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EDITED TRANSCRIPT

RMD.N - Q2 2021 Resmed Inc Earnings Call

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OVERVIEW:

RMD reported 2Q21 revenue of \$800m, non-GAAP net income of \$206m and non-GAAP diluted EPS of \$1.41.

CORPORATE PARTICIPANTS

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

Brett A. Sandercock *ResMed Inc. - CFO*

James R. Hollingshead *ResMed Inc. - President of Sleep & Respiratory Care Business*

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

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

David Pendarvis *ResMed Inc.*

CONFERENCE CALL PARTICIPANTS

Andrew Goodsall *MST Marquee - Healthcare analyst*

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

David Bailey *Macquarie Research - Research Analyst*

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

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

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

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

Matthew Ian Mishan *KeyBanc Capital Markets Inc., Research Division - VP and Senior Equity 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*

Suraj Kalia *Oppenheimer & Co. Inc., Research Division - MD & Senior Analyst*

PRESENTATION

Operator

Welcome to the Q2 Fiscal Year 2021 ResMed Earnings Conference Call. My name is Chantel, and I'll 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.

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

Great. Thank you, Chantel. Good morning, and good afternoon, everyone. Welcome to ResMed's Second Quarter Fiscal Year 2021 Earnings Conference Call. Thanks for joining us. 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.

With me on the call today are our CEO, Mick Farrell; and CFO, Brett Sandercock; and several other members of management will be available during the Q&A following our prepared remarks.

During today's call, we will discuss some non-GAAP measures. For a reconciliation of the non-GAAP measures, please review the notes to today's earnings press release and our earnings presentation. As a reminder, our discussion today may include forward-looking statements, including, but not limited to, expectations about ResMed's 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.

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

Thanks, Amy, and thank you to all of our shareholders for joining us on today's call. On this, our first call for calendar year 2021, we are happy to see the steady growth of production, distribution and availability of vaccines around the world. Clearly, we all want to see faster production and wider distribution so that people can be safe from COVID-19 and free to open up their communities and free to get back to their lives. We continue our work here at ResMed to support frontline respiratory therapists and pulmonary physicians, critical care physicians as well as providers, patients and ResMedians around the 140-plus countries that we operate in.

In our core markets, the patient diagnosis trends in sleep apnea, COPD and asthma are steadily increasing, modestly improving on the trends we saw in the September 2020 quarter. We're seeing this improvement of patient flow even as second and third waves come through Northern Winter Hemisphere nations because physicians and providers are adopting digital health, which enables patient engagement, even when people cannot or do not want to meet live and in person.

In my remarks today, I will provide a high-level overview of our December Q2 FY '21 business results and then hand the call over to Brett for further detail on the financials. I will also review progress towards our ResMed 2025 strategic goals, including execution highlights against our quarterly and annual operating priorities.

Today, we have published and reported solid high single-digit growth in top line revenue and strong double-digit growth in both net operating profit as well as earnings per share. These results once again speak to our ResMed team's ability to work innovatively and deliver results even when facing lower patient activity and little-to-no incremental benefit from ventilator sales.

During the second quarter of fiscal year 2021, we generated over \$170 million of cash, allowing us to return over \$57 million in dividends to shareholders. We have also grown research and development investments in digital health technology as well as hardware, software and clinical research. We forecast increasing digital health demand from patients, from physicians, from providers and from healthcare systems as they embrace remote patient monitoring and they adopt data-driven population health management systems.

We have an exciting pipeline of innovative solutions that will generate both medium and long-term value for our customers, with an industry-leading IP portfolio, including over 6,000 patents and designs.

Our digital health ecosystem is an important competitive advantage for ResMed that offers integrated care to drive superior clinical outcomes, to drive better patient experiences and to drive lower healthcare system costs.

We now have over 8 billion nights of respiratory medical data in our cloud-based Air Solutions platform. We have sold over 13.5 million 100% cloud-connectable medical devices into the market from ResMed, and we have over 15 million patients enrolled in our AirView solutions in the cloud.

With these data liberated to the cloud, we can unlock value for all of our customer groups. We can unlock value for patients through myAir, we can unlock value for physicians through AirView and we can unlock value for IDNs, payer providers as well as private and government insurers for data-driven population health management. That's the future of healthcare.

The goals we share with all of our customers are these three: one, to improve patient outcomes, patient quality of life, patient chronic disease outcomes; two, to lower overall healthcare system costs; and three, to bend the curve of chronic disease progression. To be clear, the spectrum of chronic diseases that we look out here at ResMed are, of course, including our core focus areas of sleep apnea, COPD and asthma, but it also includes biological systems interaction with cardiovascular disease, with cancer, with type 2 diabetes, with neuromuscular disease, Alzheimer's and beyond.

During our last earnings call, I discussed how COVID has continued to accelerate the rapid adoption of digital health technology around the world. We are seeing the recognition of the value of remote patient screening, virtual diagnoses, remote patient management and a rapid evolution of digital reimbursement models in many of the nations that we serve patients.

As an example of just one of these, Germany, during the quarter, approved reimbursement for mandibular repositioning devices, including our digital 3D printed dental sleep apnea product called Narval. This is the first time Germany has approved such a product type to treat sleep apnea. In addition, several German states are looking at and experimenting with digital health reimbursement models. These are exciting developments, and we expect this will benefit our German business over time.

We have also seen other national governments, including France, Japan and the United States where they've adopted models and taken action to accelerate digital health adoption.

Remote healthcare is of incredible importance during this COVID-19 pandemic, but digital health is also valuable well beyond the impact of COVID because it provides better availability of healthcare, it provides excellent quality care for patients, and it provides significantly lower costs for healthcare systems worldwide. These trends are key to ResMed's 2025 strategy. We believe the accelerated adoption of digital health solutions represents a significant and permanent shift of the adoption curve for ResMed's market-leading digital health solutions.

