



ResMed Inc. Q&A

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David: All right. Good morning, everyone. I think I will start with a question or two, and then please jump in. We'll try to remember to repeat the question each time.

Mick, in your prepared presentation, you talked about a bit of a pivot in the strategy. Certainly, that's an incoming question that I get a lot with the number of recent acquisitions, nearly a billion dollars.

Perhaps, I could get you to talk to how the thinking has changed at ResMed from an outsider's perspective. Since the Brightree acquisition in particular, we've seen a bit of a change. We saw a slightly different set of slides today, so I'll get you to talk to that.

Mick: Thanks, David. Obviously, we're launching our 2025 strategy, and so there is, I'd call it, a slight pivot to more of an emphasis on the third leg of our growth stool, which is the software as a service part of our business. Part of that is it's now eight percent of our global revenues.

You just take the US. It's 16, maybe 20 percent of our US revenues that come from our software business. It's incredibly strong gross margins. It's got good growth profile. It's an area that, I think the last three years, people have seen that ResMed's a really good owner of software assets.

We've integrated that team and helped them perform and grow and expand, but it didn't start just three years ago with Brightree. It was seven years ago with the acquisition of Umbian that we really started the pivot, if you like -- if you can call it that -- to digital health.

We did it because we actually see that there's a future of exciting growth there. You don't want to be the Blockbuster that has the chance to buy Netflix for 10 percent of its market cap and then goes out of business. Netflix is worth whatever it is today, \$150 billion.

When we were looking at our strategy assessment slides and internal analysis in 2012, we could see digital health was coming as a strong trend in our industry. We wanted to be on the leading part of it, not on the lagging part of it. I'd call it a strategic imperative versus a pivot, and one that

we're happy to talk about publicly now since we're in such a strong position.

We're very comfortable to tell everybody what we're doing in this space versus having a quiet strategy. It's now to be a very active and open strategy now it's out there.

David: I guess the related question there is, how much more do you need to spend?

Mick: Look, the cash and access to cash that we have doesn't burn a hole in our pocket at all. We look at acquisitions on three characteristics. Does it fit our strategy? Does it fit within sleep apnea, within COPD, and within our software strategy? Does it have a really good financial return that we can see really good ability to get value back for our shareholders?

Is there a cultural fit? Is there a meeting of the minds, if you like, from the management team and us? David Van Sickle and his team at Propeller, when I met them in Madison during the diligence process, I was inspired by what they want to do in COPD by having people use those inhalers and stay out of hospital.

There's some personal reasons why the founders of that company are so focused on the disease state that I won't talk about. Just someone having a passion for the industry, that cultural fit, is such a big part. That happened with Umbian, with Raj still there and as a president of that group. It's happened with Brightree where that team's incredibly focused on it.

The radar is still there, but as I said in the prepared remarks, we're pivoting a little to return from the slightly north of \$1 billion we've spent over the last three years that we've invested in these great software as a service companies to show return from.

David: Just to round that out, who do you see as the competitors? Who's also moving in this direction? Who's ahead of the game? Is there any of the major competitors, the traditional Philips Respironics in this space, or are you open opportunity?

Mick: The catchphrase at ResMed is, "Our biggest competitor is ignorance." It's still true, the lack of awareness and education in sleep apnea and COPD, which is why we formed the joint venture with SleepScore Labs and with Verily to get the word out to 900 million people worldwide.

In the connected health space, the digital health space, it's a lot more than just our traditional competitors. There's a lot more people playing in that space. You've got Apple. You've got Alphabet. You've got Amazon.

You've got many others. Obviously, you've got Epic and Cerner coming from the hospital side. You've got a number of health insurers, United, Anthem, coming from the health insurance side.

Actually, you have to switch from saying, "Are these competitors or people that we can form partnerships with?" Because it's going to take a bunch of different companies in MedTech and in pharma and in insurance and in tech industry to really understand and get the value from digital health.

You've seen our partnership with Verily. You've seen our partnership with SleepScore Labs. We have many others we're not talking about yet across that ecosystem because I think it's actually a switch from, "Are we competing together?" versus, "What's the value we can provide, and who can be our best partners in doing that?"

Eventually, there'll be groups that will compete with each other, but for now, it's an early enough phase that we're really just looking at, "Where's the value, and who can we best partner with?" We made a couple of bets that are public and some that aren't yet.

David: Looking out to 2025, eight percent of revenue in the last 12 months, where are we going to see the software business delivering as a proportion of the business? What are you targeting?

