Q2 2019 Earnings Call

Company Participants

- Calvin Darling, Senior Director of Financial Investor Relation
- Gary S Guthart, President and Chief Executive Officer, Member of the Board of Directors
- Gary S. Guthart, President and Chief Executive Officer, Member of the Board of Directors
- Marshall L Mohr, Executive Vice President and Chief Financial Officer
- Marshall L. Mohr, Executive Vice President and Chief Financial Officer

Other Participants

- Amit Hazan
- Analyst
- David Lewis
- Imron Zafar
- J.P. McKim
- Larry Biegelsen
- Richard Newitter
- Robert Hopkins
- Tycho Peterson

Presentation

Operator

Ladies and gentlemen, thank you for standing by. Welcome to the Intuitive Surgical Q2 2019 Earnings Release Call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session, instructions will be given at that time. (Operator Instructions)

I would like to turn the conference over to our host. Mr.Calvin Darling, Senior Director of Finance Investor Relations. Please go ahead.

Calvin Darling {BIO 17664656 <GO>}

Thank you. Good afternoon and welcome to Intuitive second quarter earnings conference call. With me today, we have Gary Guthart, our CE; and Marshall Mohr, our Chief Financial Officer.

Before we begin, I would like to inform you that comments mentioned on today's call may be deemed to contain forward-looking statements. Actual results may differ materially from those expressed or implied as a result of certain risks and uncertainties. These risks and uncertainties are described in detail in the company's Securities and Exchange Commission filings, including our most recent form 10-K, filed on February 4, 2019 and 10-Q, filed on April 19, 2019. Our SEC filings can be found through our website or at the SEC's website. Investors are cautioned not to place undue reliance on such forward-looking statements.

Please note that this conference call will be available for audio replay on our website at intuitive.com on the Latest Events section, under our Investor Relations page. In addition, today's press release and supplementary financial data tables have been posted to our website. Today's format will consist of providing you with highlights of our second quarter results as described in our press release announced earlier today, followed by a question-and-answer session. Gary will present the quarter's business and operational highlights. Marshall will provide a review of our second quarter financial results. Then I will discuss procedures and clinical highlights, and provide our updated financial outlook for 2019. And finally, we will host a question-and-answer session.

With that, I will turn it over to turn it over to Gary.

Gary S Guthart {BIO 3429541 <GO>}

Thank you for joining us today. This second quarter of 2019 was a solid one for Intuitive with healthy customer interest and demand for our products. Overall, procedure growth met our expectations while capital placement succeeded them. Global procedure growth was approximately 17% in the second quarter of 2019. Growth again centered on general surgery in the United States with positive contributions to the global growth rates from Germany, France and Japan. In China, we are pleased with procedure performance, given the recent release of systems under the new quota.

Turning to the United States year-over-year growth in the quarter was 16%. General surgery growth again accounted for the largest increase year-over-year, accompanied by expected moderation of growth in US urology and gynecology. Underlying this performance, we saw continued strength in bariatrics and cholecystectomy with modest tempering of growth rate in hernia and colon resection.

Given the different types of procedures being performed by general surgeons, we see additional demands on system access and accounts, as well as increased demands on our representative's time to support different procedure types. We believe system placement strength in the US as driven in part by the desire of general surgeons for increased access. We have efforts on going to manage these issues. Calvin will take you through global procedure dynamics in more detail later in the call.

With regard to our installed base, placement of new systems in the quarter was strong with growth in total placements rising 24% from Q2 of 2018. Net of trade-ins and retirements, our da Vinci installed base again grew 13% over Q2, 2018 to approximately

5,270. The mix of system placements this quarter moved towards our flagship Xi System, while both sales of X System and trade-ins remained healthy. The proportions of systems placed under operating leases was 32% this quarter, compared with 33% last quarter. We do not anticipate this quarter-to-quarter variance is indicative of a larger trend in leasing.

With regard to capital average sales price the mix of systems and geographies last quarter resulted in a lower ASP, when compared to historical trends. The second quarter saw a reversal of mix dynamics, with more fully featured system sales and a greater proportion of system placements in direct markets, resulting in an ASP that is higher than recent quarterly averages. As we said last quarter, this variance in ASP quarter-to-quarter is the result of system and regional mix, not a fundamental change in our philosophy.

Turning to expenses, we continue to invest, as we launch new platforms, strengthen our computational capabilities, and execute projects that support future scale, and provide leverage opportunities as we grow. Our spending met our expectations, falling within the range of projections we shared with you last quarter and supported by solid procedure growth and capital placements.

Financial highlights of our second quarter results are as follows; procedures grew approximately 17% over the second quarter of last year. We placed 273 da Vinci surgical systems, up from 220 in the second quarter of 2018. Our installed base again grew 13% from a year ago. Revenue for the quarter was approximately $1.1 billion, up 21%. Pro-forma gross profit margin was 71.3%, compared to 71.1% in the second quarter last year. Instrument and accessory revenue increased to $579 million, up 22%. Total recurring revenue in the quarter was $780 million, growing 21% over Q2 of 2018 and representing 71% of total revenue. We generated a pro-forma operating profit of $455 million in the quarter, up 17% from the second quarter of last year, and pro-forma net income was $388 million, up 18%.

As you know, we measure our efforts by their ability to positively impact the quadruple aim, better outcomes, better patient experienced, better care team experienced, and lower total cost to treat per patient episode. We believe intelligent surgery takes the integration of three elements. First, a deep understanding of human interactions that inform holistic system design. Second, the development of high-quality smart and cloud-connected robotic imaging and instrument systems. And lastly, informatics and AI to deliver relevant validated insights

For our customer surgery has been digitized for the past 20 years, while we've made significant progress over our history, we believe continuous improvement is required and we have deployed our investment toward these aims. We design instruments and accessories to enable repeatable high-quality surgeries that are efficient and cost-effective relating to total cost to treat. Taking one example of our advanced instrument platforms, our second generation SureForm staplers are now in the market at both 60 millimeter and 45 millimeter instrument lengths and represent product families.