Let me now briefly update you on our top 3 strategic priorities. These 3 priorities are: one, to grow and differentiate our core sleep apnea, COPD and asthma businesses; two, to design, develop and deliver world-leading medical devices as well as globally scalable digital health solutions; and three, to innovate and grow the world's best software solutions for care delivered outside the hospital and especially in the home.

In our core market of sleep apnea, we continue to see sequential improvement in new patient diagnosis trends as well as very strong resupply activity, both of which have supported another quarter of solid revenue growth that you can see in the numbers we just released. We're seeing 70% to 90% of the pre-COVID patient flow coming through our biggest market in the United States, and to take an example of a European country, in Germany, we're already back to 85% to 90-plus percent in some states of Germany of pre-COVID patient flow.

Even in countries like China, in our large Asia region, where we saw the sharpest declines at the start of this crisis with very severe lockdowns in Asia and particularly in China, we're now back to already seeing around 70-plus percent, 70% to 75% of pre-COVID patient flow coming through the mainly hospital clinics in our China market. Obviously, the recovery rates of new patients starting sleep apnea therapy may be impacted by the typical seasonality we see in our largest market here in the United States in the March quarter, as a result of insurance deductibles resetting at the start of the calendar year. This is as per normal.

This seasonal impact affects devices more than it affects mask systems given the relative price points of the 2 categories, and the fact that the vast majority of mask revenue is returning customers on resupply programs. The resiliency of our mask and accessory resupply has been strong throughout the COVID-19 pandemic, and we see it as remaining strong through the recovery and strong in a post-COVID peak world. We continue to produce clinical research showing that diagnosing and treating sleep apnea saves money and improves quality of life for patients.

This quarter, we are now showing data that treating sleep apnea is actually a life and death decision. The latest data from the European Respiratory Journal, which published during the quarter results from a 30-year study. The high-level summary of these results were that treating sleep apnea increases patient quality of life and extends quantity of life. It also showed the converse side in that not treating sleep apnea leads to a significantly higher incidence of heart attack, type 2 diabetes and ischemic heart disease, leading to significantly higher healthcare costs treating those diseases and ultimately leading to earlier death.

Let me now turn from sleep apnea to a discussion of our respiratory care business, focusing on our strategy to better serve COPD and asthma patients worldwide. Our goal is to reach more patients in our core respiratory care markets, including non-invasive ventilation as well as life support ventilation as well as newer areas, including pharmaceutical drug delivery and high flow therapy. We make the smallest, quietest and most comfortable devices on the market, and they are all 100% cloud-connectable.

We continue to see rapid adoption of the AirView for Ventilation software solution that we launched in Europe in the midst of the peak of the COVID-19 crisis there about 9 months ago. We accelerated the time-to-market to meet the needs of physicians and patients during the COVID peak and it's proved to be very useful during the peak and beyond the peak. The value being provided through this platform has helped healthcare systems in the markets they're operating in.

In short, we are making digital health part of the standard of care for respiratory care, not just in Europe but worldwide. During the quarter, we decided to exit the portable oxygen market and shut down our concentrator business in that category. We entered the POC market in 2016 as a way to engage with stage II and stage III COPD patients. Since then, in these last 5 years, we have acquired Propeller, giving us access to COPD patients even earlier in their COPD disease progression, including stage I and stage II COPD patients.

Additionally and especially during COVID, we've seen more rapid adoption of high flow therapy that can support some COPD patients. And of course, we have our core non-invasive ventilation and life support ventilation solutions for more severe COPD patients in markets globally already. In short, we don't need POCs to help in our end-to-end digital health pathway for COPD.

Additionally, given no positive changes to POC reimbursement in the latest round from the U.S. government and the economics of our customer acquisition cost versus lifetime value, the POC market itself is not as attractive as it was 5 years ago.

The bottom line is this: we have pharmaceutical drug delivery management through Propeller to support COPD patients in stage I and stage II COPD, we have the emergence of high flow therapy for stage II and stage III COPD and we have growing use of non-invasive ventilation and life support ventilation to support patients in stage III and stage IV COPD.

So in summary, we are very well positioned to help patients, physicians, providers and payers with an end-to-end digital health management pathway for COPD.

Let me now review our Software as a Service business. During the quarter, our SaaS business grew in the mid-single digits year-on-year, driven by a continued strong uptake of our Brightree HME resupply solutions. The impact of COVID on surgical procedures and other in-hospital and out-of-hospital visits has impacted discharge rates that particularly affect the census at skilled nursing facilities and hospice. On the other hand, the flow of patients in home medical equipment and home health has been recovering well, even stronger.

So as we look across our portfolio of out-of-hospital care settings, including home medical equipment, skilled nursing facilities, home health and hospice, life plan communities, private duty home care and senior living, we expect that the weighted average market growth rate of these verticals will be in the low-to-mid single-digit range for fiscal 2021. We expect this weighted average market growth rate portfolio to return to mid-single digits and then to high single-digits as hospital discharge and ambulatory surgery center discharge rates return.

Our offerings are very well received in each of the verticals that we serve. So we will not just accept these market growth rates, we will look to meet and beat that group market growth rate as we did this quarter, getting a return from our significant investments in R&D within Brightree and MatrixCare. And through expansion of our partnerships with hospital-based electronic health record providers.

Brightree continues to innovate to drive resupply growth. Of particular note, the integration and scaling of the SNAP technology is going very well. This has allowed our home medical equipment customers to expand their resupply programs and support more patients with better engagement at a time during the COVID pandemic when they desperately need new innovation, both the providers and the patients.

MatrixCare has also introduced new technology. We introduced new voice-to-text technology at the point of care, which helps address caregiver shortages, which are ripe during COVID by enabling better and more efficient workflows for the customer, while also delivering a better experience for the ultimate customer who's the patient.

