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RMD.N - Q3 2022 Resmed Inc Earnings Call

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## OVERVIEW:

Co. reported 3Q22 group revenue of \$865m and YoverY revenue growth of 12%.

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

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

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

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## PRESENTATION

### Operator

Hello, and welcome to the Q3 Fiscal Year 2022 ResMed Earnings Conference Call. My name is Kevin, 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 of Investor Relations and Corporate Communications. Amy, you may begin.

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

Great. Thank you, Kevin. Hi, everyone, and welcome to ResMed's Third Quarter Fiscal Year 2022 Earnings Conference Call. We appreciate you 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 our earnings press release and presentation, which are both available now.

With me on the call today are ResMed's 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, President and Chief Operating Officer; Jim Hollingshead, President, Sleep and Respiratory Care; and David Pendarvis, our Chief Administrative Officer and Global General Counsel.

During today's call, we will discuss several non-GAAP measures. For a reconciliation of these non-GAAP measures, please review the supporting schedules in today's earnings release or the appendix of the earnings presentation.

As a reminder, our discussion today will include forward-looking statements, including, but not limited to, expectations about our future operating and financial 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'd like to now turn the conference 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 third quarter of our fiscal year 2022 ended March 31.

Our third quarter results reflect strong performance across our business with double-digit revenue growth in our Sleep and Respiratory Care business and high single-digit growth in our Software-as-a-Service segment. Our growth is the direct result of our global team's ability to pivot and drive for results, even as we continue to manage through several external challenges that are impacting our business, including: one, ongoing supply chain disruptions; two, COVID restrictions in parts of the world; three, recovering post-COVID peak patient flows; and four, unprecedented demand from a competitor recall, which will keep them out of the market at least through the end of the calendar year.

The global supply chain environment remains very challenging across multiple industries. I'm very proud of our team, growing double digits this quarter year-on-year with an astounding 30% growth this quarter for devices in U.S., Canada, and Latin America. Even with this incredible growth, the demand in the market was even greater.

As with almost all customers in the global components industry, we remain on allocation from our suppliers, particularly for electronic components with our #1 bottleneck being semiconductor chips. This allocation impacts our ability to meet the incredible demand that we see in our marketplace, and we are forced, in turn, to allocate ResMed products to our customers. We have established guiding principles for allocation, giving priority to [the production and delivery of devices to the] (added by company after the call) highest acuity patients first.

Additionally, the ongoing challenges of sea freight and air freight due to reduced availability and increased prices are impacting our ability to efficiently get components into, and finished goods out of, our factories worldwide. We are working closely with our global supply chain partners doing everything that we can to secure additional supply to further increase production of our devices.

This work includes a combination of a number of work streams: one, shoring up the flow of existing parts from existing suppliers; two, establishing flow of existing parts from new suppliers; three, validating new parts from existing suppliers; and four, validating and verifying new parts from new suppliers, as we review and redesign across key devices in our portfolio. In addition, we have a fifth line of work. So it's 5 lines of work, and that fifth line is reengineering designs to eliminate and/or mitigate the top bottlenecks to achieve greater flow through our supply chain.

The most significant example of a project in this fifth line of work is our newly released AirSense 10 card-to-cloud device. This device eliminates the #1 bottleneck of the 3G, 4G comms chip while facilitating secure data upload to our cloud-based software platform called AirView, so that providers and physicians can access the data and better manage the patient.

We've already begun to offer AirSense 10 card-to-cloud devices in select markets to some customers, and we will be ramping up from there. With these 5 lines of work continuing in parallel, we have been able to offset some of the impact of continuing component shortages and decommits to help us better support patients, providers and physicians.

We recognize that this is a very difficult situation for all of our customers, including physicians who feel the pressure from their patients, home medical equipment providers who see this every day in their businesses, but also payers and entire healthcare systems and especially the most important customer, the patient themselves. We are partnering across the industry to be the solutions provider to these problems.

We expect a significant backlog of patients diagnosed and coming through the system to be present for at least the next 12 to 18 months with incredible associated demand. We are working to address this demand with this portfolio of supply projects and beyond. And we will get through this time stronger than ever as an industry and as a company.

Our #1 priority will always be patients, doing our best to help those who suffer from sleep apnea, chronic obstructive pulmonary disease, asthma and other key chronic respiratory insufficiency diseases, as well as those who benefit from our out of the hospital care Software-as-a-Service solutions. Our goal is to ensure that every person gets the care that they need, where they need it and when they need it.

Let's now briefly discuss the other broad market conditions in our industry. We continue to see steady ongoing recovery of patient flow and demand through the diagnostic channel across the countries that we operate in. In fact, many countries are above 100% of pre-COVID levels of patient flow. However, ongoing surges, variants and government restrictions continue to impact a few countries, which remain below pre-COVID diagnostic levels. China is a case in point right now with severe shutdowns in Shanghai and beyond.

But across our portfolio, our global portfolio, we're in 140 countries that we serve, I expect that these metrics will steadily improve to pre-COVID patient levels and beyond as vaccines and boosters roll out globally and people remain focused on their personal respiratory health and hygiene. It's been a big learning through COVID.

With the adoption of digital health solutions for screening, diagnosis and remote patient setup and remote patient monitoring as well as establish COVID cleaning protocols, sleep labs and other facilities, I expect the impact of new variants to diminish in absolute impact each and every time.

