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RMD.N - Q2 2022 Resmed Inc Earnings Call

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OVERVIEW:

RMD reported 2Q22 revenues of \$895m, an YoverY growth of 12%.

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 & Corporate Secretary*

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*

CONFERENCE CALL PARTICIPANTS

Andrew Paine *CLSA Limited, Research Division - Research Analyst*

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

Craig Wong-Pan *RBC Capital Markets, Research Division - Analyst*

Dan Hurren *MST Marquee - Healthcare Analyst*

David Bailey *Macquarie Research - Analyst*

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

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

Lynne Harrison *BofA Securities, Research Division - VP in Global Equity Research*

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

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

Michael K. Polark *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

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

Saul Hadassin *Barrenjoey Markets Pty Limited, Research Division - Analyst*

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

Steven David Wheen *Jarden Limited, Research Division - Analyst*

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

PRESENTATION

Operator

Hello, and welcome to the ResMed Second Quarter Fiscal Year 2022 Earnings Conference Call. (Operator Instructions) As a reminder, this conference is being recorded.

It's now my pleasure to turn the call over to Amy Wakeham, Vice President, Investor Relations and Corporate Communications. Please go ahead, Amy.

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

Great. Thanks, Kevin, and hi, everyone. Welcome to ResMed's Second Quarter Fiscal Year 2022 Earnings Conference Call. We thank you for joining us. This call is being webcast live and the replay will be available on the Investor Relations section of our corporate website later today, along with a copy of the earnings press release and presentation, which are both available now.

With me on the call today are Chief Executive Officer, Mick Farrell; and Chief Financial Officer, Brett Sandercock. During the Q&A portion of our call, Mick and Brett will be joined by Rob Douglas, our President and Chief Operating Officer; Jim Hollingshead, our President, Sleep and Respiratory Care; and David Pendarvis, our Chief Administrative Officer and Global General Counsel.

As a reminder, on today's call, we will discuss some non-GAAP measures. For a reconciliation of the non-GAAP measures, please review the notes in today's earnings press release or the appendix of the earnings presentation. Our discussion today may also 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 that are made today.

I'll now 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 today as we review results for the December quarter, the second quarter of our fiscal year 2022. Our second quarter results continue to demonstrate the strong performance across our business, benefiting from the ongoing extremely high demand for our sleep and respiratory care devices as well as the steady recovery of markets from the peaks of COVID-19 impacts.

We achieved double-digit growth in our business as we navigate three major externalities: one, the recovery of patient flow post the COVID maximum peaks; two, global supply chain constraints, particularly in electronic components; and three, the almost unlimited demand associated with a competitor recall that has actually extended further in terms of volumes of their devices that were impacted and the duration of their repair and replace process. The bottom line is we have at least twelve more months of this incredible demand for ResMed products.

I'm very proud of 8,000 ResMedians serving patients in 140 countries worldwide. Our global teams are finding ways to deliver products and solutions to home care providers, physicians and healthcare systems and ultimately into the hands of patients who need them most.

Clearly, the global supply chain environment remains very challenging across multiple industries, and we are not immune to its impact. During the quarter, despite growing double digits year-on-year, we were not able to meet all the demand available in the market. We are being allocated components from our suppliers, particularly electronic components and even more specifically, semiconductor chips, and we are thus being forced to allocate our outbound products to our customers.

We have established an allocation process with clear guiding principles that give priority to the production and delivery of devices to meet the needs of the highest acuity patients first. In addition to component supply issues, the ongoing challenges of sea freight and air freight are impacting our ability to respond as rapidly as we would like to the demand for ResMed products. Freight costs are increasing across the board on inbound components from suppliers and on outbound products to our distribution centers and for ultimate delivery to our customers. As a result of these increased costs, we implemented a surcharge on our products starting in January to share some of the burden of these increased costs with customers. Given all the increases in prices from commodities to specialty products across multiple industries around the world, the necessity of this surcharge has been understood and accepted by our customers.

We are working closely with our global supply chain partners, doing everything that we can to gain access to additional supply of the critical components that we need to further increase production of our medical devices. We are also re-engineering designs, validating new parts, pieces, suppliers and accelerating new product launch and development to further catch up with the demand. We understand that this is a difficult situation for all of our customers, including physicians, home medical equipment providers, payers, healthcare systems and the most important customer,

the patient. Our #1 priority will always be patients, doing our best to help those who suffer from sleep apnea, COPD, asthma and other respiratory chronic diseases as well as those who benefit from our out-of-hospital healthcare software solutions.

To grow and differentiate our sleep and respiratory care business, we will develop, design and deliver world-leading therapy solutions that can be scaled globally. And we're going to deliver the world's leading out-of-hospital software solutions to empower each person's healthcare wherever they are. Our goal is to ensure that every person gets the care that they need, where they need it and when they need it.

Let me step back to discuss the broad market conditions in our industry. We're seeing steady ongoing recovery of demand across the countries that we operate in. We are still seeing a divergence in the total patient flow from 85% to 100% of pre-COVID levels in most countries and above 100% of pre-COVID levels in a few locations. These metrics will continue to steadily increase towards pre-COVID levels and beyond as vaccines and boosters roll out globally. Each new COVID variant has an impact, but with the adoption of digital health solutions for screening, diagnosis and remote patient setup and remote patient monitoring as well as established and well-established processes for COVID cleaning protocols at sleep labs, we expect the impact of new variants to diminish in absolute impact each time.

Our global ResMed team remains committed to working with national, state and city governments as well as local healthcare systems, hospitals and healthcare providers to supply ventilators, masks and training for acute care and the important transition to home as needed. Given the steadily decreasing severity of each impact on the hospitalizations and severe disease from COVID, the demand for ventilators is now consistent with pre-COVID levels.

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

The U.S. launch of our next-generation device platform called AirSense 11 continues to go very well. This new platform has provided much needed additional product supply as we faced all-time high demand for ResMed devices. We expect to introduce the AirSense 11 platform into additional countries throughout calendar year 2022. In parallel, we will continue to sell our globally available market-leading platform, the AirSense 10, to maximize the total volume of CPAP, APAP and bilevels available for sale. In fact, the only product that the AirSense 10 is inferior to is the AirSense 11.

As you saw in our results with double-digit growth this quarter, the ongoing adoption of both the AirSense 10 and AirSense 11 platforms remains very, very strong. With the AirSense 11 platform and our digital health technology ecosystem, we are engaging patients in their therapy digitally like never before in the industry.

We are also making it easier and more efficient for our customers to manage their patient populations using our full suite of software solutions, including myAir for patients, AirView for physicians and Brightree for home medical equipment providers. When customers use these digital health technology solutions, they have increased efficiencies, lower costs and we achieve improved outcomes for patients and their physicians. We have peer-reviewed published evidence showing that combining AirSense platform with myAir software and AirView software, we see over 87% adherence to positive airway pressure therapy. This was in a study with over 85,000 patients.

On our latest and greatest platform, the AirSense 11, we are driving even higher adoption rates of the myAir app than ever before. In fact, we are seeing more than double the uptake of patients signing up to myAir and fully engaging with ResMed software technology. The net result is that this delivers a better patient experience, better efficiency for the home care providers and more importantly, greater long-term adherence to therapy. We saw this demonstrated in the ALASKA study in partnership with the French healthcare systems, where we showed in a study with over 176,000 patients that those patients who adhered to CPAP therapy had a 39% relative reduction in mortality rates versus control. Demonstrating these types of better patient outcomes and lower costs for the healthcare system at a scale not seen before in the industry are critical components of the ResMed 2025 strategy.

