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# EDITED TRANSCRIPT

RMD - Q1 2020 Resmed Inc Earnings Call

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## OVERVIEW:

Co. reported 1Q20 group revenue of \$681m, non-GAAP net income of \$135m and GAAP diluted EPS of \$0.83.



OCTOBER 24, 2019 / 8:30PM, RMD - Q1 2020 Resmed Inc Earnings Call

## CORPORATE PARTICIPANTS

**Amy Wakeham** *ResMed Inc. - VP of IR & Corporate Communications*

**Brett A. Sandercock** *ResMed Inc. - CFO*

**David B. Pendarvis** *ResMed Inc. - Chief Administrative Officer, Global General Counsel & Secretary*

**Michael J. Farrell** *ResMed Inc. - CEO & Director*

**Robert A. Douglas** *ResMed Inc. - President & COO*

## CONFERENCE CALL PARTICIPANTS

**Andrew Goodsall** *MST Marquee - Healthcare analyst*

**Anthony Charles Petrone** *Jefferies LLC, Research Division - Equity Analyst*

**Chris Cooper** *Goldman Sachs Group Inc., Research Division - Research Analyst*

**David A. Low** *JP Morgan Chase & Co, Research Division - Research Analyst*

**David Bailey** *Macquarie Research - Research Analyst*

**Retel Janu** *Crédit Suisse AG, Research Division - Research Analyst*

**John Deakin-Bell** *Citigroup Inc, Research Division - Director & Head of Healthcare in Australia and New Zealand*

**Lynne Harrison** *BofA Merrill Lynch, Research Division - VP*

**Malgorzata Maria Kaczor** *William Blair & Company L.L.C., Research Division - Research Analyst*

**Michael Stephen Matson** *Needham & Company, LLC, Research Division - Senior Analyst*

**Saul Hadassin** *UBS Investment Bank, Research Division - Executive Director & Research Analyst*

**Sean M. Laaman** *Morgan Stanley, Research Division - Australian Healthcare Analyst*

**Shane A. Storey** *Wilson Advisory and Stockbroking Limited, Research Division - Senior Analyst*

**Steven David Wheen** *Evans & Partners Pty. Ltd., Research Division - Senior Research Analyst*

## PRESENTATION

### Operator

Welcome to the Q1 Fiscal Year 2020 ResMed Inc. Earnings Conference Call. My name is Chris, and I will be your operator for today's call. (Operator Instructions) Please note that this conference is being recorded.

I will now turn the call over to Amy Wakeham, Vice President Investor Relations and Corporate Communications.

Amy, you may begin.

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**Amy Wakeham** - *ResMed Inc. - VP of IR & Corporate Communications*

Great. Thank you, Chris. Good afternoon and good morning, everyone. Thanks for joining us, and welcome to ResMed's First Quarter Fiscal Year 2020 Earnings Call.

This call is being webcast live and the replay, along with a copy of the earnings press release and our updated investor presentation, will be available on the Investor Relations section of our corporate website later today.



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Joining me on the call today to discuss our quarterly results are CEO, Mick Farrell; and CFO, Brett Sandercock. Other members of management will be available during the Q&A portion of the call.

During our call, we will discuss several non-GAAP measures. For a reconciliation of the non-GAAP measures, please review the notes to today's earnings release. As a reminder, our discussion today may include forward-looking statements, including, but not limited to, expectations about our future performance. We believe these statements are based on reasonable assumptions. However, our actual results may differ. You are encouraged to review our SEC filings for a discussion of the Risk Factors that could cause our actual results to differ materially from any forward-looking statements made today.

With that, I'd now like to turn the call over to Mick.

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### **Michael J. Farrell** - ResMed Inc. - CEO & Director

Thanks, Amy, and thank you to all of our shareholders for joining us today as we review the results for ResMed's first quarter of fiscal year 2020.

On today's call, I will discuss our long-term strategy, I'll then review top-level financial results, some business highlights from the quarter and a few key milestones, then I'll hand the call over to Brett, who will walk you through our financials in further detail.

We have started fiscal year 2020 right where we left off with 2019. Our team achieved another quarter of balanced growth across the portfolio, driven by continued strong performance in the mask category.

We are taking share with recent new product introductions and our solutions are enabling increased therapy adherence as well as expansion of resupply programs to those who need it.

Our dedicated team of more than 7,500 ResMedians around the world have again delivered strong results.

As the world's leading software-driven medical device company, we continue to use technology to advance our leadership position.

We have sold more than 10 million 100% cloud-connectable medical devices into the market, and our AirView cloud-based ecosystem manages more than 11 million patient accounts.

In the last 12 months, we changed over 15 million lives by providing a person with a ResMed device or a complete mask system, to help them breathe better and live better lives.

In addition, our Brightree and MatrixCare branded out-of-hospital software systems are helping to manage 93 million more people. So during the last 12 months, we improved more than 108 million lives with ResMed products, services and software solutions. We are well on our way to the ambitious goal to improve 250 million lives in 2025.

Our connected solutions are providing us with valuable access to deidentified therapy data that we are using to derive actionable insights to benefit patients, physicians and providers, as well as to inform future innovation in products and software. These datasets are growing exponentially, and we now have 5 billion nights of medical sleep and respiratory care data in the cloud. Our relentless focus on product and software innovation continues to set us apart from our competition. We remain laser-focused on growth in our core market of sleep apnea as well as in our adjacent respiratory medical markets of chronic obstructive pulmonary disease as well as asthma. Our expanded focus to now grow outside-the-hospital software solutions allows us to help customers create efficiencies to take cost out of the healthcare system and to improve the quality of care across home medical equipment, home health, hospice, skilled nursing facilities, life plan communities and beyond. We believe the future of healthcare is outside the hospital. That's where ResMed competes today, that's where we are winning today, and that's where we will continue to win in the future as we provide market-leading value to customers.



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Let's now briefly review our top-level financial results for the quarter. We achieved another quarter of double-digit revenue growth, up 17% in constant currency across the portfolio.

This growth was well balanced across domestic U.S. and global product sales, as well as balanced across our software-as-a-service businesses.

