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RMD.N - Q1 2024 Resmed Inc Earnings Call

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## OVERVIEW:

Company Summary

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## PRESENTATION

### Operator

Hello, and welcome to the ResMed First Quarter Fiscal Year 2024 Earnings Conference 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.

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

Great. Thank you, Kevin. Hi, everyone. Good morning and good afternoon. Welcome to ResMed's First Quarter Earnings Call for Fiscal Year 2024. We are live webcasting this call, and the replay will be available on the Investor Relations section of our corporate website later today along with a copy of the earnings press release and presentation, 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, to answer any questions you may have.

During today's call, we will discuss several non-GAAP measures. We encourage you to review the supporting schedules in today's earnings press release for a reconciliation of the non-GAAP measures to the GAAP reported numbers. In addition, our discussion today will include forward-looking statements including, but not limited to, expectations about our future financial and operating performance. We make these statements based on reasonable assumptions. However, our actual results could differ. Please refer to 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 all of our shareholders for joining us today. Our first quarter fiscal year 2024 results reflect strong growth across our entire business with double-digit top line growth. This growth was driven by double-digit global growth in the masks category and double-digit growth in our Software as a Service business. We also achieved high single-digit global growth in devices even as that category annualizes very high growth in the prior year period. The flexible and agile work of our supply chain, manufacturing and distribution teams has enabled us to provide ongoing global availability of our market-leading 100% cloud connectable flow generator platforms.

We have unconstrained supply of our AirSense platforms enabled by excellent volumes of the AirSense 10 platform globally and fast-ramping approvals, launches and delivery of the best-in-class AirSense 11 platform country by country. During the quarter, we accelerated delivery of the AirSense 11 in Japan, and we launched the AirSense 11 in Australia and New Zealand.

We have plenty of runway ahead on our pathway to launch in all of the 140 countries where we sell our solutions. We are very proud to be able to support all global demand for flow generators through a combination of AirSense 10 and AirSense 11 platforms. We remain laser-focused on accelerating the production and delivery of the AirSense 11 platform. We are moving swiftly on that front.

Our Masks and Accessories business grew 21% year-over-year, amongst a highly competitive market with all global players on the field in this category. Our commercial teams are doing an amazing job of showing the clinical and economic benefits of the ResMed mask portfolio. Our clinical and commercial teams are also partnering with physicians and provider customers to drive resupply programs directly with patients.

The peer-reviewed and published clinical evidence showing that adoption of a resupply program leads to better patient outcomes is proving itself out in a real-world customer by customer. We continue to see strong growth in the U.S. masks business where provider resupply programs can scale, powered by our digital health ecosystem, including AirView for physicians and providers and myAir for patients.

For patients around the world, especially in nonreimbursed markets, we are developing, launching and scaling outreach and subscription programs to help the consumer who is the ultimate customer to take control of their own health and engage directly in refreshing their mask, tubing, humidifier and other accessories. This has been a permanent uptick since COVID-19. People care about respiratory health and respiratory hygiene and they are taking action, and we are supporting them with digital solutions and services to meet their needs.

Before I turn to review updates on our key strategic priorities, I'd like to spend a little time discussing actions we've taken to accelerate profitable growth across ResMed and to power our long-term success. We've taken immediate steps to ensure we're prioritizing the right things to drive profitable growth, and our leadership teams have carefully reviewed opportunities to improve our performance. We have stopped some projects that were not working out as well as we thought.

We've increased investment in areas that we believe will be pivotal to long-term success, such as our digital health tech investments as well as focused hardware and software development. Creating the smallest, the quietest, the most comfortable, the most connected and the most intelligent health care solutions in the market. These changes have impacted some of our teams. And this week, we have taken actions that resulted in a reduction of our global workforce by 5%.

Decisions like this that impact people are never easy. However, we know that we are doing the right thing, and we're doing the right thing to accelerate our growth and to refocus on our long-term mission. I feel more strongly than ever that we are well positioned with an incredibly long runway of profitable growth and value creation for all of our stakeholders as we move forward.

Let's now turn to a discussion of our 3 key strategic priorities: number one, to grow and differentiate our core Sleep Apnea and Respiratory Care business; number two, to design, develop and deliver market-leading medical technology as well as 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, a field that we call residential medicine.

There are over 2 billion people worldwide suffering from sleep apnea, chronic obstructive pulmonary disease, respiratory insufficiency due to neuromuscular disease and insomnia. There are millions more that we can support as they navigate the complex outside hospital health care

system. We believe that health care should be delivered in the lowest cost, lowest acuity and highest comfort location possible. Very often, that is a patient's own home. We have a massive opportunity ahead of us to help hundreds of millions of people worldwide. Our end markets remain incredibly underpenetrated with many opportunities to add value, reduce friction, lower costs and improve patient outcomes.

Now that we've been able to comfortably support overall global market demand for sleep devices for the last few quarters, we're ramping up our demand generation initiatives. We're investing in marketing efforts to raise awareness and patient engagement across specific global markets. We are leveraging traditional health care channels as well as investing in cost-effective direct-to-consumer demand gen campaigns to help what we call sleep concern consumers find their way into the screening, diagnostic, treatment and management pathway. We will act as a digital concierge to guide patients on that journey.

In terms of analyzing the results of these efforts to date and ongoing, we are tracking new patient starts in our physician and provider-based ecosystem, AirView, which now has more than 22.5 million patients, as well as the new user starts in myAir, where patients themselves choose to participate in their personalized health care journey to better breathing and better sleep. Patient flow into the funnel is at an all-time high.

