the new applications?

Sarndra Ulrich

Jarden Limited, Research Division

Yes, so 38%.

Michael Grenfell Daniell

Non-Executive Director

Yes, I don't remember if it was 20-something. It was 20%. Bear in mind, in the first half, we were lapping quite a substantial inventory build by our hospital distribution partner in the U.S. So that growth was artificially suppressed by that.

Sarndra Ulrich

Jarden Limited, Research Division

Okay. So the 1H number was the one that was suppressed rather than 2H [indiscernible] by anything.

Michael Grenfell Daniell

Non-Executive Director

Yes, and the 2H has got that 2% tailwind in it. So I'd be thinking mid-30s rather than 38% has been what the real number was.

Operator

Your next question comes from the line of Nachi Moghe from Morningstar Research.

Nachiket Moghe

Morningstar Inc., Research Division

Just wondering, as there's a lot of this competitive bidding and the resulting market shift to the winning bidders, do you think that will cause some level of disruption in the market and probably in the interims low OSA growth?

Paul N. Shearer

Senior Vice President of Sales & Marketing

This is Paul speaking. In terms of slowing market growth, it will probably have some kind of impact. And the reason is that as patients get disruption to the supply, they would need to go to the bidders sort of who won the bid. So there could be a period of time, there is a small disruption to supply, therefore, affecting market growth, yes.

Michael Grenfell Daniell

Non-Executive Director

There was a trial, a smaller trial run about -- started about 18 months ago, and there was a small blip there but it wasn't overly material. There is a grandfathering or grandparenting clause in there that patients are able to stay with their existing supplier even if they didn't win a bid. So that will help minimize any disruption as it goes through the change.

Nachiket Moghe

Morningstar Inc., Research Division

Okay. So in terms of the OSA market growth, we should be thinking at what the lower end of the 6% to 8% range is it for this year, for 2014?

Michael Grenfell Daniell

Non-Executive Director

We are still thinking the market growth will continue where it has been and possibly with a little improvement because we've got a high degree of under penetration of treatment. You've got markets outside of the U.S. growing quite strongly, and you've got a home sleep testing in the U.S. really gaining traction. And that's increasing capacity for diagnosis, of course, because every bid is now in potential diagnostic side, and it's opening up a much more corrective form of diagnosis to many patients who have been reluctant to go into the lab. So at this point, we are not predicting a slowdown in market growth.

Nachiket Moghe

Morningstar Inc., Research Division

Right, correct. And how much is home sleep testing now as a proportion of the overall?

Michael Grenfell Daniell

Non-Executive Director

It varies a lot by geography. In some geographies, we're hearing as high as 50%. If we had to take a guess at it, perhaps, I'm going to ask Paul to take that guess.

Paul N. Shearer

Senior Vice President of Sales & Marketing

Outside the U.S., as a proportion of overall all sleep test, we're thinking it's probably roundabout 25% for home sleep test and 25% of all sleep test in the U.S. currently.

Nachiket Moghe

Morningstar Inc., Research Division

Right, okay. And just another question on pricing. I mean, do you continue to expect pricing to be in the 3% to 5% range. Price declines in OSA?

Antony G. Barclay

Yes, we haven't seen a change in that pace over the -- well, for a number of years now. You get the odd exception. There might be a particular item, but that's what our expectation is. And that is, as we mentioned earlier, offset by a movement to high spec flow generators, a greater proportion being Auto, for instance, and, in our case, a positive shift on masks as well.

Operator

[Operator Instructions] There are no further questions at this time, so I'll now hand the call back to your speakers for any closing remarks.

Michael Grenfell Daniell

Non-Executive Director

Okay. Well, thank you, and thank you, everyone, for joining us on the call. As you can tell, we are pretty positive about the coming year. And the results we're achieving are very much the results of the efforts of our teams here in New Zealand and in 30 countries around the world, so I'd like to acknowledge and thank them for their outstanding efforts and for the results that we're achieving. We'll talk to you next time. Thank you.

Operator

Ladies and gentlemen, that does conclude our conference for today. Thank you so much for your attendance. You may all disconnect.