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OVERVIEW:

Co. reported 3Q23 group revenues of \$1.12b.

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PRESENTATION

Operator

Hello, and welcome to ResMed's Third Quarter Fiscal Year 2023 Earnings Call and Webcast. (Operator Instructions) As a reminder, this conference is being recorded.

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

Amy Wakeham - *ResMed Inc. - Chief Communications & IR Officer*

Great. Thank you, Kevin. Hello, everyone, and welcome to ResMed's Third Quarter Fiscal Year 2023 Earnings Conference Call.

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 the presentation, both of which are available now.

On the call today are Chief Executive Officer, Mick Farrell; and Chief Financial Officer, Brett Sandercock. Following our prepared remarks, Mick and Brett will be joined by Rob Douglas, President and Chief Operating Officer; and David Pendarvis, Chief Administrative Officer and Global General Counsel for our Q&A session.

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

Our discussion today will include forward-looking statements, including, but not limited to, expectations about our future financial and operating performance. We believe these statements are based on reasonable assumptions. However, our actual results could differ. Please review our SEC filings for a complete discussion of the risk factors that could cause our actual results to differ materially from any forward-looking statements made today.

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

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

Thanks, Amy, and thank you to our stockholders for joining us today as we review the results for the March quarter.

Our third quarter fiscal year 2023 financial results reflect very strong performance across our entire business. Through the hard work of our ResMed team worldwide, we've been able to steadily improve supply and manufacturing output to deliver for customers and most especially for patients with now full market availability of our life-saving products and therapy solutions.

During the quarter, we were able to offer unconstrained access to cloud-connected AirSense 10 flow generator devices in North America as well as an improved access to those cloud-connected devices across our global markets.

We continue to work through some supply chain constraints with our latest and greatest AirSense 11 platform and we expect to steadily improve the global availability of AirSense 11 over the next several quarters. We are thrilled to have the AirSense 10 platform off allocation and fully available to customers in the U.S. and other major markets in swift succession.

I would like to send a huge personal thank you to our Six Sigma Black Belt supply chain and our manufacturing teams. Partnering with our global supplier alliance, we have been able to significantly increase production to the point that we are now able to deliver cloud-connected devices to meet the needs of all of our customers in the U.S. and we are working hard to make that the case in all 140 countries that we sell into worldwide as we move forward.

Last quarter, we made a commitment to meet the global demand for connected CPAP and APAP devices with a combination of AirSense 10 and AirSense 11 by the end of calendar year 2023. As I just noted, we have already achieved that goal in our largest market, and we will be well ahead of that goal across all of our global markets.

Supply chain challenges aren't completely behind us, but we have passed the nadir in supply, and we see steady increases in supply ahead. Our amazing R&D teams and global supplier alliance teams have designed and validated new components. They have added new suppliers and they have worked hand-in-hand with existing suppliers to secure the flow of parts that we need.

We're also focused on scaling our manufacturing capabilities with the world's biggest and highest output manufacturing plant on the planet in the field of respiratory medicine. That high-tech facility is now fully up and running in Tuas, Singapore. We are working country by country to secure the necessary regulatory approvals as we ramp production and delivery of the AirSense 11 platform across global markets. Given this global ramp plan, we expect to remain on allocation for the AirSense 11 platform for the next few quarters with AirSense 10 covering all the difference in demand. With this combination of Air 10 and Air 11, we have the 2 best sleep apnea therapy platforms in the market, and we are now able to service all of our customers' needs.

Our incredible growth rate of 43% in global device revenue this quarter speaks to that market leadership position of these 2 platforms. Customers are voting with their wallets.

Our mask and accessory business also continued its strong growth trajectory, with 15% global growth in constant currency this quarter across our masks businesses. Mask growth is supported by both new patient growth as well as enhanced resupply programs to existing patients catalyzed by ongoing core patient demand.

We have now reached the point that new patient flow is well above the levels we saw pre COVID. In fact, March, as we just finished, March 2023 was our highest quarter ever for new patient setups in our cloud-based patient management system called AirView. Our digital health ecosystem enables and drives long-term adherence, pushing towards 90% adherence for our highest-performing customers. Even as we now pass 3 years since the start of COVID, there continues to be sustained heightened awareness by patients of the importance of respiratory hygiene and respiratory health. This has been a major step change that has held for now 12 quarters. We consider that a permanent change at this point.

In the U.S. market, customers' resupply programs, including Brightree resupply, have augmented growth. In our consumer-driven markets, outreach programs and subscription programs have also driven mask replenishment rates. Patients want fresh equipment because there is less leak and more comfort for them, the person who was suffocating before this treatment. Physicians want fresh equipment because they have seen peer-reviewed, published evidence that patient resupply is directly correlated to increased patient therapy adherence. Our teams continue to work incredibly hard to achieve these double-digit growth results amid a challenging industry environment.

All 10,000 of us ResMedians are laser-focused on continuing to deliver both the devices and masks for our customers globally every week, every month and every quarter.

Let's now briefly review updates on the top 3 strategic priorities for our company: number one, to grow, expand the reach of and differentiate our core sleep apnea and respiratory care businesses; number two, to design, develop and deliver market-leading devices as well as market-leading digital health solutions that can be scaled globally; and number three, to create, innovate and grow the world's best software solutions for care delivered outside the hospital.

The launch of and market reaction to our AirSense 11 device platform continues to go very well. Patient feedback remains very positive, and we continue to see strong adoption of our myAir patient app. In fact, Air 11 adoption rates of myAir are more than double the adoption rate of myAir with the AirSense 10 platform. It turns out that patients love getting their own data every day on their myAir app with a daily score, daily coaching, therapy engagement through advanced analytics and patient-focused algorithms.