Our 60 millimeter stapler has four staple lengths available and is sold in the US, Europe, Korea, Australia and now in Japan. Our 45 millimeters SureForm stapler has five different staple length cartridges, as well as a straight tip and curved tip instrument and is available in initial launch in the United States and our direct EU markets. Measured through Q2, surgeons have fired Intuitive staplers clinically over 1 million times cumulatively, since our stapling launch.

Turning to systems, we are in the first phase of launch of da Vinci SP. We installed 13 systems in Q2 to bring our clinical installed base of SP to 34. Our teams have done a nice job of resolving the manufacturing variances that slowed our installs in Q1. The highest per system utilization of SP is occurring in Korea, where regulatory clearances support the access to a large range of clinical applications, the Korean experience with SP is encouraging with regard to the broad possibilities for our platform.

In Korea, procedures in urology, gynecology, general surgery and head and neck surgery are being performed. In the United States, we have two cleared indications for SP, urologic and trans oral surgery. As you know, we're pursuing additional clinical indications for SP and have engaged regulatory agencies regarding their requirements. These requirements are in discussion, which implies projected timelines for additional indications are not yet available. Our pipeline of interested SP customers is healthy and the combination of additional indications for SP, and our readiness for deployment at larger scale pace the speed of our SP commercial expansion.

In flexibly diagnostics, our Ion platform is focused on the need for accurate, timely biopsies to support definitive early diagnosis of suspicious lung cancers of lesions for lung cancer. Ion received FDA clearance in the first quarter. With 510 clearance, we have initiated our next phase, focused on clinical use, customer feedback and production optimization.

First cases on the cleared system, were performed at the end of Q1 and we plan a measured roll out this year. Placements to date are at hospital sites collecting data, far three have been initiated and over 50 procedures have been performed so far. We're pleased with early clinical results and look forward to our customers continued progress. We expect commercial placements to commence in the next few months, along with the initiation of additional clinical collection sites. We do not anticipate material revenue from Ion in 2019.

Turning to imaging and analytics, this week, we announced the acquisition of the 3D robotics endoscope business from our long-time supplier, Scholly Fiberoptic. The transaction is subject to closing conditions and thereafter, we look forward to welcoming their employees to the Intuitive team. Leading visualization has been a core pillar of our offerings and we believe it is essential to the future of intelligent surgery. This acquisition strengthens our design and supply chain capabilities and increases our manufacturing capacity for imaging products.

For the balance of the year, our focus remains in completing the tasks we set for ourselves. First, supporting adoption of da Vinci in general surgery and in key procedures in global markets. Second launching our SP and Ion platforms. Third, driving intelligent surgery innovation. And finally, supporting additional clinical and economic validation in our focus procedures and countries.

Before, I turn the call over to Marshall, I'd like to take a moment to acknowledge our Chief Operating Officer, Mr.Sal Brogna, who announced his intention to step back from day-to-day operations after 20 years at Intuitive. Sal has made enormous contributions to building our product line our capabilities, and in the past few years, our leadership team. I extend my personal thanks and that of the company for his efforts over these past two decades. We anticipate working with Sal post transition on projects of mutual interest.

I'll now turn the call over to Marshall, who will review financial highlights.

Marshall L Mohr {BIO 5782298 <GO>}

Good afternoon. I'll describe the highlights of our performance on a non-GAAP or on a pro-forma basis. I will also summarize our GAAP performance later in my prepared remarks. Reconciliation between our pro-forma and GAAP results is posted on our website.

Key business metrics for the second quarter were as follows; second quarter 2019 procedures increased approximately 17% compared with the second quarter of 2018 and increased approximately 7%, compared with last quarter. Procedure growth continues to be driven by general surgery in US and urology worldwide. Calvin will review details of procedure growth later in this call. Second quarter system placements of 273 systems increased 24%, compared with 220 systems last year and increased 16%, compared with 235 systems last quarter. We expanded our installed base of da Vinci systems by 17% to approximately 5,270 systems.

This growth is consistent with last quarter and slightly higher than the 12.5% increase last year. The utilization of clinical systems in the field measured by procedures per system, grew approximately 3.5%, which is slightly lower than last quarter growth of approximately 4% and below the 5% growth last year.

Our revenue overview is as follows; second quarter 2019 revenue was $1.1 billion, an increase of 21%, compared with $909 million for the second quarter of 2018, and an increase of 13% compared with $974 million last quarter. Instrument and accessory revenue of $579 million, increased 22% compared with last year, which is higher than procedure growth primarily reflecting customer buying patterns and increased usage of our advanced instruments.

Instrument and accessory revenue realized per procedure was approximately $1,920, an increase of 4% compared with the second quarter of 2018, and a decrease of 2% compared with last quarter. Systems revenue for the second quarter of 2019 was $344 million, an increase of 24% compared with the second quarter of 2018, and an increase of 39% compared with last quarter. Systems revenue in the quarter reflected higher system placements, higher ASPs and higher lease related revenue. We completed 88 operating lease transactions representing 32% of total placements compared with 44% or 20% of total placements in the second quarter of 2018, and 78% or 33% of total placements last quarter.

As of June 30, we have 486 operating leases outstanding and realized approximately $25 million of revenue related to these arrangements in the quarter, compared with $12 million last year and $20 million last quarter. Operating leases create a future source of recurring revenue and reduce the volatility of system revenue, while the increased number of operating leases placed in the quarter dampens short-term revenue growth for the quarter in which they're placed.

Operating leases included usage based financing that we provide to certain experienced hospitals. We believe that our lease financing alternatives align with customer objectives and have enabled faster market adoption. Related to systems purchased over the lease period, we earn a small premium, reflecting the time value of money. And in the case of usage-based arrangements, the risk that those systems may not achieve the anticipated usage levels. The proportion of these types of arrangements could increase long-term and will vary quarter-to-quarter.