Let me now update you on our top 3 strategic priorities. Number one, which is to grow and differentiate our core sleep apnea, chronic obstructive pulmonary disease and asthma businesses. Number two, to design, develop and deliver world-leading medical devices as well as digital health solutions that can be scaled globally. And number three, to innovate and grow the world's best software solutions for care that is delivered outside the hospital, where people live and especially in the home.

The U.S. launch of our next-generation device platform called AirSense 11 continues to go very well. Although it is challenging to differentiate ongoing positive customer sentiment and feedback from the incredibly high demand in the U.S. market and beyond. The AirSense 11 has provided much needed additional product supply as we face all-time high demand for ResMed devices and it couldn't have launched at a better time for that purpose to help us mitigate ongoing component shortages.

We will introduce the AirSense 11 into additional countries in the fourth quarter that we're in right now here of fiscal year 2022 and throughout fiscal 2023. In parallel, we will continue to sell our globally available market-leading platform, the AirSense 10, which is second in customer preference only to the AirSense 11. Including the new card-to-cloud AirSense 10, as we seek to maximize the total volume of CPAP, APAP and by levels available for all of our customers.

With our digital health technology ecosystem, we are engaging patients in their therapy in a digitally native environment like never before in the industry. We are also making it easier and more efficient for our home medical equipment and home care provider customers to manage their patient populations using our full suite of software solutions, including myAir for patients, AirView for physicians and providers and Brightree for HME providers.

When customers use these digital health technology solutions, they have increased efficiencies, lower costs, and together with us, we achieve improved outcomes for patients and their physicians. With the latest technology built into the AirSense 11 platform, we are driving higher adoption rates of the myAir app by patients, higher than ever before. Right now, we are seeing more than double the myAir adoption rate as patients engage directly in their own healthcare.

People want personal care. They want their own data, on their own app, on their own phones. And they like the coaching and the personal engagement of our digital ecosystem. This means more patients are signing up onto myAir every day and fully engaging with ResMed's software technology, helping us to now pass over 11.5 billion nights of respiratory medical data in the cloud.

Ultimately, these software solutions, these big data, deliver a better patient experience. They deliver better efficiencies for home care providers, and most importantly, they deliver greater long-term adherence to therapy by patients.

Let me spend just a couple of minutes outlining some real-world evidence showing that greater therapy adherence leads to lower hospitalizations, lower mortality and better clinical outcomes through mitigation of chronic disease. We are demonstrating better patient outcomes and lowering costs for the healthcare system at a scale not seen before in the industry. These are critical components of the ResMed 2025 strategy.

The latest example is a study recently published in the landmark American Journal of Respiratory and Critical Care Medicine Journal, also known in the industry as the Blue Journal. This article demonstrates that patients with obstructive sleep apnea and chronic obstructive pulmonary disease who were adherent to CPAP therapy, versus nonadherent to CPAP therapy, and it showed significant year 1 and year 2 reduction of clinical use by over 30% and reduction of inpatient hospitalizations by nearly 50%. It showed a 20% reduction in year 1 and year 2 total healthcare resource costs, which included a 25% reduction in emergency room costs and a 52% reduction in inpatient hospitalizations. These are important metrics for the whole healthcare system.

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 diagnostic funnel. COVID-19 has advanced awareness, adoption and acceptance of digital health and respiratory health, including telehealth tools and specifically home-based sleep apnea tests. Although driving demand generation is not a priority in the immediate term, given the supply shortage and the incredible demand we're facing, we are maintaining our long-term focus and investments in this diagnostic channel so that we are ready when conditions improve to ensure sustainable long-term pipelines of new patients coming through the channel. With 1.6 billion people worldwide suffering from sleep apnea, COPD and asthma, it's also our duty to do this.

We are innovating with partners and our customers to create even more efficient and effective approaches to sleep apnea patient identification, screening, diagnostics, treatment and management. We will continue to invest in technology that enable what we call an end-to-end seamless digital experience for patients.

One example we recently rolled out is the next generation of our remote mask selector tool that makes mask selection and sizing easier and more effective by creating personalized mask recommendations based on a patient's health, sleep attributes and their own facial measurements.

Choosing the right mask is challenging to do remotely. But getting the right mask fit is crucial to patient comfort and long-term adherence. The technology MaskSelector is a web-based tool that solves this problem by prompting the patient to answer a few simple questions and follow a few easy steps with their camera-enabled smartphone to capture a digital facial scan. Based on the answers and the digital facial measurements, MaskSelector then provides a recommended mask and sizing. Whether a patient is then being set up at home remotely or preparing for a face-to-face interaction with the respiratory therapists and clinical staff at a provider's office, MaskSelector helps the patient quickly get to the right mask for their unique needs.

Turning to a discussion of our respiratory care business, focusing on our strategy to better serve the 380 million patients with COPD worldwide and the 330 million patients that suffer from asthma worldwide. Our goal is to reach many 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 our 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 for COPD and other respiratory insufficiency patients remained strong throughout the quarter, especially in markets outside the U.S. where providers shifted focus to supporting the most severe and highest acuity patients. This demand and the work of providers is aligned with the ResMed guiding principles of our allocation process, specifically to give the highest priority to manufacturing life support ventilation. As I speak, we are not component constrained on our life support ventilator called Astral.

Let me now review our Software as a Service business for out-of-hospital care. During the quarter, our SaaS business 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. Our SaaS customers recognize the need for technology solutions to solve their challenges with efficiency and scale. And our software services and solutions help them achieve both.