We continue to deliver operating leverage in the quarter, leading to a non-GAAP operating profit growth of 22% year-over-year and non-GAAP diluted earnings per share of \$0.93.

Turning to a brief discussion of our sleep apnea and respiratory care businesses. In the devices category, we delivered a good quarter.

We achieved year-over-year constant currency device growth of 6% globally, supported by very strong 8% device growth in the United States, Canada and Latin America geographies.

We achieved 4% constant currency growth of devices in combined Europe, Asia and Rest of World. We achieved excellent device growth in the U.K., Switzerland and across our Nordics countries. As discussed over the last few quarters, we experienced a continued headwind during the quarter for device growth in France as a result of digital health-related fleet upgrades.

We expect that headwind to ease by the end of this fiscal year and then return to market device growth in France.

It is great to see a steady flow of our digital health solutions into different European countries and to see positive constant currency device growth across the continent this quarter.

The growth in the masks and accessories category of our business was incredibly strong during the quarter. We were up 19% in constant currency globally. This is well ahead of market growth rates, indicating we gained significant market share during the quarter.

The reason that we continue to take share around the world is that we make the smallest, the quietest and the most comfortable masks available in the market.

Our flagship masks, the AirFit F20 and the AirFit N20 continue their growth across global markets. The success of these flagship masks was augmented during the quarter by good uptake of our recent mask launches.

To recap those launches, we have now launched four new masks during the last twelve months, the F30, the N30i and the P30i. And just this week, actually on Monday, our newest innovation was launched, the N30. We have the right mask for every patient, every time. And the N30 adds innovative dimensions to this portfolio. The N30 is a world first tube down nasal cradle CPAP mask in a new product subcategory that we are calling the Minimalist category. The N30 is our smallest, our lightest mask ever and our quietest nasal mask ever. I personally think this new N30 is another winner from our amazing research and development engineers. Watch this space as it gets into the hands of our market-leading marketing and sales teams.

Our mask portfolio, overall, is positioned to offer world-leading options for physicians to prescribe for homecare providers to fit in the first-time step-up and most especially, for the needs of the ultimate customer, the person who suffocates every night with sleep apnea. We remain focused on driving innovation to meet all underserved customer needs. The bottom line is that our new masks have a lot of runway ahead. Unfortunately, they don't let me talk about ResMed's future product pipeline, so I won't. Our success comes as healthcare providers, physicians and patients around the world continue to vote with their wallets and choose ResMed products. Not just for the innovative design and high quality of our devices and masks, but also for the sustainable value proposition of the digital health solutions that we offer.

Our digital end-to-end solutions, combined with available 100% cloud connectivity as well as information provided to patients on their own smartphones through apps like myAir and apps like Propeller are all leading to significant improvements in lowering costs, in improving health outcomes and improving quality of life for patients around the world.

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Through digital health technology, we are driving patient engagement so that people can enjoy the benefits of the best therapy available. In parallel, we are also ensuring that the cost of chronic disease can be better managed by physicians, healthcare providers, payers and governments. There is still a long way to go. Our research that was just published by The Lancet Respiratory Medicine journal in July shows that there are over 936 million sleep apnea sufferers worldwide, while only around 20 million or so are being treated today.

We keep forging ahead, investing in our own research and development to drive further innovation and advancement, as well as by working with partners. On the partnership front, our joint venture with Verily is working on software solutions to help identify and engage and better manage more people with sleep apnea.

It is very early days on in this JV, but our philosophy is that the more a person knows about how much they suffocate every night and the consequences of that suffocation on their own personal healthcare outcomes, the more likely they will seek solutions. Over time, we know that this partnership will drive incremental growth in our core sleep apnea business while allowing ResMed to participate in a broader, chronic disease management ecosystem, covering not just sleep apnea but also, cardiovascular disease, diabetes, COPD and beyond.

These chronic disease management platforms will include clinical care as well as wellness improvements in nutrition, in cardiovascular exercise and in mental health.

Let's now turn to our second vector of growth here at ResMed, our business in respiratory care. There're nearly 400 million people worldwide suffering from chronic obstructive pulmonary disease or COPD. We don't believe they are well served by healthcare systems today. We see the opportunity to better manage COPD through the use of technology with digital end-to-end solutions that can help patients as they progress with this chronic disease, including how patients are communicated to, how patients are encouraged in their medical care and how patients are looked after as individual persons.

We're advancing our respiratory care strategy in multiple ways. Earlier this summer, we introduced a number of enhancements to AirView, our cloud-based patient management platform. We are making management of ventilation patients much simpler and much more useful for home medical equipment providers.

Physicians and HMEs can now look deep into therapy data to see key performance indicators, such as pulse rate, inspiratory time, maximum airflow and even a patient's rapid shallow breathing index, or RSBI. All these data are now available within our digital healthcare ecosystem with the easy-to-use AirView platform. Our goal is to help create a frictionless experience when managing COPD patients with ResMed's solutions.

Our team at Propeller also continues to grow their business as we move from pilot trials to commercial partnerships with leading respiratory pharmaceutical companies. The team was recently at the European Respiratory Society Annual Congress in Madrid. It was great to see Propeller represented at multiple pharma booths, including live demonstrations of Propeller solutions for physicians. Propeller was also featured in several scientific presentations during ERS, including the public announcement of a new large COPD outcomes trial that's sponsored by Novartis.

The trial will compare Propeller plus COPD standard-of-care to COPD standard-of-care alone. The trial has already begun enrolling patients during this quarter.

As we outlined, when we acquired Propeller in January, the digital health opportunity with respiratory medicine adherence will take time to build into critical mass.

This quarter, we passed a significant milestone, with more than 100,000 people enrolled into the Propeller ecosystem.

Let's be clear. We are still in the early days of market development here. The analogy is that we are now just lacing our shoes for the digital health ultramarathon in both COPD and in asthma. So there's lots of terrain ahead. The evolution that we have made in our respiratory care business has set ResMed up to become the global leader in digital health for COPD, from stage I and stage II COPD with Propeller's pharmaceutical adherence solutions to stage III and stage 4 COPD with portable oxygen concentrators as well as our cloud-connected noninvasive ventilation solutions.