We recognized $27 million of lease buyout revenue in the quarter, compared with $12 million last quarter and $13 million last year. This buyout revenue has varied significantly from quarter-to-quarter and will likely to do so. We do not expect the second quarter buyout -- level of buyout revenue to repeat. 38% of the current quarter system placements involve tradeins, reflecting customer desire to access or standardize on fourth-generation technology. This is an increase in the proportion of trade-ins compared to 34% in the second quarter of 2018 and 36% last quarter.

74% of the systems placed in the quarter were da Vinci Xi and 20% were da Vinci X System, compared with 67% da Vinci Xis and 25% da Vinci Xs last quarter. 13% of the systems place were SP systems. Our rollout of the SP surgical systems measured, putting systems in the hands of experience da Vinci users while we optimize training pathways in our supply chain. Globally, our average selling price, which excludes the impact of operating leases and lease buyout was approximately $1.54 million, compared with $1.42 million last year and $1.31 million last quarter.

Our mixed system and customers in the second quarter of 2019 was very favorable relative to prior periods. We had a high mix of Xi versus X and Si Systems. We also had a low mix of distributor versus direct sales. In the second quarter of 2019 we also had fewer multi-system arrangements where we provided volume discounts. The mix of systems, customers and size of arrangements will vary over time. We expect system ASPs to be in a range of the midpoint of the first two quarters.

Outside of the US results were as follows; OUS procedures grew approximately 20%, compared with the second quarter of 2018 and increased 4% compared with last quarter. Second quarter revenue outside of the US of $314 million increased 19%, compared with the second quarter of 2018 and increased 11% compared with last quarter. The increase compared with the prior year reflects increased in instruments and accessory revenue of

$34 million or 29% growth. The increase in instrument and accessory revenue was primarily driven by procedure growth and customer buying patterns.

Outside of the US, we placed 80 systems in the second quarter, compared with 82 in the second quarter of 2018, and 81 systems last quarter. Current quarter system placements included 30 into Europe, 24 into Japan and eight into China. 61% of the systems placed in the quarter were da Vinci Xis and 33% were da Vinci X Systems, compared with 38% da Vinci Xis and 44%, da Vinci X's last quarter. 12 of the system placements were operating leases compared with six last year and 11 last quarter. Placements outside of the US will continue to vary as some of the OUS markets are in the early stages of adoption, some markets are highly seasonal reflecting budget cycles or vacation patterns, and sales into some markets are constrained by government limitations.

Moving on to gross margin and operating expenses. Pro-forma gross margin for the second quarter of 2019 was 71.3%, compared with 71.1% for the second quarter of 2018 and 71.2% last quarter. The increase compared with second quarter 2018 and last quarter, primarily reflects higher system ASPs. Future margins will fluctuate based on the mix of our new products, the mix of systems and instrument and accessory revenue, system ASPs, and our ability to further reduce product costs and improve manufacturing efficiency.

Pro-forma operating expenses increased 27%, compared with the second quarter of 2018 and decreased 1% compared with last quarter. Spending is consistent with our plan and includes in order of magnitude of increase, costs associated with the expansion of our OUS markets, spending on our informatics capabilities, and investment in our infrastructure in order to scale the business.

Our pro-forma tax rate for the second quarter was 20% and within our expectations of 19% to 20%. Our tax rates will fluctuate with changes in the mix of US and OUS income, changes in taxation made by local authorities, and with the impact of one-time items. Our 2020 tax rate will increase with the return of the medical device tax. Our second quarter 2019 pro-forma net income was $388 million or $3.25 per share, compared with $327 million or $2.76 per share for the second quarter of 2018 and $312 million or $2.61 per share for the last -- for last quarter.

I will now summarize our GAAP results. GAAP net income was $318 million or 200 -- or $2.67 per share for the second quarter of 2019, compared with GAAP net income of $255 million or $2.15 per share for the second quarter of 2018, and GAAP net income of $307 million or $2.56 per share for last quarter. The adjustments between pro-forma and GAAP net income are outlined and quantified on our website, and include excess tax benefits associated with employee stock awards, employee equity and IP charges, amortization of intangibles and acquisition related items, and legal settlements.

We ended the quarter with cash and investments of $5.1 billion, approximately the same as March 31st, 2019. Cash generated from operations was offset by stock repurchases and investments in working capital and infrastructure during the quarter. We've repurchased approximately 400,000 shares for $200 million at an average purchase price of $477 per share.

In the quarter, we grew inventory by $45 million to $513 million, representing approximately 140 days of inventory. We continue to build inventory to address the growth in the business as well as mitigate risks of disruption that could arise from trade, supply or other matters. With the growth in the business and our focus on efficiency and scale, we expect our capital expenditures will increase over $250 million in 2019.

And with that, I'd like to turn it over to Calvin, who'll go over procedure performance and our outlook for 2019.

Calvin Darling {BIO 17664656 <GO>}

Thank you, Marshall. Our overall second quarter procedure growth was 17%, compared to 18% during the second quarter of 2018 and last quarter. Our Q2 procedure growth was driven by 16% growth in US procedures and 20% growth in OUS markets.

In the US, Q2 procedure results were generally consistent with recent trends. Q2 growth was again driven by growth in US general surgery, thoracic and benign gynecology procedures. Q2 2019 US procedure growth was 16%, compared to 17% last year and last quarter, reflecting anticipated slight moderation and mature urology and gynecology procedures in general surgery growth rates. In US general surgery, second quarter hernia repair and colorectal procedure growth remained solid, although at slightly lower growth rates than last quarter and last year.