Patient utilization of a digital health platform like myAir is directly linked to adherence, which is then directly linked to better patient outcomes as seen by the physician, which ultimately drives better outcomes for the payer and the provider. Given these trends, increasing production and global availability of the AirSense 11 platform clearly remains a top priority and an obligation, and we will continue to drive market penetration, leading the market, expanding the market as we scale production and achieve regulatory approvals country by country.

Meanwhile, we continue to improve the software and digital health technology that drives a significant component of the value proposition for our connected devices. Over the next several quarters, we will introduce several artificial intelligence-driven coaching features into the AirView system as well as on the patient-facing myAir app. These AI algorithms will provide personalized suggestions to improve the patient experience and ultimately, to increase patient therapy adherence. Many of these AI-driven solutions will be available on both the AirSense 10 and the AirSense 11 ecosystems.

ResMed's AirSense 11 device is the best positive airway pressure device on the planet, followed very closely by the second best device, which is the AirSense 10 platform. And together, they share the same digital health technology ecosystem. We will continue to invest in the ecosystem supporting these platforms as we innovate solutions for the benefit of physicians, providers and especially patients.

The bottom line is that our digital health technology investments have a multiplier effect across both Air 10 and Air 11 ecosystems, catalyzed and powered by AirView and myAir.

Pivoting to our Respiratory Care business. We continue to drive growth and adoption of our bilevel and other noninvasive ventilator solutions around the world as well as investing in our newer-to-market technologies, for patients, including neuromuscular disease, COPD and asthma and beyond.

During the quarter, we announced a pilot collaboration between our digital therapeutics team under the Propeller Health brand and the University of California Davis Health system. This partnership allows eligible UC Davis Health patients to have access to Propeller's digital therapeutics platform, including sensors for inhaled medications, a mobile app, a web portal as well as ongoing patient support. Data from the Propeller sensors will be transmitted to the UC Davis Health's electronic health record system through an API to support patient enrollment and remote patient monitoring.

It's still early days for this technology. However, combined with our investments in clinical research for home-based high-flow therapy for the treatment of COPD in the home, we see these technology innovations as important clinical additions for treating respiratory disease and an integral part of our 2025 growth strategy as we now pivot to look beyond to ResMed 2030.

Turning to our Software-as-a-Service offerings for care delivered outside the hospital, our SaaS business grew strongly at 35% year-over-year in the quarter, including the contribution our recently acquired MEDIFOX DAN team in Germany. On an organic basis, SaaS growth in the quarter achieved high single-digit growth of 9% across our SaaS portfolio. We're excited about the strong sustainable growth of our core SaaS business, and we are very pleased to see MEDIFOX DAN contributing to our growth in its first full quarter as part of the global ResMed Group.

We continue to grow with customers that deliver care outside the hospital as they increase utilization of our software and data solutions to improve and optimize business efficiencies and patient care. Here at ResMed, we believe the future of health care is in lower cost, lower acuity settings. We are investing in technology that our customers need to operate and scale as patient volumes grow in these facilities and out of hospital facilities.

As the post-COVID patient census continues to improve, in our facilities verticals we are seeing pent-up demand for technology investments that continue to come to market across skilled nursing facilities, nursing homes and beyond. Our home medical equipment SaaS business under the Brightree brand continues to grow at a very rapid pace and deliver sustained, profitable growth. We are seeing the ongoing impacts of staffing shortages across all of the outside hospital health care verticals that we serve. This pressure on our customers provides opportunities to drive conversations about the benefits of our software solutions to streamline and drive efficiencies across their businesses so that they can free up staff to focus on their core purpose of serving patients and improving patient outcomes.

Our SaaS business remains an important part of ResMed's growth strategy, and it complements the market-leading software and device solutions that we have in our core sleep apnea and respiratory care businesses. Our Brightree ReSupply program continues to demonstrate the synergies we can generate between our SaaS business and our core SRC business. Brightree ReSupply automates the entire process from contacting the patient, interacting with the payer on coverage, communicating directly with the patient, collecting co-pays and managing the logistics and distribution process of product. The ultimate goal is to keep a CPAP, APAP or bilevel therapy user replenished with the supplies that they need to enable a better and longer-lasting therapy experience. This results in better outcomes for the patient, the physician, the provider and the payer.

We are well positioned as the leading global strategic provider of SaaS solutions for outside hospital care globally. And we have created differentiated value for our customers and long-term sustainable growth for our stakeholders. We are transforming out of hospital health care at scale, leading the market in digital health technology across our business.

We now have over 14.5 billion nights of medical data in the cloud. And we have over 20.5 100% cloud connectable medical devices on bedside tables in 140 countries worldwide. We are liberating data to the cloud every day and unlocking value for patients, for providers, for physicians, for payers and entire health care systems. We are leading the industry, and we won't stop innovating.

We're investing 7% of our revenue in R&D. It's worth noting that the annualized revenue pool is now well north of \$4 billion. There is so much opportunity ahead of us, it's inspiring and it's exciting.

ResMed's mission remains crystal clear. We have a goal to improve 250 million lives through better health care in 2025. This patient-centric mission drives and motivates ResMedians every day. We made excellent progress towards that inspiring goal with our growth over the last 90 days. And

during the last 12 months, we have improved over 156 million lives with the delivery of a device platform to a patient or a full mask system to a patient or a digital health software solution that directly impacts a patient, helping each person to sleep better, to breathe better and to live a high-quality life with health care delivered right where they live.

Let me close my remarks with my sincere gratitude to the more than 10,000 ResMedians working across 140 countries for their perseverance, their hard work and their dedication today and every day. Thank you.

With that, I'll hand the call over to Brett in Sydney for his remarks, and then get in the queue because we will open up for Q&A from the group. 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 third quarter of fiscal year 2023. Unless noted, all comparisons are to the prior year quarter.