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Let's now turn to our third vector of growth, our software-as-a-service business.

We continue to integrate and optimize the SaaS portfolio for long-term growth. Our competitive advantage drives from our leadership position in SaaS solutions for home medical equipment, for skilled nursing facilities, for home health, hospice, life plan communities and home care services.

ResMed is the best strategic player competing in these verticals, and we have the expertise running global digital Health systems at scale to be able to succeed in the future. Our SaaS portfolio continues its growth trajectory this quarter with revenue up 83% year-on-year during the quarter. Clearly, growth in this first quarter was accelerated, leveraging our MatrixCare acquisition in November of 2018.

We will lap that acquisition during this current second quarter. We estimate that the underlying market growth of the blended portfolio of seven out-of-hospital SaaS verticals that we serve is in the high single digits. Leaving out the MatrixCare acquisition, we grew right in line with the market in Q1. We have set up an execution plan to continue to innovate and to continue to launch marketing-leading upgrades, combined with new capabilities that will allow us to gain market share in our SaaS verticals and participate in the fastest-growing ones so that we can beat market growth. We plan to exit fiscal 2020 with solid double-digit growth in our SaaS business segment. One example of the progress that we're making in our SaaS portfolio is the recent announcement of our collaboration with Cerner as a new preferred provider for home health and hospice software. This agreement validates ResMed as an industry-leading provider of digital health solutions for out-of-hospital healthcare.

Our MatrixCare managed offerings for home health and Hospice customers includes the best-of-breed capabilities from both the MatrixCare technology and from the Brightree technology.

This agreement ensures our Home Health and Hospice solution is available to all of Cerner's large customer base. The net result is growth opportunities for both Cerner and MatrixCare sales teams. In fact, at the recent Cerner Healthcare Conference, a major healthcare system with a very large home health business was introduced to the ResMed solution and they are quickly moving towards a contract with our MatrixCare team.

It is clearly early days as the ink dries on the Cerner contract, but the bottom line is we are excited to drive growth from this partnership and to leverage interoperability to provide value for all of our customers.

In summary, for the SaaS business, we have the vision to transform and significantly improve out-of-hospital healthcare. We are helping people stay out of the hospital and in the care setting of their choice, with lower costs and higher quality of life for the person. The best place that people often choose is almost always their own home. Aging in place is a trend that is growing, not just in the U.S. but, globally and we plan to enable and leverage that positive change. We think that's an important part of the future of healthcare.

Before I turn the call over to Brett, let me close with this. We have had a great start to the new fiscal year, and we are well-positioned to grow throughout fiscal year 2020 and beyond.

We have positioned ResMed for the long term as the global leader in digital health, driving both top line and bottom line growth, as well as executing on our strategy to improve 250 million lives in healthcare that's delivered outside the hospital in 2025. We are focused on our triple aim, to slow chronic disease progression, to reduce overall healthcare system costs and to improve outcomes and quality of life for the ultimate customer, the person who simply wants to sleep well, to breathe well, and to live a better life well away from that hospital. With that, I'll turn the call over to Brett in Sydney for his remarks, and then we'll open up for Q&A. Brett, over to you in Sydney.

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**Brett A. Sandercock** - ResMed Inc. - CFO

Great. Thanks, Mick. In my remarks today, I'll provide an overview of our results for the first quarter of fiscal year 2020.

As Mick noted, we had a strong quarter. Group revenue for the September quarter was \$681 million, an increase of 16% over the prior year quarter.

In constant currency terms, revenue increased by 17%. Excluding revenue from acquisitions, group revenue increased by 11% on a constant-currency basis.



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Taking a closer look at our geographic distribution and excluding revenue from our software-as-a-service business, our sales in U.S., Canada and Latin America countries were \$370 million, an increase of 13% over the prior year quarter.

Sales in Europe, Asia and other markets totaled \$224 million, an increase of 4% over the prior year quarter.

However, in constant currency terms, sales in combined Europe, Asia and other markets increased by 8% over the prior year quarter.

Breaking out revenue between product segments, U.S., Canada and Latin America device sales were \$187 million, an increase of 8% over the prior year quarter.

Masks and other sales were \$183 million, an increase of 19% over the prior year quarter.

For revenue in Europe, Asia and other markets, device sales were \$152 million, which is consistent with the prior year quarter, but in constant-currency terms, a 4% increase.

Masks and other sales in Europe, Asia and other markets was \$72 million, an increase of 15% over the prior year quarter, or in constant-currency terms, a 19% increase. Globally, in constant-currency terms, device sales increased by 6% while Masks and other sales increased by 19% over the prior year quarter.

Software-as-a-service revenue for the first quarter was \$87 million, an increase of 83% over the prior year quarter.

During the rest of my commentary today, I'll be referring to non-GAAP numbers. The non-GAAP measures adjust for the impact of amortization of acquired intangibles and the purchase accounting fair value adjustment to MatrixCare deferred revenue.

The prior year comparable excludes amortization of acquired intangibles. We have provided a full reconciliation of the non-GAAP to GAAP numbers in our first quarter earnings press release.

Our gross margin for the September quarter was 59.5% compared to 58.3% in the same quarter last year and 59.3% in Q4 FY '19. Compared to the prior year, our gross margin increased by 120 basis points. This was predominately attributable to manufacturing and procurement efficiencies, the MatrixCare acquisition and favorable product mix.

Moving on to operating expenses. Our SG&A expenses for the first quarter were \$167 million, an increase of 14% over the prior year quarter. In constant-currency terms, SG&A expenses increased by 16%.

Excluding acquisitions, SG&A expenses increased by 6% on a constant-currency basis. SG&A expenses as a percentage of revenue improved to 24.6% compared to 25% that we reported in the prior year quarter.

Looking forward, subject to currency movements and taking into account recent acquisitions, we expect SG&A as a percentage of revenue to be in the range of 23% to 24% for the remaining three quarters of fiscal year 2020.