Another key aspect of our long-term growth strategy is driving awareness and increasing the flow of patients through the top of the sleep apnea diagnosis funnel. COVID-19 has advanced awareness, adoption and acceptance of respiratory health and respiratory hygiene but also adoption and acceptance of digital health and telehealth tools, including home-based sleep apnea tests.

Although increasing demand is not as important in the immediate short-term given the ongoing competitor recall, we have a long-term focus, and we're always focused on that long-term demand gen opportunity. We are innovating with partners and our customers to create an even more efficient and effective approach to sleep apnea patient identification, screening, diagnostics, treatment and management. We will continue to invest in technology that enables an end-to-end, seamless digital experience for patients.

As we mentioned in our October call, during the second quarter, we acquired Ectosense, a leading provider of cloud-connected home sleep apnea testing technology worldwide. We believe Ectosense's digital and easy-to-use solutions in the hands of physicians, sleep lab technicians as well as consumers can help significantly increase both diagnostic and screening rates as well as general sleep apnea awareness.

Let me now turn to a discussion of our respiratory care business, focusing on our strategy to better serve the 380 million patients with chronic obstructive pulmonary disease, or COPD, worldwide and the 330 million patients that suffer from asthma worldwide. Our goal is to reach hundreds of millions of patients with our respiratory care solutions, including noninvasive ventilation and life support ventilation as well as newer therapeutic areas such as cloud-connected pharmaceutical delivery solutions from our Propeller technology and high-flow therapy offerings such as our product platform called Lumis HFT.

Demand for our core noninvasive ventilation and life support ventilation solutions was strong throughout the quarter, especially in markets outside the U.S., where providers shifted focus to support the most severe, highest acuity patients. This demand is aligned with the guiding principles of our allocation process, namely to give the highest priority to manufacturing life support ventilation and noninvasive ventilation devices, including bilevels that meet the needs of these highest acuity patients first.

Adoption of the AirView for Ventilation software solution that we launched in Europe a little over a year ago remains solid, and we continue to expand this technology to regions around the world. AirView for Ventilation has provided value by helping physicians and the healthcare systems they operate in to manage high-risk patients during the COVID-19 pandemic. But it is also increasingly being used on an ongoing basis to enhance quality of care through early and proactive intervention at the first sign of respiratory medical issues to help reduce the risk of hospitalization. We see a world where AirView for Ventilation is standard of care for COPD treatment, the way that our core sleep apnea AirView platform is now standard of care for sleep apnea treatment.

Let me now review our Software as a Service business for out-of-hospital care. During the quarter, our SaaS business showed improved sequential growth. We achieved high single-digit growth year-on-year across our portfolio of SaaS markets, including home medical equipment as well as facilities-based and home-based care settings.

The continued growth of home-based care is providing tailwinds for our home medical equipment as well as our home health and hospice products. And we continue to grow with customers as they increase their utilization of our software and data solutions to improve and optimize business efficiencies and patient care, including Brightree and SNAP resupply.

The COVID-19 pandemic has been and remains challenging for some of the verticals in our SaaS business, particularly skilled nursing facilities, as the effects of the highly contagious Omicron variant remains a headwind for patient volumes in these settings. We will continue to watch this closely as COVID rates peak and then decline with this latest variant, as has happened in many regions around the country and around the world. As COVID restrictions continue to ease and our customers improve their line of sight to better conditions, we expect to see pent-up demand for technology investments, which provides opportunities for us to sell more and more services and solutions to existing customers, as well as to increase our new customer pipeline.

As we look at our portfolio of solutions across care settings, we expect our SaaS group revenue growth to accelerate, achieving sustainable high single-digit growth as we exit this fiscal year. As always, our goal is to meet or beat that market growth rate as we continue to innovate and continue

to take market share from competitors. We are the leading strategic provider of SaaS solutions for out-of-hospital care, and we provide mission-critical software across a broad set of very attractive markets.

Our latest and greatest SaaS solutions address the #1 issue reported across our customer base, which is staffing challenges. Our SaaS customers expect this problem to persist and they recognize the need for technology solutions to help solve their challenges with efficiency and scale. And our software services and solutions help them achieve both of these outcomes. We are well-positioned and we have created differentiated value for our customers and for ResMed within our SaaS business.

Looking at the broader portfolio of ResMed's businesses across sleep and respiratory care as well as our SaaS solutions, we remain confident in our long-term strategy and our pipeline of innovative solutions. Our sleep and respiratory care solutions treat the most prevalent and highest cost chronic conditions, and our SaaS solutions support the care settings where people face these and other chronic conditions.

With this combination, we can fundamentally transform out-of-hospital healthcare at a scale that no other company can match. And we are set up for sustainable growth through ongoing investments in R&D to the tune of 7% of our revenues, commercial excellence in partnerships with CVS, Verily and beyond, as well as future acceleration through strategic M&A as well as tuck-in M&A as we move forward.

Our patient-centric, physician-centric and provider-centric approach, combined with our unique ResMed culture, means that we are positioned to continue winning in the vastly underserved medical markets of sleep apnea, chronic obstructive pulmonary disease, asthma and beyond. We are transforming out-of-hospital healthcare at scale, leading the market in digital health technology with over 10.5 billion nights of medical data in the cloud and over 16 million 100% cloud-connectable medical devices on bedside tables in 140 countries worldwide, we are unlocking value by using de-identified data to help patients, providers, physicians, payers and in entire healthcare systems. We have invested in the privacy, cloud operations and AI and ML-driven data analytics capabilities to do this at a scale that is unmatched by competitors, and we are increasing our lead every day.

Our mission to improve 250 million lives through better healthcare in 2025, drives and motivates ResMedians every day. We again made excellent progress toward that inspiring goal during this last quarter.

Before I hand the call over to Brett for his remarks, I want to once again express my sincere gratitude to more than 8,000 ResMedians for their perseverance, hard work and dedication during these ongoing unprecedented times. Thank you.

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

Brett A. Sandercock - ResMed Inc. - CFO

Great. Thanks, Mick. In my remarks today, I will provide an overview of our results for the second quarter of fiscal year 2022. Unless noted, all comparisons are to the prior year quarter.

We're pleased with our financial performance in Q2 despite the headwinds we faced as a result of significant ongoing supply chain constraints and a challenging freight environment. Group revenue for the December quarter was \$895 million, an increase of 12%. In constant currency terms, revenue increased by 13%. Revenue growth reflects increased demand for our sleep and respiratory care products across our portfolio driven by recovering market conditions and by increased device demand in response to the ongoing product recall by one of our competitors.

In the December quarter, we recorded immaterial incremental revenue from our COVID-19 related demand consistent with the prior year quarter. Looking forward, we expect negligible revenue from COVID-19 related demand. However, we will continue to estimate it for you as appropriate.

In relation to the impact of our competitor's recall, we estimate that we generated incremental device revenue in the range of \$45 million to \$55 million in the December quarter. For the first half of FY '22, this reflects incremental revenue in the range of \$125 million to \$145 million. We continue to expect component supply constraints will limit the total incremental device revenue opportunity to somewhere between \$300 million and \$350 million for the full fiscal year 2022.

