

# Question and Answer

## Operator

[Operator Instructions] Your first 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. Could you just talk a little bit about the dropoff in SleepStyle flow generator sales in the second half, whether that was cannibalization, whether it was share loss or whether it was just yes, the shift in yes, from the market away from a lot of price devices up to all those in operating devices?

### **Michael Grenfell Daniell**

*Non-Executive Director*

A combination, Mark. It's clearly quite a little bit of cannibalization with ICON growing strongly. But at the bottom end of SleepStyle, we're not really actively pursuing business at the bottom in there any longer. They are very low cost units. We're putting the emphasis on the ICON and the highest value items.

### **Marcus Curley**

*Goldman Sachs Group Inc., Research Division*

Does that reflect the fact that there's no money to be made at the bottom end anymore?

### **Michael Grenfell Daniell**

*Non-Executive Director*

Margins are, they're not very attractive there. They're not a sensible product for our customers to be using them in many cases. They need full compliance recording and reporting capability. And the benefits of improved compliance that come with a better unit with little humidity and the like.

### **Marcus Curley**

*Goldman Sachs Group Inc., Research Division*

And then, such, can you just a feel in terms of at this moment in time, how much SleepStyle would make up of flow generator sales, I mean, how long have we got to go to see this sort of dissipate out of the business?

### **Michael Grenfell Daniell**

*Non-Executive Director*

I think we've got at least a year yet, of SleepStyle ramping down.

### **Marcus Curley**

*Goldman Sachs Group Inc., Research Division*

Okay. And then just maybe just on Mexico, could you just provide a little bit more color in terms of the level of benefit that you saw in FY '12 versus the cost in FY '11 and where you expect that to go in FY '13?

### **Michael Grenfell Daniell**

*Non-Executive Director*

Yes -- FY '11, if I recall correctly, was about a NZD \$4 million cost, and setting up in Mexico and beginning manufacturing there. We saw about a \$4 million benefit in FY '12. And we're looking for that to be more on the \$7 million, \$8 million range in FY '13.

### **Marcus Curley**

*Goldman Sachs Group Inc., Research Division*

And then just with regard to guidance, Mike, you referred to, I suppose revenue growth going from current levels up towards mid-teens and that driving constant currency growth, I think of 15% to 20% at the profit level, so the offset to Mexico, is the factory cost, and you have, I think you'll be assuming the U.S. duty costs are unrecoverable, does that sort of what's back in the...?

**Michael Grenfell Daniell**

*Non-Executive Director*

The quantity that Tony gave you for the quarter that, that would apply for was taking into account a small amount of recovery, but largely not recoverable.

**Marcus Curley**

*Goldman Sachs Group Inc., Research Division*

Okay. And then -- and so \$2 million for the building costs, so I think it could be \$8 million on an annualized basis.

**Michael Grenfell Daniell**

*Non-Executive Director*

For -- yes. Well because that's going to be a big step up in capacity for us in terms of R&D and the like in future, so if I -- that's inevitable.

**Marcus Curley**

*Goldman Sachs Group Inc., Research Division*

And then, just, Tony, just on hedging benefits for FY '13, can you just give us a sort of a broad indicator of what sort of number is baked in, it's sort of the midpoint of the currency, if you like?

**Antony G. Barclay**

*Consultant*

We'll have that. I'll give you either end. In relation to the 18 end of the scale, we are on the sort of \$43 million Kiwi mark and at the 75 a little obviously less, around the \$30 million mark.

**Operator**

The next question comes from the line Jason Familton from First NZ Capital.

**Jason Familton**

*First NZ Capital Limited, Research Division*

Just a couple of questions, if I may. Just on Mexico, I'm just wondering what just capacity utilization is in that factory at the moment I guess the benefit you talked about into full year '13 and potentially beyond?

**Michael Grenfell Daniell**

*Non-Executive Director*

We're using less than half of its capacity in terms of the floor area. And we expect to continue to ramp up every year over the next 3 years or so, and get to about half of our consumables out for -- coming out of Mexico, maybe a bit more in fact, we have capacity there.

**James Schofield**

*Deutsche Bank AG, Research Division*

Okay. And do you think on just on that CapEx number, obviously ramping up non Building 3 CapEx from around \$17.5 million to \$30 million next year? Just wondering whether you can outline where that CapEx is going to be spent and I guess what on?

**Michael Grenfell Daniell**

*Non-Executive Director*

We've got quite a broad range of new products coming through, as I alluded. Some that we've already introduced and that we'll be adding more capacity on as sales ramp up. And other products we haven't yet introduced, but obviously there's quite a bit of tooling and manufacturing equipment and then subsequent capacity ramp up.

**Operator**

Your next question comes from the line of Tristan Joll, from UBS.

**Tristan Joll**

*UBS Investment Bank, Research Division*

Couple of things have already been asked, but I guess, just on that flow generator growth of 18% at constant currency. Can you give us some sort of indication what part of that relates to volume versus parts?