R&D expenses for the quarter were \$48 million, an increase of 24% over the prior quarter or on a constant-currency basis, an increase of 27%. Excluding acquisitions, R&D expenses increased by 2% on a constant-currency basis.

R&D expenses, as a percentage of revenue, was 7.1% compared to 6.6% in the prior year. Looking forward, subject to currency movements, we expect R&D expenses, as a percentage of revenue, to be in the range of 7% to 8% for the balance of fiscal year 2020.

Amortization of acquired intangibles was \$18.5 million for the quarter, an increase of 44% over the prior year quarter, reflecting the impact from our recent acquisitions.



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Stock-based compensation expense for the quarter was \$13.3 million.

Non-GAAP operating profit for the quarter was \$191 million, an increase of 22% over the prior year quarter, while non-GAAP net income for the quarter was \$135 million, an increase of 16% over the prior year quarter.

Non-GAAP diluted earnings per share for the quarter were \$0.93, an increase of 15% over the prior quarter, while GAAP diluted earnings per share for the quarter were \$0.83.

On a GAAP basis, our effective tax rate for the September quarter was 20.2%, while on a non-GAAP basis, our effective tax rate for the quarter was 20.6%. Looking forward, we estimate our effective tax rate for the full fiscal year 2020 will be in the range of 19% to 21%.

Cash flow from operations for the first quarter was \$162 million, reflecting robust underlying earnings. Capital expenditure for the quarter was \$22.7 million.

Depreciation and amortization for the September quarter totaled \$38 million. And during the quarter, we paid dividends of \$56.1 million.

We recorded equity losses of \$6.8 million in our income statement in the September quarter associated with our Verily joint venture. We expect to record approximately \$7 million of equity losses each quarter in fiscal year 2020 associated with the joint venture operations.

Our Board of Directors today declared a quarterly dividend of \$0.39 per share. And during the quarter, we repaid \$49 million of our outstanding debt. At September 30, we had \$1.2 billion in gross debt, and \$1 billion in net debt. Our balance sheet remains strong with modest debt levels.

Finally, to recap, our top line revenue was strong this quarter with growth across all major categories.

Gross margin expanded and our operating costs remain well controlled. As a result, we are continuing to drive operating leverage with Q1 non-GAAP operating profit, up 22% year-on-year. We are focused on driving operating results, integrating our SaaS acquisitions, and ensuring we continue to invest in our strategic long-term opportunities. And with that, I'll hand the call back to Amy.

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**Amy Wakeham** - ResMed Inc. - VP of IR & Corporate Communications

Great. Thanks, Brett. We are now going to turn the call over to the Q&A portion. (Operator Instructions) We're now ready for the Q&A portion of the call.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) Our first question comes from Gretel Janu with Crédit Suisse.

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**Gretel Janu** - *Crédit Suisse AG, Research Division - Research Analyst*

So just firstly, just on the -- U.S. device growth continues to be very strong. Just wondering, what would be the growth in kind of new patients set-ups in the quarter? Give us some detail on that.



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**Michael J. Farrell** - *ResMed Inc. - CEO & Director*

Yes. Thanks for the question, Gretel. So we don't actually have full visibility even to the number, right. We sell to -- in the U.S., to high medical equipment companies that then sell to patients that are renewing in their 5-year renewal or to new patients. So we don't have full visibility into that. But it is interesting with a reasonably sized patient pool in the United States, it would be a good double-digit percentage or so of those that will be replenishment devices.

But the 8% growth I think is really ahead of market. We think the market growth is in the sort of mid-single digits, and so to be at 8% growth in the U.S. shows that we are taking some share due to the value of Air Solutions, AirView and myAir and all the sort of digital health solutions that are there.

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**Operator**

Your next question is from Steve Wheen with Evans.

**Steven David Wheen** - *Evans & Partners Pty. Ltd., Research Division - Senior Research Analyst*

Yes. Just a question also on the devices.

There seems to be certainly amongst the DME land, a bit of a rush on COPD codes and the setting up of patients with ventilators. Just wondering if you're seeing any benefit from that particularly around -- amongst your Astral -- or your ventilator range, in particular the Astral.

**Michael J. Farrell** - *ResMed Inc. - CEO & Director*

Steve, thanks for the question. We actually saw really solid growth in the core sleep business, as a sizable chunk of that 8% growth in the U.S. Astral tends to be more of a player, ventilation in general tends to be more of a player in Europe. And so some of that sort of 4% constant currency growth in Europe, Asia and Rest of World will be driven by the Astral, and some sort of much smaller element of the 8% U.S. growth. But one thing that we've been really strong with our DME customers is to make sure that the right device goes on the right patient at the right time. And when you look at COPD, there were lots of solutions from our AirCurve S, AirCurve ST, as well as some noninvasive ventilation as well as even our Stellar product in noninvasive ventilation all the way through to our Astral product, which is really a life support ventilator and should be used in very severe COPD and in life-support needs. And so yes, it really wasn't a huge contributor in the U.S. this quarter, probably slightly more significant in Europe. But it's really good solid, balanced growth, if you like, from our sleep apnea side with some additions from respiratory care, is how I'd position it.

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**Operator**

Your next question comes from Margaret Kaczor with William Blair.

**Malgorzata Maria Kaczor** - *William Blair & Company L.L.C., Research Division - Research Analyst*

Just kind of big picture. I know some people are going to focus on the device sleep apnea growth, but in all, you guys ended up delivering 11% top line growth, excluding acquisitions. I mean that's above market in almost every category and even as you're seeing a headwind in France. So I guess looking out whether it's this year or the next couple of years, what prohibits you guys from continuing that double digit top line growth rate? And what could drive it higher or lower from today's level?



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**Michael J. Farrell** - ResMed Inc. - CEO & Director

Thanks for the question, Margaret.

Certainly, we did have a very good quarter here in Q1. And as you said, we grew sort of 11% constant currency, globally in our Sleep and Respiratory Care combined businesses.

