

Question and Answer

Operator

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

Tristan Joll

UBS Investment Bank, Research Division

Just one question on RAC to start with. I recall back at the AGM, I think you said that you're expecting 18% constant currency growth in the half, and I see today, it's 14%. So I was just wondering what, if anything, what's the major driver behind that change over what is relatively a short period of time?

Michael Grenfell Daniell

Non-Executive Director

Yes, so Tristan, we did get caught by surprise by our U.S. hospital distributor quite suddenly deciding they had run their inventory up a little high and then reducing it quite late in the half. And that was the primary reason for it. It turns out they actually built inventory earlier in the year unbeknownst to us, and that caused us to maybe forecast a little high as well.

Tristan Joll

UBS Investment Bank, Research Division

Okay. So I mean, that really doesn't, like you said, influence your -- the longer-term outlook that you were mentioning at the AGM [indiscernible]?

Michael Grenfell Daniell

Non-Executive Director

Oh, no, absolutely not.

Tristan Joll

UBS Investment Bank, Research Division

Okay. And then just with the OSA, I hear your comments around product mix offsetting the underlying decline, are you able to give us any color about whether those underlying declines have increased in the U.S. subject to competitive bidding? Or are you seeing anything different in the U.S. to what you're seeing in the rest of the world, I guess is the question?

Antony G. Barclay

Paul will comment on that.

Paul N. Shearer

Senior Vice President of Sales & Marketing

Tristan, you're referring to price decline in the U.S. So in terms of flow generators we've -- and masks, we're very much within that 2% to 5% range. And so we're pretty much as normal, and we're getting a premium for our new technology and our new mask technology, so we're selling those at higher prices than we are with our -- the more older [ph] type of masks.

Tristan Joll

UBS Investment Bank, Research Division

Okay. So I mean, you're effectively saying that the mix change is overriding anything that you could see from competitive bidding.

Paul N. Shearer

Senior Vice President of Sales & Marketing

That's certainly yes.

Tristan Joll

UBS Investment Bank, Research Division

Okay, it's pretty positive. I mean, the other -- just the other question on OSA was -- I see you've given underlying revenue growth for -- or total and then net of the SleepStyle. Can you tell us what percentage of sales is now reflected by ICON against the SleepStyle?

Michael Grenfell Daniell

Non-Executive Director

For OSA flow generators, ICON is around nearly 90% now. So the SleepStyle, as you would expect and as we expect, is becoming pretty small now.

Tristan Joll

UBS Investment Bank, Research Division

Okay. And then one more, if I can, just on the hedge gains, obviously, it was not an even distribution of the noncash closeouts. What kind of hedge gain is baked into the full year guidance, if I can ask that? Presumably, it dips down a little bit in the second half is what I'm getting at.

Michael Grenfell Daniell

Non-Executive Director

Yes. I mean, you can always ask Tristan. We're looking at something depending, obviously, on where the currency sits of around the sort of low 20s in the second half, and that there's only effectively 2 months, this last month and November, that we have the closeout gains available to us.

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 more for me. Firstly, on OSA, you obviously talked about your second quarter pickup in flow gens to a fairly encouraging level. Can you talk a little bit about what you're seeing in masks in that second quarter? Has that -- has the 19% sort of altered a lot during the half?

Antony G. Barclay

Pretty consistent, Marcus. Bearing in mind, we are still rolling out masks, in particular Pilairo Q and Simplus, into the biggest market and to United States. So we're seeing -- we saw pretty consistent growth, and well, we're hoping it might improve a bit more yet.

Marcus Curley

Goldman Sachs Group Inc., Research Division

Yes. I suppose if you put those 2 numbers together, it would suggest you have into [ph] the second half in the high teens rather than low teens, I would say.

Antony G. Barclay

Well, we're not going to give explicit guidance for each half of the business, but that's certainly what we're hoping to do.

Marcus Curley

Goldman Sachs Group Inc., Research Division

And then just you talked about the inventory distortion in the RAC business. Under the -- if you x that out, what sort of performance did you see from your core sort of intensive care business in terms of sort of underlying demand dynamics there?

Michael Grenfell Daniell

Non-Executive Director

That's consistent with what we normally expect, which is in the mid, high single-digit range. And then you have those new applications growing at 29%, which guide the overall result.

Marcus Curley

Goldman Sachs Group Inc., Research Division

All right, okay. So there wasn't x inventory, you're still seeing clearly positive growth?

Michael Grenfell Daniell

Non-Executive Director

Yes, yes, definitely. And the inventory [indiscernible], if you like, apply reasonably evenly across the business.

Marcus Curley

Goldman Sachs Group Inc., Research Division

Okay. And thirdly, on gross margin, you talked about your 1% to 2% guidance ongoing. Obviously, it was a lot more than that in the half. Are you expecting some level of resolution [ph] in the second half with regard to your gross margin performance?

Michael Grenfell Daniell

Non-Executive Director

I believe we are.

Marcus Curley

Goldman Sachs Group Inc., Research Division

So for this year it will be much higher than that sort of 1% to 2%?