Mick: It's going to grow. It's going to grow. We're not going public with a total, but it's going to 8, 10, 15, 20, 25 percent of our revenue over the coming periods of time. It's going to grow just because its growth rates are faster. It's going to grow because we're investing in it.

It's going to grow because it's where the future of healthcare software should be, which is outside the hospital. I think there's not enough people focused on that. ResMed has proven that we're pretty good in that space, and we're excited to continue to grow.

David: Any questions from the audience on these topics before we move on to some of the core business questions?

Man: She had something...

[crosstalk]

David: Sorry. Excuse me. Please.

Audience Member: Maybe you should talk about strategy in some of the privacy issues that [inaudible] ?

Mick: The question from the back was how are we managing privacy issues? That's something that Rob and I have focused a lot of time on. We meet with Todd, our Chief Information Security Officer, who came from the music industry and the entertainment industry, and knows a lot about the important financial services industry. We have folks in our team.

Clearly, cybersecurity and making sure those data are well-protected is a big part of our job. It's an ongoing, day-to-day element of just making sure you're best in class and not having any hubris and always being productively paranoid. It's certainly something that we look at on a very intensive basis.

Rob, you want to talk to...?

Rob: Sure. There's a few interesting challenges in Europe with the GDPR legislation. We're well-progressed around all of the systems that we need to support that. There's other legislation coming around. We see it as a developing area.

In fact, like many of these regulatory areas, we actually think privacy can be a competitive advantage for us if we can provide the type of trust and the types of service and relationships and information to people appropriately.

You'll see us also using the data and publishing outcome data. We don't have any problem with that, provided we properly treat the information and anonymize it and all of that. We've got all those systems in place as well. We see it as an opportunity.

David: Maybe just moving back to the core sleep business where most of the Q&A usually focuses. The six to eight percent growth that you've talked about for the market, is the outlook that that can be sustained for many years into the future?

Mick: Yeah. Mid to high single-digits growth of the core sleep apnea and COPD business will just happen due to macro trends of aging and demographics. We don't just accept that. We want to drive growth faster than that, and you've seen us do that over the last five years.

We plan to do it as we move forward through investing in new areas and driving new areas, as

well as investing in the core and driving patients into the core. If you just liberate the data to an individual person, if you let somebody know how many times they suffocate at night...

You've got an app on your phone that tracks every step you take and tells you all your steps you take. How about you had an app that helped you understand exactly how you slept last night and if you suffocated at all, recommended that you go and talk to a doctor and get treated for it? It's not now the doctor having to find you. It's you finding the doctor.

That's where the opportunity comes as we look at our growth rate, moving from a six to eight, to a seven to nine or something like that. Could it be even more than that? We've now got a pretty big \$2 billion number that we're building on here. I do think that we don't just accept that market growth rate. We say, "Well, what about the other 800 million people that are still suffocating?"

David: The competitive dynamics there? What observations have you made about how the competitors have changed over the last five years?

Mick: Obviously, we look at our competitors and what they're doing in the different space. We tend to look forward more than look back. We make the smallest, quietest, and most comfortable devices in our space, and now the most connected in that space. We're not really looking back.

I think that it's good to have worthy competitors, and we have good competition in the different devices and how small, quiet, and comfortable we can make them. There's some links to physics on some of that stuff. The connectivity side is much earlier in its development cycle and where that's going.

We look at the competitive market space and actually a broader ecosystem of how we're going to change the healthcare systems, which is just what widget is going to treat this disease or that disease.

David: I guess what I'm getting at is the connected care seems to have really limited the ability for smaller players to compete. We're not in a market where there are fewer larger competitors. Would you agree with that? Do you think that's got further to play out?

Mick: Here's the thing. If you're a home care provider and you're using our connected health, digital health system, and we're saving you 50 percent of the labor costs of setting a patient up on therapy, it's going to be much harder for someone to come in and say, "Oh, look, I've made one. It's 10 bucks cheaper," when I'm saving them 100 bucks on their labor cost.

Yeah, clearly there's some competitive dynamics for that. We didn't build the digital health ecosystem to provide protection, but it does have that benefit. It's only benefit as long as we're providing the best benefit to the customer, so our job is always to focus on the customer and what benefit we can provide them.

There's two elements to that. One is that 50 percent reduction in the labor cost setup. The other one, which is really the most important customer, when you think about it, is the individual, the person who's suffocating.

Getting the information that we're now getting through might get to that patient so they can see how they were breathing and how it's improving their health on a personal basis, that's a stickiness. That's a relationship that's really important for that patient to have. "Oh, this device cares for me. It's sharing its data with me." It's something that's a transformation in digital health.

