

# Question and Answer

## Operator

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

## Tristan Joll

*UBS Investment Bank, Research Division*

Just a couple of questions around OSA and, in particular, mix. Mike, you said that underlying price declines were offset by the premium products. Does that mean that we assume all of the mask growth was volume? So you're looking at about 5% volume growth in OSA masks for the half?

## Michael Grenfell Daniell

*Non-Executive Director*

Yes. Maybe just a fraction under, I think we might have just got a slightly higher value per mask, but very, very close.

## Tristan Joll

*UBS Investment Bank, Research Division*

Okay. And then I'm just interested in the overall flow gen mix. So ICON is going forward at 5%. What is the -- that sort of implies that SleepStyle is going backwards reasonably quickly. What's the sort of mix between SleepStyle and ICON at this point?

## Michael Grenfell Daniell

*Non-Executive Director*

Tony might confirm this, but off the top of my head, I think we're about 75% ICON, 25% -- yes, Paul is nodding here, about 25% SleepStyle.

## Antony G. Barclay

Yes.

## Tristan Joll

*UBS Investment Bank, Research Division*

Okay, great. And then just a bit of housekeeping in terms of the guidance. The D&A comment you just made, Tony, the \$1.2 million, is that -- that's all D&A and that's incremental to the first half. Is that correct?

## Antony G. Barclay

Yes, it is because we'll start depreciating that building as we occupy it over the next couple of months.

## Tristan Joll

*UBS Investment Bank, Research Division*

Okay. So the second half D&A looks like it's going to be somewhere in the order of \$15 million?

## Antony G. Barclay

That seems in the reasonable sort of space, yes.

## Tristan Joll

*UBS Investment Bank, Research Division*

Okay. And just given some of the things going on with capitalized interest and stuff, and the fact that this half's was lower -- this half's net finance costs were lower last year, what are you forecasting for net interest for the full year?

**Antony G. Barclay**

For the full year, around about \$5.5 million.

**Operator**

[Operator Instructions] Your next question comes from the line of Sinclair Currie of NovaPort Capital.

**Sinclair Currie**

Just wondering about the cost line going forward. We saw some pretty good leverage, I guess, in this half. And I was just sort of interested whether you sort of thought that could be maintained going forward and whether or not South Korea would put a bit of a dent in that as well?

**Michael Grenfell Daniell**

*Non-Executive Director*

We expect to continue to maintain good leverage, both in the expenses side, so primarily SG&A, and also operating leverage in terms of both gross margin and reduced cost of goods. So we would expect to see that trend continue, in fact, for several years. South Korea, we expect to be accretive. So we would not expect that to cause any real change there.

**Operator**

Your next question comes from the line of Claire Rogers of Fairfax Media.

**Claire Rogers**

I just noted you said you've got an increasing quantity and range of the company's products now manufactured in Mexico. I was just wondering if you could say if any of that manufacturing has moved from Auckland.

**Michael Grenfell Daniell**

*Non-Executive Director*

A very small amount moved from Auckland when we first set up there, just to seed the manufacturing in Mexico. But given our underlying growth, almost everything we do in Mexico is increase in capacity that we've put into Mexico.

**Claire Rogers**

Okay. So no jobs in pip [ph] here?

**Michael Grenfell Daniell**

*Non-Executive Director*

We employ more people, employees in New Zealand now than we did when we started in Mexico.

**Claire Rogers**

Okay. How many is it now then?

**Michael Grenfell Daniell**

*Non-Executive Director*

Oh, our total number in New Zealand is about 1,700 at present.

**Claire Rogers**

1,700. And total headcount across the company?

**Michael Grenfell Daniell**

*Non-Executive Director*

At about 2,600, bearing in mind, a big chunk of the offshore people are in sales and marketing.

**Operator**

Your next question comes from the line of Ian Abbott of Goldman Sachs.

**Ian Abbott**

*Goldman Sachs JBWere Pty Ltd, Research Division*

Just wondering if you could touch on the mask business a little bit more, just perhaps to go into which countries you've launched the Eson and the Pilairo. And also just to get a bit of color around -- I mean, with these launches, you often get a pretty good takeup the first order. Are you at the point where you now are getting stronger pay orders from some of your distributors?

**Paul N. Shearer**

*Senior Vice President of Sales & Marketing*

I'll take this question. It's Paul Shearer speaking. Well, starting with Eson, we're getting very good takeup. The RollFit auto sealing technology is very, very good. It's been very well received. We've had that in Europe since about September, we actually started earlier but the vacation period out there in Europe slowed things down, so effectively didn't get into the market until about September, and we've seen good takeup in Europe. We're getting repeat purchases. In the U.S., we have had Eson now for effectively about 4 weeks. Gain [ph] has been very, very well received. We're getting some repeat purchases. Obviously, a lot of people are just trying it out and getting a feel for it. It's been extremely well received. In sleep beds it's been very well received also. People -- sleep lab technicians just love the feel they're getting. So they see that as being a good opportunity for them. So on Eson, we're getting very, very good reception from it. We're getting very good repeat purchases from it in the market, as we head to longer places like Canada, Australia, Europe, and we expect the same thing to be happening in the U.S. Pilairo, we have had that now in the U.S. for about -- going on over 3 months now. That's had a very, very good reception, both -- largely dealers. We haven't spent as much time in sleep bed, that particular product because we're just selling pretty much what we can make. So therefore, we're having to delay the release in Europe until about December. So we are obviously getting repeat purchase on Pilairo and getting extremely good reception in all the markets where we have released that product.