We are well above the rates that we saw pre-COVID in 2019 across all geographies, triple digits across the board. The bottom line is that we are driving strong growth of patients into the funnel. We believe the work that's being done in the pharmaceutical industry right now with obesity drugs will be a net positive for patient flow and patient growth in sleep apnea, COPD and for ResMed overall.

In terms of existing patients in our installed base, we are actively tracking a cohort of many thousands of patients on these GLP-1 medications and APAP therapy. We are not seeing any significant change in the PAP adherence rates nor any reduced participation in resupply programs versus control groups. These data indicate that there is a cohort of patients on combined therapies in a stable state.

In terms of new patients activated into the funnel, we are seeing the number of new patients activated into the health care funnel picking up. We see patient flow is not only strong but increasing. We believe in treating the whole person here at ResMed, including a combination of cardiovascular exercise, diet and nutrition as well as good sleep and breathing. That combination was called the Triumvirate of health by Professor Bill Dement from Stanford, may he rest in peace. And we think a combination of these 3 elements will result in the best outcomes for patients. It is quite possible that this new class of drugs may become as large or even larger than the cholesterol class or the blood pressure treatment class of pharmaceuticals.

If this is the case, we will see a whole new population of patients activated with their primary care providers that we may never have seen in the health care system. If this comes to pass, we may see benefits for the entire health system and for the people being treated themselves and for ResMed, as more and more people are evaluated and screened for sleep apnea, respiratory insufficiency and other key chronic conditions as part of their primary care evaluations. Our data are showing an all-time high of patient flow and that supports this thesis.

Stepping back and looking at the science in the field of respiratory medicine, we have created a forward-looking epidemiology model for our core market of sleep apnea, spanning over 2 to 3 decades into the future. We have assumed an aggressive case for high market penetration of this new class of pharmaceuticals. We will publish the epidemiology model in our investor deck straight after this call. The model starts using a baseline of the global prevalence of sleep apnea, which was 936 million people in 2015. And this is based on peer-reviewed and published data from the Journal Lancet in 2019. Our epidemiology model grows with conservative population and aging assumptions to a prevalence of around 1.4 billion people suffering from sleep apnea in 2050.

We then overlaid an aggressive assumption for the adoption of this new pharmaceutical class globally. We assumed some of the highest penetration rates that we have seen reported by analysts in the industry. With this aggressive and sustained adoption of the new drug class, we forecast that the global prevalence of sleep apnea will still be around 1.2 billion people in 2050.

Now in terms of the market penetration of our PAP therapy into this population, we have assumed market growth from our 22.5 million patients with PAP therapy here at the end of calendar year 2023 using steady-state market growth rates that we saw in the years leading up to 2019. That is mid-single-digit growth for devices and high single-digit growth for masks.

With these growth rates, we reached around 109 million patients on our PAP therapy by 2050. That leaves 1.1 billion people remaining in the addressable market in 2050. Over and above those already on our PAP treatment. We will continue to update our epidemiology model with all the new data as they arise. However, the bottom line is that there remains a huge number of people needing our sleep apnea treatment solutions today and for the next 2 to 3 decades and beyond.

While we're proud that we have peer reviewed and published data showing that we can achieve over 87% adherence of patients to our PAP technology, combining our best-in-class med tech hardware with our digital health solutions, AirView and myAir. That still means 10% of our patients on an annual basis will need alternatives. We are investing in those alternative therapies, and we are actively working with direct -- to direct patients who do not adhere to PAP, that 10%-plus to second-line therapies, such as dental devices, where we have invested and scaled the market-leading 3D printed dental device for sleep apnea in Europe called Narval.

In addition, we have investments in other second-line therapies, including pharmaceuticals, and hypoglossal nerve [stim] technology. We want every patient who suffocates at night to find a path to good breathing and good sleep. And it looks like there's 1 billion of them we need to help. We start with the highest efficacy and lowest cost therapy, which is PAP technology, where we have very high adherence rates and the best outcomes for patients, and we go from there.

Given this incredible multiple decades long plus runway of growth and as part of our ongoing efforts to improve and streamline that end-to-end patient pathway and to make it easier for sleep physicians and sleep labs to diagnose and manage these patients. We're excited about our Somnoware acquisition that we closed during the last quarter.

Somnoware is software for pulmonary and really all sleep physicians. And it complements our current portfolio of software offerings for physicians, homecare providers and patients, including AirView, Brightree and myAir, respectively. The goal is to ultimately drive greater efficiency and better patient care by helping sleep physicians to take best-in-class care of their patients with increased efficiency and a better overall experience for the doctor and for the patient. We're making progress across several digital health technology initiatives to drive the value proposition of our cloud-connected devices even higher. We are investing in several artificial intelligence-driven data products and capabilities in our Air Solutions ecosystem.

This quarter, we started rolling out a digital product in our U.S. market called Compliance Coach. Compliance Coach is built for home care providers to help them efficiently focus efforts and prioritize outreach to increase patient compliance and ultimately to drive better patient outcomes by helping them meet and beat 90-day adherence goals. The application utilizes ResMed's many billions of nights of deidentified sleep and respiratory care data in the cloud to predict the likelihood that a patient will be adherent to therapy or not. The AI product then advises and coaches the home care provider to best identify the patients who may struggle and to meet compliance requirements where they can.

So they can prioritize their interventions and outreach to the best probabilities to support patient success. It's early in our rollout program of Compliance Coach. However, customers using the product are excited and engaged and are starting to see results. Watch this space for many more ways that we can work with all of our customers to unlock value from incredible depth of de-identified data using tech like AI and ML for the ultimate benefit of physicians, providers and patients.