As we shared last quarter, we expect our fiscal third quarter to remain supply constrained similar to our fiscal second quarter, therefore, limiting incremental revenue during the third quarter. We see supply challenges to some extent easing in our fiscal fourth quarter and into fiscal year 2023.

Looking at our geographic revenue distribution and excluding revenue from our Software as a Service business, sales in U.S., Canada and Latin America countries increased by 14%. Sales in Europe, Asia and other markets increased by 12% in constant currency terms. By product segment, globally, in constant currency terms, device sales increased by 16%, while masks and other sales increased by 10%.

Breaking it down by regional areas, device sales in the U.S., Canada and Latin America increased by 19% as we benefited from incremental revenue due to a competitor's recall and favorable product mix as we sold an increased proportion of higher acuity devices. This is consistent with our guiding principles for product allocation, namely that we are giving priority to the production and delivery of our devices to meet the needs of the highest acuity patients first.

Masks and other sales increased by 9%, reflecting solid resupply revenue and achieved despite the challenging device supply environment, which continues to limit new patient setups. In Europe, Asia and other markets, device sales increased by 13% in constant currency terms, again, reflecting the benefit from incremental revenue due to a competitor's recall.

Masks and other sales in Europe, Asia and other markets benefited from improved patient flow relative to the prior year and increased by 11% in constant currency terms. Overall, our Asian operations, in particular, delivered a strong quarter.

Software as a Service revenue increased by 8% in the December quarter. We saw strong performance out of the HME segment as customers continue to utilize our SaaS solutions to streamline and more efficiently run their businesses, and we are seeing some stability in the skilled nursing care segment as it continues to emerge from the challenges of the COVID-19 pandemic.

For the second half of fiscal year '22, we expect to continue to benefit from our competitor's inability to supply new patients and from the global sleep market's general recovery from COVID-19 impacts. However, as we have said for the last few quarters, while we are working hard to increase device output, we will not be able to meet all the expected demand resulting from our competitor's recall, primarily because of significant and ongoing supply constraints for electronic components.

We are operating in a very dynamic supply chain environment. As I stated earlier, we continue to expect component supply constraints will limit the incremental device revenue resulting from our competitor's recall to somewhere between \$300 million and \$350 million for fiscal year '22. This includes the device revenue we were able to generate in the first half of fiscal year '22. We expect Q3 to remain challenging but Q4 to be better.

During the rest of my commentary today, I will be referring to non-GAAP numbers. 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 declined by 230 basis points to 57.6% in the December quarter. The decrease is predominantly attributable to higher freight, component and manufacturing costs and unfavorable currency movements, partially offset by positive product mix, particularly in relation to strong growth of our higher acuity devices.

Moving on to operating expenses. During Q2, we maintained a disciplined approach in our ongoing spend to support our operations. But we are seeing a more normalized expenditure profile as COVID-19 impacts subside. SG&A expenses for the second quarter increased by 9% or in constant currency terms increased by 10%. The increase was predominantly attributable to an increase in employee-related expenses. Importantly, SG&A expense as a percentage of revenue improved to 20.7% compared to 21.2% in the prior year period. Looking forward and subject to currency movements, we expect SG&A expense as a percentage of revenue to be in the range of 20% to 22% for the second half of FY '22.

R&D expenses for the quarter increased 14% on both a headline and a constant currency basis. R&D expenses as a percentage of revenue was 7% compared to 6.9% in the prior year quarter. We continue to make significant investments in innovation because we believe our long-term commitment to technology, product and solutions development will deliver sustained competitive advantage. Looking forward and subject to currency movements, we expect R&D expenses as a percentage of revenue to be in the vicinity of 7% for the second half of FY '22.

Our non-GAAP operating profit for the quarter increased by 5%, underpinned by strong revenue growth, partially offset by the contraction of our gross margin. On a GAAP basis, our effective tax rate for the December quarter was 15%, while on a non-GAAP basis, our effective tax rate for the quarter was 15.6% compared to the prior year quarter of 15.2%. The relatively low tax rate in Q2 in both the current quarter and prior year quarter reflects a favorable tax benefit associated with employee equity vesting that typically occurs in the second quarter. Looking forward, we estimate our non-GAAP effective tax rate for the full fiscal year '22 will be in the range of 19% to 20%.

Our non-GAAP net income for the quarter increased by 5% and our non-GAAP diluted earnings per share for the quarter increased by 4%. Our cash flow from operations for the quarter was \$220 million, reflecting robust underlying earnings, partially offset by higher working capital. Capital expenditure for the quarter was \$30 million. Depreciation and amortization for the quarter totaled \$41 million. During the quarter, we paid dividends to shareholders totaling \$61 million.

We recorded equity losses of \$1.9 million in our income statement in the December quarter associated with the Primasun joint venture with Verily. We expect to record equity losses of approximately \$2 million per quarter through the balance of fiscal year '22 associated with the joint venture operation.

We ended the second quarter with a cash balance of \$194 million. At December 31, we had \$680 million in gross debt and \$486 million in net debt. Our debt levels remain modest. And at December 31, we had approximately \$1.6 billion available for drawdown under our existing revolver facility. In summary, our liquidity position remains strong.

Our Board of Directors today declared a quarterly dividend of \$0.42 per share, reflecting the Board's confidence in our operating performance. Our solid cash flow and low leverage provide flexibility in how we allocate capital. Going forward, we plan to continue to reinvest for growth through R&D. We also expect to continue to deploy capital for tuck-in acquisitions such as Citus Health and Ectosense, an acquisition we completed on October 1.

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

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

Great. Thanks, Brett, and thanks, Mick. Kevin, let's go ahead and now turn the call over to you to provide instructions and then run the Q&A portion of the call.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question today is coming from Chris Cooper from Goldman Sachs.

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

Mick, can you just remind us, please, of the specific measures you're employing to mitigate the component supply challenges? And I guess, where you're seeing more and less success?

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

Yes, Chris. Thanks. It's a very pertinent question, obviously, and we're pursuing multiple paths, as I outlined in the prep remarks. We're focusing on, the first thing we're doing is going to our existing suppliers and existing supply chains and really imploring them to prioritize medical devices over the other aspects. They have choices to give to electric cars or cellular phones, consumer devices and medical devices, and we are working with

them directly on that. We're seeing some benefit on that, certainly at the level of maintaining the sort of double-digit growth that you saw during this quarter.

In addition to that, we are redesigning parts and pieces and components within our existing platforms, and we're bringing new platforms to market faster. So we're working on Air 10 designs and Air 11 designs. We're also re-engineering our supply chains to validate and verify new suppliers to be able to get there. And so that whole combination gives us a lot more confidence that as we look to March quarter to get better than December, but then June quarter to get significantly better than March. And then as we go through September and December of this calendar year, we really start to free up, a lot of those projects come into play, and we're seeing a lot of confidence with them. But over that portfolio, Rob, do you have any more information to provide maybe, Chris, around what we're doing with supply chain and parts?

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

Maybe only also, Chris, this has sort of been going on for a year now. And we knew these shortages were going to be coming. So our teams had been working on all those activities that Mick's been talking about throughout the year starting to bear fruit. It does take time, and that's why we're talking about sort of things don't fix immediately. We're talking about it continuing to be challenging for this coming quarter and starting to see improvement further out. That said, it's a very dynamic situation and things do change on a weekly basis. And so our teams have to be extremely agile. And we're actually putting a lot of resources into it, got a really strong team of engineers and commercial relationship people with the suppliers and our product teams are all really focused on this as we work through these challenging times.