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

As businesses continue to open up, we've been able to visit customers in person as well as to attend SaaS trade shows, where interest in our Brightree, MatrixCare and Citus offerings, to name a few, remain very strong. We have a very solid pipeline in SaaS.

The COVID-19 pandemic has been and remains challenging for some verticals in our SaaS business, particularly skilled nursing facilities, where headwinds have kept patient census rates below pre-pandemic levels. But 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 provide opportunities for us to sell more services and more 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 maintain high single-digit growth as we exit this fiscal year and well into the next fiscal year and beyond. As always, our goal is to meet or beat that market growth rate as we continue to innovate, and we expect to grow the market and take market share.

We are the leading strategic provider of SaaS solutions for outside-hospital care. And we provide mission-critical software across a broad range of very attractive vertical markets. We are well-positioned, and we have created differentiated value for customers and for ResMed with our SaaS businesses. I'm excited about the future of our SaaS business. It's an important part of ResMed's future growth, and I see a lot of opportunities to innovate in lower cost, lower acuity settings of care. It's the future of healthcare delivery with strong organic and inorganic growth ahead for ResMed.

Our focus is on personal care that is patient-centric, physician-centric and provider-centric. This 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.

As I said earlier, we have over 11.5 billion nights of medical data in the cloud, and we have over 17 million cloud-connectable medical devices on bedside tables in 140 countries worldwide. We are unlocking value by using de-identified data to help patients directly but also to help providers, physicians, payers and entire healthcare systems.

We have invested in the cybersecurity, the privacy, cloud operations as well as data analytics, including artificial intelligence machine learning capabilities to do this at a scale unmatched by our competitors, and we are increasing our lead each and every day. Our two key software customer-facing products, AirView and myAir, are now 100% managed in the cloud. So not only are our devices cloud-connected and our software cloud-enabled, we here at ResMed as a company are cloud-connected and cloud-enabled. In fact, we are a leading digital health company, globally.

Our mission and goal to improve 250 million lives through better healthcare in 2025 drives and motivates me and ResMedians around the world every day. We made excellent progress towards that inspiring goal during the last quarter.

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

With that, I will hand the call over to Brett in Sydney, and then we will move to open the lines for Q&A. Over to you, Brett.

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

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

We had solid financial performance in Q3 despite the headwinds we faced as a result of significant ongoing supply chain constraints and a challenging freight environment. Group revenue for the March quarter was \$865 million, an increase of 12%. In constant currency terms, revenue increased by 14%. 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 March quarter, we recorded immaterial incremental revenue from COVID-19 related demand consistent with the prior year quarter. Looking forward, we expect negligible revenue from COVID-19-related demand.

In relation to the impact of our competitors' recall, we estimate that we generated incremental device revenue in the range of \$35 million to \$45 million in the March quarter. For the first 3 quarters of FY '22, this reflects incremental revenue in the range of \$170 million to \$190 million. We continue to experience challenges in securing sufficient components, and this has hampered our ability to materially increase our supply of devices.

We expect our fiscal fourth quarter to remain supply constrained and similar to our recent fiscal quarters, therefore, limiting incremental revenue during the fourth quarter. We now expect the total incremental device revenue opportunity for fiscal year 2022 will fall somewhere between \$200 million and \$250 million.

Looking at our geographic revenue distribution and excluding revenue from our Software as a Service business, sales in U.S., Canada and Latin America increased by 18%. Sales in Europe, Asia and other markets increased by 11% in constant currency terms. By product segment globally, in constant currency terms, device sales increased by 21%, while masks and other sales increased by 9%.

Breaking it down by regional areas, device sales in the U.S., Canada and Latin America increased by 30% 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.

Mask and other sales in the U.S., Canada and Latin America increased by 7%, reflecting solid resupply revenue achieved despite the challenging device supply environment, which continues to limit new patient setups. In Europe, Asia and other markets, device sales increased by 10% in constant currency terms. Mask and other sales in Europe, Asia and other markets increased by 13% in constant currency terms.

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

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 third quarter earnings press release.

Our non-GAAP gross margin declined by 150 basis points to 58.1% in the March quarter. The decrease is predominantly attributable to higher freight, component, and manufacturing costs, partially offset by a positive product mix due to strong growth in our higher acuity devices, and improvement in average selling prices following the introduction of the device surcharge.

Moving on to operating expenses. We are seeing a normalized expenditure profile as COVID-19 impacts subside compared to the low comparable and negative growth rates we experienced in Q3 last year. SG&A expenses for the third quarter increased by 14% or in constant currency terms, increased by 17%. The increase was predominantly attributable to an increase in employee-related expenses.

SG&A expenses as a percentage of revenue at 21.1% remained broadly consistent with the 20.9% we recorded 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 balance of FY '22.

R&D expenses for the quarter increased by 19% or in constant currency terms increased by 22%. The R&D expenses as a percentage of revenue was 7.7% compared to 7.3% 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 a sustained competitive advantage.

Looking forward and subject to currency movements, we expect R&D expenses as a percentage of revenue to be in the range of 7% to 8% for the balance of 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 and higher operating expenses. On a non-GAAP basis, our effective tax rate for the March quarter was 21.1% compared to the prior year quarter non-GAAP tax rate of 19.4%. 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 2% and our non-GAAP diluted earnings per share for the quarter also increased by 2%.

Cash flow from operations for the quarter was \$117 million, reflecting robust underlying earnings, partially offset by higher levels of working capital. Capital expenditure for the quarter was \$48 million. Depreciation and amortization for the quarter totaled \$42 million.