Our expanded relationship with Cerner is progressing very well. We are now Cerner's preferred solution across home health and hospice as well as home medical equipment and their pharmacy and infusion businesses. Our increasingly important relationship with Cerner is leading to better interoperability for providers, our mutual customers, and an improved experience for patients. We anticipate opportunities to deepen and expand this collaboration to sleep apnea and COPD disease management with these partners over time.

Clearly, 2020 was an unprecedented year for companies across every industry, and there was much suffering around the world. However, we see some blessings during all that suffering. Importantly, we here at ResMed, we were able to be there during the emergency. We were able to pivot our whole team and our whole business to provide over 150,000 ventilators during the peak needs of the pandemic and get them to where they needed based upon a humanitarian epidemiology model.

Additionally, COVID has highlighted the importance of respiratory health. COVID generally kills people through acute respiratory distress syndrome. And it's awful, but that has raised the awareness of respiratory hygiene, respiratory health and the field of respiratory medicine. The crisis also showed us the importance of digital health and has accelerated the awareness and adoption of technologies that can be used for remote patient screening, remote patient diagnosis, remote patient set up as well as remote patient monitoring and management.

We have seen this crisis drive the importance of healthcare delivered outside the hospital. And that's where ResMed competes for more than 90% of our business. And it's where we add value to customers and where we win. We have seen an ability to bring digital technology that we've been inventing and developing for over a decade, digital screening, digital diagnostics, digital therapeutics and digital health management of patients.

With over 1.5 billion people worldwide suffering from sleep apnea, COPD and asthma combined, we see incredible opportunities for greater and greater adoption of these scalable technologies. We are poised to continue relentless innovation and development as well as to provide the global scale that's needed to drive this technology to the 140 countries that we operate in and beyond.

Before I hand the call over to Brett for his remarks, and then we get to the Q&A, I want to once again express my sincere genuine gratitude to the more than 7,500 ResMedians, whose perseverance, hard work and dedication during the incredibly challenging circumstances of 2020 allowed our partners in healthcare to save the lives of many hundreds of thousands of people around the world with emergency need for ventilation, literally given the gift of breath and the gift of life to many during COVID. I also thank you for the rapid pivot back to our core markets and our core purpose of helping people with sleep apnea, COPD, asthma and all those who need world-class care delivered well away from the hospital and preferably in their own home. Thank you.

With that, I will hand the call over to Brett in Sydney, and then we'll move to Q&A. Brett?

Brett A. Sandercock - ResMed Inc. - CFO

Great. Thanks, Mick. My remarks today, I will provide an overview of our results for the second quarter of fiscal year 2021 and some remarks on our FY '21 second half outlook. Unless noted, all comparisons are to the prior year quarter.

As Mick noted, we had a strong quarter. Group revenue for the December quarter was \$800 million, an increase of 9% over the prior year quarter. In constant currency terms, revenue increased by 7%. Consistent with our prediction during the Q1 earnings call, we derived minimal incremental revenue from COVID-19 related demand in the December quarter.

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 \$427 million, an increase of 5%. Sales in Europe, Asia and other markets totaled \$281 million, an increase of 17%, or in constant currency terms an increase of 10%.

By product segment, U.S., Canada and Latin America device sales were \$205 million, an increase of 1%. Masks and other sales were \$222 million, an increase of 8%. In Europe, Asia and other markets, device sales totaled \$188 million, an increase of 16% or in constant currency terms, a 10% increase. Masks and other sales in Europe, Asia and other markets were \$93 million, an increase of 18% or in constant currency terms, an increase of 12%.

Globally in constant currency terms, device sales increased by 5%, while masks and other sales increased by 9%. Software as a Service revenue for the second quarter was \$92 million, an increase of 6%. On a non-GAAP basis, SaaS revenue increased by 5%.

During my commentary today, I will be referring to non-GAAP numbers. The non-GAAP measures adjust for the impact of amortization of acquired intangibles, restructuring expenses, the purchase accounting fair value adjustment to MatrixCare deferred revenue, litigation settlement expenses and the fair value adjustment of equity investments. We have provided a full reconciliation of the non-GAAP to GAAP numbers in our second quarter earnings press release.

Our non-GAAP gross margin improved by 20 basis points to 59.9% in the December quarter compared to 59.7% in the same quarter last year. The increase is predominantly attributable to manufacturing efficiencies, favorable product mix changes and foreign exchange rates, partially offset by declines in average selling prices.

Moving on to operating expenses. Our SG&A expenses for the second quarter were \$169 million, a decrease of 1% or in constant currency terms, SG&A expenses decreased by 3%. SG&A expenses as a percentage of revenue improved to 21.2% compared to the 23.3% we reported in the prior year quarter, benefiting from cost management and reduced travel as a result of COVID-19 restrictions. Looking forward, we expect SG&A expenses in the second half of FY '21 to increase in the low single-digits relative to the prior year period.

R&D expenses for the quarter were \$55 million, an increase of 10% or on a constant currency basis, an increase of 7%. R&D expenses as a percentage of revenue was 6.9% compared to 6.8% in the prior year. We continue to prioritize our investments in innovation because we believe our long-term commitment to technology, product and solution development will deliver sustained competitive advantage. Looking forward, we expect R&D expenses to continue to grow year-over-year in the high single-digits, reflecting this commitment to innovation.

Total amortization of acquired intangibles was \$19 million for the quarter and stock-based compensation expense for the quarter was \$15 million. Non-GAAP operating profit for the quarter was \$254 million, an increase of 16%, reflecting strong top line growth, expansion of gross margins and well contained operating expenses.

On a GAAP basis, our effective tax rate for the December quarter was 14.8%, while on a non-GAAP basis, our effective tax rate for the quarter was 15.2%. We continue to expect our effective tax rate for the full fiscal year 2021 will be in the range of 17% to 19%.

Non-GAAP net income for the quarter was \$206 million, an increase of 17%. Non-GAAP diluted earnings per share for the quarter were \$1.41, also a 17% increase. Our GAAP diluted earnings per share for the quarter were \$1.23.

