

Question and Answer

Operator

[Operator Instructions] Your first question comes from the line of Marcus Curley from Goldman Sachs.

Marcus Curley

Goldman Sachs JBWere Pty Ltd, Research Division

Just a couple of questions on the masks, on the OSA masks. Can you give us some sort of color in terms of what makes your nasal pillow unique compared to other offerings in the market?

Michael Grenfell Daniell

Non-Executive Director

It's quite a different approach to the other nasal pillows offering in the market. Obviously, very, very light, very easy to fit, very comfortable and has minimal head gear.

Marcus Curley

Goldman Sachs JBWere Pty Ltd, Research Division

Okay. And so when will the, sort of the public status in a couple of months' time, is that what you're saying?

Michael Grenfell Daniell

Non-Executive Director

We'll be rolling out the first units into Australasia within the next 2 or 3 weeks.

Marcus Curley

Goldman Sachs JBWere Pty Ltd, Research Division

And the reason for a New Zealand-Australia launch, is that a reflection of the fact that, it's sort of a new style of mask for you, and you'd like sort of a slow ramp into sales?

Michael Grenfell Daniell

Non-Executive Director

Eventually, all of our new products are launched in Australasia first. It's obviously close to our R&D base. We also have regulatory processes to go through in other countries. So for instance, the United States requires a FDA 510(k) process, and that can take several months.

Marcus Curley

Goldman Sachs JBWere Pty Ltd, Research Division

And the nasal mask is more of a step-up from what you've got at the moment as opposed to a step change?

Michael Grenfell Daniell

Non-Executive Director

Yes. That's more of an incremental change, but a very worthwhile one. As we said earlier, we believe it to be now the quietest nasal mask in the market.

Marcus Curley

Goldman Sachs JBWere Pty Ltd, Research Division

And from previous comments, you've still got another 2 masks to come?

Michael Grenfell Daniell

Non-Executive Director

Yes, at least 2 more. Yes.

Marcus Curley

Goldman Sachs JBWere Pty Ltd, Research Division

And so that is -- is that more likely to be in next financial year?

Michael Grenfell Daniell

Non-Executive Director

We -- it's either very late this year for one of them and in the next financial year for the next one.

Marcus Curley

Goldman Sachs JBWere Pty Ltd, Research Division

Okay. And then just, Mike, on your guidance comments on the masks, were you suggesting that you're not anticipating growth in masks this year?

Michael Grenfell Daniell

Non-Executive Director

Yes. I think that's a reasonable assumption. Yes.

Marcus Curley

Goldman Sachs JBWere Pty Ltd, Research Division

Okay, reflecting the current momentum in the business and the length of time it takes masks to get up to speed?

Michael Grenfell Daniell

Non-Executive Director

That's right. Yes, yes.

Marcus Curley

Goldman Sachs JBWere Pty Ltd, Research Division

And so you would be thinking that mask revenue growth, you're currently around that 6% to 8%. Yes, so by default, sort of -- my question is, is that a constant currency number you're talking about in terms of market growth levels?

Michael Grenfell Daniell

Non-Executive Director

Market growth levels?

Marcus Curley

Goldman Sachs JBWere Pty Ltd, Research Division

Yes, you said...

Michael Grenfell Daniell

Non-Executive Director

Yes, I guess so. Yes, yes.

Marcus Curley

Goldman Sachs JBWere Pty Ltd, Research Division

So what areas do you think you're losing -- what mask categories do you think you're losing share in and to whom?

Michael Grenfell Daniell

Non-Executive Director

Well, we haven't launched any new masks for some time. So I guess, we're probably fairly even in that regard.

Marcus Curley

Goldman Sachs JBWere Pty Ltd, Research Division

Okay, and -- okay, and then just on the respiratory business, yes, can you give us some color on what the growth was in the existing or traditional products? And where that was coming from, whether it was greater spend per patient or more patients?

Michael Grenfell Daniell

Non-Executive Director

Combination of factors there. In our traditional base, which as you know, is humidification from base of ventilation, as I alluded to earlier, we saw a return to growth in humidifier controllers after we've been -- now that we've fully lapped the effect of the swine flu scare. We believe we're taking market share still. The market is growing, of course, around the world, particularly with an aging demographic and developing markets improving their intensive care capability. What's probably a component in there, our distributor in the United States had some logistics changes, and we think they built a little bit of inventory, so a small component of that as well.

Marcus Curley

Goldman Sachs JBWere Pty Ltd, Research Division

Okay, and then just 2 small housekeeping numbers for Tony. What was constant currency growth in COGS?

Antony G. Barclay

14% for the half.

Marcus Curley

Goldman Sachs JBWere Pty Ltd, Research Division

And what was the operating profit impact from balance sheet translations?