Let me discuss the forward pathway stemming from our joint venture with Verily right now that was called Primasun. Based on a mutual agreement between ResMed and Verily, we've made the decision to unwind the joint venture's day-to-day operations. We expect this to be complete by the end of the current quarter. Over the past years of this partnership, we've learned how to leverage technology to better identify, engage, diagnose and manage sleep concern consumers in our U.S. market.

We expect to take ownership of key assets of the Primasun developed model so that we can build on the investment and the learnings and ultimately accelerate our ongoing demand generation efforts with sleep apnea patients across ResMed.

It is exciting to take the learning from demand gen work in 1 project and in 1 country and to now look to apply that on a global scale across the 140 countries where we provide solutions. Our growing Respiratory Care business continues to be supported by the increased adoption of both noninvasive and life support ventilator solutions in terms of next-gen respiratory care therapies.

We continue to invest in clinical and economic trials for high-flow therapy that we call HFT, with the goal of cost effectively treating COPD in the home. We continue to generate strong clinical evidence and economic outcomes that we believe will support broader adoption of these technology innovations for treating lung disease in the home. We believe this has the potential for future growth for ResMed over the medium to long term.

We remain focused on addressing COPD as one of the top 3 chronic diseases for hospitalization and the #1 cause of rehospitalization. The prevalence of respiratory insufficiency due to COPD as well as neuromuscular disease continues to increase and we are focusing and developing and plan to offer low-cost, high-quality solutions to address this health care epidemic.

Our SaaS business had another great quarter with year-over-year growth of 32%. SaaS business growth was powered by another full quarter contribution from our fast-growing MEDIFOX DAN business in Germany, as well as high single-digit organic growth across our Brightree and MatrixCare brands in the U.S. market. The sustained high single-digit organic growth in our SaaS business is driven by strength in the HME segment and stability as well as increased tech adoption by customers in the facilities segment. We see a pathway to stable double-digit organic growth across the SaaS business, as well as increased net operating profit performance from this part of our business.

The ongoing synergies between our digital health solutions in SaaS and our core business remains strong, and we continue to leverage that through combined management of cloud compute, cyber security, interoperability, tech dev as well as customer-facing synergies, including patient resupply technology in our core business.

During the quarter, we appointed Gregg Timmons as the new General Manager of our Brightree business. I'm excited to support Greg and Bobby to continue to drive growth in our home medical equipment providers and to help our customers across the U.S. market. This quarter, I traveled to Hildesheim, Germany to meet in person with the entire team from our MEDIFOX DAN business.

The growth in tech solutions for ambulant home nursing as well as stationary nursing home businesses is very strong in Germany. With an aging population in that country and a government that is driving care to be more home-based through their policies and more digital through their policies, we see a long runway for growth with our MEDIFOX DAN team and across our global Software-as-a-Service business.

Our SaaS business remains an integral part of ResMed's growth strategy. This business complements the market-leading software and device solutions we have in our respiratory medicine business and we are well positioned as the leading global strategic provider of SaaS solutions for residential medicine globally. And we have created differentiated value for customers and will drive long-term sustainable growth for our shareholders.

Before we get into a detailed update on our financials, let me say this here at ResMed. We are transforming respiratory medicine and residential medicine at scale. We are leading the market in digital health technology across our markets. As we continue to scale and drive efficiencies in our operations, we will leverage appropriate pricing and cost reductions to drive profitable growth. We're focused on driving top line revenue and tight cost discipline as well as increased efficiencies so that we can accelerate profitability, delivering value for all of our stakeholders and especially the 2 billion patients plus worldwide who need our help.

As we move through fiscal year 2024, I'm confident and laser focused that we will continue to see improvements in our gross margin with [GM] leverage programs focused on 5 key areas: number one, to drive the launch of AirSense 11 into new global markets and to increase the availability of AirSense 11 ultimately in all the country markets that we serve; number two, to drive ongoing strong mask growth with a combination of resupply programs, subscription programs and new product launches. And you can see that's working this quarter; number three, to increase software solutions growth moving from high single-digit organic growth to double-digit organic growth with increased net operating profit leverage in that segment; number four, to move the higher cost components and freight costs that we've seen through our legacy through our P&L.

Turning what was a supply chain crisis headwind into a steady tailwind as we move through fiscal year 2024; and number five, to implement cost reduction actions in noncore areas of our business to free up cash and to accelerate investments in market-leading med tech and digital health solutions.

So in terms of Digital Health Investments and Solutions, we now have over 16 billion nights of de-identified medical data in the cloud and over 22.5 million 100% cloud connectable medical devices sold in more than 140 countries worldwide. We continue to lead the industry in digital health

technology, and we don't plan to stop anytime soon. There is so much opportunity ahead of us. ResMed's mission and key goal remain crystal clear to improve 250 million lives through better residential health care in 2025.

This patient-centric mission drives and motivates ResMedians every day. During the last 12 months, we have improved over 165 million lives with the delivery of a medical device directly to a patient, a complete mask system to a patient or a digital health software solution, helping each person to sleep better, to breathe better and to live high-quality lives with best-in-class health care delivered right where they live. I'm very excited about the opportunities in front of us.

In closing, I want to express my sincere gratitude to the 10,000 ResMedians for their perseverance, their hard work, their dedication, both today and every day. Thank you.