**Michael Grenfell Daniell**

*Non-Executive Director*

Not often you get a sales guy telling you how easy it is.

**Ian Abbott**

*Goldman Sachs JBWere Pty Ltd, Research Division*

You need to increase his budget, Mike, I think.

**Operator**

Your next question comes from the line of Alex Smith of Citigroup.

**Alexander Evans Smith**

*Citigroup Inc, Research Division*

You've said -- you mentioned that market growth rates were 6% to 8% for OSA, and that there were signs that growth rates could improve in home sleep testing and so forth. Can you just talk to what those signs are and why you think growth rates could improve from here?

**Michael Grenfell Daniell**

*Non-Executive Director*

Yes. Well, the signs that we're seeing in the market are that home sleep testing is gaining traction, that greater proportion of diagnoses are being conducted using HST. That has 2 potential effects. It increases capacity for diagnosis and it also increases the proportion of flow generators that are auto pressure setting

devices, which are high-value device. So we think that given that we expect that trend to continue that, that will eventually result in some lift in market growth.

**Operator**

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

**Nachiket Moghe**

*Morningstar Inc., Research Division*

The RAC business, 11% constant currency growth, was that basically driven by volumes? Or could you give us the split between volumes and price increases in that business?

**Michael Grenfell Daniell**

*Non-Executive Director*

It's primarily volume, although we have had just some modest price increases in some markets, but it's primarily volume.

**Antony G. Barclay**

And favorable product mix.

**Michael Grenfell Daniell**

*Non-Executive Director*

Yes, and favorable product mix. It's worth bearing in mind, as I mentioned, that, that slightly understates our underlying growth because in the first half last year in the U.S., our distribution partner in the hospitals increased their inventory because of some logistic changes. So obviously, we haven't had that same inventory increase this year.

**Nachiket Moghe**

*Morningstar Inc., Research Division*

Yes, yes. And the growth was sort of -- your humidifiers grew 11% as well. That's what you sort of mentioned in the call, is it?

**Michael Grenfell Daniell**

*Non-Executive Director*

Yes.

**Nachiket Moghe**

*Morningstar Inc., Research Division*

And what was driving growth in humidifiers? Because that's been quite outstanding compared to the previous years, right, in...

**Michael Grenfell Daniell**

*Non-Executive Director*

Sure. Two things. There was a brief lull in capital expenditure in hospitals following the global financial crisis. And as humidifier devices are not really capital expenditure, but acquisition of the humidifier can be linked to acquisition of the ventilator, which is more of a capital item. So we've seen that effect reduce. And of course, as we're driving into broader markets with our technology into broader respiratory markets, more humidifier controllers are needed for that, so that's helping to lift the growth rate there as well.

**Nachiket Moghe**

*Morningstar Inc., Research Division*

And then is there any specific market which is showing better growth? Is it Asia that is driving growth there? Or is it Europe? Which markets do you see growth sort of picking up and which markets are doing well in that business?

**Michael Grenfell Daniell**

*Non-Executive Director*

We're seeing very good growth in -- right around the global market. Bear in mind, the U.S. growth would have been slightly less impacted by that inventory build last year. But if we drilled through that, we've seen good growth in the U.S. as well.

**Operator**

Your next question comes from the line of Ian Abbott of Goldman Sachs.

**Ian Abbott**

*Goldman Sachs JBWere Pty Ltd, Research Division*

Mike, yes, I might just have a follow-up, if I could. Just on competitive bidding, have you got any update on when we might hear the outcome of the latest round of tenders?

**Michael Grenfell Daniell**

*Non-Executive Director*

No, we haven't. As I'm sure you know, that, that was scheduled to come out some weeks ago, but perhaps the U.S. election has delayed publishing that information. So we're all sitting waiting for that.

**Ian Abbott**

*Goldman Sachs JBWere Pty Ltd, Research Division*

Right. And I suppose given that, that's not out yet, is it fair to say that it's a bit early for you to have had any discussions with DMEs about how you both progress forward in -- once competitive bidding takes hold?

**Michael Grenfell Daniell**

*Non-Executive Director*

Well, we've had -- I'll get Paul to give some more color on this. We've obviously had many discussions with our customers over the last year or more since the pilot competitive bidding was put in place. And our thrust is helping our customers improve efficiency and effectiveness of their business, but Paul can expand on that.