During the quarter, we paid dividends to shareholders totaling \$61 million. We recorded equity losses of \$2.6 million in our income statement in the March quarter associated with the Primasun joint venture with Verily. We expect to record equity losses of approximately \$2 million to \$3 million per quarter through the balance of fiscal year '22 and into FY '23 associated with the joint venture operation.

We ended the third quarter with a cash balance of \$202 million. At March 31, we had \$681 million in gross debt and \$479 million in net debt. Our debt levels remained modest. And at March 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 provides flexibility in how we allocate capital. Going forward, we plan to continue to reinvest in growth through R&D. We also expect to continue to deploy capital for tuck-in acquisitions.

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

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

Great. Thanks, Brett. Kevin, I'd like to ask you to come back on the line. I'll turn the call over to you to provide instructions and to manage the Q&A portion of the call.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) Our first question today is coming from David Low from JPMorgan.

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

If I could just start with a question on the guidance and the benefit from the Philips' recall. So it's fallen \$100 million short of where you're projecting a year or so ago. Just wondering how you are now thinking about that opportunity set as we move into the new financial year?

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

David, yes, it's Mick here. That's a good question. And clearly, in the second half of the year now, we're readjusting that expectation for FY '22 now in total to be \$200 million to \$250 million.

Look, I'll just be very open, very specifically a contract from 12 months ago with a particular -- I will not name them, but a particular semiconductor supplier had a very significant double-digit de-commit in these last months, weeks. And there's a commitment from 12 months ago that had some very strong supply, and it went down double digits.

And so with that as a headwind into us, all the tailwinds of our work, the 5 projects -- 5 lines of projects going on, our supply chain allowed us to sort of take 2 steps forward and 2 steps back versus 2 steps forward and 1 step back. And that didn't allow us to achieve that extra \$100 million of incremental revenue that we thought that we would achieve here through fiscal '22 for the first half. And so that's going to be tougher and it moves things a little bit further back.

Having said that, some of these projects coming to market such as the card-to-cloud AirSense 10 device, where we eliminate that bottleneck, or the #1 bottleneck, which is the 3G, 4G comms chip. And we allow the next bottleneck, which is another electronic component to become the one. We can then speed up some production to make up some of that difference. And that's allowed us to achieve the 30% year-on-year growth that we saw in devices in U.S., Canada, and Latin America and the 10% year-on-year growth that we achieved this quarter for Europe, Asia, and rest of world.

Look, it's not perfect sailing ahead when you get decommits. I never heard that word decommit. We're offering -- you've got a signed contract. You're offering money, very good margins, long-term contracts and people just can't supply, often force majeure and other aspects coming into play. But I can tell you that all the work that we've been doing, these hard works by our supply chain, have allowed us to actually to achieve these results despite that headwind.

We're not planning on giving guidance for FY '23 around this. We are saying that -- this is what I'll say. What we're doing is going to strive for sequential growth every quarter as we go ahead. So sequential growth from March to June, June to September, September to December throughout this fiscal year, that's what we're going for.

And I actually think as you start to look towards the second half of the calendar year, you look at the December quarter, there are a number of other projects that don't involve necessarily the risk of an externality, of a de-commit from someone else. There's enough projects and enough, I would say, new suppliers, new components, new designs and new engineering, reengineering that we're doing around both the hardware and the software, to give us strong confidence in supply of product ahead.

So I think our supply chain has done amazingly. And if you look at what we would have achieved, 14% growth constant currency year-on-year, yes, we could have got to 20% or 25% if we had unlimited supply, decommits and changes in supply chain in global semiconductor and other electronic components have been a headwind. But I think with all the work we've got, we're going to power through this. We've got a strong ship. There are waves ahead, but we're going to power through it stronger than ever. And I think our team has done a great job and the supply that we're going to get throughout this calendar year will be a great opportunity for sequential growth as we go through.

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**Operator**

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

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

Just one question on the backlog of patients. So you did mention in your prepared remarks. Just trying to see if you can quantify how large the backlog is currently. And how long are patients waiting to get on to treatment? Is there something that ResMed can do to keep these patients engaged? Or is there a risk that they potentially fall out of the system if they don't get on to product in a short period of time?

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

Thanks, Gretel. It's a great question. And yes, as you know that, I talked about at least 12 to 18 months of the backlog here, which is in many industries, you say fantastic to have a backlog, but these are patients awaiting therapy.

And to the specific part of your question, Gretel, how long will any individual patient wait? It's not like a patient gets a diagnosis, and they have to wait 12 to 18 months. It depends on the geography and the environment. It might be 8 days or 8 weeks depending on the geography and our flow of products. But an individual patient is not sitting out there told you've got this life-threatening disease. We'll take care of you next April. They're being told, look, it's going to take 4 weeks. And they're not happy with that. I mean they've been told they suffocate, maybe 100 times per night, maybe 50 times per hour if they've got very severe sleep apnea. And they're suffocating, they want therapy. And so that pressure is there and the desire is there. We're watching very carefully.

I mean obviously, we're involved in the substitute therapies. We sell a dental device all across Western and Northern Europe. We're the #1 provider with Narval, our technology. We're not seeing this huge movement over to dental and hypoglossal nerve stim that we're investing through Nyxoah. We're not seeing a huge movement over to those substitutes.

So they're being told by the doctor, it's 8 days or it's 8 weeks. And they're accepting that, and they're sitting there in that pipeline. What I mean by the 12- to 18-month backlog is if you look at the net of the industry, this is building up because the #2 player here is out. As I said earlier this week, they said at least through the end of this calendar year, I think they said they'd only be 90% done with their recall by the end of this calendar year.