With that, I'll hand the call over to Brett in Sydney. And after Brett's remarks, we will open up for Q&A from the entire group. Brett, over to you.

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

Great. Thanks, Mick. In my remarks today, I'll provide an overview of our results for the first quarter of fiscal year 2024, unless noted, all comparisons are to the prior year quarter. We had strong financial performance in Q1. Group revenue for the September quarter was \$1.1 billion, an increase of 16%. In constant currency terms, revenue increased by 15%. Revenue growth reflected the ongoing combined availability of AirSense 10 and AirSense 11 sleep devices to support solid underlying global demand as well as strong growth across our mask product portfolio. Year-on-year movements in foreign currencies positively impacted revenue by approximately \$10 million in the September quarter.

Looking at our geographic revenue distribution and excluding revenue from our Software as a Service business, sales in U.S., Canada and Latin America countries increased by 10%. In constant currency terms, sales in Europe, Asia and other markets increased by 18%. Globally, in constant currency terms, device sales increased by 8%, while masks and other sales increased by 21%. Breaking it down by regional areas, device sales in the U.S., Canada and Latin America increased by 2%, which reflects the fact that we are cycling a particularly higher prior year comparable that was driven by sales of our card to cloud devices.

Masks and other sales increased by 23%, reflecting growth in resupply and new patient setups. In Europe, Asia and other markets, device sales increased by 20% in constant currency terms, again, reflecting strong demand and significantly improved availability of cloud-connected devices. (inaudible) patient setups.

Software as a Service revenue increased by 32% in the September 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 7% in the September quarter. MEDIFOX DAN contributed revenue of \$25.7 million for the September quarter, consistent with our expectations at the time of the acquisition. Note, we will anniversary this acquisition in Q2 FY '24, so our headline SaaS growth rate will moderate in Q2.

Turning to 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 first quarter earnings press release. Gross margin declined by 160 basis points to 56% in the September quarter. The decrease primarily reflects an increase in component and manufacturing costs, partially offset by favorable product mix due to the increase in mask growth relative to device growth and favorable foreign currency movements. Sequential gross margin improved by 20 basis points, driven primarily by favorable product mix.

Moving on to Operating Expenses. SG&A expenses for the first quarter increased by 15% or in constant currency terms increased by 14%. The increase was predominantly attributable to increases in employee-related costs as well as the incremental SG&A expense associated with the MEDIFOX DAN that we acquired in November 2022. SG&A expenses as a percentage of revenue was 20.2% compared to the 20.3% 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 18% to 20% for fiscal year '24. This guidance also reflects the impact of restructuring we initiated earlier this week, and we estimate this will result in a reduction in our workforce of approximately 5%. We expect to complete the restructure during our second quarter of fiscal year '24.

R&D expenses for the quarter increased by 20% or in constant currency terms increased by 21%. The R&D expenses as a percentage of revenue was 6.9% compared to the 6.6% in the prior year period. Looking forward and subject to currency movements, we expect R&D expenses as a percentage of revenue to be in the range of 6% to 7% for fiscal year '24. Operating profit for the quarter increased by 10%, underpinned by strong revenue growth, partially offset by a lower gross margin. Our net interest expense for the quarter was \$15 million, we expect interest expense to be in the range of \$12 million to \$14 million per quarter over the balance of fiscal year '24. Our effective tax rate for the September quarter was 20.1%, broadly consistent with the prior year quarter.

Looking forward, we estimate our effective tax rate for fiscal year '24 will be in the range of 19% to 21%. Our net income for the September quarter increased by 9% and non-GAAP diluted earnings per share of \$1.64 also increased by 9%. During the quarter, we recorded a provision of \$8 million associated with the expected cost of the recently announced Astral field safety notification. We also recorded acquisition-related expenses of \$0.5 million during the quarter.

These both have been treated as non-GAAP items in our Q1 financial results. We recorded losses of \$4.5 million in our September quarter associated with the Primasun joint venture with Verily. As Mick discussed, the joint venture will be winding down operations, and we will incur no further losses going forward in relation to Primasun.

Cash flow from operations for the quarter was \$286 million, reflecting solid underlying earnings and stable working capital balances. Capital expenditure for the quarter was \$30 million, and depreciation and amortization for the quarter totaled \$45 million. We ended the first quarter with a cash balance of \$209 million, and at September 30, we had \$1.4 billion in gross debt and \$1.2 billion in net debt. During the quarter, we reduced our debt by \$80 million. At September 30, we had approximately \$825 million available for drawdown under our revolver facility, and we continue to maintain a solid liquidity position.

During the quarter, we also closed our previously announced Somnoware acquisition, a company that provides an upstream diagnostic management platform that is complementary to our current AirView and Brightree solutions. Our Board of Directors today declared a quarterly dividend of \$0.48 per share. As part of our capital management activities, we plan to resume our previously authorized share buyback program starting in our second quarter. We expect to purchase shares to the value of approximately \$50 million per quarter. This will more than offset any dilution from the issue of employee equity during the year.

Finally, concurrent with our capital management activities, we plan to continue to reinvest in growth through R&D and expect to deploy further capital for tuck-in acquisitions.

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

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

Great. Thank you, Brett, and thank you, Mick. Kevin, let's go ahead and turn the call back over to you to remind participants about instructions for the Q&A portion of the call.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) Our first question is coming from David Bailey from Macquarie.

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

Mick, I'd just like to press a bit more on some of the comments around the market to 2050. Just interested in your thoughts around GLP-1 has potentially been complementary to see that as opposed to being a substitution for. Just and maybe just giving some thoughts around the upcoming clinical trials and how that could influence that uptake going forward?