Other general surgery procedures, such as cholecystectomy, bariatric, and liver and pancreatic cases made increasing contributions to growth in Q2 with higher growth rates than the last quarter. As anticipated, US procedure growth in mature urology and gynecology procedure categories moderated in Q2 compared to last year. US gynecology growth and urology growth were in the mid-single-digits. dVP growth specifically was in the low single-digit range in close alignment with the underlying incident rate for prostate cancer. As a mature procedure category, we believe that our US prostatectomy volumes have been tracking to the broader prostate surgery market. In other US procedures, adoption of lobectomies and other thoracic procedures was again solid during the second quarter.

Second quarter OUS procedure volume grew approximately 20%, compared with 22% for the second quarter 2018 and 21% last quarter. Second quarter 2019, OUS procedure growth was driven by continued growth in dVP procedures and earlier stage growth in kidney cancer procedures, general surgery, and gynecology. Q2 OUS procedure growth faced modest working day headwinds due to the timing of the Easter holiday, mostly affecting Europe and other national holidays, particularly in Japan.

Japan procedure growth remains strong, but moderated somewhat in Q2, reflecting lower growth rates in mature urology procedures as we reach higher levels of market penetration, the impact of holidays and the anniversary of the new procedure reimbursements. In China, after several quarters of declining procedure growth, procedure growth accelerated slightly in Q2 driven by procedures performed on new systems installed under the latest system quota. In Europe, procedure growth was driven by strong results in Germany and France. Overall, European procedure growth was largely consistent with prior periods with variation by country.

Now turning to the clinical side of our business, each quarter on these calls, we highlight certainly recent published studies of note. However, to gain a more complete understanding of the body of evidence, we encourage all stakeholders to thoroughly review the extensive detail of scientific studies that have been published over the years. We are pleased to see the evidence landscape regarding our recently cleared Ion endoluminal system start to grow. A manuscript describing the first term and use experience led by Dr.David Fielding from the Royal Brisbane and Women's Hospital in Brisbane, Australia has recently been accepted for publication in the peer-reviewed medical journal, Respiration.

Previously presented at the annual CHEST conference in 2017, this study was designed to evaluate the safety and feasibility of the Ion and endoluminal platform and included 29 consecutive subjects with follow-up data through six months. Although each nodule was located in the peripheral part of the lung and the mean nodule size was approximately 15 millimeters. Approximately 97% of the nodules were reached with a tissue sample suitable for assessment obtained. Importantly, across the entire study populations, no instances of neumotorax, bleeding or device related adverse events were reported, suggesting a good safety profile.

We believe that further scientific study and clinical evidence will be essential to build the market for Ion. Soon after receiving FDA clearance for Ion in the US, we initiated a post-market clinical study called PRECISE, intending to enroll 360 subjects across six key centers in the United States. Full details regarding the construct of the PRECISE study are available on the web at clinicaltrials.gov.

In May of this year, a large scale real world comparative study using the National Cancer Database was published in the journal Colorectal Disease. The analysis led by Dr.Ravi Kiran from New York Presbyterian, Columbia University Medical Center, compared the results of over 41,000 patients from between 2010 and 2015 by surgical approach. The National Cancer Database captures data from over 1,500 cancer accredited facilities and represents approximately 70% of newly diagnosed cancer cases.

The population for the study consisted of approximately 15% robotic-assisted, 33% laparoscopic and 52% open procedures. In propensity score matched analysis with over 4,000 subjects in each cohort comparing the robotic LAR approach to the laparoscopic approach. The robotic LAR was associated with shorter length of stay, 6.3 days versus 6.8 days and lower risk of conversion to open, 7.5% versus 14.95%. With multi-variate analysis, showing laparoscopic LAR patients being 2.2 times more likely to be converted to open. Compared to open LAR, the robotic-assisted approach had shorter length of stay, 6.3 days versus 7.8 days. A higher rate of negative margins 97.01% versus 95.96% and higher nodal yield 17 versus 16.4.

The authors concluded and I quote, for patients with rectal cancer, robotic LAR shows recovery benefits over both open and laparoscopic LAR with reduced conversion to open compared with laparoscopic LAR and less prolonged length of stay compared with laparoscopic LAR and open LAR. Robotic LAR is associated with short-term oncological outcomes comparable to open LAR, supporting its use in minimally invasive surgery for rectal cancer.

I will now turn to our financial outlook for 2019. Starting with procedures, last quarter, we forecast 2019 procedure growth of 15% to 17%. We are now refining our forecast to the upper half of this range and expect full year 2019 procedure growth of 16% to 17%.

Turning to gross profit, on our last call, we forecast our 2019 full year pro-forma gross profit margin to be within 70% and 71% of net revenue. We now expect to come in at the higher end of that range. Our actual gross profit margin will vary quarter-to-quarter depending largely on product regional and trade-in mix and the impact of new product introductions.

Turning to operating expenses, we continue to expect to grow pro-forma 2019 operating expenses between 24% and 28% above 2018 levels. We continue to expect our non-cash stock compensation expense to range between $320 million and $340 million in 2019. We expect other income, which is comprised mostly of interest income to total between $130 million and $135 million in 2019, up from $120 million to $130 million forecast on our last call. With regard to income tax, we continue to estimate our 2019 pro-forma income tax rate to be between 19% and 20% of pre-tax income.

That concludes our prepared comments. We will now open the call to your questions.

Questions And Answers

Operator

(Question And Answer)

(Operator Instructions) And our first question comes from the line of Rob Hopkins with Bank of America. Please go ahead.

Q - Robert Hopkins {BIO 2150525 <GO>}

Oh. Great, and good afternoon. So first question, I wanted to ask about U.S. procedure growth. So I'm ask the overall Q2 U.S. growth on the procedure side accelerated a little bit when you take into consideration the year ago comp, but you called out some slight moderation in hernia and colorectal. So I was wondering if you could just talk about that a little bit. Like was that -- was the growth you experienced in hernia and colorectal this quarter different than you expected and how do you manage through this issue of kind of managing access? Thank you.