So that means the rest of us have to step up, and ResMed is the #1 player, and we're stepping up the most. And we're stepping up incredibly well. And I think we'll do that through it. But even when they come back online, it's not like the backlog goes away, the day they come on. That's there, and it's for all of us to drive.

I think the share that we've gained is going to be entrenched because of the digital solutions we have, and we'll go and gain from there, but the patients are there. And I think it's awful that somebody might have to wait 4 weeks or 8 weeks. I don't want them to wait more than 4 to 8 hours. But right at the moment, we're in this situation will be that way for a period of time given these unprecedented circumstances.

**Operator**

Your next question is coming from Lyanne Harrison from Bank of America.

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

Can you just talk a little bit about the device and mask dynamics in both Americas and Rest of the World? Obviously, Americas had softer devices but -- sorry, had Americas had stronger device growth but much softer mask growth there. Can you, I guess, share what your thoughts are around to the extent that's driven by fewer devices in the market as opposed to resupply, and then vice versa for the rest of the world?

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

Thanks, Lyanne, for the question. Yes, as you mentioned, very strong device growth in the U.S., Canada, and Latin America, 30% and very solid growth in devices in Europe, Asia, elsewhere at 10%, netting out at 21% CC across that sector.

In the mask side, actually, if you go back to 2019, Lyanne, when we were talking about market growth rate, we were talking then about devices mid single-digits and masks being high single-digits. I look at our global mask growth rate at 9% constant currency, with the headwind of new diagnosis down due to competitor being out for new patient starts, and the U.S., Canada and Latin America at 7% constant currency. It's pretty reasonable growth. New patients are down, but what we're actually doing there is working with resupply, with Brightree ReSupply, with Snap

technology resupply, in the U.S. and around the world with some of our models of working with patients directly in markets like Australia, New Zealand, Singapore, and our Western and Northern European teams working with hospital and care delivery systems to achieve that 13% constant currency growth in Europe, Asia, and America.

And I think I'll hand to Jim Hollingshead, the President of our Global Sleep business. But Jim, I think we're actually taking share in some of those categories during the quarter.

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

Yes. Thanks, Mick, and thanks, Lyanne. It's a great question. I think this is one of those weird circumstances for us where the numbers don't actually very clearly convey the underlying dynamic. And the reason for that is the volumes and the revenue growth we're producing in different markets is almost completely contingent on which SKUs we can produce.

So it's a little bit complicated, but when we can produce devices that have cell chips that can go into certain European markets and we have those components, then we get more growth for that period of time as we ship those products. And then sometimes those specific SKUs get constrained.

And so the dynamic is actually pretty constant across all geographies, which is very, very high demand for our devices, very, very high demand for our masks. There is a headwind on masks because new patient starts are down because the market is undersupplied. But really across all geographies, there are tailwinds for masks because in the U.S., we have very resilient resupply. And in other European markets, we have very resilient resupply in markets like France and Northern Europe.

And so the number -- the differences you've seen in the growth rate is actually driven by component supply and not by demand dynamics, if that makes sense. So it continues to be really almost unlimited demand for our products across the board.

With devices, obviously, in the U.S., we introduced AirSense 11. That freed up a lot of capacity for us. That's why we got such outsized growth relative to the other markets in the U.S. market this quarter. And, but mask growth is pretty steady across all the markets.

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**Operator**

Your next question today is coming from Saul Hadassin from Barrenjoey.

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

Just a quick one on the guidance that you've provided for the full year for the Philips share gains and that revenue contribution, the other component, obviously. What do you think is the underlying growth rate of the base business, excluding that share gains? I guess, in other words, what were you expecting to grow the business by -- how do you come up with that \$200 million to \$250 million? And I guess the question really is what do you expect the base business to be able to grow at considering the supply constraints that are in the market at the moment?

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

Yes. Saul, thanks for the question. And look, these estimates started about 6 months ago. I'll probably get Brett to give a little bit of detail around how we actually came up with the details of the calculations of the \$300 million to \$350 million and the \$200 million to \$250 million. I'll give you the CEO's perspective first. And the CFO will come and give more quantitative detail in a moment.

But the way I look at it is about 6 or 8 months ago, I guess it was June -- mid-June when the competitor announced this -- there were estimates on the sell side from \$50 million of incremental revenue for ResMed during the fiscal year, up to \$950 million from some of the sell-side analysts.

And we thought, look, that range is just too broad. We generally don't give guidance. We leave that to the job of very smart people on the sell side and the buy side to do so, but that variance was too big.

And so we said, let's calculate it. Let's take our forecast that we had at that time, 8, 9 months ago for the fiscal year '22 and then look at what we think we can achieve based upon parts and components we can get into our factories and product we can make to take care of what is a seemingly infinite demand. So we'll just be rate limited on the parts and pieces. And we looked at mostly comms chips and some other electronic components would be rate limiting. And so we said, okay, let's see how high we can ramp those with our great work from our ops team looking at ResMed 2030, 2035 and a brand new plant in Singapore.

We actually weren't limited and aren't limited on manufacturing capacity. It was just about supply. And we estimated \$300 million to \$350 million in incremental revenue, above our forecast growth. We didn't actually give a public number on what our forecast growth was. We just talked about that incremental revenue being there, letting sell-side models for their forecast add on to that in the \$300 million to \$350 million.