We had strong financial performance in Q3. Group revenue for the March quarter was \$1.12 billion, an increase of 29%. In constant currency terms, revenue increased by 31%. Revenue growth reflected improved availability of sleep devices to support the strong underlying demand for these products as well as solid growth across our broader product portfolio. Year-on-year movements in foreign currencies, in particular, a weaker euro, negatively impacted revenue by approximately \$20 million in the March quarter.

We recorded incremental revenue of approximately \$15 million from COVID-related demand in the March quarter. However, looking forward, we expect negligible revenue from COVID-related demand.

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 32%. Sales in Europe, Asia and other markets increased by 28% in constant currency terms.

Globally, in constant currency terms, device sales increased by 43%, while masks and other sales increased by 15%. Breaking it down by regional areas, device sales in U.S., Canada and Latin America increased by 48% as we benefited from strong demand and improving availability of our connected devices. Masks and other sales increased by 14%, reflecting solid resupply and growth in new patient setups.

In Europe, Asia and other markets, device sales increased by 36% in constant currency terms, again reflecting strong demand and improving availability of connected devices. Masks and other sales increased by 15% in constant currency terms, reflecting increased patient setups.

Software-as-a-Service revenue increased by 35% in the March quarter, reflecting the contribution from our MEDIFOX DAN acquisition and continued strong performance from our HME vertical. Excluding our MEDIFOX DAN acquisition, SaaS revenue grew by 9% in the March quarter. MEDIFOX DAN contributed revenue of \$26.6 million for the March quarter, consistent with our expectations at the time of the acquisition.

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.

Gross margin declined by 200 basis points to 56.1% in the March quarter. The decrease primarily reflects product mix shifts due to the significant increase in sleep device sales as well as component cost increases and unfavorable foreign currency movements, partially offset by increases in average selling prices.

Moving on to operating expenses. SG&A expenses for the third quarter increased by 25% or in constant currency terms increased by 28%. The increase was predominantly attributable to increases in employee-related costs and travel expenses as well as the incremental SG&A expense associated with our MEDIFOX DAN acquisition. SG&A expenses as a percentage of revenue improved to 20.5% compared to the 21.1% 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 fiscal year '23.

R&D expenses for the quarter increased by 14% while in constant currency terms increased by 16%. R&D expenses as a percentage of revenue was 6.8% compared to 7.7% in the prior year quarter.

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 fiscal year '23.

Operating profit for the quarter increased by 27%, underpinned by strong revenue growth, partially offset by a lower gross margin. Following the acquisition of MEDIFOX DAN, our net interest expense for the quarter was \$15 million, and we expect interest expense to be a similar amount for the balance of fiscal year '23.

Our effective tax rate for the March quarter was 20% compared to the prior year quarter effective tax rate of 21.1%.

Looking forward, we estimate our effective tax rate for fiscal year '23 will be in the range of 19% to 21%.

Our net income for the March quarter increased by 28%, and non-GAAP diluted earnings per share increased by 27%. Cash flow from operations for the quarter was \$283 million, reflecting solid underlying earnings, partially offset by a modest increase in working capital.

Capital expenditure for the quarter was \$29 million. Depreciation and amortization for the quarter totaled \$44 million.

We ended the third quarter with a cash balance of \$228 million. As of March 31, we have \$1.6 billion in gross debt and \$1.4 billion in net debt, reflecting the funding of our previously announced MEDIFOX DAN acquisition.

During the quarter, we reduced our revolver debt by \$215 million. As a result, at the end of the quarter, we had approximately \$605 million available for drawdown under our revolver facility, and we continue to maintain a solid liquidity position.

Our Board of Directors today declared a quarterly dividend of \$0.44 per share.

Going forward, we plan to continue to reinvest in growth through R&D, reduce our overall debt levels and deploy further capital for tuck-in acquisitions.

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

Amy Wakeham - ResMed Inc. - Chief Communications & IR Officer

Great. Thank you, Brett, and thank you, Mick. Kevin, I'd like to now turn the call over to you to provide instructions and then run the Q&A portion of the call.

QUESTIONS AND ANSWERS

Operator

Certainly. (Operator Instructions) Our first question is coming from Lyanne Harrison from Bank of America.

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

Yes. Good morning, all. Before I start, I want to say thank you to David Pendarvis. We're certainly sad to see him retire, but we know that we're in safe hands with Amy.

In terms of my question, obviously, some very good device revenue there, but I wanted just to talk about the -- you mentioned the third quarter, you had a new patient high, higher than what we've seen pre-COVID. Can you provide some comments of how much of that new patient backlog remains? And also, what sort of progress you're making on the re-PAP backlog? And if you can discuss that according to the Americas and rest of the world separately, that would be very helpful.

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

Well, thanks for the question, Lyanne, and the tribute to Dave for his 20-plus years, 22 years of -- I think it was -- this is his 83rd investor call, eight-three, so amazing tribute to Dave and we are in very safe hands with Amy on the Investor Relations front.

To your question, look, yes, incredible growth, 43% growth in device revenue this quarter to an all-time high, many factors that have gone into that, primarily that we were able to deliver on our promise to get unconstrained on AirSense 10, 100% connected devices, and we've got those end markets. And so I think we were able to take care of all of the demand of customers in the U.S. market, period, end of story. We said we'd be there by the end of this calendar year, but we're there already here right now.

And as I said in the prep remarks, we're going to be scaling the AirSense 11 steadily and strongly as that new platform, the latest and greatest comes to market, and we move forward.

In terms of backlog of those sort of new patients, I think we're there in the U.S. But in terms of re-PAPing, I think there's a lot more to do. And we're going to partner across the U.S. with all of our thousands of home medical equipment companies to start to work through that re-PAP program. But I think that's going to happen over time. We just got to the point where we're completely unconstrained on AirSense 10 in this quarter. I think it's fantastic. I want to get unconstrained on AirSense 11. That's going to take a few, a number of quarters.