If you think about the global growth and we have enough data now to know that the growth really is in that mid- to high single digits. So Devices is growing in the mid-single digits, and Masks is growing in the high single digits. Clearly, we did take share in Q1, and a lot of that is driven by the digital health technology on the flow generator side to have the -- some of the share taking on the device side. And then the new product introductions that I detailed in the prepared remarks, four new masks in addition, to two strong flagship masks there. So NPI has been an incredible contributor to us. Just if you think through the year ahead, even during this quarter which we are currently in the second quarter, we're going to lap one of those four product launches on the mask side and we'll continue to lap those during the quarter. So look, I'm always very excited about our innovation, the smallest, the quietest, the most comfortable, the most connected. And I think that innovation drives. But you can't outgrow market forever, right? You've got to then focus on getting more patients into the funnel, which is our whole identifying gauge, and enroll people in. So I think, a fantastic Q1. But as we look through the fiscal year, we think we can meet or beat market growth, but you're not going to beat it every single time.

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**Operator**

Your next question is from David Low with JP Morgan.

**David A. Low** - JP Morgan Chase & Co, Research Division - Research Analyst

Mick, during the period -- or we heard -- we saw from your competitor Philips that they had issues with their connected care business. They talked about tariffs, et cetera. Just wondering sort of market landscape in the U.S. whether you saw any disruption from that? You think some of the -- that ResMed may have been a beneficiary of the issues that they were working through?

**Michael J. Farrell** - ResMed Inc. - CEO & Director

Yes, I'll hand that --, good question, Dave, I'll hand that to Rob Douglas, our COO.

**Robert A. Douglas** - ResMed Inc. - President & COO

So David, just generally on the tariffs issue, just to reiterate. As we said before, the way our whole supply chain is configured, we're not really affected by the specific tariffs.

We export very little into China from the U.S. and very little from China to the U.S. Our supply chain is more Southeast Asian focused. And we've got a great team in China doing local products for China, so that's pretty solid. Our AirView solutions on the other hand -- mostly by the way, developed by teams all around the world, but really a strong product offering, continues to deliver superior value to our customers and we think -- with day-in and day-out, we'll fight competition with those products and believe that we've got a better proposition to offer. So we -- from our perspective, we didn't see any particular competitive issues that were sort of changing the normal competitive dynamics.

We do have to sell and execute well, and our teams have been doing that.



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**Operator**

Our next question is from Andrew Goodsall with MST Marquee.

**Andrew Goodsall** - *MST Marquee - Healthcare analyst*

Perhaps, just thinking forward into competitive bidding, and I guess the bids are in. So I guess by next summer, we've got a sense where the clearing prices land. I'm just wondering whether there's any preliminary comments you've got in your thoughts there or any preliminary actions you're taking, I guess to prepare for competitive building? And whether that involves new product launches or anything in your hat? Just as any preliminary jobs you're doing or preparatory actions?

**Michael J. Farrell** - *ResMed Inc. - CEO & Director*

Yes. Thanks for the question, Andrew, I'll hand that to David Pendarvis.

**David B. Pendarvis** - *ResMed Inc. - Chief Administrative Officer, Global General Counsel & Secretary*

Thanks, Andrew. The -- obviously, we spend a lot of time along with others in the industry trying to educate the market participants so they would be able to bid effectively and bid smartly, given the new rules. We remain encouraged with the changes that were put in place principally that the clearing price is what's going to drive reimbursement as opposed to the median price under the old regime, and some of the other changes that were made including requiring bonds to bid in particular. We're hoping that that together with the education that the industry did, will lead to smart bids, and that will lead to a fairer, more realistic reimbursement. We obviously didn't participate in the bidding process and haven't had direct conversations with customers about what they bid. So it's all conjecture at this point as to where the ultimate reimbursement will land. But no matter where it is, whether it's a private pay reimbursement change or a Medicare U.S. change or something elsewhere in the world, we're continuing, working with our customers to help them be more efficient, help them take advantage of the opportunities that present themselves, and to enable them to better serve patients under whatever the reimbursement schemes are. So we'll definitely continue to do that and watch where the U.S. Medicare landscape evolves. But at the moment that's still a year and a bit away. So we'll just keep doing what we're doing and obviously, focus on it when the time comes.

**Operator**

Your next question is from Lyanne Harrison with Bank of America Merrill Lynch.

**Lyanne Harrison** - *BofA Merrill Lynch, Research Division - VP*

Solid mask growth outside of America. And I just wanted to understand you've had one of your competitors launch a new full-face mask outside of America.

Have you seen any difference in your full face mask sales outside of the U.S. versus within the U.S.? And how are you positioning yourself now that they've got FDA approval to launch within the U.S.?

**Michael J. Farrell** - *ResMed Inc. - CEO & Director*

Yes. So thanks for the question, Lyanne. And look, we have multiple competitors in the 120 countries we sell into, and we expect new product introduction from our competitors on a regular basis. Yes, as you noted, during the quarter we had 19% constant currency growth in U.S., Canada, Latin America. We also had 19% constant currency growth of masks in Europe, Asia and Rest of World where some of those masks and new launches have already been in play during the quarter. So I think we've -- I know we've got the most robust sleep apnea mask portfolio on the planet versus



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our competitors in all the 120 countries that we precipitate in. But there is no arrogance or hubris here. Our team of R&D engineers are furiously working not only on a technology to address underserved needs, but to think differently about how to really achieve that ultimate goal, which is sort of the silent CPAP and the invisible mask. And if you look at the N30 that we just launched, this minimalist category mask, it's about as close to an invisible mask as you can get.

It is small, it is quiet, it is comfortable. So look, I love innovation coming to the market from our competitors and from us because it keeps us all honest. But during the quarter we performed very well versus all the NPI from our competitors with our own NPI. And I expect us to be able to do that into the future and competition is just a healthy part of making sure that tens of millions of people get the breathing they need.

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**Operator**

Your next question comes from John Deakin-Bell with Citi.

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**John Deakin-Bell** - Citigroup Inc, Research Division - Director & Head of Healthcare in Australia and New Zealand

Perhaps a question for Brett. Just to deconstruct that gross margin expansion a little bit. I think previously you've given us the feel for what was from the MatrixCare. But can you just maybe elaborate a little bit more in terms of strong mask growth, higher margins that will have impacted? And also whether there is a more benign pricing environment in the U.S., which is helping as well?