**Michael Grenfell Daniell**

*Non-Executive Director*

It's pretty equal because, as I think I might have said earlier, any price decline has been offset by a positive mix shift with ICON being a better pricing then SleepStyle.

**Tristan Joll**

*UBS Investment Bank, Research Division*

Okay. So that's the price part of it. But what would be the actual split volume price in the '18?

**Michael Grenfell Daniell**

*Non-Executive Director*

Well, the 2 are the same, that's I guess what I'm saying is that the volume and price largely matched.

**Tristan Joll**

*UBS Investment Bank, Research Division*

I'm sorry, okay. Excuse me. The other question I have is just around, home sleep testing and clearly that's structurally a very good trend. I just wondered whether you're seeing any volatility in terms of that transition, whether it's creating any lumpy sales behaviors?

**Michael Grenfell Daniell**

*Non-Executive Director*

We've heard that suggested that there's obviously been a teasing as referrers and providers adjust to providing home sleep testing. So in fact, when it first began it may well have caused a decline in capacity with labs putting on more beds. So it has probably caused some lumpiness. But we're starting to get the feeling that it's moving out of that phase now and will start to become beneficial.

**Operator**

Your next question comes from the line of David Low from Deutsche Bank.

**David Low**

Maybe if I could just follow up on the question on home sleep testing. My -- have you got any sense as to what percentage of patients are going through that channel now?

**Antony G. Barclay**

*Consultant*

I can't say [indiscernible]

**Michael Grenfell Daniell**

*Non-Executive Director*

Well David, I mean, we don't really know. It's [indiscernible] I guess, we're the second rounded out at 15% and growing.

**David Low**

Yes, okay. There was the comment made a bit earlier in the presentation about compliance and how important compliance data is. One of the things that's still a little bit unclear on is, it's clear that Medicare is collecting compliance data. I'm just wondering what your sense is as to what the managed care organization's requirements are there? I don't think that we put similar rules into place on all of their patients?

**Michael Grenfell Daniell**

*Non-Executive Director*

That's a difficult question to answer concerning variables, some organizations are requiring data. A lot of them aren't requiring data, so...

**Antony G. Barclay**

*Consultant*

I think the trend right now is that question actually you got, David?

**Lewis G. Gradon**

*MD, CEO & Executive Director*

The trend and if we start thinking globally here, is the trend does awards more and more providers with requesting their data. We're seeing it beginning in at more other companies in the world now.

**Michael Grenfell Daniell**

*Non-Executive Director*

And that will push up the value chain presumably as that requirement's needed.

**David Low**

And final question, competitive bidding is seemingly a very hot topic in the sleep space as well in the U.S., and with a lot of fears as to what it might mean to manufacturers. I'm just wondering what your expectations are on how that'll play out?

**Michael Grenfell Daniell**

*Non-Executive Director*

Well, we're being pretty consistent. And this is -- it's never a great thing when your customers are under reimbursement pressure from their customers, if you like. But then that's a voluntary thing. Those dealers are setting those prices themselves in return for increased volume. And when they've got increased volume it's more important than ever that those patients are compliant with the therapy. So as they get paid for setting up their patients, and so they get the benefits of the ongoing revenue. And that's where having great systems, easy-to-use, comfortable flow generators and masks, very efficient collection of their compliance data, the ability to intervene if the patient's not compliant, to help them become compliant becomes increasingly important. So we see it as an opportunity for our technology.

**David Low**

You're not worried that the other side of it is that those that win these bids will be coming back to their suppliers asking for better pricing?

**Michael Grenfell Daniell**

*Non-Executive Director*

Of course, I'll be asking.

**David Low**

And your expectation in terms of how much you need to give?

**Michael Grenfell Daniell**

*Non-Executive Director*

Well, the price is in round 1. As they bid, we're pretty much equal to whole value that we receive. So the discount they offered. So we're not anticipating any significant change in our pricing.

**Operator**

[Operator Instructions] There are no further questions from the phones. Back to you.

**Michael Grenfell Daniell**

*Non-Executive Director*

We'll just -- Gianno, we'll just give people one more shot at it before we conclude.

**Operator**

A question has come through from the line of Stephen Ridgewell from Macquarie.

**Stephen Ridgewell**

*Macquarie Research*

Just a question on constant currency gross expectations for '13. A moment ago you said that's more of a split on -- for the OSA business, what you might be expecting for masks in the first half versus the second half and also for flow generators, first half, second half?

**Michael Grenfell Daniell**

*Non-Executive Director*

Yes. We are, as we said earlier, expecting kind of mid single-digit growth in the first half overall and moving into the teens, more mid-teens, hopefully in the second half. It's fairly consistent for both halves of our business, the RAC and the OSA components of the business. The driver in OSA, we expect to be significantly from masks, as our new masks gain traction. And we also expect flow generator growth to move up again as well, as we get traction with our response relief and SensAwake and the Premo, so reasonably symmetrical at this point.