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

Yes. Thanks for the question, David. And I'm just happy that we've had 90 days and we put some sites behind the analysis of this as the world leader in the field of respiratory medicine and sleep apnea, we really know these prevalence numbers really well. And so that baseline of 936 million patients from 2015, growing to 1.4 billion through 2050 is really, I think, pretty conservative in its assumption of the growth rate of populations and aging populations in lower growth areas.

But what that shows is 1.4 billion available in that time, not including any impact from any of these GLP-1 class of drugs. And we took really the maximum aggressive efforts, including all current indications and some future ones to assess what the impact could be on the potential of patients in terms of sleep apnea prevalence worldwide, really aggressive and assume not only aggressive penetration but sustained that the adherence rate would stay sort of 80% to 100% on these drugs, which they're not achieving out there in the market, but we just said, let's take that high penetration case and that showed 1.2 billion patients in 2050.

And so we will look at every update that comes from the pharma industry. They're very active in this class of GLP-1 but we think we're taking a very high penetration analysis to get there. And so we'll continue to look at any new data that come on and every quarter, we'll update that epidemiology model and move it around.

But what it shows is a huge opportunity, 1.1 billion patients above our penetration at quite high growth rates through the next number of decades. To your question around concomitant therapy and use, that's what we've been seeing in the last 2 years since a number of these have been out there in the diabetes side and on the obesity indications, it's obviously early days, but we're tracking many thousands of patients on GLP-1s and PAP we're seeing maintenance of adherence. We're seeing maintenance of resupply programs and really no change.

When you look at -- so that is the aggregate level, we are seeing no change there. We are seeing more patients coming into the funnel. Look, we know we're doing our awareness programs, our demand gen programs and there are other alternative therapies doing demand gen that bring patients into the funnel that we get a benefit from. But we truly believe that this idea that you could come in to the health care system, someone who's maybe obese, or morbidly obese likely avoiding the health care system, there's a high avoidance of people with BMI of 30, 32, 35 of the primary care system. And so we believe it will bring more patients in. We're seeing that with our very high patient flow.

So look, we're just looking at the data we're observing, which is patients on concomitant therapies there multiple years, and we're going to track those and track the adherence and we'll publish that every quarter. We're seeing actually our adherence rates steady and resupply rates steady in that installed base. And in the new patient flow side, we're actually seeing increased all-time highs of patients coming into the funnel.

So we're watching all of these above and we're looking for 2 to 3 decades and still see with highest case penetration, you can roll in any study like you're still going to see north of hundreds of millions to 1 billion patients between the likely penetration in our disease state and beyond. But David, thanks for the question, and I look forward to ongoing discussions.

**Operator**

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

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

If I could stick on the same topic. Mick, could I get you to talk a little bit to the 22.5 million patients that you've got on myAir. It would be really good to understand how they sort of fit into the categories of mild, moderate and severe sleep apnea. Because as much as you've given us some very big numbers we're fully aware that about half of those patients are in the mild category. And it's unclear to me that many of those patients are currently seeking treatment or will seek treatment in future. So if you could just help us with what you can see in the data, and so we can make an assessment as well, please.

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

Yes, David, look, thanks for the question. And as you look at the epidemiology data, there's a number of splits on AHI. What we're lacking in the market is a split around symptomatology and how patients feel. And as we're looking at the data, patients with AHIs, 5 to 15, 15 to 30 and 30 plus and overlapping that with concomitant therapy, we'll be peer-reviewing and publishing data at upcoming conferences in 2024 on this to show some of these nuances of deltas.

But on the aggregate group, we're not seeing changes in adherence. And even in the subsets, of mild to moderate. We're not seeing significant changes in adherence rates or new patients coming into the funnel. AHI is a great measure of the number of suffocation episodes per hour. Just to remind people, an AHI of 14, just under 15%, which is considered mild is suffocating every 4 minutes of sleep. So a doctor may call that mild, but to a patient who's suffocating every 4 minutes of sleep, in 15 -- 14 times an hour, and you're sleeping all through the not having 80, 90 suffocation episodes. They stick on the therapy and new patients coming in as well.

So look, we're watching this really carefully, and we're really analyzing by AHI, by symptomatology, by craniofacial distance between the tongue and the uvula and actually size of tongue because there's a whole lot of factors that go into -- go into the prevalence of sleep apnea. And obviously, the issues around hypopneas which are far more prevalent in women and lead to worse excessive daytime sleepiness, headache and comorbidities that are not associated with weight at all.

But look, we're looking through all of these data. And as we look forward over the next number of decades, there will be an impact. There's no question by these weight loss medications. But it will be on the margin and it won't be -- I mean, certainly, the market believes it's going to be dramatic given the last 90 days of our stock. And I can tell you, every bit of clinical data that we have going forward and every bit we have going retrospectively. And we've got the biggest database in the world, and it's 21.5 million patients. As we look at that split between mild, moderate and severe, we're not seeing changes.

But look, every quarter, we'll continue to update that, and we'll do more and more splits on severity. We published this epidemiology model this quarter, and we'll continue to update it and continue to provide data. I'm also making sure that we keep some of those data, so we can get them into the peer reviewed and published press like the Lancet article that started this epidemiology model, and so we'll be publishing the information that we can. And then every quarter here on the -- on our investor side, but they will also be running the real science and epidemiology models and healthy con and outcomes research work and making sure that gets into the peer reviewed and published press as well.