And then, of course, that's just 1 country. We're in 140 countries worldwide. We're going to go get regulatory in all of them and then get those products to market. And so it's going to be an ongoing process over the coming quarters and years to continue there.

I'm not going to say that we're going to see this sort of exceptional 43% growth on an ongoing basis. The market growth is closer to the mid- to high single digits in this space. But we're seeing that market growth come back. We're seeing the new patients come back. We are through that pandemic side, and we're getting new patient flow. We see it in our home sleep testing data. We're looking at all the stuff coming through ApneaLink Air. We're seeing it in the number of patients being set up in AirView. All-time high, but we're looking at that every week, every month and every quarter and it's steadily improving.

And it's not just the U.S. It's in Western Europe, Northern Europe, and it's certainly coming through Asia. Very strong growth in China over the last number of quarters as we've come through the COVID crisis there as well.

So that's my summary there, Lyanne, great question.

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

Sorry, can I just clarify? When you said that you're there on the backlog, is that both for the United States and rest of the world?

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

Yes. So we're through the backlog in the U.S., and we're going to be progressively working our way through the other 139 countries. It's not -- it's a complex system where when you get regulatory approval, say, for the AirSense 11, you've got to go region by region, you can do European Union, but then you have to go country by country for many of these approaches for Brazil, for China, for India, and it takes time to get them there to get unconstrained with the 2-platform approach that we've been able to take in the U.S., Canada and a number of other countries.

But look, we'll give you updates over the coming quarters, Lyanne, as we get unconstrained, country by country, we'll report it to you. And our goal is to be unconstrained everywhere tomorrow, it's just not logistically possible to be able to do that. So we're going slowly and steadily to that. But I'm just happy to be 9 months ahead of when we were saying we're going to deliver an unconstrained at least in some of our top markets here, and we'll keep you updated as we go forward.

Operator

Your next question is coming from Dan Hurren from MST Marquee.

Dan Hurren - MST Marquee - Healthcare Analyst

Look, I'm going to let somebody else ask the gross margin question, but I'd like to ask about the SG&A and just the fact that it's remained relatively constant as a percent of revenue during the course of the recall, which considers a bit counterintuitive when you consider the fact that the products have been in shortage and et cetera, and similarly selling themselves. So I just wonder if we could talk about the key elements of that SG&A and the mid to long-term trajectory there as volumes continue to improve.

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

Yes, that's a great question, Dan. I'll hand over to Rob Douglas, our President and Chief Operating Officer, to cover our SG&A.

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

Yes, Dan. So you know us and you know how we operate. No matter what's going on, we're fiscally disciplined. And we're always keeping an eye on the future and where we're going and what's happening as we build in expenses. We absolutely talked about the fact that we weren't doing face-to-face marketing and a lot of travel and those types of things earlier in the pandemic. And as that's started to come back, we've had to manage carefully how that's been an extra load on our SG&A. But it's really a factor of careful management.

Everyone is aware of the issue of employee costs and those things, which are moving in the time of inflation. And we continue to manage that carefully. And we're extremely prudent about what we add in on and how we go. And so we really don't want to get ahead of ourselves and end up like some of these other companies that have found them way overprovisioned in their go-to-market operations and had to make corrections.

So we're in good shape, and we've got a solid plan and we should be able to stick very carefully with Brett's forecast on our SG&A.

Operator

Your next question today is coming from Mathieu Chevrier from Citi.

Mathieu Chevrier - Citigroup Inc., Research Division - Assistant VP & Senior Associate

You obviously had a very strong devices growth in the quarter. I was just wondering whether you still believe that you can sequentially grow every quarter in fiscal year '23 in devices? And then how should we think about FY '24 and the returns -- potential return of Philips to the market and whether there's been any update there?

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

Yes. Thanks for the question, Matthew. And yes, last quarter, I certainly said that we expect to see sequential growth of devices throughout the calendar year actually here through 2023, and that was our forecast.

I've got to tell you this \$607.9 million of device sales in the quarter was ahead of where I thought we were at that point. That's a big number to come up. And as Brett said, there's about \$15 million of ventilator sales to China in there as they went through another phase of COVID as they reopened during the March quarter. So if you take that out, it's still a big number to shoot for here in Q4.

But we have the best commercial teams on the planet in respiratory medicine sales. And Q4, for us, our fiscal year Q4 is a big time in those there's president's clubs in some geographies, there's fiscal incentives everywhere for people to finish their fiscal year strong. And so there's a lot of incentives.

So yes, it's a tough number to get there on sequential growth. Taking out those ventilators. I think we can do it. I'm confident in my team. I'll back my team. They got a little bit ahead of me here in March, and I love that. I'd love them to be a little bit ahead of me in June. And so I'm confident we can do that.

More important than that is that we are now taking care of every patient's needs in our major markets, and our goal is to be there in all 140 countries. So some of it is that revenue growth, and it's amazing, but it's really about patient care and it's about leaving no patient behind.

And it was really disappointing, I think, for us as an industry, some of these quarters over the last 8 quarters, that as an industry, we weren't able to take care of every patient that got a prescription. We're now doing that in our major markets, and we plan to absolutely fulfill that, not only where we've already achieved it, but to get ahead of it in all the other countries as we go.

So sequential growth is good. We're going to be pushing towards trying that. But more important than that, taking care of every patient in every geography and working as hard as we can to get to those patients and get them a world-quality mask and get them on a resupply program because that's what leads to long-term adherence not just that onetime device sale. But getting an adherent patient, that 87%, 90-plus percent adherence rates on not just a 90-day basis, but an ongoing basis. So that's our challenge, Mathieu. Great question. Thank you.