Antony G. Barclay

It was in the order of about 200,000, so very, very small in the half.

Marcus Curley

Goldman Sachs JBWere Pty Ltd, Research Division

Minus 200,000?

Antony G. Barclay

Correct.

Operator

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

Sarndra Ulrich

Jarden Limited, Research Division

I'll make it quick. I'd just -- you may have answered the question already with Marcus, but just to clarify, 11% constant currency growth for the first half, but again with the second half not being -- the flow generators not being as aggressive as the first and second half, the masks really being an FY '13 story, would the constant currency growth for the full year be a little bit under the double digits? Would that be fair to say?

Michael Grenfell Daniell

Non-Executive Director

Somewhere in the -- very, very close to double digits, yes.

Sarndra Ulrich

Jarden Limited, Research Division

So the 9% to 10%.

Michael Grenfell Daniell

Non-Executive Director

Yes.

Sarndra Ulrich

Jarden Limited, Research Division

So the assumption being that RAC would still be in that sort of 14% to 15%, would that be fair?

Michael Grenfell Daniell

Non-Executive Director

Certainly, low to mid-teens, yes.

Sarndra Ulrich

Jarden Limited, Research Division

And also just the -- just so I can clarify with the hedging gains, the \$22 million in the first half, you've disclosed here, in terms hedging gains contributing versus \$16.5 million last year, and so what you're saying now is that apples-to-apples, the second half is \$9 million versus the \$22 million, is that right, Tony?

Antony G. Barclay

The \$9 million is purely the closed-out portion. It was \$8 million of closeout in the first half.

Sarndra Ulrich

Jarden Limited, Research Division

Okay. So \$8 million versus \$9 million?

Antony G. Barclay

So [indiscernible] the \$22 million.

Sarndra Ulrich

Jarden Limited, Research Division

Okay, so that says the \$8 million and the \$9 million, that's a \$17 million, okay, that's your -- another one. Yes, sorry, carry on.

Antony G. Barclay

Are you looking for more of an answer?

Sarndra Ulrich

Jarden Limited, Research Division

Yes, and I get the \$8 million and the \$9 million now. I didn't hear the \$8 million bit before. And the \$22 million you were saying before I interrupted.

Antony G. Barclay

Yes, well, the \$22 million was the guidance for the first half of which \$8 million was from the closeout, so \$14 million was from the regular settlements that we had. And that number will be fairly similar, and the second half will be closer to the \$0.80. [indiscernible] thankfully.

Sandra Ulrich

Jarden Limited, Research Division

Okay. And just in terms of -- you were just talking about before the impact of the economy. And I know that Respirationics has come on a bit more aggressively in pricing. You say that's not necessarily in your space, but is the impact on the economy -- everyone says you're always saying a growing market. Is this purely just people just fearing that spend because it's not necessarily a priority, and particularly in the States? I mean, are you talking about the States and Europe? Or where would the focus be when you're talking about...

Michael Grenfell Daniell

Non-Executive Director

Primarily in the United States. But yes, you can defer diagnosis and treatment for OSA. Not sensible to do so, of course. But it's a fairly long-term chronic disease. So people do defer it, and we think the economy has had some impact there, and to some degree in Europe as well.

Sandra Ulrich

Jarden Limited, Research Division

So the ASP, I mean, that's coming through, that includes some others as well that are ASP impaired, that -- would that be -- even though you sort of -- you refer to again not being in the end of the market, would that ASP be, because it's the higher end of 3% to 5% mark, again is it because people are buying cheaper products? Or what's happening there?

Michael Grenfell Daniell

Non-Executive Director

I guess it's a competitive market particularly when the market itself's growing a little slower.

Operator

[Operator Instructions] Your next question comes from the line of Marcus Curley from Goldman Sachs.

Marcus Curley

Goldman Sachs JBWere Pty Ltd, Research Division

Just in terms of the new building CapEx, I think you said 53 for this year, Tony?

Antony G. Barclay

51, I think it was.

Marcus Curley

Goldman Sachs JBWere Pty Ltd, Research Division

So what's your estimate for the total building cost now?

Antony G. Barclay

It's still at the 95.

Marcus Curley

Goldman Sachs JBWere Pty Ltd, Research Division

95. So how much is that left to run next year?

Antony G. Barclay

I think from memory that's about 20 or just under into next year. We've already had about 15 to 20 in the last year.

Marcus Curley

Goldman Sachs JBWere Pty Ltd, Research Division

Okay, and then on Mexico, obviously, turnaround there in terms of contribution. Have you given any thoughts in terms of, I think your previous guidance some time ago was sort of, I think, around \$20 million from the end target for Mexico. Has that been revisited recently? Is that still relevant and...