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**Operator**

Next question is coming from Dan Hurren from MST.

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**Dan Hurren** - MST Financial Services Pty Limited, Research Division - Healthcare Analyst

I was going to ask some questions about the results rather than GLP-1 drugs, if that's okay?

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

Dan, that would be delightful.

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**Dan Hurren** - MST Financial Services Pty Limited, Research Division - Healthcare Analyst

Okay. All right. Look, just a question for Brett. Could you walk us -- can you just walk us through the headwinds and tailwinds for gross margin over the balance of FY '24. And maybe we're seeing some pricing increases out there in the market and product mix shifting around. Could you just perhaps walk through those factors?

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

Yes, sure, Dan. As we look forward on GM, I mean, Mick mentioned it in his remarks as well. But if you look at it in terms of GM, we do feel that we're going to see improvements in our gross margin over FY '24. And those tailwinds are really going to be around improved product mix, manufacturing improvements and efficiencies that we think we can drive. Freight cost reductions are still making their way through inventory and some of that will manifest in FY '24. We're seeing stabilized component costs now. We -- that was a headwind even for this quarter but we're cycling -- largely cycling that, particularly in the second half FY '24.

And then we have, obviously, the AS10 to AS11 transition that will be progressive over FY '24 as well. And then your point mentioning a little bit around pricing as well. So a combination of those factors will give us confidence, I think, in the gross margin through FY '24.

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**Operator**

Your next question is coming from Chris Cooper from Goldman Sachs.

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

Sorry to come back to it, guys, but I think it is an important topic. So just on the patient data mix that you're tracking CPAP patients also in GLP-1s. Can you just update us on how many patients you're tracking there? And -- and when you intend on publishing that? I know Rob foreshadowed last month that you would be sort of releasing that data? Would it make sense to do that before? Or do you think maybe after the major study that's going to read out next year? And just any high-level thoughts you have on the outcome of that study would be helpful at this stage.

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

Yes. Thanks, Chris. And so yes, there will be ongoing longitudinal studies that will get out to the peer-reviewed press, but obviously, look, it's an urgent issue. And if you look at the market reaction in the last 90 days, there's an assumption of 30%, 40% reduction in immediate TAM, right? If you look at that market cap change, and it's just in congress with every piece of scientific evidence that we've looked at historically and going forward.

Yes. So there's many thousands of patients on our GLP-1 plus PAP database. We also have 17,000 patients that we're tracking that have had gone through bariatric surgery and our own PAP therapy post surgery with 50-plus percent weight loss reductions in that cohort. So we're tracking much stronger weight loss cohort and this sort of -- depending on which type of GLP-1, 10, 20, 30, plus percent weight loss reductions in the extreme case of the 50% weight loss reductions.

And so we'll be publishing data in the peer-reviewed clinical press across all of those cohorts as we go forward. Yes, we will choose as we keep putting out the epidemiology data, we will choose to put some of those data, which aren't going into the peer-reviewed press, right? So we don't

corrupt those studies that we actually want to get into the clinical information that can really be out there versus just the stuff that we put together for an investor, which then would prohibit that -- those same data going into a clinical paper.

But we are finding the balance between those, and we definitely hear you that the market is looking for those data. I can tell you now that the data on aggregate are showing no change despite how you look at which GLP-1 class, which AHI group for adherence and resupply. But I will start to find the right division between the information we can get out on the short- to medium-term basis and the information that needs to go in those longitudinal studies to really show the sites behind this and really balance it out.

One of the best ways we're doing it every quarter is to show the incredible growth that we're getting in our devices and our masks and particularly the resupply of masks, right? There's no impact of anyone's recall. There's no impact of any drug therapy and you just look at the replenishment rate of masks. If you're not on therapy, you're not ordering masks, and we're seeing really strong resupply.

The other fact to bring into this that we can publish and do publish is the number of patients in our Air Solutions ecosystem, 22.5 million patients that continues to go up. We had record numbers of new patients starting up. And in addition to that, record numbers of patients themselves engaging with myAir and that's driven by AirSense 11 being far more digitally engaged and higher rates of adoption of that. But we're seeing a really strong uptake of patients that flow in and patients on adherence, but we'll continue to publish every quarter those data and the appropriate data we can from the clinical, and we'll definitely update the epidemiology model every quarter.

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#### Operator

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

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

Just on your Americas mask growth, could you provide some more details on where that additional growth in resupply has been coming from? And how long do you think you can sustain that strong year-on-year growth in mask revenues?

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

Yes. Thanks, Craig. It's a really good question because the mask growth across the group was 21% on constant currency. Europe was incredibly strong at 15% constant currency growth in a full competition market with everybody on the field and 23% in U.S., Canada, Latin America.

Look, as I said in my description in the prepared remarks on our look forward over the next number of decades, the stable market growth in our field was mid-single digits on the device side and high single digits on the mask side. If you look at the 5-year CAGR, 3-year CAGR leading into 2019 pre COVID. And that's sort of what we're looking at that epidemiology model that mid-single-digit growth on devices and high single-digit growth on masks.

So if you think of that as the market growth in a stable state, it then comes up to, well, what can ResMed do in market demand? What can we do in demand gen? What can we do to get patients into the funnel? I truly believe to the 3 questions focused on this new class of drugs, I do believe we are seeing more patients come into the funnel, more patients into primary care.

That's great. I mean I think there's \$1 trillion worth of market cap now from these companies, and they will turn that into marketing to bring people in for their miracle drug, and that will absolutely bring patients in for assessment for all the comorbidities that are associated with a patient that might have been severely overweight and now likely on the other side of these will still be overweight including sleep apnea, COPD and other cardiovascular diseases and beyond.