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

So can I ask, I mean, relative to the update you were providing on the last quarter results in October, are you now more or less confident that the deficits that you're currently seeing in components can be addressed by the fourth quarter?

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

Yes. It's a good question, Chris. I'm actually precisely where I was in October that I think we said in October, it's going to be tough in December. It's going to be tough in March, and really start to open up in June and then as we go out throughout the calendar year. So I stand by that. And I stand as Brett said earlier, looking at fiscal '22, the \$300 million to \$350 million of incremental product.

I mean, look at the December quarter, 16% growth year-on-year in devices amongst a global supply chain crisis, COVID-19 recovery and all the challenges that are there. That's really strong. But we're going to get stronger than that as we go throughout the fiscal and as we go throughout the calendar year. This seemingly infinite demand is going to be with us for the whole of this calendar year and potentially beyond that. And so all the projects that Rob talked about, if the starting gun went off sort of June 14 when the competitor put this recall notice and field safety notices globally out, our team have done a pretty darn good job getting to 16% year-on-year in this crisis in the December quarter.

I think it will get, as I said in October, I think it will get better in March than December and significantly better in June. And then really start to free up as we hit September and December. And with almost infinite demand, you never quite catch up to that, but we're going to get faster and faster and grow more year-on-year as we go throughout the calendar year.

Operator

(Operator Instructions) Our next question is coming from Dan Hurren from MST Marquee.

Dan Hurren - *MST Marquee - Healthcare Analyst*

Mick, you mentioned that ventilation demand was back at pre-COVID levels, but I presume you're talking about the hospital vents or hospital patients. So I was hoping you could give us some color or detail on ventilation into the home healthcare market, specifically how the Astral product has performed whilst displacing the Trilogy range over the last couple of quarters?

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

Yes. Thanks for the question, Dan. I'll have a first stab at it and then hand to Jim Hollingshead, who's our President of Sleep and Respiratory Care. Yes. So what I said in the prep remarks is that what we're seeing is that the demand for ventilators is really around that COPD, neuromuscular disease, respiratory insufficiency markets are where they were pre COVID-19 pandemic. So that we're seeing that flow of sick patients finding their way through digital health solutions, telehealth monitoring, digital work with their pulmonary and/or COVID cleaning protocols in labs with their pulmonary physicians. We're getting the prescriptions for those products.

The vast majority of our revenue, 90-plus percent globally on respiratory care, are out-of-hospital respiratory care. So even Astrals, but Stellars and bilevel ST-As, STs and ASVs. They're used for ventilation outside the hospital. So those seem to be back in terms of patient flow. Jim, any further color to provide Dan on that?

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

Yes. And Dan, the only thing I would add to what Mick said is that our Astral product is performing really well in the market. It's got very sophisticated algorithms that can treat a wide range of patients and demand for it has been really strong. And so in general, the Astral has been very well accepted and some of the algorithms we've added over the last several months have driven demand up for it. It's also benefiting from the -- for what is for us a tailwind from the Philips recall. And so there's a bit of incremental demand for Astral in that context as well.

Operator

Our next question is coming from Sean Laaman from Morgan Stanley.

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

Mick and team, I hope you're all well. Mick, I'm hoping we could get an update on the new RTM codes from CMS and how that might be influencing Propeller.

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

Yes. Sean, it's a great question. And as you know, Propeller technology is, for those who may not know is our cloud-connected pharmaceutical delivery product for both COPD and asthma. And a lot of those are in pilot stage and partnerships with governments in Europe and private payers in the United States. And so we are -- do have some commercial models going. They're not material to the global business. But Dave Pendarvis, do you have any data about RTM codes that we've got through reimbursement and any impacts on those for Propeller and across the business?

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

Yes. Well, generally, we're happy to see coding and reimbursement flow towards more remote monitoring type activity. That's a positive. At the same time, Propeller is working both to have physician adoption of those codes, and we're working to see the funding come through with that. And nothing changes quickly in terms of medical practice. And Propeller is also working with healthcare systems and other system-wide bases to try to adopt the Propeller system.

So I'd say we're encouraging, but it's still a little early in the day for us to say we're seeing material uptake for Propeller as a result. But certainly, it improves the operating conditions, and we think this is a long-term trend that will benefit Propeller as well as the rest of the business and its remote patient monitoring in the long run.

Operator

Your next question today is coming from Matthew Mishan from KeyBanc.

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

You saw a sequential improvement quarter-over-quarter in U.S. masks. Can you give us a sense of what the drivers of that are? And whether or not you expect continued sequential improvement moving forward?

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

Matt, and it's great to see U.S., Canada, Latin America at a strong 9% constant currency growth on masks. And Europe, Asia, rest of world at 11% year-on-year with a strong double-digit 10% growth worldwide. And as you said, that is up from last year.

Look, I think I'll start and maybe hand to Jim for some more color. But at the broad level, COVID-19 has shown the importance of respiratory health and respiratory hygiene. And we said this in 2020 when we saw that sort of uptick of the growth of our masks and accessories business. And we just launched SNAP and we have Brightree ReSupply. And a lot of people thought, well, this is a secular step up. It's just up while people are people with stock holding some commodity products. This is a stockholding issue. And we said, no, this is sustainable. We're talking to patients. We're doing the Net Promoter Score. We're analyzing the data. Consumers want, have always wanted more healthcare. They've now seen the reason for respiratory health and respiratory hygiene.

We're now two years into this and we are seeing sustained growth at the patient level demand for respiratory health, respiratory hygiene. We're adding to that the technology from SNAP, technology from Brightree. But in other parts of the world, where those technologies aren't there, we're partnering with our home care providers, with patients directly and beyond to encourage and make that happen. But Jim, any further color on the sustainability of this strong milestone?

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

I think Mick just listed a couple of tailwinds there related to, I do think patients have changed their behavior in the context of COVID and are much more keen to get clean, refreshed consumables in their experience. And I think our customers worldwide have gotten better at providing that and the U.S. market in particular, there's a very strong push on resupply and has been for months, and so that's the tailwind. There's always a Q2 cyclical tailwind because of deductibles. So that's a normal cyclical thing.

But the other thing I think is really important to point out is that our mask portfolio is performing really, really well. We have the -- we do have the widest range of masks available to fit really almost any patient experience. We continue to take share, I think, which is a really important dynamic for us. So not massive shocking movement, but incrementally, we continue to take a bit of share over the last two or three quarters, we've taken some points of share. And so that's been really good.

The only headwind on masks is the Philips recall because the Philips recall is dampening new patient starts. And so that's a tiny headwind against four or five tailwinds that we've just listed, and we feel really confident about our mask portfolio going forward.

Operator

Next question today is coming from Craig Wong-Pan from Royal Bank of Canada.

Craig Wong-Pan - *RBC Capital Markets, Research Division - Analyst*

Just a question on U.S. device sales. I was wondering if you could provide any comments on the split there between AirSense 11 and AirSense 10? And how that kind of proportion of sales between the two might compare to the first quarter?

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

Craig, it's a pertinent question, but it's one we don't feel comfortable going into the details on. What I can tell you as an N equals 1 personal user of this AirSense 11 platform is that the delivery is smaller, quieter, more comfortable, more connected. My wife actually asked me if it was on when I turn it on, it is that much smaller, quieter and better than our last generation, already the leading platform.