A - Gary S Guthart {BIO 3429541 <GO>}

Yeah, this is Gary. We saw a tad of moderation, I think demand remains strong and what we're really seeing is what we indicated to you. We have two things going on, one is there are a lot of different procedure types, and now in busy centers competition for system access, we can of course solve that with additional systems placed as well as work with folks on efficiency of use. And we're doing both and you've heard that from us over the last several quarters. The next one is our commercial teams have been growing in the United States to support the growth of the company and it takes some time to have teams come up to full productivity and we were the percentage of new folks and new territories has been ticking up the last couple of quarters and it's the new ratio is amongst the highest we've had in the last few. Employee retention has been great it's really around increased need to get increased case coverage and so there it's supporting our new folks in the field with tools and some of it is just time on task.

A - Calvin Darling {BIO 17664656 <GO>}

Yes, Bob you know from just a pure mathematical standpoint, you know we track adoption curves pretty regularly around here and it's a mathematical reality that really all points along the curve the rate of growth actually declines. So, our results here in Q2 is aligned with what we would have expected and clearly there's a lot substantial remaining opportunity in both hernia and colorectal procedures and our checks with surgeons generally indicate healthy demand.

Q - Robert Hopkins {BIO 2150525 <GO>}

That's great. Thank you for the color. And then just one on the system side, because revenue growth from system sales, this quarter was much higher than the first quarter due to mix as you called out, but the placement numbers and the placement growth in both quarters suggest very strong underlying demand for your systems in both quarters. I was just wondering if you could talk a little bit about the differences you saw from Q1 to Q2 in that mix dynamic and what that suggest about the outlook for the rest of the year on the system side? Thank you.

A - Marshall L Mohr {BIO 5782298 <GO>}

Yeah. We're this is Marshall. We have seen, as you suggested reasonable strength in terms of system placements. I don't think there's anything really different quarter-to-quarter other than the mix, and other words the buying behaviors of the customers hasn't changed. We're seeing a nice cycle on trade-outs and but we did see again more Xis this quarter, and there's volatility or variability between quarter-to-quarter as it relates to particularly our distribution channel. And so we saw a fewer distributor sales this quarter and more direct sales and our direct sales are at a higher price than what we sell to our distributors as they incur the selling costs associated with those systems. So that's really -- that's the color that we would provide on systems revenue.

Q - Robert Hopkins {BIO 2150525 <GO>}

Great. Thank you.

A - Gary S. Guthart {BIO 3429541 <GO>}

Marshalls, is it fair to look at it and say, if you view the first half as a whole rather than in different quarters you'd get a better picture?

A - Marshall L. Mohr {BIO 5782298 <GO>}

That's true Gary. You should when you look at the ASPs, you should think about the combination of the two, because 1.31 was a low point and 1.54 is a high point.

Operator

Next question comes from the line of one line of Tycho Peterson with JP Morgan. Please go ahead.

Q - Tycho Peterson {BIO 4279327 <GO>}

Hey, thanks. Maybe I'll just follow-up on that last question. Why should a ASPs take a little bit of a step back? You did -- you skew more toward fully featured system sales, obviously your procedure mixes expanding, why you'd logically should ASP step down a little bit going forward?

A - Marshall L. Mohr {BIO 5782298 <GO>}

You should expect that the, again distributor sales tend to be variable quarter-to-quarter, so I think you should blend the first quarter and the second quarter, when you're looking at what level of the distributor sales you should expect, and I think same thing with the mix of Xi and X just depending on the geography X is targeting geographies, where reimbursements are pressured and so this quarter just based on mix we wound up selling fewer X is and that should even out as well.

Q - Tycho Peterson {BIO 4279327 <GO>}

And we've had couple of quarters now of operating leases in kind of the low 30s, it was 29% at the end of last year, is this kind of the new norm in your viewer or how should we think about operating leases in terms of mix going forward?

A - Marshall L. Mohr {BIO 5782298 <GO>}

I don't think about it as norm, I think that there's going to be variability quarter-to-quarter and yes Q2 is slightly lower, it's not close to being the same as Q1, but I think over time, we will accommodate customers in we think that, on the other hand leases are positive for the company it that they -- as I said in my prepared remarks it increases the recurring revenue. It eliminates volatility, it also an enables a upgrade cycle when and if new systems come out. So, we think it's a positive and so we'll supply those to customers as they ask for them. I would guess that over time -- or we're there were predicting over time. There's the possibility that the percentage actually will increase.

Q - Tycho Peterson {BIO 4279327 <GO>}

Okay and then on IRIS, I know it's early days, I didn't really hear you bring it up in the comments, but can you just talk a little bit about interest levels for kidney and liver and how we should think about the expanded use of that going forward?

A - Gary S. Guthart {BIO 3429541 <GO>}

I think the interest from the forward-leaning surgeons is very high. I think in general people are looking out seeing, additional access to data IRIS just a reminder for everybody is the integration of preoperative imaging, 3D imaging into a case in real time. We're not in the clinic yet, we do have our 510(k) clearance were working through agreements with first customers we don't expect revenue this year, I think directionally there's quite a lot of support. I think part of what we want to develop in the market as we go forward is use cases and really getting the value statement for them. In terms of what it drives, either accuracy or efficiency or both, early response is great, but these things take a little time to develop and to develop the evidence base that goes behind it.

Q - Tycho Peterson {BIO 4279327 <GO>}

Okay. Thank you.

Operator

Next question comes from the line of David Lewis with Morgan Stanley. Please go ahead.

Q - David Lewis {BIO 15161699 <GO>}

Oh, good afternoon. A couple questions here. I'll start with Gary. Gary last year, procedures began to inflect from a perspective and they still remain pretty strong, as you think about the next inflection for procedure growth, I mean do you think it's more likely that it comes from a new systems, obviously SP Ion creating this access, you've already talked about on this call or accessing new geographies, Japan and China I notice you already mentioned in a comment, that just a few systems in Japan -- sorry in China was able to drive some demand, so across those three buckets, Gary, systems access geographies, what is the most likely driver of the next wave of procedure inflection?