**Paul N. Shearer**

*Senior Vice President of Sales & Marketing*

Well, pretty much what Mike is saying, Ian. We obviously having ongoing discussions all the time. That's obviously been a hot topic now for quite a period of time. And we are really discussing their customers. They obviously want to drive better pricing where they can, but that's not going to resolve the situation with competitive bidding, if prices come down pretty similar to what's been happening in round one. So they're going to become more efficient. Got to employ technology to kind of drive efficiency, improve their processes, and that's what we're talking to them about, both on compliance, monitoring right through to get the mask that reduce the patient contact and improve the compliance they get, ongoing revenue streams. So there's a lot of work being done in that area, and that's a good opportunity.

**Ian Abbott**

*Goldman Sachs JBWere Pty Ltd, Research Division*

Is it fair to say that -- and is your expectation that -- I think you talked about unit price declines of 3% to 5%. Is that -- you see any reason that, that might change next year?

**Paul N. Shearer**

*Senior Vice President of Sales & Marketing*

Well, it's always hard to predict the future, but we're comfortable with that, that 3% to 5% kind of range that we've always operated in, and we think that's -- moving forward, that seems a sensible model to be working with.

**Operator**

Your next question comes from the line of Matthew Prior of Bank of America.

**Matthew Prior**

*BofA Merrill Lynch, Research Division*

Just a quick question in regards to competitive bidding and the comment just made around compliance systems. I noted with interest that you launched the InfoSmart Infosys kind of program or platform this year, and you've got products like the InfoGSM modem coming out. Can you talk a little bit about the uptake of Infosys amongst your client base, obviously the big DMEs, the mid-tier and then the moms-and-pops down the bottom in terms of how much of that market has Infosys and is using it at this stage?

**Michael Grenfell Daniell**

*Non-Executive Director*

Yes, our InfoSmart system has been very well received. And we're tracking registrations of customers every month, and it's growing at a very fast rate as people take it on board. We're only just really beginning to ship the first volumes of our GSM modem into the North American market at present. So it's relatively early days there. We've been running trials for some time now. Those have been very successful. And we're now broadening availability, so it's looking good. And we're very encouraged by the acceptance of the system we have and the flexibility of the integrated system we have for helping our customers retrieve the data, report on it, put it into their own systems.

**Matthew Prior**

*BofA Merrill Lynch, Research Division*

Great. And if I can just ask one follow-up. We hear a lot about compliance in terms of masks per machine, in terms of patient consumption of consumables. Can you give us an update as to where you see that presently for your business and obviously the trends going forward or more recently with things like InfoSmart?

**Michael Grenfell Daniell**

*Non-Executive Director*

It varies a lot by market and it depends on what the practice in those markets are. The U.S. probably has the greatest usage of masks per patient because the reimbursement regime supports that in the U.S. As you're probably aware that up to 4 masks per year are possible in the U.S. It's probably nearer the 2 masks per year mark at present. There may be some room for a bit of improvement on that. Other markets are probably closer to 1 mask per year. We tend to think that it's a little better than 1 mask per year on average around the world.

**Operator**

There are no further questions in the queue. Please continue.

**Michael Grenfell Daniell**

*Non-Executive Director*

Maybe we will just give one more opportunity since we have some time, and if not we'll end.

**Operator**

[Operator Instructions] We have a further question now from the line of Ray David [ph] from FIM [ph].

**Unknown Analyst**

Just maybe if you can comment on what you think your respective market shares may be within some of your products?

**Michael Grenfell Daniell**

*Non-Executive Director*

We have -- we believe we have the leading position in heated humidification devices used in the ventilator space -- ventilation space around the world, probably better than a 50% market share, maybe higher than that. It's difficult to measure accurately. We have pretty small shares in the -- in some of the new applications we're moving into because we're only just beginning to penetrate what we see as being quite significant opportunities there. It's a little easier to calculate in the OSA business since there are other companies reporting in that space. We think our overall market share in OSA globally is running at about 7% or 8% in total, a little above that in masks and a little below that in flow generators.

**Unknown Analyst**

Okay. And what would be, I guess, your inhibitors to that market share increasing in OSA? Is there any particular challenges that you see? Or is it just more about the product?

**Michael Grenfell Daniell**

*Non-Executive Director*

It's about having great products that our customers prefer. And over the last decade, we've gone from 0 market share in flow generators and masks, and we see a good opportunity to steadily increase that share.

**Operator**

There are no further questions at this time. Please continue.

**Michael Grenfell Daniell**

*Non-Executive Director*

Okay. Thank you, Alvaro. Thank you, everyone, for joining us this morning. As you can imagine, our teams around the world are very excited by the opportunities presented by the new products we've been talking about this morning and the new applications that we are pursuing. I'd really like to acknowledge and thank them all for their outstanding efforts and the results we're achieving. Thanks very much. Bye.

**Operator**

Ladies and gentlemen, that does conclude our conference for today. Thank you for participating. You may all now disconnect.