Antony G. Barclay

It is and it has, Marcus, and I think we might have indicated at the annual shareholders meeting in August, we're looking accelerate our growth and capacity in Mexico, is somewhat dependent on exchange rates, of course, the actual saving but we've now got a \$30 million target in mind.

Marcus Curley

Goldman Sachs JBWere Pty Ltd, Research Division

And any guidance on what year -- what financial year that's realistic to occur in?

Michael Grenfell Daniell

Non-Executive Director

That'll be ramping up from where we are now over the next, call it, 4 years or so.

Marcus Curley

Goldman Sachs JBWere Pty Ltd, Research Division

Okay. So this year is year one of the 30 with 3 more or...

Michael Grenfell Daniell

Non-Executive Director

May well call this one, yes, I think more like, yes, it's 0. Yes, near 0 now.

Marcus Curley

Goldman Sachs JBWere Pty Ltd, Research Division

Okay. And then obviously, the Americans couldn't come to any conclusions overnight on reforms. Has the prospect of healthcare cuts kept you up at night, have you got any views on whether it's going to be material to your sales in the U.S.?

Michael Grenfell Daniell

Non-Executive Director

Yes, well in theory, it's never helpful if your customers aren't getting paid as well. But if you look at the hospital scene, we've got a number of new products and products we've introduced in the recent past that are aimed at helping to improve care and outcomes and efficiency of care. And we're getting some pretty positive feedback in that arena. So we're seeing it as an opportunity.

Marcus Curley

Goldman Sachs JBWere Pty Ltd, Research Division

Okay, and then finally, you've produced pretty good operating leverage this year. Should we be anticipating the ability to sort of repeat that or repeat the ability to grow your cost below sales next year? Or is that going to be simply limited to the Mexico benefits?

Michael Grenfell Daniell

Non-Executive Director

We -- because we've put quite a bit in place over the last -- the prior 2 years, if you like, we see an ongoing opportunity in the new financial year as well to generate some operating leverage.

Marcus Curley

Goldman Sachs JBWere Pty Ltd, Research Division

Okay. In addition to Mexico or...

Michael Grenfell Daniell

Non-Executive Director

Yes. In addition to Mexico.

Marcus Curley

Goldman Sachs JBWere Pty Ltd, Research Division

Yes, so, okay. And then finally, dividends. The Board decided to, obviously, hold the dividend, I suppose from memory last time when you spoke about the dividend, the expectations, I think, were that -- earnings were going to be growing this year, and hence the reason why dividends were retained last year. But looking at guidance, it looks like a flat year. Yes, can you give some color in terms of, given that your growth stopped, why the dividend is still being maintained?

Michael Grenfell Daniell

Non-Executive Director

Paying a dividend isn't inhibiting our growth in any way and we did quite a large shareholder base who appreciate the dividend. So the Board policy's remains as it's been expressed and I think reiterated at the shareholders' meeting that the intention is to hold dividend and grow it as earnings growth allows. Of course, exchange rate headwinds have made that difficult to grow it in absolute terms, but the plan is to pay a dividend.

Antony G. Barclay

Well, I think, Marcus, it's still an objective of reducing the percentage payout over time as the earnings lift over time as well, to being something closer to 60% of the tax-pay profit.

Marcus Curley

Goldman Sachs JBWere Pty Ltd, Research Division

Sure. So we shouldn't be forecasting absolute levels of dividend to decline unless things go a lot worse?

Antony G. Barclay

In terms of currency, yes.

Operator

The next question comes from the line of David Lowe [ph] from Deutsche Bank.

Unknown Analyst

Mike, if I could just come back to your comments on the market growth in the OSA space, just wondering whether -- what your thoughts were on new patient's device sales versus mask sales, and whether there's much differential between the 2?

Michael Grenfell Daniell

Non-Executive Director

It's very hard to measure given the reducing amount of disclosure in this area, so no, I don't have any particular data on that.

Unknown Analyst

I mean I guess I'm looking at ResMed's numbers where they're seeing mask sales up 20 and device is going backwards, and that would imply that new patients on new devices, if their numbers are at all representative, I mean, I guess, do you have any sense as to whether there's a...

Michael Grenfell Daniell

Non-Executive Director

If you're thinking the economy is having an impact, presumably that has an impact on new patients of people who are deferring diagnosis. It may have an impact on the replacement cycle as well, given that patients do pay a proportion of the cost.

Unknown Analyst

Right. And homes lead testing as a theme or a trend, I mean, do you have any sense as to whether that's yet important or growing?

Paul N. Shearer

Senior Vice President of Sales & Marketing

Yes, it's Paul here, David. Yes, it is a growing trend. And in parts of the States, we have seen a growing trend in that area.

Unknown Analyst

And is that helping or would that be boosting growth? Or is it a disruption because you're converting from labs to homes lead testing? And maybe is your read, is it positive or neutral?