So what I can tell you is it is taking off every single AirSense 11 we can make is sold that day. It comes out of the factory, it's already pre-sold and they are moving fast. And so it is increasing as a portion of our U.S. sales. For competitive reasons, we're not going to split out how quickly that S-curve is coming up. But the points I made in the prep remarks are really strong. The AirSense 10 on its own is the second-best product in the market after only the AirSense 11. So it is already there. And every AirSense 10 we can get a component for and then put through the production line gets sold as well. So we're selling both in parallel. And customers are demanding both and will take both over any of the competition. And so we're driving those out there.

We're driving great growth of both, and we will do throughout all of calendar year 2022 as the Philips recall will last at least that long in their update just this week. And so 90 days ago, it was twelve months ending in September. We were ready for that scenario that will come back in September and get our great mask uptake, as Jim was saying earlier. We're now ready for their new scenario, which is December, and we're ready to expand our components and our share on the device side and driving as much of that demand as is possible. So we're ready for all the scenarios of all the above. But yes, we're not going to break down the exact AirSense 11 versus AirSense 10.

I can tell you it's growing extraordinarily fast. The S-curve uptake is great, and patients are loving it. So throughout calendar year, we will introduce it to other countries around the world, and we expect the same sort of level of uptake in those other countries.

Operator

Our next question is coming from Andrew Paine from CLSA.

Andrew Paine - *CLSA Limited, Research Division - Research Analyst*

Just wanting to get a bit more clarity on your ability to re-engineer parts and redesign elements in your devices. How is that going to be achieved? And does this mean you won't be as exposed to chip shortages from 4Q and onwards? And when do you think these changes will allow you to be running at full capacity and in essence, meeting current demand?

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

Yes. Andrew, great three-part question. I'll start with it, and then maybe, Rob, you can't cover anything I missed to Andrew's components there. But look, yes, the starting gun went on this project in April when they said there was a quality issue, June when they said there was a recall. We were already ready for those supply chain shortages that COVID-19 would drive. And if this recall for our competitor hadn't happened, we would

be able to meet all the existing demand. As you saw, we grew 16% year-on-year in this quarter, and that would have been great growth, taking some good share in the core competitive market.

But with that starting gun going off in June, we did start those re-engineering projects. We said, look, we are not going to be able to just go back and ask for more supply. We know the supply chain constraints. We know the automotive industry, cellular comms and others are all screaming for more product, too. And so we started those re-engineering of components and parts. We started also re-engineering the Six Sigma black belts looking at our supply chain and analyzing different suppliers and revalidating and assuring that we could get them there. And so there's a bunch of projects going on. I run out of fingers looking at them.

But when I look at that portfolio, it gives me strong confidence to say, we saw some of them come to fruition in December, some more in March. But in the June quarter, I think a bunch of these projects will free up supply and then you hit September and December and the portfolio of projects that are going to get to market in terms of a new supplier, a new piece, a new redesign will get there. And that's what gives us that confidence in that recovery of the amount of share we're going to take through 2022. Rob, what did I miss there?

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

Maybe just going into some of the sort of the re-engineering processes. You know these, Andrew, these products have hundreds of components in them. And if you're missing one, you can't build any of the product. So you'll actually see us as we build buffers around all this, we will see our inventory levels of materials go up as we build buffers of these alternatives.

Now some of the components, they're easy to have as alternatives. You've got to revalidate them. And in the medical device world, you've got to have very rigorous revalidation of alternate components, and that's often a lot of the engineering work. But some of the other components like the micro controllers and things like that, they are a lot more complex. They interact with the embedded software on the systems, all of that type of thing. The design and validation processes for those are more complex and do take more time. We've got projects across all of those areas going on in there.

And as we make these alternatives, then we're scheduling the longer-term commitments, the relationships with the suppliers, building the inventories and making sure we have options. That said, I keep coming back to the fact that it is a very variable situation. And just when you think you've got everything right, then you start seeing other components be challenges. So our teams, as I said earlier, have to be really agile and keep competing on this. You've got to keep running really fast to track these issues.

Operator

Our next question today is coming from John Deakin-Bell from Citigroup.

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

I'm just trying to get a bit more color around the underlying new patients, maybe between the U.S. and the rest of the world. And just give us a sense of where you think we're at in different markets and perhaps some sense of when you think it might get back to the patient growth we were in 2019.

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

Yes, John, it's a very complex question because, as you know, we operate in 140 countries and all the different Greek letter variants of COVID flow through those 140 countries at different rates. One great thing because we have strong visibility and awareness into this as we talk to the pulmonary and critical care physicians and we watch hospitalization rates and ventilation usage rates and ICU/CCU usage rates is each variant seems to be, although more and more communicable, less and less severe in the impact in terms of hospitalizations, severe need for ventilatory help and death.

And so the work that we did in 2020 and 2021 establishing these digital protocols, home sleep apnea testing protocols, that pulmonary doctors who previously hadn't done telehealth visits are now doing them. Doctors who weren't embracing ApneaLink Air or some of the NOx digital diagnostics components have embraced them throughout 2020 out of necessity and then 2021 out of scale.

So as we enter 2022 here, we're feeling very comfortable across those 140 countries. I gave in the prep remarks sort of a wide band, right, 85% to 100% of pre-COVID patient flow depending on the country, the city, the location. There are some, as I said in the prep remarks, there are some locations that are above 100%. And I won't go into the detail, North Rhine-Westphalia this quarter or Bavaria last quarter or Southern France this quarter, southeast of the U.S. this quarter. But what we're seeing is, as the variants come down, those protocols go, we're hitting those. If you take 2019 as the base year, we're hitting those 100% triple-digit rates in some locations.

And so gives us a lot of confidence because the beauty is we're in all 140 countries. So that portfolio, I feel every 90 days we're seeing positive movement, even though a particular location might go back two steps and one might go forward three steps. On aggregate, we're seeing sort of one step forward for ResMed as we look across that portfolio every 90 days.

That's why we're able to see this great strong 16% device growth across our region. It's not only share-taking. There's some good flow of patients coming through. What worries me a little bit, John, is actually some of the backlog that might be happening in the system due to our competitor just not being in the market for 18 months, right, in aggregate, according to their call this week. It will be 18 months from June 2021 through December 2022. That backlog of patients, we can't get them all, right? We're ramping up, as Rob said, doing everything we can to ramp up. We're not going to get them all.

And so that backlog of patients, even when our competitor comes back, it's going to have to flow through the system. So this is not just an effect that's over the day our competitors back. There's going to be a number of quarters where ResMed is going to grow, take share and deal with this flow of patients through this. So although we are pushing very strong around our long-term demand gen, we're not turning up the dial yet on driving the top of the funnel because, frankly, the top of the funnel is full and growing, and will do for the next 12 months.

Operator

Our next question today is coming from Gretel Janu from Credit Suisse.

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

More of a medium-term question, Mick. So as the industry isn't able to meet the demand for new patients at the moment, what are you doing to ensure that patients don't fall off the waiting list I guess, do you see any risk that the industry will see lower growth in the medium term from all the disruption over this 12-, 24-month period?