During the December quarter, we closed our portable oxygen concentrator business. We recognized restructuring expenses of \$13.9 million associated with the closure. Going forward, the cessation of our POC business will have an immaterial impact on both group revenue and earnings per share. We do not expect to incur additional expenses in connection with this activity in the future, and we have adjusted for this one-time expense within our non-GAAP results for the quarter.

Cash flow from operations for the quarter was \$170 million, reflecting robust underlying earnings, partially offset by increases in working capital. Capital expenditure for the quarter was \$35 million. Depreciation and amortization for the December quarter totaled \$41 million. During the quarter, we paid dividend of \$57 million.

We recorded equity losses of \$2.6 million in our income statement in the December quarter associated with the Verily joint venture. We expect to record equity losses of approximately \$5 million per quarter in the second half of FY '21 associated with the joint venture operations.

We ended the second quarter with a cash balance of \$256 million. At December 31, we had \$826 million in gross debt and \$570 million in net debt. Our debt levels remain modest. At December 31, we had a further \$1.4 billion available for drawdown under our existing revolver facility. Our Board of Directors today declared a quarterly dividend of \$0.39 per share, reflecting the Board's confidence in our strong liquidity position and operating performance.

Our solid cash flow and liquidity provide flexibility in how we allocate capital. We have focused on paying down debt as well as ensuring we have cash reserves to support the company through the uncertainty caused by the ongoing pandemic. Going forward, we plan to continue to reinvest for growth through R&D. We will also likely deploy capital for tuck-in acquisitions, such as SNAP, which was completed during the third quarter of fiscal year 2020.

We intend to continue returning cash to shareholders through our dividend program, and we may also resume our share buyback program sometime during the calendar year; this program has been on pause since our acquisitions of MatrixCare and Propeller Health in fiscal year 2019.

Turning now to our FY '21 outlook. At a high level, we are seeing negligible COVID-19 generated demand for our ventilators and do not expect any incremental benefit in the second half of FY '21. Note, as a reminder, we recorded \$35 million in COVID-generated ventilator revenue in our March quarter last year and \$125 million in COVID-generated ventilator revenue in our June quarter last year.

Mask and accessories have continued to demonstrate resilience and growth over the past 3 months, reflecting the insulating value of the large patient installed base and the success of our resupply service offerings. We expect to see continued year-on-year growth of our mask sales in the second half of FY '21.

Notwithstanding continued COVID-19 challenges, we continue to expect a sequential increase in new sleep patients, which should support our device sales as we move through the second half of FY '21. However, we typically experience a small seasonal sequential decline in revenue from Q2 to Q3, largely attributable to the reset of deductibles in health insurance plans in our U.S. market. We expect this trend will also be apparent in FY '21.

Of course, like many other companies, we continue to experience significant uncertainty in the current environment, including the potential disruptive impacts of ongoing restrictions imposed in many of the countries we operate in. As a result, our forecast and possible future revenue outcomes remain dynamic.

And with that, I will hand the call back to Amy.

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

Great. Thank you, Brett, and thank you, Mick. Chantel, let's now go ahead and turn to the Q&A portion of the call.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from Margaret Kaczor with William Blair.

Malgorzata Maria Kaczor Andrew - William Blair & Company L.L.C., Research Division - Partner

Maybe the first one for me just to hit it off. You guys mentioned that there were negligible vent sales this quarter. So does that imply that this is a good revenue base now for our model to grow off of for that core sleep business? And the reason I ask is, if it does, and vent sales went from \$40 million last quarter. None this quarter, it actually does imply that the sleep business is doing quite well. So any details would be great.

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

Thanks for the question, Margaret. And yes, clearly, in the December quarter, we had, as we predicted, sort of de minimis ventilator sales a little bit in Northern Europe, perhaps, but not material across the group. And as Brett said in the remarks just now from him, and I said as well, we expect no sort of COVID-related ventilator sales throughout the rest of the fiscal year and beyond, people have enough in the hospitals, which is great.

And so yes, look, it does start to form a good base when you look at the core business of sleep apnea, COPD and asthma patient flow. I mean, as we said, the seasonality, usually from Q2, December quarter, to Q3, March quarter, related to the U.S. market on deductibles and so on. But for the other 139 countries we're in and across the portfolio, it's a good base to start to get that slow and steady improvement in the patient flow in this new digital health-driven world, Margaret, of patients going to primary care on Zoom and telemedicine and getting referrals to their specialists and coming through the pipeline. And so we think it's better for the long term, but it is slowly and steadily coming back from that base.

And yes, as we said sort of in those numbers of the percentage flow of patients, as best we can see it, we saw improvement from September to December. And so you noted that in taking up [AC1]the vent sales over that 90-day period as well.

Operator

Your next question comes from David Bailey of Macquarie.

David Bailey - Macquarie Research - Research Analyst

Mick and Brett, just interested in actually what you have seen adherence levels over COVID-19? Whether you've seen a pickup over the last sort of calendar year and any extension of that? Any sort of relationship that you've been able to garner from -- between resupply and adherence levels. Any comments there would be interesting.

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

Yes. It's interesting. It's -- we've certainly seen sort of modest sort of single-digit improvements in overall adherence as we look at the big data, and we're actually doing a whole bunch of research on this to understand the sort of kinetics and dynamics of COVID-19 on the market. I think really early stage in sort of March, April, people -- there was a lot of things going around that maybe using a CPAP would bring more virus in the room if you have other people in the room, there was some fear and uncertainty and doubt in that early period. But I think that was all covered over by doctors saying, listen, if you get treated for sleep apnea, it's actually preventative in improving your lungs and lower impact and severity of COVID-19. And again, look, there's so much clinical literature out there in terms of the general press. But through the scientific data we're able to see, people are adhering. Those who are adhering are adhering more and sleeping more and using the devices more.