We've adjusted that to \$200 million to \$250 million. So on top of whatever that growth was, we think it will be 200 to 250 million, and that's really getting down to these this last quarter, Q4 gives a bit more detail on that.

Brett, any further quantitative info you want to give on that to Saul's question there?

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

Yes. Thanks, Mick. I think you got that right. We saw, really what we did is we looked at our pre-recall forecast and it's very much an estimate on what we think that incremental demand was.

And to your question, kind of what would the underlying growth be? I mean if you backed out that incremental revenue you'd get -- you'd probably get circa 10% growth on devices. So it's still pretty strong.

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**Operator**

Our next question is coming from Dan Hurren from MST.

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**Dan Hurren** - MST Marquee - Healthcare Analyst

I just wanted to ask, in regards to -- you mentioned Astral, the Astral was not on allocation, it's unlimited or, sorry, is not constrained. Can you just talk about how that product is traveling and competitive -- and the competitive market with Philips being out of the market for their products?

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

Yes, Dan, thanks for the question. And yes, you're right. As I said in the prep remarks, we -- it was our guiding principle that we take care of the sickest patients first and the highest acuity devices first, and the Astral is that. And so we've done a great job. Our ops team, supply chain team, manufacturing team has done a great job. We are not supply constrained on that and we are going head-to-head with the Trilogy and Evo. And what I see is regular leases of recalls and issues with our competitor in that space, and so not just our brand reputation and the amazing technology that's in the Astral. It's incredibly reliable and very high quality. And I believe we've been taking share there for a number of quarters.

But Jim, do you want to give detail on the Astral and how well that's doing, the U.S., rest of the world?

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

Yes. Thanks, Mick. Thanks, Dan. The Astral is performing really, really well from a competitive point of view. We've taken share with the Astral. It's a very, very strong device offering. We've made a number of improvements to that platform over the last couple of years. And also, remember that the Astral can be connected to an attachable modem, which can then allow patients using an Astral to be monitored in the cloud. And we have that capability now in our AirView platform worldwide.

And so we've had a lot of adoption of monitoring ventilated patients in our AirView platform, especially a very strong growth in Europe with that offering. And so Astral continues to perform extremely well.

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**Operator**

Your next question is coming from Matthew Mishan from KeyBanc.

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

Just going back to the de-commit. Did you give a sense of why your orders were, from over a year ago, were decommitted? And just -- how do you -- how does the semiconductor supply chain get unlocked over like the next 3 to 6 months? Like what are they telling you needs to happen incrementally so that you can get a steadier supply moving forward?

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

Matt, it's a great question. I'll talk a little bit about what our supply chain is doing. And I'll hand over to Rob Douglas, our COO, to go through the incredible work that Andrew Price and Linda Laidlaw, our President of Global Ops and the Head of our Supply Chain are doing there.

But I can tell you what they're getting me to do. They're getting me to work with the CEOs of these companies and the heads of production. And we're working and providing information to show the importance in how these technologies that they're providing are going into life-saving medical devices. I actually created a video for the investors and the internal employees at one of our major electronic component suppliers to talk to them about how every chip they give us gives the gift of breath to a person who's suffocating.

And to really get that message through, I mean, I think in the huge demand for electric cars and cloud-connected consumer devices and across the board, demand is up across industries. And so it can be hard if you're a component-maker to differentiate industry A from B from C and know where it's going.

When they know, firstly, that we pay high margins, that we have long-term contracts, that we're a recession-resistant industry as showed through the global financial crisis, and the benefit for employees looking for purpose that, hey, this chip doesn't just go into a car and goes from A to B or give cloud-connectivity to a refrigerator. This thing literally keeps them breathing and allows them and their doctor to see that breath and that improvement of incomes, reduction of costs and reduction in mortality.

So getting that message through is really strong. We've been working very strongly since the starting gun sort of went off on this, June last year, and we're getting better and better. But across the industry, Robert, it's a tough environment for supply.

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

Yes, it is tough, Matt. And the way the electronics and semiconductor industry works is like any other industry. There's a number of players, have got long-term forecast, which they need to have because the capital investments in order to build capacity take a long time to develop. But they've really only got short-term clarity on what the demand levels are going to be.

And actually, the electronic industry has always been feast-or-famine for particular components like that. This is just a worse than usual version of the usual situation. There was so much excess demand around the COVID environment. So many new dynamics like, as Mick mentioned, electric vehicles taking up demand, and consumer electronics and all of that.

And then the key suppliers have all their own inputs that have those sort of same investment issues coming. So they're also an allocation for their raw materials as well. And then they have a number of contracts. And as Mick gets to it is, if we can manage the priorities that these people have and -- by the way, whenever we talk to almost anyone in any industry, we end up talking to somebody who either has sleep apnea, or their loved ones have sleep apnea, or their good friends have sleep apnea. So we can get a really strong measure through as to why it should be a priority.

But sometimes, they've got contracts and they need to be able to call force majeure on those contracts before they can supply us. So it's a very complex project. We keep working on it. As Mick mentioned, we've got these other longer-term projects that are really designing around the constraints and putting in options so that we can have what were traditionally single-source components, we have options for multiple source components. We have many different communication modules that can operate in the -- into the units now, and different protocols, and we'll keep working on that.

But it's not going to clear short-term. And we're going to need this great sort of agile performance from our supply team to really try and predict the areas of decommits so that we can inform our engineering teams of what they should be designing around, and get started on those key areas before they become problems. But these are tough problems to solve, but we're working on them.