So we're watching that really closely. Look, we've consistently over decades that we've been in business, not just accepted mask growth rates from the market, we said, let's drive it higher and higher. The 23% is extraordinary and very strong in a highly competitive market. But I look at what we're doing with resupply, I look at what we're doing with new product launches. I look at what we're doing to drive patients into the funnel.

And I think we can meet and beat that high single digits that the market would grow at. And with us being such a strong share, we get to -- when we do demand gen, we get to get a very good share of those patients through the funnel. So there's more of an incentive for ResMed to drive demand-gen initiatives when we get such a good share of it on the device and mask side, and we're seeing that in many of the markets we operate in worldwide. But it's a great question.

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**Operator**

Next question is coming from Sean Laaman from Morgan Stanley.

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

Mick, really good OpEx control in the quarter. And I think Brett mentioned, if I pick it up correctly, 18% to 20% as a guide on revenue going forward. I'm just wondering if there is more restructuring to be done -- or to be done? Or you think you're rightsized at the moment?

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

Yes, Sean, thanks for the question. And as I said in the prepared remarks, stuff that impacts our people are the toughest decisions to make, and we did this week, have a change in 5% of our global workforce reduction, a 5% of our global workforce. And tough decisions to make. I really think that, that is -- if you think about it, that is the restructuring.

There are some changes I'm looking at in the operating model, sort and roles and responsibilities and a focus on a more product-led and brand-led company that will come over time, but they're not massive restructures. And I think what that 18% to 20% of revenues that Brett talked about in SG&A is indicative of the change that we've made here and reestablished a new base and a push for, as you said, really strong profitable growth across our business.

But look, the world has changed. We are already a product-led organization but our brand has increased in its value across the world, and we need to document and understand that and understand how to engage people in nonreimbursed markets as consumers into the funnel. And we've already invested in a number of our D2C markets in that, and we're driving that.

And in our B2B and B2B2C markets, we're also working with our health care partners and distributors in the channel to work out how to best get patients into the funnel. So we're sort of, if you like, we're freeing up cash to reinvest in demand gen, reinvest in getting patients into the funnel. And we think there's a billion reasons in terms of the patients that need our help to get out there and do it. And that's going to be there for decades, and we've got to find better ways to do it. But to answer your question directly, yes, that restructure is done, and we're now focused on moving forward.

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**Operator**

Your next question 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 focus on the quarter as well. You guys talked about this all-time high patient flow number, which is notable. When you said the channel, I guess, were you referencing those are CPAP prescriptions or folks getting tests and any color you can give us on how that growth profile compared to recent quarters? And anything kind of on the U.S. device growth this quarter as well.

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

Yes. Thanks, Margaret. And yes, so look, we have a relatively low share of the diagnostic space in home sleep apnea testing with our apnea and care product. It's so we are tracking that. Those are up. The best data we have is through our Air Solution System. So we talk about the 22.5 million patients on our Air Solutions Platform and almost 7 million patients that we now have on myAir, patients directly engaged in. So we watch those starts very closely. We also do have [deidentified] and objective data from our Brightree showing across the whole industry, patients coming into the funnel in sleep apnea, but also across other medical equipment categories.

And I can tell you, patients are getting engaged and finding their way into the -- to the primary care treatment funnel and specifically in sleep apnea. And we believe it's not short term that this is a sustainable rate of growth of patients coming in. And I think it's really exciting to see that.

To your question specifically about device growth, yes, so it's 8% globally. I mean I got to say I'm incredibly proud of our Europe, Asia and Rest Of World Markets growing 20% this quarter, year-on-year. That's where we're competing directly with our competitor that was out for their recall. They're back in many countries, in Europe, Asia and rest of world, meeting and beating them head-to-head, I think, proves out the thesis that ResMed has the best-in-class products, but services and solutions, not just the hardware but the software and the capability we've been investing in that for a long period of time.

This period a year ago, the September quarter 2022, we had just unleashed card to cloud on an unallocated basis, and it took off despite usually what is quite a low growth quarter in September, given that summer here in the U.S. We had incredible growth last summer with our card to cloud solutions. So we're lapping that growth.

I think the team with that device growth of 2% is building on what was an extraordinary uptick from card to cloud. But when we look at the number of patients coming through the diagnostic funnel and the setups coming into AirView and the setups of the patients coming into myAir, the growth rate of patients is mid-single digits plus and with [repap] really up there.

And so I think that's why I can say that I think it's sustainable for us to meet and beat sort of the pre COVID 2019 earlier CAGR of mid-single digit growth for devices, we can meet and beat that throughout demand gen and high single-digit growth in masks. We can definitely meet and beat that through our work and experience and expertise now on resupply, engagement with patients and the changes that happen during COVID are focused on respiratory health and respiratory hygiene. So I hope that answers your question, Margaret. Thanks to that.

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**Operator**

Next question is coming from Steve Wheen from Jarden.

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

Yes. Just a question back on to the gross margin. When we think about fourth quarter's growth margin it went down largely because of FX and mix and yet we've got that going in your favor in this quarter. I'm just curious as to really what is holding that gross margin back when you do have such a strong mix geographically with devices in Rest of World up but also masks as a category overall up and you've got the FX tailwind as well. And just to clarify, the Astral field safety notice cost is not in the 56% gross margin from what I can work out, if that's correct as well.