Michael Grenfell Daniell

Non-Executive Director

Certainly, for the full year, we're still forecasting, Marcus, to be above 200, probably closer to 250 for the full year. But certainly not as much in the second half as we've, I guess, we've got quite a bit of a product mix already baked in that we've received, if you like, in the first half, more to come but not to the same level. But certainly, the second half is at the upper level of the 100 to 200 that we're kind of guiding to on a regular basis.

Marcus Curley

Goldman Sachs Group Inc., Research Division

Okay. So the second half is a standalone on the second half of last year, at the upper end of the 200 rather than -- so you have...

Antony G. Barclay

Of the 100 to 200, yes.

Operator

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

Sarndra Ulrich

Jarden Limited, Research Division

All of my excellent questions have been stolen, and I haven't even got one to make up. But usually [ph], I don't like to miss out, so I'm just going to ask about RAC in the second half. In terms of -- if you're looking at mid-teen guidance in the second half and you're talking about potentially [indiscernible] or

hypothetically high teen OSA, does that mean RAC could be sort of more towards the 10% to 11%, if you talk about the flu season, comparing this to the flu season of last year or have I got my timing wrong on that?

Michael Grenfell Daniell

Non-Executive Director

[indiscernible] We are expecting OSA growth, constant currency, to be higher than RAC in the second half, and we are allowing for that big spike up in the flu season last year.

Sandra Ulrich

Jarden Limited, Research Division

Okay. So if RAC were closer to, I don't know, [indiscernible], don't read much into it.

Michael Grenfell Daniell

Non-Executive Director

Of course [indiscernible]...

Operator

Your next question comes from Nachi Moghe from Morningstar Research.

Nachiket Moghe

Morningstar Inc., Research Division

Just on the -- I think Michael mentioned about the flow generator growth in the second quarter of 12%. That is including SleepStyle, is it?

Michael Grenfell Daniell

Non-Executive Director

Yes, it is. That's all flow generators, yes.

Nachiket Moghe

Morningstar Inc., Research Division

Okay. And just on the OSA business, does the OSA business also include revenues from Evo [ph]? And I'm just wondering, how is that progressing?

Michael Grenfell Daniell

Non-Executive Director

The Evo [ph] product line staddles both the OSA in the sense that we think of OSA as home care and RAC, so some Evos [ph] in OSA and some of them RAC. And off a small base, it's going very well.

Nachiket Moghe

Morningstar Inc., Research Division

Okay, cool. And could you also give us some color on how the -- just the home sleep testing is progressing in the U.S. and how big is the home sleep testing at the moment?

Paul N. Shearer

Senior Vice President of Sales & Marketing

It's Paul here. Yes, it's progressing very well. We think probably out of all sleep tests, home sleep test are probably 25% to 30% of sleep tests done in the United States. And so a lot of [indiscernible] are getting involved on sleep testing. So we're seeing that accelerating. But at the moment, it's hard to get hard fixed number. We think it's -- between 25% to 30% of all tests are home sleep tests.

Nachiket Moghe

Morningstar Inc., Research Division

Yes. So that's sort of boosting the market growth overall, is it? So the market growth now more like 8% than 6% now for OSA?

Antony G. Barclay

It's very difficult to give a hard number on that. We're the only company now that's reporting OSA revenue explicitly. The other guys who report have got other categories in their revenue. So we are hearing market growth of 6 to 8. We concur with that. But to get more granular, that is impossible today.

Nachiket Moghe

Morningstar Inc., Research Division

Right, right. And just on the distributed products business, did that business actually go backward in the first half and...

Antony G. Barclay

Yes, it did. And we've been signaling for some time that we have some legacy products there that we're not expecting to grow. And in fact, we're expecting it to decline. And that's in the distributed and other category.

Nachiket Moghe

Morningstar Inc., Research Division

Yes, so that will continue to the decline is it, going forward, isn't it?

Antony G. Barclay

We think so. Yes, yes, we do.

Nachiket Moghe

Morningstar Inc., Research Division

Yes, and just in terms of your direct sales and the benefit sale you have achieved so far, so can we expect further sort of benefits over and above what you achieved in terms of direct sales of the products [indiscernible] which are not present at the moment?

Michael Grenfell Daniell

Non-Executive Director

Well, as you know, we've recently gone to a direct sales model in South Korea, and previous to that, Japan. We're seeing great growth out of both of those markets. And so they're contributing well, and we expect them to continue to, and yes, in the longer term, there will be other opportunities there, but nothing that we -- is pending or that we are talking about.

Nachiket Moghe

Morningstar Inc., Research Division

Yes. And just lastly on capital expenditure, so over the next few years, could we expect capital expenditure to be around the second half sort of run rate going forward?

Antony G. Barclay

Well, certainly, when we're not on a regime of needing to build a facility, Nachi, we tend to be somewhere in the 5% to 6% of revenue being CapEx for the new tooling production lines and some replacement CapEx. Those are the sort of percentages that you should be thinking about in the near term.

Operator

[Operator Instructions] There are no further questions at this time. Please continue.

Michael Grenfell Daniell

Non-Executive Director

Thank you, Reagan, and thank you, everyone, for joining us this morning. We're obviously pleased with the results we're achieving, and that, of course, is due to our team around the world. They're doing a great job, and we'd really like to acknowledge them for their success. Thanks again for joining us, and we'll talk to you next time.