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**Brett A. Sandercock** - ResMed Inc. - CFO

John, it's Brett. I mean I think it's all of those things. It's probably the pricing environment is relatively benign at the moment. So impacts there are pretty modest. In terms of acquisitions that contributed around 50 basis points. So if you think about that it's still a really strong, let's call it organic expansion of the margin, which is really good. That's really around the manufacturing and procurement efficiencies and then clearly, some product mix benefit there as you saw the outperformance in the mask growth. So a combination of all those factors of all those factors, I think, led to that expansion.

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**Operator**

And your next question comes from David Bailey with Macquarie.

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**David Bailey** - Macquarie Research - Research Analyst

Just in relation to U.S. masks and accessories. You talked to adherents and resuppliers as key drivers of growth. Just wondering if you can comment on your views as to those factors being drivers of growth over the next two to three years.

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**Michael J. Farrell** - ResMed Inc. - CEO & Director

Yes. That's a good question, David. I'll hand that over to Rob.

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**Robert A. Douglas** - ResMed Inc. - President & COO

Yes. Thanks, David. Yes, the resupply programs has definitely supported the mask portfolio, and we've talked many times. You've got to understand the sort of feedback of this. If you can get patients onto a good mask they're more likely to stay on treatment and do better and then they'll need a mask. And so we continue to see that dynamic happening. Our software solutions support the resupply programs and enable our HME customers to manage resupply programs more efficiently and ensure that the patients have the treatment that they need, when they need it, are also supporting



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it. These are long term programs. We've been running resupply programs for many years now and they -- and our teams will continue to refine and focus it. As Mick said earlier though, these markets are competitive. We do have competitors playing it. We have competition in resupply programs as well as in masks. And it really gets down to we've got a really strong team executing broadly across the -- across all parts of the portfolio on this that will continue to make sure that we're providing the best solutions for the patients and providers, delivering the best outcomes. So I think it's really steady as she goes progress. We love -- we really like these resupply programs and they're providing us a very solid steady business.

**Operator**

Next question is from Sean Laaman with Morgan Stanley.

**Sean M. Laaman** - *Morgan Stanley, Research Division - Australian Healthcare Analyst*

Mick, I'm wondering if we could get a little bit more granularity on the Novartis study you mentioned in your preliminary comments? And perhaps, some timelines, that would be really useful.

**Michael J. Farrell** - *ResMed Inc. - CEO & Director*

Yes. Thanks for the question, Sean. I wasn't at ERS, but I'll hand over to Dave Pendarvis who can give us some more detail on the Novartis clinical trial.

**David B. Pendarvis** - *ResMed Inc. - Chief Administrative Officer, Global General Counsel & Secretary*

Terrific. Sean, we mentioned in the opening remarks, it's goes by the name of MAGNIFY and of course, with trial these days you have to have a good acronym and that stands for maximizing adherence and gaining new information for your COPD. And the trial is going to be -- it's obviously sponsored by Novartis and what it's doing is taking patients within clinics and then within those clinics randomizing the patients to either standard clinical practice or using Propeller. And then there'll be comparison and the end point is the time to failure of treatment. And then failure of treatment is defined in various ways such as needing an additional medication, having some particularly acute exacerbations, winding up in hospital, those kinds of things. And it'll look and see whether or not adding the adherence benefits of Propeller lengthens the time that patients stay in that good controlled state. It's beginning recruiting now, and I believe it is supposed to run through the end of 2021.

So it will take quite a while before it meets, it's the end of that time period. But important thing is a lot of the data that's been out now had been done in the asthma setting. Obviously, that's an important area and we want to take care of those patients. But the COPD strategy is very important to us because of the way it connects with our overall respiratory care strategy. So having someone like Novartis sponsor a study, looking at the Propeller benefits to a COPD patient population, we think is a real important milestone, and we'll look for good benefits to come out of that study in the future, but it will be a few years.

**Operator**

Your next question comes from Anthony Petrone with Jefferies.

**Anthony Charles Petrone** - *Jefferies LLC, Research Division - Equity Analyst*

Great. I'm just going to have a follow-up to the Novartis question and somewhat. Mick, you mentioned, a couple of weeks ago indications of interest from AstraZeneca, GLAXO and Novartis on Propeller Health. Just wondering if you have an update there? And anything you can share potentially on how that would be priced on a per user per month basis?



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**Michael J. Farrell** - ResMed Inc. - CEO & Director

Yes. Thanks for the question, Anthony. Pharma companies -- there are many respiratory pharmaceutical pharma players in the field and the names you mentioned all have drugs in the market. One thing about pharma companies, they're very competitive with each other and they don't want information shared too much publicly. Certainly on our investor deck we put the names of those where we have published clinical data with and we're working with.

And the reason we're bringing Novartis in our prep remarks here is that's a public clinical trial. One of the interesting things that's happening here is there is a lot of trials that aren't public that are happening out there that obviously we cannot talk about. As we look forward, the important thing, if you think about milestones, Anthony, to sort of -- to look at on this sort of digital health option play, if you like, that we have in our strategy with the Propeller solution is when somebody goes from these pilot trials to a commercial trial, and when they would allow us to talk about that publicly. And so if and when that happens, that's the milestone, I think that's most important in a material element to our shareholders.

As I said in the prep remarks, we got in early with Propeller and this is a long road. I think I used the analogy that it's an ultramarathon. This is beyond just 26.2 miles. This is a huge journey, COPD #2 cause for hospitalization and rehospitalization, the #3 cause of death. This has such good runway for us in the future, but there's nothing material in the quarter. And so we're just giving the update. We hit 100,000 patients. We think that's fantastic. It's great validation to have Novartis start this public study. It's going to take a couple of years, as Dave said. But I would expect that before those couple of years, we'll have some other milestones of going to some commercial trials that we can talk about in upcoming conference calls. But right at the moment, this quarter, Anthony, there's nothing to report other than really good early data.