**Operator**

We have another question from the line of Marcus Curley from Goldman Sachs.

**Marcus Curley**

*Goldman Sachs Group Inc., Research Division*

Just on that point, why do you anticipate your respiratory business sliding from 13% to mid-single-digit?

**Michael Grenfell Daniell**

*Non-Executive Director*

Well, hopefully it won't.

**Marcus Curley**

*Goldman Sachs Group Inc., Research Division*

Okay. But you're not seeing anything, sounded like, the exit run rate on Q4 was actually stronger than '13.

**Michael Grenfell Daniell**

*Non-Executive Director*

Yes, so in first half, we're expecting we're up against that \$7 million headwind of inventory build in the U.S. So that's what's driving that. But your second half mid-teens seems to be a pretty good target, doesn't it?

**Operator**

We have got a question from the line of Andrew Goodsall of UBS.

**Andrew Goodsall**

*UBS Investment Bank, Research Division*

Perhaps I'm just going to ask you to expand a little bit more on Europe, I guess just to help our understanding of sort of where that's -- that we're hearing things, just of people are reluctant to make decisions at the moment there, so if just ask a little bit to expand a little bit more?

**Paul N. Shearer**

*Senior Vice President of Sales & Marketing*

It's Paul here, Andrew. What we're finding our business is going pretty well in Europe overall. I mean that it's not less about economic uncertainty. We're not very capital intensive. So from the capital side of the business, we don't, again it doesn't really [indiscernible] of us too much, because, yes, on the largely, most of our products through the consumable low value capital, around \$1,000 type of thing. So certain geographies are bigger than others. Obviously in Europe, it has been more difficult in places like the sadly, U.K., Ireland, Spain, Italy. But overall, our business has come through pretty well. It's been largely unaffected.

**Andrew Goodsall**

*UBS Investment Bank, Research Division*

Just a final one. And just on Asia Pac. Just what you're seeing, I guess in particular, a place like Japan?

**Michael Grenfell Daniell**

*Non-Executive Director*

Well, as you know, we changed our distribution model in Japan about 18 months ago, maybe 2 years ago, now. And that transition has gone extremely well for us. And has driven good growth, obviously, now that we're selling directly from some distributors in Japan at better pricing. And we are driving ongoing good growth in Japan. And then when you look broader in Asia-Pacific, countries like China, for instance, are growing at a double or triple the rate as the rest of the business, off a smallish base, and becoming more and more significant to us.

**Operator**

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

**Alexander Evans Smith**

*Citigroup Inc, Research Division*

I haven't seen the release. You're talking about trying to bring gearing down to the 5% to 15% level. And I guess monetizing hedges as being important contributors to cash certainly in '12 and '10. And you mentioned it's harder to do that going forward. Does the desire to reduce gearings still give you sufficient room to continue to pay the \$0.124 dividend?

**Antony G. Barclay**

*Consultant*

It's Tony here. I think absolutely. Clearly, we'd like the currency to be a bit louder than it was to the system yet within trump. But decrease to note the target there, and we'll get there it might just take slightly longer if we see how our currency with the dividend that this stage is locked in.

**Alexander Evans Smith**

*Citigroup Inc, Research Division*

Longer-term, I mean how critical is it for the currencies to reverse?

**Michael Grenfell Daniell**

*Non-Executive Director*

It's not critical. It'll be helpful, obviously. But we've got a very firm strategy of culminating permanent weaker U.S. dollar, stronger Kiwi. And they're tinged around, the new products are introducing, our higher margin products growing at faster rates. We've obviously got the benefit of Mexico as well. And we've got other efficiencies we're taking in the business. So we confident we can accommodate no hedging in the future against these or higher exchange rates, but it's always nice if we get a bit of assistance as well.

**Alexander Evans Smith**

*Citigroup Inc, Research Division*

And does the SG&A spend start to decrease? Or is the as the facilities there remain, come online and come up to speed?

**Michael Grenfell Daniell**

*Non-Executive Director*

If you think about the guidance this year of \$60 million, half of it is building. So if we run into '14 at the same sort of run rate, we'll be having the CapEx due. From a cash flow point of view, that's all positive as well.

**Operator**

[Operator Instructions] There are no further questions at this time. Back to you.

**Michael Grenfell Daniell**

*Non-Executive Director*

Okay, great, thanks Gianni [ph]. And thanks, everyone, for joining us on the call. I'd just like to conclude by saying that our teams around the world are particularly excited by the opportunities presented by the new products that we've rolled out, and will be rolling out, and also the new applications that we're working on. We would really like to acknowledge -- thank the team for their outstanding efforts and the results that we're achieving. Thanks very much.

**Operator**

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