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

Gretel, I'll have the first go and hand to Jim. I mean the short answer to your question is absolutely not. I do not see any growth slowing down. In fact, the backlog, certainly for ResMed, I see incredible growth coming for our industry. And so a lot of the demand gen stuff I talked about, and we talked about it on our Investor Day, with CVS partnerships on the brick-and-mortar side in the front line. And then on our Verily partnership, Primasun on the front line. We are not turning the dials on that demand gen up, but we don't need to through 2022, but we will start to turn them up in 2023. And I think what we'll see is the backlog will come in and our demand gen will come in, and we'll actually, post-COVID, see a faster growth rate of our industry because of all the learnings of digital health, home sleep apnea testing, seamless and digital end-to-end journeys for patients. It's got better for patients when they get into the system.

The trouble is now, the competitor that can't provide the therapy at the end, and that does create a bit of a backlog. But I think on the other side of this, we'll actually see increased secular growth. The mid- to high single-digit growth of our industry might move up 50, 100, even more basis points because of the embracement of digital net-net. But Jim, anything to Gretel's question around industry growth there?

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

Yes. Gretel, I guess I would just add a couple of things. The first one is we're working really hard with our channel partners to understand the dynamic of patient wait lists and working really hard with physicians on that. And so we're, as you know, we're prioritizing higher acuity patients, higher acuity conditions with our production. But we know that there are kind of straight OSA patients out there that are facing a longer way list, and we're working with our customers to try to reduce those wait times and to better manage an understanding of when we can deliver product to which customers. So that's just sort of a general thing we're trying to do.

I think the other thing that will help us to drive growth on an ongoing basis is we're working right now on programs that will allow us to capture patients who maybe faced a long waitlist, and I don't want to go into great detail on that, but our marketing teams in our main countries are working on those programs right now. And as we have more supply, we feel pretty confident we'll be able to run programs that will be able to re-engage patients that maybe have, they're tired of waiting or something like that. So we think we'll be able to capture a big part of that backlog, which there is a backlog, and we think there'll be an even bigger backlog as that goes forward.

And the last thing I would add is we're pretty active in developing new channels. And so those are new and growing areas for us. But if you think about something like CVS HealthHUBs, there's a new channel that continues to grow. CVS continues to invest there. That's a new way for patients to be reminded that they were diagnosed with OSA or to be reminded that they might need resupply. And CVS is just one example where we're working in new channels. We're doing that not just in the U.S., but in multiple markets around the world.

So we're going to expand the ability to reach of different channels for patients to get treated and we're accelerating those now. We'll be accelerating those programs even more as production comes up to higher volumes and we're able to treat more patients.

Operator

Our next question today is coming from Saul Hadassin from Barrenjoey Capital.

Saul Hadassin - Barrenjoey Markets Pty Limited, Research Division - Analyst

Just maybe one for Rob. Rob, just on the discussion around semiconductors and the shortages. Can you talk to us about the line of sight you get as it relates to the inflow of those chips and then the manufacturability? In other words, is it still taking circa three months to process devices? And so you're in a position now to know what your volume on flow generator is looking like into fourth quarter because you have those chips either sitting with you now or they're due to come in over the next few weeks?

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

Yes. Actually, as I was saying earlier, we've actually had to greatly extend our forecast lead times to get the supply commitments that we want, actually multiyear. So at that level, we have a long view. Yes, our cycle times are actually pretty short. The longest part of our cycle time, and variable part of it, is freight. And so a lot of the challenges of forecasting sales on a weekly basis is what's happening to any freight that's stuck off Los Angeles or something like that. Now we can mitigate that at a cost with air freight, and we do that, but we certainly can't do 100% on freight.

And so we're trying to balance up those sort of freight demands and that does create a variability. So the hardest thing for predicting what we're forecasting over the next couple of weeks is actually those freight deliveries. Our internal systems around delivering them out of our warehouses are extremely slick and really run well. And we've got great teams in those warehouses.

Our factory capacity, we typically run a policy of having significant burst capacity in these factories. And as we've said before, we've just invested in a major new factory in Tuas in Singapore. And out of that factory, we would normally have the capacity to meet all of the industry demand. So

we can actually push stuff through that system really quickly. The key issue is that variability and the propensity of the suppliers to meet their commitments.

Now they do everything they can to meet their commitments. But actually, some of those freight issues, they have the same issues. They have the same issues of allocation from their suppliers. And so we have to manage all the way through all of those layers to get there. So it's a long answer. But really, the main factor is suppliers and the short-term variability is freight.

Operator

Our next question today is coming from Lyanne Harrison from Bank of America.

Lyanne Harrison - *BofA Securities, Research Division - VP in Global Equity Research*

I guess you've spoken about volume in detail, but can we talk about price and provide some color on the trends you're seeing in average device prices this quarter, perhaps with some reference to discounting, if you can?

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

Yes. Lyanne, it's a good question. And traditionally, we don't talk much that about at all. But one thing I will say is that we announced it in our prep remarks, my prep remarks here today that we have a surcharge now on all ResMed devices that are associated with exactly the last question from Saul where Rob was talking about increased air freight and sea freight costs. Sea freight costs of 5x or 10x what they were. Air freight was always a significant factor above sea freight, and it's got more expensive, too. And so all of that has meant that we had to provide that surcharge to our [customers] (corrected by company after the call).

So we haven't done a price increase as some of our competitors have to the customers, but we have put a surcharge on devices starting in January. Our customers have accepted it. I mean, the people running these companies go to a supermarket and see the price of milk or the prices of whatever commodities that they're purchasing in their daily lives going up in price. And so a surcharge from us given the nature of this has made sense to them.

And so your question was, what's the levels of price discounting. There is no price discounting right now. In fact, we're taking away some of the early pay and some of the other factors that were there that were non-price related, but impacted sort of cash flow there because it's very important in an environment like this to make sure that the costs are shared in a fair and equal way through the supply chain, and we're doing that through a surcharge.

But as I see it, the mix side, the second part of your question, we're following our guiding principle on allocation here. If we have limited chips and parts and pieces, we will make an Astral before a Stellar, before an AirCurve ST-A, an ST, an ASV and so on down to an APAP and CPAP. And so the mix can lead to some sort of ASP mix increases on that, but any individual like-for-like product, we're keeping the prices where they are because we're in steady reimbursed environment. Our customers, we have relationships going back decades. We want them for decades for the future, and we really value those relationships. And so we're really focused on this sort of temporary surcharge where it's going to be associated with those increased costs we have and any impact on ASP is really around mix towards those higher acuity products.

Operator

Your next question today is coming from Steve Wheen from Jarden Australia.

Steven David Wheen - Jarden Limited, Research Division - Analyst

I've got a somewhat related question for Brett just with regards to the gross margin. So I was just wondering if you could help us sort of break into that number a little bit, particularly from the point of view of the next few quarters. So I'm trying to put into context the surcharge as to what sort of effect that will have. And then there's obviously other drivers, which all look quite positive, like FX, mix, maybe the AirSense 11 pricing. So if you could sort of maybe comment on any of that. And then lastly, maybe a headwind. Is there any pricing pressure coming from the semiconductors suppliers to you guys? So if you'd help me unpack that gross margin that would be great.

Brett A. Sandercock - ResMed Inc. - CFO

Yes. Thanks, Steve. Let me try and unpack that a little bit. On the gross margin, if you look at it year-on-year, pretty big decline and really freight was the big one and logistics costs. Some component cost increases coming in, and also manufacturing because it's really hard to optimize on the manufacturing front at the moment. We're just trying to make sure we can really maximize output rather than efficiencies. So that's playing out. That played out year-on-year. If you look at it sequentially, in quite good shape, a little bit of an increase there sequentially, actually.