Operator

Next question is coming from Gretel Janu from Credit Suisse.

Gretel Janu - Credit Suisse AG, Research Division - Research Analyst

I'll ask the gross margin question. Is the mix really the key driver of the weaker gross margin here? Do you have -- is the higher price offsetting component costs? And just as we look forward, if you're going to continue to assume strong device sales growth, should we expect gross margins to continue to be weaker at these levels in the short term?

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

Yes. Thanks for the question, Gretel. And as you said, and as Brett said in his prep remarks, we had some headwinds on gross margin, which were geography mix, where it was more in low-margin countries, U.S., Canada. And then product mix. We saw more CPAP and APAP growth than we did by level or life support or even other noninvasive ventilators. And so those headwinds are going to start to subside. Look I am actually -- I think, Gretel that as I look forward, I see gross margin expansion in double-digit basis points ahead for the coming quarters and throughout the fiscal year and the calendar year. I'm bullish on gross margin expansion because I see geography mix and product mix headwinds subsiding. I'm bullish on gross margin as I see ventilator growth opportunities start to come back, and I see mask growth and replenishment growth, new patient growth start to come on masks. And I'm bullish on gross margin as we go forward because I see inventory costs starting to -- we're going to start to cut into that and bring them down versus the run-up we had with our competitor being out of market.

And I also -- I'm bullish on gross margin because I see us being able to get better freight costs as we go forward. And as you said, we have been offsetting some of that gross margin headwinds with ASP holding steady in our core business, increasing ASPs in our SaaS businesses. And we've had some freight surcharges and others with customers. As we start to see our costs come down, we'll take away some of those surcharges and so on, and so we'll balance that out.

But net-net, I see us being able to expand our gross margin and grow as we look forward throughout not just the fiscal year here at '23, but for calendar year here in '23.

Operator

Your next question is coming from Matt Taylor from Jefferies.

Matthew Taylor - Jefferies LLC, Research Division - Equity Analyst

Sorry, I was on mute. I just wanted to ask about how much we should expect the mask trends to start following the device trends as you become more unencumbered. I thought maybe there would be a little bit more mask growth this quarter, not taking away from a good result. But maybe you could talk about that as a derivative.

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

Yes. Thanks, Matt, for your question. And you know that as you look at our masks and accessories business, it's sort of 70% to 80% of our mask growth is replenishment. It's existing patients out there who are coming back for a fresh mask, a fresh humidifier, a fresh set of tubing, heated tubing and so on and filters. So it's the mask and accessories is 70%, 80% replenishment business. And so it's not as directly impacted.

So new patient growth is incredible. We're back to better than pre-COVID, and we're growing from there. And that's great to see that sort of strong growth of new patients coming in. But it doesn't sort of directly correlate to your point. It's less a derivative and more sort of a compounding effect over time as you -- like compound interest. as you build up that installed base, those patients are ordering. If they are ordering on a 3-month or 6-month basis, that becomes a compounding effect on the device growth today, leading to a future investment in growth in masks over the coming fiscal quarters and fiscal years as you build that installed base.

So there's not a direct correlation. 43% device growth doesn't immediately correlate to mask growth. But I mean, to your point, 15% global mask growth on a constant currency basis is incredible. Pre-COVID, we would have been very proud of a number like that. Post-pandemic, coming through this growth, I'm incredibly proud of the team and what they're able to do, not just in new patient setups but in the replenishment programs.

And as I said in the prepared remarks, it's not just in the reimbursed markets where we've got formalized system. In France, the U.S., Japan, we have formalized systems to go with our customers to patients to ensure they -- if they want it, that the patient gets a mask when they need it. We're also working in our consumer-driven markets, where we're driving adherence programs, subscription programs that are fast-growing in many of our

geographies, where it's cash pay or direct-to-consumer interaction and they're saying, "I want a fresh mask." And so it's true to the core demand. It's not just a system-driven one. This is a patient-driven one. And that's the part about mask growth that I think is most exciting.

Final thing I'll say on mask growth is that I think there were some skeptics. 2 or 3 years ago, people were like, "Oh, this step up in respiratory health and hygiene, step-up in mask replenishment. That's a short-term trend due to COVID pandemic." We're 3 years since the start of this COVID pandemic, and that has been 12 quarters of strong mask growth. So I think that strong mask growth is sustainable for the future. We've been able to execute for 12 quarters, and we plan to continue to do that as we go forward.

Operator

Next question is coming from Michael Polark from Wolfe Research.

Michael K. Polark - Wolfe Research, LLC - Director & Senior Analyst

I'll ask another twist on the mask question. As you've better filled on the device side, especially in the U.S., are you -- is there a halo impact in terms of winning share incrementally on the consumables side? Is that a dynamic that's played out recently or could play out over the next year or so as the device, kind of the urgency to step into the device void abates and you refocus on other priorities?

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

Yes. Look, Mike, there's certainly a relationship and when our commercial teams there are working with the best platform, the AirSense 11 and the best -- second best platform, the AirSense 10, both of which are better than our competitors, they're also obviously offering the best masks, the best mask portfolio out there, and we have a leading share in that in all 140 countries as well. So there's definitely a synergy effect in that it's the same people talking to the same physicians, the same providers, the same health care systems. And so we're there.

In addition, there's some sort of clinical technical needs. I mean we design our products to work better together. Our masks on our devices have far more accurate mask leak detection. They have far more accurate detection of pressure and control of an APAP device or a bilevel device, and particularly if it's used on an overlap patient say, who has obstructive sleep apnea and COPD, you need that IPAP and the EPAP, the pressure control to be right on. When you use our bilevel with our mask, that's going to be far more accurate and the physicians know that and they will script towards that for those patients.