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

Yes. And in short, our goal will be through all that work that Rob just talked about to make sure we take 3 steps forward, so that when you do get the 2 steps back on this or that component, we're still moving forward sequentially every quarter throughout the year and then really freeing up, as Rob said, the long-term stuff starts to come into fruition over the next 3, 6, 9 months and beyond. Thanks for the question, Matt.

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**Operator**

Your next question is coming from David Bailey from Macquarie.

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**David Bailey** - Macquarie Research - Analyst

I might just follow up on those five areas of work. You mentioned sourcing, validation, and reengineering. Just wondering where progress sits relative to your plans, if there have been any benefits to date? And when do you think these projects are expected to complete such that you do start to see some of those benefits coming through?

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

David, it's a great question, and it's really complex, and I'll probably hand to Rob to maybe give some of the detail on it. But those five lines of work have multiple projects within each of them, I throw out a term like new parts from new suppliers. That means our R&D team is reengineering a new part, validating, verifying, putting through all the quality tests. We're seeing in our market how incredibly important that is, and we will not compromise on quality.

And then you've got to validate and verify a new supplier and get them through. And so just 1 of those 5 lines of work is an incredible amount of work for our quality, regulatory, R&D, engineering, production, and manufacturing teams. And so these aren't overnight. It's not like we're just having a cell phone here or a comms chip in a consumer device. This thing, a life support event, has to be working all day every day. A CPAP has to work every night. And we are, I think, able to, with all that work. I mean, as you saw, we got \$200 million to \$250 million just this fiscal year ahead of incredible growth in our supply chain, pivoted to all of that.

If there hadn't been this competitor recall, we, as an industry, ResMed, would have been absolutely able to do with every single supply chain constraint that had happened, throughout this. And that speaks to the flex and the ability to go. We have these products that have been going 9 months. I actually think they're doing well. It's hard to say even if I gave you on each of those 5 lines of work, the key milestones on it. There are probably 5 projects within each of them. So it's sort of a 5x5, 25-point matrix.

Rob is looking at this. Jim is looking at this on a daily basis. I get the updates every second or third day. As a CEO, I used to focus all my time just on customers, talking to customers, talking to health insurers, and showing the benefit of our therapy. I'm spending a lot more time with supply chain than I want to. But right now, that's where the urgent need is. And for the next 3, 6, 9, 12 months is where we're going to be focused.

But at the same time, we're investing in demand gen so that as supply starts to come back -- and it will -- and as the competitor comes back online, we can turn that demand gen back on, securing all these share gains we've got through the digital entrenchment, and then drive for future growth.

But Rob, how do you summarize all the work we're doing, for David, simply here?

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

Dave, we wouldn't break down all the individual projects. But I mentioned having multiple comms protocols, multiple chips, multiple sources of chips. And to Mick's point, our issue around quality and patient safety is just so important. So we can't really take any undue risk or give any give on the quality of the validation processes, and making sure we're doing the right things through all of that.

So we can't just throw in a new component and say, let's see if it works. We've got to really do all the proper life testing and check-throughs. So that's why it doesn't happen overnight. But the teams are working on it, and they say they're thinking around how to forecast the right areas so that we can get on the front foot on these.

Another important area is our ability to burst demand and burst supply when we do get solutions come in. And you actually will see our inventory levels have increased. And that's interesting in a time when really every product we make is immediately delivered to customers and sold, and that's because we're working hard on making sure we've got all the raw material inventories, including longer-term commitments with these suppliers, which actually we've had to do in order to guarantee short-term supply. And so we've got very strong inventories of nearly everything but the few that are short. But when those few ones short, that were short, come in, we're able to put them quickly into production and quickly get them on to patients.

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**Operator**

Our next question is coming from Mike Matson from Needham & Company.

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

I wanted to ask about this card-to-cloud device. Can you maybe comment on how that works? I assume that they collect the data on the card and then has to be uploaded somehow. And then is there any kind of long-term repercussions from having these out there in your installed base in terms of lost data over time or anything like that?

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

Thanks for the question, Mike. And I'll hand to Jim to walk through some further detail. And I can tell you from ResMed, when we really first got into digital health in 2002, we had paging devices on experimental parts of our devices. In 2005, we started to -- with the S8 launch in 2006, '07, had some SD cards that were in those devices.

And so we sort of had this world of card-to-cloud at ResMed for well over a decade. 10, 15 years that we've had the ability to do that type of technology. Obviously, with the AirSense 10, we changed the whole market. We did the sort of reverse Amazon play where we said 100% connectivity in the AirSense 10 through the comms chip. And then you take it seamlessly, and it's taken to go there.

Look, this is a humanitarian emergency right now. We have a competitor out of the market, and there's not enough comms chips to go around the world. And we looked at this and said, well, look, why don't we go to where we were before, which is a great technology of card-to-cloud. The differentiator for us is AirView that the doctors use, myAir that the patients use, and the whole ecosystem of data.

And so I think it's far more efficient and appropriate that it goes straight into a secure end-to-end encrypted from the device there. But in this time of emergency, for a period of time, who knows how long it will last, these AirSense 10 card-to-clouds are a whole lot better, patient getting that technology, than one of the competitors out there that has some klugey solution that may or may not be encrypted, the who knows how it works, and the device and it might not be as reliable.

So the AirSense 10 is the second best device in the market, second only to the AirSense 11. So card-to-cloud is out there. But Jim, it's early days. How is it going?