If you go forward, we're still going to have freight and logistics costs coming through. I mean, that's still going to be, I think, a headwind for, I think, for the rest of this calendar. FX probably relatively neutral as we look forward. And I think ASP declines won't -- we've typically had that, but I don't think we'll see that going forward. We have the surcharge. It's only a small surcharge so, and we're only, we're not recovering anywhere near our increasing cost there. But as Mick said, we're looking to share that.

So they're kind of, they're still with us. There are some headwinds there. We've got AirSense 11 coming through, which is at a price premium, but that's only in the U.S. market at the moment. But taking in a medium-term view, that will be supportive. But the other one to call out is, as particularly in Q4, as we increase the output or the volumes from the supply constraints easing, then we'll have higher revenue there, but in a relative sense, it will be more of the kind of lower acuity in terms of that mix. So that one will be a little bit of a headwind because the product mix won't be as beneficial as it has been. So there's some puts and takes there, but that's kind of how I see it at the moment.

Operator

Your next question today is coming from David Bailey from Macquarie.

David Bailey - Macquarie Research - Analyst

You sort of touched on this in part of your earlier remarks, but I just wanted to confirm that you're confident that some of the changes in relation to digital initiatives over the past couple of years will allow the system to deal with the backlog of new patients over the medium term?

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

Yes, David, it's a really pertinent question, and I feel very confident. And we've watched it. Before this recall was announced through to June '21, we saw great adoption for 18 months of all the digital solutions, from doctors getting involved in telehealth, to the adoption of identification, engagement, enrollment and diagnostic systems on a digital basis. In countries where, like in Germany where home sleep apnea testing was less than 10% of the total diagnoses in 2019. It went to huge double digits throughout 2020 and has stayed quite high despite the reopening with COVID cleaning protocols of sleep labs throughout Germany.

And so I think as you look on aggregate, David, that adoption that happened in the last two years will be a huge impact, permanent adoption of digital health screening tools. And as Jim said, as we open up new channels, we're going to roll that digital end-to-end solution through multiple new funnels to get patients into the funnel through our Verily partnership with Primasun, through our CVS partnership. And they're the two public ones in the U.S., but we're doing, as Jim said, stuff in the other 140 countries that are on more a partnership basis with the U.K. government, with

the NHS, some great information from our U.K. team I was looking at over the last week, incredible work in our Northern Europe team, our Western European team, the partnership with the French government.

I talked about the ALASKA study. That's just the peer-reviewed published evidence that's out there. We're doing stuff on the ground that we're not talking about publicly but has incredible adoption of digital health technologies in conjunction with the French social security system supporting that through high reimbursement of cloud-connected CPAP versus non cloud-connected CPAP because they see the results. They see higher adherence. They see better outcomes and they see lower costs. Not only death rate, lower death rate of those who are CPAP adherent, but lower hospitalization. So it saves lives and saves money. So David, it's a permanent adoption. I think it will improve our efficiency as an industry as we get into '22, '23 here and beyond.

Operator

Your next question today is coming from Margaret Kaczor from William Blair.

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

I wanted to follow up a little bit on some of the math that you guys had implied from the benefit of the competitive recall. And if we sort of keep the fiscal Q3 benefit similar to what we saw in fiscal Q2, maybe tick it up a little bit, the fiscal Q4 benefit sounds like it's going to be \$130 million, \$140 million or so at the midpoint of your range. So as we think about that with Philips extending the timing of the impact of the recall, should we be using that \$140 million as a base benefit as we go into the second half of the calendar year, especially given that it sounds like even at that range, the demand maybe isn't fully satisfied? And so it could theoretically go higher especially with the underlying market improvement. Jim's help here would be great.

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

Yes, Margaret, it's a great question, and I'm not going to get into sort of the detailed breakdown of the \$350 million through the fiscal year. But as you said, look, it is back-end loaded in terms of Q4 is going to be the lion's share of that because all the projects that Rob talked about earlier will come to fruition in June, September and December. And so the only guidance I think I've given in the last 9 years as CEO was around this \$350 million on the revenue side there for fiscal '22. And so I'm not going to go into 2023. We did that because the models were quite wide there on the benefit from this recall on the sell-side for as low as \$50 million to as high as \$950 million. So we wanted to rate set it at \$300 million to \$350 million. We're still comfortable with that for fiscal '22.

But as you look for fiscal '23, look, I do think that the share that we're taking this year will be a long-term sustainable share. When we go in and take share, we don't just go into a competitive account and say, great, here's your product, go. We work with people who are adopting, existing relationships with people who are adopting myAir for their patients, getting that 60%, 70% uptake that we've seen with AirSense 11. They're working with AirView. All their physicians are on the cloud platform, getting that efficiency. They're using Brightree and they're partnering up in the United States and beyond. So that digital end-to-end, it becomes a very sticky platform because the value is so strong.

They lower their labor costs by 50% setting up the device. They improve adherence to 87% for their patients and their physicians and it becomes permanent. So I do think that the share we're taking will be long-term sustainable. When our competitor comes back, they're going to have to go after the low-priced people first that don't have all that digital end-to-end. When they try to come after us, we're going to be so far ahead with 18 months' worth of digital health innovation and all the work that we're doing to partner with physicians, patients and providers.

I look forward to it. We were winning this football game before we got the penalty kick. It's like we were the Kansas City Chiefs and we were up 42 to 0, and then we got a penalty kick, and now we're up 45 to 0. We didn't need the penalty kick to get there. So I still think we'll win on the other side of this.

But having said that, we're not going to give guidance around '23, but everyone will have their models. I think that certainly with our competitor being out for the calendar year, we're going to take incredible share this calendar year. I think as they come back, their name brand will be different. They'll have to start from the ground up and we'll have a strong lead as we go through fiscal '23 and beyond.

The most important thing, we're not really looking back at our competition. We're looking forward as we were talking about. As Jim and I have been talking about, it's about the digital health solutions, getting patients into the funnel and finding new ways to get the one billion people worldwide who have sleep suffocation into the funnel and 80% to 90% of them are undiagnosed. That's what we're laser-focused on.

Operator

Your next question today is coming from Suraj Kalia from Oppenheimer.

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

Mick, one question from my side. And Mick, let me pose this as a hypothetical. Obviously, demand is not being met, right, whether because of supply constraints or so forth. How do you ration between an organic ResMed patient that will be sticky long-term versus, let's say, a Philips patient that potentially could generate a higher ASP short term? I guess a subpart of that, I'm also trying to understand, do you see mix and matches going out in the field, i.e., tubes and accessories with blowers being mixed and matched just to meet demand?

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

Suraj, it's a good question. And look, we don't, particularly in the United States market, we work with home care providers. And we're really taking the human patient-first model here first, which is we start with the highest acuity patients and work our way down. With our partnerships with home care providers, we start with existing relationships, digital adoption and because it drives best efficiency for the system and best outcomes for patients.

So we don't make priorities. I will choose this patient because it will be more profitable or this system because it will be there. We focus on that acuity first, those relationships and the adoption of digital because the long-term is what we're focused on. We don't want some short-term revenue and some short-term gains that you just give up. We're looking for transforming the healthcare system towards our 2025 goal. And so that's where our priorities are. Any further color, Jim, you'd like to provide on Suraj's question?