A - Gary S. Guthart {BIO 3429541 <GO>}

I think in the near term access in core markets is going to be important. What's been nice here in the last few years is the procedure base has been building, so healthy double-digit growth rates in procedures and absolute growth numbers are starting to become substantial and making sure that those surgeons who want access to the system have it has been important, and it's been important has been one of the drivers for our increased flexibility and agility and capital acquisition models. As you look at SP and Ion both of those are interesting platforms that I think over time will expand the total available market for robotic systems and diagnostics in single port or single Xs surgery, they take some time to develop in the speed with which they develop is. As I said in the script paced by additional indications and manufacturing scale. Longer term I think those things are exciting, but it'll take some time to go through. Geography we've seen real successes, but they take time. Japan has been a great success. They're doing a really nice job, but it is really heavy lifting to do all the things required to build market access from partnering networks, to training centers, to the clinical evidence base to support additional adoption.

So, I think those things are important, we have invested in them and we'll continue to do so. So short answer, maybe not a perfect modeling answer, but I'll leave that to you.

Q - David Lewis {BIO 15161699 <GO>}

Okay, and then it just to be a [ph] trying to get a sense of thinking about the SP roll out and the Ion roll out, your Ion commentary was fairly consistent with the first quarter. If I think about the first four quarters of SP, obviously accessing[ph] out that the manufacturing issues last quarter. Did you see Ion rolling out may system place in perspective in a similar fashion to SP is the reason why it would be faster in the first four quarters of commercialization or slower? Thanks so much.

A - Gary S. Guthart {BIO 3429541 <GO>}

Yeah, I anticipate measured in these first four quarters of launch as we optimize our systems on our side and also gathering our data. After that, we'll see, I don't think I'd predict it one way or another for you. The indications are in Ion, we feel pretty good about to get started. I think of the size of that market is real and so we'll see a year from now, I think as to how fast we want to move. On SP, it has, I think great long-term potential. It requires additional clearances, in the U.S. anyway, keep moving and so we'll do that in sequence.

Operator

Next, we'll go to the line of Amit Hazan with Citigroup . Please go ahead.

Q - Amit Hazan {BIO 6327168 <GO>}

Hey, good afternoon, guys. Let me start with one on the quarter and just follow after that. So on the quarter, the I&A versus procedures, I&A was up 22% procedures up 17% that the widest gap, I can recall in a little while. If you touched on it a bit, but maybe just a little bit more color. Is it that, new and advanced instruments driving something that's sustainable or are there one time things in there that we should consider?

A - Calvin Darling {BIO 17664656 <GO>}

Yeah, I think in general, we have seen increasing revenue, instrument and accessory revenue per procedure. Obviously, there's variability by quarter based mostly on the timing of customer orders. But in general, we've been gradually increasing and the biggest aspect of that a has been increasing usage of the advanced instruments from Vessel Sealing, the Vessel Sealer Extend, we launched recently, now to stapling as well and the 60 millimeter stapler we launched last year and more fully available this year in the U.S. So I think that's been the biggest factor that that's probably been more than offsetting most everything else, whether it's more procedures in general surgery hernia repair and others that maybe lower tool usage. So I think that's the biggest factor there.

Q - Amit Hazan {BIO 6327168 <GO>}

And just a slightly longer-term question on flexible endoscopy with surgical instruments, one of your bigger future robotic competitors has been talking about this publicly now for the first time, in just the past month or so can you talk to, how much of a priority this is for Intuitive, what you can tell us about the opportunity from a robotic perspective?

A - Gary S. Guthart {BIO 3429541 <GO>}

Sure. In general as we've described before, we like to think in platforms and what I mean by that is, if we can build some core technologies from advanced imaging to great precision to great software, then we can mix and match those core capabilities to pursue different endpoints clinically. And so you look at SP, SP is an exceptionally powerful system that brings together four instruments through a single access point. You look at Ion, and Ion has exquisite sensing and a flexible endoscopy you're on flexible diagnostic platform. Over time, I think those two different sets of ingredients give us a lot of opportunity and optionality. And so, I think those things are interesting and they could open for us additional clinical markets over the long-term. That said, product design is subtle, and architectural choices are really, really important doing it right getting a great clinical outcome comes down to sub-millimeter precision and microsecond timings of these electronics. And as a result, we want to make sure that we really deliver on the things we put in the market from SP to Ion. So we're not sprinting to go as broad as possible, we really want to make sure we deliver against the commitments we make and for the customers who purchase our products. There's a fair amount of history out there of companies that have failed to attend to the details and starts strong and peter out and so we're careful and thoughtful about it.

Operator

Next question comes from the line of Larry Biegelsen with Wells Fargo. Please go ahead.

Q - Larry Biegelsen {BIO 7539249 <GO>}

Thanks guys. Thanks for taking the question. First, could you talk about the strategic and financial implications of the FiberOptics acquisition and I had one follow-up?

A - Gary S. Guthart {BIO 3429541 <GO>}

Sure I'll speak to why we did it. This is a -- Scholly is a strong team and supply chain partner that has been important for us over many years. Clearly, great imaging manufacturing capability, design capability and processing is a core part of surgery of the future and interventions of the future. As we've grown, we wanted to make sure that we can continue to invest in that space both on the design side and on the manufacturing and production capability side. It's been a great partnership with that team, we respect them and have been very productive with them and so that gives us additional optionality and agility going forward in a core part of our business. On more of deal specifics and logistics, I'll turn it over to Marshall.

A - Marshall L. Mohr {BIO 5782298 <GO>}

So entered into an agreement to acquire certain assets and operations from Scholly for cash consideration of approximately $100 million, the exact amount of the consideration and timing of the closing is subject to certain closing conditions and so that will occur over the next future period and the employees will transfer after each of the closing events occurs.