And David, to your point, they are participating more in those resupply programs. They are seeing the importance of respiratory hygiene and respiratory health. And when they get a text response or an app click and a chance to say, yes, I want that new mask, I want that new tubing, I want that new humidifier. They're clicking it at much higher rates and getting closer to, frankly, what they should have always done, which is keeping respiratory hygiene at top of mind.

So I would say modest improvements in overall adherence. And more significant improvements in the probability that a person says, who is adherent says, "I want to get that mask. With that co-pay, I want to get that mask now to get resupply." And in cash markets, same thing as well. So it's a really good question, David, it's a complex equation, and we're working through all the variables. But yes, modest improvement in adherence and really good improvement in mask resupply, as you saw in the numbers as well as you saw in the health of the patients.

Operator

Your next question comes from Lyanne Harrison of Bank of America.

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

Mick and Brett, just a question, I'm trying to understand the trend in new starts, I guess, the recovery rates you quoted for your key markets do not appear to have improved much compared to the rates you quoted at the last results call. Can you give us some color on what you're hearing in relation to the pipeline, in particular, physician access to sleep testing, whether it's been in the lab or at home to your key markets, particularly as COVID cases surged in November and December?

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

Yes, Lyanne, it's a good question. And like David, it's complex because there's 140 countries all adopting digital health at different rates and all having different sort of national rules around retail and restaurants as well as how you get back to life and back to healthcare as well.

Healthcare has proved pretty resilient. I think because people know it's an essential industry. And the data that I shared earlier around truly life and death decision of using a CPAP or not for treating sleep apnea, I mean it's incredible to have those data in the hands of our physicians worldwide as they're driving adherence. It's one thing to be doing a digital telemedicine call with a patient over Zoom or secure network, it's another one to say, listen, using this device will save your life as well as improve your quality of life.

And so the numbers are plus or minus 10% anyway. And that's why the ranges are so broad. But look, the U.S. key market is somewhere between 70% to 90% of pre-COVID patient flow as best we can measure it by ApneaLink Air usage by AirSense 10 sort of Air Solutions activations of new devices and reactivations of resupply devices.

And it's not perfect data, and it's different in all the 50 states just in the country that I'm living in here between California or Massachusetts and Florida, very different areas of opening up of their whole economies on local and state regulations. But that range is pretty broad, but it's pretty accurate in terms of the patient flow-through. And that's why I think you've seen people really participating in mask and accessory resupply programs, but a slowdown, obviously, of new patient starts.

And to your point about the kinetics of it. Yes, from the September quarter, I think, we've moved up sort of somewhere between 5% and 10% in each of the key markets. I talked about, U.S., China and Germany as examples for Americas, Europe and Asia. So that's 5%, 10% -- 500 basis points plus improvement in the quarter. It's not -- this V shape back to 100% December 2019 again. But it's a slow, steady sort of U-shape improvement in the flow of patients which we think does then over time, flow through with all the systems and all the restrictions in the portfolio of 140 countries through to patients getting set up and started on their lifetime of therapy on sleep apnea or COPD therapy.

Operator

And your next question comes from Saul Hadassin with UBS.

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

Just a quick question on rest of world sales, Michael, ex U.S. sales. So strong growth rates both across flow generators and masks. I just wonder if you can give a bit more color. If sleep therapies are still sort of recovering back to, as you said, 85%, 90% in some regions. Just what else drove that very strong growth rate across those 2 product categories? And was there any tender timing, for example, in Asia Pac that maybe contributed to that strong growth rate?

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

Thanks for the question, Saul. I'll have a little bit of a go at it and then hand to Rob Douglas, our COO, beside me here to provide more detail. Look, as I said, there was some modest sales of ventilators in Western and Northern Europe during the quarter. That will flow into the devices number at plus 10% their constant currency and then the masks at plus 12% constant currency. Again, this is Europe, Asia and the whole entire rest of world. So we're talking 135-plus countries. And so Rob, do you want to have a go at summarizing that all for Saul succinctly?

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

Yes, let's just cross off the last point, Saul, there wasn't any tender changes or issues in any of those markets, particularly. But across the board, really interesting, we still had strong performance in many, many countries. Usually, the countries are varying and some are strong and some aren't so, at a given time. But it looked like there was a pretty good strong performance, and we think the same underlying fundamentals that we've talked about, particularly in the U.S. market, were applying at different scales in these markets.

And so in many small markets, we saw the uptake of the digital solutions being really strong. And in fact, underpinning that in our own technology base, we had a really good performance from our technology team to meeting those digital requirements in each of the different countries as well. And then there was just really sort of patient demand for making sure that treatment is up to scratch is really good. We saw those dynamics across the board. It's a whole sort of a resurgence -- didn't seem to have quite the effect that you might have thought because I think the health systems and what they actually didn't need to shut down everything in the health system, and they knew what they could keep open. And so then the sort of the diagnosis processes and that kept going on.

As Mick said before, things aren't yet back to fully open and normal, but the whole system is striving to get there and additional things like uptakes in home sleep testing in some markets have been supported as well. So it's really our whole suite of solutions is supporting a market that needs to treat these patients has kept us going.

Operator

Your next question comes from Matthew Mishan of KeyBanc.

Matthew Ian Mishan - KeyBanc Capital Markets Inc., Research Division - VP and Senior Equity Research Analyst

Mick, just a quick one for me. Just what is the pushback from the payer community on closing the gap and reimbursement between at home sleep testing and lab-based tests?

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

Thanks for the question, Matt. Look, I think the payer community, and it varies. And I'll take the example of the United States where it's probably a 25% government reimbursement, 75%, if you like, in our sleep apnea field of private payers. They're all very supportive of both in-lab and home sleep apnea testing. If you look at this country, pre-COVID was probably 45% home sleep apnea testing versus 55% in-lab. I think that's moved up very significantly during COVID. Obviously, during the peak of the lockdowns, it went very high. And it will probably level out somewhere in that 50%, 55%, 60% range of the diagnoses being home sleep apnea testing.