And then for the respiratory therapist doing a setup, they know our products are designed better together. Our teams have shown in the clinical and technical data of how they're designed. And so there is a strong positive synergy effect. So yes, I do think there's a correlation between them. You can think the sort of simple commercial. I mean, they're selling it, but then you look at it from a physician's perspective on clinical and then the therapist's perspective on fit and comfort and leak. So I think all that goes together to show that there's some good synergy between our device growth and mask growth over time.

Operator

The next question is coming from David Low from JPMorgan.

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

Mick, can we go back to gross margins? I mean if I heard you correctly, you said you expect gross margins to expand into double digits in future. Can I pin you down a little bit on what sort of time frame? And are we talking gross margin percentage? Are we talking gross profits? Just trying to understand what you're expecting on that front, please?

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

Yes, David, thanks. I'm going to hand to Brett to go through more detail. But what I was saying is I expect double-digit basis points improvement from where we're at in the quarter. 56.1%, I see is the nadir, and I want to grow from there. So I see us being able to move that up, I don't know, 10, 20, 30, 50, 100 basis points over the coming quarters and beyond.

But, Brett, do you want to provide a little more detail for David, to the headwinds, the tailwinds and all the fun that goes into gross margin?

Brett A. Sandercock - ResMed Inc. - CFO

Yes, sure. Sure, Mick. Yes, David, it's -- I mean we wouldn't -- we're not going to try and quantify, but when we look at it, we do expect margin expansion over the coming quarters. So if you look at some of the key ones that have hurt us year-on-year or -- it's around -- it's product mix, obviously, was a massive increase on sleep devices. We had to deal with component cost increases coming through year-on-year, but that looks to be stabilizing there. So that's -- there's 2 big headwinds that we expect will moderate.

And then we're working on manufacturing, logistics, freight costs. We're looking at efficiencies. So we're focused back on that now. And that -- again, these should improve over the coming quarters as well. Then on top of that, with the AirSense 11 platform, that does contribute positively to gross margin as well. Now that one will take time as we roll that out. But if you kind of put in the -- I guess, you look at it, that sort of the headwinds are moderating. We should get a few tailwinds in manufacturing and logistics. And that kind of gives us the confidence we think we can get that expansion from here on in.

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 & Research Analyst

I wanted to maybe follow up on some of the patient demand metrics that you guys gave early on the call. I think I heard maybe high single-digit market growth in the U.S. or Americas. And then should we add re-PAPS to that so that, so that ultimately leads us to a double-digit growth rate? And then how do you think about the, I guess, once Philips does potentially reenter the marketplace for you guys on a long-term growth? Can you, I guess, continue at that double-digit top line growth rate?

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

Yes. Thanks for the question, Margaret. I think there's so much that goes into it. But yes, look, we're on the other side of this pandemic, right? Not only just the pandemic's become an endemic in the way that the world's opening up and we're driving forward, but in our industry, we're now seeing that strong growth of patients that we're really starting to pick up. And yes, it's mid- to high single digits growth on the patients starting to come through the funnel now, and that's really strong.

How long that's sustainable and how we can drive it? That's -- it's going to be up to us as the market leader. We have the market lead here, and we're going to drive awareness programs. We're going to drive demand generation programs. We're going to partner with -- I just got an update from a team here in the U.S. market, looking at a project to bring patients into the funnel and to drive patients into the funnel. And as the market leader, that's really our job, so not just accept market growth, but to drive market growth. So this is going to be an active thing that we're going to be looking at as we move forward. And it's very exciting for us to do that.

I'm not going to quantify it out. I mean given where we're at, I know you have your models, everyone on the sell side and buy side has their models. But I would say to that, whatever your models are, think about an active leader engaging in digital awareness, marketing awareness and driving

and curating patients through the channel. And we've learned a lot through the COVID crisis about digital health, about engaging with patients in home testing in remote setup and virtual pathways that have really been necessary at the peak of the pandemic and now become a catalyst for future demand generation.

So I don't know, Rob or Lucile, if you have any extra thoughts on that?

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

Just one other minor point, Mick. That new patient growth's really solid and there's so many untreated patients. We can see a long-term future in that. But also as we build our long-term adherence programs and start driving long-term adherence, that will keep the mask growth ahead of that new patient growth and we see a long-term outlook for that too.

Operator

Next question is coming from Andrew Paine from CLSA.

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

Yes. Just thinking about your ability to retain market share when Philips comes back to the market, it's a bit up in the air still, but assuming from the start of FY '24, what levers do you think you can pull here to ensure that you do retain market share? Are we looking at kind of things like pricing as a factor? Or do you think there's other things that will help you retain that share?

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

Yes. Thanks for the question, Andrew. And yes, certainly, look, we look at all competition. We've got competitors based in Western Europe and in Asia that we've been competing with very strongly for the last few decades and certainly the last 2 years. And 1 competitor who's been out of the market for new patient setups for 2 years and who knows how much longer. They'll have to come in -- that third competitor, they'll have to come in and start fighting to become the #2 share player from a 0% new patient setup share. And we look forward to that. We were beating that particular competitor in 2019 before they had their recalls. So I know we'll be able to beat them when they come back in.

And so no, our goal is to cede 0 share. Our goal is to actually maintain and grow share. As the market leader, that gets more and more difficult to take more and more share, but that's our goal. We have the smallest, quietest, most comfortable and most cloud-connected devices. But more important than that, we've created a digital ecosystem that engages patients with myAir, doctors with AirView, health care systems by APIs that link into Epic or Cerner in the U.S. and health care systems around the world in U.K. and NHS, Northern Europe into government and Western Europe into government-run health care systems. And we're engaging with patients in our consumer-driven markets incredibly well. So our goal is to maintain and grow that share.