Paul N. Shearer

Senior Vice President of Sales & Marketing

I think it's just been positive because hopefully, it'll mean that, there may be more diagnoses as people prefer to be diagnosed in the home than the lab. And there's been an increasing trend to auto CPAP which is good for the industry, too, as people do titrations in the home.

Unknown Analyst

Okay, so I presume the trend, you're seeing the trend towards auto setting devices in your mix?

Paul N. Shearer

Senior Vice President of Sales & Marketing

I guess we are.

Unknown Analyst

Yes, all right. And just a final one, competitive bidding, I mean, we've -- it's been rolled out in the 9 cities, and we got the 90 cities to follow. Again, probably one that we're struggling to get a clear read on whether there's -- what the actual impact is. Is your -- any sense as to how it's played out so far and what we should expect?

Michael Grenfell Daniell

Non-Executive Director

Yes, well, that's a while off yet. And so at the moment, it's pretty much business as normal, and I guess we're going to see what transpires at a future date.

Unknown Analyst

I mean, when you say it's a way off, I mean, it's introduced in the 9 cities, so I guess that's still a pretty small part of that market. And you wouldn't have noticed any obvious trends in those regions?

Michael Grenfell Daniell

Non-Executive Director

The knee jerk obviously of is people who are voluntarily put down to lower pricing is to want lower cost. Our response is that well, it's important for those patients to be compliant. And so using devices that are

the most attractive to the patient and comfortable, and we've got an increasing emphasis as the market does on compliance recording and monitoring, so it's helpful in that sense.

Unknown Analyst

Okay. I guess the other trend I'm worried about is the consolidation amongst distributors, given price comes down you need scale to be profitable. Now whether there's any evidence of that, I'm struggling to find. Any comments on that at all?

Michael Grenfell Daniell

Non-Executive Director

We don't have any particular data on that area, either.

Operator

The next question comes from the line of John Hester from LINWAR Securities.

John Hester

ANZ Equities Pty Limited, Research Division

Mike, would you care to expand at all if you can on your spectacular growth in your flow generator sales, 47% growth. Can you talk about mix or mix between high and low-end devices and where you saw the most of the growth. I know we've already alluded to auto set devices going really well, and perhaps on a geographic mix as well?

Michael Grenfell Daniell

Non-Executive Director

Yes. Well, obviously, that's on the back of our launch of ICON which really only started getting momentum in the latter part of the first half last year. So we are lapping a period where we didn't have much ICON, and now of course ICON is the majority of our flow generator sales. We are getting a premium price for ICON as well, which helps. We've seen good growth in all of the geographies where ICON is available, which is most of them. There's 1 or 2 holdout countries that have very long regulatory cycles. So I mean, the reason for it is ICON. But as we mentioned earlier in the call, we do need to anticipate that we are now beginning to lap the full introductions, so those spectacular levels of growth are unlikely to continue.

John Hester

ANZ Equities Pty Limited, Research Division

Sure. And you may have heard ResMed talking about problems specifically in the low end, and you said that you don't participate in that section of the market. So I suppose, how is that manifesting in your sales of your lowest end device? Is there any effect at all?

Michael Grenfell Daniell

Non-Executive Director

We -- it's only a very small part of our revenue, is that really bottom end. We are very much a value-add kind of company. We have particular features that help with compliance and with monitoring compliance, and it really is not part of the market that we really play in.

John Hester

ANZ Equities Pty Limited, Research Division

Okay, then. And just moving on, can you talk a little bit more about the AIRVO product which was launched a little over 12 months ago, I believe, and how that's gone?

Michael Grenfell Daniell

Non-Executive Director

Yes, well, off a small base because it is very new. We are seeing very strong growth in AIRVO, and positive feedback. We're primarily in the hospital setting with the AIRVO at present. Obviously, the long-term

opportunity is in the home setting to help keep those patients out of hospital. But we're getting very positive feedback on AIRVO.

John Hester

ANZ Equities Pty Limited, Research Division

And from the distributors in the home setting who distribute AIRVO to the home setting, I mean, are they appointed now, and have they got the product? Or is it still in an acute setting?

Michael Grenfell Daniell

Non-Executive Director

It's primarily in acute with some that's going into the home. We need to get the physicians in the hospital prescribing the device, of course, and then sending their patients home with it, or alternatively patients they have in the home prescribing it. So we're in that process at present.

Operator

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

Michael Grenfell Daniell

Non-Executive Director

Amy, I just might like to give one more opportunity before we close off the call.

Operator

[Operator Instructions]

Michael Grenfell Daniell

Non-Executive Director

Okay. Well, it sounds like we've answered everything. Great to have you along on the call again. Thanks for joining us, and we'll talk to you again next year. Thank you. Bye.

Operator

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