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

Just a couple of things. First thing is, we're not making the decision about the patients. It's the provider that's making the decision about the patients. But we're driving our production mix for higher acuity so that we can enable providers to meet the needs of the higher acuity patients first. That's the first thing I would say.

Second thing, just as a reminder, I think we mentioned this, I think we mentioned it today, but we've certainly talked about this on previous calls. The way we're prioritizing product allocation is higher acuity patients, but we're also prioritizing, effectively prioritizing the existing ResMed customer volumes, right? And that's a very explicit decision, right, because we could have said the alternate. We could have said, we're going to take this opportunity to go take accounts that have favored Philips historically.

But in fact, what we've done is we've done all of our allocations of product based upon the history we have with our customers. And de facto what that means is that it's customers who have been more adoptive of ResMed products who are getting more volume from us, right? And one of the opportunities for us as our volumes build is to actually, once we've met the demands of those customers, to actually take competitive share in accounts that might have trended more towards Philips historically. So that's, and we've had some questions on growth next year. I think that's a big opportunity for us on growth next year.

And then the third thing on your question is, it's always been the case that providers will mix and match one manufacturer's mask with one manufacturer's device or whatever. There's a little bit more of a tie to the device and the tube if it's a heated tube because those are lock and key. So our heated tube works with our devices and not with others. But we have higher share. We have a higher attach rate for all the consumables in the market than our competitors do. So when there's mixing and matching, it's almost always to our benefit.

Operator

Our next question is coming from Michael Polark from Baird.

Michael K. Polark - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

It's a U.S.-centric one. And I'm curious, Inspire is second line to CPAP therapy in the U.S. The company has been running a fairly active marketing campaign with TV commercials. In 2021, they spent \$50 million. That number is going to be a lot higher in '22, and I think a regional campaign is going national. Inspire is second line so it goes without saying on that. But their commercials tend not to portray CPAP therapy in the best light. And I'm curious what you think about this and if there's any counter detailing efforts you can do to respectfully push back on some of the marketing runs that Inspire is doing?

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

Yes. Thanks for your question, Michael. And it speaks to substitute therapies, which is something we look at very carefully because ResMed stands for respiratory medicine, not CPAP manufacturer, right? And so we've been in alternative therapies for sleep apnea therapy for decades. We have a dental, 3D printed dental device called Narval. We're the #1 provider of dental sleep apnea therapy in Western Europe, Northern Europe and many other countries around the world. And we've invested in a technology in this space of the company you mentioned, Inspire. Hypoglossal nerve stimulation is the category. We invested in a company called Nyxoah, N-Y-X-O-A-H, which is actually now listed on Nasdaq and a European exchange. And they're in PMA trials here in the United States and MDR work in Europe. And so that product will come to market in this segment.

Look, yes, we've seen some people do D2C advertising in this space. There was an oxygen delivery company that had a guy from Star Trek for a while. I think these things of demand gen in the old-school way is not the future for us. We're focused on social media. Our partnership with Google and Verily is around people typing in, "my husband snores", "I snore", and getting through a digital end-to-end pathway to identify, engage and enroll people through. And we haven't really gone old-school media with demand gen. We certainly don't need it in calendar 2022.

To your point, you can't change. You can market however you want in the industry, but you can't change clinical and economic realities. CPAP is the most economical and best noninvasive way to treat sleep apnea, period. Now we make a sleep apnea device and a dental device and we're invested in hypoglossal nerve stim. I say that on the clinical and economic reality, you talk to any pulmonary person, even an ENT surgeon will say, no, you have to try CPAP, you have to try dental, and then you'll try the hypoglossal nerve stim. ResMed is going to be involved in all three categories. I think they'll all be valid, but I think they should be known. Here's primary, here's secondary and here's tertiary.

And the economic reality is clear. You can Google the price. It's probably gone up a little on CPAP.com for a CPAP from those providers or easybreathe.com. They're probably \$500 for the device and trailing of, what, \$100 on a mask every year. Compare that to a \$25,000 surgery. I don't care what your high deductible health plan and health savings account is in the U.S., that's a lot of money for the individual and a boatload for the health system. So there'll be some economic realities of payers doing care management around this as it grows. Good category, long-term.

My opinion on the stuff is, any talk, including The Wall Street Journal article this morning around one billion people suffocating, 80%, 90% of sleep apnea undiagnosed, any news about sleep apnea, sleep suffocation is good for ResMed and it's demand gen. I prefer it in 2023 than 2022 because we've got enough demand to keep us going for 12 months. We'll be turning the knobs on our social media, our digital and our brick-and-mortar demand gen in 2023.

Operator

Our final question today is coming from Mike Matson from Needham & Company.

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

Yes. Just want to ask about the surcharge. I don't know if you're willing to disclose roughly what percentage that is? And is that something that's being applied to all your products, in other words, the devices and masks and accessories, or is it just specific to devices? And then finally, is this something that's tended to be temporary or something that you expect to be more permanent? And I have a follow-up as well on something else.

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

Yes, Mike. Thanks. And we may not have time for your follow-up given we're fifteen minutes over already. But look, the surcharge, I'm comfortable, I think there was a sell-side note that was public out around this. It's a \$12 surcharge in the U.S. and a EUR 12 surcharge in Europe and it's basically on all devices. It's not applying on the mask side. So that's the answer to those.

To the question of how long will this last? Obviously, we're in discussions with customers around the world. If you look at Rob's answer to the question, if you're reading the transcript, further up that transcript, it's a complex issue around sea freight, air freight, component costs, semiconductor, microchips. And we don't know how long those freight costs will be high, those component costs will be high. So I will say the surcharge will be there as long as those are there. It's temporary, but it's as long as those are there. And I think you've got many other stocks in your portfolio where they're talking, they are the semiconductor manufacturer or there are others who give you further detail on how long they think they will have supply chain constraints and therefore, higher cost to pass through to their customers. So that would be the way I'd answer your two questions, Mike.

Thank you for bringing those through. And thank you to everyone for staying an extra fifteen minutes. There's a lot to go on this quarter. Look, thanks to all of our shareholders for joining us on the call. Once again, I'd like to thank the opportunity for the 8,000 ResMedians, many of whom are also shareholders who listen in here for your dedication and hard work, helping people breathe better, sleep better and live better lives outside the hospital in 140 countries. Thanks for all that you do today and every day. Thanks for surviving this COVIDness and the Zoom calls and all the craziness.

Thanks also to our frontline heroes who aren't on Zoom calls. They're doing patient care, technical care, sales teams visiting customers every day. I'd also like a special call out to the frontline supply chain team, management, procurement, distribution and our digital health teams working around the clock to keep up with every new launch of myAir, AirView and Brightree and MatrixCare. So thank you all. I look forward to talking to you all again in 90 days. Thank you. I'll hand it to you, to Amy, to close this out.

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

Great. Thanks, Mick. And to echo Mick's comments, thank you, everyone, for sticking with us an extra 15 minutes. It enabled us to get through everybody in the call queue. We do appreciate your interest and your time. And if you have any follow-up questions or additional questions, please don't hesitate to reach out to us directly. This does conclude our second quarter 2022 call. Kevin, I'll turn it back to you to close things out.

Operator

Thank you. That does conclude today's teleconference and webcast. You may disconnect your line at this time and have a wonderful day. We thank you for your participation today.

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