Certainly, there are fewer players that can compete on the connected health and digital health side than can compete in just making a widget.

David: Outside the US? How would you characterize connectivity or connected care outside the US versus, presumably, the US as the leading market in that space?

Mick: I've been talking for about 35 minutes. Rob, do you want to take that? Or, Dave, if you want to take that? Dave, you go and take that.

Dave: Sure. Outside the US, it obviously varies country by country. We were fortunate in the last year to see some major changes in reimbursement that tended to drive adoption of connected care in the sleep apnea space in France and in Japan. Those were big benefits for us during calendar FY18.

In other countries, you've got other situations. In some of the northern European countries, it's more of a hospital-based system. Even there, we see good adoption of connected care to further the ends.

We've got teams in each of the countries -- be it China, be it Poland, be it the UK -- that's trying to figure out how to take that advantage that we have with connected care and adapt it to the local situation of their own local market.

You can't really paint with one brush outside the US, but I think we are making good progress. It is having those same benefits of providing both advantages to the dealer, if you will -- we are that dealer in Germany, so we see those benefits ourselves -- as well the ultimate thing, which is the benefit to the patient, and then the cost savings to the overall health-care system.

We're quite confident that strategy will be locally delivered and still benefit us outside the US.

David: Any questions from the audience? Please.

Audience Member: You may have mentioned this during your presentation, but I'd love any additional commentary on Mobi. Anything about timing, that's probably [inaudible] ?

Dave: Rob, you go.

Rob: We've been talking about the Mobi for a while. We've had it in a controlled market release for a fair bit of last year. We've announced that we will be launching it in this quarter. When I say launch, moving from our controlled release to our full product release. I can confirm we will be doing that.

In the controlled launch, we've been very happy with its performance. These are a really high-quality product and delivering good oxygen output. In terms of the specifications, we haven't talked about the specs in the exact details. What we've said is the benefit of portable oxygen is if you can live more or your normal life and be out of the home and going shopping and doing whatever you do.

Then the trade-offs of specifications are actually really a balance of things like size, weight, oxygen output, and battery life. The Mobi, we believe, has a very good balance of those parameters that will enable our patients who are using it to live their life. We're excited, and it will be launching this quarter.

Audience Member: Just a question. It relates to that, portable concentrators have the durability to only be a couple of hours a day or however long. How long will it take before a POC has the durability and the cost to replace a stationary concentrator, or is it even possible for a POC to be durable enough to last three, four, five years and be used 24/7?

Rob: We think that's a technology development. There's probably a few generations of products before it gets there, but absolutely, that would be the goal of improving that technology.

Audience Member: Sorry. Stationary concentrators cost about 400 to 500 bucks to the DME. Can you get costs down in manufacturing, or is that the iteration of that?

Rob: There will be factors in that. The technology will advance. None of the technology improvements...Just the way we do technology improvements, we won't let them add cost. Then scale and improvement will drive cost out. It will take time. As you said, the products are not at that stage yet.

David: Maybe on that space...Oh, sorry. Go ahead, please. No, you go.

Dave: I was going to change the topic.

Audience Member: In the Propeller entity, are there additional pain points as being part of the ResMed family instead of PBM that you see being solved as part of ResMed's family for providers or patrons?

Mick: The question, for those on the webcast, was would Propeller address some other pain points of the ecosystem with ResMed as the owner versus their previous owners and private equity and so on?

Yeah, I'd think so. ResMed brings a couple of things to play. Firstly, the first point is Hippocratic oath, "Do no harm," so keep the strong management team. I see Richie McHale's in the room here, the president of our respiratory care division. He's working with David as co-CEOs, if you like, of that Propeller thing.

David Van Sickle, we want him to keep running and delivering what they've done, which is 58 percent relative improvement in adherence on taking your asthma meds. 25 percent reduction in the total costs of COPD. Rule number one, have them keep growing and keep developing these great partnerships with GSK, and Boehringer Ingelheim, and other pharma companies that aren't yet public.

Secondly, though, I do think we bring some other special elements to play. We're a 30-year player in the field of respiratory medicine. We plan to be here for the next 30 years. We think we are a fantastic long-term owner of the asset that can provide good, strong cash flow and investment in R&D that we've done in our other business verticals.

There's special value we have in that we have scaled digital health to three billion nights now of medical data and sleep apnea and COPD. That number is significantly larger than Propeller currently had, but an ambition that they have. We'd love to help them do that.

The final thing I'll say before opening up to the rest on the panel here is the fact that we sell in 120 countries. As Dave just mentioned, we have digital health and connected health capabilities in the US, France, Germany, Japan, many other countries of the 120 that we sell into.