But more important than that, to grow the market. As the market leader, that's sort of our obligation. There are now, with the latest epidemiology rising up, around 1 billion people with obstructive sleep apnea that needs to be treated worldwide. And if you add in COPD, asthma and insomnia, you're talking 2.5 billion people in our total addressable market. So you can think about share, but it's really not Coke and Pepsi was out and Pepsi's coming back. This is not a low-growth carbonated beverages market. This is a high-growth digital health technology market in medtech, and that's how we're driving it forward.

But yes, I look forward to just getting the uncertainty out of this #3 player. I want them back in. Let's see and let's compete and we'll keep our share and grow it and game on. Look forward to it.

And actually, one last thing I'll say on that. People have been talking about when that #3 competitor comes back, how will they come back? Their CFO last week said, "Oh, no, we won't be coming in and lowering prices. We'll look to take 2019 prices and add to that with inflation." So game on. I look forward to it.

We've always competed on value. We've always competed on driving that, and it's never been a competition on price for us. We've always been a price premium to the other players, but we save them more money. So that the smart customers are using our products because it's more profitable.

Operator

Next question is coming from Matthew Mishan from KeyBanc Capital Markets.

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

Mick, you mentioned at one point that you're getting 90% adherence on some of your best customers. I'm just curious like where that is versus kind of baseline. And how you can move that forward with like the rest of your customer base?

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

Yes, Matt, it's a really good question. And so the peer-reviewed, published evidence out there is an 87% adherence number that's been out there for a couple of years. If you look at the average of the market, where people maybe aren't using as much of the digital capabilities, the patients aren't using myAir, the doctors aren't using AirView, general industry adherence might be, on average, 60% to 70%, right, with a competitor device that's not connected or maybe someone who's not fully engaged with the digital ecosystem we have.

As they start to get engaged, there's actually a peer-reviewed, published evidence on this, just adding -- just adding the doctor using AirView moves up adherence by 10%. So you go from, let's say, an average of 65% to 75% for that customer just having the doctor use AirView. If the patient uses myAir, you move up almost another 10%. So for that example, you might go from 75% to 85% adherence, where the doctor is using AirView and the patient's using myAir. To get to those 90s, you need a really special customer that's really engaged and really investing in tech that takes our tech and sort of adds algorithms and adds capabilities to it. And we have a number of those sophisticated customers in Europe and the U.S., and we partner with them, and we do joint development with them. And we love that training. We learn from each other. Because together is how we deliver the care. We're a manufacturer and we're a provider of digital health solutions, we've worked with providers in our biggest countries to get there.

And where we don't, in smaller consumer-driven markets, we have to pick up the ball and engage directly ourselves. But that 90% is achieved in very rare cases, but it's -- that peer-reviewed, published evidence shows that it can be done with the tech at 87%.

And yes, to your point, how do we get everyone up to that 87%, that 90%, that is a process of engagement of training. And that's why I say our share is not only going to stay where it is, but have the chance to grow from that because we are the market leader in this.

No one is investing like we are in cloud compute. No one is investing like we are in analytics in AI and ML and engagement with patients and physicians and providers. And we're not doing it alone. We're doing it with the ecosystem, with the patients. We're listening to them. With the physicians and with the providers.

Thanks for the question, Matt.

Operator

Next question is coming from Saul Hadassin from Barrenjoey Capital.

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

Mick, just a question on Primasun. I just noticed this quarter, the investment was very low, certainly less than what the guidance had been. So I'm wondering, did something change this quarter? And any update on how that project is going?

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

Yes. Saul, it's a great question because let's just talk to our whole sort of demand generation and engagement approach. I mean, as you know, Primasun is a joint venture with Verily in the U.S. market, looking to digitally engage -- well digitally identify, engage and enroll patients in a sort of digital health pathway, from sleep-concerned consumer all the way through to diagnosed patient on treatment and management.

We have activities through our core U.S. and North America marketing team. And obviously, in the other 139 countries we operate in, we're looking at other digital ways to engage the 1 billion people who need our help.

So look, we're looking at investments. We're at pilot phase of some trials, and we're getting ready to scale some approach with Primasun, with our U.S. programs and many of the others we're operating in all parts of the world. And so as we start to roll those out, now that we're at the point where we've got full capability to supply, as we said in the prep remarks and throughout the call, with AirSense 10 and AirSense 11 as a combination, we can really turn to start to turn the dial up on these demand-generation initiatives with undiagnosed sleep apnea patients. And I'm excited to start doing that.

So those investments might pick up a little over the coming quarters, but they'll have a huge return in bringing patients into the funnel. So watch this space.

Operator

Next question is coming from Suraj Kalia from Oppenheimer & Company.

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

Mick, can you hear me all right?

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

Got you loud and clear, Suraj.

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

Perfect. So Mick, first, let me just express my thanks to David. David, wish you have a great retirement. It's been a pleasure dealing with you all these years.

So Mick, a lot of questions have been asked. Your comment about AI caught my attention. So Mick, think about it this way. Suraj comes in, he's gone through the CPAP titration, the sleep lab. Certain parameters have been set at a bilevel, a variable, whatever. How would -- what parameters specifically would your AI/ML-based algos tell a patient? And the reason I ask is specifically trying to understand how will you use this to improve compliance?

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

Well, Suraj, it's a really good question. And we only have 5 minutes left in the call. I could spend a whole 50 minutes of it. A lot of those things are actually quite proprietary as we put together these AI and ML models on how we would coach a patient. Particularly you talk about a high acuity patient like that on bilevel or ventilation, noninvasive ventilation therapy.