**Operator**

Your next question comes from Saul Hadassin with UBS.

**Saul Hadassin** - UBS Investment Bank, Research Division - Executive Director & Research Analyst

I want to ask about the SaaS business, Mick and the tie-up with Cerner. It suggests that Cerner is effectively leaving that post-acute space to providers like yourselves. I'm interested to know the -- how much work needs to be done to allow for the two architectures to talk to each other? If you have any electronic medical record, for example, in the acute space offered by Cerner, what work has to be done in terms of your SaaS business to allow those two systems to talk to each other? When do you expect to see the ability of the benefits of that type to come through?

**Michael J. Farrell** - ResMed Inc. - CEO & Director

Yes. Thanks for the question, Saul. It allows us to talk to the area of interoperability, which is incredibly important for us here at ResMed.

We have 100 API calls per second from integrators into our Air Solutions ecosystem. So every second, 100 interactions with another EHR, EMR, whether it's an individual person on their myAir app checking their therapy or a physician at Massachusetts INE looking over 20,000 patients to do some management by exception protocol.

And so the Cerner contract or deal is that they -- Cerner are looking for ResMed and really truly through our MatrixCare-managed team to take care of home health and hospice customers for them. So they have customers that have hospital systems, but for the out-of-hospital part where it goes to home health and hospice they want ResMed to be their partner to take care of those. And we think it's a really exciting opportunity for the MatrixCare sales team and for the Cerner sales team to partner up and have that move forward. And it was really interesting at the Cerner conference to have our MatrixCare and Brightree teams there and all the technology available from the iPad app and all the capabilities that we have for home health and hospice and to get some really good leads. It's not going to be material in the next 90 days for us, this Cerner contract, but the reason we are talking about is that idea of interoperability with Cerner, with Epic, with Allscripts, with all the players in in-hospital healthcare, we think it's going to be really important that ResMed is the best person that can provide that handshake that API from someone in acute care to what they

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call post-acute care, but what we call out-of-hospital healthcare. And we think that partnership is going to be really strong. So we'll give you updates as the quarters progress not just to the Cerner home health and hospice partnership but to other partnerships with hospital systems, hospital providers and EHR providers. We think it's a good milestone to show that a -- one of the top 3 leader along with Epic and Allscripts there and hospital EHR has chosen ResMed as their home health and hospice care provider with our MatrixCare-managed solution, and we're really excited about that.

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**Operator**

Your next question is from Thomas Yeo with Goldman Sachs.

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**Chris Cooper** - *Goldman Sachs Group Inc., Research Division - Research Analyst*

Chris Cooper on for Tom. Apologies, if I've missed it, but didn't hear much commentary on Mobi or portable oxygen concentrator this morning in your prepared remarks. Could you just give us an update there?

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**Michael J. Farrell** - *ResMed Inc. - CEO & Director*

Yes. Thanks for the question, Chris. I'll hand the to Rob.

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**Robert A. Douglas** - *ResMed Inc. - President & COO*

Thanks, Mick. Yes, Thomas, we -- as you recall, we launched Mobi very early this year. And we've sort of been in a really -- still in a learning mode. It's a great product. We're actually learning a lot about the performance of the product. And we've talked about and continue to validate the issue of the balance of the performance specifications and how the product works. And so we're in good shape there. What we are also learning is that it is challenging through -- particularly through the U.S. reimbursement model how to get the right patients on the right treatment, and how to get that properly funded. And we've been trialing experiments and looking at ways to optimize and develop that. Really we're learning a lot about what our sort of future pathways to market would be and how to -- how can we make it best suitable for our HME customers to support patients, and also what are the future needs of products further down the track and learn -- fitting learnings into our future roadmap. So with that all going on, the other learning processes are quite successful. We're still not the major market share player with the product, and that's unlikely to change into the short-term future with the Mobi product, as they're currently investing in it and the way we're heading at the moment.

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**Operator**

Your next question is from Mike Matson with Needham & Company.

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**Michael Stephen Matson** - *Needham & Company, LLC, Research Division - Senior Analyst*

I guess I just wanted to ask about there is a, I guess, a bill in Congress, H.R.2771 to kind of extend the rural relief from the bidding program that I think is set to expire at the end of 2020. So just curious to get your thoughts on that and what that would means if that were not to be successful?

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**Michael J. Farrell** - *ResMed Inc. - CEO & Director*

I'll hand that question to Dave Pendarvis.



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**David B. Pendarvis** - ResMed Inc. - Chief Administrative Officer, Global General Counsel & Secretary

Thanks, Mike. Yes, there's a lot of efforts underway in the U.S. Congress right now to try to provide relief, particularly the one you mentioned, which is trying to extend the relief that was given that was sort of 50/50 blend between prior reimbursement and the new system reimbursement into those rural areas. We certainly support that legislation. We think it's important that our customers who are operating particularly in extended areas where they've got to drive many miles to patients' homes need to have reimbursement that reflects the operating cost that they've got. And we would certainly hope that the champions that are there in Congress will carry the day. Now your question implies, there's a lot going on in the U.S. Congress these days. It's very difficult to predict whether something like that will ultimately pass, or whether CMS could respond on their own and provide that kind of relief. If it doesn't, I think as I said before, when talking about competitive bidding, we'll obviously work with our customers to do what we can to support them. We think the remote capabilities of our devices are ideal for providing care in a remote setting. You can do things like change some of the settings on the CPAP. You can certainly interrogate the CPAP for information about the quality of the therapy that has been provided, all without having to drive to someone's home. So we think that those systems, and helping customers whether they're in rural areas or not, to deploy them is probably the best thing we can do to help in that kind of a setting. But we'll continue to support that legislation and other efforts with CMS to try to make sure that the Medicare policies and reimbursement is as favorable as it can be for the ultimate benefit of Medicare beneficiaries.

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**Operator**

Your next question is from Shane Storey with Wilsons.