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

Steven, it's Brett. Yes, that's correct. That's excluded a non-GAAP item from 56%, but if you're talking year-on-year on the gross margin, really the biggest impact coming through was component cost increases that we're still cycling through and working through inventory. So that was the biggest factor. We did see some product mix favorability there, but not enough to offset those component cost increases, for example. That was the biggest impact on the year-on-year reduction in GM.

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**Operator**

Next question is coming from Saul Hadassin from Barrenjoey Capital.

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

Mick you've kind of commented on sustainability of U.S. flow gen growth. I just wanted to ask you, so the growth rate based on revenues this quarter implies about a 17% CAGR going back to 1Q fiscal '20, so the September '19 quarter. So I'm just wondering if you think you can sustain sort of the dollars of flow gen sales that you reported this quarter? Or if you think sales are going to step down as we work through the rest of fiscal '24. Just wondering if you can sustain the level of sales in dollar terms?

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

Yes. Thanks. It's a good question, but it's a complicated answer because there's so many moving pieces between that baseline you took there for that CAGR number '19 and '20 with the COVID shutdowns, our spin-up on ventilators with 150,000 vents at the start of 2020 and then the slowdown and the restart-up of the sleep apnea funnel and the shift that happened through 2020, 2021. And then, of course, the perturbation that made it a perfect storm of a competitor with a recall of 5.5 million devices and '21 through '23 and ongoing.

So with all that, I'll just talk to the market growth rate that we saw stable pre-2019, right, of that mid-single-digit growth of devices and high single-digit growth in masks. We think that where we're at now taking our baseline of now we can meet and beat that growth rate, right? And so that definitely doesn't mean going backwards. Take what we've got now, which is, I believe, a very strong share of the U.S. market. And in the 140 countries we're in competition, but it's a good place for us to be. We are looking at from where we are achieving mid-single-digit plus growth in our devices and high single-digit growth on our masks.

And no, we don't intend to go backwards at all. In fact, we intend to not only go forward but go forward strongly. And I think what was shown up in the numbers this quarter is our incredibly strong growth. I talked earlier that our incredibly strong growth in devices of 20% in Europe, Asia and Rest Of World. We had 15% growth in masks in Europe, Asia and around the other countries.

And so I think what it's shown is that ResMed is going to go head-to-head with full competition out there and be able to meet and beat the competition because we've got the smallest, quietest, most comfortable, most connected, the most intelligent health systems, and it's that whole combination of not just the product, but the solution, the service and how it's embedded in the health care system to the patient, to the physician that allows us to achieve that. So we're not going backwards. We're going forward Saul, and we're going to grow at or ahead of market. And in many countries, we're going to drive demand gen to increase the whole aggregate market growth rate, and pull more patients into the funnel because now we've got a greater incentive than ever to do that. Thanks for the question.

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**Operator**

The next question is coming from Mathieu Chevrier from Citi.

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

One on SaaS, please. So what will drive the SaaS revenue to now grow double digits from high single digit previously?

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

Yes. Thanks for the question, Mathieu, and welcome to covering ResMed. Yes. So look, what's going to happen is with our organic SaaS business, as you saw in the quarter, we had good high single-digit growth at 7%. And we've sort of been in that sort of 7% to 8% in our organic growth across our U.S. franchise really MatrixCare plus Brightree. And with the MEDIFOX DAN group, we haven't sort of been breaking out organic growth within that. But it is going to be incremental to that group.

But in addition to that, there's a great product pipeline at both Brightree and MatrixCare, that I feel confident and some portfolio focuses on the high-growth parts of their portfolio and moving out or backing up with some of the low growth areas in that portfolio of MatrixCare that gives me great confidence as I look forward over the fiscal year and beyond that we're going to turn organic growth from sort of where it is now in the high single digits to double double-digit growth on a stable organic basis across that SaaS business.

So Mathieu, it's a combination of MEDIFOX DAN increase in the group but also some great product pipelines in the current business to be able to get us there. And the final punchline I'll put there is, in addition to that, driving that better top line growth, we're working -- we were restructured as well on SG&A and some R&D in our SaaS business this week -- this quarter. And that will allow us to get good leverage on the net operating profit bottom line. And I see that moving closer and closer to the ResMed group and even being a strong contributor, an even stronger contributor for us as we look to maximize our long-term EPS and return on invested capital across our group.

So great question, Mathieu, but we're very confident we can achieve that as we go through fiscal year '24, '25 and beyond in our SaaS business.

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**Operator**

We reach 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 & Chairman

Well, thanks, everybody, for attending this call and for the great detailed questions. And thanks, Kevin. Yes. Look, I'll close with this, ResMed is well positioned for ongoing future success and accelerated profitable growth. We're taking actions to prioritize on the right initiatives, and we're optimizing costs to fuel our long-term growth.

The opportunity in front of us is huge and largely untapped and it's an incredible runway. We see more and more people coming into the health care system every quarter and we'll benefit and help them sleep better, breathe better and live better lives in 140 countries. And we'll keep proving it to you every quarter as we go forward. Thanks to all the 10,000 ResMedians, many of whom are also shareholders, for all that you do today and every day.

And with that, I'll hand the call back to you, Amy, to close us out.

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

Great. Thank you, Mick. Thanks, everyone. We appreciate your interest and your time. As always, if you have any additional questions, please don't hesitate to reach out to us directly. This does conclude ResMed's First Quarter 2024 Conference Call. Kevin, you can now end the call.

**Operator**

Thank you. You may now disconnect your lines and have a wonderful day. We thank you for your participation today.

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