Q - Larry Biegelsen {BIO 7539249 <GO>}

Thanks, Marshall. And then on Ion, we haven't heard you talk about the opportunity or timing outside the U.S. what the status particularly in China and rest of the world. Thanks for taking the questions guys.

A - Marshall L. Mohr {BIO 5782298 <GO>}

Yeah, on the specifics on China, we're in discussions with Chinese Regulatory Agencies about, how best to bring it to market and timing there. I don't have a definitive answer for you yet. But it's an active discussion. Clearly, we believe there are end user opportunities and value healthcare value to bring in China and in Europe, and in other markets, and we'll take it in sequence. We think this is a powerful set of technologies and a powerful platform. We are still in the early days. Our greatest organizational focus right now is on really understanding the technology and the use of it carefully. The early clinical results are great and they are differentiated relative to other products in the market so far in these early days. That's really important to us, we will focus there. And as we build strength and experience and scale then it gives us a lot of opportunities to the engage rest of the world.

Operator

Next we go to the line of Lawrence Keusch with Raymond James. Please go ahead.

Q - Analyst

Great. Thanks. This is John Shoe[ph] for Larry. Maybe if we could start without providing guidance for 2020. Can you give us some high level guide post for how we should generally think about investment spend, next year going into 2019? You obviously have a lot of products on your plate this year, but just any high level color would be greatly appreciated?

A - Marshall L. Mohr {BIO 5782298 <GO>}

Well, we will give you a better color, when it comes to January about what's going to happen next year. But the things that we're investing in are not short-term investments. They take -- they occur over a long period and so you should expect that spending will continue to -- continue on those and on other matters going forward and as we grow the company, of course, there's an increased amount of support that's necessary to grow the company particularly on the sales side in terms of personnel and commissions. And so, I think spending will increase I won't give you anything more specific than that until we get later in the year.

A - Gary S. Guthart {BIO 3429541 <GO>}

Maybe I'll just speak for a lots good[ph]. We think the opportunity for improved performance and, therefore, opportunities for the business are substantial. And what paces us as to how we decide, how much we will invest and when is that, which we think we can do with excellence. Generally speaking we see more opportunity than we think we can pursue. We wind up saying no to some things, that are probably good ideas, but we don't know that we can perform them well, and so that's what balances our investment portfolio. And we'll continue to use that philosophy as we plan out 2020 and go forward.

Q - Analyst

Great. And then just on the balance sheet, you obviously have $5 billion plus in cash, you bought back some stock in the quarter, you also did a tuck-in acquisition for imaging capabilities. Can you just remind us, how you think about your capital deployment priorities at this point?

A - Marshall L. Mohr {BIO 5782298 <GO>}

Yeah. The philosophy and approach to capital deployment hasn't really changed, but to remind you, we think about that cash obviously to operate the company. We're making investments in our future, the we want cash, the market is volatile in terms of the environment is volatile, in terms of tariffs and other things going on. We want to make sure we've got proper investments to be able to deal with those and then ultimately we look for opportunities to buyback stock and return cash to shareholders.

Q - Analyst

Okay. Great. And then just I could sneak one last one in on the tax rate. I think you mentioned, the medical device tax coming back in 2020, by my estimate I think we're coming up with an impact of roughly $30 million. Is that a decent ballpark for how you're thinking about the impact of product gross margin in 2020?

A - Calvin Darling {BIO 17664656 <GO>}

Yes, when we're talking about medical device tax, so we were recognizing in the past, we charge that expense item to cost of sales. So, it impacts our gross margin there, we saw an impact around 70 basis points to 100 basis points then and it's probably a similar kind of impact should that be reenacted.

Q - Analyst

Okay, great. Thank you.

Operator

Next we will go to the line of J.P. McKim with Piper Jaffray. Please go ahead.

Q - J.P. McKim {BIO 18054566 <GO>}

Hi, good afternoon. Thanks for taking my question. I wanted to ask one on just this push to on trade-ins and upgrading the installed base to generation four I think after the last quarter, I think half the installed base was still older generation. And so can you give us an update on where that is today? And then just how strategically how important is that to you to get everyone on Gen-4 ahead of competition that, in theory, should come sometime next year or after that?

A - Calvin Darling {BIO 17664656 <GO>}

Yeah, I'll give you the numbers and let Gary talk to the strategy, you heard on this call, it was another 38% of our system sales involved trade-ins this quarter. It's likely to continue to be a significant part of our capital sales in future periods. At this point in time it is about 45% of our installed base of 5,270 systems that are Gen-3 and prior mostly size[ph].

A - Gary S. Guthart {BIO 3429541 <GO>}

We think it helps, I mean as to the strategy we think our customers appreciate it. Many customers now are multi-system owners or across their integrated delivery network. They have systems at different hospitals where surgeons visit. So having consistency helps them Gen-4 products have a greater access to advanced instruments and other technologies and is well appreciated. So, in that sense, we think we can lean in and help those organizations go do it. There's a different set of regulatory clearances in different countries around the world, there are different trade-in economics in each country. So, as you think about the analysis, you think a little bit about, which region and which country can move most quickly and we work through that as well.

Q - J.P. McKim {BIO 18054566 <GO>}

Okay. And then if I could ask one on just. The comments you made on the general surgery dynamics with hernia and some of the others is tempering based on just law of large numbers, but the shift to bariatrics and some more on chole. I mean the shift on general surgery, what does that do for your instrument ASPs? Are they more advanced instruments as you shifts to different procedures in general surgery?

A - Marshall L. Mohr {BIO 5782298 <GO>}

Highly variable, you look at Chole's[ph]. Those are lower revenue per procedure cases. If you look at bariatrics, it's the other side, where a lot of staple pliers are used. So, it's highly variable landscape.