That's a strong advantage that we have with servers and cybersecurity capabilities, and as Rob talked about, GDPR, understanding what European or Japanese or South Korean legislation is and regulation is. They're all the things we bring to the party. You add onto that the synergistic benefits into our core businesses and what we can do with cost.

We've now got data from a ventilator, an oxygen device in the future that's cloud-connected, and a cloud-connected COPD inhaler. What can you do with all of that information to help keep that COPD patient out of hospital, in the home where they want to be, where the healthcare system wants them to be, where the doctor wants them to be?

That's just the start of it.

Audience Member: Thank you.

David: Switching topics again, one of the strong earnings drivers in the last 12, 18 months has been operating margins. We've seen significant improvement. What can you talk about what the drivers of that have been? How much opportunity is left on that front?

Mick: Rob?

Rob: Sure. In our business, the first point is we're a growth business and we invest in growing the company. We've really focused on that, but we need to invest and grow profitably. For several years now, we've had a very strong operating excellence or business excellence program. In fact, we'd had similar elements of that program going in in the cost-of-goods side, supporting the gross margin side of it.

We've taken a lot of the capabilities in that and expanded it across the business. Just given the volume growth that we see in the business, we really are able to generate operating leverage on all aspects of the company as we go forward.

It's an internal commitment to keep doing it. We've got really good teams. I think we're of a scale now where we can keep continuing to do that. The internal message is very much, "Don't be wasteful. Don't keep wasting money over-investing in the stuff that you're doing. Make that more efficient so we can invest in new areas that we're taking in the company." Obviously, the software side of it's a big part of that.

David: Perhaps in a related topic, gross margins have been pretty stable. We're now in a funding environment that equally has been stable for the last year or so. Is there much opportunity on gross margin front, after you've weathered the storm of competitive bidding, to see some improvement come through?

Mick: Our goal on the gross margin side is stability. We're not talking about amazing gross margin expansion, but we're not looking at gross margin contraction. What we want to do is have balanced growth in our portfolio.

We're not going to stop the growth of portable oxygen concentrators, which are dilutive to group margin, because it's great gross profit dollars that we can reinvest in our business and grow in that space. Similarly, we're not going to only invest in gross margin percentage accretive software businesses that drive that, but we will as they intrinsically grow as well.

It's a portfolio play across our three businesses, and we want to keep a balance there. As you noted, it's great that we've seen some good stability in our gross margin, and leverage in our operating margin, and then, really importantly, leverage to our earnings-per-share growth that we've been able to achieve over the last number of years.

David: Any other questions from the audience? Please.

Audience Member: I think one of your competitors mentioned that, the Mobi, their expectation is that the rate is still unclear towards generation product. They mentioned that providers aren't a fourth-generation [inaudible] the third-generation product because of the higher [inaudible] .

What would be your [inaudible] ?

David: Rob?

Rob: Again, we were trying to avoid, and we have so far avoided, getting into a blow-by-blow

spec comparison of the different products in the market. We say that that's trade-off of flow rates, size, battery life, and weight, all important. We think Mobi's a good spot. It'll be in the market.

We're not early to the market. We're not a market leader. We will continue to develop and take share as we grow that product and invest in the further enhancements to it. We heard that comment too, but we think the Mobi's in a good spot.

Mick: I listen to what customers say, and they vote with their wallets.

David: Perhaps a last question from me, then. The litigation's ongoing. I was wondering if you could give us a quick update as to what we should expect for calendar 2019?

Dave: It's going to be a busy year for us. As you know, this is a worldwide battle that we have. There are a number of trials that actually come up beginning in the spring, so both with the USITC. There's two cases there. There's a case in Australia. There's a case in New Zealand. All of them are set for trial during calendar 2019.

Even with trials, you can have appeals. They're not necessarily fully dispositive. As you start getting independent observers, i.e., judges, making decisions on these cases, just as you did in Germany, we think we'll end up on the best side of those decisions. We're quite confident that it'll be a good year for us and that, as those decisions start coming out, it'll be to our advantage.

David: Much chance of resolution, do you think, in 2019?

Dave: You never know. As I said, usually, when you start getting decisions, things get a little clearer because, until you get there, both sides are really entrenched in their positions. We'll see. We're quite confident, and it's a long-run game for us.

David: Great. I think we're almost out of time. Mick, David, Rob, thank you very much. Thanks, everybody.

Mick: Thanks, David.

Rob: Thank you, David.

Dave: Thank you.



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