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

It's very early days, and we'll be bringing it to more and more geographies. But to Mick's point, we really just want to make sure patients get on therapy. I mean that's the driving rationale for launching this device, this card-to-cloud version. It's basically an AirSense 10 without the cell chip in it.

So to the process question, Mike, you asked is about the devices all have SD cards in them, the SD card has to get to the provider. The provider uploads the data into the cloud. We've actually just relaunched, or launched, a renewed and better version of the process for doing that for the software that allows the upload into the cloud.

And the great advantage of the whole system is that the patient still can be managed in AirView, and AirView is the best patient management system on the market. We know that it has the strongest preference, the strongest performance, it's secure, it's encrypted, it protects privacy, and importantly, all of our customers are using AirView right now in their workflows.

And so what the card-to-card device is missing is one step, which is the daily cloud-uploaded data and a wireless system. The data will come into the system, into the cloud, when the SD card gets uploaded by the providers. So I don't think anybody will do that on a daily basis. They'll do it relatively infrequently.

The data is all there in the SD card. The device stores the data for months, so no data is lost. It's just the frequency of upload. And again, the main rationale behind it is we want to make sure patients get on therapy. There's a growing patient backlog. We can produce these devices at volume. And it gets around our biggest constraint, which is the communication cell chip.

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**Operator**

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

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**Unidentified Analyst**

This is Maggie on for Margaret. I wanted to ask the incremental benefit guidance question a little bit of a different way. So obviously, the supply constraints here are not allowing you to service all the patients out there, so you're reducing it by \$100 million. So as the pie improves, and when it does, do you think that you will be able to recover that full \$100 million in the next fiscal year, and even more than that?

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

Thanks for your question, Maggie. I mean the short answer is yes, absolutely, through not just the technology Jim was talking about, the AirSense card-to-cloud, but all the other projects Rob has been talking about, the 5 by 5, 25-plus matrix of incredible projects that are going through that are going to free up supply. And sequentially, as we go through this year, we're going to get growth and growth and growth.

And so just to be clear, it was on top of, as Brett said, strong sort of 10% forecast growth. We then had, in addition to that \$300 million to \$350 million of incremental. That incremental was reduced to \$200, 250 million as we said today for this fiscal year that we're in. But that incremental growth, those patients will be there and we will be in the backlog, and we will get to them in fiscal '23, and more as we continue to grow throughout the fiscal year 2023.

It's not like this is an overnight success, and 1 of the 25 projects works tomorrow and we're all perfect. It's incremental, continuous improvement, step-by-step improvement of an amazing ops and supply chain team, and an amazing sales and delivery team working with customers on this allocation, and understanding how to bring that product to market, and understanding on the marketing side to just get ready for the demand gen that's going to need to happen to get all the backlog in and new patients in as we go in throughout fiscal year '23 and beyond.

But the short answer is, Maggie, yes, we will get to that increment, and more, throughout the coming 12, 18 months.

**Operator**

Our final question today is coming from Suraj Kalia from Oppenheimer.

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

Mick, a lot of questions have been answered. Mick, if we layer a recessionary environment on top of an inflationary environment, can you just give us some guidance in terms of new order flow-throughs, patient behavior, resupply orders? Especially -- it almost seems inevitable that there's another complicating factor on the horizon.

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

Thanks, Suraj. Yes. Look, I mean, clearly, inflation is high. And as you've seen, that's been hitting some of our areas of cost. We have some price mitigation on the AirSense 11 and on global surcharge and some sort of SKUs across the range to deal with inflation and to share some of the pain of that that we are seeing from our suppliers within the channel. But -- so that's how we're sort of mitigating the impacts of inflation.

Your question about a future recession, who knows? We have a long bull market. One thing I know about ResMed, and I was here through -- I was actually running the global sleep business through '08, '09 and '10. And I'd just taken over it the year before. And ResMed was remarkably resistant to that global financial crisis. In a recessionary environment, people may forgo that extra Tesla, that extra phone for \$2,000, but they will not forgo that extra CPAP for \$1,000 as much. And so we were very recession-resistant through that last global financial crisis, had a bull run here globally for 10, 12 years. It is possible.

Suraj, you're probably better at predicting the timing of when a recession may come in the next 12, 24, 36 months, I don't know. But I know that as opposed to other consumer industries and automotive industries and fast-moving consumer goods, med tech and particularly consumer-driven med tech like ResMed in sleep apnea, we've been very recession-resistant. So a very strong player throughout that and gives us a competitive advantage, I think, over some of the other players fighting for the dollars available.

But look, who knows what the timing of any of that would be? But we've got mitigation plans in for inflation, I think, very good experience and capabilities to deal with downturns and/or recessions. But thanks for the question.

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**Operator**

We've reached the end of our question-and-answer session. I'd like to turn the floor back over to Mick for any further or closing comments.

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

Well, thanks, Kevin, for handing the phone back. And thanks again to all of our shareholders for joining us on this call. I'd like to once again thank the 8,000 ResMedians. Many of you are also shareholders through our ESPP, so thank you for that, for your dedication and your hard work, helping people breathe better, sleep better and live better lives outside the hospital in 140 countries worldwide.

Thanks for what you do today and every day. I look forward to talking to you and all of our stakeholders here again in 90 days. Thank you, and we can now close the call.

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

Great. Thanks, Mick. Thank you, everyone. To echo him, we appreciate your interest and your time. As a reminder, if you have any additional questions, please don't hesitate to reach out to our Investor Relations team directly. This does conclude our third quarter 2022 conference call. Kevin, I'll turn it back to you to close things out.

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**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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