Payers often have deltas of -- I think it can vary from \$250 for home sleep apnea tests. And \$750, \$800 for an in-lab test, just relative to the costs there. Obviously, for the payer, they would want if it's clinically equivalent patient and good sensitivity and specificity of the data and good patient outcomes and patient satisfaction as well the payers care about, they would flow towards home sleep apnea testing where they can. But look, I'll hand over to Dave Pendarvis to add any more further color on that dynamic?

David Pendarvis - *ResMed Inc.*

Yes, Matt, at least in the U.S., there actually are some pretty straightforward dollar investment and time requirements that go into reimbursement for a lot of payers. And the fact of the matter is, PSG equipment is a lot more expensive to purchase, more expensive to operate. And it takes more time from both the physician and the facility. So that's what they're looking at, more so than necessarily the incentives that are driven by the lower cost of home sleep testing, and the higher reimbursement rate of PSG. We certainly support good PSG when it's appropriate for the patient. And there's a lot of sleep hubs that have invested a lot of capital and they invest a lot of time for their staff in that. And it's important that they'd be reimbursed adequately. So they both have their place in the market. But I think it's generally those sorts of things that go into their reimbursement decisions, not necessarily what outcomes they're trying to drive.

Operator

Your next question comes from the line of Andrew Goodsall of MST Marquee.

Andrew Goodsall - *MST Marquee - Healthcare analyst*

Just looking at your margins, obviously, mask growth outpaced flow generator. So I can see the mix effect. Could you talk to that mix effect, but also expand on your comments on average selling price decline?

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

Brett, that's for you.

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

Yes. Sure. Thanks, Mick. Thanks, Andrew. Yes, I mean, we had -- if you looked at it year-on-year, 20 basis point expansion. So it was kind of a moderate expansion. So those -- the moving parts that I talked about and those impacts are pretty modest or pretty small overall. The mix pretty much kind of that strong mask growth is going to underpin that product mix. If you looked at year-on-year, a little bit of benefit from FX, but pretty minor. And then on ASPs, again, it's I'd characterize as pretty benign environment from a pricing perspective, and that's probably reflected in that pretty small movements in the gross margin year-on-year.

Andrew Goodsall - *MST Marquee - Healthcare analyst*

So the ASP is pretty modest, but you flagged it...

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

Yes, if you looked at it on historic context, I think it's a pretty benign environment for us relative to historical trends.

Operator

Your next question comes from the line of Sean Laaman of Morgan Stanley.

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

Mick, I have a question on the exit of the POC business. If I get this right, and I think I've got it simplistically, right, but please correct me that you think you've got those mid-stage COPD patients covered already through non-invasive vents, and there's better reimbursement and maybe there's better clinical outcomes. But Mick, is there any sort of change in the thinking about how the funnel might operate to get to those patients and service them with non-invasive vents with Propeller?

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

Yes, Sean, it's a great question. And yes, you're right. Look, what Propeller that acquisition is about 24 months old or so. So what that allowed us to do is to get to patients much earlier in the COPD development cycle. It's really stage I COPD, where you have that shortness of breath, climbing a flight of stairs and you go to see the primary care doctor and talk about it. And they do the diagnosis and find out that you do have some lung dysfunction. And this broad category called chronic obstructive pulmonary disease, you get put in that bucket. And there's many different types of therapies that the doctor can go to, but a lot of them are those pharmaceutical therapies upfront. And those inhalers are not used as prescribed when they're just given a prescription. The same is when a pill is prescribed for high cholesterol or blood pressure, the adherence rates are very low in the general population, 50% plus or minus.

And with Propeller Health, we're able to drive those adherence rates up double digits on a relative basis and drive to incredible adherence rates that the pharma industry just hasn't seen in respiratory medicine. And so Propeller technology is really exciting. It's really new. We have major global pharmaceutical companies partnering with us in major markets driving that. Early days, but we think that allows us to get to stage I, stage II patients in a very significant scalable way to get them on that sort of end-to-end digital health journey in COPD. As they progress to stage II, stage III, they sometimes get prescriptions for high-flow therapy, oxygen and ventilation, right? And so we're there, with non-invasive ventilation and life support ventilation, which is really stage III, stage IV.

And in that sort of crossover phase from the pharmaceuticals to the ventilator, both oxygen and high-flow therapy are used. High-flow therapy is newer and more scaling, and we think more related to our core business and the core devices we make. And it allows us to treat the patients and take care of the patients. And so POC just became an additional one that wasn't as important in that end-to-end journey and certainly didn't have the sort of margin profile or the growth profile with the changes in reimbursement to allow us to have the same growth opportunity that we have in non-invasive ventilation and life support ventilation. So that's sort of it in a nutshell.

Operator

Your next question comes from Gretel Janu of Credit Suisse.

Gretel Janu - Cr dit Suisse AG, Research Division - Research Analyst

Can you talk a bit more about the future pricing environment in the U.S.? I know you said it's benign currently, but in the quarter, we did have the announcement of two key DMEs merging. So do you expect great ASP price declines going forward than this benign environment that you're currently in?

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

Thanks for the question, Gretel. I'll hand that to the President of Global Sleep & Respiratory Care business. Jim, over to you. Jim, you may be on mute.

James R. Hollingshead - ResMed Inc. - President of Sleep & Respiratory Care Business

Sorry. Can you hear me now? It's a terrible, terrible way to enter the call. Thank you, Gretel, for the question. Thanks, Mick. I think that what we've seen this year is benign is maybe too soft a word for price, but I'll go with benign. We've had a pretty stable pricing environment, I think, in anticipation of -- the market was anticipating the competitive bid rates. And then, of course, competitive bid got delayed. And obviously, the AdaptHealth acquisition of AeroCare creates an even larger customer for us. They're a very important customer for us, and we enjoy a very good relationship with them. I think both with that move and then with ongoing trends into the year, we should see something that looks like a more normal pricing environment, I think, in the second half of the fiscal year and going forward. And it will be a little bit different by market as it always is, but I would expect it to be kind of back in a more normal trend.