**Shane A. Storey** - Wilsons Advisory and Stockbroking Limited, Research Division - Senior Analyst

It may be a bit tangential, but it relates to the CMS reimbursement changes that hit field nursing providers this month. Sort of weighing up that as an incremental opportunity for Matrix. I mean, do you have an estimate of the proportion of providers that are yet to good solutions there? And just interested to know, just how much growth there is -- scope sorry, towards available for Matrix there in the SaaS market?

**Michael J. Farrell** - ResMed Inc. - CEO & Director

Yes, Shane, thanks for the question. It's a good win. There are changes in reimbursement, not just in HME, as we just talked about, but also in skilled nursing facilities and within home health and hospice. These provide excellent opportunities for software-as-a-service providers to -- if you're ahead of the game, as MatrixCare was for the skilled nursing facilities changes, and as we are for the home health and hospice changes to be able to support customers through that change and even grow share. Because you've got the best solution that deals with those changes well. One thing I can say is that the new CEO there at MatrixCare, StevePacocco, has formed great relationships with the customers, and he has a great sales team that know the skilled nursing facility teams really well. And we've not only helped them through these changes in this quarter, but also set them up for success that our systems are operating well under the new reimbursement approach within the -- those verticals. So that's a -- when you roll that all together, it's part of sort of that 2020 execution plan I talked about earlier that we see a good path even if the blended rate of growth across these seven out-of-hospital healthcare verticals is in those high single digits. We think there are areas where we can get better growth than that. And we plan to exit 2020 with a double-digit growth trajectory in the segment of SaaS, and part of that is going to be doing just what your question asked about, which is, every part of the vertical whether it's skilled nursing facilities, whether it's our new play in home health and hospice, the hunting license with Cerner, in addition to our ability to grow share through having solutions that are ahead of the curve on reimbursement changes. They're all opportunities to be able to grow faster and get -- form longer partnerships with our customers.

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**Operator**

Your next question is from Steve Wheen with Evans.



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**Steven David Wheen** - *Evans & Partners Pty. Ltd., Research Division - Senior Research Analyst*

Just wanted to come back to Brett on the gross margin. You've typically given a bit of a range of that in terms of guidance. Are you able to do that again this quarter?

**Brett A. Sandercock** - *ResMed Inc. - CFO*

Yes. Sure, Steve. I mean there's a lot of moving parts, but I would think it would be broadly consistent with where we were for Q1.

**Operator**

And your next question is from Anthony Petrone with Jefferies.

**Anthony Charles Petrone** - *Jefferies LLC, Research Division - Equity Analyst*

Just quick follow-ups on masks. I know you mentioned Mick, a couple of launches. I'm just wondering how much stocking potentially there was in the quarter? And then just on lead item. Is there any -- Dave, you mentioned, we spoke a couple of days ago, but is there any indication on how this is kind of coming in post the notification period?

**Michael J. Farrell** - *ResMed Inc. - CEO & Director*

Yes. So Anthony I'll take the first part of your question on masks and Dave will take the second part. Yes, clearly, we had excellent new product introduction over the last 12 months. But our -- your question is around do people do stocking orders. Our U.S. distribution and frankly our global distribution partners are getting very intelligent about inventory management. Not just those who use Brightree and have ResMed's Brightree inventory management system, which will actually manage it for them, but many of them are getting really appropriate on that, knowing when a new mask comes, watching how their RTs are setting it up and seeing the patient flow and making sure they don't get too ahead of the curve or behind the curve. You don't want a patient in the fitting room that wants the N30 and it's not there, but on the other hand you don't want excess inventory because they have inventory carrying costs as everyone knows, and our U.S. distributors are actually quite sophisticated on this. So I -- obviously when some -- when you launch a brand new mask people do need to make sure they got that mask on the shelf, but given the proportion of existing resupply patients, which is a very large portion particularly of U.S. distributors' patient flow, we don't think there was material impact from stocking. Now we don't have full insight into our customers that aren't using Brightree or other inventory management solutions, but we think it's a pretty steady approach and we've done new product introductions over the 20, 30 years we've been in business, and I don't -- we haven't seen that at a significant rate before, and I don't think we saw any significant rate at that during the last quarter. Dave, the second part of the question is for you.

**David B. Pendarvis** - *ResMed Inc. - Chief Administrative Officer, Global General Counsel & Secretary*

Sure. Yes, thanks, Anthony. Yes, I mentioned a little bit earlier that ResMed along with other industry participants put a lot of energy and resources behind trying to educate the market participants who are going to be bidding about various factors, including lead item pricing, and we developed a calculator that was put out. There were some stats that were just discussed in the MedTrade meeting just earlier this week in Atlanta that there were over 17,000 downloads of that calculator. And that's just simply the one that was available to the participants here. CMS had their own calculator that folks, no doubt, downloaded. From the conversations that I've had -- my understanding is that most DMEs have a pretty good understanding of lead item pricing and how it works and hopefully, they've availed themselves of the tools to be able to model out scenarios based on their own business and their own volume of products in different categories. So that they can bid intelligently and in a way that's going to ultimately drive a fair and reasonable reimbursement. So I'm confident that we got that message out, that it was received. Obviously, we don't know how people bid, and we'll work with customers as best we can to try to implement things when the day comes. But we're confident that we did what we could to try to educate.

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**Operator**

And we are now at the 1-hour mark so I will turn the call back over to Mick Farrell.

**Michael J. Farrell** - ResMed Inc. - CEO & Director

Thanks, Chris. And thanks again to all our shareholders for joining us on the call this quarter. I'd also like to thank the 7,500 ResMedians, many of whom are also shareholders for their dedication and hard work, helping people breathe better, sleep better and live better lives outside the hospital in 120 countries worldwide. Thanks for all that you do today and every day. We'll talk again with all of our shareholders in approximately 90 days. Talk to you all then.

**Amy Wakeham** - ResMed Inc. - VP of IR & Corporate Communications

Great. Thank you all again for joining us today. If you do have any additional questions, please don't hesitate to reach out to Investor Relations or to me directly. As previously mentioned, all documents including the transcript and a replay of today's call will be available on our website later today. Chris, you may now close the call.

**Operator**

Ladies and gentlemen, this does conclude today's conference call. Thank you for your participation and you may now disconnect.

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