A - Gary S. Guthart {BIO 3429541 <GO>}

Bariatrics is -- in early innings and as we start to optimize the instrument kit, there in we're seeing really pulled from the market there. We haven't changed our priorities in the U.S. sales force with regard to general surgery. We continue to believe there is opportunity and value in, of course, hernia and colorectal procedures, the bariatric side are really customers coming to us and starting to move that along.

Q - J.P. McKim {BIO 18054566 <GO>}

Thank you.

Operator

Next, we go to the line of Richard Newitter with SVB Leerink. Please go ahead.

Q - Richard Newitter {BIO 16908179 <GO>}

Hi, thanks. I have two and housekeeping, with the housekeeping, can you just quantify what the selling day headwind was, what your procedure growth would have been excluding the not the selling day, but some of the headwinds that you would have related to the holiday, timing, and what not and then Gary I was wondering, with respect to the capacity issues just getting robot time. Are there certain types of procedure mix cases or certain types of institutions where you can proactively get in front of those capacity issues to get there before they occur and is there any kind of characteristic of the institutions procedure mix that specifically is leading to the capacity constraints?

A - Calvin Darling {BIO 17664656 <GO>}

} Yeah. First on the working day is really minor, in the quarter not a big thing. We mentioned in the commentary. Overall maybe a 30-ish basis point impact on procedure volume with of a much larger portion of attributable outside the U.S., due to the timing of Easter.

A - Marshall L. Mohr {BIO 5782298 <GO>}

On the capacity side, as we've said in the past. Our customer base doesn't one size does not fit all. Each institution runs with different operating cadences within their organization. So in some places we see extremely efficient capital utilization, really focused approach, where they have very high predictability and get a lot of procedures out of the system. We're delighted to support that and we help to benchmark that and teach others as they need it. We see other institutions that for various reasons, are operating at lower capital capacity, for some reasons that are quite good, some maybe teaching institutions, some maybe institutions that take on the most complex comorbid patient. Patient sets where predictability of procedure duration is difficult. So you can imagine if you're sharing a system between a thoracic surgeon who's performing lung cancer procedures and a general surgeon who's doing hernia repairs. The cadences and rhythms in scheduling are quite different and you're going to get less optimal scheduling. To the extent that we can have those conversations up front and help them optimize we do, that's something we've been strengthening over time. So I think we can do better than we do today.

Q - Richard Newitter {BIO 16908179 <GO>}

Great. Thanks. If I get one more just -- the China utilization pick up on just eight systems placed under the quota. Did that surprise you that it was able to translate into a pickup in volumes so quickly. It was always of the impression that you needed -- there was going to be a lag time to train institutions, if you could comment there? Thanks.

A - Gary S. Guthart {BIO 3429541 <GO>}

I don't know, if we were surprised. I'd say we were pleased, that tells you the level of commitment and motivation of those customers to make their investment productive. Last questioner, please.

Operator

The last question comes from the line of Imron Zafar with Deutsche Bank . Please go ahead.

Q - Imron Zafar {BIO 7558242 <GO>}

Hi. Good afternoon. Thanks a lot for taking my question. First question is on Japan, I believe you noted some moderation in procedure growth there. But at the same time. We're still seeing some very strong capital equipment placement numbers this quarter. Can you just sort of give us some color on, what's driving these placement? Is it more sort of greenfields robotics programs that are looking to get into presumably urology or is it the established customers wanting to get more into general surgery. In light of the sort of the less financial incentive that they have. I'm just wondering if there's any -- if the growth should continue to slow going forward in general surgery.

A - Gary S. Guthart {BIO 3429541 <GO>}

Yeah, it's a combination of greenfields, where you have hospitals that are positioning themselves to do the newer procedures that were approved for reimbursement last year. And there's still a trade in cycle going on in Japan, our distributor had sold SIs on leases and as those leases are coming up, are coming due then we see customers wanting to upgrade to the newer technology.

Q - Imron Zafar {BIO 7558242 <GO>}

Okay, thank you. And then we've heard some mention from some surgeons on some third parties that hospitals can ship instruments to their that are approaching the end of their useful life and that this limited useful life can be extended presumably via some sort of a software intervention or something is this something that you're seeing any impact from or is there any regulatory preclusion that would limit the ability for companies to do this kind of stuff?

A - Marshall L. Mohr {BIO 5782298 <GO>}

On the -- on how good an idea is it the people in reprocess like that are bound by the same regulatory framework that we are in terms of assuring the quality of that product and making sure it's not sold as an adulterated product and they have to take on that burden and it is a sophisticated one. Calvin, I'll you respond?

A - Calvin Darling {BIO 17664656 <GO>}

No. Yes, I think that's especially it.

Q - Imron Zafar {BIO 7558242 <GO>}

In terms of materiality of it?

A - Calvin Darling {BIO 17664656 <GO>}

Yes and you look at our revenue per procedure. I mean it's we've talked about that a little bit and I don't think we've seen any impact on that.

Q - Imron Zafar {BIO 7558242 <GO>}

Great, thanks for taking my question.

A - Gary S. Guthart {BIO 3429541 <GO>}

Thank you. That was our last question. In closing, we believe there is a substantial and durable opportunity to fundamentally improve surgery and acute intervention. Our teams continue to work closely with hospitals, physicians, in care teams, and pursuit of what our customers have termed the Quadruple Aim, better and more predicable patient outcomes, better experiences for patients, better experiences for the care teams and ultimately a lower total cost to treat. We believe that accomplishing this aim takes the integration of three elements. First a deep understanding of the human interactions across the continuum of care. Second, smart and connected systems, imaging and instruments that augment care team. And third, the ability to measure impact through analytic insights and translation of these insights into action driving positive change. Thank you for support on this extraordinary journey. We look forward to talking with you again in three months.

Operator

Ladies and gentlemen, that does conclude your conference for today. Thank you for your participation and for using AT&T executive teleconference service. You may now disconnect.