Operator

Your next question comes from David Low of JPMorgan.

David A. Low - JPMorgan Chase & Co, Research Division - Research Analyst

My question just on the software business, Mick, I think you commented that Brightree delivered most of the growth, MatrixCare, et cetera, facing more of a challenge from the pandemic. Could I elaborate a little bit? I mean how much growth did you see through Brightree? And what's driving that? And I guess, most importantly, can we maintain that growth in that part of the software business?

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

Yes. Thanks for the question, David. And yes, clearly, Brightree had strong growth driven by the strength of our home medical equipment customers and their ability to pivot their businesses to mask and resupply and the great adoption of Brightree ReSupply sort of our core resupply software there. But also the SNAP technology acquisition that we closed almost exactly a year ago, we were doing due diligence a year ago and closed it sort of later on during this March quarter.

And so those two technologies have been very well adopted. But look, in addition to that, our Brightree team, it's a significant double-digit percent of their revenues in R&D. They've delivered a whole bunch of innovation, some COVID-related management opportunities for their HME customers as well as other innovative ways to grow their business. And so that's allowed the Brightree business to support HMEs and really help them survive and thrive in the early stages and later stages of COVID-19. And it's a great help to the industry, and I'm really proud that ResMed and Brightree was able to deliver that.

On the MatrixCare side, yes, it's a tougher story because the verticals that they operate in were more severely affected, skilled nursing facility, census was down high double-digits at the peak of the crisis and still is down year-on-year in terms of the number of patients in skilled nursing facility operations, and that impacts MatrixCare's census rates and ability to grow. In addition, hospice affected similarly.

On the other hand, home health has been a growth light within the MatrixCare area. And the addition of our MatrixCare brand - it's HEALTHCAREfirst, Brightree, and MatrixCare technology - it's all combined under the MatrixCare brand, has been growing really well. And Navin and his team who are -- the VP is driving that has seen incredible growth in home health and hospice.

And I think if you look across that portfolio, what sort of the guide that we give, because you can go through all the verticals in detail is that we think that, that weighted average market growth rate is mid- to -- low to mid-single digits right now. You saw we grew 6% in the quarter. So we're growing a little bit ahead of market, taking a little -- some of those verticals.

But as the weighted average market growth rate goes to mid-single digits, we're going to look to meet and beat that. And then when it gets back to high single digits, as the flow of patients from hospitals and ambulatory surgery centers picks up, we will then see skilled nursing facilities, hospice and all the verticals pick up their census rates and get us back to those sort of growth rates and beyond over time.

So David, it's really sort of related to the whole recovery of the economy and that really related to the hospital, what people are calling elective surgeries. And I think if you need a heart valve or a new hip, it's hardly elective when the pain or the probability of death starts going up. And I think healthcare systems are really starting to address that and get their patients back into care, so we should start to see those recoveries over time.

Operator

Your next question comes from Mike Matson of Needham & Company.

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

I guess I just wanted to ask about the decision to exit the POC market. I know you made some comments on that in the prepared remarks, but wondering if you could elaborate on that a little bit. I guess what I'm wondering is was this really a market issue? Do you think the market is just not attractive? Are the margins on the products too low relative to your other products? Was the product that you had to kind of start with just not competitive enough? Or were there other reasons for exiting this market? I guess what I'm getting at, was this a product issue, a market issue or both?

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

Thanks for your question, Mike. I said what I said in the prepared remarks and the question before. Maybe I'll hand to Jim Hollingshead for any further detail. I mean, we have the end-to-end play with all that we have in our core capabilities and Propeller, high-flow therapy, non-invasive ventilation and life support ventilation. But Jim, any further detail you want to share for Mike?

James R. Hollingshead - *ResMed Inc. - President of Sleep & Respiratory Care Business*

Yes. Thanks, Mick, and thanks, Mike. I think, Mike, if we're balancing sort of market versus our portfolio is the way I would frame it. I think it's a little bit of both. So if you look at the market, we've thought for a long time that POCs should be reimbursed in a better way, in a differential way because they create a lot of value for patients, they allow patients to be mobile and to get out and about, which is actually better for their care. But especially in the U.S. market, reimbursement has always been upside down, sort of unfavorable to POCs versus stationary. And we entered the category knowing that and were innovating it. We actually feel really good about the products we had been developing a product, we had a market and the next-generation that we were developing. But then you see how reimbursement has not changed, and in fact, has become less favorable. And in relative terms, the category is just not that attractive, right? It doesn't have the same growth that it had 5 years ago when we entered as a category, and that sort of thing.

And then when you take that line of business and compare it to our overall portfolio in the sleep and respiratory care business, in relative terms, it's not nearly as strong a profile as the other opportunities we have to invest in innovation, right? So we have a fantastic opportunity to continue to invest in Propeller Health, a fantastic opportunity. It's early days but a fantastic opportunity to invest in high-flow therapy, which we think has a really interesting clinical profile and could be of great benefit to patients. And then, of course, as we continue to grow our digital offerings, our R&D portfolio, there's just plenty of places for us to put R&D into other digital offerings and the expansion of our digital offerings.

And so -- it's both a question of looking at the market and where that category had evolved since we'd entered with that acquisition, but also just looking at the range of opportunities we have in hand, and making a decision to invest in things that we think are forward more attractive, both for ResMed shareholders and also for patients.

Operator

Your next question comes from Chris Cooper of Goldman Sachs.

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

Look, most of my near term questions have been asked. So just given there's been lots of reference to high-flow therapy today, I guess, it would be remiss of me not to just ask you guys for a bit more of a sort of comprehensive update on where you're positioned and what your strategy is there? I mean, do you guys have what you need in terms of current portfolio? Or are there some areas that might make sense from a sort of tuck-in perspective? And just generally, I guess, your views on market growth? And how you fit within that over the quarters and years ahead? I mean, the references you made today are indicative clearly of how increasingly important this therapy looks in various respiratory markets, but I'd just be keen to get some sense of quantification from you if that would be possible.