But look, yes, certainly, I look at our compliance predictors and our compliance analysis tools that can help empower an HME in the U.S. and just some of the ways in which we're able to use AI and ML to drive prioritization of the most at risk for quitting patients and those who are so close enough to get there and those were definitely there and just need some sort of digital coaching. That sort of triage, if you like, which has previously been done manually, is now going to an automated way. And it's -- we've always had some levels of that automation, but to have an algorithm that learns as it goes and to get better and better at it, it just serves the doctor. It serves the respiratory therapists. And both of them are super pleased to see that level of efficiency, reduction of, if you like, the administrative management and focus on the toughest patients but also making sure that the best patients get the digital coaching and help that they need.

So it's really we're triaging compliance, adherence and beyond. But watch this space. We're going to launch a bunch of new products that I'll be able to talk to very specifically what they are and what they do over the coming quarters.

Operator

Next question is coming from Craig Wong-Pan from RBC.

Craig Wong-Pan - RBC Capital Markets, Research Division - Director of Equity Research & Equity Research Analyst

I just note the inventory balances continued to increase. So I was wondering when you might start to see that come down. And also, is there much card to cloud inventory or parts in that number still?

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

Yes, Craig, thanks for the question. It did move up just a little bit in the quarter. I actually have got a very strong target for Andrew Price, President of our operations and the whole manufacturing team to get that number down because we're through the peak of this, and we've got full supply, let's get that number down.

But Brett, do you want to speak to some of the details of how we're going to turn that inventory number down significantly over the coming quarters and fiscal year?

Brett A. Sandercock - ResMed Inc. - CFO

Sure. Sure, Mick. Yes. I mean I'd characterize it, Craig, that we stabilized that inventory this quarter and really that drove the really strong operating cash flow that you saw. But I think there's more that we can do. And the aim is to reduce those inventory levels overall. I mean, a number of things we can do, but some of the -- someone might point out, we're seeing improvement in lead times, which will help. You've got, I guess, getting from port to port's improved a bit, so we can lower inventories.

We're continuing to increase sea freight versus air freight. So some of that manifests in inventory. But eventually, that kind of stabilizes at a ratio. We're tuning safety stock levels now because we've got more predictability on what we need and when we can get supply. And then inventory, obviously, is future looking. So we're looking to support sales.

So we just got to balance all that. But all that said, I think we're looking for inventory levels, that trajectory to gradually go down over the course of FY '24.

Operator

Our final question today is coming from Chris Cooper from Goldman Sachs.

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

Thanks, Mick. I'm just after your latest thoughts on the diabetes and obesity drugs, please. We -- I guess we had another positive update last night. They do seem to be coming thick and fast at the moment. I guess could you just share how ResMed are thinking about these? And to what extent their success may have any impact on your business, please?

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

Yes. Thanks, Chris. Yes. No, it's a huge market and actually quite exciting. We've always wanted to have interactions. We actually -- when I first joined the company 23 years ago, we were working with bariatric surgeons and looking at patients that would go through bariatric surgery and maybe from 450 pounds down to 200 pounds. And our challenge in those days when it was mostly a CPAP market was how do we make sure they get on APAP because their needs, their AHI might go from 50 when they were at 450 pounds to 30, when they were 250 pounds, but that 30 is still severe sleep apnea. So we had to have an APAP algorithm that could adjust with them.

These days, the market is 80% APAP and so you don't need to make sure that a patient on, let's say, a weight loss drug or so on, that sees a weight loss and their AHI needs go down from very, very severe sleep apnea to just severe or moderate to severe. We have the algorithms and the capabilities within the devices with our AutoSet algorithm to adjust automatically. And we'll also have all the digital health data. So that the pulmonary doctor can partner up with the primary care or bariatric-type doctor that's working on -- and it'll presumably be PCPs working on the obesity drugs, and they can monitor the patient to see how much better they're getting, maybe more adherence, more participation in their fitness and exercise for the overall health.

So for us, actually, and you know we're invested in one of the sleep apnea drugs, it's not a weight loss drug. It actually goes to the core of trying to treat sleep apnea, which is called Apnimed. We're going to partner with pharma in this space.

We've seen the substitute of the sort of tiny sort of whatever it is, 0.5% of patient flow into these implanted devices. And there's a company out there doing, I think lots of very expensive advertising, but it's driving lots of patients into the funnel. It's demand gen for us because they market it as a button to treat sleep apnea, but it's actually an implanted medical device the size of a pacemaker that goes into the chest. When the patient finds that out, they say, "Well, what are the alternatives?" "Oh, there's a noninvasive alternative like CPAP or APAP available" and the patient goes online with that.

I think some of the pharmaceutical advertising in this space will drive us to the 80% of undiagnosed patients in the space to say, "Hey, look, I'll take the pill first and maybe then I need sleep apnea therapy or vice versa." But we think there's a lot of opportunity to partner here with pharma.

We're already partnering with our Propeller division with some of the COPD and asthma drug delivery. I look forward to not just with Apnimed, but these other obesity drugs to understand how they drive patients into the funnel and how we work with them to treat those patients.

Operator

Thank you. 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 closing comments.

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

Well, thanks, Kevin, and thank you again to all of our stakeholders for joining us on the call. I'd once again like to take the opportunity to thank the 10,000 ResMedians. Many of you are also shareholders. So thank you for what you do and for investing in our company as well. Thank you for your dedication and hard work, helping people sleep better, breathe better and live better lives in 140 countries.

You delivered these numbers that we just reported. Thank you for all that you do.

I'll hand the call back to Amy, and then we'll close out.

Amy Wakeham - *ResMed Inc. - Chief Communications & IR Officer*

Great. Thank you, Mick. Thanks, Kevin, and thanks, everyone. We appreciate your interest and your time. If you do have any questions -- additional questions, please don't hesitate to reach out directly.

This does conclude our third quarter 2023 conference call. Kevin, you can now close this out.

Operator

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

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