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

Thanks for your question, Chris. And look, it's a really exciting new area for us. Obviously, we're further down the road on Propeller Health, and it's starting to move in the stage I, stage II area. During COVID-19, there were uses of high-flow therapy for patients with low oxygen. And it's always been an area that has been looked at. What we're interested in, ResMed, 90% of our revenues are in the home. We're really interested in home care. And the idea of high-flow therapy in the home, we think, has a lot of future. There's not a lot of reimbursement, in fact, virtually zero anywhere around the world. So it's a new development area. But we think given some of the clinical data that are coming out, and some of the research we're doing with providers around the world, there is an opportunity to get patients out of the hospital and into the home with high-flow therapy treatment.

As a stepping stone and a pathway to our non-invasive ventilators and life support ventilators and in combination with our drug delivery systems. So it's very early days, Chris, not at all material to our business, but it -- provides that sort of bridge portfolio, if you like, from Propeller through to the ventilation side. And we think was validated somewhat during COVID-19 and some clinical data that we are working with people with around the world says that. As we look towards 2025, we think this will be a good part of our home care portfolio of taking care of patients with high-flow therapy.

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

And just a very brief follow-up, Mick. So for the home care opportunity to really manifest in the way you expect, do you need reimbursement to become more supportive? Or do you think that the current arrangements would allow that to happen?

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

Chris, I think we'd want to see reimbursement models develop because that's how change happens, right? I mean it's both, the Hippocratic Oath and Adam Smith, if you like, that are required to move some areas of healthcare. We've seen that in digital health, where we had amazing solutions for over a decade in the field of liberating data to the cloud and driving up adherence and so on. But it was when we started to see models in the U.S. and France and Japan and now Germany, where digital health started to be reimbursed because it is providing care that is of value and then reflecting that for the doctors and the providers and reimbursing in that.

So I think reimbursement is a very important part of developing the home care market for high-flow therapy. So obviously, our research and partnerships with payers, providers and IDNs will be along those lines.

Operator

Your next question comes from Suraj Kalia of Oppenheimer.

Suraj Kalia - *Oppenheimer & Co. Inc., Research Division - MD & Senior Analyst*

Mick, can you hear me all right?

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

Got you, loud and clear, Suraj.

Suraj Kalia - *Oppenheimer & Co. Inc., Research Division - MD & Senior Analyst*

Perfect. So Mick, a couple of subpart questions related to COVID. Are you seeing any COVID-related shifts in the mask replacement cycle? Now, are these transient are relatively stickier in nature? And if I could, has COVID identified any manufacturing location reoptimization that would help you all realize incremental margin gains over the next few years?

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

Thanks, Suraj. I'll hand the first question to Jim around replacement rates around masks during COVID and the stickiness of that and beyond. And then the second part around global manufacturing to Rob Douglas. So Jim, you first?

James R. Hollingshead - *ResMed Inc. - President of Sleep & Respiratory Care Business*

Sure. Thanks, Mick. Thanks, Suraj. On mask replacement, I think what we've seen all year during the pandemic is a couple of -- we've talked about this, I think, on this call before, we've seen a couple of dynamics. The first one is, I do think patients are just more attentive to the idea that their equipment might be older. I think there's a greater sensitivity and awareness on behalf of patients to sort of have clean and disinfected breathing apparatus, right? I mean -- so I think that's driven a bit of incremental demand, and it's an open question as to how persistent that will be. But I would think it's going to be a bit more persistent. I think you'll see patients just more attentive to cleaning their masks and their tubes and resupply on a regular cadence. But that's speculation. We've certainly seen it this year. I don't know how long that will continue or if it will increase and so on.

I think the other thing that, of course, has been happening is in the markets where resupply is a benefit, which is largely the U.S. market or other markets where it is for the provider. But in the U.S. market, I think HME customers have been, if anything, more focused on driving resupply as a part of their business to patients. And so that's been a marriage of two trends, where the HME wants to pay attention to resupply as new patient starts have been slower and the patient wants the equipment. And I think that behind that -- in addition, behind that, we've had increasing adoption of automated resupply platforms, including our offerings there. So I think all three of those trends have led to higher resupply overall. And I think it probably will persist, but it's very difficult to predict as all things go.

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

Yes. And Suraj, to your question on the manufacturing impact, the whole issue around COVID has been very challenging for supply chains and freight terms all over the world for many, many companies. And I think like many companies, we're carefully looking at the resilience of our supply chain through there. There are other issues going on around politics and trade relationships that we've got to work. Some of these are going to be beneficial as you talk about the margins and some of the headwinds. And I think as we continue to scale our business we should be able to run faster than those headwinds over time.

Operator

We're now at the end of the scheduled time for the call. So I will now turn the call back over to Mick Farrell.

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

Thanks, Chantel, and thanks again to all our shareholders for joining us on today's call. I'd like to once again take the opportunity to thank the 7,500 ResMedians, almost all of whom are shareholders for their dedication and hard work, helping people sleep better, breathe better and live better lives outside the hospital in over 140 countries. Thanks for all that you do today and every day. Thanks especially to our ResMed heroes on the front lines, production, distribution, tech service, customer service, talking to customers and delivering product every day. I look forward to talking with all of our stakeholders here again in 90 days. Thank you. Amy, over to you.

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

Great. Thanks, Mick, and thank you all again for joining us today. I know we weren't able to get to all the questions in the queue. So please don't hesitate to reach out to me directly if you've got anything further. And as previously mentioned, all the documents, along with the transcript and a replay of today's call will be available on our website later today. Chantel, you may now go ahead and close out the call.

Operator

This concludes ResMed's Second Quarter of Fiscal Year 2021 Earnings Live Webcast. You may now disconnect.

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